



# Financial Services Update: Implications of Minnesota Court of Appeals' Ruling on Security Interest Priority

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A recent decision by the Minnesota Court of Appeals may have an impact on a bank's security interest of personal property.

The Minnesota Court of Appeals found that a bailee (a party who stores or possesses an asset of another) has priority over a perfected security interest, regardless of notice to the perfected secured party. In this case, a bailee was in possession of and storing the borrower's generators since 2006 pursuant to a storage agreement. The generators were stored continuously by the bailee since 2006.

In 2013, the lender loaned \$250,000 to the borrower and took a security interest in the generators. The security agreement provided representations by the borrower that the collateral, which included the generators, was "free and clear of all security interests, liens and encumbrances" except otherwise disclosed liens contained within the security agreement. The lender properly perfected its security interest by filing a UCC financing statement with the Minnesota Secretary of State. At the time that the lender perfected its security interest, the bailee had not filed any documents regarding its lien, including not filing a UCC financing statement.

Although the record on appeal is not clear, it appears the lender had no knowledge of the bailee's proposed lien at the time of lending the money. The lender brought an enforcement action to take possession of its generators collateral claiming priority and the bailee responded, alleging it had priority. The court held that a bailee in possession has priority over any security interest regardless of whether the secured party had notice of the bailee's lien when the secured party created its security interest. The court relied upon Minnesota Statutes § 514.18, subdivision 1 in stating a possessory statutory lien has priority. The court seemed to state that § 514.18, subdivision 3, which limits the priority of liens if a party has notice of the security interest, only applies to nonpossessory liens created under § 514.18, subdivision 2. Therefore, if the bailee still has possession and claims a lien, its lien will be prior to the lender's security interest. *Dusenberry v. Hawks, et al.*, No. A160961, 2017 WL 1316129, at \*1 (Minn. Ct. App. April 10, 2017).

**Practice Tip:** Lenders should perform thorough due diligence prior to lending funds to a party who is pledging security that might be stored by a third party. Further, after advancing funds where personal property has been pledged as collateral, lenders should manage credits closely to ensure that its borrower



is in possession of the personal property, or, if in the hands of third parties, that the third party is paid in full. If a lender is not diligent, the lender's security interest may be trumped by a "secret lien" in the form of a bailee's lien.

This is just one case and issue that will be addressed at the Gray Plant Mooty St. Cloud Banking Seminar on May 16. Sign up now!