



# **Farmers' Guide to Minnesota Lending Law**

**Second Edition  
June 2003**

**Farmers' Legal Action Group, Inc.**

This book incorporates all changes  
made by the Minnesota Legislature  
through the 2003 Special Session.

# **Farmers' Guide to Minnesota Lending Law**

Second Edition, June 2003

Written by David R. Moeller and  
Stephen Carpenter

Edited by Karen R. Krub

This publication was made possible with the generous support of:

Legal Services Advisory Committee

Minnesota Lawyer Trust Account Board

Southern Minnesota Regional Legal Services, Inc.

Bush Foundation

Otto Bremer Foundation

and

The Minneapolis Foundation

PUBLISHED BY

Farmers' Legal Action Group, Inc.  
46 4th Street East, Suite 1301  
St. Paul, Minnesota, 55101  
lawyers@flaginc.org  
www.flaginc.org

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Cover photo © Bryce A. Nixon.

Publisher's Cataloging-in-Publication  
(*Provided by Quality Books, Inc.*)

Moeller, David R.

Farmers' guide to Minnesota lending law / written by  
David R. Moeller and Stephen Carpenter ; edited by Karen  
R. Krub. -- 2nd ed.  
p. cm.  
Includes index.  
ISBN 1-890508-05-5

1. Agricultural credit--Law and legislation--  
Minnesota. I. Carpenter, Stephen (James Stephen)  
II. Krub, Karen R. III. Title.

KFM5566.A4M64 2003

346.77607'3

QBI03-200460

## **Acknowledgments**

Stephen Carpenter wrote the first edition of this book published in 1996. David Moeller updated and revised the book for this second edition. Karen Krub provided editorial supervision. Several other people provided input along the way. They include: Lynn Hayes, Jill Krueger, Gary Petersen, Mary Nell Preisler, Jan Boll, and Bruce Lubitz.

Ann Pagel Newman managed the production of the book: her work included the copyediting, layout, and oversight of the printing and online publication process. Debby Juarez assisted Ann in this long process.

The team of all the people listed here, together with all the funders listed on the title page, have contributed to a product that is intended to help thousands of Minnesota farmers to understanding their legal rights and, hopefully, to preserve their farms.

Randi Ilyse Roth  
Executive Director  
Farmers' Legal Action Group  
May 2003

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Dedicated to the memory of Paul Wellstone.

May we all continue to remember  
the passion and drive in  
Senator Wellstone's work on behalf of  
Minnesota family farmers.

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## Chapter One

# Introduction

### I. Credit and farming

Credit is the lifeblood of farming. Serious price, production, and weather difficulties almost always become credit problems. The stark and ongoing reality is that mortgaged farms are lost or nearly lost to foreclosure, property pledged as collateral is repossessed, judgment liens are entered—and the livelihood of family farmers is threatened.

Credit problems are almost always legal problems. In an ideal world, the law would be clear enough and the legal system fair enough that everyone would be on a more or less even footing in legal matters. Unfortunately, the law can be complicated, and even where the law is simple at its core, legal language is confusing and difficult.

Farming without a working knowledge of lending law—or the resources to buy legal assistance—can have devastating results. The aim of this book is to give farmers a basic outline of lending law. Because so few legal situations are exactly the same, this book can only offer a general outline of the law.

### II. Keeping a written record of credit arrangements

The strictly business nature of agricultural credit has long been softened by informality. Informal and unwritten agreements may well still work for some people in some cases, but in general it is important to keep thorough written records of dealings with creditors. As a matter of law, many agreements must be in writing to be legally enforceable. These are discussed briefly in Chapter Two.

Even when it is not required by law, it is a good idea to keep a written record of dealings with creditors. The main problem is not unfair or sharp business practices—although that is common enough—but, instead, simple confusion and misunderstandings. Most disputes about leases, contracts, and other legal agreements are the result of the two basically honest parties having different interests and different ideas about the meaning of the agreement itself. This type of problem is much more common in an age of conservation compliance, government crop programs, and complex security agreements.

Even the most honest and trusting relationships can change through no fault of farmers or their creditors. Banks change hands or are sold out; landlords can pass away or sell the land. The list of possible problems is very long. Keeping good records of dealings with a creditor is a little like buying insurance. It is done not because farmers expect to have problems, or because they want to go to court at the drop of a hat, but because in that rare case that farmers do have

serious problems with creditors, it will be extremely important to be able to prove exactly what happened and when. One way to think about keeping good records is to imagine that they may be needed to prove to a stranger exactly what happened between the farmer and the creditor. No one's memory is good enough to recall all of the important details.

Some suggestions follow.

#### **A. Keep copies of documents**

Keep copies of all loan agreements, promissory notes, security agreements, mortgages, contracts for deed, leases, and the like, and note on them the date they were signed, sent, or received.

#### **B. Put important contacts with creditors in writing**

Farmers should document every important contact with their creditors. Letters should be written and copies kept.

#### **C. Verify what is sent and received**

In many cases, it will be important to show that documents sent were received. There are two simple ways to create proof that someone received a letter or form. First, farmers can mail letters and documents by certified mail, return receipt requested, and keep the evidence of receipt.

A second way to prove that someone received a letter is to bring two copies of the letter or form into the office in person. The person accepting the letter should be asked to write on each copy: (1) "received," (2) the date, and (3) his or her signature. Farmers should keep a signed copy for themselves.

#### **D. Document telephone calls and conversations in writing**

Farmers should keep a diary of every conversation they have with creditors. A short notation in a diary of the date and significant details of the conversation can help farmers remember dates and details.

If anything important is said in a telephone call or in a meeting with a creditor, the best strategy is to write a letter to the creditor immediately. The name of the person spoken with should be mentioned along with the date of the call or meeting and what was said. The letter should also include a statement that the understanding of the conversation described in the letter will be presumed correct if no written response is received in "x" number of days.

### **III. Getting help — attorneys and advocates**

While the aim of this book is to provide a basic understanding of farm lending issues, it is still important to talk with an experienced attorney or farm advocate about how to handle a specific problem. The law is filled with exceptions and details—and the situation of every farmer is always different—so this book can never be a substitute for an experienced look at a farmer's individual case.



This book cannot be a substitute for an experienced attorney or advocate. Each farmer's situation is different and needs an experienced person to look at its specific details.

### A. Minnesota Farm Advocates

Located throughout the state are Minnesota Farm Advocates. Advocates are experienced in assisting farmers in financial crisis. They are trained in negotiating with creditors, have a good understanding of creditors' policies, can help farmers identify legal issues, and can help farmers decide if they need to talk with an attorney. If an attorney is needed, advocates can usually refer farmers to one experienced in working with family farmers in financial difficulty. Advocates are also experienced in assisting farmers with financial records, such as cash flows and balance sheets, that are needed during negotiations with lenders and government agencies. Advocates are especially helpful in preparing farmers to participate in farmer-lender mediation. Because Minnesota Farm Advocates are supported by grants and the state legislature, their services are available at no cost.

To find an advocate, call the Farm Advocate Program Administrator at 1-800-967-AGRI (2474).<sup>1</sup>

### B. Attorneys

There are times when debt problems are serious enough and the stakes high enough that farmers need legal advice.<sup>2</sup> An experienced attorney should be able to explain how the laws affect a farmer's individual situation, give legal advice on which choices best fit the farmer's goals, draft the legal papers needed, and, if necessary, represent the farmer in court.

#### 1. Looking for an attorney

There are several things to look for in an attorney. If the farmer does not know the attorney, it makes sense to ask for references from other farmers and friends. A few suggestions about picking an attorney follow.

##### a. Experience in helping farmers

Because legal work in the farm area is complicated, experience is necessary. At a minimum, the attorney should be able to consult with someone with more experience. An experienced attorney should be happy to give references from other farmers.

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1 Additional information is available at: <http://www.mda.state.mn.us/commissioner/fadvoweb.htm>.  
2 Stephen Carpenter and Randi Ilyse Roth, *Family Farmers in Poverty: A Guide to Agricultural Law for Legal Services Practitioners*, 29 CLEARINGHOUSE REVIEW 1087 (Apr. 1996); Carl Flink, *Finding a Place for Low-Income Family Farmers in the Legal Services Equation*, 35 CLEARINGHOUSE REVIEW 677 (Mar.-Apr. 2002); Larry R. Spain, *The Opportunities and Challenges of Providing Equal Access to Justice in Rural Communities*, 28 WM. MITCHELL L. REV. 367 (2001), available at [http://www.wmitchell.edu/lawreview/volume28/issue1/12\\_spain.pdf](http://www.wmitchell.edu/lawreview/volume28/issue1/12_spain.pdf).

**b. Willing to sometimes say they don't know**

No matter how good attorneys are, they will not know the answer to everything. Legal work in the farm area is complex. Good attorneys answer some questions by saying they do not know or will need to look it up. Be wary of someone who has a smooth answer to every possible question.

**c. Trustworthiness**

Trust may be the most important thing when choosing an attorney. A farmer must trust the attorney with private financial documents and must be willing to explain all of the facts to the attorney—even those which might seem embarrassing.

**d. Reliability**

Much of an attorney's work depends on meeting strict deadlines. Reliability is therefore extremely important.

**2. Be clear about the work to be done and the cost**

Private attorneys can be very expensive, and fees vary a great deal. A farmer working with an attorney needs to be sure of exactly what work the attorney will be doing and how much it will cost. While the final bill cannot always be predicted very easily, the attorney should be willing to give a good idea of what to expect.

**C. Legal referrals**

Legal Services attorneys can sometimes provide free legal help to low-income farmers. The Minnesota Family Farm Law Project (MFFLP) is a program that provides legal assistance to financially distressed family farmers in Minnesota in conjunction with the offices of Southern Minnesota Regional Legal Services (SMRLS), Mid-Minnesota Legal Assistance (MMLA), and Legal Services of Northwest Minnesota.<sup>3</sup> MFFLP services are free or provided at a reduced cost to eligible farmers. In general, priority is given to cases to prevent foreclosure on family farm homesteads and repossession of farm machinery, equipment, livestock, crops, and real estate that are necessary to the farm operation. In addition, priority is given to cases to secure the release of income from farm production and/or obtain the extension of credit for family living and farm operating expenses. Legal services offices providing assistance in farm cases can be found in:

**St. Cloud:**

St. Cloud Area Legal Services  
1-888-360-2889 and 320-253-0121

**Willmar:**

Western Minnesota Legal Services  
1-888-360-3666 and 320-235-9600

**Mankato:**

Southern Minnesota Regional Legal Services  
1-800-247-2299 and 507-387-1211

**Worthington:**

Southern Minnesota Regional Legal Services  
1-800-233-0023 (within 507 area code only)  
and 507-372-7368

**Winona:**

Southern Minnesota Regional Legal Services  
1-800-372-8168 and 507-454-6660

**Moorhead:**

Legal Services of Northwest Minnesota  
1-800-450-8585 and 218-233-8585

<sup>3</sup> Additional information is available at: <http://www.mnlegalservices.org/familyfarm/>.

Brief legal advice and referrals are available to all Minnesota farmers from Farmers' Legal Action Group, Inc. (FLAG) at 1-800-233-4534 and 651-223-5400. A list of FLAG's publications can be found in Appendix B and on the web at <http://www.flaginc.org>. The Minnesota State Bar Association has a statewide referral service for people needing an attorney: 1-800-292-4152.<sup>4</sup>

#### **IV. What this book covers**

This book discusses some of the most important types of credit farmers use and some of the specific problems that may arise if farmers have difficulty paying a debt. One set of terms should be defined at the beginning: the law most often describes the parties in a credit relationship as the debtor and the creditor. The debtor is the person who owes the money. In general, this book assumes that the debtor is a farmer. The creditor is the person to whom the debt is owed.

**Debtor** — The person who owes money. This book assumes that the farmer is the debtor.

**Creditor** — The person to whom the debt is owed.

An explanation of the chapters in this book follows.

##### **A. Some agreements must be in writing**

Many agreements can be perfectly legal and enforceable even if they are not in writing. For some types of agreements, however, the law requires that the agreement be put in writing to be enforceable. Chapter Two gives a brief summary of the law covering these agreements.

##### **B. Real estate debt**

The most common arrangements for farm real estate debt are mortgages and contracts for deed. After a default, mortgages may be foreclosed and contracts for deed may be canceled. Sometimes this requires a court action, but more often the foreclosure or cancellation may go ahead without the creditor needing to go to court. A foreclosure can also lead to a money judgment against the debtor for any amount not recovered from the foreclosed property. Along the way farmers may have statutory rights—a "right of first refusal" and "a right of redemption"—which may allow the farmer to keep part or all of the land. These topics are discussed in Chapter Three.

##### **C. Secured credit**

Much farm operating credit is provided by creditors who require farmers to provide "security" for the debts. That is, the farmer signs an agreement allowing the creditor to take some of the farmer's property if the farmer does not pay the debt. These secured debts are largely governed by Minnesota's version of the Uniform Commercial Code (UCC), which was revised effective

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4 Additional information is *available at*: <http://www.mnbar.org/attref-public.htm>.

July 1, 2001. Some creditors may automatically get a security interest in a farmer's property under the provisions of state law. These "statutory liens" include landlord's liens and mechanics' liens. Secured credit, operating loans, and statutory liens are discussed in Chapter Four.

#### **D. Unsecured credit**

Many creditors do not have a security interest in debtors' property. In other words, although the debtor owes the creditor money, the debtor has not given the creditor the legal right to take the debtor's property in case of a default. These creditors still have a legal remedy if the debtor defaults. An unsecured creditor may file a court action against the debtor, win a judgment against the debtor for the amount of the unpaid debt, and obtain a "judgment lien" against the debtor's property for the amount owed. Judgment liens can lead to garnishments, sheriff's levies, and other creditor actions to collect the debt. Unsecured credit is discussed in Chapter Five.

#### **E. Leases**

Farmland, equipment, and livestock are now often leased. Chapter Six discusses leases and some of the problems farmers may face using them.

#### **F. Mediation**

Farmers who have difficulty with their creditors often have the chance to use Minnesota's farmer-lender mediation program. Chapter Seven discusses mediation and how it can be helpful to farmers.

#### **G. Bankruptcy**

For some farmers in financial distress, bankruptcy may be the best option. While some bankruptcies lead to liquidation of the farming operation, others are designed to keep family farmers on the land. Chapter Eight summarizes these options.

#### **H. Taxes**

Farm taxes are complicated and are not discussed in this book in any detail. Chapter Nine, however, gives some basic information about the way a farmer's credit situation may affect income taxes.

#### **I. Alternative Dispute Resolution (ADR)**

All civil lawsuits filed in Minnesota district courts are subject to an Alternative Dispute Resolution (ADR) requirement. Chapter Ten summarizes how the ADR requirement may affect farmers' debtor-creditor relationships.

#### **J. Scam artists targeting farmers**

Chapter Eleven briefly discusses some of the unscrupulous practices used by scam artists targeting farmers in difficult financial circumstances.

## Chapter Two

# Some Agreements Must Be In Writing: The Statute of Frauds

## I. Introduction

Many agreements and contracts are legal and enforceable even if they are only made orally. Leaving no written record of such agreements may bring other problems, but as a matter of law they are as legal as the longest and most detailed written contract.<sup>1</sup>

Some agreements, however, must be in writing to be enforceable. Laws imposing this requirement are generally called “statutes of frauds.” Minnesota’s version of the statute of frauds requires that certain kinds of agreements be in writing. In general, for a written agreement to serve as a binding contract, it must set out the names of the parties involved, the subject matter and terms and conditions of the contract, and the “consideration”—which means the money, service, or some other thing of value being offered as payment—and must be signed.<sup>2</sup>

## II. What agreements must be in writing

Several types of agreements must almost always be in writing to be legally enforceable. These include:

### A. Agreements that cannot be completed within one year

If it is not possible for the actions required by the contract, by its own terms, to be completed within one year, the agreement must be in writing.<sup>3</sup> Technically, the question is not whether the agreement was actually completed in that year, or how long the parties thought it would take to complete it, but rather whether or not completion of the contract within one year was possible.<sup>4</sup>

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1 See, for example, *Larson v. Archer-Daniels-Midland Co.*, 32 N.W.2d 649, 653-54 (Minn. 1948). In *Bergstedt, Walhberg, Berquist Assoc. v. Rothchild*, 225 N.W.2d 261, 263 (Minn. 1975), the Minnesota Supreme Court held that no legal distinction is made in the effect of an enforceable promise as expressed in writing, orally, in the acts of the parties, or in a combination of means.

2 Minn. Stat. §§ 336.2A-201, 513.01. In general, it is the signature of the party who is being forced to fulfill his or her obligations under the contract that must be included.

3 Minn. Stat. § 513.01(1).

4 Minn. Stat. § 513.01(1); *Bussard v. College of St. Thomas, Inc.*, 200 N.W.2d 155, 161 (Minn. 1972).

## B. Agreements to transfer land

Agreements concerning the transfer of any interest in land, no matter how limited that interest may be, must be in writing.<sup>5</sup> The only exception to this rule is that a real estate lease of one year or less is not required to be in writing.<sup>6</sup>

## C. Lease of land for more than one year

The lease of land for more than one year must be in writing. Lack of a written agreement makes the contract void, not just unenforceable.<sup>7</sup> "Void" means it is as if the contract does not exist, while "unenforceable" means one party cannot compel the other party to abide by the contract. Leases are discussed in more detail in Chapter Six.

## D. Lease of goods with total payments of \$1,000 or more

An agreement to lease goods with total payments of \$1,000 or more must name the parties to the lease, must be signed by the party that is attempting to avoid the contract, and must describe the goods leased.<sup>8</sup> Leases are discussed in more detail in Chapter Six.

## E. Agreements to lend money in the future

A person may not sue to enforce a credit agreement unless the agreement is in writing.<sup>9</sup> For example, borrowers claiming that a bank promised to advance additional funds to the borrowers in the future must have the agreement in writing before they can try to force the bank to actually loan the money.<sup>10</sup>

## F. Sale of goods for \$500 or more

An agreement to sell goods for a price of \$500 or more must be in writing to be enforceable.<sup>11</sup> In general, to qualify as "goods," the things to be sold must be movable and may not be services.<sup>12</sup> A written agreement is not required, however, if the goods were specially manufactured for the buyer, the buyer admitted that there was an agreement, the buyer accepted and paid for the goods, or the seller accepted payment for the goods.<sup>13</sup>

## G. Most security agreements

Security agreements must be in writing to be enforceable against the debtor and other creditors unless the creditor has possession of the collateral.<sup>14</sup>

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5 Minn. Stat. §§ 513.04, 513.05.

6 Minn. Stat. §§ 513.04, 513.05.

7 Minn. Stat. § 513.05; *Bruder v. Wolpert*, 227 N.W. 46, 47 (Minn. 1929).

8 Minn. Stat. § 336.2A-201.

9 Minn. Stat. § 513.33; *Rural American Bank v. Herickhoff*, 485 N.W.2d 702 (Minn. 1992); *Drewes v. First Nat'l Bank*, 461 N.W.2d 389 (Minn. Ct. App. 1990).

10 *Moody v. Citizens State Bank*, No. C3-02-275 (Minn. Ct. App. Aug. 13, 2002) (unpublished).

11 Minn. Stat. § 336.2-201(1).

12 Minn. Stat. §§ 336.2-105, 336.2A-201(1).

13 Minn. Stat. § 336.2-201(3).

14 Minn. Stat. §§ 336.9-203(b), 336.9-102(a)(73).

## H. Others

Other agreements that generally must be in writing include a promise to be responsible for another's debt or to pay a discharged or released debt,<sup>15</sup> an agreement to submit any dispute to binding arbitration,<sup>16</sup> and an agreement setting interest at over 6 percent annually.<sup>17</sup>

## III. If the agreement is not in writing

In general, failure to put in writing an agreement that falls under the statute of frauds means that the contract is unenforceable.<sup>18</sup> Although the parties are *permitted* to carry out such an agreement even when there is no written contract, because the oral agreement is unenforceable, neither one could go to court to *force* the other party to fulfill his or her promises.<sup>19</sup> There are exceptions to this rule, however. If the parties acted as if the contract were valid, for example, and one or both parties at least partially fulfilled the contractual promises, the contract may be enforceable even if it is not written down.<sup>20</sup>

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15 Minn. Stat. § 513.01(2), (4).

16 Minn. Stat. § 572.08.

17 Minn. Stat. § 334.01. See Appendix A for a short discussion of limits on interest rates.

18 *Royal Realty Co. v. Levin*, 69 N.W.2d 667, 671-72 (Minn. 1955); 44 DUNNELL MINN. DIGEST, *Statute of Frauds*, § 5.01 (4th ed. 1999).

19 *Royal Realty Co. v. Levin*, 69 N.W.2d 667, 671-72 (Minn. 1955).

20 *In re Guardianship of Huesman*, 354 N.W.2d 860, 863 (Minn. Ct. App. 1984).

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## Chapter Three

# Mortgages and Contracts for Deed

## I. Mortgages and contracts for deed — a basic introduction

Mortgages and contracts for deed are among the most important and most complicated documents that farmers sign. It is important, therefore, to understand the exact terms of these agreements before signing them. This chapter contains only a general discussion of mortgages and contracts for deed and some of their important terms. Each farmer's situation and contract can be different.

### Recording real estate documents

Many real estate documents used by farmers—such as mortgages and contracts for deed—are officially recorded. This means whoever is being paid—typically the lender—is responsible for filing them with the registrar of titles or the recorder of the county in which the real estate is located.

## A. Mortgages

In a mortgage, the borrower is the mortgagor, and the lender is the mortgagee. The mortgagee can be an individual, a private bank, the government, Farm Credit Services, or another financial institution.

**Mortgagor** — The borrower. This book assumes that the farmer is the borrower.

**Mortgagee** — The lender.

Most farm mortgages are given by a farmer borrower to a lender as collateral for a loan, usually to enable the borrower to purchase or improve land. A mortgage gives the lender a claim against real estate identified in the mortgage agreement. The lender can foreclose on the property if the borrower fails to repay the loan or otherwise violates the loan terms.

Although a mortgage allows the lender to foreclose on the land if the borrower defaults, the borrower legally owns the mortgaged land.

### 1. There are typically two documents in a mortgage transaction

When obtaining a loan secured by a mortgage, borrowers will likely sign two documents: a promissory note and the mortgage itself. It is possible that these agreements could be combined.

#### a. *Promissory note*

A promissory note is a promise to pay money. It sets the terms of the promise to the lender, including the amount owed, the interest rate charged, when payments are due, and so forth. A promissory note may be enforceable even if the mortgage is not, and it may remain enforceable even after a foreclosure.

#### b. *Mortgage*

As mentioned earlier, a mortgage is an agreement giving the lender the right to foreclose on the real estate if the borrower fails to pay the loan or otherwise violates the terms of the loan. That is, the mortgage gives the lender added assurance that the debt will be repaid because the lender can take any property named in the mortgage and sell it to raise funds to reduce or eliminate the debt.

Mortgages are usually officially recorded, which, if done correctly, gives notice to the general public of the mortgage. Failure to properly record a mortgage can affect the lender's rights in the property in relation to the borrower's other creditors. However, it does not affect the binding nature of the agreement between the borrower and the lender.

### 2. Satisfaction of mortgage

When a borrower finishes repaying the loan, he or she can ask the lender for a "satisfaction of mortgage" certificate. The satisfaction of mortgage certificate should say that the lender no longer has a legal interest in the real estate. In general, a lender must give this certificate to the borrower within ten days after it is requested.<sup>1</sup> The borrower should record the satisfaction of mortgage certificate with the recorder of the county where the real estate is located.<sup>2</sup> Until the certificate is filed, the mortgage may impair or affect the legal title of the real estate of the land, which can hold up sales or make it difficult to obtain another mortgage on the real estate. If the borrower somehow cannot get the lender to provide a certificate, the law provides penalties against the lender and allows some borrowers to file a document that has a similar effect.<sup>3</sup>

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1 Minn. Stat. § 507.41.

2 Minn. Stat. § 507.40. If a mortgage can be recorded in more than one county and a "satisfaction of mortgage" certificate can be filed in one of those counties, a certified copy of the certificate may be recorded in another county as if it were the original.

3 Minn. Stat. §§ 507.40 to 507.412. This is only allowed for mortgages with an original principal amount of \$1,500,000 or less and may only be done by a title insurance company for a borrower where the lender failed to file the release. Minn. Stat. § 507.401.

## B. Contracts for deed

In a typical contract for deed, a buyer purchases land directly from a seller with a binding contract. Often in a contract for deed, the buyer is called the vendee and the seller is called the vendor.

**Vendee** — The person who buys the property. This book assumes that the farmer is the vendee.

**Vendor** — The seller of the property.

The seller in a contract for deed promises to transfer title to the land after the buyer makes a certain number of payments over a set time. While the payments are being made, the buyer does not own the land; the buyer does, however, have an “equitable interest” in the land. This means that the buyer can occupy and generate income from the land—for example, by farming it. The contract for deed should list the rights and obligations of both buyer and seller. Buyers must record the contract with the county recorder or registrar of titles in the county where the land is located within four months after the contract is signed.<sup>4</sup> Buyers who fail to record the contract for deed within this time period are subject to a civil penalty equal to 2 percent of the principal amount of the contract debt.<sup>5</sup>

Once all payments are made under a contract for deed, the seller should give the buyer a deed stating that ownership of the real estate passes from the seller to the buyer. The buyer should file the deed with the registrar of titles or the county recorder of the county in which the land is located.<sup>6</sup>

In 2001 the Minnesota Legislature created a new legal arrangement called a “transfer statement for a contract for deed.”<sup>7</sup> Contract for deed sellers sometimes pledge their interest in a contract for deed—which is the right to a stream of payments until the contract for deed is paid in full—to another party.<sup>8</sup> If these rights are assigned to a third party, the buyer then sends payments under the contract to that third party, while the original seller retains title to the property.<sup>9</sup> The new “transfer statement for a contract for deed” allows the formal transfer of rights in the property from the original seller to the third party upon the completion of all recording

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4 Minn. Stat. § 507.235.

5 Minn. Stat. § 507.235, subd. 2.

6 Minn. Stat. § 507.34.

7 Minn. Stat. §§ 336.9-619, 507.236, 508.491, and 508A.491. This legislation was in response to the adoption of changes to Minnesota's secured credit laws, known as Revised Article 9 of the Uniform Commercial Code. For an overview of these changes, see Larry M. Wertheim, *Revised Article 9 of the U.C.C. and Minnesota Contracts for Deed*, 28 WM. MITCHELL L. REV. 1483 (2002) available at [http://www.wmitchell.edu/current/info/stuorganizations/lawreview/Article\\_Files/Volume\\_28/Issue4/05\\_Wertheim.pdf](http://www.wmitchell.edu/current/info/stuorganizations/lawreview/Article_Files/Volume_28/Issue4/05_Wertheim.pdf). Chapter 4 discusses secured credit and Revised Article 9.

8 Minn. Stat. § 336.9-102(a)(2).

9 Minn. Stat. §§ 336.9-607, 336.9-619.

requirements.<sup>10</sup> The formal recognition of this transfer allows the buyer to obtain title to the property directly from the third party when all of the payments under the contract have been made.<sup>11</sup>

### **C. Differences between mortgages and contracts for deed**

Farmers use both contracts for deed and mortgages to buy real estate. There are important differences between the two. When a commercial lender is involved, mortgages are usually used. Contracts for deed are more common when the transaction is between family members or private individuals. Important differences between the two types of agreements include the following.

#### **1. Buyers can lose money already paid if a contract for deed is canceled**

In a contract for deed, the seller keeps legal title to the property until the full contract price is paid. This means that the buyer does not really own the land until the whole contract is paid off and title changes hands. If the buyer defaults and the contract is canceled, the buyer can lose all of the money paid up to that point. This result, and possible exceptions to it, are discussed starting at page 66.

Mortgages are different in that the borrower has legal title to the mortgaged property. If there is a default on a mortgage loan, the borrower will be credited for the amount already paid, and the lender will only be entitled to take value from the property up to the amount of the unpaid debt.

#### **2. Contracts for deed can allow sellers to act more quickly after default**

In practice, a contract for deed can be canceled more quickly than a mortgage can be foreclosed, especially if the foreclosure is by action. (Foreclosures by action are explained below.) This may make a contract for deed more attractive to a private seller. In addition, contract for deed purchasers do not have a right of redemption; mortgage purchasers do have this right. The right of redemption, discussed beginning at page 53, can extend a defaulting borrower's right to possess and use the property.

#### **3. Tax differences**

Mortgages and contracts for deed can have different tax consequences. Although the effect on any single person's taxes can vary greatly, for many sellers there is a tax advantage to using a contract for deed, because the income from the sale is spread out over time rather than coming in one lump sum.<sup>12</sup>

#### **4. Mortgages can give sellers finality**

If the land purchase is financed through a mortgage, the seller is usually completely finished with the transaction when the loan is made. Later, if the borrower has problems

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10 Minn. Stat. § 336.9-619(b).

11 Wertheim at 1501-02.

12 26 U.S.C. § 453; Roger A. McEowen and Neil E. Harl, *PRINCIPLE OF AGRICULTURAL LAW* § 7:05 (2001).

making payments, it is the bank or other lender—not the seller—who takes action. With a contract for deed, however, the seller is the one who takes action if there is a default.

### **5. A contract for deed may be cheaper for the buyer**

A contract for deed may be easier for the buyer to arrange financially. Because contracts for deed offer some financial advantages for the seller, interest on a contract for deed is often less than that for a mortgage. In addition, the down payment for a contract for deed is usually lower than the down payment on a mortgage.

## **II. Mortgages and contracts for deed — basic terms**

It is important to read and understand every part of the mortgage and loan agreement or contract for deed before signing.<sup>13</sup> Basic rights and responsibilities are explained in that agreement. For example, a contract for deed lists the price of the real estate, the interest rate charged on the remaining balance, and the amount and due date for each installment. Violations of the terms of a mortgage or contract for deed may bring foreclosure or cancellation. Farmers who have questions about any real estate credit transaction, including a mortgage agreement or contract for deed, should talk to a lawyer. Some of the important terms in mortgages and contracts for deed are discussed below.

### **A. Real property, personal property, and fixtures**

There are two basic legal categories of property that are important for credit agreements: real property and personal property. The difference can be important because most mortgages cover only real property. Personal property may be used as collateral for debt and may be repossessed by creditors, but the rules are different.

#### **1. Real property vs. personal property**

The difference between personal and real property is unfortunately not always clear, and lawyers can go round and round arguing the fine points of distinction between the two. In general, real property includes land and buildings. A mortgage or contract for deed covering real property, therefore, usually includes buildings on the land. Property not completely connected to the land, such as tractors, livestock, cars, and household goods, is usually personal property.

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13 Helpful sources for mortgages and contracts for deed include: Phillip L. Kunkel and Scott T. Larison, *Mortgages and Contracts for Deed*, UNIVERSITY OF MINNESOTA EXTENSION, available at <http://www.extension.umn.edu/distribution/businessmanagement/DF2593.html>; Phillip L. Kunkel and Scott T. Larison, *Termination of Contracts for Deed*, UNIVERSITY OF MINNESOTA EXTENSION, available at <http://www.extension.umn.edu/distribution/businessmanagement/DF7294.html>; and Phillip L. Kunkel and Scott T. Larison, *Mortgage Foreclosures*, UNIVERSITY OF MINNESOTA EXTENSION, available at <http://www.extension.umn.edu/distribution/businessmanagement/DF7297.html>.

## 2. Fixtures

Near the dividing line between real property and personal property are fixtures. Fixtures can be covered by a mortgage or contract for deed.<sup>14</sup> The question of what is or is not a fixture, and therefore whether or not the property is covered by the mortgage or contract for deed, can be complicated. In general, fixtures are something that is attached to the land. Storage bins, some silos, and milking equipment are examples of property that might be fixtures. Whether or not property is a fixture can depend on a number of factors, such as the extent to which the property was attached to the land and the intent of the person putting the fixture in place. The best way to avoid disagreements and confusion about whether a fixture is covered by a lending agreement is to explain in the mortgage or contract for deed what will and will not be covered.<sup>15</sup>

## 3. Crops

Crops are personal property and therefore are usually not covered by a mortgage or contract for deed. Unless the crops are specifically included, therefore, a lender may not claim an interest in a crop based on a mortgage or contract for deed. A “rents or profits” clause in a mortgage may, however, allow the lender to claim an interest in the farmer’s income from the land, including crops. Rents or profits clauses are discussed at page 60.

## B. Description of the property

Before signing a mortgage or contract for deed, farmers should be certain that the description of the real estate and personal property is correct. Farmers who are not sure should ask a professional—such as an appraiser, surveyor, or attorney—to review the legal description.

## C. Cross-collateralization or “dragnet” clause

A lender who has made multiple loans to the same borrower may seek the right to take the property obtained with the funds from one loan as security in case of a default on the borrower’s other outstanding loans. That is, a borrower who obtains a loan to purchase real estate may be asked to include a term in the mortgage allowing the lender to foreclose on the real estate if the borrower defaults on any loan owed to the lender. This is called cross-collateralization, and a provision in a loan agreement giving this right to a lender is sometimes called a “dragnet clause.” Under such a clause, the collateral given in one agreement crosses over to cover all of the loans with that lender.

For example, suppose that in 1990 a farmer obtained an operating loan from First Big Bank. Then, in 1992, First Big Bank gave the farmer another loan secured by a mortgage on the farmer’s real estate. The mortgage agreement for the 1992 loan says:

This Mortgage Agreement serves as security for all existing and future indebtedness of Farmer to First Big Bank, including but not limited to the loan advanced in 1990.

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14 22 DUNNELL MINN. DIGEST, *Fixtures* (4th ed. 1994); 31 DUNNELL MINN. DIGEST, *Mortgages*, § 1.06(d) (4th ed. 1996).

15 *Minnesota Valley Breeders Ass’n v. Brandt*, 348 N.W.2d 115 (Minn. Ct. App. 1984).

As a result of this sentence, the mortgage will be security for the 1992 loan and the “existing . . . indebtedness” of the “loan advanced in 1990.” So, if the farmer defaults on the 1990 loan, First Big Bank will likely be able to take the farmer’s real estate to pay what is owed on the 1990 loan, even though in 1990 the farmer did not give the bank a mortgage for that loan.

The enforceability of cross-collateralization clauses is somewhat unsettled, and whether any particular cross-collateralization clause is legal can be confusing.<sup>16</sup> If a creditor is enforcing a cross-collateralization agreement against a farmer, the farmer should speak with an attorney.

#### **D. Interest**

Mortgage loan papers and contracts for deed should specify the rate of interest to be paid. Borrowers should make sure the mortgage loan amount and the interest rate on the loan papers are correct. In a contract for deed, it is important for the buyer to make sure that the installment payments do not add up to more than the agreed-on purchase price plus interest. An amortization schedule, which any bank should have, can help with calculating the proper payments. There are legal limits on the amount of interest many creditors can charge.<sup>17</sup>

#### **E. Using the loan money**

A mortgage loan agreement may limit the use the borrower may make of the loan money. Violating any of these restrictions may put the borrower in default on the loan.

#### **F. Other payments and penalties**

In addition to regular payments and interest, other payments may be required by the mortgage loan or contract for deed. For example, a borrower/buyer may be required to keep current on taxes and assessments, insurance premiums, and payments on other loans or leases affecting the property.<sup>18</sup> If such other payments are required, they are as important as payments on the loan or contract for deed itself, and failure to pay them might be considered a default.

In some cases, mortgage loan papers or contracts for deed allow the lender or seller to charge a penalty or extra interest if certain conditions are not met. For example, the agreement may permit extra charges if the borrower/buyer makes a late payment. In addition, the mortgage loan or contract for deed may say that if the borrower/buyer does not promptly repair damage to buildings on the real estate, the lender/seller can complete the repairs, bill the borrower/buyer for the work, and add a penalty and interest to the amount owed.

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16 See Grant S. Nelson & Dale A. Whitman, *REAL ESTATE FINANCE LAW*, Vol. 2, § 12.8 at 236-44 (4th ed. 2002); Milton Roberts, Annotation, *Debts Included in Provision of Mortgage Purporting to Cover All Future and Existing Debts (Dragnet Clause)—Modern Status*, 3 A.L.R. 4th 690 (1981 & Supp. 2001).

17 For some creditors, if a loan of under \$100,000 is made for an agricultural purpose, the interest may not be more than 4.5 percentage points over the federal discount rate at the time of the loan. Minn. Stat. § 334.011, subds. 1, 3. Banks and other financial institutions may charge up to 21.75 percent interest. Minn. Stat. § 47.59, subd. 3. See Appendix A for a more detailed discussion of interest rate limits.

18 Agricultural mortgages executed after July 31, 2001, are exempt from paying the mortgage registry tax assessed by Minn. Stat. § 287.035. Minn. Stat. § 287.04. An agricultural mortgage is one where the proceeds are used to acquire or improve agricultural property as classified by state property tax laws.

Any such extra charges or penalties must be clearly specified in the terms of the loan or contract for deed. It is important to read these documents thoroughly to understand what obligations are included and what the consequences can be for failing to meet any obligations.

### **G. Acceleration clauses**

Real estate purchases usually involve scheduled payments over a long period of time—sometimes many decades. One consequence of defaulting on a mortgage loan or contract for deed can be that the payment schedule is “accelerated” and the entire debt becomes due immediately. Mortgages and contracts for deed often set out the circumstances in which the lender or seller can accelerate the debt.

### **H. Due on sale clauses**

A due on sale clause in a mortgage loan means the lender can accelerate the debt if the borrower sells or transfers part or all of the mortgaged land without the lender’s permission. A due on sale clause in a contract for deed has the same effect.

### **I. Mortgage power of sale clauses**

A power of sale clause in a mortgage allows the lender to foreclose by advertisement, that is, without filing a lawsuit. If the mortgage does not include a power of sale clause, the lender must file a court action to foreclose on the loan.<sup>19</sup> Foreclosure by advertisement is discussed below.

### **J. Mortgage rents and profits clauses**

It is legal for lenders to take as additional security for a debt the rents and profits from mortgaged property. If the borrower signs such an agreement, he or she gives as collateral for the loan the income from the land, as well as the land itself. Such an agreement may make sense for a farmer when the loan is made if, for example, it secures new credit; but a rents and profits clause may prove costly during a foreclosure. A rents and profits clause gives a mortgage lender the right to claim the rents and profits from the land after a foreclosure and before the end of the borrower’s right of redemption. In some cases, a rents and profits clause can lead to the borrower’s loss of the property during this period. These clauses are discussed in more detail below at page 60.

### **K. Warranties of title**

Warranties of title are important in real estate purchases because they help ensure that the seller is providing “good” title to the property being purchased. That is, warranties of title help ensure that there are not other parties who claim an interest in the property that conflicts with the seller’s interest. Nearly every mortgage and contract for deed, therefore, should include some form of warranty of title. In general, mortgage lenders insist on such a warranty. Contract for deed buyers should make sure that the contract has a warranty of title.

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19 Minn. Stat. § 580.01; 31 DUNNELL MINN. DIGEST, *Mortgages* § 11.03 (4th ed. 1996).



Many legal interests can affect a title to real estate. A common example is an easement.<sup>20</sup> An easement might allow other people to cross the land, for example, or permit a utility to place lines or maintain buried lines on the property. The interests of other creditors, such as previous lenders or those holding a mechanic's lien, can also affect title to real estate. Many such interests can be found with a title search by a lawyer or title insurance company.

## L. Types of deeds

When purchasing property, the seller gives the buyer a deed. In a contract for deed situation, the buyer obtains a deed when the purchase price has been paid in full. In a mortgage situation, the borrower obtains a deed at the beginning when the loan is issued and the seller is paid off. When the deed is recorded, the public is put on notice that the real estate was conveyed to the buyer.<sup>21</sup>

The type of deed received can be important. In general, there are three different types: warranty deeds, limited or special warranty deeds, and quit claim deeds.<sup>22</sup> If the type of deed is not listed in the sales agreement, the seller must provide a warranty deed.<sup>23</sup>

### 1. Warranty deed

A warranty deed gives the buyer title to the real estate.<sup>24</sup> In addition, the seller promises that: (1) the seller holds title and possession to the real estate and has the right to convey it to the buyer; (2) the real estate is free of other legal interests; (3) the buyer will have peaceful possession of the property, meaning no other person has a claim to possession of the real estate; and (4) the seller will defend the title to the real estate if anyone else claims an interest in it.<sup>25</sup>

### 2. Limited or special warranty deed

A limited or special warranty deed usually gives the same warranties as a warranty deed, except that the warranties only extend to the period when the seller owned the real estate. Therefore, if it turns out that the seller did not have "good" title, due to something that occurred prior to the time the seller originally purchased the property, the seller is not responsible for defending the buyer from any such claims against the real estate.

### 3. Quit claim deed

A quit claim deed gives the buyer title to the real estate but no warranties from the seller.<sup>26</sup> The seller is conveying all of his or her interest in the property but makes no promises about whether someone else might also have an interest in the property. If the

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20 17 DUNNELL MINN. DIGEST, *Easements* (4th ed. 1992).

21 Minn. Stat. § 507.34.

22 Minnesota Statutes provide model examples of warranty and quit claim deeds. Minn. Stat. § 507.07. See also 6A MINNESOTA PRACTICE, *What type of deed to use* § 43.3 (3rd ed. 1990).

23 *Building Indus., Inc. v. Wright Prod.*, 62 N.W.2d 208 (Minn. 1953).

24 Minn. Stat. § 507.07.

25 Minn. Stat. § 507.07; *Bell v. Olson*, 424 N.W.2d 829, 833 (Minn. Ct. App. 1988).

26 Minn. Stat. § 507.06.

seller will only give a quit claim deed, the buyer should consider buying title insurance from a title insurance company.

### **M. Title insurance**

Title insurance helps protect the buyer's legal right to the ownership of the real estate. It does not, however, give a guarantee of a clear title. This is true for two reasons. First, the title insurance policy likely will include a number of policy exceptions, which will be listed. For example, many title insurance policies do not cover whether the property is zoned for a particular use. Second, a title insurance policy does not always mean that no one else has an interest in the real estate. Instead, the policy usually is an agreement by the title insurance company to pay for the cost of defending the buyer's legal interest in the real estate if there is a problem. Some policies do cover losses the buyer suffers if rights in the real estate are lost.

### **N. Environmental contamination**

In the last decade or so, liability for hazardous wastes on real estate has become a concern for landowners. Both federal and state laws can make owners and other responsible persons pay for environmental cleanup, and cleanups can be very expensive.<sup>27</sup> Both federal and state laws contain exemptions for innocent landowners, but the liability any person may have for environmental damage is hard to predict. As a result, many real estate sale contracts now include an environmental warranty.

#### **1. Mortgage lenders**

Congress enacted legislation in 1996 that protects a lender from liability as an "owner or operator" of foreclosed mortgaged property, provided the lender attempts to sell the mortgaged property as soon as possible.<sup>28</sup> However, lenders who actively participate in management of a mortgaged property may still face liability for environmental contamination. To protect themselves and to preserve the value of their interests in mortgaged property, lenders often require that borrowers promise not to use or store certain chemicals on the real estate and promise to pay the lender for its costs if chemicals are found there.

#### **2. Contract for deed sellers**

Buyers using contracts for deed should protect themselves from liability by making sure that they do not buy contaminated real estate. One way to do this is to get a warranty from the seller that no chemicals were used on the real estate and that the seller will pay any costs imposed if chemicals are found there.

A contract for deed seller may also want warranties from the buyer concerning environmental contamination since the buyer will have the ability to pollute the real estate during the term of the contract, while the property is still owned by the seller.

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27 42 U.S.C. § 9607; Minn. Stat. § 115B.03; *Gopher Oil Co., Inc. v. Union Oil Co., Inc.*, 955 F.2d 519 (8th Cir. 1992).

28 42 U.S.C. § 9601(20)(E). Minnesota law provides similar liability protection to creditors foreclosing on mortgages and terminating contracts for deed. Minn. Stat. § 115B.03, subs. 6, 7.

## O. General restrictions in mortgages and contracts for deed

Mortgages and contracts for deed often contain restrictions on the borrower/buyer's use of the property and on other borrower/buyer's business decisions. These restrictions apply only until the mortgage or contract for deed is paid off. These agreements also often require the borrower or buyer to provide certain information to the lender or seller. With the written consent of the lender or contract for deed seller, sometimes a borrower or buyer can be released from restrictions like the ones discussed below.

### 1. Using the property

Mortgages and contracts for deed often restrict the use of the property while the debt is outstanding. For example, use of the land may be restricted to farming. Other common limitations include preventing the borrower or buyer from: (1) mortgaging or leasing the property, (2) allowing a third party to obtain a lien against the property, or (3) changing the real estate. Agreements also commonly require that the real estate be tended so it does not decrease in value and that the real estate be kept in good repair.

### 2. Business decisions

A mortgage or contract for deed also may restrict certain business decisions or require the consent of the lender or seller before some business actions are taken. It is common, for example, for these agreements to: (1) restrict transfer or mortgaging of the borrower/buyer's assets, (2) ban bankruptcy filings, and (3) ban changes in the leadership of a corporation or partnership that owns the property. In addition, some contracts for deed restrict the purchaser's right to transfer his or her interest in the property.<sup>29</sup>

### 3. Providing information

Borrowers and contract for deed buyers may also be required to provide the lender or seller with certain information. For example, lenders may want to see annual financial statements or be notified of lawsuits filed against the borrower/buyer.

## P. Default

The definition of a "default" in loan or contract for deed documents is crucial for two reasons. First, the foreclosure of a mortgage and cancellation of a contract for deed is usually triggered by a default. Second, the definition of a default is not found in the law; therefore, the definition in the loan documents is legally binding.

Usually people think of a default as being late with payments. Actually, a default can include many other problems as well—including some problems that would otherwise not seem that serious, such as being late with a property tax payment. The loan agreement or contract for deed will usually provide a long list of actions by the borrower or buyer that count as a default.

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29 In *Bank Midwest v. Lipetzky*, C0-01-236 (Minn. Ct. App. May 20, 2003), the Minnesota Court of Appeals held that contract for deed language prohibiting the buyers from "selling, transferring, or assigning" their interest in the contract without written permission from the seller did not limit the buyers' right to mortgage their interests as contract for deed buyers.

The consequences of a default can be severe. It cannot be emphasized enough that farmers need to know exactly what triggers a default.

#### **Q. Notice and cure**

Mortgages and contracts for deed sometimes include the right to notice and cure. This means that the lender or seller must give notice to the borrower or buyer if there is a default. The lender or seller must then also give the borrower or buyer the right to cure the default within a reasonable amount of time before taking action to enforce the debt or cancel the contract for deed.

#### **R. Remedies for lenders and sellers**

If a borrower or buyer defaults, the lender or seller typically has the right to certain remedies. For example, under some mortgage agreements, default by the borrower allows the lender to take over the operation of the farm. While these remedies are limited to some degree by the law, in general the written agreements set out lender or seller options.

### **III. Mortgage foreclosures**

If a borrower defaults on a mortgage, the lender may attempt to foreclose, and the borrower faces losing possession of the real estate. Farmer borrowers may be able to cure a default or negotiate an agreement with the lender and also may be eligible for farmer-lender mediation. After the foreclosure process begins, a borrower has the chance to reinstate the mortgage by complying with its terms. Reinstatement can prevent a foreclosure sale. If there is a foreclosure sale, the borrower has a right of redemption and perhaps a right of first refusal as well. After foreclosure, a borrower may be required to pay a deficiency judgment if the foreclosure sale does not cover all that was owed to the lender.

#### **Possible steps in a foreclosure**

The following is a rough listing of the possible steps in a foreclosure.

1. Default and acceleration.
2. Mediation and possibly notice and cure.
3. Negotiation with the lender—possibly including a deed in lieu of foreclosure or settlement that ends foreclosure.
4. Creditor begins foreclosure process—by action or advertisement.
5. Reinstatement of mortgage—which ends foreclosure.
6. Foreclosure sale.
7. Redemption period.
8. Deficiency judgment if sale of the property does not cover the debt.
9. Right of first refusal.

#### **A. Default and acceleration**

As discussed earlier, borrowers should carefully review their loan agreements to understand what actions will be considered a default on their mortgage loans. If a default occurs, the loan

agreement should specify what actions the lender may take. This may include demands for special fees and penalties.

Acceleration of all payments is a common result of default on a loan. This is typically the lender's first step in the foreclosure process. Borrowers who receive an acceleration notice should treat it very seriously and are advised to seek legal advice early to better understand their options for responding to the notice.

### **B. Mediation**

Lenders deciding to foreclose on a farm mortgage in Minnesota may be required to serve the borrower with a written notice of the availability of farmer-lender mediation.<sup>30</sup> Chapter Seven discusses mediation.

### **C. Notice and cure**

As mentioned earlier, a mortgage agreement might give the borrower a right to notice and cure of a loan default. If a mortgage includes such a provision, the lender must notify the borrower if there is a default and give the borrower or buyer the right to cure the default within a reasonable amount of time before taking action to enforce the debt.<sup>31</sup> Borrowers should review their mortgage agreements carefully to determine whether they have a right to notice and cure of any default.

### **D. Special procedures for mortgages held by Farm Credit Services and the Farm Service Agency (formerly FmHA)**

If Farm Credit Services (FCS) is the lender, it is required to send borrowers a restructuring policy before beginning foreclosure.<sup>32</sup> If FCS does not send the policy, the debtor may be able to stop the foreclosure.<sup>33</sup>

If the lender is the Farm Service Agency (FSA)—formerly the Farmers Home Administration (FmHA)—different rules and procedures apply. Contact FLAG for more information about FSA borrower rights.

### **E. Deeds in lieu of foreclosure**

Some lenders may suggest that a defaulting borrower voluntarily surrender the land to the lender before foreclosure. Usually this is done through a "deed in lieu of foreclosure." A deed in lieu of foreclosure, therefore, is a substitute for a foreclosure. The borrower's right of redemption (discussed later at page 53) is lost if a deed in lieu of foreclosure is used to transfer the

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30 Minn. Stat. § 582.039.

31 See, for example, *McKay v. Ryan*, 284 N.W. 57 (Minn. 1939), where the Minnesota Supreme Court held that the buyer's demand four days prior to the end of a 60-day period to cure a default with a contract for deed did not allow the seller reasonable time to cure the default.

32 12 U.S.C. § 2202a.

33 *Burgmeier v. Farm Credit Bank of St. Paul*, 499 N.W.2d 43 (Minn. Ct. App. 1993).

mortgaged property to the lender.<sup>34</sup> Some factors to consider about deeds in lieu of foreclosure include the following.<sup>35</sup>

**1. Borrower loses the entire property and loses it more quickly**

In a deed in lieu of foreclosure, borrowers essentially give up any legal arguments they might have used to prevent the foreclosure. They also give up their right to redeem the property (discussed later at page 53), particularly the right to designate and redeem the homestead portion of the property. In addition, borrowers lose land more quickly under a deed in lieu of foreclosure than if there is a foreclosure sale. Foreclosures take some time to enforce, and, even after a foreclosure sale, many borrowers can remain on the land during the redemption period.

**2. It costs less for the lender**

If the lender goes ahead with the foreclosure, the borrower may be charged with the cost of the foreclosure action itself, which can be considerable. Although the lender pays the foreclosure costs up front, the lender can try to pass them along to the borrower later. A deed in lieu of foreclosure avoids much of this cost.

**3. It can help in negotiations with the lender**

The fact that a deed in lieu of foreclosure is less trouble and expense for the lender and resolves the whole issue sooner gives the borrower a negotiating point with the lender. If the borrower agrees to a deed in lieu of foreclosure, the lender might, for example, waive its right to seek a deficiency judgment for any debt that is not covered by the value of the mortgaged property.

**F. Foreclosure — by action or by advertisement**

Foreclosures in Minnesota come in two types: by action and by advertisement. Most foreclosures are by advertisement, because they are quicker and cheaper for the lender. For borrowers, the difference between the two determines the way the lender gives notice of the foreclosure sale and the way the lender gets permission to foreclose.

In general, lenders are more likely to use a foreclosure by action if they want to seek a deficiency judgment against the borrower or there are some legal issues that would make foreclosure by advertisement difficult.

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34 In a few circumstances, a deed in lieu of foreclosure is not legal. This includes, for example, if the lender has taken unconscionable advantage of the borrower, if there is not fair consideration given for the bargain, or if the transaction was intended to provide additional security for the mortgage debt and not as a sale of the real estate. *Gandrud v. Hansen*, 297 N.W. 730 (Minn. 1941); *O'Connor v. Schwan*, 251 N.W. 180 (Minn. 1933).

35 If the borrower voluntarily surrenders the mortgaged property, the borrower might also lose the right to harvest a crop already planted. *Seifert v. Mutual Ben. Life Ins. Co.*, 281 N.W. 770 (Minn. 1938); *Gunderson v. Hoff*, 209 N.W. 37 (Minn. 1926).

## 1. Foreclosure by action

Foreclosure by action is technically a lawsuit in which the creditor goes to court to get permission to foreclose on the property.

### Possible steps in a foreclosure by action

1. Summons and complaint
2. Hearing
3. Judgment
4. Notice
5. Sale

#### *a. Summons and complaint*

When filing the lawsuit in a foreclosure by action, the lender delivers a “summons and complaint” to the borrower.<sup>36</sup> The complaint describes the default and asks the court for a judgment and an order to sell the borrower’s real estate to pay the debt.<sup>37</sup> Notice of the borrower’s opportunity to designate property as homestead or as separate agricultural tracts must also be included in the summons and complaint.<sup>38</sup> The borrower has 20 days after being served with the summons and complaint to file an answer with the court.<sup>39</sup> The answer should make any legal arguments the borrower has in response to the complaint.

#### *b. Hearing*

After the answer is filed, the court will issue a scheduling order that sets out the timeline for how the case will proceed. This scheduling order will include the date of any pre-trial conferences and the hearing date.<sup>40</sup> At the hearing, or sometime after the hearing, the judge will decide whether the lender is entitled to foreclose on the borrower’s property. In some cases, the judge may also determine how much money is due to the lender and whether the mortgage is valid. Borrowers are allowed to represent themselves in the foreclosure hearing. To be effective, however, borrowers will probably need an attorney, both to prepare legal papers and to represent them in court.

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36 Minn. Stat. § 581.01; Minn. R. Civ. P. 3.01, 3.02. Minnesota court rules allow a summons and complaint to be served by “publication” in mortgage foreclosure cases if the lender is unable to locate the borrower. Minn. R. Civ. P. 4.04(a)(5).

37 Minn. R. Civ. P. 8.01, 8.05.

38 Minn. Stat. §§ 582.041, 582.042.

39 Minn. R. Civ. P. 12.01.

40 Minn. R. Civ. P. 16.02. If a party fails to obey a scheduling or pretrial order, fails to appear at a scheduling conference, or does not participate in the process in good faith, the court may order monetary sanctions against that party. Minn. R. Civ. P. 16.06.

### *c. Judgment*

If the borrower does not file an answer to a complaint in 20 days, the lender will generally ask for a default judgment.<sup>41</sup> A default judgment means that the lender wins because the borrower “defaulted” by not answering the complaint. If the lender is given a default judgment or if the borrower challenges the foreclosure in a hearing and loses, the court will enter a judgment and order the sheriff to hold a foreclosure sale to pay the debt.<sup>42</sup>

If the borrower files an answer and the judge agrees with the borrower, the foreclosure will be stopped or at least delayed. In some cases, the judge may only require the borrower to pay part of what the lender is demanding.

### *d. Notice*

The borrower will receive notice of the court’s decision and foreclosure sale.<sup>43</sup> Normally the foreclosure sale notice will be delivered by the sheriff. The notice will describe the court’s decision and set out the date, time, and place of the sheriff’s sale. The sheriff will also post and publish for six weeks in a local newspaper in the county where the mortgaged property is located a notice of foreclosure sale listing the date, time, and place of the sale and a description of the property to be sold.<sup>44</sup>

## **2. Foreclosure by advertisement**

Minnesota law sets out a step-by-step process that lenders may use for foreclosure by advertisement. In this process, the lender does not need to file a lawsuit or seek court approval before foreclosure. Because of the relative simplicity of this process and lower cost, in most cases lenders choose to foreclose mortgages by advertisement.

### *a. When lenders can use advertisement*

If the borrower defaults, a lender can foreclose by advertisement if: (1) the mortgage has a power of sale clause that allows foreclosure in case of default, (2) the lender is not seeking to recover the debt through any court action against the borrower, and (3) the mortgage is officially recorded.<sup>45</sup>

### *b. Required notice*

If these requirements are met, the lender can begin foreclosure by publishing a notice of foreclosure in a local newspaper in the county where the mortgaged

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41 Minn. R. Civ. P. 55.01.

42 Minn. Stat. § 581.03.

43 Minn. Stat. § 550.19.

44 Minn. Stat. § 550.18. Posting in three public places within the county in which the property is located satisfies the public posting requirements. Minn. Stat. § 645.12, subd. 1; *Fidelity & Deposit Co. v. Riopelle*, 216 N.W.2d 674, 680 (Minn. 1974).

45 Minn. Stat. §§ 580.01, 580.02. The lender must discontinue any existing legal action against the borrower, but it may foreclose if a prior judgment was completed but not fully paid. Any assignments of the mortgage must also be recorded.



property is located. The notice must be published for six weeks and must list the date, time, and place of the sale.<sup>46</sup>

If the borrower occupies the land, the lender must also serve the borrower with a copy of the notice at least four weeks before the foreclosure sale.<sup>47</sup> The notice must include certain information, including notice of the borrower's opportunity to designate some of the mortgaged property as homestead or separate agricultural tracts that may be redeemed separately and notice that the borrower has the right of redemption.<sup>48</sup> If the information in the notice of sale is wrong, or if the notice is not published properly, a foreclosure may be invalid.<sup>49</sup>

### 3. Foreclosure and court action for the debt

A lender might decide to sue a defaulting borrower to collect the amount due under the promissory note or loan agreement. This is different from a foreclosure. In an action on the debt, the lender is not directly trying to take the mortgaged property. If a lender does seek a personal judgment against a borrower on a promissory note and the lender holds a mortgage on real property used in agricultural production, the maximum judgment that the lender can get is the difference between the amount due on the note and the fair market value of the property.<sup>50</sup>

In many cases, the lender will not be able to seek both a court judgment for the debt and foreclosure of the mortgage at the same time. Lenders may not, for example, use the foreclosure by advertisement process and at the same time bring any other legal action against the borrower on the debt.<sup>51</sup> In addition, if the borrower signed the mortgage before March 23, 1986, and the mortgage is on property used in agricultural production,

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46 Minn. Stat. §§ 580.03, 580.04. The notice must also include: (1) the name of the mortgagor and mortgagee, (2) the original principal amount secured by the mortgage, (3) the date of the mortgage and information on when and where it was recorded or registered, (4) the amount claimed to be due and any taxes paid by the lender, (5) a description of the premises, and (6) the time allowed for redemption. Minn. Stat. § 580.04. There must be at least 42 days from first publication to date of sale. *White v. Mazal*, 257 N.W. 281 (Minn. 1934).

47 Minn. Stat. § 580.03. Tenants in possession must be served notice of the foreclosure except where they are the junior or subordinate tenant. *Cassery v. Morrow*, 111 N.W. 654 (Minn. 1907); *Farm Credit Bank v. Kohnen*, 494 N.W.2d 44 (Minn. Ct. App. 1992).

48 Minn. Stat. §§ 580.04, 582.041, 582.042.

49 See Minn. Stat. § 580.20.

50 Minn. Stat. § 582.30, subds. 4, 6. Limits on judgments on after-acquired property and the three-year statute of limitations mentioned at page 65 also apply to these judgments. Minn. Stat. § 582.30, subds. 7, 9. Judgments are discussed in Chapter Five.

51 Minn. Stat. § 580.02(2). In order to foreclose by advertisement, the lender must stop other legal action to collect the debt. If an earlier judgment on the debt was executed but not completed, the lender may use the foreclosure by advertisement process.

the lender may either foreclose on the mortgage or seek a judgment and payment on the note, but not both.<sup>52</sup>

#### 4. Defending against foreclosure

In most cases, a lender seeking a foreclosure acts legally. Depending on the circumstances, however, it may be possible for borrowers to challenge foreclosures by showing that the mortgage or foreclosure process used by the lender did not satisfy all legal requirements for a valid foreclosure. For example, if the mortgage is defective because it was drafted incorrectly, was not properly notarized and recorded, or lacks a power of sale clause or an acceleration clause, foreclosure may be invalid. Similarly, a borrower might be able to argue that the lender did not send out required cure notices or failed to fulfill the foreclosure notice requirements.<sup>53</sup> Or it might be the case that the default claimed by the lender as the basis for the foreclosure is not considered a default under the terms of the note or mortgage. In such situations, the borrower may be able to slow, or in some cases even prevent, a foreclosure. It is probably not realistic for a borrower to try to stop a foreclosure alone. Successfully challenging a foreclosure by a lender will probably require the help of a lawyer.

### G. Designating separate parcels for sale and redemption

As mentioned earlier, farm borrowers facing foreclosure should be provided with notices about their rights to designate separate parcels within the mortgaged property if certain requirements are met. In a foreclosure by action, these notices should be provided with the summons and complaint.<sup>54</sup> In a foreclosure by advertisement, these notices should be included in the initial foreclosure notice.<sup>55</sup>

It may be to the borrower's advantage to designate real estate to be sold and redeemed separately. That way the borrower can redeem the part of the property he or she most wants to keep without being forced to try to redeem and pay for all of the mortgaged property.

#### 1. Designating homestead property

If the real estate contains the borrower's home, the borrower should receive a homestead designation notice.<sup>56</sup> This notice explains that the home and some of the land surrounding it may be designated as a homestead and that this property can be sold and redeemed separately from the rest of the borrower's real estate.<sup>57</sup>

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52 Minn. Stat. § 582.31; *Metropolitan Life Ins. Co. v. Christison*, 451 N.W.2d 222 (Minn. Ct. App. 1990). This statute only protects a party against whom a lender could have commenced both actions and not where another party guarantees the mortgage. *Ed Herman & Sons v. Russell*, 535 N.W.2d 803 (Minn. 1995). This provision was held not to apply where FmHA (now FSA) partially released some mortgage notes to facilitate a sale of farm property and the court determined that it was not a foreclosure. *United States v. Nelson*, 101 F.3d 1284 (8th Cir. 1996).

53 Minn. Stat. § 580.02(1).

54 Minn. Stat. §§ 582.041, 582.042.

55 Minn. Stat. §§ 582.041, 582.042.

56 Minn. Stat. § 582.041, subd. 1.

57 Minn. Stat. § 582.041, subd. 2.

The homestead may include any amount of real estate as long as it: (1) includes the home, (2) conforms to local zoning rules, and (3) is “compact” so as not to unreasonably affect the value of the rest of the real estate.<sup>58</sup>

The lender and the sheriff do not have the right to change the homestead designation on their own if they do not like it or think it is illegal.<sup>59</sup>

## 2. Designating agricultural tracts

If the borrower’s real estate is agricultural land and contains separate tracts—parcels of land with separate legal descriptions—the borrower will receive a designation notice explaining that, if the borrower requests, the tracts will be sold and available for redemption separately.<sup>60</sup>

Tracts designated to be sold separately must: (1) have been previously recorded as separate tracts, (2) meet local zoning ordinance requirements, (3) have an entrance by direct access to a public road or by permanent easement, and (4) not have a shape that unreasonably affects the value of the remaining real estate.<sup>61</sup>

## 3. How to designate the separate parcels

The procedure for designating parcels is different, depending on whether the foreclosure is by action or advertisement. If the foreclosure is by advertisement, the borrower must serve a copy of the legal descriptions of the separate parcels—whether homestead property or separate agricultural tracts—on the lender, the sheriff, and the county recorder or registrar of titles at least ten business days before the scheduled foreclosure sale.<sup>62</sup> If the foreclosure is by action, the borrower must provide a copy of the legal descriptions of the separate parcels to the court as part of the foreclosure proceeding.<sup>63</sup>

If the legal requirements for a homestead designation or agricultural tract designations are met, the sheriff must offer and sell the parcels separately.<sup>64</sup> The borrower may then redeem the parcels separately or redeem all of the property.<sup>65</sup>

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58 Minn. Stat. § 582.041, subd. 3. For example, a designation creating a landlocked parcel could unreasonably affect the value of the remaining land. *Federal Land Bank of St. Paul v. Carlson*, 398 N.W.2d 595 (Minn. Ct. App. 1986).

59 *Federal Land Bank of St. Paul v. Carlson*, 398 N.W.2d 595 (Minn. Ct. App. 1986).

60 Minn. Stat. § 582.042, subd. 1. “Agricultural land” is not defined in the statute. One court has suggested that borrowers are only eligible for this designation if they qualify as either a family farm or a family farm corporation. *Resolution Trust Corp. v. Lipton*, 983 F.2d 901 (8th Cir. 1993). The statutory authority for this requirement is not found in Minn. Stat. § 582.042. The court may have concluded that farmers should not be eligible for this designation unless they are also eligible for farmer-lender mediation under Minn. Stat. § 583.24.

61 Minn. Stat. § 582.042, subd. 3.

62 Minn. Stat. §§ 582.041, subd. 3, 582.042, subd. 3.

63 Minn. Stat. §§ 582.041, subd. 3, 582.042, subd. 3.

64 Minn. Stat. §§ 582.041, subd. 4, 582.042, subd. 4.

65 The redemption period is the same for all of the property. Minn. Stat. §§ 581.041, subd. 5, 582.042, subd. 5.

## H. Reinstatement of the mortgage before the sale

A mortgage may be reinstated any time before the foreclosure sale. Reinstatements eliminate the default that triggered foreclosure in the first place. To reinstate the mortgage, the borrower pays to the sheriff, the holder of the mortgage, or the foreclosing attorney the amount needed to bring the mortgage current.<sup>66</sup> A borrower has a reinstatement right whether the lender sought foreclosure by action or by advertisement.

The amount the borrower must pay to reinstate the mortgage includes all payments due up to the time the reinstatement payment is made, any interest owed, and reasonable lender expenses.<sup>67</sup>

Reinstatement is possible even if the mortgage has been accelerated. If the lender accelerated the loan, the borrower does not need to pay the full, accelerated amount of the loan—only the amount that would have been owed had the lender not accelerated.<sup>68</sup>

## I. Foreclosure sale

Foreclosure sales are auctions.<sup>69</sup> Sale proceeds are paid to the lender for the mortgage debt, and the borrower gets back any surplus.<sup>70</sup> If the sale proceeds do not fully satisfy the borrower's debt, the lender may seek a deficiency judgment, discussed starting at page 62.<sup>71</sup> Usually, but not always, the highest bidder at a foreclosure sale is the lender. Most lenders seek to add the cost of the foreclosure to the amount the borrower owes under the mortgage. In a foreclosure by advertisement, in order to have a legal right to recover these costs, the lender must file papers proving the costs with the county recorder within ten days after filing the record of the sale.<sup>72</sup> Costs for a foreclosure by action are handled by the court.<sup>73</sup>

### 1. Selling parcels separately

The borrower may prefer to have the mortgaged property divided into more than one parcel for the foreclosure sale. For example, if parcels are sold separately, it may be easier to keep part of the farm in the family. Whether farm and homestead property will be sold in separate parcels will usually be controlled by the borrower's redemption designations, discussed earlier.

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<sup>66</sup> Minn. Stat. § 580.30.

<sup>67</sup> Minn. Stat. § 580.30; *First Trust Co. v. Leibman*, 445 N.W.2d 547 (Minn. 1989). Reasonable expenses can include insurance or delinquent taxes paid by the lender, attorneys' fees, and other costs. Attorneys' fees are discussed at Minn. Stat. §§ 580.30, 582.01.

<sup>68</sup> *Davis v. Davis*, 196 N.W.2d 473 (Minn. 1972).

<sup>69</sup> Minn. Stat. §§ 550.20, 580.06. The auction is held in the same county where the real estate is located. Foreclosure sales operate the same way whether the foreclosure was by advertisement or action.

<sup>70</sup> Minn. Stat. §§ 580.10, 581.06.

<sup>71</sup> Minn. Stat. §§ 580.225, 581.09, 582.30.

<sup>72</sup> Minn. Stat. § 580.17. An excessive claim of costs or interest can result in a triple recovery for the borrower if the borrower brings a successful lawsuit within one year after the sale. Minn. Stat. § 580.18; *Pokorny v. Builders Fin.*, C6-93-407 (Minn. Ct. App. Aug. 24, 1993) (unpublished).

<sup>73</sup> Minn. Stat. § 581.09.

If the borrower for some reason is not eligible to make those designations, the law still limits how the property will be sold. In a foreclosure by advertisement, if the mortgaged property includes separate and distinct farms or tracts, they should be sold separately unless this option is waived by the borrower.<sup>74</sup> Also, no more farms or tracts should be sold than are needed to satisfy the amount owed.<sup>75</sup> In a foreclosure by action, the judge may rule that distinct farms and tracts be auctioned together—if it will be “most beneficial to the parties.”<sup>76</sup> In other words, it should be to the benefit of both the borrower and the lender.

## 2. Confirmation of the sale in foreclosure by action

If the foreclosure is by action, after the sale the court will issue an order confirming the sale.<sup>77</sup> The sheriff must then issue a certificate of sale, which is to be recorded, presumably by the lender or purchaser, within 20 days.<sup>78</sup>

## 3. Mistakes in the foreclosure sale

If a foreclosure sale is conducted improperly, it may be possible to have the sale set aside.<sup>79</sup> However, in many cases a foreclosure sale will be enforced despite problems with the process. A lender will often be able to foreclose again to correct the error.<sup>80</sup>

## J. The right of redemption

If the real estate is sold at a foreclosure sale, the borrower has the right to “redeem” the property. The borrower may, in other words, repurchase the property for the foreclosure sale price plus interest from the date of the sale and reasonable expenses.<sup>81</sup>

### 1. Timing — length of redemption period

The right of redemption lasts for a limited time. In general, the borrower will either have 12 months or 6 months from the date of the sale to redeem. If the foreclosure was by advertisement, the redemption period begins on the day of the foreclosure sale.<sup>82</sup> If the foreclosure was by action, the redemption period begins on the day the court issues the order to confirm the sale.<sup>83</sup>

Most farmers have a 12-month redemption period, but it is important to make sure. Whether the borrower has a 6- or 12-month redemption period is determined by the hodgepodge of factors discussed below.

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74 Minn. Stat. § 580.08; *John W. Swenson & Sons, Inc. v. Aetna Life Ins. Co.*, 571 F. Supp. 895 (D. Minn. 1983); *In re Kjeldahl*, 52 B.R. 916, *on remand*, 52 B.R. 926 (Bankr. D. Minn. 1985).  
75 Minn. Stat. § 580.08. The amount owed includes interest, taxes paid, and costs of the sale.  
76 Minn. Stat. § 581.04.  
77 Minn. Stat. § 581.08.  
78 Minn. Stat. § 581.08.  
79 See Minn. Stat. §§ 580.20, 580.21.  
80 *Gerdin v. Princeton State Bank*, 384 N.W.2d 868, 872 n.7 (Minn. 1986). See also Minn. Stat. § 581.08.  
81 Minn. Stat. §§ 580.25, 581.10.  
82 Minn. Stat. §§ 580.23, 582.032.  
83 Minn. Stat. §§ 580.23, 581.08, 581.10, 582.032.

*a. Twelve-month redemption period*

Borrowers have 12 months to redeem their property if any of the following six circumstances applies to the mortgage.<sup>84</sup>

*(1) Mortgaged before July 1, 1967*

If the mortgage was signed before July 1, 1967, the borrower has a 12-month redemption period for that property. The size or use made of the property does not matter.

*(2) More than one-third of principal paid off*

If the borrower has paid off more than one-third of the original principal secured by the mortgage, the borrower has a 12-month redemption period for that property.<sup>85</sup> The size or use made of the property does not matter.

*(3) Mortgaged before July 1, 1987 — and over ten acres*

If the mortgage was signed before July 1, 1987, and the mortgaged land—at the time of the mortgage signing—covered more than ten acres, the borrower has a 12-month redemption period for property under that mortgage.<sup>86</sup>

*(4) Over 40 acres mortgaged*

If the mortgaged property—as of the date of the mortgage signing—covered more than 40 acres, the borrower has a 12-month redemption period. The timing of the mortgage and the use of the land do not matter.<sup>87</sup>

*(5) Land in agricultural use, over 10 acres, but less than 40 acres*

The borrower has a 12-month redemption period if the mortgaged land—as of the day the mortgage was signed—covered more than 10 but less than 40 acres and was in agricultural use.<sup>88</sup> The question of what land is or is not in agricultural use may be more complicated than it seems at first. Minnesota law uses two different definitions of agricultural use for deciding redemption periods—depending on when the mortgage was signed.<sup>89</sup>

*(a) If signed before August 1, 1994*

The legal definition of land “in agricultural use” for mortgages executed before August 1, 1994, covers most typical farms. Livestock

<sup>84</sup> Minn. Stat. §§ 580.23, subd. 2, 581.10.

<sup>85</sup> Minn. Stat. § 580.23, subd. 2(2). Technically, the amount claimed to be due and owing on the day of the notice of the foreclosure sale must be less than “66-2/3 percent of the original principal amount secured by the mortgage.”

<sup>86</sup> Minn. Stat. § 580.23, subd. 2(3).

<sup>87</sup> Minn. Stat. § 580.23, subd. 2(5).

<sup>88</sup> Minn. Stat. § 580.23, subds. 2(4), (6).

<sup>89</sup> Lenders may ask borrowers to sign an affidavit of nonagricultural use that can be recorded with the county records to ensure that the borrower will not later be able to claim that the property was in agricultural use. Minn. Stat. § 580.23, subd. 3.

production, dairying, grain farming, and horticulture qualify. Also included in this definition of land in agricultural use are wetlands, forests, and wildlife land.<sup>90</sup>

*(b) If signed on or after August 1, 1994*

The legal definition of land “in agricultural use” for mortgages signed on or after August 1, 1994, is based on property tax assessment classifications. Property is defined as “in agricultural use” if at least “a portion” of the mortgaged land is classified for property tax purposes as agricultural property or exempt wetland property.<sup>91</sup>

If a mortgage was signed on or after August 1, 1994, it is worth asking the county tax assessor to make sure that the land meets one of these technical classifications: (1) Class 1b agricultural homestead property, (2) Class 2a agricultural homestead property, (3) Class 2b rural or agricultural non-homestead property, or (4) exempt wetlands. If the land meets one of these classifications, it is agricultural property and has a 12-month redemption period, so long as it meets the acreage requirement.

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90 “Agricultural use” is defined as the production of livestock, dairy animals, dairy products, poultry or poultry products, fur-bearing animals, horticultural or nursery stock, fruits, vegetables, forage, grains, timber, trees, or bees and apiary products. It also includes wetlands, pasture, forest land, wildlife land, and other uses that depend on the inherent productivity of the land. Minn. Stat. § 40A.02, subd. 3.

91 Tax classification definitions can be found at Minn. Stat. §§ 273.13, subds. 22, 23, 272.02, subd. 11. In general, property qualifies under the tax laws as agricultural if it is contiguous acreage of ten acres or more used during the preceding year for agricultural purposes. Agricultural purposes means the raising or cultivation of agricultural products. Agricultural purposes also includes enrollment in the Reinvest in Minnesota program or the federal Conservation Reserve Program if the property was agricultural before it was enrolled in a conservation program. Property enrolled in a conservation program in 2002 retains its agricultural classification. 2003 Minn. Laws. ch. 127, art. 2, § 14 (to be codified at Minn. Stat. § 273.13, subd. 23(c)). Contiguous acreage on the same parcel, or contiguous acreage on an immediately adjacent parcel under the same ownership, may also qualify as agricultural land, but only if it is pasture, timber, waste, unusable wild land, or land included in state or federal farm programs. Real estate of less than ten acres used principally for raising or cultivating agricultural products is considered agricultural land if it is not used primarily for residential purposes. Minn. Stat. § 273.13, subd. 23(c)-(f). Exempt wetlands typically produce little if any income and have no use except wildlife or water conservation.

**You are entitled to a 12-month redemption period if:**

1. You mortgaged before July 1, 1967; or
2. You have more than one-third of the principal paid off;  
or
3. You mortgaged before July 1, 1987—and have over  
10 acres mortgaged; or
4. You have over 40 acres mortgaged; or
5. The land is agricultural land—and over 10 acres but  
less than 40 acres.

***b. Six-month redemption period***

In general, borrowers who do not qualify for a 12-month redemption period will have a redemption period of 6 months.<sup>92</sup>

***c. Other redemption periods***

Other very short redemption periods that are sometimes allowed under the law would almost never apply to an active family farm.<sup>93</sup>

***d. Waiving the 12-month redemption period***

In some cases, the lender may ask the borrower to waive the right to a 12-month redemption period and accept a 6-month redemption period instead. Such a waiver will be legally enforceable if: (1) the waiver is in writing; (2) the mortgage was executed on or after August 1, 1994; (3) the mortgage covers more than 10 acres but not more than 40 acres; (4) the land is used for agricultural purposes; and (5) the lender records the waiver.<sup>94</sup>

<sup>92</sup> Minn. Stat. §§ 580.23, subd. 1, 581.10.

<sup>93</sup> Redemption periods for voluntary foreclosures and vacant property are shorter. The two-month redemption period for a voluntary foreclosure for mortgages executed after August 1, 1993, is not applicable to homestead or agricultural property. Minn. Stat. § 582.32. "Agricultural use" is defined in Minn. Stat. § 40A.02, subd 3, and "homestead" in Minn. Stat. § 273.124. Beginning with the 2004 property tax assessment, to retain eligibility for the special agricultural homestead classification, landowners must complete a one-page abbreviated version of the full initial application in subsequent years that states the farming operations have not changed. 2003 Minn. Laws ch. 127, art. 2, § 12 (to be codified at Minn. Stat. § 273.124, subd. 14(h)). Vacant and abandoned property may have a five-week redemption period if the mortgage was executed after December 31, 1989, but only if the property, at the time of the foreclosure, was not in agricultural production and the mortgage covers no more than ten acres. Minn. Stat. § 582.032.

<sup>94</sup> Minn. Stat. 580.23, subd. 4. The waiver must be either: (1) a document separate from the mortgage, or (2) a separately executed and acknowledged addendum to the mortgage on a separate page. If the waiver is a separate document, it must be in recordable form and either recite the recorded or filed document number of the mortgage or recite the name of the mortgagor or mortgagee, the legal description of the property, and the date of the mortgage. A waiver that is a separate document must be recorded or filed no later than ten days after the recording or filing of the mortgage.



## 2. Exercising the right to redeem

The right to redeem foreclosed real estate is an important one for farm borrowers in financial distress. The law sets out detailed requirements that must be satisfied to exercise this right. Borrowers who are intending or even just considering exercising their right of redemption should make sure that they know exactly what will be required, and when.

### a. Amount the borrower pays

A borrower can redeem a parcel of real estate by paying the total of: (1) the amount bid at the sale for that parcel, (2) interest, and (3) other foreclosure-related costs for which the borrower is responsible.<sup>95</sup>

The borrower must pay interest on the bid amount and on other lender expenses for the period from the foreclosure sale to the time the borrower redeems.<sup>96</sup> If the foreclosure was by advertisement, the interest rate will be the same as it was on the mortgage.<sup>97</sup> If the foreclosure was by action, the interest rate will be the same as it was on the mortgage—except that the rate charged after the foreclosure can be no more than 8 percent.<sup>98</sup>

Other costs are those paid by the lender, such as taxes, insurance, and other mortgages. The lender must formally file a record of these costs.<sup>99</sup>

### b. Payment procedure

The borrower must pay either the person who purchased the real estate at the foreclosure sale or the sheriff.<sup>100</sup> The payment must be made by the end of the 6- or 12-month redemption period that applies to the borrower.<sup>101</sup>

Along with the payment, the borrower must provide: (1) a certified copy of the judgment, mortgage, or other document under which the borrower claims a right of redemption;<sup>102</sup> and (2) an affidavit—a written, sworn statement—of the amount owed.<sup>103</sup>

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95 Minn. Stat. §§ 581.10, 580.23.

96 Minn. Stat. §§ 581.10, 582.03, 582.031.

97 Minn. Stat. § 580.23, subs. 1, 2. If the mortgage did not include a rate of interest, interest is 6 percent.

98 Minn. Stat. § 581.10. If the mortgage did not include a rate of interest, interest is 6 percent.

99 Payments such as taxes, assessments, insurance, and mortgage payments, as well as the cost of protecting the property from damage or destruction, must be proved by the lender by an affidavit filed with the county recorder or registrar of titles. A copy must be given to the sheriff at least ten days before the end of the redemption period. Minn. Stat. §§ 582.03, 582.031. If the affidavit is not filed on time, the costs may not be added to the borrower's redemption obligation. *Tomasko v. Cotton*, 273 N.W. 628 (Minn. 1937).

100 Minn. Stat. §§ 580.25, 581.02.

101 *Sieve v. Rosar*, 613 N.W.2d 789 (Minn. Ct. App. 2000).

102 Minn. Stat. §§ 580.25(1), 581.02. Normally this would be a deed or mortgage, but it could in some cases be a copy of the docket of the judgment.

103 Minn. Stat. §§ 580.25(3), 581.02. If the right to redeem has been assigned, documentation of this right must also be included. Minn. Stat. §§ 580.25(2), 581.02.

Within 24 hours after the redemption, the borrower must file these documents with the county recorder or registrar of titles.<sup>104</sup> If the redemption was made at any place other than the county seat, the borrower can satisfy the filing requirement by mailing the documents “forthwith” from the nearest post office to the county recorder or registrar of titles.<sup>105</sup>

*c. Certificate of redemption*

After making a redemption payment, the borrower should receive a certificate of redemption from the person he or she paid.<sup>106</sup> The certificate should include: (1) the borrower’s name, (2) the amount paid, (3) a description of the foreclosure sale and the property redeemed, and (4) a statement of the source of the borrower’s right to redeem.<sup>107</sup>

The certificate of redemption must be filed with the county recorder or registrar of titles of the county where the property is situated within four business days after the borrower’s right of redemption expires.<sup>108</sup>

*d. Filing requirements*

The two filing requirements for redemptions are extremely important. If the borrower does not file the certificate of redemption within four business days, for example, the redemption right may be lost.

*(1) Within 24 hours of redemption*

Within 24 hours of redemption, the borrower must file with the county recorder or registrar of titles the documents used in making payment.<sup>109</sup>

*(2) Within four days of the end of the redemption period*

The borrower must record the certificate of redemption within four business days after the end of the redemption period.<sup>110</sup> If the borrower fails to record the certificate of redemption, the redemption may be voided by any person who later attempts to redeem the same property.<sup>111</sup>

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104 Minn. Stat. §§ 580.25(3), 581.02.

105 Minn. Stat. §§ 580.25(3), 581.02.

106 Minn. Stat. § 580.26.

107 Minn. Stat. § 580.26.

108 Minn. Stat. § 580.26. Under Minnesota law, if the last day of a period of time falls on a Saturday, Sunday, or legal holiday, that day does not count, and the period of time is extended. Minn. Stat. § 645.15.

109 Minn. Stat. § 580.25; *Sieve v. Rosar*, 613 N.W.2d 789, 792 (Minn. Ct. App. 2000).

110 Minn. Stat. § 580.26; *Tesch v. Drew*, 225 N.W. 815 (Minn. 1929).

111 Minn. Stat. § 580.26.

### Three steps to redemption after foreclosure

1. Before your redemption deadline, present:
  - a. Payment;
  - b. Documentation of your interest in the real estate; and
  - c. An affidavit listing the amount you owe.
2. Within 24 hours after you hand over your payment, file the documentation of your interest and the affidavit with the county recorder or registrar of titles.
3. Within four business days after your right of redemption expires, record the certificate of redemption with the county recorder or registrar of titles.

### 3. Effect of redemption

If the borrower properly redeems the property, the foreclosure sale is annulled.<sup>112</sup>

### 4. What happens to property during the redemption period?

Not all borrowers will want or be able to redeem their foreclosed real estate. Nonetheless, the redemption period is an important time for all borrowers because they will generally be allowed to remain on the foreclosed real estate during that period. The borrower may also be entitled to receive the income from the property during the redemption period, unless the mortgage included a “rent and profits” clause.

#### a. Right to occupy the land

Borrowers are usually allowed to live on and use the foreclosed real estate during the redemption period.<sup>113</sup> Borrowers must keep the real estate in reasonably good shape during the redemption period, but in general they may continue to use it as they have in the past.<sup>114</sup> The lender or purchaser will have a very limited right to enter the property if it is vacant or unoccupied—for example, to prevent or minimize damage to the property by changing locks, boarding up windows, and the like.<sup>115</sup> But the borrower is entitled to a key to any lock put on by the purchaser or lender.<sup>116</sup>

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112 Minn. Stat. §§ 580.27, 581.02.

113 Minn. Stat. § 561.18; *Mutual Ben. Life Ins. Co. v. Frantz Klodt & Son, Inc.*, 237 N.W.2d 350 (Minn. 1975); *G. M. Prindle & Co.*, 240 N.W. 351 (Minn. 1932); *Crowell v. Delafield Farmers Mutual Fire Ins. Co.*, 453 N.W.2d 724 (Minn. Ct. App. 1990); *Woodman of World Life Ins. Soc’y v. Sears Roebuck & Co.*, 200 N.W.2d 181 (Minn. 1972).

114 Minn. Stat. § 609.615; *Mutual Ben. Life Ins. Co. v. Frantz Klodt & Son, Inc.*, 237 N.W.2d 350 (Minn. 1975).

115 Minn. Stat. 561.18, 582.031.

116 Minn. Stat. § 582.031.

*b. Rents and profits from the land*

In general, "rents and profits" are the income from the land, including lease payments, federal farm payments, net income from crops, and the like.<sup>117</sup> Borrowers normally have the right to receive rent, income, and profits from foreclosed real estate during the redemption period.<sup>118</sup> If, however, the mortgage included a "rents and profits" clause, the situation may be very different, and borrowers may lose that potential income source.

*(1) How lenders can claim rents and profits*

Written agreements are the key to understanding what the lender can do with farm income and property during the redemption period. The loan agreement may give the lender the legal right to the rents and profits from the land. If the rents and profits clause is part of a properly recorded mortgage and it meets the other legal requirements for a security interest, the lender may have a lien on the rents and profits from the land. Chapter Four discusses security interests.

It is important to keep in mind that the lien only exists as security to pay back the amount owed to the lender. Therefore, if the entire amount owed is paid, the lender's right to claim rents and profits from the land expires.<sup>119</sup>

*(2) Requirements for rents and profits clauses*

Not all rents and profits clauses are enforceable, and not all of a borrower's farm is subject to the clause even if it is enforceable. In order for a rents and profits clause to be legally enforceable, all of the following must be true.<sup>120</sup>

*(a) Mortgage signed or formally modified after August 1, 1977*

For the lender's claim to be enforceable, either the mortgage including the rents and profits clause must have been executed after August 1, 1977, or a legal modification of the mortgage must have been executed after August 1, 1977.

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117 The exact meaning of the "rents and profits" when it comes to farmland could become a point of dispute. For title insurance certification purposes, "assignment of rents and profits" is defined as an "assignment, whether in a separate document or in a mortgage, of any of the benefits accruing under a recorded or unrecorded lease or tenancy existing, or subsequently created, on property encumbered by a mortgage, which is given as additional security for the debt secured by the mortgage." Minn. Stat. § 507.401, subd. 1. In a somewhat different context, a court has ruled that "rents" include payment made by tenants to occupy real estate, and that a "profit" is the "benefit, advantage, or pecuniary gain accruing to the owner or occupant of land from its actual use." *In re Mid-City Hotel Ass'n*, 114 B.R. 634 (Bankr. D. Minn. 1990).

118 Minn. Stat. § 580.12; *Crowell v. Delafield Farmers Mut. Fire Ins. Co.*, 463 N.W.2d 737, 738 (Minn. 1990).

119 Minn. Stat. § 559.17, subd. 3; *Cross Companies, Inc. v. Citizens Mortgage Inv. Trust*, 232 N.W.2d 114 (Minn. 1975).

120 Minn. Stat. § 559.17; *Travelers Ins. Co. v. Westridge Mall Co.*, 994 F.2d 460 (8th Cir. 1993).

*(b) Minimum loan of \$100,000*

For the lender's claim to be enforceable, the original principal loan amount secured by the mortgage must have been at least \$100,000.<sup>121</sup>

*(c) Not homesteaded*

The lender's claim to rents and profits is not enforceable against property that was entirely "homesteaded as agricultural property."<sup>122</sup> The statute gives no definition of this term. The likely effect of this provision is that a rents and profits clause will be valid on all non-homesteaded agricultural land. For example, if a bank has a mortgage on 300 acres and 160 of those acres are homesteaded, the rents and profits clause would be valid only for the other 140 acres. The question remains, however, how to define "homestead" for this purpose. One possible answer is to use the homestead designation from a redemption notice, but it seems possible that the courts could use other definitions.<sup>123</sup>

In practice, this restriction means that if the mortgage includes a rents and profits clause, during the redemption period the borrower will not have a legal right to keep the rents and profits from the farm that do not come from homesteaded land.

*(3) Receiverships under rents and profits clauses*

A rents and profits clause in a loan agreement may give the lender the right to have a "receiver" appointed to manage the property.<sup>124</sup> If properly written and executed, this part of a rents and profits clause can be legally enforceable. A receiver is a third party appointed by the court to control the property; collect the rents, profits, and other income from the property; take a fee; and dispose of the rents and profits as the court orders.<sup>125</sup>

To get a receiver appointed, the lender must go to the court and request one.<sup>126</sup> If the written loan agreement says that a receiver "is to be appointed"

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121 If the lien is on residential real estate with five or more dwelling units, the loan may be for less than \$100,000.

122 Minn. Stat. § 559.17, subd. 2(3)(iii).

123 The advantage for the borrower in using the redemption designation is that it is flexible and can largely be defined by the borrower. Minn. Stat. § 582.041, subd. 3. In some cases, however, other designations, such as those used for exemptions from judgments or federal bankruptcy, might be better. Further, the statute does not explain what happens if the borrower fails to make a homestead designation.

124 Minn. Stat. § 576.01, subd. 2.

125 Minn. Stat. § 576.01, subd. 2. Receivers are neutral parties and must be experienced property managers. The court determines a bond that the receiver must post. The court, not the lender, chooses the receiver. *Minnesota Hotel Co., Inc. v. ROSA Dev. Co.*, 495 N.W.2d 888 (Minn. Ct. App. 1993).

126 The lender must "bring an action in the district court of the county in which the mortgaged premises or any part thereof is located for the appointment of a receiver." Minn. Stat. § 576.01, subd. 2.

after a specific event—for example, the foreclosure—the court will appoint the receiver.<sup>127</sup> If no mention is made of a receiver in the agreement, or if the agreement only says that the receiver “may be appointed” by the courts, the court may well decide not to appoint one.<sup>128</sup>

## 5. What happens to the crops at the end of the redemption period?

If a redemption period ends when there are crops in the ground, there are some complicated rules for sorting out the claims of the borrower and the lender or purchaser of the property.

### a. Crops are the personal property of the farmer

Crops that a borrower plants on foreclosed land during a redemption period are the borrower’s personal property, so long as the borrower had the legal right to plant them.<sup>129</sup> As a result, if the borrower has unharvested crops in the field when the redemption period ends, the borrower is still the “planting crop owner”—even though redemption of the real estate has become impossible.<sup>130</sup>

### b. New owner may have priority in crop proceeds

In 2001 the Minnesota Legislature repealed the law that had provided options for how the crops could be harvested at the end of the redemption period because it caused inconsistent lien priorities for certain parties in limited circumstances.<sup>131</sup> Under the new law, if the new owner—who is usually the lender—has a properly filed or perfected security interest<sup>132</sup> in the crops, the new owner will have a priority claim to the crops and crop proceeds over any claim of the borrower who is a planting crop owner.<sup>133</sup> Chapter Four discusses security interests and agricultural liens.

## K. Deficiency judgments

If the sale of a borrower’s real estate does not bring enough money to pay off the mortgage debt and any other money owed related to the mortgage, the borrower may be subject to a deficiency judgment.<sup>134</sup> In a deficiency judgment action, the lender forecloses on the real estate and also seeks additional money from the borrower to satisfy the debt.

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127 Minn. Stat. § 559.17, subd. 2(a).

128 Minn. Stat. § 559.17, subd. 2(b). Traditionally, it has been difficult for lenders to have receivers appointed. *Mutual Benefit Life Ins. Co. v. Frantz Klodt & Son*, 237 N.W.2d 350 (Minn. 1975).

129 Minn. Stat. § 557.10.

130 Planting crop owners may also include farmers who had a leasehold interest and a contract for deed buyer’s interest.

131 2001 Minn. Laws ch. 57, § 7 (repealing Minn. Stat. § 557.12).

132 A security interest is a legal claim of a creditor allowing the creditor to take possession of the debtor’s property or claim proceeds from the sale of the debtor’s property if the debtor defaults on the debt. Some security interests are created by law or by order of a court. Most commonly, however, security interests are agreed to by debtors as part of a credit arrangement.

133 Minn. Stat. § 336.9-334(i).

134 Minn. Stat. §§ 580.23, subd. 2, 582.30, subds. 1, 2.

Whether or not the lender is eligible for a deficiency payment should affect negotiations with the lender from the first moment the borrower is in default.

### 1. Availability of a deficiency

Assuming that the proceeds from the foreclosure sale do not cover the full amount owed to the lender, the lender's ability to claim a deficiency hinges on: (1) whether the foreclosure was of rented land where the tenant is not the borrower, (2) whether the foreclosure was by action or advertisement, and (3) the length of the redemption period.<sup>135</sup> The length of the redemption period is explained above.

In general, borrowers will be in one of the following four categories of circumstances.

*a. Foreclosure of mortgage on rented agricultural property executed on or after May 22, 1999 — no deficiency*

If the mortgage was executed or amended on or after May 22, 1999, and the mortgaged property is used in agricultural production only by a tenant who is not the borrower, the lender will not have the right to seek a deficiency judgment.<sup>136</sup> This is true regardless of whether the foreclosure is by advertisement or by action.

*b. Foreclosure by advertisement and six-month redemption period — no deficiency*

If the foreclosure is by advertisement and the borrower has a six-month redemption period, the lender will not have the right to seek a deficiency judgment.<sup>137</sup> The lender cannot simply extend the redemption period to 12 months in order to become eligible to seek a deficiency.<sup>138</sup>

*c. Foreclosure by action — deficiency possible*

If the foreclosure is by action, a deficiency judgment is possible.<sup>139</sup> The length of the redemption period does not affect this possibility.

*d. Twelve-month redemption period — deficiency possible*

If the redemption period is 12 months, a deficiency judgment is possible.<sup>140</sup> Whether the foreclosure is by action or advertisement does not affect this possibility.

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135 Minn. Stat. §§ 580.225, 581.09, 582.30; *National City Bank v. Lundgren*, 435 N.W.2d 588 (Minn. Ct. App. 1989); *Norwest Bank Hastings v. Franzmeier*, 355 N.W.2d 431 (Minn. Ct. App. 1984).

136 Minn. Stat. § 582.30, subd. 1(c).

137 Minn. Stat. § 582.30, subd. 2.

138 *American Nat'l Bank v. Blaeser*, 326 N.W.2d 163 (Minn. 1982).

139 Minn. Stat. § 582.30, subd. 2; *Suburban Nat'l Bank v. Kopstein*, C4-94-514 (Minn. Ct. App. Sept. 6, 1994) (unpublished).

140 Minn. Stat. § 582.30.

Does the lender have the right to seek a deficiency judgment?	Foreclosure by:	
	<i>Action</i>	<i>Advertisement</i>
6-month redemption period	Yes	No
12-month redemption period	Yes	Yes

## 2. Requirements for obtaining a deficiency judgment for mortgages on agricultural property

A lender that wants a deficiency judgment against a borrower must file a lawsuit and ask the court for the judgment.<sup>141</sup> If the deficiency is related to a foreclosure on agricultural property, the lender begins the lawsuit by filing an action for the deficiency judgment and a determination of the fair market value of the property within 90 days after the foreclosure sale.<sup>142</sup>

### a. Reasonable foreclosure

For a deficiency to be available, the court must conclude that the foreclosure sale was conducted in a “commercially reasonable manner.”<sup>143</sup> If the foreclosure was not commercially reasonable, no deficiency will be allowed, no matter how short the foreclosure price was of the amount owed to the lender.

### b. Maximum amount of deficiency on agricultural property foreclosures

Even if a foreclosure sale is commercially reasonable, it may still result in a bid that is too low in the eyes of the law. The maximum deficiency in a mortgage on agricultural property is limited to the difference between: (1) the fair market value of the property; and (2) either the amount remaining on the mortgage, if the foreclosure was by advertisement, or the amount of the judgment, if the foreclosure was by action.<sup>144</sup>

The statute setting this limit notes that the “property may not be presumed to be sold” at the foreclosure sale for “its fair market value.”<sup>145</sup> Borrowers have the right to submit evidence establishing the fair market value of the agricultural property. For example, if the borrower owes \$200,000 to the lender and \$150,000 was bid at

141 Minn. Stat. § 582.30, subds. 3, 5.

142 Agricultural property is property used in agricultural production. To file an action for the deficiency judgment, the lender must serve the borrower with a summons and complaint within 90 days of the foreclosure sale. Merely filing the summons and complaint with the court is not enough. *Federal Land Bank of St. Paul v. Bennett*, 445 N.W.2d 279 (Minn. Ct. App. 1989).

143 Minn. Stat. § 582.30, subds. 3, 5. The statute does not provide a definition of “commercially reasonable.” Perhaps the court would follow the factors used under the Uniform Commercial Code and Minn. Stat. §§ 336.9-610(b), 336.9-627. Chapter Four discusses commercial reasonableness in this context.

144 Minn. Stat. § 582.30, subds. 3, 5.

145 Minn. Stat. § 582.30, subds. 3(b), 5(b).



the foreclosure sale, in most foreclosures the borrower might be subject to a deficiency judgment of \$50,000. In a foreclosure on agricultural property, however, if the court decides that the fair market value of the property was higher than the amount bid—for example, \$180,000—the borrower’s deficiency judgment would be limited to \$20,000.

*c. Limits on enforcing deficiency judgments for mortgages of agricultural property*

State law imposes some additional restrictions on deficiency judgments for mortgage debt on agricultural property. These restrictions limit a lender’s ability to collect under such a judgment.

*(1) After-acquired property not available to satisfy the judgment*

A deficiency judgment to enforce a mortgage debt on property used in agricultural production does not attach or apply to property—either real property or personal property—that is acquired by the borrower after the judgment is entered.<sup>146</sup>

*(2) Statute of limitations to collect under the judgment — three years*

If a deficiency judgment on a mortgage debt on property used in agricultural production is to be enforced by carrying out the deficiency judgment, the judgment may not be executed more than three years after the judgment was entered.<sup>147</sup> This is in contrast to the normal ten-year execution period for non-agricultural property. Chapter Five discusses judgments and executions.

**3. Deficiency for mortgages on nonagricultural property**

The rules for a deficiency on mortgaged property not used in agricultural production are similar to the rules discussed here, although the fair market value of the property is not considered and a different statute of limitations applies.<sup>148</sup>

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146 Minn. Stat. § 582.30, subd. 9.

147 Minn. Stat. § 582.30, subd. 7; *Westchester Fire Ins. Co. v. Hasbargen*, 632 N.W.2d 754, 757 (Minn. Ct. App. 2001). This limit almost certainly does not apply to federal agencies. The United States government is not bound by a statute of limitations unless Congress requires it. *United States v. Summerlin*, 310 U.S. 414, 416-17 (1940). Federal agency collection actions are somewhat limited by a six-year federal statute of limitations under 28 U.S.C. §§ 2415, 2416; *United States v. Sather*, 131 F. Supp. 2d 1146 (D.S.D. 2001).

148 Minn. Stat. § 582.30, subsd. 1, 7.

## IV. Cancellation of contracts for deed

If a buyer defaults on a contract for deed, the seller will typically have the right to cancel the contract and keep the land. The buyer faces losing not only possession of the real estate but also all of the payments made up to the point of cancellation.

### A. Seller's options if the buyer defaults

If the buyer defaults on a contract for deed, the seller might agree to negotiate and restructure the contract terms. Or, after a default, the seller may begin the process of canceling the contract. However, other remedies are also available.

#### 1. Action for specific performance and damages

In an action for specific performance of a contract for deed, the seller can sue the buyer for money rather than cancel the contract in case of default. This remedy is more likely to be used if the contract contains an acceleration clause.<sup>149</sup> The typical contract for deed does not have an acceleration clause, and without a contract clause that allows acceleration of the payment schedule, sellers must sue for each delinquent installment payment as it comes due.<sup>150</sup>

Damage actions are also possible against a defaulting contract for deed buyer, although the seller may not both cancel the contract and sue to force the buyer to meet the terms of the contract.<sup>151</sup>

#### 2. Judicial termination

Judicial terminations of contracts for deed are rarely used. Statutory cancellation is quicker and cheaper for the seller and is therefore preferred. Judicial termination requires a declaratory judgment that the contract is terminated. This type of action might be used by a seller if there is some doubt as to whether the contract can be properly terminated under the statute.<sup>152</sup>

#### 3. Deed in lieu of cancellation

If the buyer gives the seller a deed in lieu of cancellation, the buyer gives up the right to purchase the land with that contract.

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149 *Summit House Co. v. Gershman*, 502 N.W.2d 422 (Minn. Ct. App. 1993).

150 *Kosbau v. Dress*, 400 N.W.2d 106 (Minn. Ct. App. 1987). The court can retain jurisdiction to supervise the performance. This avoids the need for multiple suits. *Rodeberg v. Weckwerth*, 409 N.W.2d 57 (Minn. Ct. App. 1987).

151 *Wayzata Enter., Inc. v. Herman*, 128 N.W.2d 156, 158 (Minn. 1964); *Covington v. Prichett*, 428 N.W.2d 121 (Minn. Ct. App. 1988); *Kosbau v. Dress*, 400 N.W.2d 106 (Minn. Ct. App. 1987). The seller also may not cancel the contract and then sue the buyer for unreasonably abusing or neglecting the land. *Rudnitski v. Seely*, 452 N.W.2d 664 (Minn. 1990).

152 *Covington v. Prichett*, 428 N.W.2d 121 (Minn. Ct. App. 1988); *O'Meara v. Olson*, 414 N.W.2d 563 (Minn. Ct. App. 1987).

#### 4. Statutory cancellation

The vast majority of contract for deed sellers use statutory cancellation as a remedy for a default. This remedy is discussed below.

##### B. Farmer-lender mediation

A seller who wants to cancel a contract for deed may first be required to serve the buyer with a notice of the availability of farmer-lender mediation.<sup>153</sup> Chapter Seven discusses mediation.

##### C. Notice of cancellation of a contract for deed

Before canceling a contract for deed, the seller must personally deliver to the buyer a “notice of termination or cancellation.”<sup>154</sup> The notice explains that the contract will be canceled if the buyer does not cure the default according to the procedures in the notice.

The notice must also explain: (1) why the buyer is in default, (2) how to cure the default, and (3) how long the buyer has to cure the default.

The notice should include the name, address, and telephone number of the seller or an attorney authorized to accept payments and should state where the payment can be made.<sup>155</sup>

##### D. Reinstatement

The requirements of the notice and of the buyer’s possible cure vary somewhat depending on when the contract for deed was signed. Every contract for deed reinstatement requires at least three actions on the buyer’s part. A more recent contract for deed may require one or two more buyer actions.

###### 1. Reinstatement rules for every contract for deed

Every person reinstating a contract for deed must:

###### *a. Eliminate the default*

The buyer must eliminate whatever problem is described in the notice as creating a default.<sup>156</sup> Usually—but not always—this will be late payments. For example, if the buyer has not paid real estate taxes but was required to do so in the contract and is therefore in default, the buyer must pay the taxes to stop the cancellation.<sup>157</sup>

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153 Minn. Stat. § 559.209.

154 Minn. Stat. § 559.21, subd. 4. Notice will be served within the state in the same manner as a summons in district court. Federal and state tax liens on the buyer’s interest require separate notices to the taxing authorities. 26 U.S.C. § 7425; Minn. Stat. § 270.69, subd. 7. Failure to make the required service on the IRS does not void a cancellation and the seller is subject to the tax lien. *Bartels v. Blattner*, 595 N.W.2d 527 (Minn. Ct. App. 1999).

155 Minn. Stat. § 559.21, subd. 4(a).

156 Minn. Stat. § 559.21, subds. 1b, 1c, 2a.

157 One subtle point is that in order to reinstate the contract, the buyer is required only to make the back payments that are described in this notice—not any payments that came due after the notice but are not included in it. Minn. Stat. § 559.21, subd. 4(c).

*b. Pay cost of service*

The buyer must pay the seller's reasonable costs of serving the notice of cancellation—but only if the seller notifies the buyer of the costs by certified mail to the buyer's last known address at least ten days before the termination date.<sup>158</sup>

*c. Pay attorneys' fees*

The buyer will likely have to pay for the seller's attorneys' fees actually expended or incurred. These fees will be either \$100, \$200, \$250, or \$500, depending on when the contract was executed.<sup>159</sup>

**2. Additional reinstatement rule for contracts executed after April 30, 1980 — pay all due and owing**

If the contract for deed was executed after April 30, 1980, the payments needed to cure a default may be higher. To cure a default and reinstate a contract covered by this rule, the buyer must make all payments due to the seller under the contract through the date that payment is made.<sup>160</sup>

**3. Additional reinstatement rule for contracts executed after July 31, 1985 — 2 percent charge**

If the contract for deed was executed after July 31, 1985, the buyer must also pay an extra charge of 2 percent of any amount in default at the time the notice of cancellation was served.<sup>161</sup>

<sup>158</sup> Minn. Stat. § 559.21, subds. 4(c)(3), 1b(2), 1c(2), 1d(3), 2a(3).

<sup>159</sup> The different amounts are based on the date the contract was executed. Minn. Stat. § 559.21, subds. 4(c)(5), 1b(3), 1c(3), 1d(3), 2a(5). Amounts are as follows: for mortgages executed before August 2, 1976, the amount is \$100; for those executed after August 1, 1976, and before May 1, 1980, the amount is \$200; for those executed after April 30, 1980, and before August 1, 1999, the amount is \$250; and for those executed after July 31, 1999, the amount is \$500. No fees are due on a contract executed after July 31, 1985, unless the contract is in default for at least 30 days before the notice is served. Minn. Stat. § 559.21, subd. 2a(5). On contracts executed on or before July 31, 1985, no fees are due unless the contract is in default for at least 45 days before the notice is served. Minn. Stat. § 559.21, subds. 1b(3), 1c(3), 1d(4). Attorneys' fees are reduced if the amount of the default is less than \$1,000.

<sup>160</sup> Minn. Stat. § 559.21, subd. 4(c)(2).

<sup>161</sup> Minn. Stat. § 559.21, subds. 4(c)(4), 2a(4). This does not include earnest money contracts, purchase agreements, exercised options, final balloon payments, any taxes, assessments, mortgages, or prior contracts assumed by the purchaser.

<b>How to reinstate a contract for deed</b>			
	<b>Contract executed before April 30, 1980</b>	<b>Contract executed between April 30, 1980, and July 31, 1985</b>	<b>Contract executed af- ter July 31, 1985</b>
Cure default through date of notice	<b>x</b>	<b>x</b>	<b>x</b>
Pay cost of service	<b>x</b>	<b>x</b>	<b>x</b>
Pay attorneys' fees	<b>x</b>	<b>x</b>	<b>x</b>
Cure default through date of payment		<b>x</b>	<b>x</b>
Pay 2 percent penalty			<b>x</b>

### **E. How to make payments for reinstatements**

The notice of cancellation of a contract for deed will tell the buyer where to make any payments needed for reinstatement. If, however, the notice was not signed by the lawyer for the seller and the buyer either cannot find the seller or the seller is not in the state, the buyer can make the payment to the court administrator of the district court in the county where the property is located.<sup>162</sup> The buyer should also file proof that any other defaults have been eliminated.<sup>163</sup>

### **F. How long the buyer has to reinstate**

A notice of cancellation of a contract for deed should also explain how long the buyer has to reinstate the contract. The buyer should have at least 30 days after the service of the notice, and usually 60 days for more recent contracts, to reinstate.<sup>164</sup>

<sup>162</sup> Minn. Stat. § 559.21, subd. 4(e).

<sup>163</sup> Minn. Stat. § 559.21, subd. 4(e). If the contract for deed payments were assigned by the seller to a creditor, the buyer should, after receiving notice, send payments to the creditor, who also has the right to enforce the contract for deed. Minn. Stat. §§ 336.9-607(a)(1)(A), 336.9-406.

<sup>164</sup> Minn. Stat. § 559.21, subd. 2a.

For somewhat older contracts for deed, the amount of time the buyer has to reinstate the contract varies, depending on when the contract was executed and how much the buyer has paid on the purchase price. The following calculations depend on the percent of the purchase price that has been paid. The purchase price includes the down payment. Payments include the down payment under the contract but not interest payments.<sup>165</sup>

In general, therefore, the reinstatement period depends on when the contract was executed.<sup>166</sup>

#### **1. Contracts executed before August 2, 1976**

If the contract was executed before August 2, 1976, the reinstatement period is 30 days in all cases. That is, the buyer has 30 days after service of the notice of cancellation to cure the default and satisfy the reinstatement requirements.

#### **2. Contracts executed from August 2, 1976, to April 30, 1980**

If the contract was executed from August 2, 1976, to April 30, 1980, the reinstatement period is: (1) 30 days—if the buyer has paid off less than 30 percent of the contract; (2) 45 days—if the buyer has paid 30 percent or more of the contract but less than 50 percent; and (3) 60 days—if the buyer has paid off 50 percent or more of the contract.

#### **3. Contracts executed from May 1, 1980, to July 31, 1985**

If the contract was executed from May 1, 1980, to July 31, 1985, the reinstatement period is: (1) 30 days—if the buyer has paid off less than 10 percent of the contract; (2) 60 days—if the buyer has paid off 10 percent or more but less than 25 percent of the contract; and (3) 90 days—if the buyer has paid off 25 percent or more of the contract.

#### **4. Contracts executed after July 31, 1985**

If the contract was executed after July 31, 1985, the reinstatement period is 60 days in all cases.

#### **5. Deadlines are strict**

The deadlines for curing contract for deed defaults are strictly enforced.<sup>167</sup>

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<sup>165</sup> Mortgages, prior contracts for deed, special assessments, delinquent real estate taxes, or other obligations or encumbrances assumed by the buyer are not included as either part of the purchase price or the payments. Minn. Stat. § 559.21, subd. 1e.

<sup>166</sup> Minn. Stat. § 559.21.

<sup>167</sup> *Extraordinary Learn. & Ed. v. New Bethel Baptist Ch.*, 430 N.W.2d 184 (Minn. Ct. App. 1988).

<b>Reinstatement — How long do buyers have to reinstate after receiving the notice of cancellation?</b>					
		<b>30 days</b>	<b>45 days</b>	<b>60 days</b>	<b>90 days</b>
Contract executed before August 2, 1976		<b>x</b>			
Contract executed between August 2, 1976, and April 30, 1980, and the buyer has paid off:	Less than 30% of the principal	<b>x</b>			
	30% or more of principal but less than 50%		<b>x</b>		
	50% or more of principal			<b>x</b>	
Contract executed between May 1, 1980, and July 31, 1985, and the buyer has paid off:	Less than 10% of principal	<b>x</b>			
	10% or more of principal but less than 25%			<b>x</b>	
	25% or more of principal				<b>x</b>
Contract executed after July 31, 1985				<b>x</b>	

### G. Seller can waive the right to cancel

Even if the buyer is in default, the seller can voluntarily decide to stop the cancellation process at any time before the period to cure has run.<sup>168</sup>

If after serving the notice of cancellation the seller voluntarily accepts a payment or some other benefit from the contract, the seller waives the cancellation. For the action of the seller to be a waiver of the cancellation right, however, there must be some showing that it was a voluntary action with the seller having full knowledge of the facts and available legal rights, and with the intent to relinquish those rights.<sup>169</sup> For example, if the seller retains a late payment after service of the notice of cancellation and informs the buyer that other payments are still due, that is not a waiver of the cancellation.<sup>170</sup>

168 *Kosbau v. Dress*, 400 N.W.2d 106 (Minn. Ct. App. 1987).

169 *Thomey v. Stewart*, 391 N.W.2d 533 (Minn. Ct. App. 1986); *Freitag v. Wolf*, 226 N.W.2d 868 (Minn. 1975); *Fraser v. Scharber*, 173 N.W.2d 328 (Minn. 1969); *Odegaard v. Moe*, 119 N.W.2d 281 (Minn. 1962).

170 *Knutson v. Seeba*, C7-98-1665 (Minn. Ct. App. Mar. 30, 1999) (unpublished).

## H. Fighting the cancellation

The buyer has a right to contest, in court, the cancellation of a contract for deed in court. The court can stop the seller's movement toward cancellation with an injunction if the buyer can show any reason why termination should not occur.<sup>171</sup> As a condition of granting the injunction, the court will likely require the buyer to either make some sort of payment or give some money as security deposit.<sup>172</sup> Although the buyer is permitted to do this without legal assistance, to be effective, the buyer probably will need the help of an attorney.

### I. If a contract for deed is canceled

If the buyer is unable to cure the default or work out an agreement with the seller in mediation or otherwise, the seller can cancel the contract for deed.<sup>173</sup> Until terminated, the terms and conditions of the contract for deed remain in full force and effect.<sup>174</sup> A contract for deed cancellation results in the following.

#### 1. The buyer loses the property

When a contract for deed is canceled, the buyer loses the right to possess the property. If the buyer does not leave, the seller will probably be able to start an unlawful detainer action to remove the buyer.

#### 2. The buyer loses money already paid

If a contract for deed is canceled, the buyer loses all of the money paid on the contract.

#### 3. No deficiency judgments

When a contract for deed is canceled, the seller cannot sue the buyer for a deficiency judgment.

#### 4. Unjust enrichment claim possible

In some cases, courts conclude that a contract for deed seller was "unjustly enriched" by payments and improvements made by the buyer before cancellation and order the seller to refund some of the buyer's investment.<sup>175</sup> Usually, however, in order to claim that the seller was unjustly enriched, the buyer must show that the seller somehow

171 Minn. Stat. § 559.211, subd. 1. This remedy is in addition to any other rights the buyer has under the contract or in the law. Minn. Stat. § 559.211, subd. 2.

172 The courts have broad discretion as to what security, if any, to require of the buyer. Security need not necessarily equal the default amount. *Carlson v. Mixell*, 412 N.W.2d 771 (Minn. Ct. App. 1987). Any ongoing contract payments must be paid either to the seller or the court. *Seeger v. DeGardner*, 355 N.W.2d 465 (Minn. Ct. App. 1984). If the injunction is lifted, the buyer has another 15 days to act. Minn. Stat. § 559.211, subd. 1.

173 Minn. Stat. § 559.21, subd. 4(d). If a seller cancels a contract for deed, a transfer statement for a contract for deed cannot be used to transfer the seller's interest and the transfer statement is not effective as a conveyance. Minn. Stat. § 336.9-619(a)(3).

174 *Boehm's, Inc. v. Wacholz*, 495 N.W.2d 447 (Minn. Ct. App. 1993).

175 *Anderson v. DeLisle*, 352 N.W.2d 794 (Minn. Ct. App. 1984).



misrepresented the situation to the buyer, engaged in fraud, or acted in an immoral manner.<sup>176</sup>

### **5. Seller can recover personal property covered by the contract**

When personal property is included in a contract for deed, cancellation of the contract entitles the seller to recover the personal property.<sup>177</sup>

### **6. What happens to growing crops if the contract is canceled**

If a contract for deed is canceled when there are crops in the ground, there are some complicated rules for sorting out the claims of the buyer and the seller.

#### *a. Crops are the personal property of the farmer who planted them*

Crops that a farmer plants are his or her personal property, as long as the farmer had the legal right to plant them.<sup>178</sup> As a result, if the buyer has unharvested crops in the field after the contract for deed is canceled, the buyer is still the “planting crop owner”—even though the right to occupy and possess the land is lost.

#### *b. Seller may have priority in crops*

In 2001, the Minnesota Legislature repealed the law that provided options for how the crops will be harvested after a contract for deed cancellation because it caused inconsistent lien priorities for certain parties in limited circumstances.<sup>179</sup> The Minnesota Legislature also repealed the lien that the planting farmer had on the crop and the crop proceeds.<sup>180</sup> Under the new law, if the seller has a perfected security interest in the crops, the seller has priority over any claim of other lienholders and creditors of the buyer except a perfected landlord’s lien unless the seller is also the landlord.<sup>181</sup> Chapter Four discusses security interests and agricultural liens.

### **7. If the buyer gave a promissory note as a down payment**

In some cases, the buyer on a contract for deed gives the seller a promissory note as a down payment. If so, the seller may try to enforce the note even though the contract for deed has been canceled. If the note was given as a substitute for a payment, however, the note will likely be canceled along with the contract for deed.<sup>182</sup>

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176 *Coddon v. Youngkranz*, 562 N.W.2d 39 (Minn. Ct. App. 1997); *Covington v. Pritchett*, 428 N.W.2d 121 (Minn. Ct. App. 1988); *Kosbeau v. Dress*, 400 N.W.2d 106 (Minn. Ct. App. 1987); *Fort Dodd P’ship v. Trooien*, 392 N.W.2d 46 (Minn. Ct. App. 1986); *Anderson v. DeLisle*, 352 N.W.2d 794 (Minn. Ct. App. 1984).

177 *Rudnitski v. Sely*, 452 N.W.2d 664 (Minn. 1990).

178 Minn. Stat. §§ 557.10, 557.11, subd. 2.

179 2001 Minn. Laws ch. 57, § 7 (repealing Minn. Stat. § 557.12).

180 2001 Minn. Laws ch. 57, § 7 (repealing Minn. Stat. § 559.2091).

181 Minn. Stat. § 336.9-334(i).

182 *Novus Equities Corp. v. Em-ty P’ship*, 381 N.W. 2d 426 (Minn. 1986); *Nelson v. McBride*, 414 N.W.2d 459 (Minn. Ct. App. 1987). The seller must overcome an assumption by the court that notes are not intended as down payments.

## J. If the seller defaults

It is not common for the seller to default on a contract for deed, but it can happen. In such cases, buyers have several possible remedies.

### 1. Self help or taking action without court involvement

The seller may have financial problems. For example, he or she may be behind on mortgage payments for the same land. If the seller fails to pay an underlying mortgage, the buyer probably will have the right to make the mortgage payment and offset that amount from the contract for deed payments. If as a result the seller begins a cancellation of the contract for deed, the buyer should not withhold payment. Instead, the buyer should seek a court injunction to stop the cancellation.<sup>183</sup>

### 2. Action for fraud

If the seller has committed fraud or has otherwise violated the contract for deed, the buyer may be able to rescind, meaning cancel, the contract.<sup>184</sup> A court likely will attempt to put the parties back to their original position before the contract was executed. A refund of the payments, less a reasonable rent, is one possible remedy.<sup>185</sup>

### 3. Specific performance and action for damages

In most instances, a contract for deed buyer seeks specific performance. That is, the buyer wants the promises in the contract to be fulfilled. If the buyer has satisfied his or her obligations under the contract but the seller has not, a court can order the seller to meet the terms of the contract.<sup>186</sup> There may, in addition, be minor damages incurred as a result of the seller's actions.

## V. Minnesota right of first refusal

The right of first refusal gives some farmers another chance to buy or rent their farm after it has been lost to a creditor. Two different types are possible: a Minnesota right of first refusal and a federal right of first refusal. Eligibility can be tricky, however, and some problems are hard to predict in advance.

Under the Minnesota right of first refusal, if the farmer lost agricultural land or the farm home-  
stead because a creditor enforced a debt against it, the creditor may not be able to rent or sell that property to anyone else without first giving the farmer a chance to match any offer.<sup>187</sup>

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183 Minn. Stat. § 559.211. The court will determine the relative rights and responsibilities of the parties.

184 *Gustafson v. Gervais*, 189 N.W.2d 186 (Minn. 1971).

185 *Autrey v. Trkla*, 350 N.W.2d 409 (Minn. Ct. App. 1984).

186 *Gethsemane Lutheran Church v. Zacho*, 104 N.W.2d 645 (Minn. 1960); *Schumacher v. Ihrke*, 469 N.W.2d 329 (Minn. Ct. App. 1991).

187 The Minnesota Right of First Refusal was moved from Minn. Stat. § 500.24 to Minn. Stat. § 500.245 in 1997. 1997 Minn. Laws. ch. 126, § 6.

## A. Eligibility

Eligibility for first refusal rights hinges on: (1) whether the farmer can qualify as an “immediately preceding former owner,” (2) whether it was a corporation or government agency that took the property from the immediately preceding owner by enforcing a debt, and (3) the type of real estate property taken by the agency or corporation.

For many farmers, eligibility for the right of first refusal is fairly straightforward. In some cases, however, farmer eligibility, especially the ability to qualify as an immediately preceding former owner, can be complicated. In addition, farmers may or may not be eligible based on things over which they have no control. So while the Minnesota right of first refusal is a very valuable tool to keep farmers on the land, it can be unpredictable and should not be counted on in advance.

### 1. Must be an immediately preceding former owner

To qualify for first refusal rights, the farmer must be the immediately preceding former owner of agricultural property or a farm homestead.<sup>188</sup> This can be more complicated than it sounds. In general, it includes the following.

#### a. *Once had legal title to the property*

The farmer must have had legal title to the property.<sup>189</sup> For the purposes of the right of first refusal, a contract for deed buyer is assumed to have that legal title.<sup>190</sup>

#### b. *Lost the property due to enforcement of a debt*

The farmer must have lost the property because someone enforced a debt against the agricultural land or homestead. This includes a mortgage foreclosure, a deed in lieu of foreclosure, a contract for deed cancellation, or a deed in lieu of a contract for deed cancellation.<sup>191</sup>

First refusal rights do not apply if a lease was terminated due to a default.<sup>192</sup> However, if the lease included an option to purchase and lease payments were applied to the purchase price, this could be treated as a contract for deed by the courts.<sup>193</sup>

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188 Minn. Stat. § 500.245, subd. 1(b).

189 Minn. Stat. § 500.245, subd. 1(b).

190 Minn. Stat. § 500.245, subd. 1(b), (h). If the farm debtor is in bankruptcy, the farm debtor still qualifies as the immediately preceding former owner even if technically the bankruptcy estate may have had title and lost the property. *Farm Credit Bank of St. Paul v. Halverson (In re Solberg)*, 125 B.R. 1010 (Bankr. D. Minn. 1991).

191 Minn. Stat. § 500.245, subd. 1(a)-(b). Farmers have first refusal rights after foreclosure even if they are still in possession of the property during the redemption period. *Harbal v. Federal Land Bank of St. Paul*, 449 N.W.2d 442 (Minn. Ct. App. 1989).

192 Minn. Stat. § 500.245, subd. 1(a).

193 *Wurdemann v. Hjelm*, 102 N.W.2d 811, 818 (Minn. 1960).

*c. Must be a family farmer*

An immediately preceding former owner must also be a family farmer, a family farm corporation, a family farm partnership, or a family farm limited liability company.<sup>194</sup>

**2. The land was taken by a corporation or government agency**

First refusal rights also depend on who it was that enforced the debt and took the property.<sup>195</sup> First refusal rights apply if the property was taken by: (1) a state or federal agency, (2) a limited partnership, (3) a corporation, or (4) a limited liability company.

First refusal rights do not apply, however, if the property was taken by an individual, a family farm corporation, or an authorized family farm corporation.<sup>196</sup> For example, if a contract for deed is canceled by a private individual, he or she does not have to offer the buyer the right of first refusal. Or if the highest bidder for a farmer's property at a foreclosure sale is a private individual, the farmer will not have first refusal rights.

**3. Creditor sells or leases the property**

First refusal rights are triggered when the creditor tries to lease or sell the property. If this is never attempted, the farmer may never have first refusal rights.

**4. Property must be agricultural land or farm homestead**

First refusal rights apply only if the property in question was either agricultural land or a farm homestead.<sup>197</sup>

*a. Agricultural land*

For the purposes of Minnesota first refusal rights, agricultural land is defined as land used for producing agricultural products, such as crops, livestock, and milk, as well as fruit and horticultural products. It does not, however, include land used for timber production or poultry or feeding and caring for livestock that are delivered

194 Minn. Stat. § 500.245, subd. 1(b). A family farm is an unincorporated farming unit owned by one or more people living on the farm or actively farming. Minn. Stat. § 500.24, subd. 2(b). In general, a family farm corporation is founded for the purpose of farming and owning agricultural land. The stock is controlled mostly by family members, and no corporation holds any of the stock. At least one family member lives on or actively operates the farm. Minn. Stat. § 500.24, subd. 2(c). In general, a family farm partnership is a limited partnership formed for the purpose of farming and owning agricultural land. The majority of the partnership is held by family members. At least one family member lives on or actively operates the farm. None of the partners are corporations. Minn. Stat. § 500.24, subd. 2(h). In general, a family farm limited liability company is founded for the purpose of farming and owning agricultural land. The company has a majority of members that are family members and these family members hold a majority interest. At least one family member actively operates the farm. None of the members are corporations or limited liability companies. Minn. Stat. § 500.24, subd. 2(i).

195 Minn. Stat. § 500.245, subd. 1(a). Land sold or leased under the Minnesota family farm security program is exempt. Minn. Stat. ch. 41.

196 Minn. Stat. § 500.245, subd. 1(a).

197 Minn. Stat. §§ 500.24, subds. 2(a), 2(g), 2(i), 500.245, subd. 1(a).

to a corporation for slaughter or processing for up to 20 days before slaughter or processing.<sup>198</sup>

**b. Farm homestead**

A farm homestead is the house and adjoining buildings that are either on the agricultural land used by the farm or that are somehow used in the farming operation.<sup>199</sup>

**c. Ensuring that the property qualifies**

In order to make sure that certain property meets the definition of agricultural land or farm homestead and is eligible for first refusal rights, a farmer can get a certificate signed by the county assessor that says the land is agricultural land or a farm homestead. The farmer should file a copy of that certificate in the office of the county recorder or registrar of titles. Once this is done, it will be very difficult for anyone to claim that the property does not qualify as agricultural land or a farm homestead.<sup>200</sup>

**B. When the farmer must be offered the right of first refusal**

Farmers who are eligible for first refusal rights will have lost their property to a corporation or government agency. Once the corporation or agency receives an acceptable offer from a third party for the sale or lease of the farmer's first refusal property, the farmer must first be offered the chance to purchase or lease the property at a price "no higher" than the acceptable third-party offer.<sup>201</sup>

In some cases, the farmer may never have a right of first refusal. For example, if another creditor redeems the property, this does not trigger the farmer's right of first refusal, although that creditor may still be required to offer the farmer first refusal rights.<sup>202</sup> In addition, if a lender obtained a money judgment and then conducted an execution sale on the property before another lender foreclosed on the mortgage, the farmer may have no right to first refusal at all.<sup>203</sup>

**C. Notice of first refusal rights**

The creditor agency or corporation must notify the farmer of his or her first refusal rights at least 14 days before the first refusal property is offered for sale or lease.<sup>204</sup> A notice of offer must

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198 Agricultural land also does not include land used for processing, refining, or packaging products, or land used for providing spraying or harvesting services to processors or distributors of farm products. Minn. Stat. § 500.24, subd. 2(a).

199 Minn. Stat. § 500.24, subd. 2(i). "Farming operation" is not defined, although "farming" is defined as activities listed under the definition of "agricultural land" above.

200 Minn. Stat. § 500.245, subd. 1(j).

201 Minn. Stat. § 500.245, subd. 1(a), (d).

202 *Farmers and Merchants Bank of Preston v. Junge*, 458 N.W.2d 698 (Minn. Ct. App. 1990); *Carlson v. Lilyerd*, 449 N.W.2d 185 (Minn. Ct. App. 1989); *Sands v. Production Credit Ass'n*, No. C9-90-1116 (Minn. Ct. App. Oct. 23, 1990) (unpublished).

203 *Farm Credit Bank of St. Paul v. Michels*, 513 N.W.2d 7 (Minn. Ct. App. 1994).

204 They must either personally deliver the notice with a signed receipt or send it by certified mail with a receipt of mailing to the farmer's last known address. Minn. Stat. § 500.245, subs. 1(a), 1(f), 2, 3.

say that the property is about to either be sold or leased to a third party. It must also explain that the farmer can buy or lease the property on the same or equivalent terms.

A notice of offer must also include a description of the property, a copy of the acceptable third-party offer that the farmer must match, and the specific terms the farmer must meet.<sup>205</sup> Notices must also warn the farmer about limits on the farmer's ability to sell the property later. These limits are discussed below at page 81.

#### **D. The terms the farmer must meet**

The notice will explain the exact terms the farmer must meet to exercise the right of first refusal. The price offered to the farmer must not be higher than the acceptable offer made by the third party.<sup>206</sup>

##### **1. Cash price offer**

The price the farmer must pay is straightforward if the third party made an acceptable direct cash price offer.

For example, suppose a third party offered \$200,000 cash to a bank that now has the farmer's property after a foreclosure. The first refusal offer to the farmer will also be \$200,000 cash. The farmer may be able to arrange financing from another source, but the first refusal payment must be in cash.

##### **2. Time price offer**

If the third party made a time price offer—such as a purchase under a contract for deed—in which the payments are not all made up front, calculating the price for the farmer's offer can be more complicated. Time price offers are common. Any lease with payments extending over time is a time price offer, as is a sale of the property if a bank sells the land and also finances the purchase with a mortgage.

When the acceptable third-party offer is a time price offer, the corporation or agency has a choice. It may either offer the farmer exactly the same terms, or it may make an equivalent cash offer to the farmer. The calculation of an equivalent cash offer takes into account the present value of payments scheduled to be made over time.

For example, suppose the acceptable third-party offers \$200,000, paid out over 30 years, to a bank that now has the farmer's foreclosed property. Because of inflation, a payment of \$200,000 stretched out over 30 years is worth less than a \$200,000 cash payment today.

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<sup>205</sup> Minn. Stat. § 500.245, subd. 1(b)-(c). If the property is to be sold, a copy of the purchase agreement, including the price and terms of the third-party's acceptable offer, must be in the farmer's notice. The notice must also include a signed affidavit by the corporation or agency that the purchase agreement is true, accurate, and made in good faith. If the property is to be leased, the notice must include a copy of the lease, including the price and terms of the third-party's acceptable offer. The notice must also include a signed affidavit by the corporation or agency that the lease is true, accurate, and made in good faith.

<sup>206</sup> Minn. Stat. § 500.245, subd. 1(a)-(d). An equivalent cash offer is not required if the state participates in an offer to a third party through the Rural Finance Authority.

Therefore, the equivalent cash price, which is figured by a mathematical equation in the statute, will be somewhat less than \$200,000, but the farmer must make that payment in cash.

If the corporation or agency makes an offer based on an equivalent cash value, it will say so. Since figuring the equivalent value can be complicated, farmers should ask someone familiar with such calculations to check it.

## **E. Accepting the offer to lease or purchase**

### **1. Accept in writing**

An acceptance form for the right of first refusal should be included in the notice. The farmer should hand deliver the acceptance to the creditor or mail it by certified mail, return receipt requested.<sup>207</sup> If the farmer does not meet the deadlines listed below, the farmer will lose his or her first refusal rights.

### **2. Accepting offers to lease — 15 days**

The farmer must make use of a right to lease property in writing within 15 calendar days after an offer is mailed with a receipt of mailing or personally delivered.<sup>208</sup> An offer cannot be initiated until the 14-day pre-offer period has expired.<sup>209</sup>

### **3. Accepting offers to purchase — 65 days**

The farmer must make use of a right to buy property in writing within 65 calendar days after the notice is mailed with a receipt of mailing or personally delivered.<sup>210</sup> An offer cannot be initiated until the 14-day pre-offer period has expired.<sup>211</sup>

## **F. Meeting the obligations — 10 days**

Within ten calendar days after accepting an offer to lease or purchase the real estate, the farmer must meet his or her obligations under the offer, including making payments due at that time.<sup>212</sup> In a lease, for example, the obligation may be to pay a security deposit and the rent for that month. For a sale, the obligation may be to pay the remainder of the original purchase price. If the farmer does not meet this deadline, he or she loses first refusal rights.

## **G. Purchasing or leasing only part of the property**

The farmer may want to use the right of first refusal to purchase or lease only a part of the property.<sup>213</sup> If so, the farmer should give written notice to the agency or corporation describing the part of the property to be sold or leased separately. If the agency or corporation does not want to sell the property in parts, however, the farmer cannot force it to do so. Any separated parts of

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207 Minn. Stat. § 500.245, subd. 2(a).

208 Minn. Stat. § 500.245, subd. 1(i).

209 Minn. Stat. § 500.245, subd. 1(a).

210 Minn. Stat. § 500.245, subd. 1(i).

211 Minn. Stat. § 500.246, subd. 1(a).

212 Minn. Stat. § 500.245, subd. 1(i).

213 Minn. Stat. § 500.245, subd. 1(c), (e)(3), (i).

the property must be compact and connected so that separation does not unreasonably reduce either access to the rest of the land or its value. If the farmer elects to lease or buy only one or more parts of the property, those parts must be described in writing in the farmer's acceptance. If only part of the property is purchased or leased, the farmer will not have a right of first refusal for the remaining property after the farmer gives written notice.<sup>214</sup>

## H. Expiration and termination of refusal rights

Eventually, if the corporation or agency owns the property long enough, first refusal rights expire.

### 1. Lengthy possession by the corporation or agency

The right of first refusal may end if the corporation or agency simply keeps the land for a long time—usually but not always more than five years.<sup>215</sup> Both purchasing and leasing rights expire if this happens.

If the corporation or agency got the property from the farmer on or after May 1, 1988, the farmer loses first refusal rights once the corporation or agency keeps it for more than five years. If they got the property from the farmer before that date, first refusal rights end after they have held the property for more than ten years.

The farmer cannot force the corporation or agency to sell the property.

### 2. The farmer rejects an offer to lease — first refusal lease rights are terminated

If the farmer ever rejects an offer to lease first refusal property, the farmer loses the right to lease it from then on. Otherwise, first refusal leasing rights apply each time the property is leased.<sup>216</sup> Therefore, if the farmer accepts an offer to lease the property the first time it is offered, he or she will still have the right of first refusal the next time the property comes up for lease. If the farmer rejects an offer to lease, he or she still keeps first refusal purchase rights.

For example, suppose a farmer lost land to the bank in a foreclosure. In the first year, the farmer is offered first refusal leasing rights and accepts. In the second year, the farmer rejects a first refusal offer to lease the land. In the third year, and anytime thereafter, the farmer will have no first refusal leasing rights. If the bank gets an offer to purchase the land in the fourth year, however, the farmer still has first refusal purchase rights.

### 3. The land is sold

After the land is sold, the farmer loses first refusal rights.<sup>217</sup> Although the statute is not clear on this point, the farmer might not lose any future first refusal rights if he or she

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214 Minn. Stat. § 500.245, subd. 1(e)(3).

215 Minn. Stat. §§ 500.24, subd. 2(v); 500.245, subd. 1(e); *Travelers Ins. Co. v. Horseshoe Lake Farms, Inc.*, 456 N.W.2d 453 (Minn. Ct. App. 1990).

216 Minn. Stat. § 500.245, subd. 1(e)(1); *Coolidge v. First Am. State Bank of Sargeant*, C0-88-2316 (Minn. Ct. App. Apr. 4, 1989) (unpublished).

217 Minn. Stat. § 500.245, subd. 1(e)(1)-(2).



rejects a first refusal offer to purchase but for some reason the third party does not buy the property. Therefore, if the acceptable third-party offer to purchase the land—which triggered the first refusal opportunity to purchase to begin with—falls through or is somehow stopped with a default, the farmer should arguably still have the right to first refusal leasing and purchasing rights.

#### **4. Using first refusal on only part of the property**

If a farmer purchases or leases only a part of the property, he or she loses the right of first refusal for the remaining property.<sup>218</sup> The statute does not address if the corporation/agency initiates a partial sale or lease of the property. Arguably, the farmer should maintain his or her right of first refusal on the parts of the property not yet offered for sale or lease.

#### **I. Waiving first refusal rights**

A waiver or contractual limitation of first refusal rights can in some cases be enforceable if the farmer signed an agreement that explained plainly what rights were given up.<sup>219</sup> For example, waivers included in a deed in lieu of foreclosure or contract for deed cancellation are legal.<sup>220</sup> In general, however, waiver of a farmer's right of first refusal as a condition for obtaining a loan is illegal.<sup>221</sup>

If a farmer does grant a legal waiver directly to an agency or corporation that now has the right to own the farmer's land and must otherwise give first refusal rights, the farmer may change his or her mind about the waiver by contacting the agency or corporation in writing within 20 calendar days after signing the waiver.<sup>222</sup>

#### **J. Rights not transferable**

The right of first refusal may be inherited but may not be sold or given to someone else.<sup>223</sup>

#### **K. Reselling the first refusal property after purchasing it**

Since the purpose of the right of first refusal is to keep the farm in the hands of family farmers, there are strict rules about reselling land after the right of first refusal is used to purchase it.<sup>224</sup> Two important exceptions to these rules will help some farmers.<sup>225</sup>

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218 Minn. Stat. § 500.245, subd. 1(e)(3).

219 Minn. Stat. §§ 500.245, subd. 1(l), 325G.31.

220 Minn. Stat. § 500.245, subd. 1(l)(1)-(2). This is only permitted for agricultural land.

221 Minn. Stat. § 550.42, subd. 1. The statute also allows for several other limited waivers of the right of first refusal. These include a waiver to cure a title defect and a waiver to sell property under a contract for deed. Minn. Stat. § 500.245, subd. 1(l)(4)-(5).

222 Minn. Stat. § 500.245, subd. 1(l)(3).

223 Minn. Stat. § 500.245, subd. 1(m); *Estate of Smith v. Federal Land Bank of St. Paul*, 424 N.W.2d 312 (Minn. Ct. App. 1988). Only heirs at law or devisees named in a will are legally entitled to the notice provided by Minn. Stat. § 500.245.

224 Jonathan F. Mitchell, Comment, *Can a Right of First Refusal Be Assigned?*, 68 U. CHI. L. REV. 985, 990-91 (2001).

225 Minn. Stat. § 500.245, subd. 1(n). Farmers who violate these restrictions may be liable to a person who is harmed by a sale for damages and costs.

### 1. Cannot agree to sell the land beforehand

The farmer may not sell first refusal land to someone else if the farmer negotiated or agreed to the sale before accepting the first refusal offer.<sup>226</sup>

### 2. Selling first refusal property within 270 days

If the farmer sells first refusal land within 270 days after accepting the first refusal offer, the law makes a “rebuttable presumption” that the farmer has violated the law by negotiating the sale beforehand.<sup>227</sup> This means that even though there may be no other evidence showing that the farmer negotiated or agreed to the sale before accepting the first refusal offer, unless he or she can prove otherwise, a court will assume that the farmer did so.

### 3. Exceptions to the limit on agreements to sell beforehand

Two separate exceptions limit these restrictions. Both exceptions must be followed carefully.<sup>228</sup>

#### a. Continue farming first refusal land for one year

A farmer may negotiate to sell some of his or her first refusal land before accepting the first refusal offer if the farmer: (1) is now actively engaged in farming, and (2) agrees to remain actively engaged in farming on part of the first refusal land for at least one year after accepting the first refusal offer.<sup>229</sup>

#### b. The sale is to a family member

A farmer may negotiate to sell first refusal property before accepting the first refusal offer if the sale negotiated is to a member of the farmer’s family.<sup>230</sup> In this case, “family” means the farmer’s spouse, parents, sisters, brothers, children, and the spouse’s sisters and brothers.<sup>231</sup> However, if the property is sold to a member of the family and that family member then sells the property to a third party, a court may define this as a “sham transaction” and rule that the requirement that the sale be to a family member is not met.<sup>232</sup>

226 Minn. Stat. § 500.245, subd. 1(n).

227 Minn. Stat. § 500.245, subd. 1(n).

228 *Kjesbo v. Ricks*, 517 N.W.2d 585 (Minn. 1994).

229 Minn. Stat. §§ 500.24, subds. 2(a), 500.245, subd. 1(n).

230 Minn. Stat. § 500.245, subd. 1(n).

231 Minn. Stat. § 500.245, subd. 1(n); *Schumacher v. Ihrke*, 469 N.W.2d 329 (Minn. Ct. App. 1991).

232 *Kjesbo v. Ricks*, 517 N.W.2d 585 (Minn. 1994); *Schumacher v. Ihrke*, 469 N.W.2d 329 (Minn. Ct. App. 1991).

### L. Wrongful denial of first refusal rights

If the farmer was wrongfully denied first refusal rights, any lawsuit the farmer wishes to file to protect his or her rights must be brought within three years.<sup>233</sup> If fraud is the origin of the lawsuit, meaning there was a representation that was false, the three-year limit does not apply.<sup>234</sup>

## VI. Federal right of first refusal for Farm Credit Services (FCS) borrowers

If the lender is part of the Farm Credit Services (FCS) system, the farmer may also have a separate right of first refusal under federal law. Federal first refusal rights may apply if FCS elects to sell or rent the property. In some cases, the farmer may have more than one chance to exercise first refusal rights. It is possible that the farmer is eligible for first refusal rights under both federal and Minnesota laws. If so, the lender must honor both.<sup>235</sup>

### A. Keeping in contact with FCS

If the farmer is eligible for federal first refusal rights, FCS must send the farmer certain notices regarding the sale and how the farmer may use his or her federal first refusal rights.<sup>236</sup> FCS meets its legal notice requirements if it sends the required notices by certified mail to the farmer's last known address.<sup>237</sup> Farmers who think they may be eligible for first refusal rights should make sure FCS has their proper address.

### B. Eligibility

In order to be eligible for federal first refusal rights, the lender must be part of the Farm Credit Services system, and the farmer must be the previous owner of acquired agricultural real estate.

#### 1. The creditor is FCS

Federal first refusal rights apply if the creditor is part of the Farm Credit Services system.<sup>238</sup> FCS has gone through a number of name changes over the years. If the farmer's old loan papers say Federal Land Bank or PCA, for example, the lender is now FCS.<sup>239</sup> AgStar Financial Services, ACA is also part of FCS.<sup>240</sup> A list of FCS institutions is available on the Internet.<sup>241</sup>

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233 Minn. Stat. § 500.245, subd. 3.

234 Minn. Stat. § 500.245, subd. 3; *Sands v. Production Credit Ass'n*, C9-90-1116 (Minn. Ct. App. 1990) (unpublished) (citing *Davis v. Re-Trac Mfg. Corp.*, 149 N.W.2d 37, 38 (Minn. 1967)).

235 12 U.S.C. § 2219a(h); 12 C.F.R. § 614.4522(g) (2003).

236 12 U.S.C. § 2219a(b)-(d); 12 C.F.R. § 614.4522 (2003).

237 12 U.S.C. § 2219a(g); 12 C.F.R. § 614.4522(f) (2003).

238 12 U.S.C. § 2219a(a); 12 C.F.R. § 614.4522(a)(3) (2003). For an overview of early FCS litigation see James T. Massey, *Farmers Home Administration and Farm Credit System Update*, 73 NEBR. L. REV. 187, 205-10 (1994).

239 For more information about the Farm Credit Services system see <http://www.fca.gov>.

240 See <http://www.agstar.com/about.shtml>.

241 See <http://www.fca.gov/FCS-Institutions.htm>.

A farmer may also have first refusal rights if he or she was not an FCS borrower but owned land that served as collateral for someone who was an FCS borrower, and FCS eventually took the land.<sup>242</sup>

## **2. The farmer is a previous owner of FCS-acquired agricultural real estate**

To be eligible for federal first refusal rights, the farmer must be the previous owner of the agricultural real estate that FCS has acquired.<sup>243</sup> This means FCS now has title to the property and FCS got it as a result of either a loan foreclosure or a voluntary conveyance. If FCS got the land through a voluntary conveyance, for the farmer to be eligible for first refusal rights, FCS must have believed at the time of the conveyance that the farmer did not have the financial resources to avoid foreclosure. Whether or not the farmer had the resources to avoid foreclosure is decided by FCS. When FCS took possession of the land, it should have decided whether or not the farmer had the financial resources to avoid foreclosure and documented its conclusion in its files.

Federal first refusal rights only apply to agricultural real estate. They do not apply to other property such as machinery and crops.

## **3. Changes in the law — 1996**

The Farm Credit System Reform Act of 1996 significantly limited borrowers' federal rights to first refusal.<sup>244</sup> As of February 10, 1996, it is possible that a new FCS loan will not have the borrower rights that are discussed in this section. The change should not affect borrowers who already had loans with FCS before the act became law. Prospective borrowers should receive written notice that they will not have the borrower rights explained below.

### **C. The farmer's right to buy — FCS elects to sell the property**

If a farmer is eligible for federal first refusal rights and FCS elects to sell any part of the acquired property, FCS must, within 15 calendar days of its decision to sell the property, notify the farmer of the right to buy the property.<sup>245</sup>

FCS will give the farmer two choices. The farmer may either offer to purchase the property at the appraised fair market value or offer to buy the property at less than the appraised fair market value.<sup>246</sup>

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<sup>242</sup> 12 C.F.R. § 614.4522(a)(2) (2003).

<sup>243</sup> 12 U.S.C. § 2219a(a); 12 C.F.R. § 614.4522(a)-(b) (2003). Agricultural real estate is not defined for the purposes of federal first refusal rights, although it can include a house.

<sup>244</sup> Pub. L. No. 104-105, 110 Stat. 162 (codified at 12 U.S.C. §§ 2202a(a)(5), 2279aa-9(B)). FCS may limit borrower rights if the loan is designated as one that will be sold into a secondary market.

<sup>245</sup> 12 U.S.C. § 2219a(b)(1); 12 C.F.R. § 614.4522(c) (2003).

<sup>246</sup> 12 U.S.C. § 2219a(b)(1).

### 1. Making a first refusal offer to FCS — 30-day deadline

To buy the property, the farmer must give FCS an offer within 30 calendar days after receiving the notice.<sup>247</sup> If the deadline is missed, first refusal rights are lost.

### 2. Fair market value appraisals

The FCS notices include a listing of the fair market value of the property.<sup>248</sup> The law requires only that this value be set by an accredited appraiser.<sup>249</sup> As long as the appraiser is accredited, the farmer probably will not be able to challenge the accuracy of the appraisal.

### 3. If the offer is for appraised value — FCS *must* sell to the farmer

If FCS gets an offer from the farmer to purchase the property at the appraised value, FCS must accept the offer within 15 calendar days and sell the property to the farmer.<sup>250</sup>

### 4. If the offer is for less than appraised value — FCS *may* sell to the farmer

If FCS gets an offer from the farmer to purchase the property at less than the appraised value, FCS may still accept the offer and sell it to the farmer. FCS must, within 15 calendar days, give the farmer notice of whether it has accepted or rejected the offer.<sup>251</sup>

### 5. If the offer is for less than appraised value and FCS rejects it

If the farmer's offer was for less than the appraised value and FCS rejected the offer, the farmer may still have first refusal rights.<sup>252</sup> FCS must send notice of any other first refusal rights that apply. The farmer has 15 calendar days to make an offer to purchase the property.<sup>253</sup>

The farmer's rights hinge on a comparison between the rejected offer and an offer by a third party to purchase the property from FCS.

#### *a. Third party offers more than the farmer*

If a third party offers to buy the property and the third party's offer is more than the farmer's earlier rejected offer, FCS may accept the third-party offer. The sale may go forward even if FCS accepts less than the appraised value from the third party.

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247 12 U.S.C. § 2219a(b)(2); 12 C.F.R. § 614.4522(c) (2003).

248 12 U.S.C. § 2219a(b)(1); 12 C.F.R. § 614.4522(c) (2003).

249 12 U.S.C. § 2219a(b)(1)(A); 12 C.F.R. § 614.4522(c)(1) (2003). In *K Lazy K Ranch, Inc. v. Farm Credit Bank of Omaha*, 127 B.R. 1014 (Bankr. D.S.D. 1991), the court allowed appraisals by FCS employees.

250 12 U.S.C. § 2219a(b)(3); 12 C.F.R. § 614.4522(c)(2) (2003).

251 12 U.S.C. § 2219a(b)(4); 12 C.F.R. § 614.4522(c)(3) (2003).

252 12 U.S.C. § 2219a(b)(5)(A); 12 C.F.R. § 614.4522(c)(3) (2003).

253 12 U.S.C. § 2219a(b)(5)(B); 12 C.F.R. § 614.4522(c)(3) (2003).

**b. Third party offers same or less than the farmer**

If a third party offers to buy the property for an amount equal to or below the farmer's earlier rejected offer, FCS may not sell the property to the third party without first giving the farmer a chance to match the third-party's offer.

**c. Third party offers different terms than the farmer**

If a third party offers to buy the property and the offer includes different terms and conditions than those which were extended to the farmer, FCS may not sell the property to the third party without first giving the farmer the chance to match the conditions in the third-party's offer.<sup>254</sup>

For this purpose, financing by FCS is not a term or condition of a sale of acquired real estate.<sup>255</sup> Therefore, if FCS offers to sell the property to a third party for a certain price and offers to finance the purchase with a mortgage, FCS is not required to offer the farmer mortgage financing as well.

**6. FCS not required to finance the purchase**

FCS is not required to finance any purchases under the right of first refusal.<sup>256</sup>

**D. The farmer's right to rent — FCS elects to lease the property**

If FCS decides to lease the property, the farmer also has first refusal rights. If the farmer is eligible for federal first refusal rights and FCS elects to lease any part of the acquired property, FCS must notify the farmer of his or her right to lease the property within 15 calendar days of FCS's decision to lease the property.<sup>257</sup>

FCS will give the farmer two choices. The farmer may either offer to lease the property at the appraised fair market lease value or offer to lease the property at less than the appraised fair market lease value.

**1. Fifteen-day deadline**

To lease the property, the farmer must give FCS an offer within 15 calendar days after receiving the notice.<sup>258</sup> If this deadline is missed, first refusal rights are lost.

**2. Fair market value appraisals**

The FCS notice of first refusal lease rights should include a listing of the fair market lease value of the property.<sup>259</sup> The law requires only that this value be set by an accredited

254 Conditions and terms designed to protect the third party in case the farmer contests the sale may provide an exception to this rule. *K Lazy K Ranch, Inc. v. Farm Credit Bank of Omaha*, 127 B.R. 1014 (Bankr. D.S.D. 1991).

255 12 U.S.C. § 2219a(e); 12 C.F.R. § 614.4522(c)(4) (2003).

256 12 U.S.C. § 2219a(f); 12 C.F.R. § 614.4522(c)(4) (2003).

257 12 U.S.C. § 2219a(c)(1)-(5), (d)(3); 12 C.F.R. § 614.4522(d)(1)-(2) (2003).

258 12 U.S.C. § 2219a(c)(6)(B); 12 C.F.R. § 614.4522(d)(3) (2003).

259 12 U.S.C. § 2219a(c)(1)(A); 12 C.F.R. § 614.4522(d)(1) (2003).

appraiser.<sup>260</sup> As long as the appraiser is accredited, the farmer probably will not be able to challenge the accuracy of the appraisal.

### **3. The offer is for appraised value — FCS probably will lease to the farmer**

If FCS gets an offer from the farmer to lease the property at the appraised value, FCS must usually accept the offer within 15 calendar days and lease the property to the farmer.<sup>261</sup> If, however, FCS decides that the farmer does not have the resources available to conduct a successful farming operation or cannot meet all of the payments and terms of the lease, FCS may reject the offer.<sup>262</sup>

### **4. The offer is for less than appraised value — FCS may lease to the farmer**

If FCS gets an offer from the farmer to lease the property at less than the appraised value, FCS may still accept the offer and lease to the farmer.<sup>263</sup> FCS must give notice of whether or not it has accepted the offer within 15 calendar days after it receives the offer.<sup>264</sup>

### **5. If FCS rejects the offer — future rights to lease**

If FCS rejects the farmer's offer to lease the property for less than the appraised value, the farmer still keeps a limited right of first refusal for leasing.<sup>265</sup> FCS must send notice if these rights apply.<sup>266</sup> The farmer has 15 calendar days after receiving the notice to agree to lease the property.<sup>267</sup>

The farmer's rights hinge on a comparison between the farmer's rejected offer and an offer by a third party to lease the property from FCS.

#### *a. Third party offers more than the farmer*

If a third party offers to lease the property for more than the farmer's earlier rejected offer, FCS may accept the third-party offer.<sup>268</sup> The lease may go forward even if FCS accepts less than the appraised value from the third party.

#### *b. Third party offers same or less than the farmer*

If a third party offers to lease the property for an amount equal to or below the farmer's earlier rejected offer, FCS may not lease the property to the third party without first giving the farmer a chance to match the third-party's offer.<sup>269</sup>

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260 12 U.S.C. § 2219a(c)(1)(A); 12 C.F.R. § 614.4522(d)(1) (2003).

261 12 U.S.C. § 2219a(c)(3); 12 C.F.R. § 614.4522(d)(2) (2003).

262 12 U.S.C. § 2219a(c)(3)(A)-(B); 12 C.F.R. § 614.4522(d)(2)(i)-(ii) (2003).

263 12 U.S.C. § 2219a(c)(4); 12 C.F.R. § 614.4522(d)(3) (2003).

264 12 U.S.C. § 2219a(c)(5); 12 C.F.R. § 614.4522(d)(3) (2003).

265 12 U.S.C. § 2219a(c)(6); 12 C.F.R. § 614.4522(d)(3)(i)-(ii) (2003).

266 12 U.S.C. § 2219a(c)(6)(B); 12 C.F.R. § 614.4522(d)(3)(ii) (2003).

267 12 U.S.C. § 2219a(c)(6)(B); 12 C.F.R. § 614.4522(d)(3) (2003).

268 12 U.S.C. § 2219a(c)(6)(A); 12 C.F.R. § 614.4522(d)(3) (2003).

269 12 U.S.C. § 2219a(c)(6)(A)(i); 12 C.F.R. § 614.4522(d)(3)(i) (2003).

*c. Third party offers different terms than the farmer*

If a third party offers to lease the property and the offer includes different terms and conditions than those which were extended to the farmer, FCS may not lease the property to the third party without first giving the farmer the chance to match the conditions in the third-party's offer.<sup>270</sup>

For example, if a farmer offered to pay \$100 an acre to lease the property from FCS and FCS rejected the offer, FCS could accept an offer from someone else to rent the same land for \$110 per acre without offering refusal rights to the farmer again. If, on the other hand, FCS was about to rent the land for \$100 an acre, or \$90 an acre, FCS would first have to give the farmer a chance to rent the land for that amount and match any other conditions in the third-party's offer.

**E. FCS sells or leases at an auction**

A separate federal first refusal right also applies if FCS elects to sell or lease the property through a public auction or some similar competitive bidding process.<sup>271</sup> If this happens, FCS must notify the farmer that the property is available for sale or lease.<sup>272</sup> The notice must list the minimum amount, if any, required to qualify a bid as acceptable to FCS. In addition, the notice must tell the farmer any terms or conditions for the sale or lease.<sup>273</sup>

FCS may not discriminate against the farmer in any way at the auction.<sup>274</sup> If the farmer's bid ties another person's as the highest at the auction, the farmer with first refusal rights wins the bidding.<sup>275</sup>

A farmer's first refusal rights regarding an auction apply in addition to the rest of his or her other federal first refusal rights. This means, for example, that if FCS's first attempt to sell the property is through an auction, the farmer still has the right to buy the property for the appraised value before the auction.<sup>276</sup>

**F. Reselling federal first refusal property**

The farmer is free to sell land if he or she bought the land through the federal right of first refusal.<sup>277</sup>

**VII. Rights of FmHA or FSA borrowers**

Farmers Home Administration (FmHA), now Farm Service Agency (FSA), borrowers may have additional rights.<sup>278</sup>

270 12 U.S.C. § 2219a(c)(6)(A)(ii); 12 C.F.R. § 614.4522(d)(3)(ii) (2003).

271 12 U.S.C. § 2219a(d); 12 C.F.R. § 614.4522(e) (2003).

272 12 U.S.C. § 2219a(d)(1); 12 C.F.R. § 614.4522(e)(1) (2003).

273 12 U.S.C. § 2219a(d)(1); 12 C.F.R. § 614.4522(e)(1) (2003).

274 12 U.S.C. § 2219a(d)(1)(3); 12 C.F.R. § 614.4522(e)(3) (2003).

275 12 U.S.C. § 2219a(d)(2)-(3); 12 C.F.R. § 614.4522(e)(2)-(3) (2003).

276 *Farm Credit Bank of St. Paul v. Halverson (In re Solberg)*, 125 B.R. 1010 (Bankr. D. Minn. 1991); *Leckband v. Naylor*, 715 F. Supp. 1451 (D. Minn. 1988).

277 *Weiner v. Farm Credit Bank of St. Louis*, 759 F. Supp. 510 (E.D. Ark. 1991).

278 See volume 7 of the Code of Federal Regulation, or contact FLAG with specific questions.



## Chapter Four

# Operating and Equipment Loans, Secured Creditors, and Repossession

## I. Introduction

Many farm operating and equipment loans include security agreements. These agreements create what the law calls a security interest in a debtor's property and give the creditor the power to take possession of that property in case of a default. This chapter discusses the creation of security interests, their effect on farm operations, and the rights of creditors to take possession of secured property.

Creditors are interested in gaining a security interest in the debtor's property for two reasons. First, it allows them to take possession of the property if the debtor defaults on the debt without having to seek a judgment lien through the courts, as is required for unsecured debts. Second, if the creditor properly files the right documents, the security interest places the secured creditor ahead of other creditors in getting paid from the proceeds from a sale of the debtor's property.

The security agreements discussed in this chapter are largely covered by Minnesota's version of the Uniform Commercial Code (UCC). In general, the UCC covers debts secured by personal property or fixtures.<sup>1</sup> Personal property generally includes all possessions that are not real estate or buildings. This includes machinery, livestock and stored crops, and crops in the ground. Recently, Minnesota and every other state enacted what is known as Revised Article 9 of the UCC.<sup>2</sup> Revised Article 9 makes significant changes to the rules and procedures for secured

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- 1 Minn. Stat. § 336.9-109. The UCC covers fixtures but otherwise does not cover real estate except to the extent that contract for deed payment accounts are covered. Minn. Stat. §§ 336.9-109, 336.9-334, 336.9-619; see also Larry M. Wertheim, *Revised Article 9 of the U.C.C. and Minnesota Contract for Deeds*, 28 WM. MITCHELL L. REV. 1483 (2002) available at [http://www.wmitchell.edu/current/info/stuorganizations/lawreview/Article\\_Files/Volume\\_28/Issue4/05\\_Wertheim.pdf](http://www.wmitchell.edu/current/info/stuorganizations/lawreview/Article_Files/Volume_28/Issue4/05_Wertheim.pdf). Future payments owed to a debtor may serve as collateral and are known as "accounts." Minn. Stat. § 336.9-102(a)(2).
  - 2 2000 Minn. Laws ch. 399 and 2001 Minn. Laws ch. 195. For an overview of farm related issues under Revised Article 9, see Phillip L. Kunkel and Scott T. Larison, *Security Interests in Personal Property*, UNIVERSITY OF MINNESOTA EXTENSION (Jan. 2002) available at <http://www.extension.umn.edu/distribution/businessmanagement/DF7292.html>; Linda J. Rusch, *Farm Financing Under Revised Article 9*, 73 AM. BANKR. L.J. 211 (1999); Drew Kershen & Alvin C. Harrell, *Agricultural Finance—Comparing the Current and Revised Article 9*, 33 UCC L.J. 169 (2000); Roger A. McEowen and Neil E. Harl, *AGRICULTURAL LAW, Secured Transactions*, ch. 3 (2001); and Julian B. McDonnell, *Farm Financing Under Revised Article 9*, ch. 26 in Peter F. Coogan et al., *SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE* (2002).

transactions. These changes took effect in Minnesota on July 1, 2001, though creditors may have incorporated provisions into earlier security agreements and financing statements that reflect Revised Article 9 changes.

Debts that use real estate as collateral are discussed in Chapter Three, and debts not secured by any collateral are discussed in Chapter Five.<sup>3</sup>

**Debtor** — The person who owes money. This book assumes that the farmer is the debtor.

**Creditor** — The person to whom the debt is owed.

**Collateral** — Debtor's property identified in an agreement that is pledged to the creditor if the debtor does not repay the debt.

## II. Creating secured debt — loan agreements and promissory notes

Although the combination of documents can vary, debtors usually sign two separate agreements for a secured loan: (1) either a loan agreement or a promissory note, which is a promise to pay the amount of the debt; and (2) a security agreement, which grants a security interest in the debtor's property to the creditor. Since they are legally binding contracts, loan agreements, promissory notes, and security agreements should be read with care, and any confusion or questions should be resolved before signing. For more information, see the box beginning on page 105 entitled "Questions farmers should consider when seeking secured credit."

### A. Types of promissory notes

Usually a promissory note will be one of three types: an installment note, an open-ended note, or a demand note.

#### 1. Installment note

An installment note calls for payments of principal and interest that gradually pay off the loan by some set time in the future—usually specified in years or months. Payments under an installment note are usually scheduled at regular intervals.

#### 2. Open-ended note — lines of credit

An open-ended note is used when a loan is in the form of a line of credit. The debtor gets a line of credit of up to a certain amount, and the debtor may use the money as needed for a set period of time.

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<sup>3</sup> If the security agreement covers both real and personal property, the creditor may use the UCC concerning the personal property or may use real estate law for both. Minn. Stat. § 336.9-604.

### 3. Demand note

A demand note allows the creditor to demand repayment at any time.

## B. Terms in loan documents

Loan agreements and promissory notes are contracts between the debtor and the creditor. They include many important terms setting out the rights and responsibilities of both parties, including repayment of the loan, what qualifies as a default, and what action the creditor can take if there is a default.

### 1. Repayment terms

The loan agreement or promissory note should set out the length of the loan, how much each payment is, and what dates payments are due.

### 2. Default

If the debtor defaults on a secured loan, the creditor can take the debtor's collateral. Since the law does not define "default," the security agreement defines what acts—or failures to act—can be considered a default.<sup>4</sup>

### 3. Rate of interest

The loan agreement or promissory note should state the interest rate to be paid. There are legal limits on the amount of interest creditors can charge.<sup>5</sup>

### 4. Acceleration

An acceleration clause in a loan agreement or promissory note is a clause that allows the creditor to "accelerate" the payment schedule and claim the whole loan amount as due if specified events occur. Acceleration clauses are usually triggered by a default on the loan. For example, suppose you borrowed \$20,000 with payments scheduled over four years. If you default after the first payment and your loan is accelerated, the creditor can demand the full \$15,000 (plus any interest) immediately, even though you would otherwise only have had to make the next annual payment. A creditor may only accelerate the loan if the agreement includes an acceleration clause.<sup>6</sup> The secured creditor must accelerate in good faith, meaning that the creditor believes payment on the debt is not likely.<sup>7</sup>

### 5. Fees and expenses in case of default

Loan documents often say that the creditor can collect from the debtor reasonable attorneys' fees, legal expenses, and costs of collection that result from a default.

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4 Minn. Stat. §§ 336.9-601, 336.9-602.

5 For some creditors, if a loan of under \$100,000 is made for an agricultural purpose, the interest may not be more than 4.5 percentage points over the federal discount rate at the time of the loan. Banks and other financial institutions are allowed to charge up to 21.75 percent interest. Appendix A provides a more detailed discussion of interest rate limits.

6 *Sheet Metal Workers Local No. 76 Credit Union v. Hufnagle*, 295 N.W.2d 259 (Minn. 1980).

7 Minn. Stat. § 336.1-208.

## 6. Inspections

Some agreements allow creditors to inspect the collateral during the term of the loan to ensure that it is still providing adequate security for the debt.

### C. Waiving your rights

Many debtor rights are protected automatically by law. It is illegal for a creditor to require a debtor to waive these rights in a contract, loan agreement, or security agreement as a condition of receiving an agricultural loan unless the law specifically makes an exception and allows the debtor to give up those rights.<sup>8</sup>

### D. Co-signers and guarantors

A creditor may want someone besides the borrower—such as a family member—to co-sign or guarantee the loan. If someone does so, he or she can be held responsible for the entire loan amount.

## III. Creating security interests

A debtor granting a security interest to a creditor will probably be asked to sign a security agreement and an effective financing statement in addition to the loan agreement or promissory note. Security interests may also be created through a statutory lien.

### Security interest

A security interest is a legal claim of a creditor allowing the creditor to take possession of the debtor's property or claim proceeds from the sale of the debtor's property if the debtor defaults on the debt. Some security interests are created by law or by order of a court. Most commonly, however, security interests are agreed to by debtors as part of a credit arrangement.

### A. Security agreements

A security interest is a legal claim of a creditor allowing the creditor to take possession of the debtor's property or claim proceeds from the sale of the debtor's property if the debtor defaults on the debt. A security agreement is a contract that gives a creditor a security interest in the debtor's property. Although security interests typically are used to provide assurance of repayment for credit issued at the same time that the security agreement is signed, a security agreement may include language giving the creditor an interest in the debtor's property to secure repayment of credit advances made by the creditor in the future or to secure previous credit extensions that are already outstanding when the security agreement is signed.<sup>9</sup>

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8 Minn. Stat. § 550.42.

9 Minn. Stat. § 336.9-204.

## 1. General requirements of security agreements

In general, security agreements must be in writing, must be signed by the debtor, and must include a description of the collateral.<sup>10</sup>

## 2. Describing the property covered by the security agreement

Creditors have often attempted to use a “supergeneric” description of a debtor’s property in security agreements in order to obtain the maximum amount of collateral. This means that they would use a very general description such as “all assets” or “all the debtor’s personal property.”<sup>11</sup> Under Revised Article 9, a supergeneric description of collateral is permitted in a financing statement<sup>12</sup> but is not permitted in a security agreement.<sup>13</sup> To be enforceable, therefore, the security agreement must reasonably identify the collateral at least by category.<sup>14</sup> For instance, a security agreement giving all of the debtor’s equipment as security is valid.<sup>15</sup>

Since a statutory change in 1999, Minnesota no longer requires creditors seeking a security interest in crops growing or to be grown to include a legal description of the land on which the crops were planted in the security agreement and financing statement.<sup>16</sup> This change allows creditors to gain an interest in all crops grown by a debtor while a security agreement is in effect simply by indicating in the security agreement and financing statement that “crops grown or to be grown” are collateral for the debt.

Although Minnesota no longer requires that land descriptions be included in security agreements, it is still permissible to include those descriptions in security agreements and financing statements to limit the scope of the creditor’s interest. To protect their interests, farmers who do not intend to give a general interest in all crops to a creditor should consider writing in the security agreement a legal description of the land on which the crops that are given as collateral will be grown or another description that excludes certain farm parcels.<sup>17</sup> Farmers might also consider trying to limit the reach of a

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10 Minn. Stat. §§ 336.9-203, 336.1-201(39), (46). Signatures are not needed if the creditor possesses the collateral.

11 Minn. Stat. § 336.9-108(c).

12 Minn. Stat. §§ 336.9-502(b), 336.9-504.

13 Minn. Stat. § 336.9-108(c).

14 Minn. Stat. § 336.9-108.

15 Minn. Stat. § 336.9-108(b)(2).

16 1999 Minn. Laws ch. 105 (codified at Minn. Stat. §§ 336.9-203(b)(3), 336.9-502(b)).

17 For example, Farm Service Agency Form FSA-0440-04A, “Security Agreement (Chattels and Crops)” (June 29, 2001) (hereinafter FSA Security Agreement), uses general language that claims a security interest in all crops growing or to be grown and then states that this collateral includes but is not limited to crops “now planted, to be planted, growing or grown, or harvested on the following described real estate. . . .” Sec. II, Item 1, page 2. Under this language, the real estate description(s) would not limit FSA’s security interest in a specific crop or specifically identify some of the crops in which FSA could claim an interest. To truly limit FSA’s claim on a specific crop or parcel, debtors would need to specifically exclude the land using language such as, “except crops growing or to be grown on farm number XX” or “except crops growing or to be grown on 100 acres located at xxxxx.”

creditor's security interest over future crops by using language that specifies certain crop years or an end date, such as "except crops planted after May 1, 200x."

## B. Financing statements

A financing statement has two main purposes. First, it serves as public notice that the creditor has a security interest in the debtor's property. Second, if two different creditors ever tried to claim the same piece of the debtor's property, the financing statement helps to settle which one gets the collateral.<sup>18</sup>

Usually a financing statement, called a UCC-1, includes the legal names of the debtor and the creditor, the addresses of both parties, a description of the types of collateral, and the debtor's Social Security or Tax ID number.<sup>19</sup> If the property is to become a fixture, the financing statement must include a description of the real estate.<sup>20</sup>

### 1. Debtor's signature no longer required on financing statements

Until July 2001, the debtor would have been required to sign the financing statement.<sup>21</sup> Under Revised Article 9, the debtor's signature is no longer required.<sup>22</sup> A primary motivation for this change was to ease the use of electronically filed financing statements.<sup>23</sup> Even though the debtor's signature is not required, the creditor must still have the debtor's authorization to file the financing statement. In general, anyone who files a financing statement without the debtor's authorization may be liable to the debtor for damages.<sup>24</sup> Debtors should be aware, however, that under Revised Article 9, this authorization is automatic whenever a debtor signs or agrees to become bound by a security agreement.<sup>25</sup> Authorization to file a financing statement may also be included in the language of the security agreement itself, and some creditors may have required debtors to sign security agreements with such language before July 1, 2001.<sup>26</sup>

### 2. New filing system for financing statements as of 2001

Under the Minnesota law in effect until July 1, 2001, creditors would file financing statements in different locations, depending on the type of collateral and the debtor's location

18 Priority among creditors is discussed in Minn. Stat. § 336.9-322.

19 Minn. Stat. §§ 336.9-502, 336.9-504. IRS tax numbers are used if the farm is incorporated. Minor errors that are not seriously misleading do not make the financing statement ineffective. Minn. Stat. § 336.9-506; Minn. R. ch. 8280.

20 Minn. Stat. § 336.9-502(b).

21 2000 Minn. Laws ch. 399, Art. 1, § 73 (effective July 1, 2001) (recodifying Minn. Stat. § 336.9-402(1) (2000)).

22 Minn. Stat. § 336.9-502.

23 Rev. § 9-502, Official Comment 3.

24 Minn. Stat. § 336.9-625(b), (e)(3).

25 Minn. Stat. § 336.9-509(b).

26 See, for example, the FSA Security Agreement, which provides that FSA is "authorized to file financing statements describing the collateral, to file amendments to the financing statements and to file continuation statements." FSA Security Agreement, Sec. III.D. By signing the security agreement, therefore, the debtor gives FSA authority to file financing statements, amendments, and continuation statements without the debtor's signature.

and legal status. Under Revised Article 9, financing statements will, with very few exceptions, be filed with the Secretary of State in the state where the debtor's principal residence is located.<sup>27</sup> If the debtor is a corporation, limited liability company, or limited partnership, the financing statement is filed in the state where the debtor is registered.<sup>28</sup>

Minnesota's filing system for financing statements varies from the uniform version of Revised Article 9, which only provides for one central filing office in each state for almost all types of collateral.<sup>29</sup> In Minnesota, 79 of the 87 county recorder offices are designated satellite offices of the Secretary of State, and it is possible to file financing statements in those satellite offices as well as directly with the Secretary of State.<sup>30</sup> Information from financing statements filed at satellite offices will be automatically added to the Secretary of State's database of financing statements.<sup>31</sup> Therefore, in Minnesota, a financing statement filed with either the Secretary of State's office or an authorized county satellite office will be effective.<sup>32</sup>

### 3. Changing or correcting financing statements

A creditor may change the information in a financing statement by filing an amendment.<sup>33</sup> If a financing statement or an amendment contains incorrect information or was wrongfully filed, the debtor can file a correction statement that will be kept with the financing statement or amendment.<sup>34</sup> The correction statement gives the debtor the opportunity to clarify the record, but the financing statement will remain filed with the Secretary of State's office.<sup>35</sup>

## C. Centralized Filing System — effective financing statements and lien notices

As a part of the 1985 Farm Bill, Congress ordered the creation of a centralized computer filing system for liens on farm products.<sup>36</sup> Before this time, grain dealers who purchased grain from farmers often faced claims from farm creditors who had security interests in the grain. Under the federal Centralized Filing System, a secured creditor protects its interest and puts others on

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27 Minn. Stat. §§ 336.9-301(1), 336.9-307(b)(1).

28 Minn. Stat. § 336.9-307(e).

29 Minn. Stat. § 336.9-501. The exceptions are minerals, timber, and certain fixtures.

30 Minn. Stat. § 336.9-527.

31 Minn. Stat. § 336.9-528.

32 A complete list of Minnesota's 79 county satellite offices is posted at: <http://www.sos.state.mn.us/uccd/CountyFile.html>.

33 Minn. Stat. § 336.9-512.

34 Minn. Stat. § 336.9-518.

35 Minn. Stat. § 336.9-518(c).

36 7 U.S.C. § 1631; Minn. Stat. §§ 336A.04, subd. 5, 336A.08, 336A.11. For a general overview, see Julian B. McDonnell, *The Food Security Act and Its Relationship With Article 9*, ch. 27, in Peter F. Coogan et al., *SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE* (2002). Legislation is expected to be introduced in the 2004 Minnesota legislative session that, if enacted, will amend Minnesota statutes to reflect the changes governing the federal Effective Financing Statement for farm products made by the 2002 Farm Bill. See Farm Security and Rural Investment Act of 2002, Pub. L. No. 107-171, 116 Stat. 134, § 10604 (May 13, 2002).

notice of its claim by filing an "effective financing statement."<sup>37</sup> Persons who hold statutory liens against farmers can do the same by filing a "lien notice."

Farm products, for the purposes of the federal Centralized Filing System, include farm commodities such as corn and soybeans as well as livestock and poultry and unmanufactured crop or animal products, such as milk or eggs.<sup>38</sup>

Effective financing statements and lien notices must include the names and addresses of the debtor and creditor, a description of the property subject to the security interest or lien, the name of the county in which the property is located, and the amount owed.<sup>39</sup> A lien notice must be signed by the lienholder.<sup>40</sup> An effective financing statement must be signed by the debtor and must include the debtor's Social Security Number.<sup>41</sup>

Although the purpose of effective financing statements and lien notices is similar to the purpose of UCC financing statements discussed above, the two forms are different and may not be combined in one document.<sup>42</sup>

#### D. Continuation statements

A security interest lasts as long as the debt is unpaid. A financing statement, however, is usually only valid for five years.<sup>43</sup> After that, the creditor must file a continuation statement.

An effective financing statement also lasts for five years.<sup>44</sup> The creditor can extend it by refileing or filing a continuation statement with the Minnesota Secretary of State's Centralized Filing System.<sup>45</sup>

#### E. Termination statements

A termination statement declares that the creditor's security interest is terminated and the creditor no longer has an interest in the debtor's property. Once the debtor has paid off the debt, the creditor must provide a termination statement.<sup>46</sup> If the creditor does not produce a termination

37 An effective financing statement must be properly filed to be valid. *Monfort, Inc. v. Kunkel*, 182 B.R. 1007 (Bankr. D. Minn. 1995).

38 Minn. Stat. § 336A.01; 7 U.S.C. § 1631(c)(5). To be a farm product, these goods must be in the farmer's possession.

39 Minn. Stat. § 336A.03, subd. 2(a); 7 U.S.C. § 1631(c)(4)(C). If there is a significant change to the information in an effective financing statement or lien notice, the statement or notice must be amended to reflect the change within three months. Minn. Stat. § 336A.01, subd. 4; 7 U.S.C. § 1631(c)(4)(D).

40 Minn. Stat. § 336A.03, subd. 3.

41 Minn. Stat. §§ 336A.03, subd. 3, 336A.03, subd. 2(a)(4). The signature requirement may be changed during the 2004 Minnesota legislative session to allow electronic filing as authorized by the 2002 Farm Bill. See 7 U.S.C. § 1631(c)(4)(A)-(B). An IRS taxpayer number is used if the farmer is a business entity. 7 U.S.C. § 1631(c)(4)(C)(iii).

42 Minn. Stat. § 336A.03, subd. 2(c).

43 Minn. Stat. § 336.9-515. However, a real estate mortgage that also serves as a financing statement for a fixture on the land is valid until a mortgage release or satisfaction is filed.

44 Minn. Stat. §§ 336A.03, subd. 5(a), 336A.06; 7 U.S.C. § 1631(c)(4)(E). The debtor must sign, authorize, or otherwise authenticate that the debtor was aware of the continuation statement.

45 Minn. Stat. § 336A.06; 7 U.S.C. § 1631(c)(4)(E).

46 Minn. Stat. § 336.9-513.



statement at the time the debt is paid in full, the debtor should write the creditor and ask for one. A copy of the termination statement should be filed everywhere the original financing statement was filed. If the creditor fails to file a termination statement, the creditor is liable for any damages caused to the borrower; under Revised Article 9, the borrower may also recover \$500 from the creditor.<sup>47</sup> For effective financing statements under the federal system, the creditor must file a termination statement within 30 days after its security interest is terminated.<sup>48</sup> If the creditor fails to file a termination statement, the creditor is liable for \$100 plus any losses caused to the borrower for the first time there is a failure and \$250 for each subsequent failure to file a termination statement.<sup>49</sup>

## IV. Collateral for secured debts

As discussed earlier, a security agreement must identify at least in general terms the items or categories of property in which the debtor is allowing the creditor to take an interest. This property is then referred to as “collateral” for the debt. It is very important for debtors to understand what items of property are considered collateral for secured loans and what limitations they may face in making use of any property that is collateral.

### A. Types of collateral

In general, a security agreement can use as collateral the debtor’s personal property, such as crops, livestock, machinery, bank accounts, and other property such as future government program payments.<sup>50</sup> Other forms of collateral include the following.

#### 1. Proceeds

If the debtor sells or trades collateral, the creditor’s security interest usually continues or follows in the proceeds from the sale or trade.<sup>51</sup> For example, if you sell crops that are serving as collateral for a loan, the creditor still has a security interest in the money you got from the sale. This is true even if the check from the sale does not have the creditor’s name on it.

Use of proceeds in violation of the security agreement is called conversion, which is discussed below. Debtors should be careful to request written permission from secured creditors if they want to use proceeds from the sale or trade of collateral for anything other than paying the secured debt.

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47 Minn. Stat. § 336.9-625(b), (e)(4).

48 Minn. Stat. § 336A.07.

49 Minn. Stat. § 336A.07, subd. 4.

50 Minn. Stat. § 336.9-109.

51 Minn. Stat. § 336.9-315. The debtor and creditor may agree otherwise. Proceeds are considered whatever is received upon “sale, lease, license, exchange, or other disposition” of collateral. Minn. Stat. § 336.9-315(a)(1).

## 2. After-acquired property

The security agreement may include an “after-acquired property” clause.<sup>52</sup> This gives the creditor a security interest in property acquired by the debtor after the security agreement was signed. For example, if your security agreement gives your creditor a security interest in all farm equipment that you currently own “or will acquire” in the future, that means a tractor you buy the next year will also serve as collateral for the debt secured by that agreement.

## 3. Security in crops

If a security agreement includes crops as collateral, the creditor’s security interest may carry over to future crops.<sup>53</sup> For example, if a secured creditor from last year’s crop was not paid in full, that creditor may have a legal claim to this year’s crop or other future crops even if the creditor provided no financing for those later crops.

## 4. Deposit accounts

Since 2001, creditors have been allowed to take a debtor’s “deposit accounts” as original collateral for non-consumer debts.<sup>54</sup> To know what this change means, it is important to understand two terms: “deposit accounts” and “consumer transactions.” Deposit accounts include checking, savings, and similar accounts and certain certificates of deposit that are held at banks and other financial institutions.<sup>55</sup>

### Deposit account

Deposit accounts are checking, savings, and similar accounts and certain certificates of deposit maintained with a bank or other financial institution.

Consumer transactions involve personal, family, or household debts and property. Farmers’ credit arrangements may qualify as consumer transactions or non-consumer transactions, depending on the primary purpose of the debt and the type of collateral.

52 Minn. Stat. § 336.9-204.

53 Minn. Stat. §§ 336.9-203(b)(3), 336.9-502(b); see also Susan A. Schneider, *Statutory Agricultural Liens Under Revised Article 9 of the Uniform Commercial Code*, NATIONAL AGLAW CENTER PUBLICATIONS (Mar. 2002) at 5, available at <http://www.nationalaglawcenter.org/publications/articles/schneider.pdf>.

54 Minn. Stat. § 336.9-109(d)(13).

55 Minn. Stat. § 336.9-102(a)(29).

For example, if a farmer purchases a lawnmower on credit primarily for use around the family home, this would be a consumer transaction. The same lawnmower purchased on credit but primarily for use in the farming operation would be a non-consumer transaction.<sup>56</sup>

**Consumer transaction**

Consumer transactions are transactions in which: (1) the debt is taken primarily for personal, family, or household purposes; and (2) the collateral is primarily for personal, family, or household use.

A creditor's ability to take deposit accounts as original collateral in non-consumer transactions means that, in case of default, a farmer's creditors can seek payment from sources that in the past were partially protected from creditors. For example, Revised Article 9 provides that if a farmer signs a security agreement in exchange for credit to purchase a tractor and the security agreement includes as collateral both the tractor and the farmer's savings account, upon default the creditor may first attempt to take the funds in the farmer's savings account before going through the hassle of taking possession of the tractor and reselling it in order to satisfy the debt.

*a. Listing checking and savings accounts in security agreements*

If a creditor wants to use deposit accounts as security for repayment of a debt, the security agreement must clearly state that deposit accounts are included as collateral.<sup>57</sup> This will most likely be done in the section of the security agreement that lists or defines collateral for the debt.<sup>58</sup> Although it is possible to name (by type or account number) specific deposit accounts that are being given as security, standard security agreements will likely just state the general category of "deposit

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56 Minn. Stat. § 336.9-102(a)(24). The comments to Revised Article 9 clarify that a credit arrangement secured by more than one type of collateral will be considered a consumer transaction if at least some of the collateral is for household use. See Rev. § 9-102, Official Comment 7.

57 Rev. § 9-109, Official Comment 16; see also, for example, FSA Security Agreement, Sec. II, Item 4, p. 5.

58 Steven O. Weise, *Materials on Revised Article 9* (July 2002), available at <http://www.hewm.com/news/articles/ucc.pdf>.

accounts" and will not specify individual accounts.<sup>59</sup> Using this general language means that funds held in any deposit accounts owned or acquired by the debtor would be available to the creditor as original collateral for the debt. One possible way for farmers to limit creditors' access to their deposit accounts would be to separate their household accounts from their business/farming accounts and to make sure that the security agreement only lists the business/farming deposit accounts and does not use the general category of "deposit accounts" without limitation.<sup>60</sup> This will almost certainly require making changes to the standard security agreement provided by the creditor.

*b. Security interest gives creditors quicker and easier access to debtor's deposit accounts*

It is important to remember that using deposit accounts as original collateral for a loan is not the only way that creditors can gain the right to funds in a debtor's accounts. Therefore, listing specific accounts or even removing deposit accounts from the types of collateral given in a security agreement will not provide absolute protection for the farmer's accounts. As was true under the old Article 9 provisions, creditors can generally claim funds in deposit accounts that are not listed as collateral if the funds are proceeds from the sale of security property (discussed earlier) or if state law otherwise gives the creditor a claim against the account.<sup>61</sup> What is special about the new rule under Revised Article 9 is that creditors can have much easier access to a debtor's deposit accounts and generally need not get a court order to access the funds held in a debtor's accounts.

*c. Creditors seeking to access debtor's deposit account under a security agreement must "control" the account*

Even though the new rule makes it easier for creditors to access a debtor's accounts, there are still some requirements that must be met beyond signing the security agreement if a creditor is to gain access to the funds in the account. Most impor-

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59 See, for example, FSA Security Agreement, Sec. II, Item 4, p. 5 (collateral to be listed in the security agreement includes "[a]ll accounts, *deposit accounts*, goods, supplies, supporting obligations, investment property, certificates of title, payment intangibles, and general intangibles, including, but not limited to the following. . . .") (emphasis added). Although the "including, but not limited to" language in FSA's security agreement appears to clearly state that any specific listing of collateral would not limit FSA's interest in other accounts and rights, the instructions to FSA personnel that accompany the security agreement tell those personnel that the agreement will cover "only those accounts, contract rights and general intangibles which are listed by FSA. If security interest [sic] is to be taken on milk assignments, FSA deficiency payments, etc., and [sic] appropriate detailed description will be inserted." FSA Procedure Notice, Issue No. 119, Forms Manual Insert (FMI) page 2 (July 10, 2001). This conflict between FSA's interpretation of the agreement language for its personnel and the arguably clear language of the agreement itself is likely to cause problems for debtors. In order to ensure that a specific deposit account or other property is *not* given as security under this language, debtors should insist that the agreement explicitly state an exclusion under Item 4, such as "except account number ##### at Community Bank."

60 Bruce A. Markell, *From Property to Contract and Back: An Examination of Deposit Accounts and Revised Article 9*, 74 CHI.-KENT. L. REV. 963, 978 (1999).

61 Minn. Stat. § 336.9-315.

tantly, to have access to funds in a deposit account that is covered by a security agreement, the creditor must also have “control” over the deposit account.<sup>62</sup> Control has a special meaning for this purpose. There are three ways that a creditor can take control of a debtor’s account.

*(1) Creditor is the bank where the deposit account is located*

First, if the creditor is the bank where the deposit account is located, that creditor will have automatic control of the account.<sup>63</sup>

*(2) Creditor’s name is on the deposit account*

Second, a creditor will be considered to have control of a debtor’s account if the creditor’s name is also on the account.<sup>64</sup>

*(3) Creditor, debtor, and bank have entered into a “control agreement”*

The third way that a creditor can take control of a debtor’s account, and probably the most common way that this will occur, is for the debtor, the creditor, and the bank to enter into a “control agreement.”<sup>65</sup> A control agreement is a document that authorizes a bank to follow a secured creditor’s instructions concerning a debtor’s account funds without further approval from the debtor.<sup>66</sup> The control agreement may also restrict when or if the debtor can access any funds from the deposit account without the secured creditor’s prior written consent. This could mean the debtor’s assets are essentially frozen subject to the instructions of the secured creditor. For example, if a control agreement restricts the debtor’s ability to draw funds from the account, any request for payments from the account made by the debtor, such as an automatic payment withdrawal or a check written on the account, may be denied or dishonored by the bank. If this happens, not only will the debtor be unable to make payments, but he or she may also be responsible for charges such as insufficient funds fees.

The bank where the deposit account is located cannot be required to enter a control agreement, even if the debtor as account holder requests it.<sup>67</sup> Debtors, too, are not required by state law to sign a control agreement, though in practice the security agreements farmers sign may require cooperation with respect to obtaining control in the deposit accounts, including requiring them to sign control agreements.<sup>68</sup> For example, the Farm Service Agency’s (FSA)

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62 Minn. Stat. § 336.9-314.

63 Minn. Stat. § 336.9-104(a)(1).

64 Minn. Stat. § 336.9-104(a)(3).

65 Minn. Stat. § 336.9-104(a)(2).

66 Minn. Stat. § 336.9-104(a)(2).

67 Minn. Stat. § 336.9-342.

68 Steven O. Weise, *Materials on Revised Article 9* (July 2002), footnote 33, at 7-8, available at <http://www.hewm.com/news/articles/ucc.pdf>.

Revised Article 9 Security Agreement states that by signing the agreement, the farmer/debtor:

agrees to execute any further documents, including additional security instruments on such real and personal property as [FSA] may require, and to take any further actions reasonably requested by [FSA] to evidence or perfect the security interest granted herein or to effectuate the rights granted to [FSA] herein.<sup>69</sup>

Farmers who fail to follow FSA's instructions under the agreement, including executing documents that FSA needs to perfect its rights, will be considered in default.<sup>70</sup>

A control agreement might require the bank to agree not to sign any other control agreements regarding the debtor's same deposit accounts.<sup>71</sup> If this requirement is included and the bank signs the control agreement, the deposit accounts covered by the agreement would likely not be available as collateral for any other secured creditor, even if the debtor signs multiple security agreements that all include the debtor's deposit accounts as collateral.

Regardless of what provisions are included in the control agreements, farmers should be extremely careful to understand the documents they sign. Control agreements could result in being unable to access one's checking and savings accounts without a creditor's prior written consent, causing bank fee charges, credit rating concerns, and perhaps even greater problems.

## **B. Restrictions on collateral**

Many security agreements restrict what debtors can do with the collateral. For example, the debtor may be prevented by the agreement from selling the property, terminating a current lease, or allowing a lien to attach to the property.

### **1. Restrictions on selling**

Loan documents often say that the debtor must get the creditor's permission before selling collateral. Although creditors do not always enforce this requirement, to avoid future problems, debtors should get written permission for a sale in advance whenever it is required by the loan agreement. Even if the debtor has sold collateral without the se-

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<sup>69</sup> FSA Security Agreement, Sec. III.H.

<sup>70</sup> FSA Security Agreement, Sec. IV.B.

<sup>71</sup> A model control agreement drafted by Edwin O. Smith (a member of the Revised Article 9 Drafting Committee) requires the bank to "represent and warrant to Lender (the secured creditor) that you have not entered, and you covenant with Lender that you will not enter, into any agreement with any other person by which you are obligated to comply with instructions from such other person as to the disposition of funds from the Deposit Account or other dealings with any of the Deposit Account Collateral."

cured creditor's consent in the past and the secured creditor did not object, this does not necessarily mean that the debtor can continue to do so in the future without penalty.<sup>72</sup>

Oral permission to sell collateral—even if the loan agreement requires written permission—should be legally binding on the creditor.<sup>73</sup> To be safe, however, when a debtor gets oral permission to sell collateral, it is wise to follow up with a short letter to the creditor confirming the conversation.

## 2. Reporting requirements

The security agreement may require that the debtor provide the creditor with a list of potential buyers for the collateral. Federal law requires the debtor to follow through on this promise by providing the creditor with the names of potential buyers.<sup>74</sup>

If the debtor wants to sell the collateral to someone not on the list, the debtor must either notify the creditor in writing at least seven days before the sale and name the new buyers or pay the creditor the proceeds from the sale within ten days after the sale.<sup>75</sup>

## C. Conversion

A debtor selling collateral, making changes to collateral, or using proceeds from the sale of collateral in violation of the security agreement may be accused of conversion.<sup>76</sup> Both civil and criminal penalties can follow. The key to avoiding conversion is knowing what is required by the security agreement and following those requirements exactly.

## D. Two-party checks

When selling farm products, a debtor might be paid with a two-party check made out to both the debtor and the creditor. The debtor then cannot use the proceeds without the creditor's consent. This is intended to ensure that the debtor will use the proceeds for payment on the debt to the creditor. Sometimes it is possible to reach an agreement with the creditor to use part of the proceeds for other expenses—such as a mortgage payment or taxes. If so, the debtor should get a written agreement that explains how the proceeds will be used.

The Farm Service Agency (FSA)—must agree to allow debtors to sell certain types of collateral and use the proceeds for essential family living and farm operating expenses if the loan has not been accelerated.<sup>77</sup>

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72 *Wabasso State Bank v. Caldwell Packing Co.*, 251 N.W.2d 321 (Minn. 1976).

73 *Citizens Nat'l Bank of Madelia v. Mankato Implement, Inc.*, 441 N.W.2d 483 (Minn. 1989).

74 7 U.S.C. § 1631(h).

75 7 U.S.C. § 1631(h). Debtors failing to satisfy this requirement can be fined \$5,000 or 15 percent of the value of the property sold, whichever is greater.

76 A hog farmer who had converted sales proceeds that were subject to a security interest was subject to an action for conversion by the creditor. *Meadowland Farmers Coop. v. Behrendt*, C2-00-1753 (Minn. Ct. App. June 5, 2001) (unpublished).

77 7 C.F.R. § 1962.17. (2003). Farmers will be required to update their Farm and Home Plan with FSA to reflect the sale of the collateral and the use of the proceeds.

### E. Debtor efforts to minimize creditor's claims

Sometimes it is tempting for debtors to maximize the farm output that does not fall under a security interest since those proceeds can be used as the debtor chooses. For example, if your creditor's security interest covers only crops grown on certain property, crops you grow on other land might not be covered under your security agreement. Similarly, if you cash-rent land listed on your security agreement, that rent might not be covered by the agreement and you might be free to use that rent as you choose.

These and other similar strategies are often tried to free up funds from security interests. In many cases, these strategies can be perfectly legal. Debtors should keep several things in mind, however.

#### 1. Read the security agreement closely

The security agreement may prohibit some of these strategies. If so, pursuing them might be a default on the debt. For example, many security agreements do not let the debtor rent the land listed in the agreement. As always, it is important to read written agreements closely.

#### 2. Keep unsecured property separate

Care should be taken to keep collateral separate from the debtor's property in which creditors do not have any security interest. For example, if part of the crop from your farm serves as collateral and part of it does not, you should keep the crops and the proceeds separate. Otherwise the creditor might try to claim all of the crop and crop proceeds.

#### 3. Concealing collateral can be a crime

Debtors who—with the intent to defraud a creditor—conceal, remove, or transfer property they know serves as collateral can face stiff criminal penalties.<sup>78</sup>

## V. Default and repossession

If the debtor defaults on a secured loan, the creditor may have the right to take possession of the collateral. This section discusses that process.

### A. Default

There is no special legal definition of default.<sup>79</sup> Instead, debtors are in default when they violate the terms and conditions of their loan agreement, promissory note, or security agreement.<sup>80</sup> If the debtor does something the creditor does not like, therefore, it is probably not a default unless the loan agreement, promissory note, or security agreement specifically prohibit that

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<sup>78</sup> Minn. Stat. § 609.62.

<sup>79</sup> Revised Article 9 contained only minor changes to the default provisions for secured credit. For an analysis of the new default rules, see Donald J. Rapson, *Default and Enforcement of Security Interests Under Revised Article 9*, 74 CHL-KENT. L. REV. 893 (1999).

<sup>80</sup> Minn. Stat. §§ 336.9-601, 336.9-602.



### **Questions farmers should consider when seeking secured credit**

The most important questions farmers need to ask themselves when seeking secured credit are: (1) “Have I *read* the documents I am signing?” and (2) “Do I *understand* them?” It is critical to ask questions if you do not understand what particular language in an agreement means. These documents do more than provide access to credit; they establish legal rights and obligations between the creditor and the farmer/debtor.

Next, ask yourself exactly what *collateral* the creditor is taking for the loan. Creditors often attempt to take as much collateral as they can, listing broad categories of property in a security agreement. The collateral listed in the creditor’s printed security agreement might include property that you intend to use as collateral for a separate loan or that is unrelated to the transaction. The bottom line is to understand that the creditor will have a claim to any property listed as collateral in the security agreement, including property that fits under broad categories of collateral. Try to make sure that the security agreement includes no more collateral than is necessary to obtain the loan. For example, if vehicles are listed as collateral, you may want to only include vehicles that you specifically designate on the security agreement.

If possible, you may want to consult with an attorney experienced in agricultural credit law when considering the following questions:

#### **After-acquired property**

1. Does the security agreement include language such as “property now owned *or hereafter acquired*” when listing types of collateral? This means that the creditor will have a claim on any future purchases of property of the type listed.
2. Will the creditor make the loan if the “or hereafter acquired” language is struck?
3. If the creditor insists on having after-acquired property as collateral, can the types of property interests or property covered by the “or hereafter acquired” language be limited? For example, can the after-acquired property language cover just equipment or machinery but not any other property?
4. If the after-acquired property language cannot be stricken or limited, are you willing to give the creditor a claim on property interests or property that you acquire between the time the loan is made and when the loan is paid in full?

#### **Deposit accounts**

1. Does the security agreement list “deposit accounts” as a category of collateral for the loan? This means checking and savings accounts and some certificates of deposit (CDs).
2. Will the creditor make the loan if deposit accounts are not given as collateral?
3. If the creditor insists on having deposit accounts as collateral, can the accounts covered by the security agreement be limited? For example, can the security agreement list only specific, farm-related accounts as collateral and specifically exclude others, such as “except account #99999 at local Bank” or “except all deposit accounts at local Bank”?

4. If the deposit accounts category cannot be stricken or limited, are you willing to give the creditor a claim on and possible control over all checking and savings accounts in your name until the loan is paid in full?
5. Does the security agreement include language requiring you to sign a control agreement with the creditor and the bank where your accounts are located? For example, language such as, "Debtor agrees to execute any further documents reasonably requested by the creditor to perfect its security interest."

### Accounts

1. Does the security agreement list "accounts" as a category of collateral for the loan? This can mean the right to receive contract-for-deed payments, government farm program payments, disaster assistance payments, payments under some crop or livestock production contracts, and other types of income.
2. Will the creditor make the loan if your accounts are not given as collateral?
3. If the creditor insists on having accounts as collateral, can the accounts covered by the security agreement be limited? For example, can the security agreement list only specific types of government farm program payments as collateral and specifically exclude others, such as "including only Conservation Reserve Program payments" or "except Loan Deficiency Payments"?
4. If the accounts category cannot be stricken or limited, are you willing to give the creditor a claim on possibly all your contract-for-deed, production contract, and government payments until the loan is paid in full?

### Crops

1. Does the security agreement use language such as "to be planted" or "to be grown," indicating that future crops will be taken as collateral for the loan? Does the security agreement use general language covering all of your crops?
2. Will the creditor make the loan if the language covering future crops is struck? Will the creditor make the loan if only certain crops are covered, using land descriptions to identify particular parcels?
3. If the creditor insists on having future crops as collateral, can the security interest in future crops be limited, either by parcel, by crop year, or both? For example, can the security agreement include language such as "except crops growing or to be grown on [give land description here]" or "including only crops planted before July 1, 2005"?
4. If the language indicating future crops cannot be stricken or limited, are you willing to give the creditor a claim on all crops that you grow until the loan is paid in full? If the language covering all current crops cannot be limited, are you willing to give the creditor a security interest in all of your crops on all property?

**CAUTION:** Watch for "*including, but not limited to*" language before any list of collateral in a security agreement. This language means that any specified list of collateral would be considered examples, but the agreement would cover the entire category of collateral given. If you think a specific list is the *only* collateral you are giving, be sure that the agreement really says this.

action.<sup>81</sup> Default is most commonly caused by failure to make loan payments, but any violation of the loan agreement, promissory note, or security agreement could create a default.

## **B. Debtor rights and creditor options after default**

Before taking any action on the debt, the creditor may be required to serve the debtor with a farmer-lender mediation notice.<sup>82</sup> See Chapter Seven for a detailed discussion of the mediation process. Farm Credit Services (FCS) borrowers are also entitled to receive a notice of debt restructuring before a collection action begins.<sup>83</sup> And FSA borrowers should receive a notice of debt restructuring rights.<sup>84</sup>

When debtors default on their security agreements, creditors have several different options.

### **1. Do nothing or work out an agreement**

A creditor can wait long past the time of default before trying to collect. For example, if the collateral is growing crops, the creditor might hold off until the crops are harvested before trying to enforce the debt.

The creditor also may consider an arrangement with other creditors to extend or rearrange payments. Some creditors may be especially willing to try this if they will get more under a modified agreement than they would get if the debtor filed a bankruptcy petition.

### **2. Sue for the amount owed**

The creditor may attempt to collect by filing a lawsuit for the amount owed.<sup>85</sup> Creditors are more likely to try this tactic if seizing and selling the collateral will not bring enough proceeds to cover the debt and the debtor has other assets available that could be targeted in a court action for a judgment lien. Such lawsuits are discussed in Chapter Five.

### **3. Accelerate the debt**

Sometimes the secured creditor accelerates a loan in default. As discussed earlier, for a creditor to have this power, the loan agreement, promissory note, or security agreement must include an acceleration clause, and the creditors must accelerate in good faith, meaning that the creditor believes payment on the debt is not likely.<sup>86</sup>

### **4. Take possession of the collateral**

Unless the security agreement says otherwise, a creditor may take possession of the collateral if there is a default.<sup>87</sup> In some cases, the creditor may take the collateral without

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81 Minn. Stat. § 336.9-601. Creditors are able to demand that debtors follow security agreements strictly. *Brown v. Weeres Indus., Inc.*, 375 N.W.2d 64 (Minn. Ct. App. 1985).

82 Minn. Stat. § 336.9-601(h)-(i).

83 Minn. Stat. § 336.9-601(h)-(i).

84 7 C.F.R. pt. 1951, Exhibit A to subp. S. (2003).

85 Minn. Stat. § 336.9-601(a)(1).

86 Minn. Stat. § 336.1-208; *Sheet Metal Workers Local No. 76 v. Hufnagle*, 295 N.W.2d 259 (Minn. 1980).

87 Minn. Stat. § 336.9-609.

getting permission from a court. Creditors may not seize just any of the debtor's property; it must be the identified collateral for the loan. Debtors have other rights, which are discussed below.

### C. How creditors take possession of collateral

There are three basic ways for creditors to repossess collateral: voluntary liquidation, creditor self-help repossession, and court-ordered repossession.

#### 1. Voluntary liquidation

The creditor may want to make an agreement in which the debtor voluntarily turns the property over to the creditor. It can be difficult for a debtor to decide whether it makes sense to turn property over voluntarily. Although every farmer's situation will be different, some of the following factors might be worth considering.

*a. Is sale of the collateral inevitable?*

Voluntary liquidation may be sensible if the debtor agrees that he or she owes the full amount and concludes that the liquidation of the collateral is inevitable. If there is a chance to avoid the sale of the collateral altogether, the situation may be different.

*b. Voluntary liquidation may be cheaper*

The creditor's costs of taking possession of collateral—including storage, sales preparation, labor, trucking, repairs, advertising, auctioneering, clerking, and legal expenses—are added to the debt. A debtor might choose to voluntarily give up the collateral in order to avoid being charged these costs.

*c. Liquidation may create another default*

A liquidation—whether voluntary or not—could put the debtor in default with another creditor who also has a security interest in that property.

*d. Will the whole debt be forgiven?*

If the collateral's value does not cover the entire amount owed, the creditor could seize the property and still continue legal action against the debtor on the remaining debt. Creditors are sometimes willing to negotiate this point. In return for a voluntary liquidation of collateral, the creditor may forgive the remaining debt. Debtors should be sure to get any agreement like this in writing.

*e. Bankruptcy is an option — and a negotiating point*

Minnesota farmers in bankruptcy can often protect several thousand dollars worth of farm machinery from a creditor and possibly still continue to farm.<sup>88</sup> This can encourage the creditor to negotiate good terms with the debtor in exchange for a voluntary liquidation of collateral. The possibility of a bankruptcy can work both

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88 11 U.S.C. § 522(d)(1)-(6); Minn. Stat. § 550.37, subds. 4a(a), 5.

ways, however. A creditor fearing bankruptcy might try to take the property all the more quickly. Bankruptcy is discussed in more detail in Chapter Eight.

## 2. Self-help repossession

If there is a default, a secured creditor may simply take possession of the collateral.<sup>89</sup> There are significant limits on this power of “self-help repossession.”<sup>90</sup>

### a. Creditor may not “breach the peace”

In a self-help repossession, creditors may not breach the peace.<sup>91</sup> A breach of the peace is not defined in the statute. Minnesota courts, however, tend to be quite strict with creditors in this regard.<sup>92</sup> Creditors taking possession of collateral in a public place or from a driveway probably will not be considered to have breached the peace.<sup>93</sup> To the extent that a creditor uses physical force, makes threats, trespasses, breaks locks, or enters buildings, however, the action begins to look more like a breach of the peace.<sup>94</sup>

If the debtor tells the creditor not to take the property, the creditor must give up self-help repossession.<sup>95</sup> For example, if you send a creditor a letter—by certified mail, return receipt requested—saying that the creditor does not have permission to self-help repossession, this might prevent the creditor from taking possession, at least for the time being. A copy of the letter should be kept in your records. If the security agreement grants the creditor self-help repossession rights, the letter is sufficient to revoke this consent.<sup>96</sup>

### b. Creditor must give notice of strict enforcement if it accepted late payments in the past

If a creditor falls into a pattern of accepting late payments from the debtor, the creditor cannot suddenly take possession of collateral upon default without letting the debtor know that the security agreement will now be enforced strictly.<sup>97</sup>

## 3. Court-ordered assistance — replevin and claim and delivery

If creditors do not use self-help repossession, they may instead seek a court order allowing them to take possession of the collateral. To do so, creditors file a special kind of law-

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89 Minn. Stat. § 336.9-609(a).

90 *Steichen v. First Bank Grand*, 372 N.W.2d 768 (Minn. Ct. App. 1985).

91 Minn. Stat. § 336.9-609(b)(2). Parties are not allowed to alter by contractual agreement the creditor’s duty to not breach the peace. Minn. Stat. § 336.9-603(b).

92 *Bloomquist v. First Nat’l Bank of Elk River*, 378 N.W.2d 81 (Minn. Ct. App. 1985).

93 *James v. Ford Motor Credit Co.*, 842 F. Supp. 1202, 1208 (D. Minn. 1994).

94 *Clarín v. Norwest Bank*, No. 97-2003 (D. Minn. March 8, 1999) (unpublished); *Akerlund v. TCF Nat’l Bank*, No. 99-1537 (D. Minn. June 11, 2001) (unpublished).

95 *James v. Ford Motor Credit Co.*, 842 F. Supp. 1202 (D. Minn. 1994); *Bloomquist v. First Nat’l Bank of Elk River*, 378 N.W.2d 81 (Minn. Ct. App. 1985).

96 *Bloomquist v. First Nat’l Bank of Elk River*, 378 N.W.2d 81 (Minn. Ct. App. 1985).

97 *Cobb v. Midwest Recovery Bureau Co.*, 295 N.W.2d 232 (Minn. 1980); *Robinson v. Mack Trucks, Inc.*, 426 N.W.2d 220 (Minn. Ct. App. 1988).

suit that does not involve a full trial.<sup>98</sup> Two steps are involved. First, in a replevin action, the creditor gets the court to agree that the creditor probably has the right to the collateral. Second, in a claim and delivery action, the court gives the creditor permission to take the property.<sup>99</sup>

*a. Summons and complaint*

Creditors start the lawsuit by delivering a summons and complaint to the debtor and by filing the complaint with the court.<sup>100</sup> The debtor has 20 days from the day the summons is received to file an answer with the court.<sup>101</sup> Although debtors are allowed to represent themselves in a replevin action, to be most effective, debtors probably need the help of a lawyer to determine how best to answer the complaint.

To get a court order for possession of collateral, the creditor asks the court for permission to take the property.<sup>102</sup> In some circumstances, a court will issue an order without any notice to the debtor. Usually, however, courts do not issue an order until after the debtor has received notice and a hearing has been held.<sup>103</sup>

*b. Creditor notice*

In the vast majority of replevin actions, the debtor receives a notice explaining what the creditor is trying to do, and the court then holds a hearing that the debtor may attend.<sup>104</sup>

If a hearing is to be held, the creditor will serve the debtor with notice of the date, time, and place of the court's hearing and will include with it legal papers explaining why the creditor thinks it should be able to take the property.<sup>105</sup>

*c. The hearing*

The replevin hearing will not be a full trial. Instead, both sides briefly argue their points, and the court will make a decision based mainly on whether the creditor would be likely to win the case in a full trial.<sup>106</sup> Unless the debtor has a very strong argument—for example, that the security agreement is not legally valid, or that the debtor is not really in default—courts tend to find that the creditor would be likely to win in a full trial and award the creditor the right to take the property immediately.

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98 The lawsuit probably will be filed in either district or county court, although it could be in conciliation court or federal court. Minn. Stat. §§ 487.15, 487.23, subd. 8.

99 Minn. Stat. § 565.23.

100 Minn. Stat. § 565.23, subds. 1, 2.

101 Minn. R. Civ. P. 12.01.

102 Minn. Stat. §§ 565.23, 565.24.

103 Minn. Stat. § 565.23, subd. 3.

104 Minn. Stat. § 565.23, subd. 2.

105 Minn. Stat. § 565.23, subd. 2.

106 Minn. Stat. § 565.23, subd. 3.

In a few cases, even if the court is convinced that the creditor would probably win in a full trial, the court lets the debtor keep the property, at least temporarily.<sup>107</sup> If this happens, the court might order the debtor to make a partial payment into escrow or post a bond.<sup>108</sup>

Usually, if debtors want to keep the property until a full trial is held to resolve the issue, they must post a large bond.<sup>109</sup> A narrow exception allows some debtors to keep or get back the property for up to six months without a bond if they depend on the property to make a living.<sup>110</sup>

*d. Replevin actions without prior notice*

In certain situations, it is possible for a court to allow a creditor to take the collateral prior to a replevin hearing.<sup>111</sup> A court will only allow pre-hearing seizure of collateral if the creditor can show the court that: (1) the creditor is likely to be awarded possession at the hearing; (2) the creditor cannot contact the debtor or the creditor has reason to fear that if the debtor knew about the hearing, the debtor would wrongfully keep the creditor from taking the property; and (3) the creditor will suffer irreparable harm if it cannot take the property before the hearing.<sup>112</sup> As long as the creditor can find the debtor with reasonable effort, a court will only allow pre-hearing seizure of collateral when the court believes the debtor is about to destroy, hide, or secretly sell the property or act in a similarly fraudulent way.<sup>113</sup> The Minnesota Supreme Court has held that a creditor may only seek pre-hearing seizure of collateral if the creditor has first commenced an action against the debtor for recovery of the debt.<sup>114</sup> The Supreme Court of the United States has also warned that replevin actions without prior notice can violate the debtor's constitutional right to due process.<sup>115</sup>

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107 Minn. Stat. § 565.23, subd. 3. Debtors can keep the property, at least temporarily, if they can show that: (1) they have a reasonable defense to the creditor's claims that needs to be sorted out in a full lawsuit; (2) even if the creditor posts a bond to protect the value of the property, this will not be enough to protect the debtor; and (3) the harm suffered by the debtor if the property is taken would be substantially worse than the harm suffered by the creditor if the property is not taken.

108 Minn. Stat. § 565.23, subd. 4.

109 Minn. Stat. §§ 565.23, subd. 5, 565.25, subd. 2; *Westbrook State Bank v. Aetna Casualty & Surety Co.*, 437 N.W.2d 738 (Minn. Ct. App. 1989).

110 Minn. Stat. §§ 565.25, 565.251, 565.23, subd. 4; *Bio-Line, Inc. v. Wilfey*, 366 N.W.2d 662 (Minn. Ct. App. 1985). To keep the property under this exception, debtors must be unable to make required payments because of unforeseen economic circumstances beyond their control, must insure the property, and must make periodic payments to the creditor. Otherwise, the bond will be either 1.25 times the fair market value of the property or 1.5 times the value of the creditor's claim, whichever is less.

111 Minn. Stat. § 565.24, subd. 2.

112 Minn. Stat. § 565.24, subd. 2.

113 Minn. Stat. § 565.24, subd. 2.

114 *First Nat'l Bank of Deerwood v. Gregg*, 556 N.W.2d 214 (Minn. 1996). That is, the court held that Minn. Stat. § 565.24, subd. 2, allows for claim and delivery prior to notice and hearing of the *motion* for claim and delivery, but it does not allow claim and delivery prior to notice and hearing of the underlying action.

115 *Fuentes v. Shevin*, 407 U.S. 67 (1972).

*e. If the creditor wins possession at the hearing*

If the court decides that the creditor should get possession of the property, the court will order the sheriff to seize the property and give it to the creditor and may order the debtor to turn over the property or reveal where the property is located.<sup>116</sup> The court's order will state specifically what property may be taken by the sheriff.<sup>117</sup> Any other property taken must be returned right away. The court may give the sheriff the power to break into a building to get the property.<sup>118</sup>

## **VI. After repossession — what happens to the property**

Once creditors get possession of collateral, they either dispose of it and apply the proceeds to the amount the debtor owes, or they keep it to satisfy all or part of the debt.<sup>119</sup> If the collateral is sold and the proceeds do not cover the debt, the creditor may try to get a deficiency judgment from the debtor.<sup>120</sup> If the debtor keeps the property, a partial deficiency judgment may be allowed if certain procedures are followed.<sup>121</sup>

### **A. Creditor sells the property**

In many cases, creditors sell collateral taken after default.<sup>122</sup> If so, the creditor must protect and preserve the property before the sale and must sell it in a commercially reasonable way.<sup>123</sup>

#### **1. Auction — public sale**

Many creditors selling collateral do so in an auction. The bidding must be open to anyone.<sup>124</sup> This includes the creditor.

#### **2. Private sale**

The creditor may sell the property privately, without competitive bidding, but must still make a reasonable effort to get the highest price.<sup>125</sup> Creditors may buy the property

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116 Minn. Stat. §§ 565.25, 565.26.

117 Minn. Stat. § 565.26, subd. 1(a).

118 Minn. Stat. § 565.26, subd. 2.

119 Minn. Stat. §§ 336.9-610, 336.9-620, 336.9-621, 336.9-624.

120 Minn. Stat. §§ 336.9-608, 325G.22.

121 Minn. Stat. §§ 336.9-620, 336.9-621.

122 Minn. Stat. §§ 336.9-207, 336.9-601, 336.9-610, 336.9-611, 336.9-615.

123 Minn. Stat. § 336.9-610(b).

124 Minn. Stat. §§ 336.9-610(c)(1), 336.9-613(1)(E). According to the Revised Article 9 Official Comments, "a 'public disposition' is one at which the price is determined after the public has had a meaningful opportunity for competitive bidding." Rev. § 9-610, Official Comment 7.

125 Minn. Stat. § 336.9-610(c)(2).



themselves if the collateral is customarily sold in a recognized market or is subject to widely distributed price quotations.<sup>126</sup>

### 3. Notice to the debtor and other secured creditors

The creditor generally must send the debtor and any secured creditor that has a financing statement on file a notice explaining the time and place of any auction.<sup>127</sup> If the creditor uses a private sale, the notice must include the date after which the property will be sold.<sup>128</sup> For non-consumer transactions, notice must be sent ten calendar days or more before the sale so the debtor can pay the debt, find a friendly buyer, or bid on the property.<sup>129</sup>

### 4. Commercially reasonable sales

A sale or lease of the collateral—whether through an auction or a private sale—must be commercially reasonable in every aspect, including the method, manner, time, place, and terms of the sale.<sup>130</sup>

#### a. Burden of proof is on the creditor

It is up to the creditor to prove, if challenged, that the sale was done in accordance with Minnesota law, thereby creating a presumption that the sale was commercially reasonable.<sup>131</sup> If the creditor fails to do this—for example, because it did not give proper notice to the debtor—a court will assume that the sale would have brought at least as much as the debtor owes.<sup>132</sup> If the creditor fails to overcome this assumption in court, the creditor loses the chance for a deficiency judgment and may owe the debtor damages.<sup>133</sup>

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126 Minn. Stat. § 336.9-610(c)(2). A “recognized market” is defined in the Revised Article 9 Official Comments as “one in which the items sold are fungible and prices are not subject to individual negotiation. For example, the New York Stock Exchange is a recognized market. A market in which prices are individually negotiated or the items are not fungible is not a recognized market, even if the items are the subject of widely disseminated price guides or are disposed of through dealer auctions.” Rev. § 9-610, Official Comment 9.

127 Minn. Stat. §§ 336.9-611, 336.9-613; *Chemlease Worldwide, Inc. v. Brace, Inc.*, 338 N.W.2d 428 (Minn. 1983). Debtors signing a default statement waiving this right will not get a notice. Minn. Stat. § 336.9-624(a). There may be no notice if the property is perishable, may lose value quickly, or is customarily sold on a recognized market. Minn. Stat. § 336.9-611(d).

128 Minn. Stat. §§ 336.9-611, 336.9-613.

129 Minn. Stat. §§ 336.9-612(b), 336.9-627.

130 Minn. Stat. § 336.9-610(b). The right to a commercially reasonable sale may not be waived by the debtor. Minn. Stat. § 336.9-602(7). Under Revised Article 9, parties may determine by agreement how the commercially reasonable standards are to be measured, and this agreement will be upheld if the standards are not manifestly unreasonable. Minn. Stat. § 336.9-603(a).

131 *Chemlease Worldwide, Inc. v. Brace*, 338 N.W.2d 428 (Minn. 1983); *Ford Motor Credit Co. v. Hertzberg*, 511 N.W.2d 25 (Minn. Ct. App. 1994); *Karlstad State Bank v. Fritsche*, 374 N.W.2d 177 (Minn. Ct. App. 1985).

132 *Chemlease Worldwide, Inc. v. Brace*, 338 N.W.2d 428 (Minn. 1983).

133 Minn. Stat. §§ 336.9-625, 336.9-627; *Total Equip. Leasing v. LaRue Inv. Corp.*, 357 N.W.2d 347 (Minn. Ct. App. 1984). The debtor’s right to damages may not be waived. Minn. Stat. § 336.9-602(13). Somewhat different rules apply for consumer goods.

*b. Low price does not always make the sale unreasonable*

The fact that the collateral could have brought a better price with a different sale method, or with a sale at a different time, does not necessarily mean that the sale is commercially unreasonable.<sup>134</sup>

*c. If there is a recognized market for the property*

If a recognized market exists for the collateral—for example, corn has a recognized market—and the creditor sells the property in the usual manner in that market or sells the property somewhere else for the same price that the property would have brought in that market, the price aspect of the sale is commercially reasonable.<sup>135</sup>

*d. If there is no recognized market for the property*

If there is not a recognized market for the collateral, the creditor must sell the property using the reasonable commercial practices that dealers of that type of property use.<sup>136</sup>

## 5. Proceeds from the sale of the property — surplus and deficiency

Proceeds from the sale of the property go first to the reasonable expenses of taking possession of the property and selling or leasing it.<sup>137</sup> This may include reasonable attorneys' fees and legal expenses if they are provided for in the security agreement.<sup>138</sup> The rest of the proceeds go to pay the debt owed to the creditor who took the property, and then, upon a written demand by other creditors, any excess is paid to other creditors who had a security interest in the property.<sup>139</sup> The debtor gets any remaining money.<sup>140</sup>

If the proceeds do not cover the amount the debtor owes the creditor, the creditor may try to get the balance from the debtor through a deficiency judgment.<sup>141</sup> To get a deficiency, the creditor has the burden of proof to show that the sale of the collateral was commercially reasonable.<sup>142</sup>

134 Minn. Stat. § 336.9-627(a); *Fedders Corp. v. Taylor*, 473 F. Supp. 961 (D. Minn. 1979); *Citizen's Nat'l Bank of Willmar v. Taylor*, 368 N.W.2d 913 (Minn. 1985).

135 Minn. Stat. § 336.9-627(b).

136 Minn. Stat. § 336.9-627(b)(3); *Piper Acceptance Corp. v. Yarbrough*, 702 F.2d 733 (8th Cir. 1983). The Supreme Court of North Dakota concluded that there is not a recognized market for either livestock or farm machinery. *State Bank of Tomner v. Hausen*, 302 N.W.2d 760 (N.D. 1981).

137 Minn. Stat. §§ 336.9-608, 336.9-615.

138 Minn. Stat. § 336.9-615(a)(1).

139 Minn. Stat. § 336.9-615(a)(3).

140 The right to a surplus may not be waived. Minn. Stat. § 336.9-608(a).

141 Minn. Stat. § 336.9-608; *Fedders Corp. v. Taylor*, 473 F. Supp. 961 (D. Minn. 1979).

142 Minn. Stat. §§ 336.9-608(a)(3), 336.9-627.

## B. Creditor decides to keep the property

A creditor sometimes decides to keep collateral in satisfaction of all or part of the debt.<sup>143</sup> Prior to doing so, the creditor must send a notice to the debtor explaining this decision.<sup>144</sup> Additional notices must be sent to guarantors who are liable for any of the debtor's debt and any other secured creditor who has filed a financing statement.<sup>145</sup> The debtor may object—and force the creditor to dispose of the property—by sending a written notice to the creditor within 20 calendar days after the creditor mailed the debtor's notice.<sup>146</sup> Guarantors and other secured parties also must object within 20 calendar days after the creditor mailed a notice to those parties.<sup>147</sup> Creditors receiving a debtor's objection must then dispose of the property using commercially reasonable means, as described above.<sup>148</sup> If the debtor does not object, the creditor can keep the property.

Under Revised Article 9, secured creditors keeping collateral may seek a deficiency judgment against the debtor if the debtor receives from the creditor a written proposal that the creditor will accept the collateral in partial satisfaction of the debt, and then the debtor consents to the proposed partial satisfaction.<sup>149</sup> Guarantors and other secured creditors who have filed financing statements must also consent to the creditor keeping the collateral as partial satisfaction of the debt.<sup>150</sup>

## VII. Debtor redemption rights

Debtors have the right to get their property back from a secured creditor by redemption up until the time when the creditor disposes of the property, has contracted to dispose of it, or has gained the right to keep the property by sending the debtor the proper notice described above.<sup>151</sup> Debtor redemption rights may only be waived in writing and may not be waived until after the default.<sup>152</sup>

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143 Minn. Stat. §§ 336.9-620, 336.9-622. Revised Article 9 allows for partial satisfaction of the debt, while prior Minnesota law provided that the creditor could propose to keep the collateral only for full satisfaction of the debt. Debtor rights related to a creditor keeping collateral in satisfaction of the debt may not be waived. Minn. Stat. § 336.9-602(10). Different rules apply if the property is a consumer good. See Minn. Stat. §§ 336.9-620(g), 325G.21, 325G.22.

144 Minn. Stat. §§ 336.9-620, 336.9-102(66). A proposal to a debtor need not take any particular form, as long as it sets out the terms under which the secured party is willing to accept collateral in satisfaction of the debt. Rev. § 9-620, Official Comment 4.

145 Minn. Stat. § 336.9-621(a).

146 Minn. Stat. § 336.9-620(c)(2)(C).

147 Minn. Stat. § 336.9-620(d)(1). Other parties who were not entitled to receive notification must object within 20 days after the last notification was sent to guarantors and other secured parties or if notification was not sent before the debtor consents to the acceptance. Minn. Stat. § 336.9-620(d)(2); Rev. § 9-620, Official Comment 8.

148 Minn. Stat. §§ 336.9-620, 336.9-610, 336.9-627.

149 Minn. Stat. § 336.9-620(c).

150 Minn. Stat. § 336.9-621(b).

151 Minn. Stat. § 336.9-623.

152 Minn. Stat. § 336.9-624(c).

To redeem property, debtors pay the creditor: (1) the amount owed on the debt; (2) the creditor's expenses for seizing and storing the collateral; and (3) if the security agreement provides for them, the creditor's attorneys' fees and legal expenses.<sup>153</sup>

### VIII. Getting new credit

Once much of a farmer's property serves as collateral, it can be harder to get operating credit.<sup>154</sup> The key in the mind of potential creditors is priority. Unsecured creditors know that under the UCC priority rules, a secured creditor will generally be paid first if the debtor defaults. This section discusses some ways that debtors can help new creditors jump ahead in the line of priority. Three possible methods are to: (1) seek a subordination from a present creditor, (2) use the UCC priority rules that favor some new creditors, or (3) use statutory liens—such as landlords' liens—that can automatically place a new creditor in a high priority. There are advantages, disadvantages, and technical rules about using these devices. The following discussion explains some of the basics.

#### Getting new credit

In order to get new credit, farmers with existing security agreements may try using:

1. Subordination agreements.
2. UCC creditor priority rules.
  - a. Purchase-money security interests.
  - b. Purchase-money security interests for livestock purchases.
  - c. Standard UCC security interests.
3. Statutory liens.

#### A. Subordination agreements

In a subordination agreement, a current creditor voluntarily allows another creditor to move ahead in priority. Since subordination agreements are voluntary, debtors often need to convince creditors that it is in the best interests of everyone involved to grant the subordination. For example, a bank with a first priority claim on a crop might be willing to subordinate its interest to an input supplier, especially if the new loan amount is relatively small and the input is essential to getting the crop in. Subordination agreements should always be in writing. If the creditor is FSA, in many cases the debtor will be entitled to a subordination if certain conditions are met.<sup>155</sup>

153 Minn. Stat. § 336.9-623(b)(2).

154 The Minnesota Attorney General's Office has a publication entitled *The Credit Handbook*, which discusses how to use credit. The handbook is available by calling the Minnesota Attorney General's Office at 1-800-657-3787 or on the Internet at <http://www.ag.state.mn.us/consumer/finance/CreditHnbk/>.

155 7 C.F.R. § 1965.12 (2003); 7 C.F.R. § 1962.30. (2003).

## B. UCC creditor priority rules

The UCC creditor priority rules that cause problems for debtors seeking new credit can themselves be useful for debtors seeking new credit. Usually, priority among creditors is based on timing: the first creditor to gain a security interest in the collateral and to properly file the documents gets first priority in the collateral.<sup>156</sup> UCC rules can sometimes be used to move creditors up the priority list and help get farmers new credit. These include: purchase-money security interests, agricultural input liens, and standard security agreements.

### 1. Purchase-money security interests

A purchase-money credit arrangement exists when a creditor loans a debtor money to purchase personal property and that personal property is used as collateral for repayment of the loan.<sup>157</sup> A security interest held by a purchase-money creditor is a purchase-money interest, which gives the creditor first priority in the acquired personal property, even if other creditors have already filed valid financing statements giving them an interest in the debtor's property.<sup>158</sup> For example, even if a bank has a valid security agreement that claims all of your machinery as collateral, including machinery acquired in the future, if the machinery dealer sells you a new tractor on credit, the dealer can usually get the top priority claim in that particular tractor.

Revised Article 9 includes language that is intended to preserve the priority status of purchase-money security interests for non-consumer transactions even if the debt is refinanced or cross-collateralized.<sup>159</sup> In case of refinancing, however, the priority status only applies to the amount that is carried over from the original purchase-money arrangement.<sup>160</sup> The comments to Revised Article 9 provide an example of this involving a \$10,000 loan secured by a purchase-money security interest. Imagine that the original creditor agrees to refinance the loan and advance the debtor an additional \$2,000 secured by the same collateral. In this situation, the creditor will keep its purchase-money priority status, but only up to \$10,000—the amount of its original purchase-money interest.<sup>161</sup> The clearer language under Revised Article 9 establishing priority for purchase-money security interests that survives refinancing may mean that creditors will be more willing to provide purchase-money credit.

### 2. Purchase money security interests for livestock purchases

Revised Article 9 creates a new priority rule for purchase-money security interests in livestock that is similar to the general purchase-money priority rule described above.<sup>162</sup> A creditor's security interest in livestock will be considered a purchase-money security

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156 Minn. Stat. § 336.9-322.

157 Minn. Stat. § 336.9-103. For an overview of recent changes in purchase money security interests, see Keith G. Meyer, *A Primer on Purchase Money Security Interests Under Revised Article 9 of the Uniform Commercial Code*, 50 KAN. L. REV. 143 (Nov. 2001).

158 Minn. Stat. § 336.9-324(a).

159 Minn. Stat. § 336.9-103(f).

160 Minn. Stat. § 336.9-103(e).

161 Rev. § 9-103, Official Comment 7(a).

162 Minn. Stat. § 336.9-324(d).

interest when: (1) the creditor provides financing for the livestock purchase and files a financing statement identifying the livestock as collateral before the debtor receives possession of the livestock, (2) the creditor sends written notice of its interest to the debtor's other creditors who claim an interest in the livestock, (3) the notice is received by the other creditors within six months before the debtor receives possession of the livestock, and (4) the notice states that the creditor sending the notice expects to acquire a purchase-money security interest in the debtor's livestock and then describes the livestock.<sup>163</sup>

If the creditor satisfies these requirements, its purchase-money security interest in livestock will have priority over any other security interests in the same livestock and also over any security interests in proceeds from the livestock.<sup>164</sup> By providing for purchase-money security interests in livestock, Revised Article 9 gives creditors who finance livestock purchases priority over all other secured creditors who claim an interest in the livestock. If the debtor defaults on the debt, the purchase-money creditor should be the first to be paid.<sup>165</sup>

### 3. Creditors can take a standard UCC security interest

Unsecured creditors can usually take a standard UCC security interest in the debtor's crops or other property.<sup>166</sup> That turns them into secured creditors. Creditors need to get a security agreement signed and file the proper papers. The advantage for the creditor is that it gives the creditor a higher priority than all unsecured creditors and later secured creditors. This strategy most likely makes sense if a fairly large sum of money will be owed—for example, rental payments to a landlord.

## C. Statutory liens

Statutory liens can help farmers get credit because they allow the farmer to give a high priority to creditors who could not otherwise get a high priority. Sometimes this higher priority can convince someone to provide services, inputs, or rental land even though many of the farmer's assets and future crops are tied up as collateral. Examples of statutory liens in Minnesota include landlords' liens, mechanics' liens, and emergency veterinarians' liens.

### 1. Introduction

In general, statutory liens give the creditor a higher priority in two ways. First, the lien places the creditor ahead of any other unsecured creditors. Second, the lien puts the creditor ahead of secured creditors who have not yet legally finalized—the legal term is “perfected”—their claim on the debtor's property. The statutory lien, in other words, turns an unsecured creditor into a secured creditor. Some statutory liens, such as the landlord's lien, put the new creditor ahead of other already secured creditors as well.<sup>167</sup>

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163 Minn. Stat. § 9-324(d), (e).

164 Minn. Stat. §§ 336.9-315, 336.9-324(d), 336.9-327. The interest in proceeds would still lose out to a perfected interest in the debtor's deposit accounts.

165 Rev. § 9-324, Official Comment 10.

166 Minn. Stat. § 336.9-102(a)(72)-(73).

167 Minn. Stat. §§ 336.9-322(g), 336.9-317(a), 514.964, subd. 7, 514.966, subd. 8.

*a. Possible disadvantages to statutory liens*

Although the statutory liens discussed here can help farmers, they also carry some possible disadvantages. First, statutory liens create security interests, and, as the above sections in this chapter explain, creditors with security interests have several possible remedies if the debtor defaults, which are not available to unsecured creditors.<sup>168</sup> Second, it may be the case that other agreements the farmer has signed—possibly including mortgages, contracts for deed, and other security agreements—will go into default if certain statutory liens are filed against the farmer. As always, it is important to read all agreements closely.

*b. Filing lien statements or financing statements*

Statutory liens are automatic. After a time, however, each expires unless the creditor files a lien statement or, for those liens covered by Revised Article 9, a financing statement.<sup>169</sup> Creditors should therefore make sure to file within the time provided. The requirements for what must be included in a lien statement or financing statement vary somewhat, so farmers who are also creditors—for example landlords—will likely want to get some legal advice about what exactly to include in the statement and where to file. In general, lien statements and financing statements are valid even if they contain some minor mistakes.<sup>170</sup> Creditors should also file lien notices in the Centralized Filing System.<sup>171</sup>

## 2. Agricultural liens and Revised Article 9

Certain agricultural liens—such as landlord’s liens, agricultural input liens, breeders’ liens, and emergency veterinarians’ liens—are covered by Revised Article 9.<sup>172</sup> This means these agricultural lienholders must file a financing statement to ensure the lien’s priority against other creditors.<sup>173</sup> Minnesota had already required persons with agricultural lien claims to file lien statements in order to gain priority against the farmer’s other

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168 Minn. Stat. §§ 514.964, subd. 9, 514.966, subd. 10. For certain agricultural liens, the enforcement rules of Revised Article 9 apply.

169 Minn. Stat. §§ 336.9-310(a), 514.964, subd. 5, 514.966, subd. 6.

170 Minn. Stat. §§ 336.9-506, 514.08, subd. 1(1), 514.74; *Bierlein v. Gagnon*, 96 N.W.2d 573 (Minn. 1959); *Standard Lumber Co. v. Alasker*, 289 N.W. 827 (Minn. 1940); *S.H. Bowman Lumber Co. v. Pierso*, 180 N.W. 106 (Minn. 1920). Most liens should be filed according to Minn. Stat. § 336.9-501. Mechanics’ liens should usually be filed with the county recorder where the real estate is located. If the property is registered (sometimes known as Torrens property), filing should be with the registrar of titles. Minn. Stat. §§ 514.08, subd. 1, 514.12, subd. 1; *David Thomas Companies v. Voss*, 517 N.W.2d 341 (Minn. Ct. App. 1994).

171 Minn. Stat. §§ 336A.03, 336A.04, 336A.05.

172 Minn. Stat. §§ 336.9-102(a)(5), 336.9-109(a)(2).

173 Minn. Stat. § 336.9-310(a).

creditors. However, the inclusion of agricultural liens within Revised Article 9 will bring changes in the rules governing those liens.<sup>174</sup> Minnesota's state-specific agricultural lien statutes will still control what types of agricultural liens can be obtained and which agricultural liens will have special priority, but Revised Article 9 will generally control the lien filing requirements.<sup>175</sup> For example, to have priority over secured creditors and other lienholders, a landlord in Minnesota must now file a UCC-1 financing statement in the Secretary of State's Centralized Filing System.<sup>176</sup>

The inclusion of agricultural liens under Revised Article 9 may create two possible areas of confusion that can affect creditors' willingness to extend credit to farmers. The first area of uncertainty may arise if there are inconsistencies between Revised Article 9 and the state agricultural lien statutes establishing lien priority and filing requirements. If these inconsistencies exist, creditors may feel uncertain how to ensure their priority interest in farm collateral and may be less willing to extend credit. Such inconsistencies in Minnesota law were addressed by legislation enacted during the 2001 session intended to provide a more simplified and consolidated agricultural lien priority structure and requiring agricultural lienholders to comply with Revised Article 9 filing, enforcement, and transition procedures.<sup>177</sup>

The second area of uncertainty may arise if input providers or landlords do not know how to comply with Revised Article 9's filing or enforcement rules. These creditors may be unwilling to continue to use a lien as assurance of repayment. For example, input providers or landlords who do not change their practices to reflect the requirements of Revised Article 9 may mistakenly think that their lien priority is secure even though they have not met the filing requirements, may not understand how to protect their interests against other creditors, or may fail to provide a termination statement when the farmer makes full payment for the service or input.

Farmers who want to ensure that their lienholders continue to have priority claims to their collateral may want to consider alerting their landlords and farm input providers that their ability to obtain payment priority may be altered because of Revised Article 9. This can be a difficult topic to raise, especially when the farmer is a relative or neighbor

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174 For an overview of agricultural liens and Revised Article 9 issues, see, generally, Susan A. Schneider, *Statutory Agricultural Liens Under Revised Article 9 of the Uniform Commercial Code*, NATIONAL AGLAW CENTER (Mar. 2002), available at <http://www.nationalaglawcenter.org/publications/articles/schneider.pdf>; Donald W. Baker, *Some Thoughts on Agricultural Liens Under the New U.C.C. Article 9*, 51 ALA. L. REV. 1417 (2000); Scott J. Burnham, *Agricultural Liens Under Revised Article 9*, 63 MONT. L. REV. 91 (2002); Jo. M. Pasqualucci, *Revised Article 9 in South Dakota With Emphasis on Newly Included Agricultural Liens*, 46 S.D. L. REV. 449 (2000); and John Mark Stephens, *Boon or Boondoggle? Proposed Article 9 Revisions Incorporate Statutory Agricultural Liens for Better, Not Worse*, 30 TEX. TECH. L. REV. 1199 (1999).

175 Minn. Stat. §§ 336.9-322, 336.9-334.

176 Minn. Stat. §§ 514.964, subd. 5, 514.966, subd. 6.

177 2001 Minn. Laws ch. 57 (H.F. 285) (codified at Minn. Stat. §§ 514.963, 514.964, 514.965, 514.966). Phillip L. Kunkel and Scott T. Larison, *Agricultural Liens in Minnesota*, UNIVERSITY OF MINNESOTA EXTENSION (Oct. 2001) available at <http://www.extension.umn.edu/distribution/businessmanagement/DF7682.html>.



of the landlord or input provider. If financial problems arise, however, and the farmer cannot pay all incurred debts, these same relatives and neighbors face being near the end of the line to receive payments instead of near the top if they do not comply with new filing requirements. Lienholders can fix this potential problem through the simple filing of a financing statement in the designated government office.

### 3. Landlord's lien

Among the most important statutory liens for farmers is the landlord's lien. By properly filing such a lien, the landlord can take a top priority claim over secured creditors in crops grown on rented land.<sup>178</sup> The lien is for the amount of unpaid rent.<sup>179</sup> The lien covers crops produced on the leased land during the crop year as well as their products and proceeds.<sup>180</sup> The landlord must file a financing statement within 30 days after the crops begin growing.<sup>181</sup>

Landlords can also take a standard UCC security interest in crops as collateral for rental payments.<sup>182</sup> Although there can be advantages for the landlord in filing a standard UCC financing statement, the statutory landlord's lien usually gives the landlord a higher priority.<sup>183</sup> Some landlords will want to do both.

### 4. Harvester's lien

A person who owns or is hired to operate machinery used in harvesting crops gets a lien against the harvested crops for the value of the service provided.<sup>184</sup> To preserve the lien, the creditor must file a financing statement within 15 calendar days of finishing the work.<sup>185</sup> The lien has priority over other liens, except a perfected crop input lien for the reasonable cost of the seed from that crop and a perfected landlord's lien in the same crop.<sup>186</sup> If more than one harvester's lien exists, the conflicting harvester's liens rank equally in proportion to the value of the service provided.<sup>187</sup>

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178 Minn. Stat. §§ 514.964, subd. 7(a), 336.9-334(i).

179 Minn. Stat. § 514.964, subd. 1.

180 Minn. Stat. § 514.964, subd. 4.

181 Minn. Stat. § 514.964, subd. 5(b). The financing statement should be filed in the same manner as a UCC security interest is filed.

182 The landlord should file a standard security agreement, financing statement, and an effective financing statement, which should include a description of the land and the crop years. Minn. Stat. §§ 336.9-203, 336.9-502, 336.9-504.

183 Unlike a statutory lien, the UCC security interest may be filed at any time and can claim other property as collateral.

184 Minn. Stat. § 514.964, subd. 2. This can include harvesting, grain drying, baling, and other tasks. Minn. Stat. § 514.964, subd. 2(a).

185 Minn. Stat. § 514.964, subd. 5(c).

186 Minn. Stat. § 514.964, subd. 7(b).

187 Minn. Stat. § 514.964, subd. 7(c).

## 5. Crop production input lien

Suppliers of crop production inputs get a lien against the crops they helped produce.<sup>188</sup> Crop inputs include not only seed and fertilizers but also fuel and customized labor. The amount of the lien is the unpaid retail cost of the crop production input provided.<sup>189</sup> To preserve the lien, suppliers must file a financing statement within six months after the last input was furnished.<sup>190</sup> A crop production input lien puts the creditor above other unsecured creditors and in some cases may move the creditor ahead of already secured creditors.<sup>191</sup>

## 6. Veterinarian's lien

A veterinarian who provides emergency services gets a lien on the animals for the value of the services provided.<sup>192</sup> To preserve the lien, the veterinarian must file a financing statement within 180 calendar days after the service was provided.<sup>193</sup> Upon filing, the veterinarian will have a perfected veterinarian's lien that will have priority over all secured creditors' and agricultural lienholders' claims in the same animals.<sup>194</sup> If more than one veterinarian's lien is filed, priority is determined by the order of filing.<sup>195</sup>

## 7. Feeder's lien

A person who stores, cares for, or contributes to the keeping, feeding, pasturing, or other care of animals at the request of the animals' owner has a lien upon the livestock for the

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188 Minn. Stat. § 514.964, subd. 3. Crop production inputs are defined broadly. Minn. Stat. § 514.963, subd. 5. Crop production inputs include agricultural chemicals, seeds, petroleum products, the custom application of agricultural chemicals and planting of seeds, and labor used in preparing the land for planting, cultivating, growing, producing, harvesting, drying, and storing crops or crop products.

189 Minn. Stat. § 514.964, subd. 3(a).

190 Minn. Stat. § 514.964, subd. 5(d).

191 Minn. Stat. § 514.964, subd. 3. Suppliers have the option of sending to the other secured creditors a lien notification statement explaining that the supplier has a crop input lien. The other creditors may either let the supplier keep the lien or instead promise to pay the supplier directly. Creditors ignoring the notice lose priority to the supplier. Minn. Stat. § 514.964, subd. 3(f). In *Tracy State Bank v. Tracy-Garvin Coop.*, 573 N.W.2d 393 (Minn. Ct. App. 1998), a creditor with a prior perfected security interest in farmer's property that failed to respond to a grain cooperative's lien notification statement regarding an agricultural production input lien (now a crop production lien) lost priority for the amount of the lien listed in the letter.

192 Minn. Stat. § 514.966, subd. 1. "Emergency veterinary services" include surgical procedures; administering vaccines, antisera, antibiotics, and other veterinary services that protect human health; preventing the spread of animal disease; or preserving animals' health. Minn. Stat. 514.965, subd. 4.

193 Minn. Stat. § 514.966, subd. 6(a)-(b).

194 Minn. Stat. § 514.966, subd. 8(a). The emergency veterinarian's lien does not alter veterinarians' rights of detainer, lien, and sale of animals under Minn. Stat. §§ 514.18 to 514.22. Minn. Stat. § 514.94.

195 Minn. Stat. § 514.966, subd. 8(b).

value of the storage, care or contribution, and any legal charges against the animals.<sup>196</sup> To preserve the lien, the owner must file a financing statement within 60 calendar days after the last date that feeding services were provided.<sup>197</sup> A feeder's lien will have priority over secured creditors' and agricultural lienholders' claims in the same animals except a perfected veterinarian's lien.<sup>198</sup> If more than one feeder's lien is filed, priority is determined by the order of filing.<sup>199</sup>

### 8. Breeder's lien

The owner of livestock used for breeding services or any provider of materials used in artificial insemination has a lien upon the livestock bred and any resulting offspring for the value of the services provided.<sup>200</sup> To preserve the lien, the owner must file a financing statement within six months after the last date that breeding services were provided.<sup>201</sup> A breeder's lien will have priority over secured creditors' and agricultural lienholders' claims in the same animals except a perfected veterinarian's lien and a perfected feeder's lien in the same animals and their products and proceeds.<sup>202</sup>

### 9. Livestock production input lien

Suppliers of livestock production inputs get a lien against the livestock they helped produce.<sup>203</sup> Livestock inputs include feed and labor used in raising the animals.<sup>204</sup> The amount of the lien is the unpaid retail cost of the inputs provided.<sup>205</sup> To preserve the lien, suppliers must file financing statements within six months after the last input was furnished.<sup>206</sup> A livestock production input lien puts the creditor above other unsecured creditors and later secured creditors and in some cases may move the creditor ahead of already secured creditors.<sup>207</sup>

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196 Minn. Stat. § 514.966, subd. 4. The livestock shoeing lien is now incorporated into the feeder's lien. Minn. Stat. § 514.966, subd. 4(a). If the feeding of livestock is done under contract, the person may also get an agricultural producer's lien which gives a lien for the contract price of the agricultural commodity. Minn. Stat. § 514.945. Agricultural producers' liens are not covered by Revised Article 9, though Revised Article 9 enforcement rules are used. Minn. Stat. § 514.945, subd. 6.

197 Minn. Stat. § 514.966, subd. 6(e).

198 Minn. Stat. § 514.966, subd. 8(c).

199 Minn. Stat. § 514.966, subd. 8(d).

200 Minn. Stat. § 514.966, subd. 2.

201 Minn. Stat. § 514.966, subd. 6(c).

202 Minn. Stat. § 514.966, subd. 7(e).

203 Minn. Stat. § 514.966, subd. 3.

204 Minn. Stat. § 514.965, subd. 8.

205 Minn. Stat. § 514.966, subd. 3(a).

206 Minn. Stat. § 514.966, subd. 6(d).

207 Minn. Stat. § 514.966, subd. 3. Suppliers have the option of sending the secured creditors a lien notification statement explaining that the supplier has a livestock input lien. The other creditors may either let the supplier keep the lien or instead promise to pay the supplier directly. Creditors ignoring the notice lose priority to the supplier. Minn. Stat. § 514.966, subd. 3(f). In *Underwood Grain Co. v. Harthun*, 563 N.W.2d 278 (Minn. Ct. App. 1997), a creditor with a prior perfected security interest in cattle retained priority over the grain company's agricultural production lien (now a livestock production lien) after the creditor refused to issue a letter of commitment.

## 10. Mechanics' liens — real estate

Mechanics' liens are designed to ensure that laborers and others who work to improve real estate are paid. Anyone contributing to the improvement of real estate by providing labor, materials, or machinery for building, repairing, or removing buildings, fences, ditches, and wells, for example, gets a mechanic's lien.<sup>208</sup> The lien is for the reasonable value of the work done and of the skill, material, and machinery furnished.<sup>209</sup> Unlike other statutory liens, a mechanic's lien is a lien against real estate, not personal property (such as equipment).<sup>210</sup> If the lien is not paid, therefore, it follows the real estate and may make the property difficult to sell. Those claiming a mechanic's lien must file a lien statement against the real estate within 120 days of finishing the work or providing the materials.<sup>211</sup>

The mechanic's lien gives the creditor priority over unsecured creditors and in general ahead of secured creditors whose mortgage or other documents are filed after the mechanic's lien creditor began working on the property.<sup>212</sup>

## 11. General possessory lien — mechanic's lien for personal property

Creditors who care for, store, repair, make, or haul personal property have an automatic lien on that property for the price or value of the work or material.<sup>213</sup> This includes, for example, repair work on machinery. Creditors who have possession of the property may generally keep it until payment is made and, after 90 days of nonpayment, may sell the property to pay the debt.<sup>214</sup> Creditors losing possession of the property may preserve the lien by filing a lien statement within 60 calendar days of losing possession.<sup>215</sup>

## 12. Lien for rental value of farm machinery during farmer-lender mediation

A creditor with a security interest in seasonal use machinery may have a special statutory lien if the farmer defaults on the debt and the debt is mediated in farmer-lender

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- 208 Minn. Stat. §§ 514.01 to 514.17; 31 DUNNELL MINN. DIGEST, *Mechanics' Liens* (4th ed. 1996). An "improvement" includes a permanent addition to or betterment of the property that enhances its value and involves spending of labor or money and is designed to make the property more useful or valuable as distinguished from ordinary repairs. *Kloster-Madsen, Inc. v. Tafi's, Inc.*, 226 N.W.2d 603 (Minn. 1975).
- 209 Minn. Stat. § 514.01.
- 210 Minn. Stat. § 514.03, subd. 3.
- 211 Mechanics' liens should usually be filed with the county recorder where the real estate is located. If the property is registered (sometimes known as Torrens property), filing should be with the registrar of titles. Minn. Stat. §§ 514.08, subd. 1, 514.12, subd. 1; *David Thomas Companies v. Voss*, 517 N.W.2d 341 (Minn. Ct. App. 1994). A person who fails to follow the pre-lien notice statutory requirements will not have a valid mechanic's lien. *Niewind v. Carlson*, 628 N.W.2d 649 (Minn. Ct. App. 2001).
- 212 Minn. Stat. § 514.05, subd. 1.
- 213 Minn. Stat. §§ 514.18 to 514.22.
- 214 Minn. Stat. § 514.20. As long as possessory lien creditors possess the property, they have priority over secured creditors. Minn. Stat. § 336.9-333.
- 215 Minn. Stat. § 514.18, subd. 2. This part of the lien does not apply to motor vehicles. Minn. Stat. § 514.18, subd. 4.

mediation.<sup>216</sup> The lien is for either the total payments needed to bring the debt current until the end of mediation or the reasonable rental value of the machinery that is used for field operation during the mediation, whichever is less.<sup>217</sup> The lien is on the crops the farmer produced in the calendar year of the mediation.<sup>218</sup>

### 13. Other statutory liens

Many of the other less well known statutory agricultural liens were incorporated into the consolidated agricultural lien statutes, including the interests of people who shoe animals and the lien for the service of male animals.<sup>219</sup> Other statutory liens protect the interests of people who work with logs or timber.<sup>220</sup>

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216 Minn. Stat. § 514.661. The default must be on a purchase money loan or contract. Seasonal use machinery, for the purpose of this lien, means machinery, equipment, or implements used only for planting, row crop cultivating, or harvesting. It does not include tractors, tillage equipment, or utility implements used for general farm purposes.

217 Minn. Stat. § 514.661, subd. 2(a).

218 Minn. Stat. § 514.661, subd. 2(b).

219 2001 Minn. Laws ch. 57 (H.F. 285) (repealing Minn. Stat. §§ 514.23, 514.26, 514.62).

220 Minn. Stat. §§ 514.40 to 514.58.

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## Chapter Five

# Unsecured Credit and Judgments

## I. Introduction

Farmers often do business with people or businesses that advance credit, goods, or services without taking any security interest in the farmer's property. These are unsecured creditors. Unsecured creditors cannot simply seize the debtor's property in case of default, but they may use other means—for example judgments and garnishment—to take money and property from defaulting debtors. This chapter discusses unsecured creditors and the legal actions unsecured creditors may take to collect on unpaid debts.

Dealings with unsecured creditors are often quite informal. To avoid misunderstandings, however, all agreements should be in writing. Purchasers need clear agreements on exactly what is being purchased; the cost, including any interest; and the details of delivery and billing.

## II. How creditors get money judgments

Both secured and unsecured creditors can get money judgments against defaulting debtors, but because unsecured creditors have no other direct way to collect the debt, they are especially likely to use them. To get a money judgment in Minnesota, a creditor must file a lawsuit against the debtor seeking payment of the debt. Most often, the case is filed in a Minnesota district court.<sup>1</sup> Several steps must be completed for the creditor to get a money judgment.

### A. Summons and complaint

To begin a lawsuit for a money judgment, the creditor files a summons and complaint with the court.<sup>2</sup> In these documents, the creditor explains why it believes it is owed money by the debtor. Creditors must also provide a copy of the summons and complaint to the debtor.<sup>3</sup> Complaints usually demand that the debtor pay collection costs in addition to the underlying debt. These costs often include attorneys' fees, although the creditor might not have a right to attorneys' fees unless the debtor agreed to be responsible for them in the loan contract.

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1 Cases filed in conciliation court and federal court can also lead to money judgments. Minn. Stat. §§ 491A.01 to 491A.03, 548.11. For information on conciliation court, see *GUIDE TO MINNESOTA'S CONCILIATION COURT* (2nd ed. 1998), which is available from local legal services offices.

2 Minn. R. Civ. P. 3.

3 This must be done either by the sheriff or any non-party who is at least 18 years old. Minn. R. Civ. P. 4.02.

A summons and complaint is “served” on the debtor.<sup>4</sup> This means that they will be delivered either by a sheriff or a private process server. In either case, the server documents the day on which the papers were served.

In some cases, the creditor’s lawyer will file a money judgment lawsuit in the district court of the county where that lawyer usually does business. Debtors sued for a money judgment, however, have a legal right to be sued in the county where they live or where at least “some part” of the cause of action arose.<sup>5</sup> Debtors must claim this right within 20 days after the summons is served.<sup>6</sup>

## B. The debtor’s answer

After being served with the summons and complaint, the debtor has 20 days to file a legal answer.<sup>7</sup> In the answer, the debtor makes his or her arguments about the debt and default. A debtor may argue, for example, that he or she does not really owe the money. Debtors who have an argument against the creditor about the debt must present it in the answer.<sup>8</sup> Debtors are allowed to file an answer and argue on their own behalf in court without a lawyer. Except in conciliation court, however, this is likely to greatly reduce the debtor’s chances of success.

If the debtor does not file a legal answer to the complaint, the court will grant the creditor a money judgment by default.<sup>9</sup> It is extremely difficult to overturn a default judgment once it is entered.<sup>10</sup>

## C. Judgment

If the court decides the debtor owes the money, or if the debtor fails to answer the complaint, the court will issue a money judgment in favor of the creditor.

### 1. Generally enforceable for ten years — renewals possible

Money judgments are effective for ten years.<sup>11</sup> If the creditor is unable to recover the judgment amount within the ten years, the judgment can be renewed.<sup>12</sup>

4 Minn. R. Civ. P. 3, 4.

5 Minn. Stat. § 542.09.

6 Minn. Stat. § 542.10; *Standslast v. Reid*, 231 N.W.2d 98 (Minn. 1975).

7 Minn. R. Civ. P. 12.01.

8 Minn. R. Civ. P. 12.02.

9 Minn. R. Civ. P. 55.01.

10 DUNNELL MINN. DIGEST, *Judgments*, §§ 4.00, 5.13 (4th ed. 1995).

11 Minn. Stat. §§ 541.04, 548.09, subd. 1, 550.01. This ten-year limit also applies to liens resulting from the judgment. These judgment lien limits almost certainly do not apply to federal agencies. The United States government is not bound by a statute of limitations unless Congress requires it. *United States v. Summerlin*, 310 U.S. 414, 416-17 (1940). Federal agency collection actions are somewhat limited by a six-year federal statute of limitations under 28 U.S.C. §§ 2415, 2416 to file an action on a contract, but the federal government then has at least 20 years to enforce a judgment lien. 28 U.S.C. § 3201. Federal agencies can renew this time period to enforce a judgment lien by one additional period of 20 years. 28 U.S.C. § 3201(c). See also Department of Treasury, Federal Claims Collection Standards Workshop (Apr. 4, 2001) at 36, available at <http://fms.treas.gov/debt/fccsq%26a.txt>.

12 *Lyman Lumber Co. v. Favorite Constr. Co.*, 524 N.W.2d 484 (Minn. Ct. App. 1994).



## 2. Enforceable for only three years for farm-related debts

For some farm debts, the enforceability period for money judgments is shorter. A judgment for the unpaid balance of a debt on agricultural property owed by a farm debtor may not be executed on real or personal property after three years from the date the judgment was entered.<sup>13</sup>

## 3. Not enforceable against after-acquired property for farm-related debts

Usually when a creditor gets a money judgment, the creditor can enforce the judgment by seizing and selling property acquired by the debtor both before and after the judgment was issued.<sup>14</sup> A judgment for an unpaid debt on agricultural property owed by a farm debtor, however, cannot be enforced against property that the farm debtor acquires after the judgment is issued.<sup>15</sup>

For this purpose, agricultural property is personal property used in a farm operation, and a farm debtor is a person who has incurred debt while operating a family farm.<sup>16</sup>

## 4. Likely enforceable against the debtor's property in other states

A money judgment issued by a court in one state will generally also be enforceable in another state where a debtor has property.<sup>17</sup> Typically, the creditor will not have to file a new lawsuit but can simply file a certified copy of the original money judgment with the other state's court.

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13 Minn. Stat. § 550.366, subd. 3. The Minnesota Court of Appeals has held that a farmer's default on a grain supply contract with an ethanol cooperative created debt involving agricultural personal property and therefore was subject to the three-year limit on enforcement. *Westchester Fire Ins. Co. v. Hasbargen*, 632 N.W.2d 754 (Minn. Ct. App. 2001). These judgment lien limits almost certainly do not apply to federal agencies. The United States government is not bound by a statute of limitations unless Congress requires it. *United States v. Summerlin*, 310 U.S. 414, 416-17 (1940). Federal agency collection actions are somewhat limited by a six-year federal statute of limitations under 28 U.S.C. §§ 2415, 2416 to file an action on a contract, but the federal government then has at least 20 years to enforce a judgment lien. 28 U.S.C. § 3201. Federal agencies can renew this time period to enforce a judgment lien by one additional period of 20 years. 28 U.S.C. § 3201(c). See also Department of Treasury, Federal Claims Collection Standards Workshop (April 4, 2001) at 36, available at: <http://fms.treas.gov/debt/fccsq%26a.txt>.

14 Minn. Stat. §§ 550.02, 550.03.

15 Minn. Stat. § 550.366, subd. 3.

16 "Family farm" includes family farm corporations and authorized farm corporations. Minn. Stat. §§ 550.366, subd. 1(b), 500.24, subd. 2.

17 See, for example, Minn. Stat. § 548.27.

### III. Effects of a money judgment

Once a creditor has a money judgment against the debtor, the creditor is able to take the next steps toward collecting the debt.

#### A. Judgment lien

After the court officially finalizes a money judgment—in legal terms, the judgment is said to be “docketed”—a judgment lien is created in favor of the creditor.<sup>18</sup> The lien applies only to real property of the debtor that does not qualify for an exemption.

##### 1. Only applies to real property

A judgment lien is a lien on real estate. The debtor’s personal property—such as machinery, livestock, vehicles, and household items—is not directly affected.<sup>19</sup>

#### Real property vs. personal property

Money judgments affect property differently, depending on whether it is real property or personal property. In general, real property includes land and buildings. Personal property includes most other farm property, such as livestock, machinery, and crops. Chapter Three discusses the differences in more detail.

##### 2. Does not apply to debtor’s exempt property

The judgment lien only applies to nonexempt property.<sup>20</sup> This means, for example, that the debtor’s homestead should not be affected by the lien.<sup>21</sup> (Exemptions are discussed later in this chapter starting at page 145.)

18 Minn. Stat. § 548.09, subd. 1. The process is somewhat different for what is known as registered, or Torrens land. Minn. Stat. §§ 508.25, 508.63, 508A.63. Torrens land, unlike most real estate in Minnesota, has a certificate of title issued in favor of the owner of the property. If farmers are not sure whether their property is Torrens property, they can check with the county registrar of titles where the original certificate for each property is maintained.

19 A judgment lien generally applies to real estate owned at the time the money judgment is docketed. It also affects the debtor’s interest as a buyer under a contract for deed because the buyer may need to take action to protect the buyer’s homestead rights to the property. *Hook v. Northwest Thresher Co.*, 98 N.W. 463 (Minn. 1904).

20 Minn. Stat. §§ 510.01, 510.05.

21 Technically, the judgment is a lien on the homestead property, but the lien is not enforceable under the Minnesota Constitution. Minn. Const., art. 1, § 12. Even though the judgment lien is not enforceable against homestead property, the homestead exemption can be lost if the debtor stops occupying the property. Minn. Stat. § 510.07, *Denzer v. Prendergast*, 126 N.W.2d 440, 442-43 (Minn. 1964). Because of this possibility, the money judgment creates something of a cloud over exempt homestead property. Purchasers, for example, may worry that the homestead exemption was at one point lost before the sale and refuse to buy unless the judgment is paid.

### 3. Affects debtor's rights in the property

The judgment lien does not in itself give the creditor the right to take the real estate, although the creditor may acquire the right later through a sheriff's levy and sale, discussed below. The judgment lien does affect the debtor's rights in the real estate.<sup>22</sup> As a practical matter, as long as the lien is in place, it will be difficult for the debtor to sell the property or to get a mortgage on it.<sup>23</sup> Not only will a debtor be unlikely to be able to use the property covered by a judgment lien as collateral for future credit, the creation of a judgment lien against the debtor might put the debtor in default on existing loans.

### B. Writ of execution

The most important effect of a money judgment is that it can be used by the creditor to get a writ of execution.<sup>24</sup> A writ of execution is issued by the court and gives the sheriff, the creditor, or the creditor's attorney the power to seize and sell the debtor's property and pay the creditor the proceeds.<sup>25</sup> Unless the debtor appeals the court's decision to grant a money judgment, a writ of execution is likely.<sup>26</sup> Writs of execution are the legal trigger for sheriff's sales, garnishments, and other methods used to seize the debtor's property and money.

A writ of execution may be delayed if within ten days after the judgment is entered the debtor files a bond equal to twice the amount of the judgment.<sup>27</sup> The bond will delay execution for six months on the condition that the debtor will pay the judgment amount, with interest, by the end of the six-month period.<sup>28</sup>

A writ of execution is valid for 180 days.<sup>29</sup> Additional writs may be issued at any time during the period that a judgment is in effect.

### C. Garnishment authorized

Once a creditor has been awarded a money judgment, the creditor has the power to begin the process of garnishing earnings, money, and property that are held by another party for the debtor or are owed to the debtor by another party.<sup>30</sup> Garnishment is discussed in detail later in this chapter at page 136.

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22 Minn. Stat. § 548.09, subd. 1; 28 DUNNELL MINN. DIGEST, *Judgments* § 14.04 (4th ed. 1995).

23 A properly docketed judgment lien gives the creditor priority over later-filed liens, such as mechanics' liens and other judgment liens. If the debtor later sells the real estate, the purchaser will buy it subject to the judgment lien. Minn. Stat. § 507.34.

24 Minn. Stat. § 550.01; 22 DUNNELL MINN. DIGEST, *Execution* § 1.00(a) (4th ed. 1994).

25 Minn. Stat. § 550.04.

26 The Minnesota Rules of Civil Procedure state that the process to enforce a judgment for the payment of money must be a writ of execution unless the court says otherwise. Minn. R. Civ. P. 69.

27 Minn. Stat. § 550.36. An appeal can also delay execution.

28 Minn. Stat. § 550.36.

29 Minn. Stat. § 550.051, subd. 1.

30 Minn. Stat. § 571.71. Garnishment is authorized even before the money judgment is issued if the court so orders or the debtor fails to file an answer to the complaint.

#### **IV. Farmer-lender mediation must be offered before enforcement of a judgment**

If the debtor is eligible for farmer-lender mediation, the creditor must serve the debtor with a mediation notice before the creditor takes action to enforce a money judgment.<sup>31</sup> Mediation is discussed in Chapter Seven.

#### **V. Enforcing money judgments**

There are four ways that a creditor can satisfy its claim under a money judgment: sheriff's levy and sale, garnishment, attorney summary execution, and, in rare cases, attachment.

##### **A. Sheriff's levy and sale**

A writ of execution typically directs the sheriff to satisfy the judgment by taking and selling the debtor's property.<sup>32</sup> Technically, this is known as a "sheriff's levy and sale."<sup>33</sup> The writ can also order the sheriff to deliver the property to the creditor.<sup>34</sup>

##### **1. The sheriff's levy**

When the sheriff levies upon the debtor's property, the sheriff has either actually taken possession of the property or put the property under his or her control. In the time between a levy and sale, therefore, the debtor's right to use or sell the property is taken away. There are several important points to note about this process.

##### *a. Exempt property may not be levied upon*

Only some of the debtor's property can be taken. The law sets aside some property as exempt from seizure by the sheriff.<sup>35</sup> Exemptions are discussed in more detail below starting at page 145.

##### *b. Sheriff may not use force to levy upon property*

There are limits on the force the sheriff may use in executing the writ. Sheriffs may not break into a home, for example, and may not enter the debtor's home against the debtor's will.<sup>36</sup>

##### *c. Personal property levied upon before real estate*

The writ of execution directs the sheriff to satisfy the judgment out of the debtor's personal property first.<sup>37</sup> If the sheriff cannot find enough nonexempt personal property to satisfy the debt, the sheriff then levies upon the debtor's real estate.

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31 Minn. Stat. § 550.365.

32 Minn. Stat. § 550.08. If the debtor has property in more than one county, the court may issue a writ of execution for each county. Minn. Stat. § 550.07.

33 Minn. Stat. § 550.135.

34 Minn. Stat. § 550.03.

35 Minn. Stat. § 550.04(2). Only attached property may be seized by the sheriff.

36 DUNNELL MINN. DIGEST, *Execution* § 3.04 (4th ed. 1994); *Welsh v. Wilson*, 24 N.W. 327 (Minn. 1885).

37 Minn. Stat. §§ 550.04 (1), 550.10.

*d. Procedures for levying upon specific types of property*

The sheriff will have to follow different procedures depending on the type of property being levied upon.

*(1) Personal property*

In a levy upon personal property, the sheriff usually actually takes the property into possession.<sup>38</sup> If the property is too bulky to be moved easily, the sheriff may levy upon the property but not actually move it.<sup>39</sup> The levy applies all the same, whether or not the debtor continues to possess the property.

*(2) Real estate*

Real estate is levied upon by the sheriff filing a certificate with the county recorder saying that he or she has made a levy upon the real estate.<sup>40</sup>

*(3) Bank deposits*

The sheriff may levy upon the debtor's deposits in a bank or other financial institution.<sup>41</sup> This is done by sending the bank a writ of execution and an exemption notice. If the funds are in the name of a natural person—and not a business entity—important exemptions apply.<sup>42</sup> The sheriff may not take money from certain income sources—Social Security is one—and there are limits as to how much the sheriff may take from the debtor's earnings.<sup>43</sup> These exemptions are discussed in detail later in this chapter at page 145.

Within two days after receiving the exemption notice, the bank must send the debtor two copies of the exemption notice by U.S. mail.<sup>44</sup> If the debtor does not return an exemption claim within 14 days after the exemption notice copies were mailed, the funds are subject to the levy and must be given to the sheriff within 7 days after the 14-day period has run.<sup>45</sup>

If the debtor does claim an exemption and gives a copy of an exemption notice to the bank and the creditor's lawyer, the funds will be claimed as exempt for the debtor.<sup>46</sup> Within seven days after the date postmarked on the

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38 Minn. Stat. § 550.12.

39 Minn. Stat. §§ 550.13, 336.9-501; *Springfield Farmers Elevator Co. v. State Bank of Springfield*, 360 N.W.2d 402 (Minn. Ct. App. 1985). The sheriff leaves a copy of the writ of execution and a notice explaining that the property is levied upon and files a notice of the levy at the office of the county recorder or the Secretary of State.

40 Minn. Stat. § 550.07.

41 Minn. Stat. §§ 550.143, 550.135, subd. 3.

42 Minn. Stat. § 550.143.

43 Minn. Stat. § 550.143, subd. 3.

44 Minn. Stat. § 550.143, subd. 4.

45 Minn. Stat. § 550.143, subd. 4.

46 Minn. Stat. § 550.143, subd. 4.

envelope containing the debtor's exemption claim, the creditor may object to the exemption by mailing a written objection and the claimed exemption form to the bank and to the debtor.<sup>47</sup> After receiving the objection to exemption claim, the debtor has ten days to request a hearing.<sup>48</sup> The district court then decides the fate of the levied money.

#### (4) *Earnings*

The sheriff may levy upon the debtor's earnings.<sup>49</sup> This process works very much like a garnishment, discussed later in this chapter at page 136, except that the debtor's earnings are turned over to the sheriff and then to the creditor. In general, when levying upon a debtor's earnings the sheriff directs an employer or someone else who owes the debtor money to give the money to the sheriff. Earnings that may be taken by the sheriff include pay from an employer as well as payments to a farmer for the sale of agricultural products such as milk or livestock.<sup>50</sup>

##### (a) *Notice*

At least ten days before the sheriff serves the writ of execution on the third party who has the debtor's earnings, the debtor must receive an execution exemption notice and a notice warning that the levy may happen.<sup>51</sup>

##### (b) *Exemptions*

There are strict limits on the earnings that the sheriff may levy upon. Earnings exemptions are discussed starting at page 145. For exemptions to work, however, they must be claimed by the debtor.

##### (c) *The levy upon earnings*

If the creditor does not receive an exemption statement from the debtor within ten days after the debtor receives a notice of the earnings levy, the creditor may tell the sheriff to serve the writ of execution on whomever is holding the debtor's earnings.<sup>52</sup> The creditor must then send another notice to the debtor within the next five days, along with a copy of all of the legal papers used to take the debtor's earnings.<sup>53</sup>

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47 Minn. Stat. § 550.143, subds. 5-7.

48 Minn. Stat. § 550.143, subds. 7-8.

49 Minn. Stat. §§ 550.136, 550.135, subd. 3.

50 Minn. Stat. §§ 550.135, 550.136.

51 If the writ of execution has not been served on the person holding the debtor's earnings within one year after service of the exemption notice, the creditor must serve the debtor with another notice of levy before levying upon the debtor's earnings. Minn. Stat. § 550.136, subd. 7.

52 Minn. Stat. § 550.136, subd. 8.

53 Minn. Stat. § 550.136, subd. 11.

The debtor's earnings must be held by the third party through the last payment day within 70 days after the service of the writ of execution.<sup>54</sup> After the 70 days end, the money is given to the sheriff.<sup>55</sup>

It is illegal for an employer to penalize a debtor for a sheriff's levy on earnings.<sup>56</sup>

*(5) Unharvested crops*

The sheriff may levy upon unharvested crops, but the crops will not be sold until they are fit to be harvested.<sup>57</sup>

*(6) If the property to be levied upon is collateral for another creditor*

The sheriff is free to levy upon personal or real property that serves as collateral for another of the debtor's creditors.<sup>58</sup> The creditor receiving the property must pay the secured creditor out of the proceeds as set out in the security agreement.<sup>59</sup>

*e. Debtor may satisfy the judgment and have property returned*

After the sheriff levies upon the debtor's property, the debtor may still satisfy the judgment by paying the debt. If this happens, the debtor has the right to have the levied property returned in the same condition it was in at the time it was taken, except for the usual wear and tear of removal and preservation.<sup>60</sup>

## 2. Sheriff's execution sale

The writ of execution will also typically direct the sheriff to sell the levied property.<sup>61</sup> The sheriff must first give notice of the sale directly to the debtor and to the public.<sup>62</sup>

For personal property, the sale notice must be posted in three obvious places in the county for at least ten days before the sale.<sup>63</sup> For real estate, the notice must be posted and published in a legal paper for six weeks before the sale.<sup>64</sup> A sheriff's sale is a public auction for cash.<sup>65</sup> The sheriff must sell only the minimum amount of the property

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54 Minn. Stat. § 550.136, subd. 12.

55 Minn. Stat. § 550.136, subds. 11-12.

56 Minn. Stat. § 550.136, subd. 13.

57 Minn. Stat. § 550.17; *Gillit v. Truax*, 8 N.W. 767 (Minn. 1881).

58 Minn. Stat. § 550.16.

59 Minn. Stat. § 550.16.

60 22 DUNNELL MINN. DIGEST, *Execution* § 3.00 (4th ed. 1994); *Banker v. Caldwell*, 3 Minn. 94 (1859).

61 Minn. Stat. § 550.04.

62 Minn. Stat. §§ 550.18, 550.19, 645.12. At or before the time of posting, the sheriff must serve a copy of the sale notice on the debtor.

63 Minn. Stat. § 550.18(1).

64 Minn. Stat. § 550.18(2).

65 Minn. Stat. § 550.20.

needed to satisfy the judgment.<sup>66</sup> Real property that can be divided must be divided to avoid an over-levy.<sup>67</sup> Personal property must be sold in the sight of those at the sale.<sup>68</sup>

The proceeds from a sheriff's sale must first be used to cover all reasonable expenses involved in enforcing the order and holding the sale.<sup>69</sup> The creditor's debt is paid next, along with interest.<sup>70</sup>

## B. Garnishment

Creditors sometimes use garnishment to recover debts. Garnishment forces a garnishee—a bank, employer, or anyone else who owes money to the debtor or has the debtor's money—to hold the debtor's money and then turn it over to the creditor.<sup>71</sup> A creditor may garnish at any time after entry of a money judgment.<sup>72</sup>

### Garnishee

In a garnishment, the garnishee is the third party who owes money to the debtor or is holding the debtor's money. Banks and the debtor's employers are common garnishees.

Garnishment can affect bank accounts and wages; it can also affect other payments to farmers, such as milk checks. Debtors can exempt some money from garnishment, and they also have notice rights, although debtors sometimes learn about garnishments after the fact.

At some point in the garnishment, three things happen, although the order of these events may vary: (1) the creditor sends a summons to garnishees telling them to hold the debtor's money, (2) the debtor receives an exemption notice and may claim exemptions, and (3) the creditor collects the money from the garnishees.<sup>73</sup>

### 1. Garnishing earnings

Creditors may garnish the debtor's earnings.<sup>74</sup> This is similar to the levy upon earnings discussed earlier at page 134, but in a garnishment, the creditor rather than the sheriff takes the earnings.

66 Minn. Stat. § 550.20.

67 Minn. Stat. § 550.20; *Zetah v. Isaacs*, 428 N.W.2d 96, 101 (Minn. Ct. App. 1988).

68 Minn. Stat. § 550.20.

69 Minn. Stat. § 550.051, subd. 1.

70 Minn. Stat. § 550.051.

71 Minn. Stat. § 571.71.

72 Minn. Stat. § 571.71(3).

73 In all cases, the debtor must be served a notice of the garnishment summons and other papers served on the garnishee, along with an exemption notice, within five days after service on the garnishee. Minn. Stat. § 571.72, subds. 4, 8.

74 Minn. Stat. § 571.71.



*a. Steps in the process*

*(1) Notice to the debtor*

At least ten days before the debtor's wages are garnished, the creditor must serve the debtor by mail with a garnishment notice and wage exemption form.<sup>75</sup> The debtor can return the form and claim a wage exemption. If the creditor does not receive an exemption claim within ten days after the garnishment notice is served, the creditor may go ahead with the garnishment.<sup>76</sup>

Even if the creditor has gone ahead with the garnishment, the debtor does not necessarily lose the right to claim an exemption. If a proper exemption claim is made after the garnishment takes place, the debtor's money will eventually be returned to the debtor.<sup>77</sup> The process for claiming exemptions is explained in more detail below.

*(2) Summons to the garnishee*

The garnishment is triggered when the creditor sends a garnishment summons to the garnishee.

*b. Defining earnings*

For the purposes of garnishment, earnings include pay from a job as well as a payment for family farm production that is still held by a third party.<sup>78</sup> This means that milk checks and payment for the sale of livestock and other agricultural production can be garnished as earnings.<sup>79</sup>

*c. Limits on wage garnishment*

Creditors can only garnish part of the debtor's earnings.<sup>80</sup> Two types of limits apply, both of which are tied to the debtor's disposable earnings. Otherwise, the garnishee is required to retain the debtor's earnings equaling up to 110 percent of the creditor's claim.<sup>81</sup>

*(1) Defining disposable earnings*

Disposable income is defined as the earnings that remain after legally required deductions—such as Social Security and federal and state income tax

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75 Minn. Stat. §§ 571.924, 571.72, subd. 8. If more than one year has passed since a garnishment notice was sent, a garnishment for the same debt requires another notice.

76 Minn. Stat. § 571.926.

77 *Investors Sav. Bank v. Miller*, 440 N.W.2d 168 (Minn. Ct. App. 1989).

78 Minn. Stat. §§ 571.921(a)(2), 500.24, subd. 2.

79 Minn. Stat. §§ 571.921(a)(2), 500.24, subd. 2. Earnings include money already paid or owed for the sale of agricultural products, livestock, or milk when the farmer is a family farm, family farm corporation, or an authorized farm corporation.

80 Minn. Stat. § 571.922.

81 Minn. Stat. § 571.72, subd. 2(5).

withholding—are taken out of the check.<sup>82</sup>

*(2) Twenty-five percent of disposable earnings*

The creditor may not garnish more than 25 percent of the debtor's disposable earnings.<sup>83</sup> Once deposited in a bank, the remaining 75 percent of disposable earnings remain exempt for 20 days.<sup>84</sup>

For example, if the debtor's disposable income is \$500 a week, the most that could be garnished from that week's income—according to the 25 percent limitation—is \$125.

*(3) Creditors must leave a minimum of disposable earnings*

Creditors must also leave a minimum amount of disposable earnings in each check.<sup>85</sup> This amount is based on the federal minimum wage. At present, the minimum disposable earnings that must be left in a check each week after garnishment is \$206 ( $\$5.15 \times 40 = \$206$ ).<sup>86</sup> If the federal minimum wage changes, so will this minimum.<sup>87</sup> Once deposited in a bank, the exempt earnings remain exempt for 20 days.<sup>88</sup>

For example, if the debtor's disposable income is \$250 per week, the most that could be garnished from that week's pay—according to this limitation—is \$44.

*(4) How these limits work together*

Creditors must apply the garnishment limit that leaves the debtor with the most earnings left over.<sup>89</sup>

*d. Wage exemptions — some earnings cannot be garnished*

Some earnings are completely exempt from garnishment.<sup>90</sup> These include: (1) Social Security benefits; (2) unemployment insurance; (3) veteran's benefits; (4) accident, disability, or retirement pensions or annuities; (5) life insurance proceeds; (6) earnings of a minor child; and (7) social welfare relief based on need, such as Minnesota Family Investment Program (MFIP) and Supplemental Security Income (SSI). These funds remain exempt even after they have been deposited in a bank or other finan-

82 Minn. Stat. § 571.921(b).

83 Minn. Stat. § 571.922(1).

84 Minn. Stat. § 550.37, subd. 13.

85 Minn. Stat. § 571.922(2).

86 The minimum amount of disposable earnings that a debtor must have free from garnishment per week is 40 times the federal minimum hourly wage. When the pay period is more than a whole number of weeks, each day is counted as a fraction of a week. At present, the federal minimum wage is \$5.15 per hour. 29 U.S.C. § 206(a)(1).

87 Minn. Stat. § 571.922(2).

88 Minn. Stat. § 550.37, subd. 13.

89 Minn. Stat. § 571.922. Different rules apply if the garnishment is for unpaid child support.

90 Minn. Stat. §§ 571.72, subd. 8, 550.37.

cial institution.<sup>91</sup> In tracing these funds, the first-in, first-out accounting method is used.

#### **First-in, first-out accounting**

In tracing exempt funds that have been deposited in a bank account, the law applies what is known as a “first-in, first-out” method of accounting.

Suppose, for example, a debtor who had \$500 in nonexempt money in an account deposited \$1,000 of exempt income in the same account and later deposited \$2,000 more in nonexempt money. The total balance is then \$3,500, and the total exempt balance is \$1,000.

If the debtor then spends \$800 of the money in the account, the total balance would be \$2,700, and the exempt balance would be \$700.

The first-in, first-out accounting method assumes that the \$800 spent first took the \$500 nonexempt money, because it was deposited first, and then used \$300 of the \$1,000 of the exempt balance, because it was deposited second.

#### *e. Seventy days of earnings can be garnished*

Garnishment of earnings continues for each payday that falls within 70 days after the garnishment summons was served on the garnishee.<sup>92</sup>

#### *f. If earnings already serve as collateral for a secured creditor*

If the debtor’s earnings already serve as collateral for a secured creditor, the secured creditor has priority over the garnishment creditor in the earnings.<sup>93</sup> This means that if a debtor has \$1,000 in nonexempt earnings and a secured creditor has a claim of \$800 on those earnings, the garnishment creditor could claim no more than \$200.

#### *g. Employers may not retaliate*

An employer may not fire or discipline an employee as a result of a garnishment.<sup>94</sup> If this happens, the employee may bring a legal action against the employer within

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91 Minn. Stat. §§ 571.913, 550.37, subd. 13.

92 Minn. Stat. § 571.73, subd. 3(1).

93 Minn. Stat. § 571.81, subd. 2. This applies to all garnished assets, earnings, property, etc. A debtor’s assignment of a security interest in property within ten days before a garnishment is invalid. Minn. Stat. § 571.81, subd. 2.

94 Minn. Stat. § 571.927.

the next 90 days.<sup>95</sup> If an employer is found to have violated this law, a court may order the reinstatement of the employee and other necessary relief.<sup>96</sup>

## 2. Garnishing money in a bank account

Money deposited at a bank or other financial institution may be garnished.<sup>97</sup>

### a. Bank receives a summons and retains the debtor's money

To garnish money in a bank account, the creditor must first send legal papers, including a summons, to the bank.<sup>98</sup> The bank must retain up to 110 percent of the creditor's claim against the debtor.<sup>99</sup> The debtor cannot withdraw this money, and checks written on the account may bounce.

### b. Bank notifies debtor

Within two business days after the bank receives the garnishment summons, it must notify the debtor of the garnishment by first class mail.<sup>100</sup> This notice must include an exemption form and explain that the bank is holding the debtor's money.

### c. Exemptions

Debtors should read the exemption notice carefully. Claiming exemptions explained in the notice may result in at least some of the held money being released to the debtor.<sup>101</sup> Exemptions from bank account garnishment include money that would have been exempt from garnishment as earnings, such as Social Security benefits, unemployment insurance, workers' compensation, veteran's benefits, life insurance proceeds, and the earnings of a child.<sup>102</sup>

### d. Claiming an exemption

To claim an exemption, the debtor must fill out, sign, and mail or deliver the exemption form to both the bank and the creditor's lawyer.<sup>103</sup> If the debtor returns the exemption form within 14 days of the date the bank sent the notice, the bank should still be holding the money.<sup>104</sup> If the exemption form is returned after 14 days, the bank may have released the money to the creditor.<sup>105</sup> The debtor can still get the money back, but it will take longer.<sup>106</sup> If the creditor does not challenge

95 Minn. Stat. § 571.927, subd. 2.

96 Minn. Stat. § 571.927, subd. 2.

97 Minn. Stat. § 571.91.

98 Minn. Stat. §§ 571.911, 571.912.

99 Minn. Stat. §§ 571.911, 571.912.

100 Minn. Stat. § 571.913.

101 Minn. Stat. §§ 571.912, 571.913.

102 Minn. Stat. § 571.912.

103 Minn. Stat. §§ 571.912, 571.913.

104 Minn. Stat. §§ 571.912, 571.913.

105 Minn. Stat. § 571.913.

106 *Investors Sav. Bank v. Miller*, 440 N.W.2d 168 (Minn. Ct. App. 1989).

the exemption, seven days after the bank receives the exemption claim, the bank should release the money to the debtor.<sup>107</sup>

*e. Creditors can challenge the exemption*

A creditor may challenge the debtor's exemption claim.<sup>108</sup> If the creditor does so, the bank will not release the money the debtor claimed as exempt until a court rules on the issue.<sup>109</sup> The objection to the exemption must be sent to the debtor.<sup>110</sup> It should include a form that the debtor may use to request a hearing to defend the exemption.<sup>111</sup>

*f. Courts must help the debtor defend the exemption*

If the creditor challenges the exemption, the debtor must defend the exemption.<sup>112</sup> If the debtor does not, the exemption is lost. Within 10 days after the creditor's objection to the exemption is given to the debtor, or within 13 days after the objection was mailed to the debtor, the debtor must file with the court the request for hearing form that was included in the creditor's challenge to the exemption.<sup>113</sup> The court will send a copy of the hearing request to the bank.<sup>114</sup> If it is possible that the bank might not receive the request mailed by the court within the required time period, it is recommended that the debtor personally deliver a copy of the hearing request to the bank to ensure that the bank continues to hold the funds and does not turn them over to the creditor.<sup>115</sup> Court employees must give help with writing and filing these papers to anyone who does not have a lawyer.<sup>116</sup>

*g. Court then decides*

If the debtor files the hearing request on time, the court will conduct a hearing within five business days to decide whether or not the exemption is valid.<sup>117</sup> The bank will hold the debtor's money until the court makes a decision.<sup>118</sup>

### **3. Garnishing other personal property**

Although not usually used for this purpose, garnishment may be used by the creditor to get third parties to turn over to the creditor other property owned by the debtor.<sup>119</sup> All nonexempt personal property may be taken this way. The debtor must receive an

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107 Minn. Stat. §§ 571.914, 571.915.

108 Minn. Stat. §§ 571.914, 571.912.

109 Minn. Stat. § 571.914, subd. 4.

110 Minn. Stat. § 571.914, subd. 1.

111 Minn. Stat. § 571.914, subd. 3.

112 Minn. Stat. § 571.914, subd. 2.

113 Minn. Stat. § 571.914, subd. 3.

114 Minn. Stat. § 571.914, subd. 2.

115 Minn. Stat. § 571.914, subd. 2.

116 Minn. Stat. § 571.914, subds. 1, 2.

117 Minn. Stat. § 571.914.

118 Minn. Stat. § 571.915.

119 Minn. Stat. §§ 185, 571.73, subd. 3(3).

exemption notice and a copy of the garnishment summons and notice.<sup>120</sup> The exemptions for this garnishment include the same basic exemptions discussed later at page 145 for judgment liens, such as a homestead, a motor vehicle, and farm machinery.<sup>121</sup> A court may order the garnishee to give the property to the creditor.<sup>122</sup>

#### 4. Prejudgment garnishments

In very limited circumstances, the law allows a creditor to get a garnishment even before the court issues a money judgment. In such a case, which is known as a prejudgment garnishment, the debtor has no chance to argue his or her case in a hearing.<sup>123</sup> Prejudgment garnishments should be very rare and are likely to happen only when the creditor can show the court that the debtor is likely to take actions that will somehow defraud the creditor and unfairly prevent the creditor from collecting under the normal procedures.<sup>124</sup> This might include, for example, proof that the debtor has tried to remove or hide property that could be taken by the creditor in a garnishment.

### C. Summary executions

A summary execution of a money judgment may be issued to the creditor's lawyer instead of to the sheriff.<sup>125</sup> In practice, a summary execution is similar to a garnishment.

#### 1. \$10,000 limit

Summary executions are limited to \$10,000 per execution.<sup>126</sup>

#### 2. Targets earnings and bank deposits — not other property

In a summary execution, the creditor's lawyer gets a writ of execution from the court and sends it to the party who has the debtor's money—most often a bank, although it can be an employer or anyone else who holds the debtor's earnings and deposits.<sup>127</sup> The money is then given directly to the creditor.<sup>128</sup> The creditor's lawyer may therefore collect both the debtor's nonexempt earnings—including earnings from selling agricultural products such as milk—and the debtor's money in a bank or other financial institution. The lawyer may not use the summary execution to seek other types of personal property, such as equipment or livestock.<sup>129</sup>

120 Minn. Stat. §§ 571.72, subd. 4, 571.74.

121 Minn. Stat. §§ 571.73, subd. 3, 550.37, 571.922, 571.72, subd. 8. These exemptions follow the exemptions listed in Minn. Stat. § 550.37.

122 Minn. Stat. § 571.84.

123 Minn. Stat. §§ 571.71(2), 571.93, 571.931, 571.932; *Picht v. Jon R. Hawks, Ltd.*, 236 F.3d 446 (8th Cir. 2001).

124 Minn. Stat. § 571.93, subd. 1; *Ertle v. Press*, No. 3-95-90 at n.1 (D. Minn. May 3, 1995) (unpublished).

125 Minn. Stat. ch. 551.

126 Minn. Stat. § 551.01.

127 Minn. Stat. §§ 551.04, 551.041.

128 Minn. Stat. § 551.04.

129 Minn. Stat. § 551.04, subd. 3.

### 3. Exemptions apply

The summary execution process is limited by the same debtor exemptions that apply to garnishment, and it is controlled by the same notice requirements as well.<sup>130</sup>

#### D. Attachment

In an attachment, a creditor who has started a lawsuit seeking a judgment against a debtor may get a court order to seize—technically known as “attach”—the debtor’s property.<sup>131</sup> Attachment is different from most other creditor actions because it happens before the creditor wins any judgment. In other words, it allows the creditor to take the debtor’s property before the court decides for certain that the debtor owes the alleged debt to the creditor. Attachment would likely be used only very rarely against a family farmer. Courts should only allow it if the debtor has acted fraudulently, or if the court is convinced that the debtor is about to remove or sell nonexempt property with the intention of defrauding the creditor.<sup>132</sup> If the court grants the creditor the right to an attachment, nonexempt personal property, wages, and nonexempt real estate may be taken.<sup>133</sup> Attachment may also trigger farmer-lender mediation.<sup>134</sup> Chapter Seven discusses mediation.

## VI. Discovering assets

Sheriffs usually do not engage in detailed investigative work to find a debtor’s property. Instead, the creditor or the creditor’s lawyer is expected to tell the sheriff where to find the property. If the sheriff is not able to find the debtor’s property and returns the writ of execution, the power of the writ ends and a new one must be issued to try again.<sup>135</sup> This process may be repeated for as long as the judgment is in effect.

If a creditor is having a hard time finding the debtor’s assets, the creditor may use several legal tools against the debtor.<sup>136</sup> For example, the creditor may demand a deposition, which requires the debtor to answer questions under oath about his or her assets.<sup>137</sup> Other people who might know where to find the debtor’s assets may be subject to deposition as well.<sup>138</sup> The creditor can also force the debtor to produce documents and other material about the debtor’s assets.<sup>139</sup> This might include, for example, records, tax returns, or canceled checks.<sup>140</sup> If the sheriff returns an execution without full repayment, the creditor may also ask the judge to bring the debtor to court to answer questions under oath about the debtor’s assets.<sup>141</sup> The debtor may also be forced

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130 Minn. Stat. §§ 551.04, 551.041.

131 Minn. Stat. § 570.02.

132 Minn. Stat. §§ 570.02, 570.025.

133 Minn. Stat. §§ 570.026, 570.051.

134 Minn. Stat. § 583.26, subd. 5(a).

135 Minn. Stat. § 550.051.

136 Minn. R. Civ. P. 69.

137 Minn. R. Civ. P. 30.

138 Minn. R. Civ. P. 30.01.

139 Minn. R. Civ. P. 34.

140 Minn. R. Civ. P. 34.

141 Minn. Stat. §§ 571.01, 575.02, 575.04.

to answer written questions under oath, known as interrogatories.<sup>142</sup> Debtors who do not cooperate can be sanctioned or fined and eventually subject to contempt of court and arrest.<sup>143</sup>

## VII. Satisfied judgments

If the debtor's property is sold and the creditor is paid in full, the judgment is satisfied. If the judgment is paid or otherwise satisfied, the creditor must give the debtor a certificate of satisfaction within 10 days after the satisfaction or within 30 days of payment by check.<sup>144</sup>

## VIII. Right of redemption

A right of redemption means that the debtor has the right to repurchase some types of property sold at a sheriff's sale.<sup>145</sup> Only real property may be redeemed from a sheriff's execution sale.<sup>146</sup> Personal property may not be redeemed. The right of redemption lasts for one year.<sup>147</sup> The debtor redeems property by paying the purchaser from the sheriff's sale the amount paid for the property plus interest.<sup>148</sup> If the purchaser was a creditor, the redeeming debtor must pay the purchase price plus the amount of the creditor's lien with interest.<sup>149</sup> In addition, the debtor must show documentation of his or her interest in the property and an affidavit stating the amount owed.<sup>150</sup>

These redemption documents must then be filed with the county recorder or registrar of titles within 24 hours after the debtor hands over the redemption payment.<sup>151</sup> If the debtor redeems, he or she should receive a certificate of redemption from the person the debtor paid.<sup>152</sup> The certificate of redemption is proof of the repurchase of the property, and it must be recorded with the county recorder or registrar of titles within four days after the right of redemption expires.<sup>153</sup> If the debtor fails to record the certificate of redemption, the redemption may be

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142 Minn. R. Civ. P. 33.

143 Minn. Stat. § 575.03; Minn. R. Civ. P. 37.

144 Minn. Stat. § 548.15; *Wall v. Fairview Hosp. & Healthcare Servs.*, 584 N.W.2d 395 (Minn. 1998).

145 Minn. Stat. §§ 550.4 to 550.27; *Sardeson v. Menage*, 43 N.W. 66 (Minn. 1889).

146 Minn. Stat. § 550.24.

147 Minn. Stat. § 550.24(b).

148 Minn. Stat. § 550.24(b). The money may be paid to the person who purchased the property, the sheriff, or the court administrator of the district court for the county in which the property is located. Minn. Stat. § 550.24(b). The interest rate on judgments is set each year by the state court administrator. Minn. Stat. § 549.09, subds. 1, 2. The rate is determined by the one-year constant maturity treasury yield for the most recent calendar month as reported by the Federal Reserve. If this yield is less than 4 percent, then 4 percent will be considered the annual interest rate for the next calendar year. Minn. Stat. § 549.09, subd. 1(c).

149 Minn. Stat. § 550.24(b).

150 Minn. Stat. §§ 550.27, 580.25.

151 Minn. Stat. §§ 550.26, 580.25.

152 Minn. Stat. § 550.27.

153 Minn. Stat. §§ 550.27, 580.26. If the debtor is not redeeming as the owner or the representative, heir, or designee of the owner, the debtor must file the certificate of redemption within four days after redeeming.



voided by any person that later attempts to redeem the same property.<sup>154</sup>

## IX. Exemptions under Minnesota law

Debtors never lose all of their property to unsecured creditors. Minnesota law sets out a number of exemptions that protect certain property from seizure by creditors.<sup>155</sup> All of the methods of taking the debtor's property are limited by these exemptions.<sup>156</sup> Exemptions must, however, be claimed by the debtor.<sup>157</sup> Debtors should never assume that the exempt property is automatically protected. Any time a debtor receives an exemption notice, it is important to read the notice carefully and follow the directions in it. In general, courts should liberally interpret the exemptions to favor the debtor.<sup>158</sup>

Three types of exemptions apply: the homestead exemption, the wage exemption, and general statutory exemptions.

### A. Exemptions do not apply to property given as collateral

Debtors sometimes offer exempt property as collateral to a creditor. When this happens, the creditor may enforce this debt without regard for exemptions.<sup>159</sup>

### B. Homestead exemption

In general, creditor judgments cannot be used to take the debtor's homestead.<sup>160</sup> This includes a house owned and occupied by the debtor as a dwelling place, together with the land where it is located.<sup>161</sup> For most family farmers, incorporation of the farming business should not affect the right to the use of a homestead exemption.<sup>162</sup>

#### 1. Homestead exemptions are confusing

The law concerning homestead exemptions can be especially confusing. This is true for several reasons.

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154 Minn. Stat. § 580.26.

155 Minn. Const. Art. I, § 12. For a general discussion of Minnesota and North Dakota debtor exemptions, see Lowell P. Bottrell, *Comfortable Beds, a Church Pew, a Cemetery Lot, One Hog, One Pig, One Sheep, One Cow, a Yolk of Oxen or a Horse, and Your Notary Seal: Some Thoughts About Exemptions*, 72 N. DAK. L. REV. 83 (1996) and Kip M. Kaler, *Exemptions and Some Necessary Pigeon Holes*, 72 N. DAK. L. REV. 651 (1996).

156 Minn. Stat. §§ 510.01, 510.05, 550.04, 550.143, 550.37, subd. 1.

157 Minn. Stat. §§ 550.04, 550.143, 550.37, subd. 17, 571.912, 571.913.

158 22 DUNNELL MINN. DIGEST, *Exemptions* § 1.00 (4th ed. 1994).

159 *Moyer v. International State Bank*, 404 N.W.2d 274 (Minn. 1987); *McPherson v. University Motors, Inc.*, 193 N.W.2d 616 (Minn. 1972); 22 DUNNELL MINN. DIGEST § 1.00 (4th ed. 1994).

160 Minn. Stat. § 510.01.

161 Minn. Stat. §§ 510.01, 510.02, 510.05.

162 *Cargill, Inc. v. Hedge*, 375 N.W.2d 477 (Minn. 1985); *State Bank v. Euerle Farms, Inc.*, 441 N.W.2d 121 (Minn. Ct. App. 1989).

*a. Homestead exemptions used for two purposes*

Homestead exemptions can be used for two different purposes: either to prevent the sale of the homestead or, if the real estate upon which a homestead is located is to be sold by the sheriff, to make sure that the homestead is sold separately from the rest of the property so that later the homestead may be redeemed separately by the debtor.

*(1) Preventing the sheriff from selling the homestead*

If properly claimed, the homestead exemption can be used to make sure that creditors never force the sheriff to execute on the debtor's homestead.<sup>163</sup> Used in this way, therefore, a part of the debtor's home property cannot be taken.

*(2) Separate sale and redemption rights*

If the sheriff does execute on real estate that contains a homestead and is preparing to sell the real estate at an auction, the debtor still has a homestead exemption.<sup>164</sup> This exemption allows the debtor to designate that the homestead part of the property be sold separately at the auction—which will allow the debtor to redeem that property separately.<sup>165</sup>

*b. Different definitions and rules are used for each purpose*

These dual purposes of the homestead exemption are confusing. In addition, the two purposes of homestead rights are found in different parts of the statutes, have different definitions of a homestead, and seem to require different steps to claim the homestead right.<sup>166</sup>

*c. Homestead exemption law changed*

Minnesota's homestead exemption law changed in 1993.<sup>167</sup> Courts have defined only pieces of how these changes apply. Some of the gray areas that can be important to farmers are noted below.

*d. Farmers using the homestead exemption should be careful*

The following sections explain some of the more confusing parts of the law. While courts have untangled some of this confusion, debtors need to be very careful in exercising their homestead exemption.

**2. Defining the homestead — requirements that always apply**

The following must always be true for the debtor to claim a homestead exemption for any purpose.

<sup>163</sup> Minn. Stat. §§ 510.01, 510.07.

<sup>164</sup> Minn. Stat. § 550.175.

<sup>165</sup> Minn. Stat. § 550.175, subds. 3, 4.

<sup>166</sup> Minn. Stat. §§ 510.08, 510.09, 550.175, subds. 3, 4.

<sup>167</sup> 1993 Minn. Laws ch. 79.

*a. Debtor must live there*

For the property to qualify as a homestead, the debtor must live there.<sup>168</sup> If the debtor abandons the homestead, therefore, the exemption can be lost for that real estate.

If the debtor does not live at the homestead for more than six consecutive months, to protect the homestead exemption, the debtor must file with the county recorder a notice that is executed, witnessed, and acknowledged in the same way as a real estate deed; describes the real estate; and claims the real estate as the debtor's homestead.<sup>169</sup>

*b. Value of no more than \$500,000 — if used for agriculture*

The value of a homestead used primarily for agricultural purposes may not be more than \$500,000.<sup>170</sup> Otherwise, the value of a homestead may not be more than \$200,000.<sup>171</sup> This book assumes that the homestead is used primarily for agricultural purposes.<sup>172</sup>

This dollar limit was established in August 1993.<sup>173</sup> As of the time this book was written, several questions remained about how it will operate.

*(1) Value is equity value*

If the land is agricultural, the homestead property may not have a value of more than \$500,000.<sup>174</sup> Although the statute does not say so directly, the Minnesota Court of Appeals has ruled that the value cap is based on the debtor's

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168 *Denzer v. Prendergast*, 126 N.W.2d 440, 442-43 (Minn. 1964). "In *Denzer*, the debtor . . . owned a residual interest in a family farm that was subject to his mother's life estate. Though this future interest did not entitle him to possession or occupancy while the life tenant was alive, the debtor in fact lived with his mother. The Court concluded that an oral agreement between the debtor and his mother provided a sufficient right of occupancy . . . focusing . . . on 'whether the ownership and occupancy affords a community connection of such significance as to give reason to believe that the preservation of that connection will in the long run make the debtor and his family better able to fulfill their social obligation to be self-sustaining.' 126 N.W.2d at 444." *Peoples' State Bank v. Stenzel (In re Stenzel)*, 301 F.3d 945, 948 (8th Cir. 2002).

169 Minn. Stat. § 510.07; *In re Kasden*, 84 F.3d 1104 (8th Cir. 1996); *Muscala v. Wirtjes*, 310 N.W.2d 696 (Minn. 1981). If the debtor does not live in the homestead for five years after filing a notice claiming the real estate as his or her homestead, the exemption is lost.

170 Minn. Stat. §§ 510.01, 510.02; *In re Becker*, 215 B.R. 585 (B.A.P. 8th Cir. 1998).

171 *Kipp v. Sweno*, 629 N.W.2d 468 (Minn. Ct. App. 2001), review denied (Minn. Aug. 22, 2001); *In re Kyllonen*, 264 B.R. 17 (Bankr. D. Minn. 2001).

172 The test for whether property is urban or rural is set out in *In re Becker*, 215 B.R. 585, 587 (8th Cir. B.A.P. 8th Cir. 1998) (citing *National Bank v. Banholzer*, 71 N.W. 919 (Minn. 1897)).

173 1993 Minn. Laws ch. 79.

174 Minn. Stat. § 510.02.

equity in the homestead, not the homestead's fair market value.<sup>175</sup> For example, if the homestead's fair market value is \$550,000 but the farmer has a mortgage debt on the homestead of \$100,000, the farmer's equity is \$450,000 and the whole homestead would be exempt.

(2) *Will the \$500,000 limitation be retroactive?*

The \$500,000 limitation took effect on August 1, 1993.<sup>176</sup> It is not clear whether it applies to older debts and judgments. If the statute is not applied retroactively, debts incurred before then may not be subject to a dollar limit. In theory, a court analyzing the homestead exemption could apply the law that was in place at the time the debt was incurred, at the time the creditor got the judgment, or at the time the creditor tries to execute on the homestead.<sup>177</sup>

(3) *Farmers with high-value homesteads should investigate*

Farmers subject to a judgment and facing the possibility that their homestead property has a value of over \$500,000 should consult with an attorney to find out whether and how the courts have resolved these issues.

c. *Proceeds and insurance included*

If the debtor sells a homestead, the proceeds are exempt from creditors for one year.<sup>178</sup> This gives the debtor time to reinvest the proceeds in another homestead. Similarly, the proceeds from an insurance claim for the homestead are exempt for one year.<sup>179</sup>

175 In *Baumann v. Chaska Bldg. Ctr., Inc.*, 621 N.W.2d 795, 799 (Minn. Ct. App. 2001), the Minnesota Court of Appeals concluded that "the phrase 'value of the homestead exemption' used in section 510.02 refers to the value of the debtor's equity in the property." A federal bankruptcy decision limited collection against a homestead to a non-farm debtor's equity above \$200,000. *In re Bame*, 271 B.R. 354 (Bankr. D. Minn. 2001). Other references to the value of the property can be found at Minn. Stat. §§ 510.01, 550.175, subds. 3, 4(d).

176 1993 Minn. Laws ch. 79.

177 A statute should not be applied retroactively unless "clearly and manifestly so intended by the legislature." Minn. Stat. § 645.21. Several cases concerning changes to homestead exemption laws have applied changes retroactively. *In re Johnson*, 69 B.R. 988 (Bankr. D. Minn. 1987); *In re Sticha*, 60 B.R. 717 (Bankr. D. Minn. 1986); *In re Schuette*, 58 B.R. 417 (Bankr. D. Minn. 1986). The homestead exemption, however, is designed to "secur[e] the home against the uncertainties and misfortunes of life even at the sacrifice of just demands" and should be construed liberally in favor of the debtor. *In re Haggerty*, 448 N.W.2d 363, 367 (Minn. 1989); *In re Joy*, 5 B.R. 681, 683 (Bankr. D. Minn. 1980).

178 Minn. Stat. § 510.07. If the sale is through a contract for deed, however, the exemption on proceeds only applies to the payments the debtor got in the first year. *In re Ehrich*, 110 B.R. 424 (Bankr. D. Minn. 1990).

179 Minn. Stat. § 510.07.

*d. Rent and receipts*

Rent and all other income taken from a homestead are exempt from creditor action.<sup>180</sup> Crops growing on the homestead may be exempt, although the proceeds from the sale of the crops may not be.<sup>181</sup> If part of the homestead is used for commercial purposes, that part of the property is still exempt.<sup>182</sup> In addition, a certain amount of standing crops can be exempt under the general exemptions described below at page 153.<sup>183</sup>

**3. No larger than 160 acres — sometimes a requirement**

There may be a size limitation on a homestead exemption—depending on the type of homestead exemption claimed. If the debtor wants to make sure the homestead is not sold at the sheriff's sale, a rural homestead may be no more than 160 acres.<sup>184</sup> If the debtor wants to use the homestead designation to force the sheriff to sell the homestead separately, there is no acreage limit on the homestead.<sup>185</sup>

**4. Claiming the homestead exemption**

The law sets up a step-by-step process for the creditor and the courts to follow if the creditor wants to execute on property that includes a homestead. As with the definition of a homestead, the process of claiming a homestead exemption can be confusing.

*a. Creditor must send notice*

Before executing on the real estate, the creditor must send the debtor a notice setting out how the debtor can go about designating part of the property as a homestead.<sup>186</sup> The notice must explain that if the debtor properly claims the homestead by sending notice to the creditor, the sheriff, and the county recorder, the designated homestead will be sold separately from the rest of the property and may be redeemed separately.<sup>187</sup> This means that after the sheriff's sale, the farmer has the right to buy back the separated homestead from the highest bidder.

*b. The notice is misleading*

The notice language set out in the statute says that the land designated as a homestead "may include any amount of property."<sup>188</sup> Technically, this is correct. A

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180 *Wilson v. First Nat'l Bank of Mankato*, 69 N.W.2d 69 (Minn. 1953).

181 *In re Friedrich*, 199 F. 13 (D. Minn. 1912); *Wilson v. First Nat'l Bank of Mankato*, 60 N.W.2d 69 (Minn. 1953); *Sparrow v. Pond*, 52 N.W. 36 (Minn. 1892); 22 DUNNELL MINN. DIGEST, *Exemptions* § 1.02(d) (4th ed. 1994).

182 *O'Brien v. Johnson*, 148 N.W.2d 357 (Minn. 1967).

183 Minn. Stat. § 550.37, subds. 4a(a), 5; *In re Flitter*, 181 B.R. 938 (Bankr. D. Minn. 1995). For this exemption to apply, the debtor must be principally engaged in farming. *In re Zimmer*, 185 B.R. 786 (Bankr. D. Minn. 1995).

184 Minn. Stat. § 510.02; *In re Estate of Riggle*, 654 N.W.2d 710 (Minn. 2002).

185 Minn. Stat. § 550.175, subd. 3.

186 Minn. Stat. § 550.175, subd. 1.

187 Minn. Stat. § 550.175, subds. 1, 2.

188 Minn. Stat. § 550.175, subds. 2, 3.

debtor may claim any acreage for a homestead. The notice is misleading, however, because it does not explain that if the debtor designates too much acreage as a homestead, the debtor loses the chance to prevent the sheriff from auctioning the homestead.

*c. A proper homestead designation can keep the sheriff from selling it*

If the debtor claims a homestead that is larger than the size allowed for a homestead, the sheriff may execute on the whole property.<sup>189</sup> The debtor can then deliver to the sheriff a homestead designation.<sup>190</sup> If this is done properly, the land identified in the homestead designation should no longer be subject to the levy.<sup>191</sup>

*d. Small homestead properties should not be subject to execution at all*

The law is clear that a valid homestead is generally exempt from seizure or sale.<sup>192</sup> The statutes also suggest that unless the debtor's homestead property is too large or not set apart as a homestead, there should be no levy against it.<sup>193</sup>

*e. Designating a homestead*

In general, debtors must officially designate the homestead they want to claim by serving a copy of the homestead designation on the executing creditor, the sheriff, and the county recorder ten business days before the sale is scheduled.<sup>194</sup>

*(1) Debtor must estimate the value of the property*

As of August 1, 1993, the law makes the debtor include along with the legal description of the homestead property an estimate of the value of the property.<sup>195</sup> It is unclear whether the debtor should estimate the value of all of the land or only the homestead. The law probably requires that the debtor estimate the value of the homestead only.<sup>196</sup> The statute also does not explain whether the value listed should be the property's fair market value or the equity value. As noted above, a Minnesota court has held that the homestead exemption limit is calculated as equity value.<sup>197</sup>

*(2) Designation cannot unreasonably affect the value of the rest of the property and must be contiguous*

The homestead designation must be compact, must include the home, and must not unreasonably affect the value of the nonexempt part of the

189 Minn. Stat. § 550.175, subd. 4.

190 Minn. Stat. § 510.08(a).

191 Minn. Stat. § 510.08(a).

192 Minn. Stat. §§ 510.01, 510.05, 510.08(a).

193 Minn. Stat. §§ 510.01, 510.08(a).

194 Minn. Stat. §§ 550.175, subd. 3, 510.02.

195 Minn. Stat. § 550.175, subd. 3.

196 Minn. Stat. § 550.175, subd. 3.

197 *Baumann v. Chaska Bldg. Ctr., Inc.*, 621 N.W.2d 795 (Minn. Ct. App. 2001).

property.<sup>198</sup> The homestead exemption does not protect land that is noncontiguous with the land on which the home is located.<sup>199</sup> Noncontiguous means that the parcel with the home and another parcel do not touch or join at some point.<sup>200</sup>

*(3) Designation cannot cause significant injury to the creditor*

In addition, the homestead designation may not cause significant injury to the creditor.<sup>201</sup> This could be a limitation for some debtors. For example, suppose that the whole property includes 165 acres. Once the homestead is taken out, the property available to the creditor may only be five acres. If the remaining five acres are relatively valueless, the creditor might try to challenge the homestead designation.<sup>202</sup>

*f. Deadlines for designation*

An especially confusing part of the law concerning a homestead is deadlines. They are mentioned in two different statutory sections that say two different things.

*(1) Ten business days before the sale*

The redemption notice set out in the statute discusses the debtor's right to have the homestead auctioned and redeemed separately.<sup>203</sup> That notice says that the debtor must give a copy of the homestead designation to the creditor, the sheriff, and the county recorder at least ten business days before the sale.<sup>204</sup>

*(2) Twenty days after the notice of the levy*

Another part of the statute says that if the homestead designation is not made within 20 days after the debtor gets notice of the levy, the sheriff will have the land surveyed and set apart the homestead.<sup>205</sup> This part of the statute

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198 Minn. Stat. § 550.175, subd. 3.

199 *Michels v. Kozitza*, 610 N.W.2d 368 (Minn. Ct. App. 2000); *Peoples' State Bank v. Stenzel (In re Stenzel)*, 301 F.3d 945 (8th Cir. 2002); *In re Kyllonen*, 264 B.R. 17 (Bankr. D. Minn. 2001). In *Michels*, the farmer-debtor and his brother co-owned a 40-acre parcel of land which they partitioned. The farmer-debtor received 20 acres that were not contiguous with the parcel that included the farmer-debtor's home. Because the court found the language of Minn. Stat. § 510.01 clear that property must be contiguous, the court held that the homestead exemption did not apply.

200 In *Brixius v. Reimringer*, 112 N.W. 273, 273 (Minn. 1907), the Minnesota Supreme Court held that exempt land may "consist of two or more separate descriptions, or tracts, of land, provided the same are so situated that they may be occupied and cultivated as one body of land."

201 Minn. Stat. § 550.175, subd. 4(d).

202 *Title Ins. Co. v. Agora Lease, Inc.*, 320 N.W. 2d 884 (Minn. 1982), reached a different conclusion under the prior law.

203 Minn. Stat. § 550.175.

204 Minn. Stat. § 550.175, subs. 2, 3.

205 Minn. Stat. § 510.09. The sheriff may also designate the homestead if the creditor objects to the debtor's designation. The debtor may set the starting point for the sheriff's designation. The cost of the sheriff's survey is added to the debt and paid out of the proceeds of the sale.

seems to suggest, therefore, that if the debtor fails to designate a homestead within 20 days, the sheriff will designate one, and the homestead will still not be sold at the sheriff's sale.

*g. Creditor can object to designation*

The creditor can object to either the homestead designation itself or the estimated value of the homestead.<sup>206</sup>

The sheriff will not sell the homestead separately if the creditor challenges the debtor's right to a homestead designation in general, objects to the property designated, or claims that the value of the homestead property is more than \$500,000.<sup>207</sup> Although the statute does not say so directly, the creditor probably cannot force the sale of the whole property unless the court approves.

If the creditor objects to the fair market value estimate, the court must look at any appraisals submitted by the debtor and creditor and may also order an independent appraisal.<sup>208</sup>

*h. The court's response*

If the creditor objects to the debtor's homestead designation, the court has two options; the law is not clear about which action the court should take.

*(1) The court can change the designation*

If the creditor objects to the homestead designation, the court can have the property surveyed and appraised, designate the homestead, and determine its value.<sup>209</sup> If this happens when the court makes the new designation, it must try to match the debtor's request as closely as possible while still meeting other legal requirements for a homestead.<sup>210</sup>

*(2) The court can order the whole property sold together*

The court will most likely order the whole property sold together if the court decides that either: (1) the value of the designated homestead is greater than \$500,000, or (2) the property cannot be divided without material injury to the creditor.<sup>211</sup>

206 Minn. Stat. § 550.175, subd. 4(b).

207 Minn. Stat. § 550.175, subd. 4(a). The sheriff likely needs to get the court's approval under Minn. Stat. § 550.175, subd. 4(b).

208 Minn. Stat. § 550.175, subd. 4(c).

209 Minn. Stat. § 550.175, subd. 4(b), (f). The debtor may be charged for the costs of the survey and appraisal if the homestead was not properly designated.

210 Minn. Stat. § 550.175, subd. 4(b).

211 Minn. Stat. §§ 550.175, subd. 4(d), 510.08(b).



*i. If the whole property is sold together by the sheriff*

If the whole property is sold together, the sale proceeds up to \$500,000 go to the debtor.<sup>212</sup> Bids should not be accepted by the sheriff unless they are over the \$500,000 homestead amount.

**5. Reminder — no homestead exemption for mortgaged property and certain liens**

No homestead exemption is possible for mechanics' liens, tax liens, or mortgages on the homestead.<sup>213</sup>

**C. Earnings exemptions**

All earnings not subject to garnishment are exempt.<sup>214</sup> This exemption may not be waived by the debtor.<sup>215</sup> As discussed earlier at page 134, exempt wages that are deposited in a bank account keep their exempt character for 20 days after deposit.<sup>216</sup> To trace earnings, the courts use the first-in, first-out accounting method.<sup>217</sup> First-in, first-out accounting is described earlier in this chapter on page 139.

**D. General exemptions**

Property covered by a general exemption may not be taken by creditors through attachment, garnishment, or sale by order of any court.<sup>218</sup>

**1. How general exemptions work**

There are a number of complicated rules for determining the availability and amount of a general exemption from creditor claims.

*a. Debtor picks the property*

The decision of which of the debtor's possessions are exempt in each category is the debtor's, not the creditor's.<sup>219</sup> For example, only one car can be exempt. If the debtor owns two cars and either could be exempt, the debtor gets to pick which car is exempt.

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212 Minn. Stat. § 550.175, subd. 4(d)-(e).

213 Minn. Stat. §§ 510.01, 510.05. Claims filed for medical assistance benefits and state hospital care are also not subject to the exemption. Minn. Stat. §§ 246.53, 256B.15.

214 Minn. Stat. §§ 550.37, subd. 13, 571.922.

215 Minn. Stat. §§ 550.37, subd. 13, 571.926.

216 Minn. Stat. § 550.37, subd. 13.

217 Minn. Stat. § 550.37, subd. 13.

218 Minn. Stat. § 550.37, subd. 1; *Blue Cross & Blue Shield of Minn. v. Mount Sinai Hosp.*, C7-01-1287 (Minn. Ct. App. Mar. 12, 2002) (unpublished); *Last v. Last*, 438 N.W.2d 122 (Minn. Ct. App. 1989).

219 Minn. Stat. § 550.37, subd. 17.

*b. Individual ownership*

Usually, to be exempt, property must be owned by an individual person and cannot be owned by a partnership or business.<sup>220</sup> The exception to this rule is farm equipment, which may be owned by a partnership.<sup>221</sup>

*c. Waiving exemptions*

Most exemptions discussed in this section can be waived by the debtor.<sup>222</sup> Exemptions for personal goods and earnings, however, may not be waived.<sup>223</sup> For any waiver to be enforceable, it must be part of a written contract that describes the property no longer exempt and the contract must be signed by the debtor.<sup>224</sup>

*d. When exempt money is deposited in a bank*

Since several exemptions take the form of money, an important question is what happens when exempt funds are deposited in a bank or other financial institution. The first-in, first-out accounting method is used to determine the exemption status of funds in an account.<sup>225</sup> First-in, first-out accounting is described earlier in this chapter on page 139.

*e. How the sheriff separates out exempt property*

Several categories of exemptions include dollar limits for a certain kind of property.<sup>226</sup> Often the debtor has more of that type of property than the dollar limit allows. If the sheriff believes this is the case, he or she may levy upon all of that type of property and have it appraised by two appraisers.<sup>227</sup> If the appraisers agree that the property is worth more than the exemption, the debtor may pick out property up to the exemption value limit, and the rest is kept by the sheriff.<sup>228</sup> If the property cannot be easily divided and it is worth more than the exemption amount, the sheriff will sell all of the property and pay the exemption amount to the debtor.<sup>229</sup>

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220 Minn. Stat. § 550.37, subd. 18; 22 DUNNELL MINN. DIGEST, *Exemptions* § 1.02(w) (4th ed. 1994).

221 Minn. Stat. § 550.37, subd. 5; *In re Zimmer*, 185 B.R. 786 (Bankr. D. Minn. 1995).

222 Minn. Stat. § 550.37, subd. 19.

223 Minn. Stat. § 550.37, subd. 19.

224 Minn. Stat. § 550.37, subd. 19; *Moyer v. International State Bank*, 404 N.W.2d 274 (Minn. 1987).

225 Minn. Stat. § 550.37, subd. 20.

226 Minn. Stat. § 550.41.

227 Minn. Stat. § 550.41.

228 Minn. Stat. § 550.41.

229 Minn. Stat. § 550.41.

## 2. Types of general exemptions

Several of the exemptions described below have dollar limits. In each case, these limits are based on the current fair market value of the property, not the replacement cost.<sup>230</sup> This may be especially important for property that has little fair market value but would be expensive to replace.

### a. Farm equipment and assets

A farmer debtor may claim as exemptions farm equipment, machines, implements, and livestock used in farming, as well as the debtor's farm produce and standing crops.<sup>231</sup> Up to \$13,000 in property can be claimed with this exemption.<sup>232</sup> This amount will not change with inflation.<sup>233</sup> If the farm assets are owned in partnership within the farm family, they are still exempt for the individual debtors.<sup>234</sup>

### b. Business property

Tools, implements, machines, instruments, and furniture used for business are exempt up to \$9,000.<sup>235</sup> This amount changes with inflation.<sup>236</sup> Exempt farm equipment and business property may not have a combined value of more than \$13,000. For example, if \$5,000 worth of business property is exempt, only \$8,000 in farm equipment may be claimed as exempt. This combined total does not change with inflation.<sup>237</sup>

### c. Clothes, household goods, personal property

All clothes, food, utensils, and one watch of the debtor's family are exempt.<sup>238</sup> The value of these goods is not relevant. In addition, household furniture, household appliances, phonographs, radios, and televisions of the debtor's family are exempt up to \$8,100 in value.<sup>239</sup> This value changes with inflation.<sup>240</sup>

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230 Minn. Stat. § 550.37, subd. 21. Several exemption values change with inflation. This change will occur on July 1 of each even-numbered year. Minn. Stat. § 550.37, subd. 4a(b). For levels set in 2002, see 26 S.R. 1366 (Apr. 15, 2002), available at <http://www.comm.media.state.mn.us/bookstore/stateregister/2643.pdf>. The next published adjustment is scheduled for April 30, 2004, or sooner, to be effective July 1, 2004.

231 Minn. Stat. § 550.37, subds. 4a(a), 5; *In re Flitter*, 181 B.R. 938 (Bankr. D. Minn. 1995). For this exemption to apply, the debtor must be principally engaged in farming. *In re Zimmer*, 185 B.R. 786 (Bankr. D. Minn. 1995).

232 Minn. Stat. § 550.37, subd. 5.

233 Minn. Stat. § 550.37, subd. 4a(a).

234 Minn. Stat. § 550.37, subd. 5; *In re Zimmer*, 185 B.R. 786 (Bankr. D. Minn. 1995).

235 Minn. Stat. § 550.37, subds. 4a(a), 6; 26 S.R. 1366 (Apr. 15, 2002), available at <http://www.comm.media.state.mn.us/bookstore/stateregister/2643.pdf>.

236 Minn. Stat. § 550.37, subds. 4a(a), 6.

237 Minn. Stat. § 550.37, subds. 4a(a), 7.

238 These exemptions may not be waived except by a purchase money security interest. Minn. Stat. § 550.37, subds. 4, 4a..

239 Minn. Stat. § 550.37, subds. 4, 4a(a); 26 S.R. 1366 (Apr. 15, 2002), available at <http://www.comm.media.state.mn.us/bookstore/stateregister/2643.pdf>.

240 Minn. Stat. § 550.37, subd. 4a(a).

*d. Mobile home*

A mobile home is completely exempt if the debtor lives in it.<sup>241</sup>

*e. Motor vehicle*

A debtor may claim one motor vehicle as exempt from execution.<sup>242</sup> The vehicle may not have a value of more than \$3,600 (more if it is altered to accommodate someone who is disabled).<sup>243</sup> The value of this exemption changes with inflation.<sup>244</sup>

The value is the debtor's equity.<sup>245</sup> For example, a debtor could exempt a \$5,000 car if he or she owes \$1,400 against it, because the debtor only has equity of \$3,600 in the car.

*f. Insurance benefits*

Certain levels of insurance proceeds are exempt from creditor action.

*(1) Life insurance*

For a surviving spouse or child, life insurance proceeds are exempt up to \$36,000.<sup>246</sup> The \$36,000 is increased by \$9,000 for each dependent of the surviving spouse or child.<sup>247</sup> This money remains exempt when deposited in a bank.<sup>248</sup> These values increase with inflation.<sup>249</sup>

*(2) Accident or disability insurance*

The proceeds from any accident or disability insurance policy are exempt for the beneficiary.<sup>250</sup>

241 Minn. Stat. § 550.37, subd. 12. A mobile home is defined at Minn. Stat. § 168.011, subd. 8.

242 Minn. Stat. § 550.37, subd. 12a.

243 Minn. Stat. §§ 550.37, subd. 12a, 169.345; 26 S.R. 1366 (Apr. 15, 2002), available at <http://www.comm.media.state.mn.us/bookstore/stateregister/2643.pdf>.

244 Minn. Stat. § 550.37, subds. 4a(a).

245 Minn. Stat. § 550.37, subds. 12a, 21. One federal bankruptcy court held: "The debtor's only value in the automobile is her equity. The value of the automobile is only the extent by which the secured interest is exceeded by the fair market value. The debtor has no value in collateral that is secured. That value belongs to the creditor holding the security interest. This Court concludes that Minn. Stat. § 550.37 subd. 12a applies to the equity of the debtor in the automobile and that the Minnesota Legislature intended value to mean equity under that section." *In re Setley*, 11 B.R. 106 (Bankr. D. Minn. 1981).

246 Minn. Stat. § 550.37, subd. 10; 26 S.R. 1366 (Apr. 15, 2002), available at <http://www.comm.media.state.mn.us/bookstore/stateregister/2643.pdf>.

247 Minn. Stat. § 550.37, subds. 10, 4a(a); 26 S.R. 1366 (Apr. 15, 2002), available at <http://www.comm.media.state.mn.us/bookstore/stateregister/2643.pdf>.

248 Minn. Stat. § 550.39. The accrued value of interest under or loan value of an unmatured life insurance policy is also exempt up to \$7,200. 26 S.R. 1366 (Apr. 15, 2002), available at <http://www.comm.media.state.mn.us/bookstore/stateregister/2643.pdf>. This value changes with inflation. Minn. Stat. § 550.37, subds. 4a(a), 23.

249 Minn. Stat. § 500.37, subd. 4a(a).

250 Minn. Stat. § 550.39, subd. 22.

*g. Public assistance*

All relief based on need and the earnings or salary of someone who receives relief based on need are exempt.<sup>251</sup>

*h. Earnings of a minor child*

The earnings of a minor child of the debtor and any child support paid to the debtor are exempt.<sup>252</sup> Money from this exemption remains exempt when deposited in a bank.<sup>253</sup>

*i. Employee benefits*

The debtor's rights to future payments under a pension, individual retirement account, or similar plan or contract on account of illness, disability, or length of service are exempt.<sup>254</sup> The maximum value of this exemption is \$54,000.<sup>255</sup> This value increases with inflation.<sup>256</sup>

*j. Veterans' benefits*

All veterans' benefits are exempt for one year.<sup>257</sup>

*k. Other specific exemptions*

A family Bible, library, musical instruments, a burial plot, and a seat or pew in a house of worship are exempt.<sup>258</sup> Money from a claim of damages to exempt property is exempt.<sup>259</sup>

**3. Proceeds from sale of exempt property generally not exempt**

If exempt property is voluntarily sold for money, the proceeds are not exempt—except for the sale of a homestead.<sup>260</sup>

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251 Minn. Stat. § 550.37, subd. 14; *In re Tomczyk*, Bky. No. 02-55534 (Bankr. D. Minn. Apr. 2, 2003) (unpublished).

252 Minn. Stat. § 550.37, subd. 15.

253 Minn. Stat. § 550.37, subd. 20.

254 Minn. Stat. § 550.37, subd. 24. The United States Bankruptcy Appellate Panel for the Eighth Circuit held that a debtor's interest in his former wife's retirement account was not exempt under Minn. Stat. § 550.37, subd. 24, because he obtained an interest in those funds through his divorce settlement and not through his own employment. The court also found that even though the retirement fund was funded through the family farming operation instead of a separate employer, it made no difference. *In re Anderson*, 269 B.R. 27 (B.A.P. 8th Cir. 2001) (citing *Deretich v. City of St. Francis*, 128 F.3d 1209 (8th Cir. 1997)).

255 Minn. Stat. § 550.37, subd. 24; 26 S.R. 1366 (Apr. 15, 2002), available at <http://www.comm.media.state.mn.us/bookstore/stateregister/2643.pdf>.

256 Minn. Stat. § 550.37, subd. 4a(a).

257 Minn. Stat. § 550.38.

258 Minn. Stat. § 550.37, subsds. 2, 3. Teacher Retirement Fund Association benefits are also exempt. Minn. Stat. § 354A.11.

259 Minn. Stat. § 550.37, subsds. 9, 20. The money from this exemption remains exempt if deposited in a bank.

260 Minn. Stat. § 550.175, subd. 4.

### E. Failing to claim an exemption

A failure to claim a right of exemption at the time of a levy does not prevent the debtor from claiming the right later, as long as the exemption is claimed before the sheriff's sale and as long as no one is adversely harmed by the claim.<sup>261</sup>

### F. Converting nonexempt assets into exempt assets

Debtors faced with a money judgment or other creditor problems may be tempted to sell nonexempt assets and invest the proceeds in property that would be exempt. Many such transactions can be perfectly legal. Some such transfers, however, can be illegal, especially if they are intended to "hinder, delay, or defraud" a creditor or if they are not made for fair consideration.<sup>262</sup> Unfortunately, the difference between what is legal and what is illegal can be tricky. It is extremely important, therefore, to get qualified legal advice before switching nonexempt assets into exempt assets.

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261 *McAbe v. Thompson*, 6 N.W. 479 (Minn. 1880); 22 DUNNELL MINN. DIGEST, *Exemptions* § 1.02(y) (4th ed. 1994).

262 *Kangas v. Robie*, 264 F. 92 (8th Cir. 1920); *In re Curry*, 160 B.R. 813 (Bankr. D. Minn. 1993); *In re Tveten*, 402 N.W.2d 551, 555 (Minn. 1987). In Minnesota, the question of whether the exchange of nonexempt property for exempt property defrauds the creditor is governed by the Uniform Fraudulent Conveyance Act. Minn. Stat. §§ 513.41 to 513.41.51.

## Chapter Six

# Lease Agreements

### I. Introduction

As the number of farmers who rent land, equipment, and livestock grows, leases play an increasing role in agriculture. This chapter reviews both real estate leases and equipment and livestock leases.

In every lease there are at least two parties: the lessor and the lessee. The lessor owns the property, and the lessee rents the property from the lessor. These definitions apply to both real estate leases and leases of goods.

#### **Basic lease terms: lessor and lessee**

The lessor owns the property. The lessee rents the property from the lessor.

### A. Putting leases in writing is usually a good idea

It is almost always a good idea to put a lease in writing. Many farmers have used oral lease agreements for years without problems. These leases can be perfectly legal and, in the right situation, may be the best way for farmers to rent property. As with other types of agreements, however, putting a lease in writing helps to prevent confusion and ensure that the agreement will be legally enforceable.

#### **1. Written leases help eliminate confusion**

Usually the problem with an oral lease is not that one person tries to get the best of the other in an unfair way. More common are honest misunderstandings and confusion. Written leases help to prevent problems by laying out exactly what is expected from the lessor and lessee. While this may be especially important if the parties do not know each other well, it also usually makes sense for friends and family members. Although the risk of a misunderstanding may be small in any given year, the cost of just one problem could be very large.

#### **2. Written agreements are needed to make some leases legal**

Some leases are legally unenforceable if not in writing.

*a. Real estate leases for more than one year must be in writing*

As discussed in Chapter 2 of this book, under Minnesota's version of the statute of frauds, a real estate lease for more than one year must be in writing.<sup>1</sup> If not in writing, the lease of land for more than one year is legally void.<sup>2</sup> A tenancy from year to year—which is defined below—may be enforceable if made orally.<sup>3</sup>

(1) *"Year" means 12 months*

The law defines a year as a calendar year.<sup>4</sup> This means that if the lease covers one crop year but the crop year covers more than 12 months, the law considers the lease to cover more than one year. This means that the lease should be covered by the statute of frauds and must be in writing.

(2) *Partial performance exception*

An unwritten lease of land for more than one year might be enforceable if either the landlord or tenant at least partially fulfills the requirements of the lease.<sup>5</sup> The partial performance exception may apply, for example, if the tenant takes possession of the land and makes improvements on it, such as doing significant work in the field, especially if the landlord knew about the work but did not stop it.<sup>6</sup> Courts are reluctant to use the partial performance exception, so tenants should never plan on using it as a way of preserving a lease.<sup>7</sup> If a tenant does have an oral lease of more than a year and the landlord refuses to meet the terms of the oral lease, the courts might enforce the lease if they are convinced that it would be especially unjust and unfair to void the lease.<sup>8</sup>

*b. Leases for goods with total payments of \$1,000 or more must be in writing*

As discussed in Chapter 2, an agreement to lease goods with total payments of \$1,000 or more must also be in writing to be legally enforceable.<sup>9</sup>

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- 1 Minn. Stat. § 513.05; *Bruder v. Wolpert*, 227 N.W. 46, 47 (Minn. 1929).
  - 2 Minn. Stat. §§ 513.04, 513.05; 30 DUNNELL MINN. DIGEST, *Landlord and Tenant* §§ 2.02(a), 2.08, 3.17 (4th ed. 1995); 44 DUNNELL MINN. DIGEST, *Statute of Frauds* §§ 2.02(f)-(h), 2.05 (4th ed. 1999); *Bergstrom v. Sambo's Restaurants, Inc.*, 687 F.2d 1250 (8th Cir. 1982); *Hoppman v. Persha*, 248 N.W. 281 (Minn. 1933); *Millis v. Ellis*, 122 N.W. 1119 (Minn. 1909); *Alexander v. Holmberg*, 410 N.W.2d 900 (Minn. Ct. App. 1987).
  - 3 *Larson v. Archer-Daniels-Midland Co.*, 32 N.W.2d 649, 653-54 (Minn. 1948).
  - 4 Minn. Stat. §§ 513.04, 513.05.
  - 5 44 DUNNELL MINN. DIGEST, *Statute of Frauds* §§ 4.02(b), 4.03(c) (4th ed. 1999); *Atwood v. Faye*, 273 N.W. 85 (Minn. 1937); *Biddle v. Whitmore*, 158 N.W. 808 (Minn. 1916); *In re Guardianship of Huesman*, 354 N.W.2d 860 (Minn. Ct. App. 1984); *Nelson v. Smith*, 349 N.W. 2d 849, 852-53 (Minn. Ct. App. 1984).
  - 6 *Atwood v. Faye*, 273 N.W. 85 (Minn. 1937); *Biddle v. Whitmore*, 158 N.W. 808 (Minn. 1916).
  - 7 However, courts do apply the partial performance exception to the statute of frauds more liberally to leases than to real estate purchase agreements. *Biddle v. Whitmore*, 158 N.W. 808 (Minn. 1916).
  - 8 *Dale v. Fillenworth*, 162 N.W.2d 234 (Minn. 1968); *Nelson v. Smith*, 349 N.W. 2d 849, 852-53 (Minn. Ct. App. 1984).
  - 9 Minn. Stat. § 336.2A-201.



(1) *What payments are counted*

The value of the lease is the total of all payments to be made under the lease contract. Payments for options to renew the lease or buy the leased goods are not counted.<sup>10</sup>

(2) *Exceptions to the writing requirement*

A lease of goods with payments of more than \$1,000 does not need to be in writing to be enforceable if one of the following two exceptions applies.<sup>11</sup>

(a) *The goods are accepted*

If the leased goods are received and accepted by the lessee, the lessee cannot then claim the lease is invalid because it is not in writing.<sup>12</sup>

(b) *Admitting the contract existed in court*

If either the lessor or lessee admits in legal documents or in court that a lease was made, they cannot later claim that the lease is unenforceable because it is not in writing.<sup>13</sup>

c. *What must be included in the written lease: formal contract not always required*

When a written lease is required by law, only basic information is needed and no special words are required.

(1) *Minimum requirements when a written lease of land is required*

To satisfy the requirements when a written lease of land is required by law there must be a written contract or some other note or other memorandum that creates evidence of the lease.<sup>14</sup> The document should explain that the land is being rented, name the landlord and tenant, and explain that rent or some other benefit is being paid.<sup>15</sup> The lease needs to have the landlord's signature but does not necessarily need the signature of the tenant, especially if the tenant acts in ways to show that he or she agrees to the lease or if the

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10 Minn. Stat. § 336.2A-201(1)(a).

11 Minn. Stat. § 336.2A-201(4)(a)-(c). In addition, if the goods were specially manufactured for the lessee and are not suitable for lease or sale to others in the ordinary course of the lessor's business, the lease can be enforceable even if it is not in writing.

12 Minn. Stat. § 336.2A-201(4)(c).

13 Minn. Stat. § 336.2A-201(4)(b).

14 Minn. Stat. §§ 513.05, 513.04; *Bergstrom v. Sambo's Restaurants, Inc.*, 687 F.2d 1250 (8th Cir. 1982); 30 DUNNELL MINN. DIGEST, *Landlord and Tenant* §§ 2.00(a)-(c), 2.02(a), 2.03 (4th ed. 1995); 44 DUNNELL MINN. DIGEST, *Statute of Frauds* §§ 2.02(f), 3.00, 3.01(a) (4th ed. 1999). For general information on what to include in a written lease agreement, see Gary A. Hachfeld and Kent V. Thiesse, *Putting Your Cash Rent Agreement in Writing*, NICOLLET COUNTY EXTENSION (Jan. 1999), available at [http://www.extension.umn.edu/ruralresponse/resource\\_guide/fmaffp/pycraiw.html](http://www.extension.umn.edu/ruralresponse/resource_guide/fmaffp/pycraiw.html).

15 Minn. Stat. § 513.05.

tenant accepts possession of the written lease.<sup>16</sup>

*(2) Minimum requirements when a written lease of goods is required*

If a lease of goods must be in writing, it does not need to be extensive or detailed. Besides explaining that a lease contract has been made, to be enforceable the lease must be signed, must state the length of the lease, and must contain a reasonable description of the goods.<sup>17</sup>

Technically, a lease for goods does not need to have the signatures of both parties. It does need to be signed by the party against whom enforcement of the lease is sought.<sup>18</sup> For example, suppose a farmer and an equipment dealer agree to a tractor lease. If the farmer wants to force the equipment dealer to meet the terms of the lease, a court will only be concerned with whether the equipment dealer signed the lease. On the other hand, if the dealer is trying to force the farmer to carry out the lease, it is the farmer who must have signed the lease.

*d. If the lease is not in writing — not legally enforceable*

If a lease is required to be in writing but it is not, the lease is technically void. If there is any problem with the lease, the lessor and lessee cannot go to court to have the agreement enforced. For example, if a landlord decides to back out of an oral land lease before the lease term actually begins in order to accept an offer of higher rent, the tenant likely would not have any legal recourse.

*(1) Sometimes, no practical effect*

Often, the fact that a lease is legally unenforceable has no practical effect. If the lessor and lessee both keep the agreement and there are no misunderstandings about the specifics of the agreement, a technically void lease can be carried out without any problem.

*(2) If a tenant takes possession of land under an oral lease — possible tenancy at will*

A tenant who takes possession of land under an unenforceable oral lease may become what is technically known as a “tenant at will,” which is discussed below.<sup>19</sup> If this happens, the tenant must pay rent but may be forced to leave the land after a short time.<sup>20</sup> The landlord may terminate a tenancy at will by

<sup>16</sup> Minn. Stat. § 513.05.

<sup>17</sup> Minn. Stat. §§ 336.2A-201, 336.2A-204; 44 DUNNELL MINN. DIGEST, *Statute of Frauds* § 3.01(d) (4th ed. 1999). If the court determines that the parties intended to enter into a lease, some terms can be left open or can be indefinite and the lease will still be valid. Minn. Stat. § 336.2A-204.

<sup>18</sup> Minn. Stat. § 336A.2A-201(1)(b).

<sup>19</sup> Minn. Stat. § 504B.001, subd. 13.

<sup>20</sup> *Fisher v. Heller*, 207 N.W. 498 (Minn. 1926); *Fisher v. Heller*, 219 N.W. 79 (Minn. 1928); 30 DUNNELL MINN. DIGEST, *Landlord and Tenant* §§ 4.01(h), 7.12(g) (4th ed. 1995); 44 DUNNELL MINN. DIGEST, *Statute of Frauds* § 2.02(i) (4th ed. 1999).

giving notice to the tenant. The time between the notice and the termination must be at least as long as the interval between rental payments or three months, whichever is less.<sup>21</sup> While the unwritten lease will not control how long the tenant may remain on the land, it does control the amount of rent charged.<sup>22</sup>

### 3. Canceling or modifying written agreements

A farmer should never assume that an oral change to a written lease or an oral cancellation is valid. It is always best to get the change in writing.

In some cases, oral changes in a lease might be legally enforceable—for example, if both parties act on the modification—but the law makes this difficult.<sup>23</sup> A final written lease typically cannot be changed by an oral agreement made at the same time the written contract is signed.<sup>24</sup> For example, if a landlord and tenant sign a lease that calls for a rent of \$100 per acre but orally agree at the time they sign the lease that the rent will really only be \$90 per acre, the oral change is probably legally void.

If the lessor and lessee orally agree to change the contract sometime after the written lease is signed and then both obviously accept the new lease terms, there is a greater chance that the change might be enforceable.<sup>25</sup> In such cases, there would generally need to be strong evidence showing that both the lessor and lessee agreed to change the lease; otherwise, an oral change to a written lease is almost always void. For example, if the landlord and tenant orally agree to change the terms of the contract and the landlord knows that the tenant is acting on the changes but does not object, the landlord generally cannot later claim that he or she is not bound by the oral modification of the lease.<sup>26</sup> If the terms of the written lease agreement say that the lease may only be changed in writing, no later oral changes will be enforceable.<sup>27</sup>

### B. Negotiating a lease

Farmers can negotiate with lessors to get the best possible deal in a lease agreement.<sup>28</sup> Commercial lessors typically have their own standard lease forms, and many landlords now use photocopied form leases. Lessees do not have to accept the standard language of these agreements.

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21 Minn. Stat. § 504B.135(a).

22 Minn. Stat. § 504B.001, subds. 8, 13.

23 Minn. Stat. § 336.2A-208; 44 DUNNELL MINN. DIGEST, *Statute of Frauds* § 2.05 (4th ed. 1999). The courts may conclude, however, that the ongoing negotiations and typical transactions between the two parties and other evidence may be used to interpret a written lease.

24 30 DUNNELL MINN. DIGEST, *Landlord and Tenant* §§ 2.08, 3.17 (4th ed. 1995); Minn. Stat. § 336.2A-208.

25 *Nord v. Herreid*, 305 N.W.2d 337 (Minn. 1981).

26 *Mitchell v. Rende*, 30 N.W.2d 27 (Minn. 1947); *In re Guardianship of Huesman*, 354 N.W.2d 860 (Minn. Ct. App. 1984).

27 *Franklin Outdoor Adver. Co. v. Hovanetz*, C8-95-736 (Minn. Ct. App. Dec. 5, 1995) (unpublished).

28 See, for example, Gary A. Hachfeld, *Land Rental and Lease Agreements: Strategies for Reducing Costs and Managing Risks*, NICOLLET COUNTY EXTENSION (Jan. 1999), available at [http://www.extension.umn.edu/ruralresponse/resource\\_guide/fmaffp/lrala.html](http://www.extension.umn.edu/ruralresponse/resource_guide/fmaffp/lrala.html).

Like all other printed contracts, printed terms can be changed in writing on the lease itself if both the lessor and lessee agree.

## II. Real estate leases

Nearly half of all Minnesota farmland is rented.<sup>29</sup> This section discusses the law concerning real estate leases, especially leases of farmland.<sup>30</sup>

### A. Lease terms

In addition to the minimum terms needed for a written land lease of more than one year to be enforceable, most leases address other important issues.

#### 1. Description of the land

Disputes sometimes arise over what land is actually covered by a lease. Leases should be clear about whether they cover buildings, nontillable land, and acreage enrolled in state or federal farm programs or conservation programs. Leases should also specify who is responsible for insurance coverage, including crop insurance, and who is entitled to the proceeds in case of loss. If the number of acres is included in the lease, the lease should explain whether or not the acreage is for tillable acres, since tillable acres can change from year to year depending on the weather.

#### 2. Rental payments

The rent for a farm lease can be figured in any number of ways. The two most common are cash leases and crop share leases.

##### a. Cash lease

In a cash lease, the tenant makes a set payment in cash in exchange for use of the land.<sup>31</sup>

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29 See Lyon County Extension Office, *Trend: More farmland rented*, THE LAND, July 19, 2002, at 17. The article reports that in Minnesota "rented land represents 46.1 percent of the total land in farms" based on USDA surveys collected in 1999.

30 Helpful sources for lease agreement legal issues include: Phillip L. Kunkel, *Farm Leases*, UNIVERSITY OF MINNESOTA EXTENSION, available at <http://www.extension.umn.edu/distribution/businessmanagement/DF2593.html>; University of Nebraska Cooperative Extension Service, *Leases & Contracts*, available at <http://www.ianr.unl.edu/pubs/farmmgt/#leases>; Margaret Rosso Grossman, *Leasehold Interests and the Separation of Ownership and Control in U.S. Farmland*, PROPERTY AND VALUES: ALTERNATIVES TO PUBLIC AND PRIVATE OWNERSHIP 119 (Charles Geisler & Gail Daneker eds., 2000); and Cynthia A. Miller, *Reasonable Options for Those Who Do Not Want to Sell the Farm: Farm Leases and Farm Management Companies*, 5 DRAKE J. AGRIC. L. 251 (2000).

31 For more information on cash leases, see Damona Doye, *Developing a Cash Lease Agreement for farmland*, OKLAHOMA COOPERATIVE EXTENSION SERVICE, available at <http://pearl.agcomm.okstate.edu/agecon/farm/f-214.pdf>.

*b. Crop share lease*

In the usual crop share lease, the landlord supplies some of the equipment and some of the inputs for the crops planted on the leased land.<sup>32</sup> The landlord gets a share of the crops as rent. The landlord's rent share usually ranges from one-third to one-half of crop value, depending on local custom and on the contributions of the tenant and landlord.

*c. Mixed lease*

Farm leases sometimes require a minimum cash payment as well as a crop share interest.

**3. Farming practices**

Farm leases often specify the farming practices that the tenant must or must not use on the leased land. If the lease does not require specific practices, tenants are generally free to farm in ways that are commonly accepted in the community. Tenants do not need to leave the leased land in exactly the same condition they found it unless the lease requires so.<sup>33</sup>

*a. Tenant prohibited from damaging the property*

A tenant cannot commit "waste."<sup>34</sup> This is true whether or not waste is mentioned in the lease. In general, this means that the tenant must not allow the real estate to be permanently or severely damaged. For example, the tenant may not remove valuable topsoil from the property.

*b. Conservation practices*

Disputes over conservation practices can create problems in a farm lease.<sup>35</sup> If the landlord wants certain crops either to be grown or avoided, the lease should say so since the type of crop planted may affect eligibility for conservation programs. The same is true if the landlord wants some land to remain uncultivated. Landlords and tenants also need to be clear between themselves about required conservation compliance practices.

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32 For more information on crop share leases, see Damona Doye, *Developing Share Lease Agreements for farmland*, OKLAHOMA COOPERATIVE EXTENSION SERVICE, available at <http://pearl.agcomm.okstate.edu/agecon/farm/wf-964.html>.

33 A tenant who installed drainage tile without prior written consent of the landlord, as required in the lease, was in breach of the farm lease. *Skoberg v. Huisman*, No. C9-01-1131 (Minn. Ct. App. Mar. 19, 2002) (unpublished).

34 Minn. Stat. § 561.17; 49 DUNNELL MINN. DIGEST, *Waste* (4th ed. 2000).

35 Eligibility for federal farm programs can be affected by tenant practices. 7 C.F.R. § 12.9 (2003).

#### 4. Farm residences

Many farm leases include a house that the tenant will use as a home. Landlords of residential buildings have significant legal duties.<sup>36</sup> For example, landlords must keep the premises in reasonable repair and meet health and safety laws of the state and local governments, including maintenance of water supplies and sewage disposal.<sup>37</sup> The landlord may not force the tenant to be responsible for the upkeep and maintenance on the house unless the tenant agrees to do so in writing and the tenant gets some money for the extra work, such as reduced rent.<sup>38</sup> Landlords must pay interest on any security deposits for residential property, and leases for residential property may not provide for automatic lease renewal without notice to the tenant.<sup>39</sup>

A landlord may enter residential leased property only for a reasonable business purpose and after making a good faith effort at giving the tenant prior notice.<sup>40</sup>

#### 5. Default

Most written leases define what is considered a default under the lease.

### B. Lease renewal

One of the most confusing aspects of farm leases is renewal. Renewals are largely controlled by the terms of the lease but in some cases are determined by how the landlord and tenant act once the lease expires.

#### 1. Renewals may be controlled or limited in the lease itself

Renewals may be controlled or limited by the terms of the lease.<sup>41</sup> It is possible, for example, for the lease to be renewable at the option of the landlord or to depend on some other specified event.

#### 2. Tenancy for years and tenancy at will

Almost all farm leases will be either a tenancy for years or a tenancy at will. The difference between the two is important for understanding when and how leases are renewed. A tenancy for years ends automatically at the end of the lease's term. No notice is required. A tenancy at will, on the other hand, continues until it has been terminated by proper notice from one party to the other.

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36 Minn. Stat. §§ 504B.145, 504B.161, subds. 1, 2, 504B.178; 30 DUNNELL MINN. DIGEST, *Landlord and Tenant* § 3.12 (4th ed. 1995). For a general overview of residential landlord-tenant issues see, Lawrence R. McDonough, *Public Interest Law: Improving Access to Justice: Wait a Minute! Residential Eviction Defense Is Much More than "Did You Pay the Rent?"*, 28 WM. MITCHELL L. REV. 65 (2001).

37 Minn. Stat. § 504B.161.

38 Minn. Stat. § 504B.161, subd. 2.

39 Minn. Stat. §§ 504B.145, 504B.178.

40 Minn. Stat. § 504B.211; 30 DUNNELL MINN. DIGEST, *Landlord and Tenant* § 3.00 (4th ed. 1995); *Cardinal Estates v. City of Morris*, CX-02-1505 (Minn. Ct. App. Apr. 15, 2003) (unpublished).

41 30 DUNNELL MINN. DIGEST, *Landlord and Tenant* § 2.09 (4th ed. 1995).

**Tenancy for years:** A tenancy for a fixed period, such as two years.

**Tenancy at will:** A tenancy with no fixed term.

*a. Tenancy for years*

A tenancy for years is a tenancy for a fixed period.<sup>42</sup> For example, if a tenant and landlord agree to a lease for two years, this is a tenancy for years. Technically, a tenancy for years does not have to be set in years; it can be for a certain number of months, or for a year and a half, and so forth. For example, a lease for five months, if the term is set in the agreement, is still a “tenancy for years.”

*(1) Tenancy for years does not automatically renew itself*

A tenancy for years does not automatically renew itself.<sup>43</sup> In other words, if a tenancy for years is for one year, the tenant cannot assume that the lease will be renewed for another year.

*(2) No notice of nonrenewal required*

A tenancy for years ends automatically at the end of the term without any requirement of notice.<sup>44</sup> A landlord, therefore, is not required to give the tenant notice that the lease will not be renewed, and, likewise, a tenant is not required to give notice to a landlord.

*b. Tenancy at will*

Two main features identify a tenancy at will: the lack of a fixed term and the right of either the landlord or the tenant to terminate the lease at any time with proper notice. These leases are also sometimes called month-to-month tenancies or year-to-year tenancies.

*(1) No fixed term*

A tenancy at will does not have a fixed term or time limit.<sup>45</sup> For example, if the agreement between a landlord and tenant sets out the rent and other aspects of the lease but does not set out the total length of the lease, it is a tenancy at will.

<sup>42</sup> 30 DUNNELL MINN. DIGEST, *Landlord and Tenant* § 1.09(c) (4th ed. 1995).

<sup>43</sup> *Crain v. Baumgartner*, 256 N.W. 671 (Minn. 1934).

<sup>44</sup> 30 DUNNELL MINN. DIGEST, *Landlord and Tenant* § 5.01(c) (4th ed. 1995); *Engels v. Mitchell*, 14 N.W. 510 (Minn. 1883).

<sup>45</sup> Minn. Stat. § 504B.001, subd. 13; 30 DUNNELL MINN. DIGEST, *Landlord and Tenant* § 1.09(d) (4th ed. 1995).

(2) *Either party may terminate the lease*

In a tenancy at will, either the landlord or the tenant has the right to terminate the agreement if proper notice is given.<sup>46</sup>

(3) *Three-month notice required for termination of most farm tenancies at will*

Most farm tenancies at will are from year to year. If either the landlord or the tenant wants to terminate a tenancy at will, they must generally give notice three months before the desired termination date.<sup>47</sup> If the tenant is required to make rental payments monthly, termination of the tenancy at will requires only a one-month notice.<sup>48</sup> If the tenant refuses to pay rent or neglects the property, the landlord may terminate the a tenancy-at-will lease with 14 days' written notice.<sup>49</sup>

A landlord waives his or her right to terminate a tenancy at will after sending a termination notice if the landlord and tenant agree that the tenant can stay in spite of the notice or if the landlord otherwise shows that the right to terminate is waived—for example, by accepting rent.<sup>50</sup>

c. *Creating a tenancy for years or a tenancy at will*

Tenancies are either created expressly or by implication.

(1) *Tenancy created expressly*

A tenancy is created expressly when the landlord and tenant agree to it in direct, explicit terms. For example, if the landlord and tenant agree to a written one-year lease, they have expressly created a tenancy for years. Or, if the landlord and tenant agree that the tenant will rent the land for as long as it is agreeable to both parties, they have expressly created a tenancy at will. Landlords and tenants can expressly create a tenancy either with a written lease or with a verbal lease. As long as they make an explicit agreement, they have created the tenancy expressly.

(2) *Tenancy created by implication*

A legally binding tenancy can also be created by implication if the landlord and tenant do not create one expressly. For example, if the landlord and tenant agree to a lease but the agreement does not include a length of time to be

46 30 DUNNELL MINN. DIGEST, *Landlord and Tenant* §§ 1.09(d), 5.01(d) (4th ed. 1995).

47 Minn. Stat. § 504B.135(a); *State Bank of Loretto v. Dixon*, 7 N.W.2d 351 (Minn. 1943); *State Auto Ins. Co. v. Knuttila*, 645 N.W.2d 475 (Minn. Ct. App. 2002); 30 DUNNELL MINN. DIGEST, *Landlord and Tenant* §§ 1.09(f), 5.01(d)-(g), 5.05 (4th ed. 1995).

48 Minn. Stat. § 504B.135(a). If the rent is payable at periods of less than three months, notice must be at least as long as the time between payments.

49 Minn. Stat. § 504B.135(b).

50 30 DUNNELL MINN. DIGEST, *Landlord and Tenant* § 5.05 (4th ed. 1995); *Kahn v. American Ins. Co.*, 162 N.W. 685 (Minn. 1917); *Arcade Inv. v. Gieriet*, 109 N.W. 250 (Minn. 1906).



covered by the lease, the law holds that a tenancy at will has been created by implication.<sup>51</sup> If the courts are convinced that a tenancy at will was implied in the agreement between the landlord and tenant, it will be legally enforced as a tenancy at will.

If a land lease is void for any reason—including failure to satisfy the minimum requirements under the statute of frauds—and the tenant has already taken possession of property, a tenancy at will has probably been created.<sup>52</sup>

### 3. Holdover tenancies

Sometimes a tenant remains on leased land after the lease has ended. If this is done without the consent of the landlord, it is called “holding over.”<sup>53</sup> For example, suppose that a lease has a definite term of one year and the landlord and tenant have never reached an express agreement to renew the lease. If the tenant continues to occupy the property after the year has ended, the tenant is a holdover.

#### a. Tenants should avoid holdover tenancies

The most important point to be made about holdover tenancies is that they should be avoided by tenants. Although there will be cases in which a holdover tenant has the right to stay on the land, this will not always be the case. Tenants assuming that their tenancy for years will be extended take a large risk that they will be subject to eviction actions or lease terms and conditions that are not favorable.<sup>54</sup> As a tenancy for years comes to an end, tenants should always have a clear agreement with the landlord before assuming that they can stay on for another year.

#### b. If a tenant holds over — three possible outcomes

If a tenant who has a lease with a definite term holds over by staying on the property after the lease term ends, one of three legal results will occur: (1) the landlord and tenant can agree to a new lease, (2) the tenant can be treated as a trespasser, or (3) a tenancy at will can be created by implication.<sup>55</sup>

##### (1) Landlord and tenant can agree to a new lease

A holdover tenant and the landlord might agree explicitly to a new lease. The landlord cannot simply impose new terms on a tenant who is holding over—there must be an agreement.<sup>56</sup>

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51 Minn. Stat. § 504B.001, subd. 13.

52 *Hagen v. Bowers*, 233 N.W. 822 (Minn. 1930); 30 DUNNELL MINN. DIGEST, *Landlord and Tenant* §§ 1.09(f), 5.01(j) (4th ed. 1995).

53 *Gardner v. Board of County Comm'rs*, 21 Minn. 33, 38 (Minn. 1874).

54 *Hendrickson v. Wendt*, C1-90-1353 (Minn. Ct. App. Dec. 24, 1990) (unpublished).

55 *Johnson v. Johnson*, 64 N.W. 905 (Minn. 1895); *Unity Investors Ltd. P'ship v. Lindberg*, 421 N.W.2d 751 (Minn. Ct. App. 1988).

56 30 DUNNELL MINN. DIGEST, *Landlord and Tenant* §§ 5.12(c), 5.13(a) (4th ed. 1995).

(2) *Landlord may treat the tenant as a trespasser*

A landlord does not have to agree to a new lease with a holdover tenant. When a tenant in a tenancy for years holds over after the term of the lease has ended, the landlord may treat the tenant as a trespasser and seek to evict the tenant.<sup>57</sup> If the landlord decides to treat the tenant as a trespasser, the landlord cannot try to recover rent from the tenant for the time the tenant held over.<sup>58</sup> If the landlord accepts rent for the holdover period, the landlord cannot treat the tenant as a trespasser.<sup>59</sup>

(3) *A tenancy at will may be created by implication*

Because a tenancy at will can be created by implication—without any explicit agreement between the landlord and tenant—a holdover tenancy can turn a tenancy for years into a tenancy at will.<sup>60</sup> If so, the terms of the original lease regarding rent and other specifics remain the same.<sup>61</sup> If the tenant started out with a tenancy for years, after being held over, and the lease became a tenancy at will, the rules regarding renewals of tenancies at will—such as three-month notice—then apply.<sup>62</sup> Subsequent lease violations are not waived, and a lessor may bring an eviction action based on continuing breaches.<sup>63</sup>

### C. Nonpayment of rent

If a tenant fails to pay rent due under a lease, the landlord generally has the right to terminate the lease after giving the tenant 14 days' written notice.<sup>64</sup> In such cases, three months' notice is not required to terminate a tenancy at will.<sup>65</sup> The remedy for a default other than nonpayment will usually be limited to whatever is described in the terms of the lease.<sup>66</sup>

### D. The tenant owns the crop even after a lease ends

Crops grown on leased land are the personal property of the tenant.<sup>67</sup> This is true even if the rent is to be paid as a share of the crop.

The fact that the tenant owns the crop can have an important practical effect if the tenant is somehow prevented from harvesting a crop. The most common causes of this situation are bad

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57 30 DUNNELL MINN. DIGEST, *Landlord and Tenant* § 5.12(b)-(c) (4th ed. 1995).

58 *Priordale Mall Investors v. Farrington*, 411 N.W.2d 582 (Minn. Ct. App. 1987).

59 *Oak Glen v. Brewington*, 642 N.W.2d 481 (Minn. Ct. App. 2002).

60 *Northern Display Adver. v. Aultman, Inc.*, 191 N.W. 413 (Minn. 1923); 30 DUNNELL MINN. DIGEST, *Landlord and Tenant* § 5.13(a) (4th ed. 1995).

61 *Hildebrandt v. Newell*, 272 N.W. 257 (Minn. 1937); *Trainor v. Schultz*, 107 N.W. 812 (Minn. 1906).

62 *Northern Display Adver. v. Aultman, Inc.*, 191 N.W. 413 (Minn. 1923).

63 *Gluck v. Elkan*, 30 N.W. 446, 446 (Minn. 1886).

64 Minn. Stat. § 504B.135, subd. 2.

65 Minn. Stat. § 504B.135, subd. 2.

66 Minn. Stat. § 504B.135, subd. 1.

67 Minn. Stat. § 557.10; 30 DUNNELL MINN. DIGEST, *Landlord and Tenant* §§ 5.13(d), 10.01, 10.04 (4th ed. 1995).

weather that prevents the fall harvest and a tenant default in the middle of the lease term. At a minimum, even if the tenant is no longer in possession of the property when the crop is harvested, the tenant should have the right to remove the crop.<sup>68</sup> This right also applies to holdover tenants who still have crops in the field after the end of the lease term.<sup>69</sup> Several results are possible in this situation.

### 1. Lease may be renewed

If the problem is a delay in the harvest, it is possible that the lease will be renewed. In such cases, the tenant should get an agreement with the landlord as soon as possible.

### 2. Landlord may let the tenant harvest the crop

If the lease is not renewed, the landlord may nevertheless let the tenant harvest the crop. If so, the tenant must pay fair market value rent for the use of the property for the period of time until the harvest.<sup>70</sup>

### 3. Landlord may harvest the crop and pay the tenant for the crop value

If the landlord does not allow the tenant to harvest the crop and instead takes responsibility for the harvest, the landlord must pay the tenant the net value of the crop.<sup>71</sup>

## E. If the landlord sells the land

In general, if the landlord sells the leased land, the lease continues under the new owner.<sup>72</sup> If the lease says otherwise, however, the tenant may have to move, although the tenant still has a right to remove or be paid for the crop.<sup>73</sup>

## F. Eviction

If the tenant defaults, the landlord may be able to terminate the lease and evict the tenant through an eviction action, formerly called an unlawful detainer action.<sup>74</sup> Terminations of leases and eviction actions do not trigger farmer-lender mediation.<sup>75</sup>

Landlords may use an eviction action in several situations, including when the tenant continues to occupy the land after a lease for years has ended, after termination by notice to quit a tenancy at will, or if the tenant fails to pay rent or otherwise breaks the terms of the lease.<sup>76</sup> An evicted

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68 Minn. Stat. §§ 559.14, 557.10.

69 *Roehrs v. Thompson*, 240 N.W. 111 (Minn. 1932); *Gallager v. Nelson*, 383 N.W.2d 424 (Minn. Ct. App. 1986).

70 *Woodcock v. Carlson*, 43 N.W. 479 (Minn. 1889).

71 *Aultman & Taylor Co. v. O'Dowd*, 75 N.W. 756 (Minn. 1898).

72 *Glidden v. Second Ave. Inv. Co.*, 147 N.W. 658 (Minn. 1914); *Jennison v. Priem*, 278 N.W. 517 (Minn. 1938); *Farmers Ins. Exch. v. Ouellette*, C8-97-1504 (Minn. Ct. App. Feb. 24, 1998) (unpublished).

73 Minn. Stat. § 557.10; 30 DUNNELL MINN. DIGEST, *Landlord and Tenant* §§ 5.13(d), 10.01, 10.04 (4th ed. 1995).

74 Minn. Stat. §§ 504B.291, 504B.365; 30 DUNNELL MINN. DIGEST, *Landlord and Tenant* §§ 4.08(e), 7.01, 7.02, 7.05, 7.07 (4th ed. 1995).

75 Minn. Stat. § 583.22, subd. 2.

76 Minn. Stat. § 504B.291.

tenant still has the right to harvest or be paid the value of any crop planted on the leased land before the eviction judgment was entered.<sup>77</sup>

If a landlord is trying to evict a tenant for nonpayment of rent, the tenant may be able to stop the eviction by paying the rent due, along with interest and costs.<sup>78</sup>

### III. Leases of goods — equipment and livestock

The law treats leases of personal property, or “goods,” somewhat differently than leases of real estate. Goods include all farm equipment and livestock.<sup>79</sup> This section discusses the law applicable to leases of goods that took effect on or after January 1, 1990.

#### A. Sometimes what seems like a lease is really a security interest

Many farmers leasing equipment or livestock sign detailed written leases. Depending on the terms of the agreement, however, some of these leases will really be considered sales with a security agreement.<sup>80</sup> For a description of security agreements, see Chapter Four.

##### 1. The difference between a lease and sale can be important in many ways

Whether a lease agreement is really an agreement to create a security interest may seem at first like a legal technicality. In fact, the difference can be important to lessees for several reasons. Most significant is the availability of farmer-lender mediation.

###### a. Farmer-lender mediation not available under leases

Repossession of property under a lease does not trigger mandatory farmer-lender mediation.<sup>81</sup> Enforcement of a security agreement through seizure of the debtor’s property, on the other hand, can trigger farmer-lender mediation.<sup>82</sup> Farmers who are facing repossession of leased property by a lessor and who believe that the lease is really a security agreement can request farmer-lender mediation whether or not they received a mediation notice.<sup>83</sup> Farmer-lender mediation is discussed in more detail in Chapter Seven.

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77 Minn. Stat. § 559.14.

78 Minn. Stat. § 504B.291, subd. 1.

79 Minn. Stat. § 336.2A-103(1)(h).

80 Because so little Minnesota case law exists on this topic, reference to secondary materials may be helpful. See, for example, James C. Smith, *Leases of Personal Property*, in Peter F. Coogan et al., SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE, § 30.02 (1998).

81 Minn. Stat. § 583.22, subd. 2.

82 For the purposes of farmer-lender mediation, agricultural property does not include “property that is leased to the debtor other than removable agricultural structures under lease with option to purchase.” Minn. Stat. § 583.26, subd. 1. In one case, for example, the court denied mediation rights to a farmer whose leased combine was repossessed. *Deutz-Allis Credit Corp. v. Jensen*, 458 N.W.2d 163, 165 (Minn. Ct. App. 1990).

83 Minn. Stat. § 583.26, subd. 2(c).

*b. Rights of the lessee or debtor after repossession*

The rights of a farmer who has had property repossessed are roughly similar whether the repossession resulted from enforcement of a security interest or default on a lease. There are a few differences that could be important, however, and the secured debtor has more rights than a lessee.<sup>84</sup> First, secured creditors that have taken possession of a debtor's property must give the debtor advance notice if the property is to be sold.<sup>85</sup> Second, secured creditors that have taken possession of a debtor's property may in some cases be forced to sell the seized property and apply the proceeds to the debt rather than keeping the property.<sup>86</sup> Neither of these rights are available to lessees who had property repossessed under a lease.<sup>87</sup> Secured debtors' rights in seized property are discussed in more detail in Chapter Four.

*c. Income tax differences*

Whether an agreement is really a sale or a lease may also have tax implications for both parties. In general, if a farmer leases property, the lease payment is deductible; if the transaction is really a sale, the farmer's deductions are for depreciation and interest.<sup>88</sup> The benefits of either are likely to vary with different agreements. Unfortunately, the IRS determination of whether a transaction should be defined as a lease or a conditional sale may be somewhat different from the determination under Minnesota law that is discussed in this chapter.<sup>89</sup> Before making any decisions based on the tax code, farmers should always consult a professional tax planner.

*d. Other creditors and bankruptcy*

Whether the agreement created a lease or a security interest is of great importance to the relationship between the lessor and other third-party creditors of the lessee. If the agreement actually created a security interest and the lessor did not make all of the proper legal filings, the lessor may lose priority in the property to the lessee's other creditors. Other similar problems can continue for the lessor if the lessee files for bankruptcy.<sup>90</sup>

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84 In *Deutz-Allis Credit Corp. v. Jensen*, 458 N.W.2d 163 (Minn. Ct. App. 1990), the court limited this difference somewhat by ruling that a lessor who repossesses property from a lessee must use due diligence to mitigate damages. In this case, reasonable diligence meant minimizing losses when selling a repossessed combine. The court observed that even though "there is no secured transaction involved, the UCC's concept of commercial reasonableness is, to an extent, borrowed from common law doctrines of mitigation of damages and the rule of unavoidable consequences. Thus, although the UCC may not be directly controlling, it may be helpful in determining mitigation of damages issues." 458 N.W.2d at 166.

85 Minn. Stat. §§ 336.9-610, 336.9-611.

86 Minn. Stat. § 336.9-620(e).

87 For a brief discussion, see Smith, *Leases of Personal Property*, § 30.05[8]-[9].

88 For basic information on the taxation of leases, see Charles Davenport & Darrell Dunteman, *TAX GUIDE FOR FARMERS AND RANCHERS* 11-12, 162-64 (1993).

89 For a brief discussion of this problem, see Richard L. Barnes, *Distinguishing Sales and Leases: A Primer on the Scope and Purpose of Article 2A*, 25 U. MEM. L. REV. 873, 875-77 (1995).

90 In bankruptcy, a lessor's rights may be reduced to an unperfected security interest. For a short discussion, see Paul H. Shur, *Reclaiming Possession of Leased or Sold Goods*, 26 UCC L.J. 111, 113-15 (1993).

## 2. Determining when agreements create a security interest — not a lease — in the eyes of the law

Minnesota statutes set out a way to decide whether an agreement will be considered a lease or a security agreement.

### *a. Different rules before and after January 1, 1990*

Minnesota law regarding the definition of leases as compared to a sales agreement changed on January 1, 1990.<sup>91</sup> The discussion in this chapter focuses on agreements that began on that date or later.

### *B. The general principle — if little economic value is returned to the lessor, it's a security agreement*

In general, the law looks at the agreement to see if leased property will be returned to the lessor at the end of the lease and, if it is returned, whether it will have any remaining meaningful economic value.<sup>92</sup> If at the end of a lease there is very little value left to transfer back to the lessor, the agreement will typically be considered a security interest for legal purposes.<sup>93</sup>

### *c. Conditions creating a security interest*

If the agreement calls for the lessee to pay for the right to possess and use the property and the lessee cannot terminate the lease without paying the full rental amount, the agreement creates a security interest if any of the following four conditions is true.<sup>94</sup>

#### *(1) The agreement is for the remaining economic life of the property*

If the term of the agreement covers the whole economic life of the goods, the agreement is legally a security interest.<sup>95</sup> For example, if a farmer signs an agreement to lease a piece of machinery for eight years and the equipment has an expected useful economic life of only six years, legally this agreement is a sale with a security interest, not a lease.

#### *(2) The lessee must either become owner of the property or renew the lease*

If at the end of the lease the lessee is bound either to become the owner of the goods or to renew the lease for the remaining economic life of the goods, the

91 30 DUNNELL MINN. DIGEST, Leases § 1.00 (4th ed. 1995).

92 Minn. Stat. § 336.1-201(37).

93 Minn. Stat. § 336.1-201(37).

94 Minn. Stat. § 336.1-201(37)(a)-(e). This provision creates an assumption that a disguised security interest exists where the parties' agreement results in one of these four economic realities.

95 Minn. Stat. § 336.1-201(37)(a) (second paragraph). Such an agreement will create a security interest even if the agreement contains no option to purchase or lease.

agreement creates a security interest, not a lease.<sup>96</sup> This condition is met, for example, if the farmer signs a one-year lease for a piece of machinery that has an expected economic life of eight years and the lease also requires that the farmer renew the lease for seven more one-year lease periods.

*(3) The lessee has the option to renew for no consideration or nominal consideration*

If after meeting the terms of the lease the lessee has an option to renew the lease for the remaining economic life of the goods for either no additional cost or only “nominal consideration,” the agreement is a security interest, not a lease.<sup>97</sup>

*(4) The lessee has the option to buy for no consideration or nominal consideration*

If after meeting the terms of the lease agreement the lessee has the option to become owner of the property for either no additional cost or only “nominal consideration,” the agreement creates a security interest, not a lease.<sup>98</sup>

*d. Defining terms — “economic life of the goods” and “nominal consideration”*

The statute refers to the “economic life” of the leased property and “nominal consideration.” The definition of these terms can be tricky.

*(1) Economic life of goods*

Exactly how the economic life of leased goods should be determined is not explained in the statute. The statute does say that it should be determined at the time the parties enter into the transaction.<sup>99</sup> This means that when figuring the economic life of the property, the focus should be on the expected life of the property calculated at the time the agreement was made.

*(2) Nominal consideration*

There is no exact definition of “nominal consideration” in the statute. “Nominal” literally means “in name only” and suggests insignificance. “Consideration” is a legal term meaning any money, service, or other thing of value given in exchange for promises in a contract. In light of these definitions, a very small amount of money will obviously be nominal consideration, while payment of fair market value would certainly be more than nominal. In between these two extremes, the definition remains hazy.

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96 Minn. Stat. § 336.1-201(37)(b) (second paragraph). Arguably, “bound to renew” may mean binding in practice, although not technically binding legally.

97 Minn. Stat. § 336.1-201(37)(c) (second paragraph).

98 Minn. Stat. § 336.1-201(37)(d) (second paragraph).

99 Minn. Stat. § 336.1-201(37)(y).

*(a) Very small payments are obviously nominal*

When an agreement calls for a payment of a very small amount, courts will certainly see this as nominal consideration. For example, if an agreement gives the lessee the option to buy a dairy cow at the end of a lease for \$5 or \$10, this would be nominal consideration.

*(b) Option to buy or lease at fair market value is more than nominal*

The statute points out that if there is an option to renew or purchase the leased goods for fair market value—to be determined at the time the option is made available—the option price is not nominal consideration.<sup>100</sup> For example, if an agreement says that at the end of a lease the lessee has the right to buy the leased equipment for fair market value, this price is more than nominal.

*(c) Relative comparisons likely*

If the agreement calls for a payment between these two extremes, it is likely that a court would try to make some sort of relative economic comparison between what should be offered for a certain product and what is actually offered.<sup>101</sup>

*(d) The sensible lessee test*

As one writer has observed, an option price should be considered nominal if “the sensible lessee would in effect have no choice and, in making the only sensible choice,” would exercise the option.<sup>102</sup> Under this view, if the lessee is left with no real economic choice but to exercise the option, the price of taking the action is nominal; if reasonable people would differ over whether exercising the option is a sensible economic choice, the price is more than nominal.

*e. Considering other factors*

If the requirements described above are met, a court should rule that the agreement creates a security interest without looking any further.<sup>103</sup> It is possible, however,

100 Minn. Stat. § 336.1-201(37)(x). Additional consideration also is nominal if it is less than the lessee’s reasonably predictable cost of performing under the lease agreement if the option is not exercised.

101 For example, one court ruled that a purchase of a used combine for \$9,000, which was the estimated fair market value of the combine, was clearly more than nominal consideration. *Deutz-Allis Credit Corp. v. Jenkins*, 458 N.W.2d 163, 166 (Minn. Ct. App. 1990). In an Alabama bankruptcy case, the farmer leased 35 Holstein heifers. The agreement included an option to purchase for the fair market value of the cattle at the time the option was exercised. The calves born during the lease term, however, became the property of the farmer-lessee at no additional cost. The court held that the value of the calves made the fair value of the original cows nominal. *In re Mitchell*, 44 B.R. 485 (Bankr. N.D. Ala. 1984).

102 Barnes, *Distinguishing Sales and Leases*, at 885-86. For more discussion of possible ways to define this term, see Smith, *Leases of Personal Property*, § 30.02[4][c][iii].

103 Minn. Stat. § 336.1-201(37).



that if the test described above is not met, courts could look at other factors to conclude that an agreement is a security interest. Several factors thought to be important under the previous law—such as whether the lessor or lessee pays for the taxes on the property—do not automatically create a security interest but might be considered by a court taking a closer look at an agreement.<sup>104</sup>

## **B. Lease agreement**

Farmers leasing goods will probably be asked to sign a lease agreement. Because the lease agreement is a contract and its terms control the parties' rights and obligations, it should always be read carefully.<sup>105</sup> As mentioned earlier, the length of the lease term and a description of the goods should be included in the lease.<sup>106</sup> Although it is not legally required, leases of goods should also normally address other issues, such as those listed below.

### **1. Location of the goods**

The lease should explain where the goods are to be located. Moving the goods without permission may put the farmer in default.

### **2. Grounds for termination of the lease**

The lease should list situations in which either party can terminate the lease.

### **3. Other costs**

The lease should explain who is responsible for insuring, maintaining, and repairing the goods; who will transport and install the goods, if applicable; and who must pay for these costs.

### **4. Liability**

A lessor may want the lessee to sign a release of liability for any injury to persons or property caused by the goods. Farmers should check with their insurance company, and possibly with a lawyer, about the effects of such a provision in a lease.

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<sup>104</sup> Minn. Stat. § 336.1-201(37)(a)-(e) (third paragraph). Agreements do not create a security agreement "merely" because: (1) the present value of the lease payments is greater than the fair market value of the goods at the outset of the lease; (2) the lessee assumes the risk of loss or pays taxes, insurance, or other charges; (3) the lessee has an option to renew or to purchase; (4) the lessee has an option to renew at rent equal to or greater than the reasonably predictable fair market rent for the use of the property at the time the option is to be performed; or (5) the lessee has an option to purchase at a price equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.

<sup>105</sup> Minn. Stat. § 336.2A-301.

<sup>106</sup> Minn. Stat. § 336.2A-201.

## 5. Transfer of the lease

Sometimes a lease will say that the lease can only be transferred with the lessor's consent. Farmers may want to make sure that a lease containing such a provision also says that such consent may not be unreasonably withheld.<sup>107</sup>

## C. Warranties for leased goods

When someone leases goods, several warranties—legally binding promises about the goods—may apply. Some warranties are implied, which means they exist whether or not the warranty is ever mentioned or written down in the lease; and some warranties are express, which means they are a result of statements made by the lessor.

### 1. Implied warranties

The two most important implied warranties are a warranty of fitness and a warranty against interferences.<sup>108</sup>

#### a. Warranty of fitness

When the lessor knows at the time the lease is made that the goods are to be used by the lessee for a certain purpose and knows that the lessee is relying on the lessor's skill or judgment to pick out the goods, there is an implied warranty that the goods are fit for that purpose.<sup>109</sup>

#### b. Warranty against interference

The lessor must not have given anyone else a legal claim to the goods that interferes with the lessee's use of the goods.<sup>110</sup> Interference includes, for example, the repossession of the goods by a creditor of the lessor. This warranty is not available if the lessee had reason to know that the goods were subject to a claim or interest.<sup>111</sup>

#### c. Waiving implied warranties

The lessor may add a sentence to the lease which says that the lessee waives—or gives up—the right to implied warranties. For the waiver to be valid, it must usually be in writing, and it must be easily noticeable in the agreement.<sup>112</sup> Words that waive all warranties include “as is” or “with all faults.”

107 If consent cannot be unreasonably withheld, the lessor can deny consent only if the transfer would defeat the purpose of the lease or a similar justification is present. *Medinvest Co. v. Methodist Hosp.*, 359 N.W.2d 714 (Minn. Ct. App. 1984).

108 For a general discussion of implied warranties, see John Levin, *Lease Terms Implied Under UCC 2A*, 27 UCC L.J. 227 (1994).

109 Minn. Stat. §§ 336.2A-213, 336.2A-214. A waiver of this implied warranty must say, “There is no warranty that the goods will be fit for a particular purpose.”

110 Minn. Stat. § 336.2A-211.

111 Minn. Stat. § 336.2A-214(4).

112 Minn. Stat. §§ 336.2A-214(2)-(3), 336.1-205. Implied warranties may, however, be waived or modified by the common and accepted practices of business between parties. Minn. Stat. § 336.2A.214(3)(c).

*d. No implied warranties for defects missed in lessee's examination of the goods*

If the lessee fully examines the goods—or could have but chose not to—there is no implied warranty for defects that the examination ought to have revealed.<sup>113</sup>

**2. Express warranties**

Statements by the lessor about the goods sometimes can be legally binding as an express warranty. This includes statements made to try to convince the farmer to lease the goods.

*a. A basis of the bargain*

To create an express warranty, the lessor's statements must become part of the "basis of the bargain."<sup>114</sup> This means that the lessee must have relied on the statement as a reason for deciding to lease the goods.

*b. Claims of fact, a promise, or a description*

If the lessor makes a claim of fact or a promise to the lessee relating to the goods or describes the goods, and these statements become a part of the basis of the bargain, an express warranty has been created.<sup>115</sup> This means that if the claim of fact or promise turns out not to be true, or the description is not accurate, the legally binding warranty has been violated.

A warranty can be created even though the lessor does not use words such as "guarantee" or "warranty."<sup>116</sup> In fact, the lessor does not even need to have intended to create the warranty.<sup>117</sup> On the other hand, if the lessor only affirms the value of the goods, or makes a statement purporting to be his or her opinion only—not a fact, promise, or description—this does not create a warranty.<sup>118</sup>

**D. Default**

Several types of actions can be considered a default of a lease. In most cases, default is defined in the lease agreement, although the law defines some actions as a default whether or not they are in the lease.<sup>119</sup>

**1. No right to notice of default in a lease of goods**

In general, there is no right to notice of a default with a lease of goods, which implies there is also no right to cure.<sup>120</sup>

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113 Minn. Stat. § 336.2A-214(3)(b).

114 Minn. Stat. § 336.2A-210(1).

115 Minn. Stat. § 336.2A-210. In addition, any sample or model that becomes part of the basis of the bargain creates an express warranty that the equipment conforms to the sample or model.

116 Minn. Stat. § 336.2A-210(2).

117 Minn. Stat. § 336.2A-210(2).

118 Minn. Stat. § 336.2A-210(2).

119 Minn. Stat. § 336.2A-501.

120 Minn. Stat. § 336.2A-501(3).

## 2. Lease may limit remedies

If one party defaults on a lease of goods, the other party may cancel the lease or enforce the lease obligations with “self-help” actions such as repossession or a lawsuit.<sup>121</sup> The lease agreement may, however, limit either party’s remedies in case of default.<sup>122</sup> It is therefore important to read the lease closely.

## 3. If the farmer-lessee defaults

If the lessee fails to make rent payments or otherwise defaults on the lease, the lessor may cancel the lease contract, withhold delivery of the goods not yet delivered, and repossess goods already delivered.<sup>123</sup> The lessor may also use any other remedies listed in the lease and may file a lawsuit for damages resulting from the default.<sup>124</sup> The lessor also has the right to disable the equipment if it is left on the lessee’s property.<sup>125</sup> If the lease allows it, the lessor may require the lessee to gather the goods and make them available to the lessor to repossess it in a way that is reasonably convenient for both parties. These actions can be done as “self-help” measures as long as the lessor does not breach the peace. This generally means that the lessor may not use physical force, break locks, enter buildings, or trespass on the lessee’s property. If the lessor cannot recover the goods without breaching the peace, he or she will likely need to file a lawsuit.

The lessor may also sue the defaulting lessee for unpaid rent and other damages.<sup>126</sup> Lessors with reasonable grounds to fear that the rent will not be paid may, at any time during the term of the lease, demand assurance that the rent will be paid.<sup>127</sup>

## 4. If the lessor defaults

If the lessor fails to deliver the goods as agreed in the lease contract or the farmer rightfully rejects or revokes acceptance of the goods, the lessor is in default.<sup>128</sup> The lease may also specify other lessor actions that would be considered a default.

Once a lessee has accepted delivery of the leased goods, it is more difficult for the lessee to claim that they are not the right goods or are defective. Still, farmers discovering that leased goods are defective or otherwise do not conform to the lease agreement have the right to reject the goods within a reasonable period of time.<sup>129</sup>

If the lessor is in default, the lessee can cancel the contract, probably recover some of the money already paid, perhaps sue for damages, and take other actions that may be

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121 Minn. Stat. § 336.2A-501(3).

122 Minn. Stat. § 336.2A-503.

123 Minn. Stat. §§ 336.2A-401, 336.2A-501(1), 336.2A-523, 336.2A-525, 336.2A-528 to 336.2A-530. For a general discussion, see Paul H. Shur, *Reclaiming Possession of Leased or Sold Goods*, 26 UCC L.J. 111 (1993).

124 Minn. Stat. §§ 336.2A-501(1), 336.2A-503, 336.2A-505.

125 Minn. Stat. § 336.2A-525(2).

126 Minn. Stat. §§ 336.2A-505, 336.2A-103(1)(b).

127 Minn. Stat. § 336.2A-401.

128 Minn. Stat. § 336.2A-508.

129 Minn. Stat. §§ 336.2A-517(4)-(5), 336.2A-516(3)(a)-(c).

allowed by the lease.<sup>130</sup> In some cases, if the lessor fails to deliver the goods, it may be possible to force the lessor to actually deliver the goods.<sup>131</sup> The lessor may have the right to cure the default.<sup>132</sup>

#### **E. A lease of fixtures**

Anyone leasing a fixture—that is, goods that will attach to real estate—should file a fixture financing statement with the county recorder or registrar of titles in the county where the real estate is located.<sup>133</sup> The statement generally protects the lessee against the lessor’s creditors who may want to take the property.

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130 Minn. Stat. §§ 336.2A-505(1), 336.2A-508, 336.2A-513, 336.2A-519, 336.2A-520(2)(b).

131 Minn. Stat. § 336.2A-508(2).

132 Minn. Stat. § 336.2A-513.

133 Minn. Stat. §§ 336.2A-309, 336.9-502.

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## Chapter Seven

# Farmer-Lender Mediation

## I. Introduction

Many types of farm credit problems trigger the provisions of Minnesota's Farmer-Lender Mediation Act.<sup>1</sup> The Mediation Act requires that before a creditor enforces a debt against agricultural property by taking any of several actions described in this book—such as foreclosing on a mortgage or executing a judgment—the farmer and the creditor must meet and try to resolve the problem through mediation.<sup>2</sup> In mediation, the farmer and the creditor meet with an unbiased mediator and try to work out an agreement about payment of the farmer's debts. While the mediation process is open, the creditor cannot take collection action against the farmer's property. The creditor must also release farm proceeds to pay for family living expenses and necessary farm operating expenses.

The Farmer-Lender Mediation Program, which began in 1986, has been renewed by the state legislature through June 30, 2005.<sup>3</sup>

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- 1 For a general overview of the agricultural mediation process, see Farmers' Legal Action Group, Inc., *MEDIATION FROM THE FARMER'S PERSPECTIVE* (Jan. 1988); Gary D. Condra, *Representing Agricultural Clients in Mediation*, 73 NEB. L. REV. 154 (1994); Gary W. Koch, Gislason & Hunter LLP, *Farmer-Lender Mediation Act*, Chapter 3 in *Debtor Creditor Handbook* (MSBA CLE 8th Ed. 1999). Additional information on the Farmer-Lender Mediation Program is available at <http://www.extension.umn.edu/specializations/businessmanagement/FrmerLenderMediation.html>.
  - 2 See Farmer-Lender Mediation Act, Minn. Stat. §§ 583.20 to 583.32.
  - 3 First Special Session, 2001 Minn. Laws. Ch. 1, Sec. 25. The program was previously scheduled to sunset July 1, 2001. In addition to the four-year extension enacted in 2001, the state legislature also enacted a two-year extension of the program. When irreconcilable laws are passed in the same legislative session, "the law latest in date of final enactment, irrespective of its effective date, shall prevail from the time it becomes effective." See Minn. Stat. § 645.26. Final enactment is defined as "the date and time of day the governor signed the bill." See Minn. Stat. § 645.01. Governor Ventura signed the bill with the two-year extension on June 29, 2001, and he signed the bill with the four-year extension on June 30, 2001. Therefore, under Minnesota law, the four-year extension should control.

### The main parties in farmer-lender mediation

**Farmer** — Who owes a debt and is also therefore a debtor.

**Creditor** — One or more of the farmer's creditors.

#### A. Mandatory and voluntary farmer-lender mediation

This chapter primarily discusses the mandatory farmer-lender mediation process. When mediation is mandatory, this means only that the creditor is required to offer mediation to the farmer. Farmers are not required to accept the offer to mediate with a creditor.<sup>4</sup>

#### B. Mediation of USDA collection actions and other agency decisions

USDA agencies can be subject to Minnesota's mandatory farmer-lender mediation process if they qualify as a creditor trying to enforce a debt against agricultural property.<sup>5</sup> For example, if the Farm Service Agency (FSA) is attempting to enforce a judgment against a farmer (as described below) for a delinquent loan, FSA is required to go through the same mandatory farmer-lender mediation process as any other creditor would.

The Minnesota Farmer-Lender Mediation Program also offers voluntary mediation services as part of the administrative appeals process for farmers challenging decisions made by USDA agencies.<sup>6</sup> Various USDA agencies—including FSA, the Natural Resources Conservation Service (NRCS), Rural Development (RD), and the Risk Management Agency (RMA)—offer mediation as one step in the review of administrative decisions. Each party that participates in this type of voluntary mediation is assessed a \$50 fee payable in advance to the University of Minnesota.<sup>7</sup> Although Minnesota's Farmer-Lender Mediation Program is authorized to conduct these voluntary mediations of USDA agency administrative decisions, it is important to keep in mind that these voluntary mediations of USDA agency decisions are not the same as mandatory farmer-lender mediation required by Minnesota law, and they do not use the process described in this chapter. For information about voluntary mediation of USDA agency decisions, refer to the regulations and policies of the agency that made the decision.<sup>8</sup>

4 Minn. Stat. § 583.26.

5 Minn. Stat. § 583.24, subd. 1(a)(1).

6 7 U.S.C. § 5103(a)(1)(A); Timothy J. Sullivan, *USDA Expands the Scope of Certified State Mediation Programs*, 11 FARMERS' LEGAL ACTION REPORT 3 (1996). For further information on USDA's state certified mediation programs, see 67 Fed. Reg. 57309 (Sept. 10, 2002) (codified at 7 C.F.R. pt. 785); <http://www.fsa.usda.gov/pas/publications/facts/html/mediate02.htm>. For a historical overview of USDA's Mediation Program, see Chester A. Bailey, *The Role of Mediation in the USDA*, 73 NEB. L. REV. 142 (1994).

7 MEDIATION AT THE UNIVERSITY OF MINNESOTA: ALTERNATIVE DISPUTE RESOLUTION OPTION FOR USDA PROGRAM PARTICIPANTS (Nov. 6, 2001).

8 See 7 C.F.R. § 780.6 (FSA) (2003); 7 C.F.R. § 400.94 (FCIC/RMA) (2003); 7 C.F.R. §§ 614.102, 614.203 (NRCS) (2003); 7 C.F.R. § 1900.55 (RD, RBS, RHS, and RUS) (2003).



### **C. The relationship between mandatory farmer-lender mediation and other forms of Alternative Dispute Resolution (ADR)**

Mandatory farmer-lender mediation, which is discussed in this chapter, is a special dispute resolution process created by the Minnesota Legislature specifically for Minnesota farmers and their creditors. Outside of this mandatory process, however, Minnesota farmers are free to pursue other forms of dispute resolution. Many kinds of legal and business disputes are now resolved by some form of Alternative Dispute Resolution (ADR). ADR methods include arbitration—where a neutral arbitrator makes a binding decision—and mediation—where a neutral mediator helps the parties work out their dispute.

If a farmer and creditor agree that they want to use ADR to resolve an issue, they are generally free to do so. They may choose to use the voluntary mediation process under the Farmer-Lender Mediation Program, or they may make their own ADR arrangements.<sup>9</sup> Voluntary mediation request forms are available at county extension offices and county recorder offices. A \$50 fee is assessed to both the farmer and the creditor.<sup>10</sup> Voluntary mediation under the Farmer-Lender Mediation Program is also available for certain non-credit disputes and for rural residents other than farmers.<sup>11</sup>

If farmers are parties in a legal action, they might be required to participate in ADR before the case will proceed.<sup>12</sup> This is part of an effort by state and federal courts to reduce caseloads and resolve legal disputes outside of lawsuits. This ADR requirement, which is not specifically aimed at farmers, is different from mandatory farmer-lender mediation and is discussed in Chapter Ten.

### **D. Farmers' rights to mandatory mediation generally not waivable**

In general, creditors may not ask farmers to waive their rights under the mandatory Farmer-Lender Mediation Program.<sup>13</sup> For example, a creditor may not ask a farmer to sign a loan agreement which says that the farmer does not have the right to seek mediation in case of a default. If a farmer signs such an agreement, the waiver is not legally enforceable.

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9 Minn. Stat. § 583.25.

10 MEDIATION AT THE UNIVERSITY OF MINNESOTA: ALTERNATIVE DISPUTE RESOLUTION OPTION FOR USDA PROGRAM PARTICIPANTS (Nov. 6, 2001).

11 In 1998, the Minnesota Legislature amended the Farmer-Lender Mediation Act to encourage the voluntary use of the Farmer-Lender Mediation Program to resolve disputes in rural areas. 1998 Minn. Laws ch. 402, § 5 (codified at Minn. Stat. § 583.311). This voluntary dispute resolution is open to all rural residents for a variety of issues. Minn. Stat. § 583.311. The intent is to allow voluntary participation in the Farmer-Lender Mediation Program to resolve disputes that are not required to go through farmer-lender mediation.

12 Minn. Gen. R. Prac. 114. This requirement is a result of an action by the Supreme Court of Minnesota and is authorized by Minn. Stat. § 484.76.

13 Minn. Stat. § 583.305. Exceptions to this rule must be expressly allowed under the Farmer-Lender Mediation Act. At present, there are no expressly allowed exceptions.

## II. Eligibility for mandatory farmer-lender mediation

The mandatory farmer-lender mediation process is required in a limited number of circumstances. The following sections explain when mediation is legally required.

### A. Creditors that must offer farmer-lender mediation

Creditors whose actions are governed by the mandatory farmer-lender mediation process include U.S. government agencies, corporations, partnerships, other business entities, and individual persons.<sup>14</sup>

### B. Creditor actions that trigger mediation

The Farmer-Lender Mediation Act sets out types of creditor actions that will trigger the mandatory farmer-lender mediation process. In general, any creditor action to enforce a debt against a farmer's agricultural property will trigger the process.<sup>15</sup>

#### 1. Mortgage foreclosure and cancellation of a contract for deed of agricultural property

A foreclosure of a mortgage on agricultural property—either by advertisement or action—triggers mandatory farmer-lender mediation, as does cancellation of a contract for deed to purchase agricultural property<sup>16</sup> For a general discussion of mortgage foreclosures and contract for deed cancellations, see Chapter Three.

#### 2. Repossession of agricultural property

A secured creditor's attempt to take possession of agricultural property that serves as collateral for a debt or to seek a court order for possession triggers mandatory farmer-lender mediation.<sup>17</sup> Secured credit is discussed in detail in Chapter Four.

#### 3. Executing a judgment

Mandatory farmer-lender mediation is not triggered when a creditor seeks a judgment against a debtor to recover the debt. However, any effort by the creditor to execute a judgment and collect against a farmer-debtor's agricultural property or the proceeds from a sale of agricultural property will trigger mediation.<sup>18</sup> Collection efforts that will

14 Minn. Stat. § 583.24, subd. 1(a). One unpublished Minnesota Court of Appeals decision held that USDA was not required to participate in a mediation where it was the guarantor of a farm loan. *Norwest Bank Minnesota West v. Kostrzewski*, No. C7-89-1349 (Minn. Ct. App. Mar. 13, 1990) (unpublished).

15 Minn. Stat. § 583.26, subd. 1(a)-(b).

16 Minn. Stat. § 583.26, subd. 1(a). For the purpose of mediation, creditors include holders of mortgages on agricultural property and vendors of contracts for deed of agricultural property. Minn. Stat. § 583.22, subd. 4.

17 Minn. Stat. § 583.26, subd. 1(a). Creditors using Minn. Stat. §§ 336.9-601 to 336.9-628 to enforce a debt on agricultural property trigger mediation. Creditors, for the purposes of mediation, include creditors with a lien or security interest in agricultural property. Minn. Stat. § 583.22, subd. 4.

18 Minn. Stat. § 583.26, subd. 1(a). For the purposes of mediation, creditors include a judgment creditor with a judgment against a farmer with agricultural property. Minn. Stat. § 583.22, subd. 4.

trigger mediation include garnishment, levy, and attachment or seizure of agricultural property. For a general explanation of judgments, see Chapter Five.

### C. Agricultural property must be the target of the creditor action

For mandatory farmer-lender mediation to be triggered, the property against which the creditor is taking action must be agricultural property.<sup>19</sup>

#### 1. What is included as agricultural property

For the purposes of mandatory farmer-lender mediation, the law strictly defines agricultural property.<sup>20</sup> It can include real estate, personal property, and some other types of property.

##### a. Real estate

For the purposes of mandatory farmer-lender mediation, agricultural property includes real property that is principally used for farming.<sup>21</sup> This includes, for example, real estate used for producing crops, livestock, milk, poultry, fruit, and horticultural products.

##### b. Personal property

For the purposes of mandatory farmer-lender mediation, agricultural property also includes personal property that: (1) serves as collateral for a loan for the farm operation; or (2) is used in the farm operation, including equipment, crops, livestock, and proceeds from collateral.<sup>22</sup> Since agricultural property includes proceeds from collateral, if a creditor has a security interest in grain or milk and the debtor sells that grain or milk, the proceeds from the sale continue to be agricultural property for the purposes of mediation.<sup>23</sup> If the creditor attempts to take those proceeds, that would be considered an action against agricultural property. It might be possible to argue that if a creditor forces a farmer to sign over a proceeds check to the creditor, this triggers mediation.<sup>24</sup>

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19 Minn. Stat. § 583.26, subd. 1.

20 Minn. Stat. § 583.22, subd. 2.

21 Minn. Stat. §§ 583.22, subd. 2, 500.24, subd. 2(a). Farming includes the production of agricultural products, livestock products, and milk products. Farming does not include: (1) the processing, refining, or packaging of farm products; (2) the provision of spraying or harvesting services by a processor or distributor of farm products; or (3) the production of timber or forest products.

22 Minn. Stat. § 583.22, subd. 2.

23 Minn. Stat. § 583.22, subd. 2. Proceeds are “whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral.” Minn. Stat. § 336.9-102(a)(64); *Firststar Eagan Bank, NA. v. Marquette Bank Minneapolis*, 466 N.W.2d 8 (Minn. Ct. App. 1991). It is possible for proceeds to lose their identity, for example, by being deposited in a bank account. As long as the proceeds are identifiable for the purposes of the creditor’s security interest, however, they should still be identifiable for the purposes of mediation.

24 Mediation is triggered if agricultural property is “seize[d],” according to Minn. Stat. § 550.365, subd. 1, or if a secured creditor “tak[es] possession,” Minn. Stat. § 336.9-609, of collateral after a default.

*c. Removable farm structures*

In addition, agricultural property under mandatory farmer-lender mediation includes removable agricultural structures that are leased with an option to buy, such as silos, grain bins, or other types of removable farm buildings.<sup>25</sup>

## **2. What is not included as agricultural property**

For the purposes of farmer-lender mediation, the following are specifically not considered agricultural property.

*a. Personal property subject to a possessory lien*

Agricultural property under mandatory farmer-lender mediation does not include personal property subject to a possessory lien. A creditor may have a possessory lien if the farmer has not paid someone who stores, cares for, or contributes to the preservation, care, or enhancement of property and the creditor has possession of the personal property. For example, an implement dealer's machine shop that holds a tractor on the premises until the tractor's owner pays for the repairs may have a possessory lien.

*b. Leased property*

Agricultural property under mandatory farmer-lender mediation does not include leased property unless the property is a removable agricultural structure under lease with an option to buy.<sup>26</sup> Determining whether an agreement creates a lease or a security interest, and therefore whether creditor action will trigger mediation, can be harder than it may seem. For a discussion of the differences between leases and secured sales, see Chapter Six.

*c. Custom work farm machinery*

Farm machinery that is used primarily for custom field work does not qualify as agricultural property under mandatory farmer-lender mediation.<sup>27</sup>

## **D. Farmer eligibility for farmer-lender mediation**

To be eligible for mandatory farmer-lender mediation, the debtor must be a family farmer and the farming operation must be of at least a certain size.

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<sup>25</sup> Minn. Stat. § 583.22, subd. 2.

<sup>26</sup> Minn. Stat. § 583.22, subd. 2. Where the lease of a combine was a true lease, it was not subject to the requirements of the Farmer-Lender Mediation Act. *Deutz-Allis Credit Corp. v. Jensen*, 458 N.W.2d 163 (Minn. Ct. App. 1990).

<sup>27</sup> Minn. Stat. § 583.22, subd. 2.

### 1. Must be a family farmer

To qualify for mandatory farmer-lender mediation, the debtor must operate a family farm, a family farm corporation, or an authorized farm corporation.<sup>28</sup> Almost all farmers who would generally be thought of as family farmers will qualify. According to one unpublished Minnesota Court of Appeals decision, absentee landlords of farm property are not eligible for mandatory mediation under the Farmer Lender Mediation Act.<sup>29</sup>

### 2. Must meet minimum acreage or sales requirements

Farmer-lender mediation is not required if the farmer: (1) owns and leases a total of less than 60 acres, and (2) had less than \$20,000 in gross sales of agricultural products the preceding year.<sup>30</sup> If either one of these conditions is not present, the farmer is eligible for mandatory farmer-lender mediation. This means that farmers who own and lease less than 60 acres but sold over \$20,000 in farm products in the previous year may be eligible for mandatory farmer-lender mediation. Similarly, farmers who had less than \$20,000 in sales of farm products in the previous year may still qualify for mandatory farmer-lender mediation if they own and lease a total of at least 60 acres.

## E. Debt must be for more than \$5,000

Mandatory farmer-lender mediation is available only if the amount of the debt in question is more than \$5,000.<sup>31</sup>

### 1. Contracts for deed

The cancellation of a contract for deed to purchase agricultural property triggers mandatory farmer-lender mediation only if the remaining balance on the contract is more than \$5,000.<sup>32</sup>

### 2. Mortgages

The foreclosure of a mortgage on agricultural property requires farmer-lender mediation only if the amount of outstanding debt secured by the mortgage is more than \$5,000.<sup>33</sup>

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28 Minn. Stat. § 583.24, subd. 2. A family farm is a farming unit that is not incorporated and is owned by one or more persons who reside on the farm or are actively engaged in farming. Minn. Stat. § 500.24, subd. 2(b); *Federal Land Bank v. Wessels*, No. C7-88-2233 (Minn. Ct. App. Apr. 25, 1989) (unpublished). The definition of “family farm corporation” limits majority ownership of the company to family members, at least one of whom must reside on the farm or be actively engaged in farming the land. Minn. Stat. § 500.24, subd. 2(c). The ownership structure of an authorized farm corporation is also limited. Minn. Stat. § 500.24, subd. 2(e). In *Resolution Trust Corp. v. Lipton*, 983 F.2d 901 (8th Cir. 1993), the Eighth Circuit Court of Appeals held that a partnership will only be eligible for mandatory farmer-lender mediation if it is a “family farm” as defined in Minn. Stat. § 500.24, subd. 2(b). That is, one or more of the partners must reside on the farm or be actively engaged in farming the land.

29 *Bornhorst v. Budzik*, No. C8-90-393 (Minn. Ct. App. Aug. 21, 1990) (unpublished).

30 Minn. Stat. § 583.24, subd. 2(b).

31 Minn. Stat. §§ 559.209, subd. 1, 582.039, subd. 1, 550.365, subd. 1, 336.9-601(h).

32 Minn. Stat. § 559.209, subd. 1.

33 Minn. Stat. § 582.039, subd. 1.

### 3. Attachment, execution, levy, and seizure

The attachment, execution, levy, or seizure of agricultural property triggers mandatory farmer-lender mediation only if the creditor has a judgment against the debtor for more than \$5,000.<sup>34</sup>

### 4. Enforcing a security interest

If a creditor seeks to enforce a security interest in collateral that is agricultural property—for example, by taking possession of a tractor—this action triggers mandatory farmer-lender mediation only if the amount of debt secured by the property is more than \$5,000.<sup>35</sup> It is not clear from the language of the statute whether the \$5,000 minimum applies to the amount of the original debt or the amount still outstanding at the time of the creditor action.<sup>36</sup>

## F. Farmers who have converted security may be ineligible for mediation

A farmer who has converted security property may be ineligible for mandatory farmer-lender mediation. The farmer may face other legal problems as well, including possible criminal charges.<sup>37</sup>

For the purpose of farmer-lender mediation, a farmer commits conversion when the farmer: (1) knows a creditor has a security interest in his or her agricultural property; (2) fraudulently conceals, removes, or transfers the property in violation of the security agreement; and (3) does not pay the proceeds to the creditor.<sup>38</sup>

### 1. Conversion before mediation starts

A secured creditor who believes that a farmer has converted security property may petition the Minnesota district court in the county where the debtor resides for an order allowing the creditor to use collection actions without offering mediation.<sup>39</sup> The creditor must petition the court within one year of the conversion and before providing a notice of farmer-lender mediation rights to the farmer.<sup>40</sup> The court will issue a summons within seven days of the creditor's petition, telling the farmer to appear in court to answer the creditor's claim.<sup>41</sup> The court will then decide whether the farmer is eligible for mandatory farmer-lender mediation.

34 Minn. Stat. § 550.365, subd. 1.

35 Minn. Stat. § 336.9-601(h).

36 The statute refers to agricultural property that “has secured a debt of more than \$5,000. . . .” Minn. Stat. § 336.9-601(h).

37 See, for example, Minn. Stat. § 395.22.

38 Minn. Stat. § 583.27, subds. 4(a), 7.

39 Minn. Stat. § 583.27, subd. 7.

40 Minn. Stat. § 583.27, subd. 7.

41 Minn. Stat. § 583.27, subd. 7. The farmer will be required to appear no more than 7 and no less than 14 days after the summons is issued.

## **2. Conversion during the mediation process**

If a creditor believes that a farmer has converted security property during the mediation period, the creditor can seek an affidavit of bad faith from the mediator.<sup>42</sup> If the mediator agrees that conversion has occurred and issues the affidavit of bad faith, the creditor will be allowed to immediately proceed with action against the farmer's property.<sup>43</sup>

## **G. Some debts are not eligible for farmer-lender mediation**

Creditor action on some debts does not trigger mandatory farmer-lender mediation.

### **1. If the same debt has already been the subject of a mediation**

If a debt has already been subject to mandatory farmer-lender mediation, the creditor is not required to offer farmer-lender mediation on that same debt again.<sup>44</sup> This restriction applies whether the earlier mediation resulted in an agreement or was unresolved.<sup>45</sup> It also applies if the creditor provided a mediation notice for the debt, the farmer failed to request mediation, and the creditor is taking action within 60 days after the deadline for the farmer to request mediation.<sup>46</sup>

### **2. If the farmer has filed for bankruptcy**

If the farmer has filed for bankruptcy and the debt was listed as a scheduled debt, or a creditor filed a proof of claim form on the debt, the creditor is not required to offer farmer-lender mediation before enforcing the debt.<sup>47</sup> Creditor actions may be limited by bankruptcy rules. Bankruptcy is discussed in Chapter 8.

### **3. If the debt is for rent of seasonal use farm machinery during a prior mediation**

Farmer-lender mediation is not required if a creditor is making a claim against a farmer's crops to pay for the reasonable rental value of certain seasonal use farm machinery during a prior mediation.<sup>48</sup> This type of claim arises when a farmer has defaulted on a "purchase money" loan for seasonal use farm machinery.<sup>49</sup> If that debt is subject to farmer-lender mediation, the farmer will be allowed to keep possession of any such machinery needed "for field operation" during the mediation period.<sup>50</sup> The creditor is then entitled to a lien against the farmer's crops in the amount of the reasonable rental

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42 Minn. Stat. § 583.27, subd. 4(a).

43 Minn. Stat. § 583.27, subd. 4(b).

44 Minn. Stat. § 583.24, subd. 4(2), (4).

45 Minn. Stat. § 583.24, subd. 4(2).

46 Minn. Stat. § 583.24, subd. 4(3).

47 Minn. Stat. § 583.24, subd. 4(1).

48 Minn. Stat. §§ 583.24, subd. 4(5), 514.661, subd. 8.

49 Minn. Stat. § 514.661, subd. 2(a). Purchase money loans are described in Chapter 4.

50 Minn. Stat. § 514.661, subd. 2(a).

value of the machinery.<sup>51</sup> If the creditor later attempts to enforce the lien and collect the rental amount, that action will not trigger mandatory farmer-lender mediation.<sup>52</sup>

Under this restriction, seasonal use machinery means machinery used only for planting, row crop cultivating, or harvesting.<sup>53</sup> It does not include tractors, tillage equipment, or utility implements used for general farm purposes. It also appears that a farmer is only allowed to retain possession of seasonal use machinery that is needed during the mediation period.<sup>54</sup>

### III. Farmer-lender mediation notices

If farmer-lender mediation is required, the creditor must send the farmer an official mediation notice.<sup>55</sup> The notice may be by personal service, certified mail using return receipt signed by the farmer, or actual delivery with a signed receipt.<sup>56</sup>

#### A. Contents of the notice

The mediation notice must describe the debt owed by the farmer, the collection action that the creditor plans to take, and the property subject to the creditor's action.<sup>57</sup>

The notice must also include the following language:<sup>58</sup>

You have the right to have [the debt] reviewed for mediation. If you request mediation, a debt that is in default will be mediated only once. If you do not request mediation, this debt will not be subject to future mediation if the [creditor] enforces the debt.<sup>59</sup>

If you participate in mediation, the coordinator of Farmer-Lender Mediation Program<sup>60</sup> will provide an orientation meeting and a financial analyst to help you prepare financial information. If you decide to participate in mediation, it will be to your advantage to assemble your farm finance and operation records and to contact a County Extension

51 Minn. Stat. § 514.661, subd. 2(a). If the amount needed to bring the loan current during the mediation period is less than the reasonable rental value of the machinery, the lien will be limited to that amount.

52 Minn. Stat. § 514.661, subd. 8.

53 Minn. Stat. § 514.661, subd. 1(b).

54 Minn. Stat. § 514.661, subd. 2(a) (“the reasonable rental value of seasonal use machinery *that is used for field operation during mediation*”) (emphasis added).

55 Minn. Stat. §§ 583.26, subd. 1, 583.22, subd. 8.

56 Minn. Stat. §§ 583.26, subd. 1(a), 583.22, subd. 8. If these are unsuccessful, the creditor may send the notice by mail with a certificate of mailing. Minn. Stat. § 583.22, subd. 8. The farmer is considered to have been served five days after the date on the certificate of mailing. Minn. Stat. § 583.22, subd. 8.

57 Minn. Stat. §§ 336.9-601(h)-(i), 550.365, 559.209, 582.039.

58 Minn. Stat. §§ 336.9-601(h)-(i), 550.365, 559.209, 582.039.

59 The statutory mediation notice for a contract for deed cancellation uses the language “begins remedies to enforce the debt.” Minn. Stat. § 559.209, subd. 2.

60 The statutory mediation notices say these actions will be taken by the “Director of the Agricultural Extension Service.” Minn. Stat. §§ 336.9-601(h)-(i), 550.365, 559.209, 582.039. This language does not reflect the change in administration of the Farmer-Lender Mediation Program.



office as soon as possible. Mediation will attempt to arrive at an agreement for handling future financial relations.

#### **B. If the farmer does not receive the notice**

If the creditor starts a collection against a farmer and the farmer has not received a mediation notice, the farmer can start mediation on his or her own by filing a mediation request form with the coordinator of the Farmer-Lender Mediation Program.<sup>61</sup> The request should state that the farmer has not received a mediation notice. If the creditor was required to offer mediation, the farmer's mediation request stops the creditor's collection actions and sets the mediation process in motion.<sup>62</sup>

#### **C. If more than one person is liable for the same debt**

If more than one person is liable for the same debt on a piece of agricultural property, a single mediation is used for all of the farmers.<sup>63</sup>

#### **D. If the same farmer receives notices from more than one creditor**

The same farmer might receive mediation notices at about the same time from more than one creditor. If so, all mediation notices received before the first mediation meeting will be combined by the coordinator of the Farmer-Lender Mediation Program into the same mediation process.<sup>64</sup>

If the farmer receives another mediation notice from a different creditor after the first mediation meeting and before the end of the mediation process, it is up to the coordinator of the Farmer-Lender Mediation Program to decide how to proceed.<sup>65</sup>

### **IV. Requesting mediation**

Once farmers receive a mediation notice, they must decide whether to participate in the farmer-lender mediation process. If they wish to, a "request for mediation" form must be filed.<sup>66</sup> Mediation request forms are available from the county recorder or county extension office.

#### **A. Deciding whether to request mediation**

In some cases, it may not be in the farmer's interest to request mediation. Some debts may simply be too small to make mediation worth the time and effort. In other cases, mediation simply might not be the best strategy. For example, suppose a farmer is in default on a mortgage to the bank but is making progress in negotiations with the bank. During these negotiations, an implement company serves the farmer with a mediation notice regarding late payments for machinery. If the farmer requests mediation of the machinery debt, the bank will likely file a claim and the mortgage debt will also be mediated. In this case, the farmer might choose not to request

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61 Minn. Stat. § 583.26, subd. 2(c).

62 Minn. Stat. § 583.26, subd. 5.

63 Minn. R. 1502.0017, subpt. 1.

64 Minn. Stat. § 583.26, subd. 1(c); Minn. R. 1502.0017, subpt. 2.

65 Minn. R. 1502.0017, subpt. 2.

66 Minn. Stat. § 583.26, subd. 2(a).

mediation with the implement company, which will allow the farmer to preserve the right to mediate the mortgage in the future if negotiations with the bank do not succeed.

### **B. Mediation requests must be filed within 14 days of notice**

A farmer must file a mediation request form with the coordinator of the Farmer-Lender Mediation Program within 14 days after receiving the mediation notice.<sup>67</sup> Mediation requests must be filed with the coordinator of the Farmer-Lender Mediation Program by either certified mail using return receipt or by actual delivery of the mediation request with a signed receipt from the coordinator.<sup>68</sup>

### **C. What the farmer must include in the request for mediation**

The request for mediation filed by the farmer must include certain information. Failure to include the required information, particularly the list of all known secured creditors, can put the farmer's mediation rights at risk.

#### **1. List all known secured creditors**

The request for mediation must include a list of all of the farmer's known creditors with debts secured by agricultural property.<sup>69</sup>

#### **2. List any unsecured creditors necessary for the farm operation**

The request for mediation must also include a list of unsecured creditors that the farmer believes are necessary for the farm operation.<sup>70</sup> The statute expressly states that it is up to the farmer to decide which unsecured creditors are necessary for the operation.

#### **3. State the date notice of mediation was served**

In addition, the request for mediation must state the date that the mediation notice was received by the farmer.<sup>71</sup>

### **D. Withdrawing a mediation request**

Farmers can withdraw a request for mediation at any time before the end of the 14-day filing period.<sup>72</sup> A withdrawal must be in writing. In general, farmers withdrawing a mediation request waive their right to mediate the debt that triggered the serving of a mediation notice to begin with.<sup>73</sup> If farmers choose, however, they may file the mediation request again, as long as they do so within the 14 days allowed for filing the original mediation request.<sup>74</sup>

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67 Minn. Stat. § 583.26, subd. 2(a); Minn. R. 1502.0007.

68 Minn. R. 1502.0010. For the purpose of mediation, filing means to deliver by the required date by certified mail or another method acknowledging receipt. Minn. Stat. § 583.22, subd. 6.

69 Minn. Stat. § 583.26, subd. 2(a).

70 Minn. Stat. § 583.26, subd. 2(a).

71 Minn. Stat. § 583.26, subd. 2(a).

72 Minn. R. 1502.0007.

73 Minn. R. 1502.0007.

74 Minn. R. 1502.0007.

## **E. Failure to request mediation**

If the creditor serves a mediation notice for a debt and the farmer does not request mediation within the 14-day request period (or makes a request and then withdraws it), the farmer loses the right to mediate the debt.<sup>75</sup> In such cases, the coordinator of the Farmer-Lender Mediation Program will send a copy of a Failure to Request Mediation form to the farmer and creditor who served the mediation notice.

### **1. Creditor can enforce the debt**

Once a Failure to Request Mediation form has been issued, the creditor will be allowed to proceed with the collection actions—such as foreclosure or repossession—that originally triggered the mediation notice.<sup>76</sup>

### **2. Creditor must act within 60 days or resend mediation notice**

After a Failure to Request Mediation form has been issued, the creditor must begin collection actions against the debtor within 60 days.<sup>77</sup> Creditors who fail to begin a collection action within 60 days must file another mediation notice before enforcing the debt.

## **F. Canceling mediation if the problem is solved**

In some cases, the problem that triggered the mediation notice in the first place is solved before mediation meetings even begin. If the creditor who served the mediation notice reaches an agreement with the farmer before the first mediation meeting, the farmer and the creditor should send a written statement to the coordinator of the Farmer-Lender Mediation Program. The coordinator will then cancel the mediation proceeding.<sup>78</sup>

Similarly, if the farmer cures the default of the debt described in the creditor's first mediation notice before the first mediation meeting, the farmer and creditor should send a written statement to the coordinator explaining that the default has been cured. The coordinator will then cancel the mediation proceeding.<sup>79</sup>

## **V. Mediation proceeding notice — sent to farmer and all identified creditors**

Within ten days after a farmer has filed a request for mediation, the coordinator of the Farmer-Lender Mediation Program must send a "mediation proceeding notice" to the farmer and to all creditors identified in the mediation request.<sup>80</sup> The mediation proceeding notice sets out the basic process for the mediation and informs creditors of their rights and obligations during the mediation period.

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75 Minn. Stat. §§ 583.24, subd. 4(3), 583.26, subd. 2(a); Minn. R. 1502.0007.

76 Minn. Stat. §§ 583.24, subd. 4(3), 583.26, subd. 2(b); Minn. R. 1502.0008.

77 Minn. Stat. §§ 583.24, subd. 4(3), 583.26, subd. 2(b). The 60-day deadline begins with the farmer's failure to make a timely request for mediation.

78 Minn. R. 1502.0009, subpt. 2.

79 Minn. R. 1502.0009, subpt. 1.

80 Minn. Stat. § 583.26, subd. 4(a).

### A. Meeting times and places

The mediation proceeding notice must state the name and address of the farmer, the time and place of the mediation orientation session (discussed later in this chapter), and the time and place for the initial mediation meeting.<sup>81</sup> The initial meeting must be held within 20 days of the mediation proceeding notice.<sup>82</sup>

#### **Initiating creditor**

In the mandatory farmer-lender mediation process, the initiating creditor is the creditor who sent the initial mediation notice to the farmer. That is, it is the creditor whose intent to collect a debt by taking action against the farmer's agricultural property triggered the mandatory farmer-lender mediation process.

### B. Mediator selection process

The mediation proceeding notice should also set out the process for the farmer and creditor whose intent to take action on a debt triggered the mediation—called the “initiating creditor”—to select the mediator.<sup>83</sup> Mediator qualifications and the selection process are discussed later in this chapter.

### C. Creditor responsibilities

The mediation proceeding notice informs creditors of the prohibition on enforcing debts against the farmer and their duty to provide the farmer with specified financial statements related to the farmer's debts by the time of the initial mediation meeting.<sup>84</sup> These obligations apply to all of the creditors identified by the farmer in the mediation request—not just the initiating creditor.

In addition to the mediation proceeding notice, any secured creditor identified by the farmer will receive a claim form.<sup>85</sup> As discussed later in this chapter, if the creditor believes that the debt is not subject to mandatory farmer-lender mediation, the creditor must return the claim form and indicate the basis of that belief.<sup>86</sup>

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81 Minn. Stat. § 583.26, subd. 4(b)(1), (3), (4).

82 Minn. Stat. § 583.26, subd. 4(c).

83 Minn. Stat. § 583.26, subd. 4(b)(5), (6).

84 Minn. Stat. § 583.26, subds. 4(b)(8), (9), 5(a), (d).

85 Minn. Stat. § 583.26, subd. 4(a)(3).

86 Minn. Stat. § 583.26, subd. 4(f).

## **VI. Mediation suspends creditor actions to collect debt**

From the farmer's perspective, one of the most powerful aspects of the mandatory Farmer-Lender Mediation Program is that it prohibits creditors from taking action to enforce a debt while the mediation process is open. This is intended to allow the parties to meet and discuss the problems freely, without the farmer worrying that the creditor will take immediate action and without the creditor worrying that some other creditor will be able to seize the farmer's property.<sup>87</sup>

As powerful as the stay of creditor collection actions is, it has some important limitations. Farmers who are participating in mandatory farmer-lender mediation should be sure that they understand exactly what the prohibition means and how long it is in effect.

### **A. General suspension of creditor collection actions**

In general, the Farmer-Lender Mediation Act prohibits creditors from proceeding to enforce debt against a farmer's agricultural property until the mediation process is complete.<sup>88</sup> Prohibited actions include proceedings to enforce a debt against agricultural property by foreclosure, termination of a contract for deed, repossession, garnishment, levy execution, seizure, or attachment.<sup>89</sup>

#### **1. The initiating creditor — collection prohibited from the time mediation is triggered**

An initiating creditor is prohibited from taking action to enforce a debt against a farmer's agricultural property from the time the farmer-lender mediation process is triggered.<sup>90</sup>

#### **2. Other creditors — collection prohibited after receipt of the mediation proceeding notice**

For creditors other than the initiating creditor—that is, those creditors identified in the farmer's mediation request—collection actions are prohibited after the mediation proceeding notice has been received.<sup>91</sup> These creditors may not begin any new collection action against the debtor, and if any collection action has already been started, the creditor may not continue the action.

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87 Farmers who are facing harassment from creditors, including repeated phone calls or calls late at night, may report a violation of state law to the Minnesota Attorney General's Office at 1-800-657-3787. For more information, see <http://www.ag.state.mn.us/consumer/finance/DebtFactSheet.htm>.

88 Minn. Stat. § 583.26, subd. 4(b)(8).

89 Minn. Stat. §§ 583.26, subd. 1(a)-(b), 583.26, subd. 5.

90 Minn. Stat. § 583.26, subd. 1(a).

91 Minn. Stat. § 583.26, subd. 5(a), (b).

## **B. Creditor actions suspended for 90 days**

The prohibition on creditor collection actions under the Farmer-Lender Mediation Act generally lasts for 90 days after the farmer files a mediation request.<sup>92</sup> In some cases, however, the suspension may last for less time or for more time.

### **1. Suspension ends if the farmer fails to act in good faith**

If the mediator issues an affidavit finding that the farmer has not acted in good faith, creditor collection actions will no longer be suspended and the creditor will be able to immediately proceed with collection.<sup>93</sup> The definition of good faith is explained later in this chapter.

### **2. Suspension ends if the farmer signs an agreement allowing creditor remedies**

The farmer and creditor may sign an agreement allowing the creditor to enforce a debt against agricultural property before it would otherwise be allowed. Such an agreement must be signed by both the farmer and the creditor, and the creditor must wait for five days after the agreement is signed to take this action.<sup>94</sup> During this five-day period, either the farmer or creditor may reconsider and rescind the agreement.<sup>95</sup>

### **3. Court-supervised mediation may extend suspension of collection actions**

In certain circumstances, the district court of the county where the farmer resides may assume supervision of the mandatory farmer-lender mediation process.<sup>96</sup> Creditor collection actions will also be suspended during any such "court-supervised mediation."<sup>97</sup> At the end of the court-supervised mediation period, if the court decides that a creditor has not participated in good faith, that creditor may be prohibited from taking collection action for another 180 days.<sup>98</sup> Court-supervised mediation is discussed in more detail later in this chapter.

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92 Minn. Stat. §§ 583.26, subd. 4(b)(8), 583.26, subd. 5(a)-(b).

93 Minn. Stat. §§ 583.26, subd. 5(c)(1), 583.27, subd. 4(b).

94 Minn. Stat. § 583.26, subds. 5(c)(2), 9(c).

95 Minn. Stat. § 583.26, subds. 5(c)(2), 9(c).

96 Minn. Stat. § 583.27, subds. 3, 6(b).

97 Minn. Stat. § 583.27, subd. 3.

98 Minn. Stat. § 583.27, subd. 3.

### **Figuring deadlines in mediation**

A number of deadlines are important in mediation. They should be calculated using three rules.<sup>99</sup>

First, when an act or event triggers a time period, the day the act or event occurs does not count among the days in the time period. For example, a farmer has 14 days after receiving a mediation notice to file a request for mediation. If the farmer receives the mediation notice on Wednesday the thirteenth, Thursday the fourteenth counts as the first day of the 14-day period, Friday the fifteenth counts as the second day, and so forth.

Second, if the last day for a time period lands on a Saturday, Sunday, or legal holiday, the time period is extended until the end of the next day that is not a Saturday, Sunday, or holiday. For example, if a farmer has 14 days after receiving a mediation notice to file a request for mediation, and the fourteenth day falls on Saturday the twenty-third, the deadline is extended until the end of the day on Monday, the twenty-fifth. If Monday the twenty-fifth is a legal holiday, the deadline is extended yet again to the end of the day on Tuesday the twenty-sixth.

Third, if the time period in question is less than seven days, Saturdays, Sundays, and legal holidays do not count in the calculation.

## **VII. The mediator**

Mediators in the Farmer-Lender Mediation Program are persons who have been trained in mediation and have some background in farm finance.<sup>100</sup> The law sets out how they are selected, their role in the mediation, and how they can be removed.

### **A. Selecting the mediator**

The farmer and the initiating creditor are allowed to participate in the selection of the mediator from a list of persons working with the Farmer-Lender Mediation Program. According to the Farmer-Lender Mediation Program, the program coordinator will attempt to select a mediator based in part on proximity to the farmer and the creditor in order to avoid long-distance travel and scheduling problems. The coordinator may appoint co-mediators for complex cases.<sup>101</sup> The parties may also choose to hire their own outside mediator.

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99 Minn. R. 1502.0013.

100 Minn. R. 1502.0004(A).

101 Minn. R. 1502.0015, subpt. 3.

### 1. The farmer and initiating creditor are given a list of three names

As part of the mediation proceeding notice, the coordinator of the Farmer-Lender Mediation Program is required to send the farmer and the initiating creditor the names of three mediators who may be assigned to conduct the mediation.<sup>102</sup> The notice must also set out biographical information on each mediator, including a record of mediation cases assigned and the outcomes.<sup>103</sup>

The farmer and initiating creditor may each exclude one mediator from the list of three.<sup>104</sup> They must do this by mailing or faxing written notification of the exclusion to the Farmer-Lender Mediation Program coordinator within three days of receiving the mediation proceeding notice.<sup>105</sup>

### 2. No conflicts of interest

Anyone with a conflict of interest with either the farmer or creditor that does not allow them to be impartial is not eligible to be a mediator in that case.<sup>106</sup>

### 3. Outside professional mediators possible

If the farmer and at least one creditor agree, they can select and pay for a professional mediator who is not on the Farmer-Lender Mediation Program list.<sup>107</sup>

### 4. If the mediator withdraws from the case

If after mediation begins the appointed mediator withdraws from the case, the program coordinator will select another mediator.<sup>108</sup> The farmer or the initiating creditor can object to this mediator by showing that the mediator has a conflict of interest.

## B. Mediator duties

The Farmer-Lender Mediation Act sets out a detailed list of mediator duties.

### 1. Specific mediator duties

At mediation meetings, it is the job of the mediator to: (1) listen to the farmer and the creditors; (2) advise the farmer and creditors of assistance programs available; (3) attempt to arrive at an agreement to fairly adjust, refinance, or pay the debts; and (4) advise, counsel, and assist the farmer and creditors in attempting to arrive at an agreement for the future conduct of financial relations among them.<sup>109</sup>

102 Minn. Stat. § 583.26, subd. 4(b)(5).

103 Minn. Stat. § 583.26, subd. 4(b)(5).

104 Minn. Stat. § 583.26, subd. 4(b)(6), (d).

105 Minn. Stat. § 583.26, subd. 4(b)(6), (d).

106 Minn. Stat. § 583.26, subd. 6.

107 Minn. Stat. § 583.26, subd. 4(b)(7), (e).

108 Minn. R. 1502.0015, subpt. 2.

109 Minn. Stat. § 583.26, subd. 6(b). The statute also says that the mediator shall "attempt to mediate between the debtor and the creditors." Minn. Stat. § 583.26, subd. 6(b)(2).



In addition, the mediator should: (1) review for the parties the farmer's and creditors' rights and obligations in the mediation process, (2) explain the rules of conduct for mediation meetings, (3) explain the confidentiality of mediation, and (4) facilitate written agreements on money to be released for necessary farm operating expenses and necessary living expenses.<sup>110</sup>

## **2. No duty to explain legal rights**

Mediators do not have a duty to advise either farmers or creditors about the law or to encourage or assist them in reserving or establishing their legal rights.<sup>111</sup>

## **C. Removing a mediator**

In some cases, a party to the mediation may wish to remove an acting mediator.

### **1. Either the farmer or creditor can remove the mediator**

Either the farmer or the initiating creditor may request that the mediator be removed at any time.<sup>112</sup> The request must be in writing and sent to the coordinator of the Farmer-Lender Mediation Program.<sup>113</sup>

### **2. Replacing a removed mediator**

The program coordinator will remove the mediator and name a replacement.<sup>114</sup> New mediators may be challenged by either the farmer or the initiating creditor only by a showing that the mediator has a conflict of interest.<sup>115</sup>

### **3. Each party may remove only one mediator**

The farmer and initiating creditor may each remove only one mediator using this method during a single mediation process.<sup>116</sup>

### **4. Length of mediation not affected**

The removal of a mediator does not affect the length of the mediation period.<sup>117</sup>

## **D. Mediators immune from liability**

Mediators are immune from civil liability for actions falling within their job as mediator.<sup>118</sup>

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110 Minn. R. 1502.0016.

111 Minn. Stat. § 583.26, subd. 7.

112 Minn. R. 1502.0018, subpt. 1.

113 Minn. R. 1502.0018, subpt. 1. The rule does require that the debtor or creditor provide a reason for the removal.

114 Minn. R. 1502.0018.

115 Minn. Stat. § 583.26, subd. 6; Minn. R. 1502.0018, subpt. 2. Whether at the beginning of the mediation process or after the removal of one mediator, mediators are not allowed to serve if they have a conflict of interest. Minn. Stat. § 583.26, subd. 6.

116 Minn. R. 1502.0018, subpt. 2.

117 Minn. R. 1502.0018, subpt. 3.

118 Minn. Stat. § 583.26, subd. 7(a); *Schaffer v. Agribank, FCB*, No. C7-96-1273 (Minn. Ct. App. Feb. 4, 1997) (unpublished).

## VIII. Preparing for mediation

Preparation is crucial for a successful mediation. Financial analysts and farm advocates are available to assist farmers as part of the Farmer-Lender Mediation Program. Depending on the complexity of the issues and the value of the property at stake, a farmer might also want to seek legal advice.

### A. Financial analysts

After receiving the farmer's mediation request, the program coordinator will send the farmer the name of a financial analyst who is available to meet with the farmer.<sup>119</sup> The financial analyst is someone who is knowledgeable in agricultural and financial matters and can help the farmer in preparing the financial information needed for mediation. The financial analyst can review and, if necessary, help prepare the farmer's financial records before the initial mediation meeting.

### B. Farm advocates

After receiving the mediation request, the program coordinator will also send the farmer a list of farm advocates and an explanation of the services provided by the Minnesota Farm Advocate Program.<sup>120</sup> Farm advocates provide one-on-one assistance for Minnesota farmers who face crisis caused by a natural disaster or financial problems. They are trained and experienced in agricultural lending practices, mediation, lender negotiation, farm programs, crisis counseling, and disaster programs, and they have been trained to recognize the need for legal and/or social services. Farm advocates provide services without charge to the farmer.<sup>121</sup>

### C. Minnesota Family Farm Law Project

After receiving the mediation request, the program coordinator will also send the farmer information about the Minnesota Family Farm Law Project (MFFFLP).<sup>122</sup> MFFFLP is a program that provides legal assistance to financially distressed family farmers in Minnesota in conjunction with Southern Minnesota Regional Legal Services (SMRLS), Mid-Minnesota Legal Assistance (MMLA), and Legal Services of Northwest Minnesota (LSNM) offices.<sup>123</sup> Services are free or provided at reduced cost to eligible farmers. In general, priority is given to cases to prevent foreclosure on family farm homesteads and repossession of farm machinery, equipment, livestock, crops, and real estate that are necessary to the farm operation. In addition, priority is given to cases to secure the release of income from farm production and/or obtain the extension of credit for family living and farm operating expenses. FLAG provides backup legal assistance to MFFFLP.

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119 Minn. Stat. §§ 583.26, subd. 3(a), 583.22, subd. 6a. This must be done within three business days of the mediation request filing. The financial analyst may be a county extension agent, adult farm management instructor, technical college instructor, or another person able to carry out these duties.

120 Minn. Stat. § 583.26, subd. 3(b); Minn. R. 1502.0012.

121 Minn. Stat. § 583.26, subd. 3(b); Minn. R. 1502.0012. Additional information is *available at* <http://www.mda.state.mn.us/commissioner/fadvoweb.htm>.

122 Minn. R. 1502.0012.

123 Additional information is *available at* <http://www.mnlegalservices.org/familyfarm/>.

#### **D. Creditors must provide information before the initial meeting**

Creditors receiving a mediation proceeding notice must provide farmers with the following information by the initial mediation meeting:<sup>124</sup> (1) copies of notes and contracts for debts subject to mediation; (2) a statement of the interest rates on the debts, delinquent payments, and the unpaid principal balance and interest balances; (3) a list of collateral securing debts and an estimate of the collateral's value; and (4) any debt restructuring programs available to the farmer.

#### **E. Appraising real estate for mediation**

An important issue during the mediation process may be the value of the farmer's real estate. If the farmer and the creditors disagree over the value of real property involved in mediation, the market value will be determined by an appraisal.<sup>125</sup> This appraisal will set the fair market value to be used in the mediation and must be accepted by all parties.<sup>126</sup> The cost of the appraisal will be divided evenly between the principal creditor and the farmer.<sup>127</sup>

#### **F. Mediation planning**

For mediation to be successful, it is important for farmers to decide what they want to accomplish in mediation and to develop a plan that meets these goals.

For farmers who want to continue farming, the financial analyst should try to prepare a cash flow plan to show that the farm operation will produce sufficient income to pay debts and cover production costs.

A cash flow plan could contain a variety of options, including loan reamortization, deferral of principal or interest payments, or other debt restructuring, including forgiveness of some debt. It could also contain changes in the farm operation, the sale of some assets, or voluntarily turning some assets over to creditors.

### **IX. The mandatory farmer-lender mediation process**

Although mandatory farmer-lender mediation is a rather informal process, there are some basic requirements and limitations under the statute.

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124 Minn. Stat. § 583.26, subds. 4(b)(9), 5(d).

125 Minn. Stat. § 583.27, subd. 8. The appraisal must be performed by an accredited appraiser and made within 45 days of the dispute. The mediator will submit three names of accredited appraisers to the principal creditor and farmer. Each may strike the name of one appraiser. The appraiser not eliminated will do the appraisal.

126 Minn. Stat. § 583.27, subd. 8(3).

127 Minn. Stat. § 583.27, subd. 8.

## A. Orientation session

An orientation session must be held at least five days before the first mediation meeting.<sup>128</sup> The farmer, the financial analyst, and a mediator attend the orientation session.<sup>129</sup> Creditors participating in the mediation may attend the orientation session if they choose, although the farmer may meet privately with the financial analyst.<sup>130</sup> Sometimes these orientation sessions are held by telephone conference call.

At the orientation session, the financial analyst will review the farmer's financial and inventory records to make sure that they are complete and will explain what additional records are needed.<sup>131</sup>

The mediator will explain to the farmer the requirements for mediation and will remind the farmer that he or she has the right to seek a lawyer or other expert for advice on the legal and tax consequences of any mediation agreement.<sup>132</sup>

Farmers going to the orientation session should bring financial and inventory records, including, if possible: (1) a depreciation schedule for major farm assets, (2) agricultural production and financial income records for the past three years, (3) a current financial statement, and (4) a projected farm budget for the current year. Farmers who do not have these records have at least five more days after the orientation session to prepare records before the first mediation meeting.<sup>133</sup>

## B. Mediation meetings

The Farmer-Lender Mediation Act sets out some general requirements for mediation sessions, but the specific details of the process—such as the number of meetings and how the meetings are conducted—will be different from case to case.

### 1. Scheduling meetings

The first mediation meeting must be held within 20 days after the mediation proceeding notice is issued.<sup>134</sup> The date and time of the first meeting will be included in the mediation proceeding notice.<sup>135</sup> The mediator will schedule any additional mediation meetings during the mediation period.<sup>136</sup> The meetings must be held at a convenient and neutral place at times as convenient as possible for the mediator, the farmer, and the creditors attending, including nights and weekends.<sup>137</sup>

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128 Minn. Stat. § 583.26, subd. 3a.

129 The mediator present at the orientation session might not be the one who is assigned to the mediation. Minn. Stat. § 583.26, subd. 3a.

130 Minn. R. 1502.0014.

131 Minn. Stat. § 583.26, subd. 3a.

132 Minn. Stat. § 583.26, subd. 3a; Minn. R. 1502.0014.

133 Minn. Stat. § 583.26, subd. 3a; Minn. R. 1502.0014, 1502.0024.

134 Minn. Stat. § 583.26, subd. 4(c).

135 Minn. Stat. § 583.26, subd. 4(b)(4).

136 Minn. R. 1502.0017, subpt. 3.

137 Minn. R. 1502.0017, subpt. 3.

## 2. Meeting procedures

The mediator may set rules and procedures for the meetings in order to encourage an orderly exchange of information and views.<sup>138</sup>

Financial analysts, farm advocates, and attorneys are allowed to attend mediation meetings if they are invited by the farmer, creditor, or mediator.<sup>139</sup>

Representatives of a creditor or farmer are allowed to speak on behalf of that creditor or farmer.<sup>140</sup> A financial analyst, farm advocate, or attorney may not attend in place of a farmer or creditor unless the mediator decides a farmer or creditor is unable to attend and the attendance of someone in his or her place is beneficial to mediation.<sup>141</sup>

### C. Length of mediation period — up to 60 days

Mediation may continue through several sessions, as needed, and may last up to 60 days after the initial mediation meeting.<sup>142</sup>

### D. Mediation agreements are legally binding

If an agreement is reached in farmer-lender mediation and the parties put it in writing, the mediator will sign the written mediation agreement and witness it being signed by the farmer and creditors.<sup>143</sup> The mediator may hold a final meeting for the purpose of signing the mediation agreement.<sup>144</sup> Copies of the signed agreement are sent to all creditors who have filed claim forms.<sup>145</sup>

**It is important to get mediation agreements in writing.**

In most cases, it will benefit the farmer to get the mediation agreement in writing. If the agreement is not in writing, it may be very difficult for the farmer to enforce it.

The farmer and the creditors—both those who approved the mediation agreement and those who filed claim forms and then did not object to the mediation agreement—are bound by the

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138 Minn. Stat. § 583.26, subd. 6(b); Minn. R. 1502.0016.

139 Minn. R. 1502.0017, subpt. 4.

140 Minn. R. 1502.0017, subpt. 4.

141 Minn. R. 1502.0017, subpt. 4.

142 Minn. Stat. § 583.26, subd. 8.

143 Minn. Stat. § 583.26, subd. 9(a); Minn. R. 1502.0019, subpt. 1.

144 Minn. R. 1502.0019, subpt. 1.

145 Minn. R. 1502.0019, subpt. 2. This happens within three days of the farmer and creditors signing the agreement.

terms of the mediation agreement.<sup>146</sup> It has the effect of a legal contract and can be enforced by Minnesota district courts.<sup>147</sup>

### **E. End of mediation — termination statements**

When mediation ends, the mediator must sign and serve to the parties a termination statement.<sup>148</sup> The termination statement explains that mediation has ended and describes or refers to any agreement reached among the farmer and the creditors.<sup>149</sup> Mediation agreements may be included as part of the termination statement.

### **F. Unsuccessful mediation**

The mediation period may end without an agreement. Creditors will then be allowed to begin collection and enforcement actions against the farmer's property.<sup>150</sup>

Farmers do not lose legal defenses to collection or debt enforcement by requesting mediation. For example, redemption rights and the right of first refusal will still be available even though the farmer sought mediation and mediation was not successful. Also, farmers may still bring challenges that a debt is not enforceable or the creditor is claiming the wrong amount.

## **X. Obligations in mediation**

Both farmers and creditors have certain obligations in the mandatory farmer-lender mediation process.

### **A. The farmer's obligations**

Farmers have several legal obligations during farmer-lender mediation. Among the farmer's obligations in mediation are the following.

#### **1. Attend meetings**

The farmer must attend and participate in all mediation meetings.<sup>151</sup>

#### **2. Provide financial information**

The farmer must provide full and complete information about his or her financial obligations.<sup>152</sup> In general, information gathered by a mediator in the farmer-lender mediation

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146 Minn. Stat. § 583.28, subd. 1

147 Minn. Stat. §§ 583.26, subd. 9(b), 583.31. The mediation agreement may be used as a defense against an action contrary to it. If the mediation agreement is poorly drafted or leaves out issues that were discussed, it may be open to various interpretations by the parties. If a court determines the mediation agreement is ambiguous, it will apply rules of contract interpretation in deciding how the mediation agreement should be enforced. *Bartos v. Farm Credit Bank*, No. CX-89-1524 (Minn. Ct. App. Mar. 27, 1990) (unpublished).

148 Minn. Stat. § 583.26, subd. 10.

149 Minn. Stat. § 583.26, subd. 10(b).

150 Minn. Stat. § 583.26, subds. 1, 5.

151 Minn. Stat. § 583.27, subd. 1(a)(1).

152 Minn. Stat. § 583.27, subd. 1(a)(2); Minn. R. 1502.0024.

process is confidential.<sup>153</sup>

### **3. State reasons for rejecting restructuring proposals**

If the creditor submits a debt restructuring plan and the farmer decides not to accept it, the farmer must state in writing his or her reasons for rejecting the proposal.<sup>154</sup> This statement should explain exactly which parts in each proposal are unacceptable and explain the specific reason for rejecting each of them.<sup>155</sup>

### **4. Inspection of secured property**

Farmers requesting mediation must allow secured creditors who are participating in the mediation to inspect the farmer's secured agricultural property.<sup>156</sup> If the farmer does not allow this inspection or destroys the security property, this will be considered evidence of a lack of good faith and the farmer may be denied further mediation rights.<sup>157</sup>

### **5. Provide documents requested by the mediator**

Farmers in mediation must provide several records and documents if the mediator decides they are needed. This includes the following documents.<sup>158</sup>

- a. A current signed financial statement of assets and liabilities;
- b. The farmer's most recent depreciation schedule;
- c. Farm record books for the past three years or other evidence of crop and livestock production;
- d. A projected farm budget for the current 12 months;
- e. Copies of a FINPACK printout analysis of the farm operation, where applicable;
- f. Any appraisals of the farmer's property; and
- g. Copies of any other legal documents that are necessary for the mediation and pertain to the farm business.

## **B. Creditors' obligations**

Creditors have several legal obligations in mediation.

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153 Minn. Stat. § 583.29; Minn. R. 1502.0017, subpt. 5; Minn. Stat. §§ 13.02, subds. 9, 12, 583.26, subd. 7(b).

154 Minn. Stat. § 583.27, subd. 1(a)(4); Minn. R. 1502.0020.

155 Minn. Stat. § 583.27, subd. 1(a)(4); Minn. R. 1502.0020.

156 Minn. Stat. § 583.27, subd. 5(a). The property must be under the farmer's control, the creditor must give 24 hours' notice of the inspection, and the inspection must be made during normal business hours. Normal business hours means 8:00 a.m. to 6:00 p.m. Monday through Saturday but excludes legal Minnesota and United States holidays. Minn. Stat. § 583.27, subd. 5(a).

157 Minn. Stat. § 583.27, subd. 5(b).

158 Minn. R. 1502.0024.

### 1. Provide financial documents

As mentioned earlier, by the first mediation meeting, all of the creditors listed on the mediation request form must provide: (1) copies of all notes and contracts for debts subject to mediation; (2) a statement of interest rates on the debts, delinquent payments, and unpaid principal and interest balances; and (3) the creditor's valuation of the collateral securing the debts.<sup>159</sup>

In addition, if the mediator decides that it is necessary for the mediation, the creditor must provide: worksheets on foreclosure cost analysis, if any have been done by the lender; appraisals of the farmer's property; and copies of any other legal documents that are necessary for the mediation and pertain to the farm business.<sup>160</sup>

Refusal to provide these documents may lead the mediator to find that the creditor has not participated in good faith.<sup>161</sup>

### 2. Describe debt restructuring programs available

By the first mediation meeting, all of the creditors listed on the mediation request form must provide a statement of any debt restructuring programs offered by the creditor.<sup>162</sup>

### 3. Rejection of restructuring proposals must be in writing

If a creditor rejects a farmer's proposal to restructure a debt, the creditor must explain its reasons for the rejection in writing.<sup>163</sup> The written statement must explain why each alternative is unacceptable and explain the specific reasons for rejecting each of them.<sup>164</sup>

### 4. Must release funds for necessary living and farm operating expenses

For farmers in financial difficulty, obtaining release of farm income by creditors can be one of the most important concerns during mediation. During the mandatory farmer-lender mediation process, creditors must release funds from the sale of farm products to be used for necessary living and operating expenses.<sup>165</sup> Failure to do so is a failure to act in good faith.<sup>166</sup>

#### *a. Necessary family living expenses*

During the mediation period, creditors must release money from the sale of farm products for the farmer to use for family living expenses.<sup>167</sup> The amount that must be released varies with the family's size and amount of off-farm income. Two factors are taken into account in determining the amount that must be released for

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159 Minn. Stat. § 583.26, subd. 4(b)(9).

160 Minn. R. 1502.0024.

161 Minn. R. 1502.0024.

162 Minn. Stat. § 583.26, subd. 4(b)(9).

163 Minn. Stat. § 583.27, subd. 1(a)(4); Minn. R. 1502.0020.

164 Minn. Stat. § 583.27, subd. 1(a)(4); Minn. R. 1502.0020.

165 Minn. Stat. § 583.27, subd. 1(a)(5).

166 Minn. Stat. § 583.27, subd. 1(a)(5).

167 Minn. Stat. § 583.27, subd. 1(d); *Wieweck v. United States Dep't of Agric.*, 930 F.2d 619 (8th Cir. 1991).



family living expenses. First, creditors must release an amount equal to one and a half times the amount the family would be receiving if it were eligible for the Minnesota Family Investment Program (MFIP).<sup>168</sup> Second, creditors are not required to release more than \$1,600 per month for family living expenses, minus any off-farm income.<sup>169</sup>

*b. Necessary farm operating expenses*

During mediation, creditors must also release money from the sale of farm products for necessary farm operating expenses for any farm operations begun before the farmer received a notice of default.<sup>170</sup>

Creditors are not required to release funds for expenses that will increase the size of the farming operation or be used to plant additional crops.<sup>171</sup> Otherwise, there is no limit on the amount that must be released for farm operating costs.<sup>172</sup>

*c. If the farmer and creditor cannot agree — petition to court*

If the farmer and creditor cannot agree on the amount that should be released for necessary living expenses or farm operating expenses, either party can seek a court determination of the amount that should be released.<sup>173</sup>

*(1) Necessary living expenses decided by conciliation court*

Disputes about the amount that should be released for necessary living expenses can be resolved by the conciliation court in the county where the farmer resides.<sup>174</sup>

*(2) Necessary operating expenses or living and operating expenses decided by district court*

Disputes about the amount that should be released for farm operating expenses or for necessary living and operating expenses can be resolved by the district court in the county where the farmer resides.<sup>175</sup>

*(3) Asking the district court to decide the release amount is risky*

If the district court is asked to decide how much income should be released for farm operating expenses or living and operating expenses, the court is authorized to penalize any party that it determines was not acting in good faith

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168 Minn. Stat. § 583.22, subd. 7b; Minn. Stat. ch. 256J.

169 Minn. Stat. § 583.27, subd. 1(b).

170 Minn. Stat. § 583.22, subd. 7a.

171 Minn. Stat. § 583.22, subd. 7a.

172 Minn. Stat. § 583.22, subd. 7a.

173 Minn. Stat. § 583.27, subd. 1(c)-(d).

174 Minn. Stat. § 583.27, subd. 1(c). The conciliation court is to make a determination within ten days of receiving the petition.

175 Minn. Stat. § 583.27, subd. 1(d). The district court is to make a determination within ten days after receiving the petition.

in its position on the release of income.<sup>176</sup> First, the court may either add or subtract ten days to the time in which the creditor cannot take collection action against the farmer's property. Second, the court can make one party pay the other party's attorneys' fees and costs for the release-of-income dispute.<sup>177</sup>

## 5. Participation requirements

Whether or not a creditor must actually participate in the mediation meetings depends on how the creditor was brought into the process and what degree of protection the creditor is seeking.

### *a. Initiating creditor must participate*

The creditor who first served the mediation notice must participate in mediation.<sup>178</sup>

### *b. Creditor that believes its debt is not subject to mediation must make a case to the mediator*

A secured creditor believing that the debt owed to it is not subject to mediation must return the claim form and other supporting documents to the coordinator of the Farmer-Lender Mediation Program and explain why it believes the debt is not subject to mediation.<sup>179</sup> The coordinator will decide whether mediation of the debt is required and will notify the farmer, creditor, and mediator of the decision.<sup>180</sup>

### *c. Other creditors are not required to participate*

Other creditors identified by the farmer in the mediation request may choose not to attend the mediation meetings.<sup>181</sup> Some creditors may not want to participate in mediation, especially if the debt is relatively small. Unless these creditors file a claim form, however, they will be bound by any mediation agreement even though they did not participate in mediation.<sup>182</sup> Creditors that do not participate in mediation but do file a claim form will have the right to object to any mediation agreement, and there may be additional mediation meetings to deal with these creditors' objections.<sup>183</sup>

#### *(1) If the creditor files a claim form*

Creditors who admit that their debt is subject to mediation may, instead of participating in the mediation process, file a notice of claim and proof of claim with the mediator before the initial mediation meeting.<sup>184</sup> A creditor

<sup>176</sup> Minn. Stat. § 583.27, subd. 1(d).

<sup>177</sup> Minn. Stat. § 583.27, subd. 1(d).

<sup>178</sup> Minn. Stat. §§ 583.27, subd. 1(a), 583.28, subd. 1; Minn. R. 1502.0026. This means that the initiating creditor is not allowed to file a proof of claim form instead of attending meetings.

<sup>179</sup> Minn. Stat. § 583.26, subd. 4(f); Minn. R. 1502.0011, subpt. 1.

<sup>180</sup> Minn. R. 1502.0011, subpt. 2.

<sup>181</sup> Minn. Stat. § 583.28.

<sup>182</sup> Minn. Stat. § 583.28.

<sup>183</sup> Minn. Stat. § 583.28, subd. 2.

<sup>184</sup> Minn. Stat. § 583.28, subd. 1.

filing a claim form agrees to be bound by a mediation agreement reached between the farmer and the participating creditors unless the creditor files a written objection to the agreement.<sup>185</sup>

*(a) Opportunity to make written objection to any mediation agreement*

The mediator will notify creditors who have filed claim forms of the terms of any mediation agreement.<sup>186</sup> Each such creditor will have ten days after receiving the mediation agreement to serve (on the mediator and the farmer) a written objection to the terms of the agreement.<sup>187</sup> The written objection must identify the particular parts of the agreement that are unacceptable and state the specific reason for rejecting each item.<sup>188</sup>

*(b) New mediation meetings to address objections*

Upon receiving an objection to a mediation agreement, the mediator will meet again with the farmer and creditors to mediate a new agreement.<sup>189</sup> These mediation meetings will take place within ten days of the receipt of the written objections to the mediation agreement.<sup>190</sup>

*(c) Objecting creditor must attend new mediation meetings*

Creditors that do not attend mediation meetings but file written objections to the mediation agreement must attend and participate in the new mediation meetings that take place after the objection.<sup>191</sup> The mediator may, however, decide there is a good reason why the creditor is unable to attend.<sup>192</sup>

*(2) If the creditor does not file a claim form*

Creditors that are notified of the initial mediation meeting and do not either participate in the mediation or file a claim form will be bound by the mediation agreement and may not object to it.<sup>193</sup>

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185 Minn. Stat. § 583.28.

186 Minn. Stat. § 583.28, subd. 1.

187 Minn. Stat. § 583.28, subd. 2.

188 Minn. Stat. § 583.28, subd. 2; Minn. R. 1502.0026, subpt. 3.

189 Minn. Stat. § 583.28, subd. 2; Minn. R. 1502.0026, subpt. 4.

190 Minn. Stat. § 583.28, subd. 2; Minn. R. 1502.0026, subpt. 4.

191 Minn. R. 1502.0026, subpt. 5.

192 Minn. R. 1502.0026, subpt. 5.

193 Minn. Stat. § 583.28, subd. 1.

*d. Participating creditor must send a person with authority to make commitments*

If a creditor does participate in mediation, the creditor must send to the mediation meetings a person who has authority to make binding commitments within 24 hours to fully settle or compromise debts.<sup>194</sup>

**C. All parties' obligation — mediate in good faith**

All parties are required to mediate in good faith.<sup>195</sup> This includes creditors filing claim forms instead of attending mediation meetings.<sup>196</sup>

**1. Defining the lack of good faith**

Not participating in good faith includes the following. This list is not exhaustive. The statute states that other "similar behavior" also may be taken as evidence of lack of good faith.<sup>197</sup>

*a. Failure to attend and participate*

Regular or continued failure to attend and participate in mediation sessions without cause is a failure to act in good faith.<sup>198</sup>

*b. Failure to provide information*

Failure to provide full information regarding the financial obligations of the parties and other creditors is a failure to act in good faith.<sup>199</sup>

*c. Creditor failure to designate a representative*

A creditor in the mediation process must be represented by a person with the authority to make binding commitments within one business day to fully settle, compromise, or otherwise mediate the matter.<sup>200</sup> Failure to do so is an act of bad faith on the part of a creditor.

*d. Creditor failure to provide written statement explaining restructuring alternatives*

Failure by a creditor to provide a written statement of debt restructuring alternatives is a failure to act in good faith.<sup>201</sup>

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194 Minn. Stat. § 583.27, subd. 1(a)(3).

195 Minn. Stat. § 583.27, subd. 1.

196 Minn. R. 1502.0026, subpt. 2.

197 Minn. Stat. § 583.27, subd. 1(a)(6).

198 Minn. Stat. § 583.27, subd. 1(a)(1).

199 Minn. Stat. § 583.27, subd. 1(a)(2). This includes the obligation of a creditor to provide information under Minn. Stat. § 583.26, subd. 5(d).

200 Minn. Stat. § 583.27, subd. 1(a)(3).

201 Minn. Stat. § 583.27, subd. 1(a)(4).

*e. Failure to explain why a restructuring proposal is unacceptable*

Failure by either the farmer or a creditor to explain in writing why a proposed restructuring plan is unacceptable is evidence of a lack of good faith.<sup>202</sup>

*f. Creditor failure to release funds*

Creditor failure to release funds from the sale of farm products to the farmer for necessary living and farm operating expenses is a failure to act in good faith.<sup>203</sup>

*g. Farmer concealment or transfer of secured agricultural property during mediation*

Farmers will be found to not be mediating in good faith if during mediation they fraudulently conceal, remove, or transfer agricultural property in which they know a creditor has a security interest.<sup>204</sup>

*h. Farmer failure to allow inspection of secured property*

If the farmer does not allow inspection of security property or destroys it, this is evidence of a lack of good faith.<sup>205</sup>

*i. Abusive behavior*

Lack of good faith during mediation may include abusive behavior on the part of the farmer or a creditor or a person assisting the farmer or creditor.<sup>206</sup>

**2. Creditor unwillingness to restructure debt is not bad faith**

A creditor's refusal to agree to reduce, restructure, refinance, or forgive debt is not, in itself, evidence of a lack of good faith.<sup>207</sup>

**3. Mediator decides if a party acts in good faith**

In general, the mediator will decide whether a party to the mediation has failed to act in good faith.<sup>208</sup> Mediators believing that a party is not acting in good faith will file an affidavit—a signed legal document—with the coordinator of the Farmer-Lender Mediation Program and the parties involved.<sup>209</sup> The affidavit should give reasons why the mediator believes a party is not acting in good faith.

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202 Minn. Stat. § 583.27, subd. 1(a)(4).

203 Minn. Stat. § 583.27, subd. 1(a)(5).

204 Minn. Stat. § 583.27, subd. 4(a). The concealment, removal, or transfer must be in violation of a security agreement without remitting the proceeds to the secured party and must have occurred during the mediation period.

205 Minn. Stat. § 583.27, subd. 5(b).

206 Minn. R. 1502.0021.

207 Minn. Stat. § 583.27, subd. 1.

208 Minn. Stat. § 583.27, subd. 2; Minn. R. 1502.022.

209 Minn. Stat. § 583.27, subd. 2; Minn. R. 1502.022.

A farmer who believes a creditor is not negotiating in good faith should therefore ask the mediator to issue an affidavit making such a finding. The request to the mediator should be in writing and should explain how the creditor is mediating in bad faith.

#### 4. Courts provide limited review of mediator decisions about good faith

Parties believing that a mediator's decision regarding good faith is mistaken may ask a court to review the mediator's decision.<sup>210</sup> Review is limited, however, to whether the mediator committed an abuse of discretion in filing or failing to file an affidavit of lack of good faith.<sup>211</sup> Review for an abuse of discretion is very limited, and courts only rarely reach this conclusion.<sup>212</sup> It will therefore likely be very difficult to overturn a mediator's determination regarding a lack of good faith.

##### a. *Creditor may proceed with collection action while court is reviewing mediator decision*

If a mediator issues an affidavit of lack of good faith against a farmer, the creditors can immediately proceed to take action against the farmer's property.<sup>213</sup> This is true even if the farmer seeks court review of the affidavit.

##### b. *If the court reverses the mediator*

If the court finds that the mediator committed an abuse of discretion in filing or failing to file an affidavit of lack of good faith, the court has several options. It may: (1) reinstate mediation and renew the stay preventing creditors from taking action against the farmer, (2) order court-supervised mediation, or (3) allow the creditor to proceed right away with action against the farmer.<sup>214</sup>

#### 5. If the creditor fails to act in good faith

If the mediator decides that a creditor has failed to act in good faith, several consequences follow.

210 Minn. Stat. § 583.27, subd. 6(a).

211 Minn. Stat. § 583.27, subd. 6(a)-(b); *Obermoller v. Federal Land Bank*, 409 N.W.2d 229 (Minn. Ct. App. 1987). A mediator may offer testimony but is not required to testify as part of the court's review. Minn. Stat. § 583.27, subd. 6(c). The court must hear the petition within ten days. Minn. Stat. § 583.27, subd. 6(a). Events outside of mediation are not a factor in deciding if a party is acting in good faith. *Production Credit Ass'n of Worthington v. Springwater Dairy Farm, Inc.*, 407 N.W.2d 88 (Minn. 1987); *Rengstorf v. Richards*, 417 N.W.2d 138 (Minn. Ct. App. 1987).

212 See, for example, *Herbst v. Princeton Bank*, No. C3-96-1903 (Minn. Ct. App. June 10, 1997) (unpublished), dismissing farmers' complaint seeking court-supervised mediation due to the creditor's alleged lack of good faith and ordering the farmer to pay \$500 for the bank's attorney fees.

213 Minn. Stat. § 583.27, subd. 4(b). If the court later finds in the farmer's favor and rejects the affidavit, the court may reinstate the stay of creditor action by reopening the mediation process or ordering court-supervised mediation. Minn. Stat. § 583.27, subd. 6(b).

214 Minn. Stat. § 583.27, subd. 6(b).

*a. Court-supervised mediation possible*

If the mediator finds that the creditor has not been negotiating in good faith, the farmer can request court-supervised mediation.<sup>215</sup>

*(1) Requesting court-supervised mediation*

A request for court-supervised mediation is made by: (1) filing the mediator's affidavit, along with a request for supervised mediation, with the district court of the county where the farmer resides; (2) serving a copy of the request on the creditor; and (3) sending a copy of the affidavit to the coordinator of the Farmer-Lender Mediation Program.<sup>216</sup>

The request must be filed with the court within 10 days of the farmer's receipt of the lack of good faith affidavit or within 90 days after the farmer filed the mediation request with the coordinator, whichever is later.<sup>217</sup>

*(2) How court-supervised mediation works*

In court-supervised mediation, the court requires the mediation process to begin again.<sup>218</sup> Court-supervised mediation may last for up to 60 days.<sup>219</sup> During court-supervised mediation, creditor collection actions are again suspended and the court may issue orders necessary to compel good faith mediation.<sup>220</sup>

If the court decides that a creditor has failed to mediate in good faith during court-supervised mediation, the court may suspend the creditor's collection actions for an additional 180 days.<sup>221</sup>

*b. Creditors must pay farmer's costs and attorneys' fees*

If the mediator decides that a creditor has not participated in good faith in the original mediation, the creditor must pay the farmer's attorneys' fees and costs resulting from the request for court-supervised mediation or a request for further suspension of the creditor's collection actions.<sup>222</sup>

**6. If the farmer fails to act in good faith**

If the mediator decides that the farmer has not mediated in good faith, the mediator will issue an affidavit of lack of good faith and the creditor will be able to immediately

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215 Minn. Stat. § 583.27, subd. 3.

216 Minn. Stat. § 583.27, subd. 3.

217 Minn. R. 1502.0023.

218 Minn. Stat. § 583.27, subd. 3. If requested to do so by the court, the coordinator of the Farmer-Lender Mediation Program will provide the court with a list of mediators to be used in the selection of the mediator for court-supervised mediation. Minn. R. 1502.0025, subpt. 1.

219 Minn. Stat. § 583.27, subd. 3.

220 Minn. Stat. § 583.27, subd. 3; Minn. R. 1502.0025, subpt. 2.

221 Minn. Stat. § 583.27, subd. 3.

222 Minn. Stat. § 583.27, subd. 3.

proceed with all available debt enforcement actions, such as foreclosure, repossession, and the like.<sup>223</sup>

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<sup>223</sup> Minn. Stat. § 583.27, subd. 4(b).



## Chapter Eight

# Bankruptcy

### I. Introduction

In some cases, it makes sense for farmers in financial difficulty to consider filing a bankruptcy petition. This chapter provides a general discussion of bankruptcy, but it is only a brief overview and should not be used to answer specific questions. As much as any other topic discussed in this book, bankruptcy requires the advice of an expert.<sup>1</sup>

### II. The purpose of bankruptcy

Everyone agrees that whenever it is possible, debtors should repay money owed. It is also true, however, that when someone is buried in debt and realistically cannot pay it all back, it is important to have a system that erases part of the debt, reorganizes the remaining debt, and gives people caught in debt a chance to free themselves and continue productive lives. One of the primary purposes of bankruptcy, as the Supreme Court of the United States has explained, is to “relieve the honest debtor from the weight of oppressive indebtedness” and give debtors a “new opportunity in life . . . unhampered by the pressure and discouragement of pre-existing debt.”<sup>2</sup> The right to bankruptcy is guaranteed in the law and in fact is provided by the United States Constitution.<sup>3</sup>

### III. Planning for bankruptcy

For bankruptcy to work effectively, it is essential for farmers to think ahead and plan for it. Deciding whether to use bankruptcy and, if so, which type of bankruptcy to use can be very

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1 Helpful sources for bankruptcies include: Phillip L. Kunkel’s Farm Legal Series through the University of Minnesota Extension that has fact sheets on bankruptcies, *available at* <http://www.extension.umn.edu/distribution/businessmanagement/DF7291.html>; National Consumer Law Center, CONSUMER BANKRUPTCY AND LAW PRACTICE (6th ed. 2000); Randy Rogers & Lawrence P. King, COLLIER FARM BANKRUPTCY GUIDE (1999); Roger A. McEowen & Neil Harl, PRINCIPLES OF AGRICULTURAL LAW, ch 5 (2001); Susan A. Schneider, *The Family Farmer in Bankruptcy: Recent Developments in Chapter 12*, 3 DRAKE J. AGRIC. L. 161 (1998); Randy Rogers, *Current Developments in Agricultural Bankruptcies and Insolvencies*, 5 DRAKE J. AGRIC. L. 137 (2000); and David S. Yen, *Bankruptcy and the Low-Income Client*, 34 CLEARINGHOUSE REV. 709 (Mar.-Apr. 2001).

2 *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934).

3 U.S. Const. Art. I, § 8, cl. 4.

complicated. In addition, for bankruptcy to work well, it is important for farmers to plan business decisions well before filing bankruptcy, if possible.

### A. Prefiling strategies

Many strategies for managing assets and debts before filing for bankruptcy are beneficial and perfectly legal. For example, it is sometimes possible to arrange a farmer's finances and assets to maximize the exemptions available to the farmer.<sup>4</sup> Some actions a farmer might take before filing for bankruptcy, however, are illegal and can both ruin the bankruptcy and subject the farmer to possible criminal penalties.<sup>5</sup> Unfortunately, recognizing the difference between legal and illegal pre-bankruptcy planning strategies can be tricky.<sup>6</sup> It is extremely important, therefore, for the farmer to get qualified expert advice well before filing for bankruptcy.

### B. Last-minute filing

In some cases, a farmer may have no choice but to file for bankruptcy without much planning. A filing may be needed to at least temporarily stop a repossession or foreclosure. In such a case, it is possible to file a bankruptcy petition very quickly.<sup>7</sup>

## IV. Two general types of bankruptcy — liquidation and reorganization

Two general types of bankruptcy are available to farmers: reorganization bankruptcy and liquidation bankruptcy. The bankruptcy code provides for several specific types of bankruptcy—commonly known as chapters. Chapters 7, 11, 12, and 13 are types of bankruptcy that may be used by farmers. Chapter 12 reorganization bankruptcy was specifically designed for family farmers.

### A. Chapter 7 liquidation bankruptcy

Chapter 7 liquidation bankruptcies—sometimes called straight bankruptcies—are what come to mind most often when people think of bankruptcy. In a Chapter 7 bankruptcy, the debtor's non-exempt assets are typically sold or distributed to creditors.<sup>8</sup> (Asset exemptions are discussed below.) The proceeds from this liquidation sale are used to pay the debtor's creditors. Eventually, the debtor receives a "discharge" of most of the rest of the debts, which means the debtor is no longer legally required to pay the debts. Mortgages and other security interests, however, survive even after discharge. With careful pre-bankruptcy planning, farmers may be able to keep significant assets and may even be able to continue a farming operation after a Chapter 7 bankruptcy.

### B. Reorganization bankruptcy

In a reorganization bankruptcy, the debtor proposes a plan to pay some or all of his or her debts over a period of time. The plan is then carried out under court supervision. In a successful

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4 See National Consumer Law Center, at 67-68.

5 For example, some transfers can be defined as fraudulent. 11 U.S.C. §§ 548; 727(a)(2); 18 U.S.C. § 152.

6 See, for example, *In re Curry*, 160 B.R. 813 (Bankr. D. Minn. 1993), and *In re Johnson*, 880 F.2d 78 (8th Cir. 1989).

7 See 11 U.S.C. § 301; Fed. R. Bank. P. 1007(a)(1), (c), 3015; National Consumer Law Center, at 73-74.

8 11 U.S.C. §§ 701-728.

reorganization bankruptcy by a farmer, the farming operation continues. Farmer bankruptcy reorganizations generally will be under either Chapter 12 or Chapter 11. A Chapter 13 bankruptcy is also possible.

### 1. Chapter 13 wage-earner reorganization bankruptcy

Chapter 13 bankruptcy—which is sometimes called a wage-earner bankruptcy—is designed for individuals.<sup>9</sup> The debtor carries out a court-approved plan to make payments on debts and agrees to commit all disposable income to repaying his or her creditors. The plan must be the debtor's best good faith effort to repay creditors. The plan also should result in unsecured creditors receiving as much as if the debtor filed a Chapter 7 liquidation bankruptcy. Secured creditors should receive at least the value of their security property. After the three- to five-year reorganization plan is completed, the debtor's remaining debts are discharged.

To qualify for Chapter 13 bankruptcy, the debtor must have regular income, his or her unsecured debts must be less than \$290,525, and his or her secured debts must be less than \$871,500.<sup>10</sup> Although not designed with farmers in mind, Chapter 13 can sometimes be the best bankruptcy option, especially for farmers with smaller operations or who for some reason cannot qualify under Chapter 12.

### 2. Chapter 11 reorganization bankruptcy

Chapter 11 is a reorganization bankruptcy for businesses. The business continues to operate and the debtor files a plan to reschedule the business's debts over time.<sup>11</sup> Chapter 11 is the most complex and costly form of bankruptcy and, in some important ways, is better suited to a large corporation than a family farm. In general, therefore, Chapter 11 should only be used by family farmers when Chapter 12 is not available.

### 3. Chapter 12 farmer reorganization bankruptcy

Chapter 12 is a reorganization bankruptcy specifically for family farmers.<sup>12</sup> To qualify for a Chapter 12 bankruptcy, the debtor must be engaged in a farming operation and must have a regular annual income that is stable enough to make the payments under

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9 11 U.S.C. §§ 1301-1330.

10 11 U.S.C. § 109(e). See also 66 Fed. Reg. 10,911 (2001).

11 11 U.S.C. §§ 1101-1146.

12 11 U.S.C. §§ 1201-1231. Originally enacted in 1986, Chapter 12 has been repeatedly extended by Congress. See Susan A. Schneider, *History of Chapter 12 bankruptcy: on again, off again*, 18 AGRICULTURAL LAW UPDATE 9 (Aug. 2001). At the time this edition was written, Chapter 12 authorization was extended through June 30, 2003. Pub. L. No. 107-377. Provisions to permanently authorize Chapter 12 bankruptcies and to make certain changes to Chapter 12 eligibility requirements were included in larger bankruptcy bills that were being considered by Congress at the time this edition was written.

the plan.<sup>13</sup> Further eligibility requirements for Chapter 12 bankruptcy are: (1) no more than \$1.5 million in total debt, (2) at least 80 percent of the debt arose out of the farming operation, and (3) more than 50 percent of the debtor's (and spouse's) income came from farming in the tax year preceding the bankruptcy.<sup>14</sup>

Because of the lower debt limits and other restrictions on who may use Chapter 13 and the difficulties and expense of Chapter 11, Chapter 12 bankruptcy often provides the best alternative for farmers who meet its eligibility requirements. This is especially true given the significant leeway that Chapter 12 gives a farmer in dealing with secured creditors.<sup>15</sup> Even farmers who do not file a bankruptcy petition have found that having a Chapter 12 bankruptcy as a fall-back option helps to encourage creditor negotiations.

In general, Chapter 12 allows a farmer to reorganize if the farmer can propose a plan to: (1) pay secured creditors, over time, the value of their collateral plus interest; and (2) pay unsecured creditors (including secured creditors to the extent that they are undersecured) as much as they would receive if the farmer filed a Chapter 7 liquidation bankruptcy. The reorganization plan must be the farmer's best good faith effort to repay creditors. In addition, it must provide that the unsecured creditors will be paid any excess income, above the farmer's reasonable operating and living expenses, received by the farmer during the term of the plan (three to five years). The goal—which often is achievable—is to restructure the debts on farm assets and allow the farmer to keep assets and continue farming.<sup>16</sup>

## V. Important bankruptcy features

Several of the important features of a bankruptcy are described here.

### A. The automatic stay — stopping creditor actions

Once a debtor files a bankruptcy petition, the debtor immediately gets the benefit of an automatic stay of creditor actions.<sup>17</sup> The automatic stay temporarily stops creditors from taking a number of actions against the farmer to enforce debts. During an automatic stay, for example, a creditor is prohibited from attempting to enforce a judgment, repossess property, enforce a lien, or recover a debt. It is illegal for a creditor to violate the stay, and the stay remains in effect until

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13 11 U.S.C. §§ 109(f), 101(18)-(21). The definition of a family farmer is limited for bankruptcy purposes. Farm corporations and partnerships are considered to be "family farmers" only if they meet certain specific criteria, including the requirement that more than 50 percent of the stock or equity is held by one family and their relatives and that family conducts the farming operation. 11 U.S.C. § 101(18)(A)-(B).

14 11 U.S.C. § 101(18).

15 11 U.S.C. §§ 1221, 1225; National Consumer Law Center, at 419-20, 466-74.

16 One study concluded that a very large percentage of Chapter 12 filers manage to keep their land and continue farming and that the financial position of Chapter 12 filers tends to improve markedly after filing. Chris Faiferlick & Neil E. Harl, *Experience Shows Chapter 12 Works*, AGRI FINANCE, October 1995, at 32.

17 11 U.S.C. § 362; National Consumer Law Center, at 113-52.

the bankruptcy case is closed or dismissed, a discharge is granted or denied, or the creditor gets permission from the court to act.

For farmers acting at the last possible moment, an automatic stay may provide the only way to prevent a foreclosure or other action.

### **B. Exemptions — the minimum that can be protected from unsecured creditors**

As discussed in Chapter Five, Minnesota law exempts a number of a debtor's possessions from creditor actions to enforce unsecured debt. These exemptions also come into play in bankruptcies. In a Chapter 7 bankruptcy, for example, exempt assets will not be taken or sold for the benefit of unsecured creditors.<sup>18</sup>

The debtor in bankruptcy can choose from either the Minnesota exemptions (described in Chapter Four) or the exemptions set out in federal law.<sup>19</sup> Federal exemptions include the equity value (up to certain limits) of a homestead, a motor vehicle, household goods, and other property, including the implements and tools of the debtor's trade.<sup>20</sup> Federal exemptions tend to be far less favorable to the debtor than Minnesota exemptions.<sup>21</sup> In most cases, therefore, farmers choose Minnesota exemptions.

In general, if a debtor has given a creditor a security interest in an item of property, the debtor has waived the right to claim that property as exempt against the secured creditor. However, sometimes a debtor can use bankruptcy "lien avoidance" provisions to reduce or remove a creditor's security interests.<sup>22</sup>

### **C. Discharge of unsecured debts**

At the end of a successful bankruptcy, some unsecured debts will likely be discharged—which means that the debtor will no longer legally be required to pay them.<sup>23</sup> Not every type of unsecured debt owed by a debtor can be discharged in bankruptcy. For example, debts for child support or alimony, most student loans, and some taxes are not subject to discharge.<sup>24</sup> These will remain the debtor's obligation even after the bankruptcy is complete.

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18 On exemptions, see National Consumer Law Center, at 153-204.

19 11 U.S.C. § 522(b); Minn. Stat. § 550.371, subd. 1; *In re Stenzel*, 301 F.3d 945, 947 (8th Cir. 2002).

20 11 U.S.C. § 522(d). In general, the fair market value is used to value federal exemptions. For further information on the federal tools of the trade exemption, see Harrison M. Pittman, *Husband and Wife Farmers in Agricultural Bankruptcies: The "Tools of the Trade" Exemption*, NATIONAL AGLAW CENTER (Oct. 2002), available at <http://www.nationalaglawcenter.org/publications/articles/pittman.pdf>.

21 In October 1994, the maximum value of several federal exemptions was doubled. Pub. Law No. 103-394, § 108(a)-(d), 108 Stat. 4106, 4111-12 (1994) (codified at scattered sections of 11 U.S.C.). The values of these exemptions are to be adjusted for inflation every three years. Pub. L. No. 103-394, § 108(e), 108 Stat. 4106, 4112 (1994) (codified at 11 U.S.C. § 104).

22 11 U.S.C. § 522(f)(2); National Consumer Law Center, at 173-204. For example, secured creditors will generally be considered secured only to the extent of the fair market value of their collateral. The balance of the debt will be unsecured.

23 11 U.S.C. §§ 524, 727; National Consumer Law Center, at 325-401.

24 11 U.S.C. § 523(a).

#### **D. Voluntary payments and reaffirmation of debts**

After a bankruptcy, some farmers may wish to make payments on debts that were discharged in bankruptcy. There could be any number of reasons for someone to voluntarily pay discharged debts, including a desire to keep a business relationship with a certain creditor. Voluntary payments to a creditor after the debt has been discharged are permitted. Such payments, however, are never legally required.

It is a completely different matter, however, if a debtor "reaffirms" a debt.<sup>25</sup> Reaffirmation is a promise to pay a debt despite its discharge. Reaffirmation therefore eliminates the benefits of the discharge. Voluntary payments do not necessarily mean a debt is reaffirmed.<sup>26</sup> Reaffirmation of debt should only be done in the most rare cases.

#### **E. Effect on future credit**

A bankruptcy generally can be listed in a debtor's credit history for up to ten years.<sup>27</sup> It therefore can affect a farmer's future ability to get credit. However, farmers in substantial debt and in default likely already have a poor credit rating even without a bankruptcy. In addition, some potential creditors may be more willing to grant credit once the slate is wiped clean and they do not have to compete with past creditors.

#### **F. Income taxes**

A number of different aspects of bankruptcy and pre-bankruptcy planning efforts can affect the farmer's income taxes. The tax implications of a bankruptcy are important and often complicated. It is quite possible, for example, to lose much of the benefit of a bankruptcy due to taxes owed. Chapter Nine of this book discusses taxes briefly, but it is extremely important to get expert, individualized tax advice before filing for bankruptcy.

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25 11 U.S.C. § 524(c); National Consumer Law Center, at 109-10, 386-90.

26 11 U.S.C. § 524(f).

27 15 U.S.C. § 1681c(a)(1).

## Chapter Nine

# Income Tax Considerations

### I. Introduction

The tax implications of many debtor-creditor problems faced by farmers can be significant and extremely complicated. If not planned correctly, for example, a farm bankruptcy or non-bankruptcy workout can result in a financial disaster in which the farmer ends up with a huge federal income tax liability. The tax code may be the most confusing part of the law, and it changes quickly.<sup>1</sup>

This chapter briefly discusses some of the possible federal income tax issues that should be of concern to farmers in financial difficulty. It does not even mention other significant problems, such as state income taxes. This short chapter should therefore not be used to answer specific questions about income tax problems. It is crucial for farmers to find expert advice when confronted with the issues discussed in this chapter.

Consult an attorney to get tax advice on your specific situation.

### II. Debt forgiveness can create a tax liability

Whenever a debt is reduced or canceled, there is a potential for tax liability. If a farmer works out an agreement with a lender to reduce his or her debt, this will often result in an income tax obligation for the farmer.

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1 The following sources are helpful in the area of farm taxation: Phillip L. Kunkel and Scott T. Larison, *Tax Considerations in Liquidations and Reorganizations*, UNIVERSITY OF MINNESOTA EXTENSION (Jan. 2002) available at <http://www.extension.umn.edu/distribution/businessmanagement/DF7300.html>; Phillip E. Harris, *Self-Employment Tax for Farmers*, 6 DRAKE J. AGRIC. L. 119 (2001); James D. Cox, FARMING AND RANCHING—TAX ACCOUNTING (Tax Management, Inc. 1994); Charles Davenport, FARM INCOME TAX MANUAL (LEXIS 1999); Neil E. Harl, AGRICULTURAL LAW (Matthew Bender & Co. 1997); Gregory E. Stern, RESTRUCTURING FINANCIALLY TROUBLED BUSINESSES: TAX ASPECTS (Tax Management, Inc. 1996); William Tatlock, DISCHARGE OF INDEBTEDNESS, BANKRUPTCY AND INSOLVENCY (Tax Management, Inc. 1995); and Farm.Doc - University of Illinois at Urbana-Champaign College of Agricultural, Consumer and Environmental Sciences: <http://www.farmdoc.uiuc.edu/legal/Taxation/overview.html>.

### A. General rule — debtor has income in amount of canceled debt

In general, cancellation of a debt results in taxable income to the debtor in the amount of debt canceled.<sup>2</sup> For example, if a farmer signs over a piece of property appraised at \$65,000 in full payment of a \$73,000 debt, the farmer would likely have \$8,000 in debt-cancellation income.

Computing the actual tax liability for a debt reduction or cancellation can be quite complicated. For example, a debtor is not required to declare the income until the debt is actually canceled, but the timing of the debt cancellation can be difficult to pinpoint.<sup>3</sup>

### B. Exceptions to tax liability for debt cancellation

Despite the general rule, there are several circumstances in which the cancellation of debt does not create taxable income.<sup>4</sup> Some of the most common exceptions to the debt-cancellation income rule are discussed here. Other exceptions may apply in some cases. Using any of the exceptions can be very complicated. Consult a tax expert regarding your specific circumstances.

#### 1. Tax-deductible debt payments

No income is realized from the cancellation of a debt to the extent that payment of the debt would have made the debtor eligible for a deduction.<sup>5</sup>

#### 2. Some types of debt cancellation in bankruptcy

Some debt cancellation in bankruptcy may not be taxable as income.<sup>6</sup>

#### 3. Insolvent debtor

If the debtor is technically “insolvent,” some discharge of debt might not be taxable. A debtor is insolvent if his or her debts exceed the fair market value of his or her assets.<sup>7</sup> When filing an income tax return, an insolvent debtor can generally exclude debt-cancellation income from gross income up to the amount of his or her excess debts.<sup>8</sup> Determining whether insolvency exists, however, can be more difficult than it first appears. Only assets against which the debtor’s creditors have claims are included in determining insolvency, because the cancellation of debt does not release those assets from the creditors’ claims.<sup>9</sup> Minnesota law controls which assets can be claimed by creditors. Chapters Four and Five discuss creditors’ claims.

2 26 U.S.C. § 61(a)(12).

3 See Stern, at A-1 to A-2. If there is more than one debtor, the tax implications can be even more complicated. Other aspects of the debt cancellation can be equally complicated. See, for example, Stern, at A-2 to A-6.

4 26 U.S.C. § 108.

5 26 U.S.C. § 108(e)(2).

6 26 U.S.C. § 108(a)(1)(A).

7 26 U.S.C. § 108(d)(3). This calculation is made based on the value of the debtor’s assets and liabilities just prior to the cancellation.

8 26 U.S.C. § 108(a)(1)(B), (a)(3).

9 See Tatlock, at A-21 to A-22, Harl § 39.03[5], at 39-28 to 39-29.



#### 4. Qualified farm indebtedness

Some debt cancellation might not be taxable as income if the debt is defined as “qualified farm indebtedness.”<sup>10</sup> This debt must have come directly from the farming operation, and at least 50 percent of the debtor’s total gross income for the previous three years must have come from farming.

#### 5. Qualified real property business indebtedness

Debtors that are not incorporated might not be taxed on the cancellation of “qualified real property business indebtedness.”<sup>11</sup> Qualified real property business indebtedness is debt that is taken on in connection with real property used in a trade or business and is secured by that property.<sup>12</sup> Debts taken on after January 1, 1993, will only be considered qualified real property business indebtedness if they were taken on for the purpose of acquiring, constructing, or substantially improving real property.<sup>13</sup>

### III. Sale or transfer of assets — including surrender of property to creditors and foreclosures

The sale or transfer of property can create income and therefore have tax consequences.<sup>14</sup> Differences in the method of a sale, such as the difference between selling real estate all at once or through a contract for deed, can be important.

In addition, the general rule is that when a creditor takes property in satisfaction of a debt, the transfer will be treated for tax purposes as if the debtor sold the property for the amount of debt satisfied. This is true whether or not any cash changes hands and whether the debtor voluntarily surrenders the property or the creditor seizes it.

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10 26 U.S.C. § 108(a)(1)(C), (g)(2). The amount of the canceled debt excluded from income as qualified farm indebtedness cannot exceed the sum of what are known as the debtor's adjusted “tax attributes” and the adjusted basis of the qualified property.

11 26 U.S.C. § 108(a)(1)(D), (c). Qualified real property business indebtedness does not include qualified farm indebtedness. 26 U.S.C. § 108(c)(3).

12 26 U.S.C. § 108(c)(3).

13 26 U.S.C. § 108(c)(3)(B), (c)(4). The amount excluded from the debtor's gross income is generally capped by the amount that the principal owing on the canceled debt exceeds the fair market value of the property securing the debt. 26 U.S.C. § 108(c)(2)(A).

14 Gains or losses on property used in a business are generally governed by 26 U.S.C. § 1231.

## IV. Taxes and bankruptcy

The tax consequences of filing for bankruptcy can vary greatly, depending on a number of factors—beginning with the type of bankruptcy filed.

### A. Tax obligations in bankruptcy

In general, the act of voluntarily filing for bankruptcy creates a separate entity—called an “estate”—that takes ownership of the debtor’s assets.<sup>15</sup> When the estate sells property or when debt is canceled, it may be that the estate and not the debtor will owe taxes on the income.<sup>16</sup> However, sometimes income from the transfer or sale of property or cancellation of debt in bankruptcy may still be taxable to the debtor.

A debtor using either Chapter 7 or 11 bankruptcy has the option of stopping the tax year on the day the bankruptcy petition is filed and dividing the normal tax year into two separate parts.<sup>17</sup> This can be an extremely important—and complicated—decision for farmers and should only be made with advice from an experienced expert. Large tax liabilities can hang in the balance.

### B. Relieving tax debts in bankruptcy

In some cases, taxes owed to a government entity can be discharged in bankruptcy as if they were a debt owed to any other creditor.<sup>18</sup> The extent to which this is possible depends on a number of factors, including in some cases how long the taxes have been owed. As with all other aspects of bankruptcy and taxation, however, farmers need to seek a qualified expert to investigate these possibilities.

## V. More information

For more information, call the Internal Revenue Service at 1-800-829-1040.

To order IRS forms and publications, call 1-800-829-3676. They are also available on the IRS web site at [www.irs.gov](http://www.irs.gov). IRS publications that might be helpful include:

- Pub. 225, Farmer’s Tax Guide
- Pub. 536, Net Operating Losses
- Pub. 544, Sales and Other Dispositions of Assets
- Pub. 908, Bankruptcy Tax Guide

15 11 U.S.C. § 541(a). The debtor’s interest in certain exempt assets—such as a home, personal vehicle, furnishings, and tools of his or her trade—are generally not taken into the bankruptcy estate. 11 U.S.C. § 522(b).

16 26 U.S.C. § 1398(c), (f)(1); 11 U.S.C. § 346(b)(1).

17 26 U.S.C. § 1398(a), (d).

18 26 U.S.C. § 523(a)(1).

## Chapter Ten

# Alternative Dispute Resolution (ADR)

## I. Introduction

As of July 1, 1994, most civil lawsuits filed in Minnesota district courts are subject to an Alternative Dispute Resolution (ADR) requirement.<sup>1</sup> Since 1998, the United States District Court for the District of Minnesota has also imposed ADR requirements.<sup>2</sup> ADR is intended to give both parties a chance to resolve their dispute outside of the courtroom.<sup>3</sup> ADR requirements are different from, and in addition to, farmer-lender mediation (described in Chapter Seven). This chapter briefly discusses the ADR requirements in Minnesota district courts.

## II. Types of ADR

The legal description of various ADR processes is generally quite vague. The two most commonly used ADR methods are mediation and arbitration.<sup>4</sup>

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- 1 Minn. Gen. R. Prac. 114. This requirement is a result of an action by the Supreme Court of Minnesota and is authorized by Minn. Stat. § 484.76.
  - 2 These requirements are authorized by 28 U.S.C. § 651(b) (the Alternative Dispute Act of 1998). D.Minn. LR 16.5. For a general overview of ADR requirements in federal courts, see Caroline Harris Crowne, *The Alternative Dispute Resolution Act of 1998: Implementing a New Paradigm of Justice*, 76 N.Y.U.L. REV. 1768 (2001). Within 45 days prior to trial, each federal civil case not exempted must go through a mediated settlement conference before a magistrate judge. D.Minn. LR 16.5(a)(2). The full-time magistrate judges constitute the panel of neutrals that are available to the parties. D.Minn. LR 16.5(a)(3). At the discretion of the federal court, ADR before other persons may be conducted. D.Minn. LR 16.5(b).
  - 3 For further information on ADR, see the Advanced Dispute Resolution Institute at William Mitchell College of Law, available at <http://www.adrinstitute.org/>.
  - 4 Minn. Gen. R. Prac. 114.02(a). A number of other ADR methods are available under the Minnesota requirement. These include: (1) *Consensual Special Magistrate*. The case is sent to a neutral who makes a binding and appealable judgment. (2) *Early Neutral Evaluation (ENE)*. Attorneys present the parties' core arguments to a neutral evaluator who assesses the case and helps narrow the dispute. (3) *Mediation-Arbitration*. In this hybrid method, if there is an impasse in mediation, the parties can arbitrate. (4) *Mini-Trial*. A mini-trial helps to define issues and get a realistic assessment for settlement negotiations. The opinion of the neutral third party will be binding if the parties agree to this beforehand. (5) *Moderated Settlement Conference*. The parties present their case before a panel of neutrals, which renders a non-binding advisory opinion. (6) *Neutral Fact Finding*. The neutral investigates and analyzes the case and issues a non-binding report or recommendation. (7) *Summary Jury Trial*. The case is presented to a mini-jury, which issues a non-binding advisory opinion. The parties may also agree to create their own ADR process, so long as they explain that process to the court.

### A. Mediation

In mediation, a neutral third party facilitates communication between the parties in an effort to promote a settlement of the dispute. Mediators do not impose their own judgments on the issues.

### B. Arbitration

In arbitration, each party presents its position before a neutral third party.<sup>5</sup> The neutral third party then issues a decision, which may include an award. Arbitration is typically a binding form of ADR. Under the Minnesota ADR requirement, however, the parties are free to proceed to trial after arbitration unless they agree in advance that the arbitrator's decision will be binding.<sup>6</sup>

## III. When the ADR requirement is triggered

The Minnesota ADR requirement is triggered by the filing of a civil lawsuit.

### A. Civil cases — including foreclosures, money judgments, and replevin actions

ADR is required only for civil cases.<sup>7</sup> For the purposes of a farmer's debtor-creditor relationships, the ADR requirement is most likely to apply in three types of cases. First, it will apply in any foreclosure by action. However, the ADR requirement will not apply in a foreclosure by advertisement. Foreclosures, including the differences between a foreclosure by action and a foreclosure by advertisement, are explained in Chapter Three. Second, if a creditor seeks a money judgment against a debtor in a court action, this triggers the ADR requirement. Money judgments are explained in Chapter Five. Third, if a creditor uses a replevin action or another related action to take possession of a debtor's property, this will also trigger the ADR requirement.<sup>8</sup> Creditor actions to take possession of debtor property are discussed in Chapter Four.

Some civil cases do not require ADR. The most important of these exceptions are cases filed in conciliation court and eviction actions.<sup>9</sup> An eviction action is most often used by landowners to remove people—such as former tenants—who do not have a legal right to be on the land.

5 Minn. Gen. R. Prac. 114.02(a)(1), 114.09.

6 Minn. Gen. R. Prac. 114.02(a)(1).

7 Minn. Stat. § 484.76; Minn. Gen. R. Prac. 111.01, 114.01; see also McFarland and Keppel, MINNESOTA CIVIL PRACTICE, § 434 (3d ed. 1999).

8 In some cases, it may be possible for the creditor to take possession of the debtor's property before the ADR process is completed.

9 A number of other types of civil cases, including guardianship cases, civil commitments, harassment restraining orders, and juvenile cases are also excluded. Minn. Stat. § 484.76; Minn. Gen. R. Prac. 111.01.

## **B. Triggered by actual filing of the civil action**

ADR is required only when a civil case is filed with the court.<sup>10</sup> It is the actual filing of a lawsuit that is important. Letters threatening a lawsuit, or even the service of legal papers to another party, do not trigger the ADR requirement.

## **C. A judge can excuse the parties from ADR**

Although the use of ADR will normally be required for qualifying civil cases, judges have the ability to excuse parties from the requirement.<sup>11</sup> A judge can determine that ADR is “inappropriate” for a particular case.<sup>12</sup> There is no real explanation of when ADR may or may not be appropriate.

## **IV. How ADR works**

Detailed information about Minnesota’s ADR requirement can be found in the Minnesota General Rules of Practice for the District Courts.<sup>13</sup> A general overview of the process is given here.

### **A. Selecting the ADR process and neutral**

After a case has been filed, the court will provide the parties with information about ADR processes and a list of neutrals who provide ADR services in the county.<sup>14</sup> Generally, the parties in the lawsuit select one of the ADR processes available and decide on a schedule.<sup>15</sup> In addition, the parties select a third-party neutral to conduct the ADR process.<sup>16</sup> If the parties cannot agree on an ADR process or timing, or are unable to pick a neutral, the court will either pick the ADR method and neutral or refuse to order ADR at all.<sup>17</sup>

### **B. ADR proceedings**

The neutral will schedule the ADR process for the parties.<sup>18</sup> The ADR proceedings will typically be closed to the public unless all of the parties agree otherwise.<sup>19</sup> The Minnesota General Rules of Practice set out some detailed guidance for arbitration proceedings, including a list of arbitrator powers and procedures for taking evidence.<sup>20</sup> For other forms of ADR and for arbitration issues not addressed in the rules, the neutral is responsible for formulating the process.<sup>21</sup>

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10 Minn. Stat. § 484.76; Minn. Gen. R. Prac. 111.01, 114.01; see also McFarland and Keppel, *MINNESOTA CIVIL PRACTICE*, § 434 (3d ed. 1999).

11 Minn. Stat. § 484.76, subd. 1.

12 Minn. Gen. R. Prac. 114.04(c).

13 These rules should be available from any district court and can be found on the Internet at [http://www.courts.state.mn.us/rules/crt\\_rules.html](http://www.courts.state.mn.us/rules/crt_rules.html).

14 Minn. Gen. R. Prac. 114.03(a).

15 Minn. Gen. R. Prac. 114.04.

16 Minn. Gen. R. Prac. 114.05. Neutrals must have completed training and education requirements. Minn. Gen. R. Prac. 114.02(b), 114.13.

17 Minn. Gen. R. Prac. 114.04(b), 114.05(a).

18 Minn. Gen. R. Prac. 114.06(b).

19 Minn. Gen. R. Prac. 114.07(a).

20 Minn. Gen. R. Prac. 114.09.

21 See Minn. Gen. R. Prac. 114.09, Implementation Committee Comments (1993).

### C. When ADR is complete

If the parties resolve their dispute through ADR, the underlying lawsuit will be dismissed. If the parties do not resolve their dispute through ADR, the neutral will report the lack of agreement to the court and the case will proceed.<sup>22</sup>

The ADR processes required for Minnesota civil lawsuits are non-binding.<sup>23</sup> The parties may agree to be bound by the decision of a neutral or ADR jury, but they cannot be required to do so. For arbitrations, however, a party who disagrees with the arbitrator's decision must file a request for trial within 20 days after the arbitrator's decision is filed with the court.<sup>24</sup> If the request for trial is not filed within 20 days, the arbitrator's decision will be binding.

### D. Confidentiality of the ADR process

In general, statements made and evidence submitted in an ADR process will be confidential and cannot be used in later proceedings, including a trial.<sup>25</sup> This rule is specifically aimed at ADR processes that are intended to result in the compromise and settlement of the case. If the ADR process is binding, or if an arbitration decision becomes binding due to the parties' failure to request a trial within 20 days, evidence from the ADR process may be submitted in later proceedings.<sup>26</sup>

### V. Paying for ADR

The parties involved in ADR must pay for its costs.<sup>27</sup> The parties and the third-party neutral together decide on the proper fee.<sup>28</sup> The law generally assumes that the two parties will split the cost of the ADR process, although the parties may agree to a different arrangement.<sup>29</sup> If the two parties cannot agree on a way to divide up the costs of ADR, the court has the power to "determine a final and equitable allocation of the costs."<sup>30</sup>

22 Minn. Gen. R. Prac. 114.10(d)(1).

23 Minn. Stat. § 484.76.

24 Minn. Gen. R. Prac. 114.09(d)(2), (e).

25 Minn. Gen. R. Prac. 114.08. Neutrals may not be required to testify about ADR proceedings. Minn. Stat. § 595.02, subd. 1a, states that: "No person presiding at any alternative dispute resolution proceeding established pursuant to law, court rule, or by an agreement to mediate, shall be competent to testify, in any subsequent civil proceeding or administrative hearing, as to any statement, conduct, decision, or ruling, occurring at or in conjunction with the prior proceeding, except as to any statement or conduct that could: (1) constitute a crime; (2) give rise to disqualification proceedings under the rules of professional conduct for attorneys; or (3) constitute professional misconduct." This also applies in Minnesota federal court ADR where no "confidential dispute resolution communication" may be used outside the ADR proceeding without the consent of the party that made the communication. D.Minn. LR 16.5(c).

26 Minn. Gen. R. Prac. 114.08(c). Sworn testimony from a summary jury trial may also be used in later proceedings. Minn. Gen. R. Prac. 114.08(d).

27 Minn. Gen. R. Prac. 114.11. The statute creating the ADR requirement requires that there be an "equitable means of payment of fees and expenses" for the use of ADR. Minn. Stat. § 484.76, subd. 1.

28 Minn. Gen. R. Prac. 114.11(a).

29 Minn. Gen. R. Prac. 114.11(b).

30 Minn. Gen. R. Prac. 114.11(b).

The Minnesota Supreme Court's Implementation Committee for ADR, whose views are not legally binding, has taken the position that parties with limited financial resources "should not be denied access to ADR because of an inability to pay for a neutral" and that judges and ADR providers "should consider the financial abilities of all parties and accommodate those who are not able to share equally in costs."<sup>31</sup>

## VI. ADR and farmer-lender mediation

ADR requirements for civil lawsuits are completely separate from the farmer-lender mediation requirements discussed in Chapter Seven. Participation in farmer-lender mediation does not automatically satisfy the ADR requirements for civil cases. If a farmer has participated in farmer-lender mediation on a particular issue and the dispute is later brought to court, the judge may decide that ADR on the same issue is not necessary—but this conclusion is not required. It is also possible that one set of issues could be discussed during farmer-lender mediation—such as the possibilities for restructuring the debt—and a completely different set of problems could be addressed concerning the same debt by ADR. For example, ADR could address the validity of the mortgage or the amount of debt that was actually secured. Or a judge could waive the ADR requirement when a creditor seeks to foreclose by action but later require ADR if the creditor seeks a deficiency judgment on the same debt.

As discussed in Chapter Seven, since 1998, mediation services under the Farmer-Lender Mediation Act have been available as a form of voluntary ADR to resolve disputes in rural areas that are not subject to mandatory farmer-lender mediation.<sup>32</sup> Although the voluntary ADR process under the Farmer-Lender Mediation Program is not specifically identified as a possible neutral for the ADR requirement in civil cases, it is likely that this process would satisfy the ADR requirement if the parties choose to use it.

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31 Minn. Gen. R. Prac. 114.11, Implementation Committee Comments (1993).

32 Minn. Stat. § 583.311. The statute states that: "The administrator shall establish procedures and measures to ensure maximum use of alternative dispute resolution under this chapter for disputes in rural areas. Referrals may be accepted from courts, state agencies, local units of government, or any party to a dispute involving rural land, regulation, rural individuals, businesses, or property, or any matter affecting rural quality of life. The legislature encourages state and federal agencies and governmental subdivisions to use the services provided by the administrator under this chapter and to cooperate fully when matters under this jurisdiction are subjected to alternative dispute resolution methods. The administrator may set fees for participation in voluntary procedures to pay all or part of the costs of providing such services."

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## Chapter Eleven

# Scam Artists Targeting Farmers

For years, a number of unscrupulous scam artists have targeted financially distressed family farmers for fraudulent credit schemes of one sort or another.

In one common scam, con artists promise to find farm loans at very low interest rates with no questions asked—but the farmer must pay a large fee up front.<sup>1</sup> Then the loan money never comes, and there is no refund of the fee. While there are completely legitimate loan finders, large up-front fees should serve as a warning sign for farmers. As government credit programs become less available, these types of frauds seem likely to appear more often. Anyone with a doubt about such an offer can contact the Minnesota Attorney General's office to find out if the group offering to find the loan is legitimate.

Another scam includes the promise of a lawsuit on behalf of farmer borrowers.<sup>2</sup> One group traveled through the upper Midwest, including Minnesota, allegedly promising a gigantic money award—and the return of land lost by farmers to foreclosure—from a class action lawsuit filed in Colorado. The catch was that farmers had to pay several hundred dollars up front to get in on the award. The group mixed this effort with extreme right-wing political views. They claimed, for example, that much federal government activity has been illegal since the 1930s when the government went off the gold standard and that the monetary system has been unconstitutional since then. Even after the case was thrown out of court, the group continued to claim that it had won a multi-billion-dollar judgment. Unfortunately, hundreds of farmers were tricked into contributing at least \$300 each. Several people associated with the group have been charged with various crimes, and at least one has already pled guilty.

It is not hard to see why such a group can be successful. It can be easy to imagine that a single lawsuit can solve everything, especially when farmers feel that they have been treated unfairly. Courts, after all, do unexpected things all the time, and in fact some large lawsuits have benefited struggling farmers. In addition, offbeat and out-of-the-mainstream political views have a

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- 1 Paul Adams, *Scams Targeting Farmers Desperate for Financial Help*, AGRI NEWS, Sept. 30, 1993, at A1; see also *State ex rel. Stenberg v. American Midlands*, 509 N.W. 2d 633 (Neb. 1994). This type of fraud was also common in the 1980s. Mary Nelson & Michael Vadnie, *Loan Fraud Felons: Who They Are and How They Operate*, FARM FUTURES, May 1994, at 24.
  - 2 Jack Hovelson, *Farm Suit Scam Still Operating, Campbell Warns*, THE DES MOINES REGISTER, Mar. 15, 1994; *Charges Filed Against Sixteen People in Finance Swindle*, IOWA FARMER TODAY, Feb. 19, 1994, at 19; Barry Meier, *The Lion King of the Lien*, N.Y. TIMES, June 29, 1995, at C1; *United States v. Ensminger*, 174 F.3d 1143 (10th Cir. 1999); *Farmers & Stockmens Bank v. Stafford*, 738 P.2d 60 (Colo. Ct. App. 1987).

long and important history in the United States, and individuals and groups have every right to push for changes in the country's laws. However, promises of a very large court award based on government conspiracies should make farmers very cautious. Before contributing money to such an effort, it is important to check out the group or lawyers making the promises.

The latest scams involve the use of email fraud with deceptive offers that promise the recipient large cash prizes for simply responding to an email.<sup>3</sup>

Farmers who think they have been the victim of a scam or who want to learn more about how to protect themselves may call the Minnesota Attorney General's Office at 651-296-3353 or 1-800-657-3787. Further information is *available at* <http://www.ag.state.mn.us/consumer>.<sup>4</sup>

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3 See NDSU Extension, *National Consumers League warns of e-mail fraud*, TRI-STATE NEIGHBOR, June 28, 2002, at 2B. The National Consumers League web sites provides further information at: <http://www.natlconsumersleague.org> or <http://www.fraud.org>. Farmers can also contact them at 1-800-876-7060.

4 The Minnesota Attorney General's Office has a fact sheet entitled "Disaster Information" that discusses scams related to disaster recovery, especially those aimed at farmers. The fact sheet is *available at* <http://www.ag.state.mn.us/pdf/Disaster%20Information.pdf>.

## Appendix A

# Usury

Limits on the rate of interest that may be charged by creditors

## I. Introduction

Usury laws limit the amount of interest a creditor can charge. These rules are complicated, and the discussion here only addresses a small part of that complexity.<sup>1</sup> Farmers believing that the interest charged by a creditor may be illegally high should contact a lawyer.

In general, Minnesota law sets a very low limit on interest rates that can be charged but also sets out several broad exceptions to the low limit. In fact, the exceptions apply far more often than the general rule. The practical effect of this system is a confusing and inconsistent set of usury laws. This appendix briefly explains the basic interest rate limits in Minnesota and the five exceptions that are likely to be most important for farming operations.

## II. General rule — maximum of 6 or 8 percent annual interest

Minnesota law sets a very low interest rate maximum as a general rule. In general, creditors may charge no more than 8 percent interest per year on loans or forbearances.<sup>2</sup> If there is no written agreement between the debtor and creditor stating the interest rate, interest is set at 6 percent per year.<sup>3</sup>

## III. Exceptions to the general rule

A number of exceptions lessen the practical value of these interest rate limits.<sup>4</sup> When an exception to the general rule applies, the exception sometimes creates a different, higher interest rate

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1 For a general summary, see 48 DUNNELL MINN. DIGEST, *Usury* (4th ed. 2000).

2 Minn. Stat. § 334.01, subd. 1.

3 Minn. Stat. § 334.01, subd. 1.

4 In addition to the exceptions listed in this appendix, there may be exceptions to interest rate limits for certain federal banking institutions, including Farm Credit System banks. See 12 U.S.C. §§ 2016, 2075(c), 2131 (stating that Farm Credit Banks and Production Credit Associations can make loans at any rate authorized by their board of directors, regardless of state limits); John L. Brown, *Federal Pre-emption of the State Regulation of Agricultural Credit*, 7 DRAKE JOURNAL OF AGRICULTURAL LAW 563 (Fall 2002).

maximum. Sometimes, however, the exception creates no other maximum interest rate. If this is the case, there may be no effective limit on the interest rate that can be charged by the creditor.

The following exceptions are most likely to be important for a farming operation.

**A. If the borrower is an organization — no effective limit on interest**

Loans to organizations are exempt from the general interest rate limits.<sup>5</sup> Organizations include the government, corporations, trusts and estates, partnerships, joint ventures, cooperatives, limited liability companies, and associations.<sup>6</sup> The law does not set a higher interest rate limit to take the place of the general limit. As a result, if a farm is incorporated, there may be no effective limit on the interest that a creditor can charge.

**B. If the loan is for less than \$100,000 and is for agricultural or business purposes — substitute maximum interest rate**

If a loan or forbearance is for less than \$100,000 and is for an agricultural or business purpose, the loan is exempt from the general interest rate limit.<sup>7</sup> The definition of “agricultural purpose” for this exception includes almost anything normally thought of as farming.<sup>8</sup> An agricultural and business purpose does not, however, include a loan used to finance the purchase or maintenance of real estate used principally for the borrower’s residence.<sup>9</sup>

Although a loan of under \$100,000 for agricultural or business purposes does not fall under the general interest rate limit, the law does set a different maximum interest rate for these loans. Creditors making loans for agricultural or business purposes may charge a rate of interest of not more than 4.5 percentage points over the Federal Reserve’s discount rate at the time the loan is made.<sup>10</sup> For example, if the discount rate is 6 percent, interest charged for this type of loan may not be more than 10.5 percent per year.

**C. If the loan is for \$100,000 or more — no limit on interest if the rate is agreed to in writing**

A contract for a loan or forbearance of \$100,000 or more is exempt from the 8 percent interest rate limit.<sup>11</sup> If there is no interest rate set in writing, the interest on debt of \$100,000 or more is

5 Minn. Stat. § 334.022; *Velocity Express Corp. v. Bayview Capital Partners, LP*, No. 02-521, (D. Minn. May 9, 2002) (unpublished); *Jones v. Nelson*, 432 N.W.2d 792, 796 (Minn. Ct. App. 1988); *Midwest Fed. Sav. & Loan Ass’n v. West Bend Mut. Ins. Co.*, 407 N.W.2d 690, 695 (Minn. Ct. App. 1987).

6 Minn. Stat. § 334.022.

7 Minn. Stat. § 334.011, subd. 1.

8 Minn. Stat. § 334.011, subd. 1. Agricultural means the “the production, harvest, exhibition, marketing, transportation, processing, or manufacture of agricultural products, including horticultural, viticultural, and dairy products, livestock, wildlife, poultry, bees, forest products, fish and shellfish, and any parts thereof, including processed and manufactured products, and any and all products raised or produced on farms and any processed or manufactured products thereof.” Business means “a commercial or industrial enterprise which is carried on for the purpose of active or passive investment or profit.”

9 Minn. Stat. § 334.011, subd. 1.

10 Minn. Stat. § 334.011, subsd. 1, 3; *In re Donnay*, 184 B.R. 767, 780 (Bankr. D. Minn. 1995).

11 Minn. Stat. § 334.01, subd. 2; *Negaard v. Miller Constr. Co.*, 396 N.W.2d 833 (Minn. Ct. App. 1986); *In re Donnay*, 184 B.R. 767, 781-83 (Bankr. D. Minn. 1995).

still 6 percent per year. As a result, as long as a loan is for \$100,000 or more, there may be no legal limit on the rate of interest, as long as the two parties agree to the interest rate in writing.

Sometimes there may be a question as to whether a loan qualifies for this exception, particularly if the lender makes several separate operating advances with a total value of \$100,000 or more. In these cases, this exemption should apply if there is a contractual agreement to lend a total of \$100,000 or more. If several smaller notes are consolidated into a single note and the total amounts to \$100,000 or more, the new consolidated note should also qualify for the exception.

**D. If the lender is a bank or other financial institution — maximum interest rate is much higher**

Banks and other financial institutions fall under two special exemptions to the general interest rate limit.<sup>12</sup>

First, Minnesota law allows banks and most other financial institutions to make loans at interest rates of up to 21.75 percent per year.<sup>13</sup>

Second, banks and other financial institutions may also charge an interest rate of up to 4.5 percentage points higher than the federal discount rate charged at the Minneapolis Federal Reserve Bank at the time the loan is made.<sup>14</sup> These two exceptions work together in favor of the bank. For example, if interest rates in general are fairly low, banks can always charge up to 21.75 percent annual interest. If interest rates generally are higher, banks can charge up to 4.5 percentage points over the federal discount rate even if the rate charged is more than 21.75 percent per year.

In addition, banks may take advantage of the other exceptions mentioned above if they apply. For example, if a bank makes a loan to a corporation, or if it makes a loan of \$100,000 or more, there may be no legal limit to the interest rate charged.

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12 This exemption applies to banks, savings banks, savings associations, savings and loan associations, and credit unions organized under state law, and national banks or federally chartered savings banks, savings and loan associations, and credit unions. Minn. Stat. § 48.195.

13 Minn. Stat. § 47.59, subd. 3. Interest on open-ended credit extended through a credit card may not be more than 18 percent. An even higher rate of interest may be charged on very small loan amounts.

14 Minn. Stat. § 48.195.

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## Appendix B

*Farmers' Legal Action Group, Inc.*

### Publications

#### Newsletter

##### *Farmers' Legal Action Report*

Published five times each year, *Farmers' Legal Action Report* provides a variety of up-to-date information on agricultural law issues. Each issue includes one or more articles that discuss a current legal topic of particular interest to the farming community. The newsletter also features a number of regular columns designed to provide our readers with the most important information on agricultural law developments: case summaries from some of the most significant agricultural law court cases around the country; a review of the rules recently published in the *Federal Register*; news from and about USDA, and an update about what the attorneys at FLAG are doing. *Farmers' Legal Action Report* is supplemented with occasional in-depth articles (Focus Reports) that provide a detailed analysis of special topics affecting agriculture. Special Farmer Rates: 1 year for \$20.00, 2 years for \$35.00. Regular Rates: 1 year for \$30.00, 2 years for \$54.00.

#### Books - National

##### *Assessing the Impact of Integrator Practices on Contract Poultry Growers* (December 2001)

This report includes an analysis of a survey of broiler growers conducted in 1999, an analysis of the legal implications of provisions in 18 growout contracts, and an analysis of current state and federal laws affecting growout arrangements with recommendations for change. The project was a collaborative effort of FLAG, Dr. Lee Schrader of Purdue University, Dr. John Wilson of Duke

University, the National Contract Poultry Growers Association, Professor Neil Hamilton of Drake University Law School, and Rural Advancement Foundation International-USA (RAFI-USA). (Limited printing; no charge while supplies last. Available online at: <http://www.flaginc.org/pubs/poultry.htm>.)

##### *Federal Disaster Assistance for Farmers* (2000 Edition with 2001 supplement)

(Known in previous editions as *Farmers' Guide to Disaster Assistance*.) Our 2000 edition is published by Lexis Publishing and is accompanied by a 2001 supplement. Contains detailed information on:

- Federal Emergency Management Agency (FEMA) Individual and Family Grants
- FEMA Temporary Housing Assistance
- FEMA Disaster Unemployment Assistance
- Federal Crop Insurance
- Non-Insured Crop Disaster Assistance Program (NAP) (Farm Service Agency)
- Emergency Conservation Program (Farm Service Agency)
- Disaster Assistance for Livestock Producers
- Farm Service Agency (FSA) Emergency (EM) Loans
- Farm Service Agency (FSA) Disaster Set-Aside
- Small Business Administration (SBA) Disaster Loans

To order a copy, call Lexis Customer Service at 1-800-542-0957, and refer to product num-

ber 37595-10. Or order it online at Lexis.com. The book costs \$40 (\$38 if you order by credit card).

***Farmers' Guide to FmHA***  
(Fourth Edition, March 1990)

A guide that explains in lay terms the rights of farmers and ranchers who borrow from FmHA. Contains detailed explanations of many topics that were not covered in the first three editions, such as guaranteed loans, conversion, and the classification and sale of inventory property. Contains extensive footnotes to the FmHA regulations and is suitable for use by attorneys, legal assistants, farmers and ranchers, and advocates. Approximately 440 pages. (Note that this was published in 1990, and while it is useful for explaining farmers' rights as of that time, much of the material is now out of date.) Rate: \$26.00.

**Books - Minnesota**

***Farm to Market: Legal Issues for Minnesota Farmers Starting a Processing or Marketing Business***  
(2001)

A series of booklets discussing some of the most important legal issues that arise for Minnesota farmers seeking to develop an agricultural processing or marketing business. Booklets include: (1) Introductory Issues, (2) Choice of Business Entity, (3) Cooperatives, (4) Corporations, (5) Partnerships, (6) Limited Liability Companies, (7) Owner Agreements, (8) Employment (not yet available), and (9) Minnesota Financial and Technical Resources. Rate: \$39.00 for the set.

***Farmers' Guide to Minnesota Lending Law***  
(Second Edition, June 2003)

An aid for Minnesota farmers who need information about Minnesota state law regarding mortgages and contracts for deed, operating and equipment loans, secured creditors, repossession, unsecured credit and judgments, lease agreements, farmer-lender mediation, bankruptcy, and alternative dispute resolution. Rates: Financially distressed Minnesota family farmers, no charge; all others, \$20.00.

***Mediation From the Farmer's Perspective***  
(January 1988)

Explains the rights and obligations of the farmer and the lender under the Minnesota farmer-lender mediation law. Provides general advice for planning and participating in the mediation process. For Minnesota residents only; no charge.

To order any of these publications,  
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## Order Form

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Farm to Market: Legal Issues for Minnesota Farmers Starting a Processing or Marketing Business		39.00	
Farmers' Guide to Minnesota Lending Law <i>(see publications list for prices)</i>			
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## Glossary of Important Minnesota Lending Law Terms

**Accelerate.** A creditor's action to immediately claim the total outstanding balance of an installment debt.

**Acceleration clause.** A provision in a mortgage or other credit agreement making the total balance of an installment debt due immediately after a default by the debtor. The payment schedule for the individual installments is "accelerated."

**Affidavit.** A written statement or declaration, sworn before a person having authority to administer an oath, often a notary public.

**After-acquired property.** Property of the debtor acquired after a security agreement has been entered into.

**Agricultural lien.** A lien against agricultural property to secure payment for agricultural products, financing, or services.

**Answer.** In a lawsuit, a statement that must be filed by a party who has been served with a summons and complaint by a plaintiff. There are short time deadlines to file an answer with the court. If a party fails to file an answer, a default judgment will likely be entered by the court.

**Attachment.** A legal process through which a creditor who has started a lawsuit seeking a judgment against a debtor can get a court order to seize or "attach" the debtor's property.

**Automatic stay.** Immediately upon a debtor filing a bankruptcy petition, the debtor's creditors are prohibited from beginning new debt collection activities or continuing collection activities that have already been started.

**Bankruptcy.** A legal process that allows debtors to address insurmountable debt through a set of procedures while receiving temporary protection from collection activity.

**Collateral.** Debtor's property identified in an agreement that is pledged to the creditor if the debtor does not repay the debt.

**Complaint.** The first document or "pleading" filed with a court that begins a lawsuit.

**Consumer transaction.** A transaction in which: (1) the debt is taken primarily for personal, family, or household purposes; and (2) the collateral is primarily for personal, family, or household use.

**Contract.** A written or oral agreement between two or more parties that is enforceable by law.

**Contract for deed.** An agreement by a seller to deliver a deed to a buyer when specified conditions have been met, usually completion of payments to the seller.

**Creditor.** A person or business entity to whom a debt is owed.

**Cross-collateralization.** The use of collateral given for one secured debt to provide additional security for all other debts from the same lender. The lender thus retains a security interest in all collateral until all of the debts are paid in full rather than releasing specific items of collateral as each individual debt is paid.

**Damages.** The monetary value a person is entitled to recover by law for injuries suffered.

**Debtor.** A person who owes money. This book assumes that the farmer is the debtor.

**Deed in lieu of foreclosure.** A procedure through which a borrower/mortgagor voluntarily gives the lender/mortgagee the deed to the property named in a mortgage in order to prevent a foreclosure on the property. A deed in lieu of foreclosure, therefore, is a substitute for a foreclosure.

**Default.** Failing to meet the requirements of an agreement, often a loan or credit agreement. Most defaults involve being late with payments. However, there are other types of defaults, including being late with a property tax payment, failure to maintain enough insurance, or failure to maintain collateral. The loan agreement or contract for deed will usually provide a long list of actions by the borrower or buyer that will be considered a default.

**Default judgment.** A court judgment entered against a party who fails to respond to a complaint or otherwise defend against a lawsuit in accordance with procedural requirements, typically resulting from a party's failure to file an answer to a complaint by the required deadline.

**Deficiency judgment.** A judgment against a debtor representing the difference between the amount of debt owed and the amount a creditor has received in proceeds from the sale of the debtor's property, whether through a foreclosure sale or repossession of personal property.

**Deposit account.** Checking, savings, and similar accounts and certain certificates of deposit maintained with a bank or other financial institution.

**Discharge (of a debt).** An agreement or court order that terminates a debtor's obligation to pay a debt. For example, one outcome of a bankruptcy is the discharge of certain debts, typically unsecured debts.

**Discovery.** The process during a lawsuit by which the parties obtain information from each other and documents related to the case.

**"Dragnet" clause.** A provision in a loan agreement giving the lender the right to take the collateral that secures one loan as security for the borrower's other outstanding loans with that lender.

**Due on sale clause.** A clause in a mortgage loan giving the lender the power to accelerate the debt if the borrower sells or transfers part or all of the mortgaged land without the lender's permission.

**Enforceable.** A contract provision is enforceable if one party to the contract could go to court to force the other party to fulfill the agreement.

**Equity.** The value of a property remaining after subtracting mortgages, liens, and other debts against it.

**Eviction.** A legal process terminating a person's right to occupy a home or business property, most commonly the removal of a tenant.

**Execution.** To carry out the actions authorized in a legal document. For example, execution of a judgment lien involves seizing and selling the property subject to the judgment lien. Also, to formally enter into a written agreement, usually requiring signatures and dates.

**Exempt property.** Property that state or federal law allows debtors to keep when faced with collection of an unsecured debt. In bankruptcy proceedings, exempt property is protected from being sold to pay claims of creditors.

**File (documents).** To deliver documents, often court pleadings or real estate certificates, to the custody of a court or public office.

**Financing statement.** Often called a UCC-1, serves as public notice that the creditor has a security interest in the debtor's property. If two different creditors ever tried to claim the same item of the debtor's property, the financing statement helps to settle which creditor gets the collateral, usually based on whose financing statement was filed first.

**Fixtures.** In general, fixtures are property that is attached to land. Storage bins, some silos, and milking equipment are examples of property that might be fixtures. Whether or not property is a fixture can depend on a number of factors, such as the extent to which the property was attached to the land and the intent of the person putting the fixture in place.

**Forbearance.** When a creditor refrains from enforcing a debt when payment is due.

**Foreclosure.** A legal process to terminate a person's ownership interest in real estate that has been given as collateral for a debt through a mortgage. In Minnesota, this is done through either a foreclosure by action or foreclosure by advertisement.

**Fraudulent transfer.** A transfer of property by a debtor, often for little or no benefit in return, for the purpose of keeping the property out of the hands of creditors.

**Garnishment.** A legal process where a person's money that is under the control of another, such as a bank or employer, is taken for payment of a debt.

**Hearing.** A court proceeding (though generally not a trial) in which the court hears witnesses and evidence presented.

**Homestead exemption.** The right to treat a person's residence as exempt property that cannot be sold to satisfy claims of unsecured creditors. It also means the right to make sure the homestead is sold separately by the sheriff during a foreclosure sale so that the homestead may be redeemed separately by the debtor.

**Judgment.** A determination by a court as to the outcome of a lawsuit, often directing the payment of money.

**Judgment lien.** A lien that attaches to a debtor's property as the result of a court judgment against the debtor.

**Lien.** A legal interest of a creditor in a debtor's property to secure repayment of a debt. To distinguish them from security interests, which are given voluntarily by debtors, liens can be

thought of as being given to a creditor by operation of law—that is, without the debtor's consent.

**Mortgage.** An agreement giving a lender the right to foreclose on real estate if the borrower fails to pay a loan or otherwise violates the terms of the loan.

**Mortgagee.** A lender who receives the right to foreclose on real estate identified in a mortgage if the borrower defaults on the loan.

**Mortgagor.** A borrower who gives real estate identified in a mortgage as collateral for a loan.

**Notice (public).** Informing the entire community of a legal occurrence, most commonly by publishing in a local newspaper of general circulation.

**Notice and cure.** The lender's or contract-for-deed seller's duty to give notice (information) to the borrower or buyer if there is a default. The lender or seller must then also give the borrower or buyer the right to cure (correct) the default within a reasonable amount of time before taking action to enforce the debt or cancel the contract for deed.

**Perfection.** In secured credit transactions, the legal process where a security interest is protected against competing claims to the collateral, usually by giving public notice through filing in a government office.

**Personal property.** Property other than real estate. Personal property is not completely connected to the land, such as tractors, livestock, cars, and household goods.

**Power of sale clause.** A provision in a mortgage that allows the lender to foreclose by advertisement—that is, without filing a lawsuit.

**Proceeds.** Whatever is received upon the sale, lease, license, exchange, or other disposition of collateral.

**Purchase-money security interest.** A security interest in personal property given to the creditor that loaned the money for the purchase of the property. A purchase-money creditor has first priority in the acquired personal property, even if other creditors have already filed valid financing statements giving them an interest in the debtor's property.

**Reaffirmation.** An agreement between a debtor and a creditor in a bankruptcy process to pay a debt that would otherwise be discharged in bankruptcy.

**Real property.** Land and anything permanently attached to land such as buildings and fences.

**Recording real estate documents.** To file real estate documents—such as mortgages and contracts for deed—with the registrar of titles or the recorder of the county in which the real estate is located.

**Redeem.** To buy back property from a mortgagee or foreclosure-sale purchaser by paying the foreclosure price plus interest and costs.

**Redemption.** The right of the debtor (or other creditors) to purchase from a forced-sale or foreclosure-sale buyer property of the debtor that was sold to pay a judgment or claim against the debtor.

**Rents and profits clause.** A provision in a mortgage that gives the mortgage lender the right to claim income from the borrower's property after a foreclosure and before the borrower's right of redemption has expired.

**Replevin.** The legal process in which a creditor seeks to recover (repossess) personal property in which the creditor claims an interest.

**Repossession.** When a creditor takes back or seizes collateral after the debtor's default, usually without court permission. Often called "self-help" repossession.

**Right of first refusal.** The right under Minnesota and federal law for some farmers who lose agricultural land or the farm homestead due to enforcement of a debt to have an opportunity to match any offer made to buy or rent the farm.

**Satisfaction.** Full payment of a debt. Also, a legal document stating that a debt has been paid in full or that partial payment has been accepted as payment in full.

**Secured creditor.** A creditor that has collateral for a debt.

**Secured debt.** A debt for which the creditor has collateral.

**Security agreement.** A contract that gives a creditor a security interest in the debtor's property.

**Security interest.** A legal claim of a creditor allowing the creditor to take possession of the debtor's property or claim proceeds from the sale of the debtor's property if the debtor defaults on the debt. Most commonly, security interests are agreed to by debtors as part of a credit arrangement.

**Self-help.** Taking an action, such as recovery of property, without going through a judicial process.

**Service.** The delivery of documents, often related to court action such as a summons and complaint. Service usually involves a verifiable form delivery, either by personally delivering a copy to the recipient or by requiring a signed and dated receipt of delivery.

**Statute of frauds.** Laws imposing requirements that some agreements, such as sales of real estate and leases for more than one year, must be in writing to be enforceable.

**Statute of limitations.** A statute stating the period of time in which a claim must be brought before a court.

**Subordination agreement.** An agreement through which one creditor voluntarily allows another creditor to move ahead in priority with respect to a debtor's collateral.

**Summons and complaint.** A summons is the legal document that is provided at the beginning of a lawsuit setting out what is requested of the defendant and how the defendant must respond. A complaint is a statement of all the claims raised by the person or company bringing the lawsuit. These documents are served together.

**Title insurance.** Insurance obtained when purchasing real estate to gain coverage against losses resulting from competing claims to ownership of the property.

**Unsecured creditor.** A creditor that has no collateral for the debt owed.

**Unsecured debt.** A debt that does not involve collateral.

**Vendee.** A person who buys property. This book assumes that the farmer is the vendee.

**Vendor.** A seller of property.

**Void.** A document or transaction is void if it is without legal force or effect and nothing can cure the defect.

**Voidable.** Something that may be avoided or declared void but that is not absolutely void itself. For example, a voidable contract is one where one or more parties have the power to avoid abiding by the contract.



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