IN THE IOWA SUPREME COURT

SUPREME COURT NO. 19-1302

MIDWESTONE BANK,

Plaintiff/Counterclaim Defendant/Appellee,

v.

HEARTLAND CO-OP,

Defendant/Counterclaimant/Appellant.

APPEAL FROM THE DISTRICT COURT FOR STORY COUNTY
THE HONORABLE ANGELA L. DOYLE

APPELLANT'S FINAL REPLY BRIEF

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ARGUMENT

I. THE COMMON LAW DISCOVERY RULE EXCEPTION TO THE STATUTE OF LIMITATIONS DOES NOT APPLY TO THE BANK'S COMMERCIAL CONVERSION CLAIMS BROUGHT UNDER IOWA'S VERSION OF THE UNIFORM COMMERCIAL CODE.

A. Error Preservation.

Heartland agrees that the Bank, for the purpose of affirming the judgment, preserved the issue of whether the District Court erred when applying the two-year period applicable to actions "founded on a secured interest in farm products" under Iowa Code Section 614.1(10) to the Bank's claims rather than the five-year period for general conversion claims under Iowa Code Section 614.1(4). *See Gibson v. ITT Hartford Ins. Co.*, 621 N.W.2d 388, 398–99 (Iowa 2001) (citing *See Johnston Equip. Corp. v. Indus. Indem.,* 489 N.W.2d 13, 17 (Iowa 1992).

B. The District Court Correctly Applied the Two-Year Limitations Period to the Bank's Claims.

The District Court correctly decided that the five- year limitations period found in Iowa Code Section 614.1(4) does not apply to the Bank's conversion claims, but rather the two-year period applicable to actions "founded on a secured interest in farm products." Iowa Code Section 614.1(10); (05/31/2019 Rulings on MSJs at 7–8)(App. 428-429) (citing in support the extensive analysis of these provisions in *Farmers Coop. Co. v. Swift Pork Co*., 602 F.

Supp. 2d 1095, 1108-1109 (N.D. Iowa 2009)). In doing so, the District Court applied the common sense meaning of the statutory language. Again, Section 614.1(10) reads:

> Actions may be brought within the times herein limited, respectively, after their causes accrue, and not afterwards, except when otherwise specially declared:
> . . .
> 10. **Secured interest in farm products.** Those founded on a secured interest in farm products, within two years from the date of sale of the farm products against the secured interest of the creditor.

Iowa Code § 614.1(10) (2018).

The Bank concedes its claim is founded on its secured interest in the subject grain, but attempts to evade the two-year limitation by parsing the meaning of the word "sale" by arguing that Heartland's offset for the necessary drying and storage of the grain is not included in the sale transaction "against" the Bank's securing interest. This notion, however, is belied by the record in the case. Each grain sale involved several terms including the calculations involving numerous "tickets" (indicating separate grain deliveries) and the costs of the drying and/or storage, and then calculating the final price for the sale of the grain. (*See* Settlement Sheets, Amdd Answer Exhibits A–F)(App. 48-53).

Under Iowa's version of the Uniform Commercial Code, "[a] 'sale' consists in the passing of title from the seller to the buyer for a price." Iowa

Code § 554.2106 (2019). Further, "[s]ubject to these provisions and to the provisions of the Article on Secured Transactions (Article 9), title to goods passes from the seller to the buyer in any manner and on any conditions explicitly agreed on by the parties." Iowa Code § 554.2401. It is precisely to these Harker and Heartland set out sale terms for the grain, which is explained in the Settlement Sheets. These sheets included the necessary offsets for storing and drying the grain in order to obtain the final sale price for the grain, of which the Bank complains was against its interests. The Settlement Sheets, attached to the Amended Answer, are records of each sale transaction, which fall within the scope of Section 614.1(10).

The decision of the District Court apply the two-year limitation period to the Bank's claims under Section 614.1(10) also comports with Iowa law governing statutory interpretation:

> The interpretation of a statute requires an assessment of the statute in its entirety, not just isolated words or phrases. *State v. Young,* 686 N.W.2d 182, 184–85 (Iowa 2004). Indeed, "we avoid interpreting a statute in such a way that portions of it become redundant or irrelevant." *T & K Roofing Co. v. Iowa Dep't of Educ.*, 593 N.W.2d 159, 162 (Iowa 1999) (citation omitted). We look for a reasonable interpretation that best achieves the statute's purpose and avoids absurd results. *Harden v. State,* 434 N.W.2d 881, 884 (Iowa 1989).

Farmers Coop., 602 F. Supp. 2d at 1107. The purpose of Section 614.1(10) "is to hasten resolution of claims" . . . "founded on the secured interest in farm

products." *Id*. at 1110 (citing *State v. Pub. Emp't Relations Bd.*, 744 N.W.2d 357, 360–61 (Iowa 2008)). The Bank's position cuts against the clear purpose of the Section 614.1(10) and, in this case, its clear meaning. The Bank had a security interest in the grain, Harker sold the grain to Heartland, and the Bank sued for conversion. For these reasons, on the question of the applicability of Section 614.1(10), this Court should affirm the determination of District Court.

C. The Discovery Rule Does Not Apply to the Bank's Claims.

The District Court erred when it applied the discovery rule exception to the Bank's pre-March 16, 2016 claims. Oddly, the Bank characterizes Heartland as seeking to "punish" the Bank by simply disagreeing that the application of the discovery rule is appropriate in this case. Bank Br. at 30. As set out in the authorities cited by Heartland, there are good reasons that the discovery rule should not be applied in UCC cases involving sophisticated business parties. *Husker News Co. v. Mahaska State Bank*, 460 N.W.2d 476, 477–79 (Iowa 1990) (in a lengthy discussion, giving preeminence to the UCC's presumption "in favor of predictability and finality of commercial transactions" and joining the majority rule that the discovery rule does not apply to commercial disputes under the UCC)(citing cases).

The *Husker News Co*. ruling is not as narrow as the Bank attempts to argue. While the case dealt with negotiable instruments, it was nonetheless a conversion case, and the policy of not applying the discovery rule established there applies to all conversion cases arising under the UCC's provisions. Accordingly, the Court, in *Husker News Co*., was addressing the interplay between the state law conversion claim statute of limitations and the UCC, not every instance or cause of action where the UCC is implicated. *See Husker News Co.*, 460 N.W.2d 476, 477–78 (Iowa 1990) ("Although application of the discovery rule to a conversion case is one of first impression in Iowa, the other states that have considered the question are nearly unanimous in their refusal to apply the doctrine in this context. We find their decisions persuasive. . . .") (emphasis added).

Iowa federal courts agree that the discovery rule does not apply in commercial conversion cases, but do not limit that rule to negotiable instruments. *CMI Roadbuilding, Inc. v. Iowa Parts, Inc.*, No. 16-CV-33-LRR, 2017 WL 6210920, at *8 (N.D. Iowa Dec. 8, 2017), aff'd, 920 F.3d 560 (8th Cir. 2019) ("*But see Husker News Co.*, 460 N.W.2d at 479 (refusing to apply the discovery rule of claims of commercial conversion arising under Iowa's version of the Uniform Commercial Code.")); *Ney Leasing Corp. v. Cargill Meat Logistics Sols., Inc.*, No. C09-1051, 2010 WL 3941999, at *8 n. (N.D.

Iowa Oct. 6, 2010) ("The Court notes parenthetically, however, that the 'discovery rule' does not appear to apply in commercial conversion cases.")

Heartland is not making the argument that courts can not apply the discovery rule to any cause of action arising under the UCC, or arguing that is the holding of *Husker News Co*. The Banks' reliance on cases like *Brown v. Ellison*, 304 N.W.2d 197 (Iowa 1981) (warranties) and *Naschazel v. Mira Co., Mfg*, 466 N.W.2d 248 (Iowa 1991) (bulk transfers provision since repealed), involving non-conversion actions is, therefore, misplaced. The policy of not applying the discovery rule in conversion claims, however, is the norm. *See, e.g., Conoco Inc. v. Amarillo Nat. Bank*, 996 S.W.2d 853, (Mem)–854 (Tex. 1999) (ordering lower court to reexamine the application of the discovery rule to case involving bank's collateral (accounts receivable) in light of its ruling in *HECI Exploration Co. v. Neel,* 982 S.W.2d 881 (Tex. 1998) (declined to apply the discovery rule in suit by oil and gas royalty holders against their lessee because a royalty owner is under inquiry notice); *Lau v. Constable*, 16 CVS 4393, 2019 WL 6051554, at *7 (N.C. Super. Sept. 24, 2019) (unpublished) (claim for conversion of company accounts not subject to the discovery rule); *Tomczak v. Bailey*, 578 N.W.2d 166, 173 (Wis. 1998) (action for wrongful taking, conversion, or detention of personal property not subject to the discovery rule).

The Bank, in pressing its arguments, unfortunately peppers its submission to the Court with unnecessary, unhelpful, and unsupported accusations against Heartland. The Bank's asserts Heartland is attempting to "punish" the Bank by arguing that the Bank's claims should be limited to two-years. Bank Br. at 30. The Bank implies grain buyers like Heartland are "bad actors" engaged in "hiding," "wrongdoing," and "improper behavior." Bank Br. at 39. The Bank alleges "Heartland secretly converted proceeds," "concealed its misconduct," acted "surreptitiously," "secretly charg[ed] an offset," and "hid fact[s] from the Bank." Bank Br. at 41, 48, 50, 52, 53, 60.

The Bank's Petition contains no such allegations and, as evidenced by the affidavits provided by Don Frazer (Heartland Appendix in Support of Resist to Plf MSJ – Ex. P – Frazer Affidavit)(App. 351-354) and Brian Bailey (Heartland MSJ Appendix – Ex. O – Bailey Affidavit)(App. 204-207), Heartland believed it was always acting in accordance with long-standing industry practices. Notwithstanding the disputed facts around industry practice and the Bank's knowledge, the fact that Heartland was acting in good faith in offsetting drying and storage costs has never been in dispute. Indeed, in this conversion action, the Bank did not ultimately ask the District Court for attorney fees and costs for intentional misconduct by Heartland. The

Bank's aspersions to the contrary in order to gain some advantage now in its appellate submission is unfortunate and should be disregarded by the Court.

The Bank's casting of the present dispute with Heartland as a conflict between a bad actor (Heartland) and an innocent victim (Bank) is a distraction and not consistent with the facts of the case or the nature of parties. Heartland and the Bank are both sophisticated players in Iowa's agribusiness industry. Both, unlike the laypersons described in *Husker News Co.*, have the responsibility for "careful bookkeeping" and are in the best position to "monitor accounts and employees." *Husker News Co*., 460 N.W.2d at 479 (Iowa 1990).

Here, the Bank is presumed to be keeping track of the collateral securing its loans and on inquiry notice regarding its borrower's intentions regarding that collateral. As this Court has stated: "Strict application of the limitation period, while predictably harsh in some cases, best serves the twin goals of swift resolution of controversies and "certainty of liability" advanced by the U.C.C." *Id*. at 477.

Accordingly, Heartland requests the Court find that the discovery rule does not apply to the Bank's UCC conversion claims for the grain sales that occurred before March 16, 2016, and thus are time barred under Iowa Code Section 614.1(10), and find that a reduction of the Bank's judgment, as a

matter of law, in the principal amount of $42,111.10 is proper, and remand to the District Court with instructions consistent with these findings.

II. HEARTLAND'S UNJUST ENRICHMENT CLAIM CANNOT AND DOES NOT REQUIRE PRIVITY OF CONTRACT WITH THE BANK; THE UCC DOES NOT FORBID EQUITABLE REMEDIES; AND, THERE ARE GENUINE ISSUES OF MATERIAL FACTS IN DISPUTE THAT WARRANT TRIAL

A. Heartland Engaged in Equitable Conduct.

As discussed above, the Bank—unsupported by the record—levies charges against Heartland as being a bad actor intent on hiding the offset for the costs necessary to protect and preserve the Bank's collateral. The Bank avers that Heartland's so-called bad actions precludes any right to recovery for unjust enrichment under equitable principles. Heartland, on appeal, has shown it manifestly acted in good faith and "did equity" by relying on industry practice and doing so transparently. The Bank provides no citations to the record showing that Heartland engaged in hiding material information regarding Harker's grain from the Bank. Quite the opposite. Heartland provided Harker with the settlement sheets for each sale contemporaneously with the grain checks. (*See* Amdd Answer Exs A-G)(App. 48-54). The fact that the Bank failed to look into Harkers' grain checks is not Heartland's fault. The Bank never complained before about offsets for necessary drying and storage services. (Heartland Appendix in Support of Resist to Plf MSJ – Ex.

P – Frazer Aff. ¶ 9)(App. 353). The Bank negotiated the grain proceeds checks. (Heartland MSJ Appendix Ex. O – Bailey Aff. ¶ 14)(App. 207). Of course, the Bank—knowing Heartland was a buyer of the Harkers' grain and aware of the industry practices and customs, encouraged and authorized the Harkers to "cause . . . any and all acts that may at any time be appropriate or necessary to grow, farm, cultivate, irrigate, fertilize, prune, harvest, pick, clean, preserve, and protect the crops . . . [and] Harvest and prepare the crops for market and promptly notify Lender when any of the corps are ready for market . . . ." (Pet. Ex. 1 – Security Agreement at 2)(App. 13). All these facts establish a course of dealing and acceptance of the industry custom and practice of sale proceeds being the source of payment for necessary costs to protect the grain. There is nothing "murky" about the benefit conveyed to the Bank or Heartland's actions. *See Iowa Waste Sys., Inc. v. Buchanan Cnty.*, 617 N.W.2d 23, 31 (Iowa Ct. App. 2000). All the Bank offers is accusations, but no facts to support its aversions that Heartland did not act in good faith. The facts and circumstances in the record, however, supply ample context in favor of an equitable treatment of the Heartland setoffs.

B. Withheld Costs of Drying and Storage Are Allowed Under the Circumstances Here.

The Bank directs the Court to the decision by Iowa Courts of Appeals decision, *Larsen v. Warrington*, 348 N.W.2d 637 (Iowa Ct. App. 1984), along

with the Montana case, *Daniels-Sheridan Fed. Credit Union v. Bellanger*, 36 P.3d 397 (Mont. 2001), and West Virginia case, *Peerless Packing Co., Inc. v. Malone & Hyde, Inc*., 376 S.E.2d 161 (W. Va. 1988) for the proposition that a quantum meruit or unjust enrichment claim may never be brought against a secured lender when the benefit was received pursuant to the security interest. As set out more fully in Heartland's main brief, these cases are distinguishable from the present case as explained in *Ninth Dist. Prod. Credit Ass'n v. Ed Duggan, Inc.*, 821 P.2d 788 (Colo. 1991). There, the Colorado Supreme Court reconciled the holding in *Peerless* and similar cases from the conclusion it reached that allowed an unsecured creditor's unjust enrichment claim against the secured interest of a lender. The difference in these lines of unjust enrichment cases hinges on the knowledge, participation, and relationship between the parties. In cases allowing unjust enrichment claims, there are facts indicating "that the secured creditor initiated or encouraged the transaction by which the unsecured creditor enhanced the value of the secured collateral when the unsecured creditor supplied goods or services to the debtor." 821 P.2d at 795. In cases where courts did not allow unjust enrichment claims, the secured lender only had a general or no knowledge of the benefits being bestowed. *Id*. (putting the *Peerless* lender in the latter category). Indeed, the Montana Supreme Court in the case cited by the Bank,

Daniels-Sheridan Fed. Credit Union, makes the same distinction. *See Daniels-Sheridan Fed. Credit Union*, 36 P.3d at 403–04 (disallowing an unjust enrichment claim where the secured lender remained "uninvolved or by informing the proper parties of its intent to not pay for debts incurred in maintaining, enhancing, or making additions to secured collateral," but stating that unjust enrichment claims may be allowed where the acquiescence of the secured lender is present and where the claimant's "acts were essential to the actual preservation of the secured collateral.").

The same principles can be applied to the *Larsen* case. There, the secured lender never acquiesced to the transfer of the feeder pigs to claimant, Larsen. *Larsen,* 348 N.W.2d at 642. Evidence further showed the transfer was outside the normal course of dealing, and the record was clear that Larsen did not even know about the lender's secured interest in the pigs. *Id.* In such cases, unjust enrichment claims against the rights of a secured lender, under the *Ninth Dist. Prod. Credit Ass'n.* analysis, would not be allowed. As Heartland as already established on the appeal record, this case falls in the category of cases where unjust enrichment claims may be allowed because the course of dealing and industry practice clearly shows the prior acquiescence of the Bank to Heartland's offset for drying and storage services, which are certainly essential to the preservation of the grain. Heartland submits such an

analysis of the Larsen holding is, therefore, limited to the facts of that case, where the far different facts of the present case do allow a claim for unjust enrichment against the Bank for the amounts withheld for drying and storage of the Harker grain.

This is the same reason that the Bank's argument related to a plumber that improves a home is distinguishable from these cases and this case. The plumber would be completely unknown to the secured creditor in that case. If the plumber and the secured creditor had some sort of previous course of business or the secured creditor acquiesced to the plumber's work, then the circumstances might warrant an unjust enrichment claim from the plumber. To say that Heartland's position is that every entity who improves property automatically has an unjust enrichment claim is untrue. What is true is that the Bank, as the record makes clear, acquiesced to the essential services of drying and storage by Heartland. In such case, an unjust enrichment claim is proper.

C. The Distinction between the Buyer-Seller Industry and the Seller-Lender Industry is False.

Undisputed evidence is that withholding services essential to protecting and preserving grain is the norm in the grain industry. Parsing between the buyer-seller industry and the seller-lender industry is a false distinction. The affidavits in the record did not make that distinction, and neither should this

Court. It stretches credibility to believe that a bank would lend hundreds of thousands of dollars not only to Harker, but presumably other farmers, without an understanding of how the buyer-seller grain industry works, or even drawing such a distinction. However, all sides understand how the grain industry works, including by withholding necessary and essential costs in a grain sale. It is not "customary" to separately pay for grain as MWO asserted on page 52 of its proof brief. At the end of the day, the only evidence in the record is that the custom in the entire grain industry is to withhold grain for drying and storing charges.

D. The Timing of Harker's Sales, Coupled with the Grain Industry Practice, Provided the Bank with Notice.

The record before the Court demonstrates that the Bank had constructive notice of the drying and storing charges. The undisputed evidence in the case shows that it is necessary to dry grain before storage. (Heartland MSJ Appendix Ex. O – Bailey Aff. ¶ 7)(App. 206). The undisputed evidence in the record also demonstrates that Harker sold grain throughout the year. Harker sold grain in January, February March, August, October, and December of various years. (Pl.'s Resp. to Def.'s Stat. Add'l Facts at ¶ 12–17)(App. 388-390). It is beyond belief that the Bank was unaware that an Iowa farmer is unable to sell grain all throughout the year without drying and storing that grain based on Iowa's growing season.

Regardless of whether Harker or Heartland explicitly informed the Bank of the drying and storing, the Bank was willfully ignorant to believe Harker was not having someone dry and store at least some of the grain sold. The Bank received checks from Heartland and/or Harker all throughout the year. When Harker received these checks from Heartland, Heartland provided him with the settlement sheet explaining the check. (*See* Amdd Answer Exs. A-G)(App. 48-54). The Bank allowed Heartland to provide those services, which falls within the *Ninth District* analysis discussed above. This Court should not permit the Bank to hide its head in the sand and claiming ignorance so that it can benefit from Heartland's services. The fact that industry custom dictated withholding this grain for drying and storing, along with the timing of Harker's grain sales, provided the Bank with constructive notice of the withholding.

E. Iowa's Unjust Enrichment Does Not Require Exhaustion of Legal Remedies.

Heartland was not required to exhaust all of its legal remedies, such as a warehouse or artisan's lien, before asserting unjust enrichment. Unjust enrichment is a simple concept. Heartland must only show (1) the Bank was enriched by the receipt of a benefit, (2) the benefit was at Heartland's expense,

and (3) that is would be unjust to allow the Bank to retain that benefit.[1] *Pro Commercial, LLC v. K & L Custom Farms, Inc.*, 870 N.W.2d 273 (Iowa Ct. App. 2015). As the Eighth Circuit said in *Iconco v. Jensen Construction Co.*, "We are impressed with the simplicity of the rule echoed by the Iowa unjust-enrichment cases. '[I]t is essential merely to prove that a defendant has received money which in equity and good conscience belongs to plaintiff.'" 622 F.2d 1291, 1302 (8th Cir. 1980) (quoting *In re Estate of Stratman*, 1 N.W.2d 636, 642 (Iowa 1942)).

"[T]he Iowa law of unjust enrichment imposes no prerequisite to recovery akin to exhaustion of administrative remedies," such as the Bank is suggesting with its argument that Heartland must exhaust its legal remedies before claiming unjust enrichment. *Id.* The Bank's explanation of the tripartite relationship in this case in simply irrelevant to the fact that the Bank became richer because of Heartland's drying and storing services.

F. Industry Practice and Creation of Material Fact

Heartland did not err by not arguing that the grain industry practice was a disputed issue of fact because it was undisputed by any actual evidence, so

[1] The Bank cites *Dep't of Human Servs. ex rel. Palmer v. Unisys Corp.*, 637 N.W.2d 142, 155 n.2 (Iowa 2001) for the proposition that legal remedies bar equitable ones. However, the Court finished that footnote by stating "no independent principle exists that restricts restitution to cases where alternative remedies are inadequate."

it was not a disputed issue of fact. The only evidence in the record relating to industry practice are the affidavits of Bailey and Frazier, who testified to the industry practice. (Heartland MSJ Appendix Ex. O – Bailey Aff. ¶ 10; Heartland Appendix in Support of Resist to Plf MSJ – Ex. P – Frazier Aff. ¶¶ 7–8)(App. 206-207; 353). The Bank did not submit any evidence on that topic. (Pl.'s Resp. to Def.'s Stat. Add'l Facts at ¶¶ 6, 15, 16)(App. 386, 389-390). At the District Court level, the grain industry practice was undisputed and not a genuine issue of fact. At oral argument on summary judgment, after Heartland alerted the District Court that, as to its equitable claims, there may be a disputed facts as to industry practices, *see* Oral Argument Trans. at 21-22 (App. 412-413), the Bank conceded as an "admitted fact" . . . "about what industry practices are, and Don Frazer says that's the industry practice." Id. at 26 (App. 417).

The Bank argues on page 52 of its proof brief that it is "customary" in the grain industry to pay for drying and storing upfront. It asserts that the fact that Harker paid one time for drying and storing charges by check refutes what is industry practice. The Bank raised this particular argument for the first time in its proof brief. Heartland's position is that grain industry practice in this case is undisputed because the Bank failed to submit any evidence to the contrary, but to the extent the Court disagrees with Heartland on that point—

or the Bank now argues that it is customary in the grain industry to pay for drying and storing charges upfront—the Bank has raised a genuine issue of material fact. The Bank had the same obligation to withdraw its Motion for Summary Judgment and/or advise the District Court of all disputed facts related to grain industry practice that it asserts Heartland had.

CONCLUSION

The Bank's claims arising from the sales of the subject grain occurring before March 16, 2016 are time barred under Iowa Code Section 614.1(10), and the Bank's judgment, as a matter of law, should be reduced in the principal amount of $42,111.10. Furthermore, neither the express contract with the Harkers nor the UCC prevent Heartland from bringing an unjust enrichment claim against the Bank. It is undisputed that the Bank was enriched by the drying and storage serviced provided by Heartland. The record shows the Bank was on notice of and acquiesced to Heartland's offset for drying and storage costs from the grain sale proceeds under the well-known practice in the agricultural industry and further evidenced by the Bank's own loan documents and notices of its lien interest in the Harker grain that was sent to Heartland. At the very least, the Bank's notice of Heartland's offset from grain sales for necessary services to protect the Bank's collateral is a material fact in dispute and should be submitted to the trier of fact to determine.

Respectfully submitted,

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CERTIFICATE OF COST

I hereby certify that the cost of printing the foregoing Appellant's Final Reply Brief was the sum of $ N/A.

/s/ Johannes H. Moorlach

CERTIFICATE OF COMPLIANCE

The undersigned hereby certifies that:

This brief complies with the typeface requirements and type-volume limitation of Iowa Rs. App. P. 6.903(1)(*d*) and 6.903(1)(*g*)(1) or (2) because this brief has been prepared in a proportionally spaced typeface using Times New Roman in 14 pt and contains 4,222 words, excluding the parts of the brief exempted by Iowa R. App. P. 6.903(1)(*g*)(1).

/s/ Johannes H. Moorlach

CERTIFICATE OF FILING AND SERVICE

The undersigned certifies that on December 17, 2019, I filed this Appellant's Final Reply Brief electronically via EDMS. The undersigned further certifies that on December 17, 2019, Appellant's Final Reply Brief was served upon all parties of record to the above cause via EDMS.

/s/ Johannes H. Moorlach