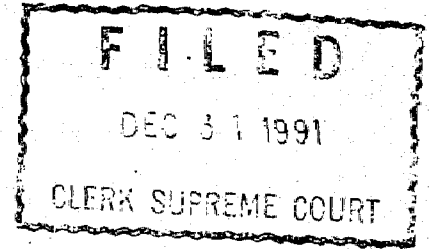


IN THE COURT OF APPEALS OF IOWA

No. 1-255 / 90-1090



ALLISON-KESLEY AG CENTER, INC.,
Plaintiff,

vs.

SCOTT HILDEBRAND and HILDEBRAND BROTHERS FARMS,
Defendants.

ALLISON-KESLEY AG CENTER, INC.,
Plaintiff-Appellant,

vs.

FIRST STATE BANK OF GREENE, IOWA,
Defendant,

and

FARMERS COOPERATIVE ELEVATOR COMPANY,
Defendant-Appellee.

Appeal from the Iowa District Court for Butler County,
Paul W. Riffel, Judge.

Appellant challenges the district court's ruling the appellee had acquired certain PIK certificates as a good faith purchaser for value. **REVERSED.**

Bruce Johnson of Gamble, Riepe, Webster, Davis & Green,
Des Moines, for appellant.

Roger L. Sutton of Sutton Law Office, Charles City, for
appellee.

Considered by Schlegel, P.J., and Hayden and Habhab,
JJ.

SCHLEGEL, P.J.

On Saturday, October 3, 1987, at approximately 9 a.m., Scott Hildebrand appeared at Allison-Kesley's office in Allison and spoke with its general manager, Gary Abbas. Hildebrand then purchased payment in kind (PIK) certificates having a total face value of approximately \$200,000 by using a "certified draft" for \$218,000 drawn on the International Credit Exchange of Acapulco, Mexico. The PIK certificates are negotiable instruments.

Shortly after leaving Allison-Kesley's office, Hildebrand, his brother, and his father went to the Farmers Cooperative Elevator Company located in Marble Rock, Iowa. Hildebrand sold the same PIK certificates to Farmers Cooperative for \$8,000 less than he had just paid for them. The Farmers Cooperative paid Hildebrand by issuing its check for \$210,062.95.

After the Hildebrands left Farmers Cooperative, Moser, the manager of Farmers Cooperative, became suspicious and telephoned Abbas, the general manager of Allison-Kesley. Abbas requested that Moser stop payment on the check issued to Hildebrand Farms. The Farmers Cooperative stopped payment the following Monday morning, October 5, because the banks had closed that Saturday noon.

In the meantime, Scott Hildebrand took the check he had received from the Farmers Cooperative and presented it for payment to the First State Bank of Greene, Iowa. The First State Bank did not pay out the entire face value of the

check, rather it paid out \$50,000--\$10,000 in cash, and two bank drafts totaling \$40,000.

Once the bank learned Farmers Cooperative had stopped payment on its check, officers of the bank, the Farmers Cooperative, and Allison-Kesley met to discuss the situation. All the parties then contacted their respective attorneys and began negotiating to protect their respective interests. The Hildebrands threatened to sue the Farmers Cooperative for stopping payment on the check.

Within a week, the parties learned of an urgent notice issued by the Federal Reserve Bank of Chicago which alerted the public that drafts issued by the International Credit Exchange of Acapulco, Mexico, were fraudulently issued. While the attorneys continued to negotiate and seek indemnification agreements from one another, the bank draft was presented for payment but was never honored. Eventually, on October 22, 1987, Farmers Cooperative lifted its stop-payment order. The balance of the check proceeds were given to the Hildebrands who were able to disperse a large part of it prior to the time Allison-Kesley obtained a court order to attach those funds still remaining in the bank. The amount of the attachment totaled approximately \$85,000.

Allison-Kesley then instituted two separate proceedings which were ultimately consolidated for trial. Allison-Kesley sought recovery from the Hildebrands based on their wrongful conversion of the PIK certificates and

their fraudulent misrepresentations in the purchase of those certificates. Allison-Kesley also sought recovery against the Farmers Cooperative for conversion of the PIK certificates, alleging the Farmers Cooperative was not a purchaser in good faith for value, and as such, is not entitled to the proceeds of the sale of the PIK certificates. After a hearing on the evidence, Allison-Kesley sought to amend its petition to allege claims that Farmers Cooperative had breached an implied contract not to lift its stop-payment order on the check and converted monies had and received.

After denying the attempted amendment, the district court concluded Allison-Kesley proved its case against the Hildebrands but not against Farmers Cooperative. Allison-Kesley appeals. Our scope of review is for corrections of errors at law only. Iowa R. App. 4. Findings of fact in a law action have the effect of a special jury verdict and are binding on us if supported by substantial evidence. Iowa R. App. P. 14(f)(1). Evidence is substantial when a reasonable mind would accept it as adequate to reach the same findings. Waukon Auto Supply v. Farmers & Merchants Sav. Bank, 440 N.W.2d 844, 846 (Iowa 1989).

I.

Allison-Kesley claims the trial court erred in ruling Farmers Cooperative was not liable. It believes the court's finding Farmers Cooperative was a purchaser in good

faith is not supported by substantial evidence. Iowa Code section 554.3302(1) defines a holder in due course as one who takes the instrument for value, in good faith, and without notice "that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person." Notice is further defined such that the purchaser has notice of a claim or defense if:

a. the instrument is so incomplete, bears such visible evidence of forgery or alteration, or is otherwise so irregular as to call into question its validity, terms or ownership or to create an ambiguity as to the party to pay; or

b. the purchaser has notice that the obligation of any party is voidable in whole or in part, or that all parties have been discharged. . . .

6. To be effective notice must be received at such time and in such manner as to give a reasonable opportunity to act on it.

Iowa Code § 554.3304(1), (6) (1991) (emphasis added).

Farmers Cooperative manager, Moser, noticed on the same day the certificates were presented that the Hildebrands had taken an immediate \$8000 loss. He immediately suspected the certificates were stolen. Farmers Cooperative made an \$8000 profit on a simple transaction by purchasing an instrument that had been discounted the same day. This fact created suspicion in Moser as to the legitimacy of the transaction.

Abbas told Moser on the morning of October 3 that he was concerned about the validity of the draft and wanted Farmers Cooperative to stop payment on the check. On October 5, Farmers Cooperative, showing its knowledge that the Hildebrand transaction was of questionable validity and

the subject of further inquiry, stopped payment on its \$210,000 check. Moser received information the International Credit Exchange could not be located and the instrument tendered by the Hildebrands for the certificates could not be collected. Moser had read the Federal Reserve's urgent notice warning about certified drafts drawn on the International Credit Exchange, Acapulco, Mexico, and fraudulently used in the midwest.

Moser testified that at the time of the October 5 meeting he knew the First State Bank had paid out at most \$50,000. The bank testified that if Farmers Cooperative had deposited only \$50,000 on October 22--instead of \$210,000--and released payment for only that \$50,000 in funds, exposure or claims the bank might have had would have been satisfied.

The test for whether a holder of an instrument has notice of any claim to it on the part of any person "is essentially objective." First Nat'l Bank in Lenox v. Creston Livestock Auction, 447 N.W.2d 132, 134 (Iowa 1989). We believe the \$8000 loss taken by the Hildebrands one hour after they had purchased the PIK certificates and the Federal Reserve urgent notice that matched the characteristics of the fraudulent draft gave Farmers Cooperative actual notice of substantial irregularities in the Hildebrand transaction. See United States Finance Co. v. Jones, 285 Ala. 105, 229 So. 2d 495 (1965). Farmers Cooperative had a reasonable opportunity to act on their

notice. See Iowa Code § 554.3304(6) (1991). We determine Farmers Cooperative was wrong to so aid the perpetrators of this fraud and, therefore, is liable to Allison-Kesley. "[T]he property obtained by fraud shall not be placed beyond the reach of the party defrauded, either by the fraudulent vendee or others chargeable with the knowledge of the fraud. To permit it would be to allow the party to profit by his fraud." Morrow Shoe Mfg. Co. v. New England Shoe Co., 57 F. 685, 694 (7th Cir. 1893).

While Farmers Cooperative arguably owed a duty to First State Bank to deposit \$50,000 to cover what the bank had paid in cash and issued in teller's checks, Farmers Cooperative had no duty on October 22, after notice of Allison-Kesley's fraud claim and all the facts showing the fraudulent scheme, to deposit the full \$210,000 to enable Hildebrands to obtain the additional \$160,000 in profits on their fraud. Payment of the additional \$160,000 on October 22 was with such notice of fraud as to cause Farmers Cooperative to question the validity of the transaction. Iowa Code §§ 554.1201(25); 554.3304(1) (1991). We believe the trial court incorrectly applied the law to the facts of this case. See Gere v. Council Bluffs Community School Dist., 334 N.W.2d 307, 309 (Iowa 1983) (appellate court not bound by trial court determinations of law); Packwood Elevator Co. v. Heisdorffer, 260 N.W.2d 543, 544 (Iowa 1977) (same). Farmers Cooperative should not have aided the perpetrators without making further inquiries to

satisfy itself the draft was a legitimate certified draft that could be collected. See Waukon Auto Supply v. Farmers & Merchants Sav. Bank, 440 N.W.2d 844, 847-50 (Iowa 1989); J. White & R. Summers, Uniform Commercial Code, § 14-6, at 717 (3d ed. 1988).

We reverse the district court on this issue. By lifting the stop-payment order with knowledge of the fraud, Farmers Cooperative is liable to Allison-Kesley for the amount Allison-Kesley lost due to the lift, \$75,000 (\$160,000 - 85,000). Iowa Code § 554.3306 (1991).

II.

Allison-Kesley additionally argues the trial court abused its discretion in denying its application to amend its petition. Because we find above Allison-Kesley has a valid claim against Farmers Cooperative, we do not address this issue.

REVERSED.

Hayden, J., concurs; Habhab, J., dissents.

HABHAB, J. (dissenting)

I respectfully dissent. In doing so, I believe the trial court correctly applied the laws. With that in mind, it is then only necessary to determine whether there is substantial evidence to support the trial court's findings.¹ This is so for, as the majority points out, findings of fact in a law action have the effect of a special jury verdict and are binding on us if supported by substantial evidence. I find substantial evidence to support the trial court's findings. Merely because we might have reached a different result is not sufficient grounds for reversal. The test is substantial evidence.

I would affirm in all respects.

1. The Uniform Commercial Code, article 3, controls here. See Iowa Code chap. 554, art. 3. I believe the critical question here is whether Farmer's Cooperative was a holder in due course at the time of the transaction. This I believe is a fact question for the fact finder to decide.