The purpose of this column is to identify some of the most disconcerting judicial decisions interpreting the Uniform Commercial Code or related commercial laws. The purpose of the column is not to be mean. It is not to get judges recalled, law clerks fired, or litigators disciplined for incompetence. Instead, it is to shine a spotlight on analytical errors, and thereby provide practitioners and judges with reason to disregard the decisions.


This case deals with the perfection of a security interest in crops. The court may have reached the correct result, but it failed to mention or consider an important fact and it relied on a rationale that has no place in a proper analysis.

The facts begin when Newsom, a Mississippi farmer, and Roberts, a farmer with operations in Indiana, Louisiana, and Tennessee, decided to work together to farm 5,100 acres in Arkansas. Under their agreement, Newsom was to provide the labor, equipment, and expertise while Roberts was to provide the financing. Roberts already had an existing line of credit with Rabo Agrifinance and applied for a new loan to finance the Arkansas venture. Rabo initially rejected the loan request, causing Newsom to advance funds needed to begin the farming operation. Later, Rabo made a smaller loan and received in exchange a security interest in the crops from Roberts and a partnership Roberts had formed. Robo filed a financing statement in Arkansas against both Roberts and the partnership to perfect its security interest.

Newsom brought an action against Roberts and the partnership for failing to provide their promised joint-venture capital. Newsome also sued Rabo seeking a declaration that Rabo did not have a perfected security interest in the Arkansas crops or, if it did, that Newsom had a superior equitable lien to secure his crop-related expenses. Rabo and Roberts filed cross-claims against each other but this column deals only with Newsom’s claims.

Newsom made three arguments for why Rabo’s financing statement was ineffective to perfect its security interest. First, Newsom claimed that the financing statement’s description of the collateral as “all crops grow, growing, or to be grown” was insufficient because it did not mention the site of the crops in Arkansas. The court quite properly rejected this argument. In doing so, the court noted that § 9-108(b)(2) provides that a description of collateral by category is sufficient. *Id.* at *8. The court also reasoned that a description of collateral need not enable a
searcher to identify the encumbered property; rather, it need only enable a searcher, aided by further inquiry, to identify the property. *Id.* at *9.

If the court had stopped there it would have been on very solid ground. Unfortunately, the court also observed that, because the financing statement was filed in Arkansas, the statement implicitly suggested that the crops were located on Arkansas land. *Id.* This is patently wrong. The law governing perfection of a security interest in crops is the law where the debtor is located, not where the crops are located. See § 9-301(1). The place to file against crops, then, is the state of the debtor’s location, not the crop’s location. See § 9-501(a). The rules are different for as-extracted collateral and fixtures covered by a fixture filing, see §§ 9-301(4), 9-501(a), but crops are not either of those, see § 9-102(a)(5). The law is also different for an agricultural lien, see § 9-302, but an agricultural lien is an interest that arises by statute, not by contract, see § 9-102(a)(6), and thus a security interest in crops is not an agricultural lien. As a result, Rabo’s filing in Arkansas in no way implied that the crops were located in Arkansas.

Newsom’s second argument was that the financing statement was ineffective because it incorrectly listed (prior to an amendment) the partnership’s address as Barretville, Indiana, rather than Barretville, Tennessee. The court properly rejected this argument too. After all, the only essential information in a financing statement is the debtor’s name, the secured party’s name, and the description of the collateral. See § 9-502(a). The filing office can reject a financing statement that lacks an address for the debtor, see § 9-516(b)(5), and a security interest perfected by a filed financing statement that incorrectly lists the debtor’s address may be subordinated to a conflicting security interest, see § 9-338(1), but a filed financing statement that lists an incorrect address for the debtor is effective to perfect.

Unfortunately, the court did not cite to any of these provisions in its discussion of this issue. Instead, the court focused on Newsom’s ability to conduct a proper inquiry had Newsom searched for and found the filed financing statement. Specifically, the court stated that “under the circumstances of this case, Newsom’s ability to inquire was not affected, given his association with Roberts and his partnership in the Arkansas operation.” The statement is true but irrelevant at best and more likely misguided. The effectiveness of a financing statement must be judged objectively, not subjectively by the knowledge of the person attacking it. Otherwise, circular priorities may result. Cf. Stephen L. Sepinuck, *Searchers Beware: Court Validates Notice of Tax Lien Filed Against Debtor’s Former Name*, 26 CLARKS’ SECURED TRANSACTIONS MONTHLY 2 (Aug. 2010) (making a similar point with respect to a notice of federal tax lien); Stephen L. Sepinuck, *Misguided California Court Changes “Consignment” Standard*, 25 CLARKS’ SECURED TRANSACTIONS MONTHLY 1 (Sep. 2009) (making a similar point with respect to whether, under the definition of “consignment,” a person is generally known by its creditors to be substantially engaged in selling the goods of others).

Newsom’s final argument was that the partnership did not own the collateral and thus a filing against the partnership could not have perfected the security interest. The court rejected this argument by noting that the financing statement also listed Roberts as a debtor and he did have ownership rights in the crops. 2013 WL 1682379 at *9. That may have been true but what
the court neglected to consider was where Roberts was located. In fact, the court never indicated where either Roberts or the partnership was located. If Roberts was not located in Arkansas—and it is worth remembering that he was a farmer with experience in three other states but who had not before operated a farm in Arkansas—then a filing against him in Arkansas would be irrelevant. The place to file a financing statement to perfect a security interest in crops is where the debtor is located, not where the crops are located. It appears that someone—either the court or Newsom’s counsel—dropped the ball on this one.


This case involved a priority dispute in consigned inventory and its proceeds. The court reached the correct result but its analysis overlooked a potentially important issue. The case also serves as a cautionary lesson for inventory financiers.

In 1997, T. Gluck & Co. began providing diamonds to a manufacturer of jewelry pursuant to a consignment and security agreement. At that time, Gluck filed a financing statement to perfect its interest and notified the debtor’s inventory lender of Gluck’s plans to retain a purchase-money security interest in the diamonds it provided. Twelve years later, after the original inventory lender had assigned its security interest to Sovereign Bank, the debtor conducted a going-out-of-business sale and remitted most of the proceeds to Sovereign Bank. Gluck sued Sovereign Bank for conversion and claimed priority in the diamonds it had provided to the debtor and in the proceeds of the diamonds.

The court ruled for Sovereign Bank and did so for correct reasons. The court noted that even if Gluck were entitled to PMSI priority in the diamonds, that priority would not extend to noncash proceeds, such as accounts. See § 9-324(b). Instead, priority would be determined under the basic first-to-file-or-perfect rule of § 9-322(a)(1), and because Sovereign Bank and its predecessor had filed timely continuation statements, that meant Sovereign Bank had priority in such proceeds.

As to the diamonds themselves, the court looked to § 9-324(b), which provides that PMSI priority in inventory applies only if the inventory financier receives the PMSI-lender’s notification of PMSI financing “within five years before the debtor receives possession of the inventory.” Because Gluck had sent only one PMSI notification, and had done so back in 1997, Gluck was no longer entitled to PMSI priority in the inventory. As a result, Sovereign Bank could not be liable for conversion.

The court was mostly correct and its ruling underscores the need for PMSI inventory lenders to renew their PMSI notifications every five years, just as they must file a continuation statement every five years to remain perfected. What the court failed to consider, though, perhaps because no one argued it, was whether any of the diamonds sold in the 2009 going-out-of-business sale had been provided to the debtor on or before 2002 and thus were received
within the five-year period. In other words, the effect of a failure to renew a PMSI notification is different from the effect of a failure to timely file a continuation statement. If a secured party fails to file a continuation statement, its entire security interest becomes unperfected (or at least that portion for which filing is necessary to perfect), and thus priority can be lost as to all of the collateral, whether acquired by the debtor before or after the financing statement lapses. In contrast, if a PMSI inventory lender fails to renew its PMSI notification, the PMSI inventory lender will lose priority only in the inventory received by the debtor more than five years after the original notification; the lender will retain priority in inventory acquired within that five-year period.

Perhaps all of diamonds that the debtor in this case acquired between 1997 and 2002 had been sold long before the 2009 sale. If that were true, then the court was correct in awarding priority to Sovereign Bank. If, however, Gluck could have identified some of the diamonds sold in 2009 as inventory acquired by the debtor during that five-year period, then Gluck should have been entitled to priority in those diamonds and in any cash proceeds thereof received by the debtor on or before delivery of the diamonds to the buyer.

**American Bank v. Cornerstone Community Bank,**

*2013 WL 4309622* (6th Cir. 2013)

The case involves insurance premium financing that went south when the bank in which the insurance broker deposited the advanced funds swept the deposit account to satisfy a debt owed to it by the broker. The premium financier sued for conversion and won. The Sixth Circuit affirmed with a decision filled with confused and sloppy analysis. Nevertheless, the court may have inadvertently reached the correct result.

The facts are more fully described as follows. American Bank agreed to loan $430,000 to Saberline Transportation to acquire an insurance policy. The loan was to be secured by the unearned premiums. American wired the funds to the insurance broker’s deposit account at Cornerstone Community Bank. Cornerstone swept the deposit account to recover on a debt owed to it by the broker. Consequently, no insurance policy was ever acquired. The broker later repaid American with other funds, but that payment was avoided as a preference in the broker’s subsequent bankruptcy. American repaid the funds to the bankruptcy trustee, preserving its rights to pursue Cornerstone for conversion. The lower court ruled for American and on appeal the Sixth Circuit affirmed.

The court began by looking at the Tennessee Premium Finance Company Act, Tenn. Code §§ 56-37-101 *et seq.*, which gives a premium financier a perfected security interest “in any premiums financed” if the borrower signs a written security agreement. Tenn. Code § 56-37-112 (subsequently re-designated as subsection (a)). From this, the court reasoned, American Bank had a perfected security interest in the broker’s deposit account and that, also pursuant to the Tennessee Act, this security interest was superior to the rights of Cornerstone.
There are at least two problems with the circuit court’s analysis. First, the court improperly conflated a security interest in the unearned premiums with a security interest in the loan proceeds that had been deposited at Cornerstone. Because the broker never acquired the policy, there never were any unearned premiums. Thus, it is far from clear that Tennessee Premium Finance Company Act applied at all.

The court’s second error flowed from its first. In ruling that American Bank had priority, the court had two alternative rulings. First, that the Tennessee Premium Finance Company Act was more specific and thus controlled over the more general rules of Article 9. Second, that Article 9 was inapplicable under § 9-109(d)(8) because the issue involved an interest in a policy of insurance. 2013 WL 4309622 at *2-3. The first ruling is questionable but defensible. The second ruling is not. The property at issue was a deposit account, not unearned premiums or insurance. Article 9 undoubtedly applies to a security interest in a deposit account. Perhaps recognizing the same analytical error by the trial court, the Tennessee legislature has since amended the Tennessee Premium Finance Company Act to expressly provide that Tennessee’s Article 9 “shall govern the relative priorities of security interests in, and any right of set-off against, funds advanced pursuant to a premium finance agreement.” Tenn. Code § 56-37-112(b) (effective April 12, 2013).

Nevertheless, the circuit court may have reached the correct result. Recall that the funds were transferred to the broker’s deposit account to facilitate the broker’s purchase of an insurance policy for Saberline. Under such circumstances, the broker arguably held the funds in trust for Saberline (and possibly also for American). As a result, the broker may not have had any right to the deposited funds and thus could not have granted a security interest in the deposited funds to Cornerstone. See Stephen L. Sepinuck, Deconstructing the Constructive Trust, 3 The Transactional Lawyer 2 (Aug. 2013). For much the same reason, Cornerstone would not have had a right to exercise setoff against the deposited funds to satisfy a debt owned by the broker, as there would have been no mutuality of obligation.

In its very first paragraph the circuit court stated that the broker “held the money . . . in trust.” Thus, the court itself seemed to embrace this idea. Unfortunately, its analysis was not based on principles of trust, but on a misunderstanding of the law and the facts.

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