

## FACING THE ISSUES®

Legal Briefs from the Attorneys of  
Mackall, Crouse & Moore, PLC

### Creditors' Corner

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#### **MINNESOTA COURT OF APPEALS CONFIRMS STRICT CONSTRUCTION OF NOTIFICATION REQUIREMENTS FOR LIVESTOCK PRODUCTION INPUT LIENS**

The Minnesota Court of Appeals recently confirmed that livestock production input providers (primarily feed providers) must strictly follow lien notification requirements in order to obtain a priority lien over a secured agricultural lender with a “first-in-time” blanket UCC filing against the borrower’s livestock herd. There are two routes where a feed supplier can prime a lender’s earlier-filed UCC interest. The first arises if the production input lien becomes effective (meaning feed has been provided) before the secured lender gives value. The more common route is available if the input supplier serves a lien notification statement on the lender in compliance with Section 514.966, subd. 4 of the Minnesota statutes, and the lender fails to respond in ten days with a commitment or refusal to honor any charges by the supplier.

The lien notification statement requires a variety of disclosures including: (1) the name and address of the lender; (2) the name and address of the supplier; (3) a description of the anticipated transactions, dates of delivery, and anticipated costs of the production inputs; (4) name and address of the person who will receive delivery of the input; (5) name and address of livestock owner; and (6) a statement that the products and proceeds of the livestock are covered by the production input lien. The statement must also be delivered by certified mail or some other verifiable method with conspicuous language on the envelope stating “IMPORTANT – LEGAL NOTICE.” In *Minnwest Bank v. Arends*, A10-2167 (Minn. App. August 15, 2011), the supplier failed to include that statement on the envelope.

The court found that the failure to include this language defeated the supplier’s claim for priority. The court found that the statute states that the supplier “shall” place that language on the envelope and thus the legislature made this requirement mandatory. Therefore, the court did not entertain the supplier’s arguments that it substantially complied with the requirement or that the lender in fact opened the notice. The court concluded that where the supplier fails to include this information, the lender has no duty to respond, and is not prejudiced by a priority lien if it does not respond in ten days.

**Practice Pointer:** The agricultural lien statutes for crop and livestock liens are similar to other lien provisions found in Article 9 and other statutory liens, such as mechanic’s liens, but there are clear differences with agricultural liens. Surprisingly, there are also few published decisions in Minnesota regarding its agricultural lien statutes. This is one of the first major decisions regarding the livestock lien statute by the Minnesota Court of Appeals. MCM is in the process of representing a lender on a similar appeal, and has experience handling issues that arise between feed suppliers and secured lenders.

## **CREDITORS CAN RECOVER FROM NOLS**

Most lending agreements provide that the lender, among other things, has a security interest in the borrower's tax refunds. If not, they should. Many times the source of any refund for a failing business or taxpayer is net operating losses which previously had a 2-year carryback. In November of 2009, Congress enacted IRC Section 172(b)(1)(H) which generally allows a taxpayer to elect an extended 5-year carryback period for an NOL for the returns filed for taxable years ending in 2008 or 2009. That section also allows a taxpayer to offset 100% of its AMT taxable income with its AMT NOL. This was previously limited to 90%. Section 505 of the Bankruptcy Code allows the Debtor or a trustee to obtain an extended determination of tax liability so that these potential recoveries can be evaluated.

**Practice Pointer:** Interested parties must act quickly so that the refunds sought are not from amended returns, in which case the IRS pays closer attention. Lenders should examine criticized loan files or workout loan files and ask the borrower to consult with its tax advisor. The lender should not give tax advice at any time. MCM attorneys are familiar with these provisions of the Internal Revenue Code and the Bankruptcy Code and can assist lenders in the methods to be applied in recovering these potential assets.

## **CONVERTING NON-EXEMPT PERSONAL PROPERTY INTO HOMESTEAD**

### **EXEMPTION PROPERTY**

The Eighth Circuit Court of Appeals reaffirmed that a debtor may convert otherwise non-exempt personal property into its homestead exemption amount, provided it follows certain procedures. In *Danduran v. Kaler (in re Danduran)*, No. 10-3813 (8th Cir., September 16, 2011), the debtor sold his homestead shortly before his bankruptcy for \$225,000. The sale included various items of personal property in the house including a pool table, hot tub, grill, mirrors, rugs, audio/video equipment, chairs, and tables. The bankruptcy court had determined that these items were not fixtures but were personal property. The real estate sales contract did not allocate the personal property as part of the purchase price. Of the sales price, \$140,860.38 was paid to the mortgage lender. The Debtor deposited the remaining \$87,501.55 into a savings account. In his subsequent bankruptcy, the Debtor claimed the entire amount of the savings account exempt. North Dakota provided a homestead exemption of \$100,000, but the trustee argued that to the extent the account included proceeds of personal property, these amounts were not exempt.

The court held that in general a debtor can convert non-exempt assets into exempt assets, but must have the intent to make the conversion and actually make the conversion. The court indicated that one way to convert personal property into a homestead exemption is to use the proceeds of the personal property to pay down the mortgage lender and increase the equity in the homestead. Depositing the money into a savings account holding homestead proceeds would not necessarily suffice. In this case, however, the Debtor argued that it used the proceeds of the personal property (which the bankruptcy court valued at \$7,700) as part of the \$140,860 payment to the mortgage lender. Thus, the remaining account balance included only proceeds of the homestead. The court ruled that it is the trustee's burden to show that proceeds from the personal property were deposited into the account. Since there appeared to be no

documentation tracing the proceeds from the sale or their use, the trustee could not prove that the personal property proceeds were deposited into the savings account. In other words, “a tie” goes to the debtor.

**Practice Pointer:** Exemption planning and fighting exemption planning can be difficult tasks. For a creditor, fighting exemption planning is usually a trustee task, but creditors who are aware of potential exemption issues should bring those to the trustee’s attention. MCM routinely represents a Chapter 7 bankruptcy trustee and can provide practical guidance to creditors suspecting substantial exemption abuse.

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