In 1989, Diversified, a Minnesota commercial lender, entered into a revolving line of credit agreement with Eades, a Nebraska cattle feed merchant. Diversified secured its financing to Eades through a Credit and Security Agreement ("Security Agreement") dated November 22, 1989, by which it took perfected security interests in Eades’ assets. Under Paragraph 3(a) of the Security Agreement, Eades granted Diversified a security interest in its inventory, documents of title, accounts receivable, equipment and fixtures, equity securities, general intangibles, and all proceeds and products, all defined as “Collateral.” Paragraph 3(A) of the Security Agreement provides in pertinent part:

Grant of Security Interest. Borrower hereby assigns to Lender and grants Lender a security interest (collectively referred to as the “Security Interests”’) in the property described below, as security for the payment and performance of each and every debt, liability and obligation of every type hereafter owed to Lender ... The Security Interests shall attach to the following property of Borrower (the “Collateral”), including all proceeds and products thereof:

RECEIVABLES: Each and every right of Borrower to the payment of money, whether such right to payment exists or hereafter arises, whether such right to payment arises out of a sale, lease or other disposition of goods or other property, out of a rendering of services, out of a loan, out of overpayment of taxes or other liabilities, or other transaction or event, whether such right to payment is created, generated or earned by Borrower or by some other person whose interest is subsequently transferred to Borrower, whether such right is or is not already earned by performance, and howsoever such right to payment may be evidenced, together with all other rights and interests (including all liens, security interests and guaranties) which Borrower may at any time have by law or agreement against any account debtor or other person obligated to make any such payment or against any property of such account papers, bonds, notes and other debt instruments, and all rights to payment in the nature of general intangibles; all checking accounts, savings accounts and other certificates of depositary accounts and all savings certificates and certificates of deposit maintained with or issued by Lender or any other bank or other financial institution.
GENERAL INTANGIBLES: All general intangibles of every type and description now owned or hereafter acquired by Borrower, including (without limitation) all present and future foreign and domestic patents, patent applications, trademarks, trademark applications, copyrights, trade names, trade secrets, shop drawings, engineering manuals, operating instructions, customer or supplier lists and contracts, licenses, permits, franchises, the right to use Borrower’s corporate name, and the goodwill of Borrower’s business.

(emphasis added). Eades agreed “to deposit in one or more special collateral accounts maintained for Lender at Firstier Bank, Omaha, Nebraska, or any other bank reasonably satisfactory to Lender and Borrower, all collections on accounts, contract rights, chattel paper and other rights to payment constituting Collateral, and all other cash proceeds of collateral, immediately upon receipt thereof, in the form received, except for Borrower’s endorsement when deemed necessary.” The Security Agreement specified that “[e]xcept to the extent otherwise required by law, this Agreement and the transactions evidenced hereby shall be governed by the substantive laws of the State in which this Agreement is accepted by Lender.” Diversified filed a financing statement with the Nebraska Secretary of State on November 27, 1989 to perfect its security interest and preserved its perfected status by filing a continuation statement on October 25, 1999. As of all the transactions in dispute, Diversified held a valid and perfected security interest of record in California in all Eades’ receivables and general intangibles.

Prior to March 2000, Eades supplied grain feed to dairies and other cattle operations throughout California, including Plaintiffs. Plaintiffs purchased cattle feed from Eades’, sometimes dealing with Eades directly, but most of the time dealing through brokers Wes Creswick and Stan Lawrence of Feed Services Company, Eades’ California agents. Eades offered a prepay program to provide customers an incentive to prepay for cattle feed. Customers who prepaid could get a discount of $2 a ton off the price of the commodity; alternatively, they could earn interest on their prepaid balance at the rate of 7% per year. The prepay program allowed Eades’ customers to prepay at the end of one year for feed to be delivered in the following year. A tax deduction was taken by the buyer for the full amount of the purchase, including for undelivered feed. As feed was needed throughout the following year, Eades shipped feed and the prepay deposit balance was reduced.

The contract of sale confirmation between each plaintiff and Eades called for delivery of a fixed amount of grain over a specified period of time at a fixed price, with certain terms and conditions specified on the reverse side of the contract. The sales agreement specified that “salesmen and brokers are not empowered to give contracts to bind the Seller.” An integration clause provided:

This contract constitutes the entire understanding between the parties hereto and no modification or amendment of this Contract shall be valid or binding unless agreed to by both parties and confirmed in writing by either parties to the other. THERE ARE NO ORAL AGREEMENTS OR WARRANTIES COLLATERAL TO BE AFFECTING THIS CONTRACT. Buyer agrees to be bound by the terms of this Contract in the event of any conflict in terms or conditions hereof with Buyer’s contract for such purchase.
No trust was made. No segregation or earmarked accounts were established for prepayments. Tax deductions for prepayments were taken. Interest was paid on prepayments.

At the end of 1999, Plaintiffs’ aggregate feed prepayments to Eades were approximately $1.85 million. In two instances, one of the plaintiffs and another customer requested and received a refund of prepayment monies that had been deposited earlier with Eades.

Since 1989, Eades deposited the prepayments it received from its customers into a lockbox at National Citibank in Minneapolis. Cash proceeds in the lockbox were used to pay down Eades’ line of credit to facilitate additional advances under the line of credit. Eades had no verbal or written agreement with any customer that restricted Eades’ ability to use all prepayment funds to pay Eades’ lender. The parties dispute whether Eades included prepayments in the daily accounts receivable reports provided to Diversified. In no instance was there any written … modification of any prepaid feed contract.

In 1999, Eades began to experience financial difficulties. Throughout 1999 and into 2000, Eades sought other investors or a new lender. In Fall 1999, Diversified discovered Eades had materially misreported its accounts receivable balance to Diversified, requiring Diversified to reduce by $3.7 million the collateral base that Diversified was able to lend on under its loan formula. The physical count of feed inventory for the fiscal year ending July 31, 1999, revealed that Eades had to write down its inventory nearly $1 million in addition to another, early 1999, nearly half million dollar downward inventory adjustment made by Eades. The audit and inventory adjustments resulted in a preliminary operating loss to Eades through July 31, 1999, of almost $2 million.

In January 2000, Diversified refused to extend Eades new letters of credit on behalf of Eades’ customers and imposed new borrowing restrictions on Eades. When Eades was informed by Diversified that Diversified would no longer issue letters of credit for Eades’ customers, Eades deposited $525,195.60 in prepayments it had received from six of the Plaintiffs into money market accounts at A.G. Edwards & Sons, Inc. in Omaha, Nebraska. Eades established the A.G. Edwards & Sons accounts for prepaying customers who might want letters of credit. The accounts were in Eades’ own name. Eades did not notify the customers of the deposits into the A.G. Edwards accounts. Eades designated each account as “for the benefit of” (“fbo”) a specific customer to keep track of the individual prepay balances of each customer.

On January 21, 2000, Diversified learned that Eades had deposited some of the prepayment money with A.G. Edwards. Diversified declined to renegotiate the terms of the existing credit restrictions and refused to extend additional funds until Eades paid down its loan balance. Subsequently, Eades forwarded the A.G. Edwards deposit funds to Diversified and Diversified advanced additional money to Eades under Eades’ line of credit. Eades’ customers, including Plaintiffs, received shipments of feed through March 2000. After Eades’ unaudited financial statements revealed additional net income loss and Eades was unable to comply with new borrowing restrictions, Diversified stopped making additional advances to Eades on February 14, 2000.
On February 22, 2000, Eades’s president, Bob Eades, sent a letter to David Andreas, President of National City Bank of Minneapolis, regarding the prepayment deposits made to the bank pursuant to the lending arrangement with Diversified. Eades’ letter states in part:

Eades Commodities Company customers presently have on deposit with Diversified Business Credit $1,583,886.16. These deposits are for the benefit of 30 dairy farmers in six states. These farmers depend on these funds to feed their animals. The urgency in live animal matter is hours not days or weeks and DBCI personnel will not discuss this with us.

These deposits are not “proceeds of collateral,” they are classified as “non-accounts receivables” they are reported to DBCI this way and DBCI requires us to maintain records separate from collateral accounts receivable. DBCI is refusing to release these deposits. Your bank has a fiduciary responsibility to return these funds.

On March 1, 2000, Stan Lawrence, a Feed Services Company employee, sent a number of Plaintiffs a letter urging them to contact a lawyer because he thought there was a considerable difference of opinion regarding the prepay money. The Lawrence letter states in relevant part:

To the best of my knowledge Eades Commodities is insolvent, they cannot ship product on contracts from their suppliers to their customers because the bank [h]as withdrawn the line of credit and seized all prepay accounts. There is a considerable difference in opinion regarding the prepay monies between Eades and the Bank. While the bank has legal right to all monies arising from Accounts Receivable (i.e. Invoices) [[,][t]he prepays represent “trust” accounts that are not receivables until the product is shipped to and arrives on the dairyman’s property.

* * *

A security interest is enforceable if: (1) value has been given; (2) the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured third party; and (3) there is evidence that the debtor intended to pledge the collateral through one of a variety of methods, but generally through execution of a security agreement. Cal. Com. Code § 9203(b). The Security Agreement with Eades defines Diversified’s security interest in receivables as “each and every right of borrowers to the payment of money ... whether such right to prepayment is or is not already earned by performance.” The Security Agreement provides: “Except to the extent otherwise required by law, this Agreement and the transactions evidenced hereby shall be governed by the substantive laws of the State in which this Agreement is accepted by Lender.”

[FN2] Under California law, “account receivable” means “account” as defined in paragraph (2) of subdivision (a) of Section 9102 of the Commercial Code. Cal. Civ. P. § 481.030 (2002). An “account ... means a right to payment of a monetary obligation, whether or not earned by performance, (i) for property that had been or is to be sold...” Cal. Com. Code § 9102(a)(2)(2002).... [Thus,] the prepayments appear to be “accounts,” as a monetary obligation unearned by performance or right to payment for goods sold not evidenced by an instrument or chattel paper, nor earned by performance.
Diversified argues it held a prior perfected security interest in all Eades’ assets including receivables and general intangibles pursuant to the Security Agreement, which extended to the prepayments Eades received, even if Eades had not delivered all the feed for which Plaintiffs prepaid. Alternatively, if the prepayment funds are not classified as “accounts,” they are “general intangibles” which are covered by the Security Agreement. *In re Coupon Clearing Service* defines general intangibles as “any other rights to payment, whether earned or not yet earned, to the extent that they arise other than from goods sold or leased or from services rendered, would not constitute accounts, but general intangibles.” *In re Coupon Clearing Service*, 113 F.3d 1091, 1102 (9th Cir. 1997). The prepayments arose from the sale of goods to be delivered in the future and are accounts.

Plaintiffs rejoin Diversified’s security interest never attached because Eades had no rights in the prepayments. [Plaintiffs’ expert] Mr. Bettencourt opines that in the agricultural industry “as product is shipped, and only then, the broker should make the appropriate accounting entry to show that the income has been earned.” He further opines that prepays are not accounts receivable because prepayments are a credit balance not a debit balance; thus, prepayments are not covered by the Security Agreement. These are legal opinions disguised in accounting parlance. Except for accounting treatment, the opinions are inadmissible legal conclusions and not helpful to the trier of fact. *See FED. R. EVID. 702*.

Plaintiffs further argue Eades did not intend to pledge the prepayments as collateral. Willy Creek … contends Section 9102(a)(2)(vi) explicitly provides that the term “account” does not include rights to payment for money or funds advanced or sold. Willy Creek’s argument that Section 9102(a)(2)(vi) explicitly provides that the term “account” does not include rights to payment for money or funds advanced or sold is flawed, because the “rights to payment for money or funds advanced or sold” refers to Eades’ right to payment for money or funds, not Plaintiffs’ rights to payment for money or funds from Eades. The payments were made for feed (goods) sold and delivered or to be delivered in the future.

Mr. Bettencourt’s opinion that the prepayments are not accounts receivable is an inadmissible legal conclusion entitled to no weight. Accountants are not competent to give legal opinions about interpretation of the Uniform Commercial Code. The evidence establishes Diversified had a prior perfected security interest in Plaintiffs’ prepayments as the funds were received by Eades and deposited into Eades’ accounts, under the Security Agreement. Paragraph 3 of the Security Agreement defines Diversified’s security interest in receivables as “each and every right of borrowers to the payment of money … whether such right to prepayment is or is not already earned by performance.” Diversified’s security interest is enforceable because (1) value was given, i.e., it refrained from terminating Eades’ line of credit or declaring default in the loans for insecurity and loaned more money to Eades; (2) the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured third party, i.e., Eades had the funds in its own bank accounts or its accounts at A.G. Edwards, or paid the funds to Diversified to reduce Eades’ loan balances; and (3) there is evidence that the debtor (Eades) intended to pledge the collateral under the terms of the security agreement.

Value was given when Diversified advanced money to Eades. Eades was prepaid for cattle feed by each Plaintiff and in return delivered or promised to deliver feed on each Plaintiffs’
demand. Eades had rights in and in fact dealt with the collateral, the prepayments, as its own, because it was not prohibited from commingling the prepayments with its general business account or from using the prepayments in the conduct of Eades’ business. Eades regularly commingled the prepayment funds and used such prepayments to pay down its line of credit and for other purposes. This course of dealing shows Eades understood the prepayments were its accounts because the prepayments were for goods; to wit, cattle feed sold and delivered or to be delivered. All Eades’ bank and investment accounts were subject to the Security Agreement. Although Eades was not consistent in reporting its prepayments in collection reports to Diversified, there is no dispute Eades transferred prepayments to Diversified as debt service to pay down Eades’ line of credit.

Diversified's security interest was perfected through the filing of various financing statements of record which gave Plaintiffs notice of Diversified’s rights. Cassel v. Kolb, 72 Cal. App. 4th 568, 575, 84 Cal. Rptr. 2d 878 (1999). Plaintiffs did not take a security interest in Eades’ assets, nor did they take steps to segregate and preserve their prepayments in separate trust accounts, nor did they arrange for letters of credit to assure the prepayment performance obligation. As general unsecured creditors, they stand behind Diversified, which holds a prior perfected security interest in these prepayments.

Plaintiffs contend equitable principles can serve to override Diversified’s claim of priority under the Uniform Commercial Code priority scheme. Plaintiffs cite Knox v. Phoenix Leasing, Inc., 29 Cal. App. 4th 1357, 35 Cal. Rptr. 2d 141 (1994), arguing California law allows restitution from a creditor with a perfected security interest. Plaintiffs also argue Diversified’s decision to foreclose its security interests after Eades received a large influx of prepayments in December 1999 was in bad faith.

Knox interprets Producers Cotton Oil Co. v. Amstar Corp., 197 Cal. App. 3d 638, 242 Cal. Rptr. 914 (1988), to permit restitution, “when an unsecured creditor provides goods or services that are necessary to preserve the collateral, this is an expense the secured creditor would ordinarily incur as part of the duty to use ‘reasonable care in the custody and preservation of collateral in his possession.’” Knox, 29 Cal. App. 4th at 1366. Knox’s interpretation of Producers Cotton was unnecessary to the decision and is dicta. That dicta is inapplicable to this case because Plaintiffs, as unsecured creditors, did not provide goods or services that were necessary to preserve the collateral. The prepayments for feed were the collateral, once received by Eades. Nor did Plaintiffs pay their funds with intent and knowledge that the payments would be used to persuade Diversified to keep Eades in business. To the contrary, the payments were solely for Plaintiffs’ benefit, to buy feed and obtain tax deductions, prior supply, and favorable prices. While the timing of Diversified’s decision to foreclose is suspicious, the Security Agreement provides “all loans which Lender may determine to make under this Agreement shall be repayable on demand.” A creditor’s insisting on payment under an express legal right, even if in bad faith, is not actionable. Kruse v. Bank of America, 202 Cal. App. 3d 38, 68, 248 Cal. Rptr. 217 (1998). Plaintiffs do not show equities that override Diversified’s claim of priority as a perfected secured creditor under the UCC priority scheme.

*     *     *

Weststeyn-6