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A Quest for Justice in the Conversion of Security Interests

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A Quest for Justice in the Conversion of Security Interests

BY RUSSELL A. HAKES*

TABLE OF CONTENTS

I. INTRODUCTION .................................. 839
II. IMPACT OF LEGAL CLASSIFICATION .............. 841
   A. Classifications of Property Law .............. 842
      1. Real and Personal Property Law .......... 843
      2. Possession and Personal Property ....... 843
   B. Classification of Conversion ............... 845
III. THE LEGAL FRAMEWORKS ....................... 847
   A. Framework of Article 9 ..................... 847
      1. Prior Creditor's Monopoly Power ....... 847
      2. Doubling Security on Transfer .......... 851
      3. Bifurcated Concept of a Debtor ........ 853
      4. Irrelevant Knowledge, Inadequate Notice .. 853
      5. Code Remedies ................................ 855
      6. Incomplete Rules on Meaning of Priority .. 860
   B. Framework of Conversion .................... 862
      1. Common Law Conversion ..................... 862
         a. Historical Development ................ 863

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b. Tort and Property ........................................ 865

c. Elements and Principles of Conversion .............. 867

2. Conversion of Security Interests .................... 872

a. Early Applications .................................. 873

b. Current Applications ................................ 876

(1) Elements of Conversion ............................ 876

(2) Debtor and Secured Party .................. 881

IV. ANALYSIS ............................................. 885

A. Conceptualizing Conversion ........................ 885

1. Property Remedy or Tort? ....................... 885

2. Coordination with Article 9 .................... 887

B. Should Conversion Protect Security Interests? .... 888

1. Security Interests vs. Ownership Interests .... 889

2. Benefits to the Secured Party ................. 890

3. Do Innocent Converters Deserve Protection? .... 892

a. Junior Creditors ................................ 892

b. Buyers ......................................... 895

c. Seller's Agents ................................ 896

4. Appropriate Protection ........................... 896

a. Avoiding Personal Liability .................. 897

b. Allocating Ultimate Liability ................ 897

C. When Is a Security Interest Converted? .......... 900

1. Refusal of a Demand ............................ 902

2. Exceptions to Demand and Refusal .......... 904

3. Are Collateral Transfers Wrongful? ............ 906

a. Impact of Section 9-311 ....................... 907

b. Conversion by Transferees .................... 910

c. Conversion by Transferors and Agents .... 914

(1) Subsequent Transfers ........................ 914

(2) Debtor's Agents ................................ 915

d. Conversion by Execution or Foreclosure .... 918

(1) Protecting Senior Creditors ................ 921

(2) Viability of Subject-to Sales .............. 922

(3) Right to Proceeds ............................ 924

4. Are Transfers with Knowledge Wrongful? ....... 927

5. Is Complicating Enforcement Wrongful? ....... 929

6. Conversion of Proceeds ......................... 930

V. CONCLUSIONS AND RECOMMENDATIONS .......... 934

A. Judicial Accommodations ....................... 936

B. Legislative Accommodations ................... 936
I. INTRODUCTION

The confluence of the tort of conversion and secured transactions under Article 9 of the Uniform Commercial Code creates undercurrents for legal reform. Courts frequently address claims by secured parties that third parties converted their security interests. The courts' analyses of the issues raised by such claims are generally unsatisfactory, and their holdings are often inconsistent. Despite the lack of judicial clarification, an examination of the interaction of conversion with the property interest of a secured party provides important insights for both Article 9 and conversion law.

What rights in personal property constitute a security interest? How is a security interest enforced? While any student of Article 9 readily answers these questions at one level, the difficulty in finding satisfactory answers at a deeper level reveals serious inadequacies in Article 9 and other laws governing personal property. In particular, difficulties arise when a secured creditor exercises its rights against personal property that has been sold or encumbered.

Although Article 9 establishes a fairly comprehensive scheme to determine priority between secured parties and transferees of personal property, it does not resolve the meaning of priority. If a junior creditor

1 Unless otherwise noted, all references to the "Uniform Commercial Code," the "Code," or the "U.C.C." are to the 1990 Official Text, and all references to "Article Nine" are to Article 9 of the Uniform Commercial Code.

2 See, e.g., Permanent Editorial Board for the Uniform Commercial Code, PEB Study Group Uniform Commercial Code Article 9, Report, 220-22 (December 1, 1992) (suggesting revisions to Code comments in order to clarify that conversion is not a fait accompli when junior creditors exercise rights to the collateral) [hereinafter Study Group Report]; ROBERT A. HILLMAN ET AL., COMMON LAW AND EQUITY UNDER THE UNIFORM COMMERCIAL CODE ¶ 25.01[3][a][ii]-[iii], 25.02[5] (1985 & Supp. 1991) (discussing the inconsistencies of court holdings with pre-Code law and the U.C.C., which find liability for conversion in instances of the mere exercise of rights to the collateral).

3 U.C.C. § 9-306(2) continues the security interest in transferred collateral unless the secured party consents to the transfer or the Code provides a contrary rule of priority, such as U.C.C. § 9-307(1), which protects buyers in the ordinary course of business.

exercises rights to collateral before a senior secured party, can the senior repossess from the junior or vacate its levy? If the senior secured party vacates its levy, what rights does the lien creditor retain in the property? If the junior succeeds in selling the collateral, does the senior have a right to the sale proceeds? Does the buyer at the sale take the property subject to the senior security interest?

Currently, such questions are resolved in common law actions used to assert priority. The Code provides no mechanism for a prior secured party to assert its rights against buyers of collateral subject to its security interest, or for junior creditors who first exercised rights to the collateral. The traditional non-Code actions are replevin (or its equivalent)\(^5\) and conversion. The Code attempts no regulation of these remedies or their use in enforcing prior security interests.

Replevin and conversion differ fundamentally in character and implications. Replevin enables the creditor to gain possession of the property. This power accomplishes the creditor's first step in pursuing its bargained-for rights to transform its property interest into money in order to satisfy the secured obligation.\(^6\) Conversion, in contrast, enables the creditor to recover money damages in a forced sale of the property. It provides the creditor with the equivalent of a completed foreclosure\(^7\) so that the creditor is able to realize and apply the full value of the collateral against the secured obligation. Hence, no need to resort to Article 9 remedies exists. In effect, a secured party who prevails in a conversion action obtains a third source of recovery for its debt in addition to the debtor and the collateral: the personal liability of a third party.

While courts frequently resolve secured parties' claims of conversion, they operate without parameters to ensure that the elements of conversion further the policies underlying Article 9. Conversion is generally viewed as a tort protecting possessory rights to personal property, yet it developed as a legal remedy for serious interference with ownership rights.\(^8\) Attempts to distill the


\(^6\) See infra text accompanying notes 97-101.

\(^7\) See infra text accompanying notes 90-94.

\(^8\) See infra text accompanying notes 137-53 (reviewing the historical development
essential elements of a conversion action identify as the central inquiry the determination of whether justice requires a forced sale of the property to the converter.\textsuperscript{9} Little has been written about when interference with a security interest is serious enough that justice compels such a forced sale.

An analysis of when justice should compel the forced sale of property in order to benefit a secured creditor demonstrates the lack of a consistently applied conceptual framework governing interests in personal property. Secured parties’ rights, particularly those dependent on priority, are based on concepts of constructive notice relating to Article 9’s filing system. Conversion is based upon a framework that establishes rights in property by possession. The rights of transferees may be governed by laws grounded in conceptual frameworks that focus on neither Article 9 constructive notice nor possession.

An examination of the justice inquiry, in light of the insights provided by an understanding of the divergent legal frameworks for personal property, suggests modifications to the tort of conversion as applied to security interests. Such modifications not only facilitate just results, but also significantly clarify the rights of secured parties and transferees of collateral. Applying the insights to the tort of conversion facilitates better understanding and development of its doctrines.

II. IMPACT OF LEGAL CLASSIFICATION

The simple act of classifying a particular body of law profoundly affects analysis of its principles and development of its doctrines. Professor Dan B. Dobbs illustrates this point by observing that in the twenty years between the first and second editions of his treatise on remedies, the literature of remedies matured to “become an accepted and important separate field of study”\textsuperscript{10} rather than “merely adjunct or subsidiary points”\textsuperscript{11} in substantive law fields. The contrast between treatment as subsidiary points and treatment as an independent field of study is an equally valid distinction for any body of law that achieves widely recognized status as a legitimate classification of law. However, that distinction has a negative corollary. Classification that disengages a rule of law from another body of law to which it frequently applies

\textsuperscript{9} See infra notes 186-89 and accompanying text (outlining the elements of conversion listed in RESTATEMENT (SECOND) OF TORTS § 222A).
\textsuperscript{10} 1 DAN B. DOBBS, DOBBS LAW OF REMEDIES: DAMAGES—EQUITY—RESTITUTION ix (2d ed. 1993).
\textsuperscript{11} Id.
impedes development and study in harmony with policies unique to the other context.\textsuperscript{12}

Because classifications are imperfect, rules of law classified with one body of law often may be used to resolve issues arising in transactions generally governed by another body of law. Because those rules developed in an environment invigorated by different policies, this cross-over creates the potential both for new insights and for results discordant with fundamental policies. Whether the cross-over benefits or detracts from the other body of law may simply be a function of time. In the short term, the conflicting policies likely impact more significantly. As the rule of law is applied with greater frequency, courts, practitioners, and scholars focus on the issues raised by the interaction, and the fresh perspectives likely exert a beneficial influence.

A. Classifications of Property Law

Well-recognized classifications of law may result as much from historical accident as from careful logical philosophical distinctions. Property law represents one of the broad classifications of substantive law. Property subdivides readily into personal property\textsuperscript{13} and real property. This subdivision originated in the way legal issues affecting these types of property were resolved. Real property was so designated because interests in it were enforced by actions in rem, in which the property itself was recovered. Personal property was so named because interests in it were enforced by actions in personam, in which damages rather than the property were recovered.\textsuperscript{14} In part because legal actions involving these two types of property were based on very different common law forms of action, the two bodies of law followed different courses of development. Tracing the divergent developments and postulating reasons for the different courses taken by real property and personal property law are beyond the scope of this article. Some effects of this divergent growth, however, underlie the issues to be examined.

\textsuperscript{12} Dobbs alludes to a similar problem, albeit not in such pejorative terms, in his observation that "substance and remedy are not always so separable; because remedy seeks to execute the substantive policy . . . ." \textit{Id.} at x.

\textsuperscript{13} "Personal property" is used here in the traditional sense, rather than as used by Radin to refer to its relationship to personhood. \textit{See} Margaret J. Radin, \textit{Property and Personhood}, 34 \textit{STAN. L. REV.} 957 (1982).

\textsuperscript{14} \textit{See} RAY A. BROWN, \textit{THE LAW OF PERSONAL PROPERTY} § 1.7 (Walter B. Raushenbush ed., 3d ed. 1975).
1. **Real and Personal Property Law**

In addition to the old forms of action, the characteristics of mobility and relative value distinguish the two types of property. Real property is immovable, and each parcel or interest generally has significant value. Thus, systems were devised readily to keep public records of real property interests in order to apprise third parties of those interests. Such recording systems became a central organizing theme for much of real property law. Rules governing real property developed as a recognized body of law which was further divided into several subcategories relating to the nature of the transaction, such as landlord-tenant, real estate finance, and real estate sales.\(^\text{15}\)

In contrast, personal property is mobile,\(^\text{16}\) and many items have only modest value. These characteristics militated against development of similar recording systems for most personal property. Rather, historically, a presumption that possession was ownership primarily determined knowledge of valid interests in personal property.\(^\text{17}\) Possession failed to provide the unifying theme for personal property which recording systems provided for real property. The rules governing personal property developed as diverse bodies of law relating to particular transactions. Much of what could otherwise be classified as personal property law became known as the law of sales; the law of liens, pledges and chattel mortgages; the law of bailments; the law of bills and notes; or the law of fixtures. Today a major portion of the law governing personal property is classified as commercial law, governed in the first instance by the various Articles of the Uniform Commercial Code.\(^\text{18}\)

2. **Possession and Personal Property**

The distinguishing characteristics of being movable or intangible subclassify personal property as tangible and intangible property. The historical names for these sub-categories explain key legal principles

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\(^{15}\) See generally id.

\(^{16}\) Mobility as used here includes not only the ability to physically move tangible personal property, but also the ease of transferring ownership and control of tangible and intangible personal property. Of course, knowledge of the financing statement does provide some protection as the creditor may make further inquiries before extending any credit.


\(^{18}\) E.g., U.C.C. § 9-102 (applying to all secured transactions involving personal property).
governing them. Tangible personal property (also known as chattels) was known as choses in possession, while intangible personal property was known as choses in action. Rights in chattels were acquired and enforced by possession, while rights in intangibles were vindicated by legal action. These differences profoundly affected the development of laws governing personal property.

Possession, while not easily and clearly definable, provided a readily available and initially useful basis for determining interests in tangible personal property. Numerous legal rules were based upon the concept of possession. In medieval times, possession was ownership (at least against a wrongdoer), subject to defeat at law by the one improperly deprived of possession. Conversion, one of the in personam actions which distinguished personal from real property, relies heavily upon possession.

Although possession was a fundamental concept for the operative principles of much of the early personal property law, it also deterred development of the law. It formed a major barrier to the development of the law of secured transactions. Prior to the promulgation of Article 9, a myriad of security devices developed to avoid the requirement of possession by the secured party. The law of secured transactions under the Code to a large extent addresses issues that arise when the debtor, rather than the secured party, possesses the personal property collateral.

In our highly commercial society it is widely understood that one in possession of tangible property may be an owner, pledgee, lessee, consignee, common carrier, warehouseman, or bailee for some other purpose. The incidences of ownership have been divided into a large

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19 Brown, supra note 14, § 1.7.
20 Id.
21 See id. § 2.6.
22 See supra note 17.
23 See infra notes 139-46 and accompanying text.
24 See, e.g., Clow v. Woods, 5 Serg. & Rawle 275 (Pa. 1819); Twyne’s Case, 76 Eng. Rep. 809 (Star Ch. 1601).
25 See infra notes 82-96 and accompanying text; see also Douglas G. Baird & Thomas H. Jackson, Possession and Ownership: An Examination of the Scope of Article 9, 35 Stan. L. Rev. 175 (1983) (examining the treatment of ownership and possession of personal property and property interests not considered security interests); Steven Wechsler, Rights and Remedies of the Secured Party After an Unauthorized Transfer of Collateral: A Proposal for Balancing Competing Claims in Repossession, Resale, Proceeds, and Conversion Cases, 32 Buff. L. Rev. 373, 373-74 (1983) (discussing the impact of the legal development of non-possessory security).
number of separate rights and powers in addition to possession, the full bundle of which is probably not yet fully defined or definable. One of the most significant rights included in ownership of or title to property is the right to use and enjoyment. The present right to use and enjoyment of tangible personal property includes possession; the reversionary right does not.

Intangibles did not initially enjoy the benefits provided to tangible personalty by the concept of possession. Although with the legal fiction that certain choses in action became reified (represented by a writing that could be possessed and transferred by delivery), significant developments occurred in the law governing some intangible property. More significantly, because valuable intangibles often are not capable of possession, alternative legal concepts have been necessary to the development of law governing that property. Article 9, by establishing alternatives to possession, provided significant integration of rules governing both tangible and intangible property relevant to security interests. Alternatives to possession which developed, however, were not necessarily integrated into other rules of law governing the same personal property.

While possession is still an important concept relating to tangible personal property, it no longer plays the central role it once played. Certainly ownership and possession are no longer essentially related. Article 9 has been a significant force in the diminution of the role of possession. Recognizing this simple fact about possession and personal property is critical in evaluating laws derived from and still significantly based upon the “possession equals ownership” concept.

B. Classification of Conversion

Legal rules affecting personal property that were not specific to a type of transaction or a type of personal property and thus classified as a separate body of law became legal orphans. They were grouped with other bodies of law with which they shared some substantive characteristics. The personal property remedy of conversion suffered this fate. It relates to tort law because it generally involves non-consensual transactions. Historically, conversion was classified as tort law in part because separate coverage of personal property was dropped from the law school curriculum.27

26 That body of law became classified as law of bills and notes based in part upon the nature of the personal property and in part upon the type of transaction involved.
However, the remedy of conversion is a somewhat ill-fitting appendage to the law of torts. Because conversion has its only impact on issues of personal property, it has become to a significant extent a mere backwater of tort law.\(^\text{28}\) Warren described conversion as a “no-man’s”\(^\text{29}\) land that property professors wanted to give to tort professors and tort professors wanted to leave to property professors.\(^\text{30}\) Prosser’s 1957 assessment that conversion was the “forgotten tort”\(^\text{31}\) because most of the little that had been written about it was “quite perfunctory”\(^\text{32}\) still holds. At the same time, conversion commands little attention and interest in the bodies of law governing personal property to which it applies and upon which it draws. It has become in effect a second-class citizen in both tort law and the bodies of law governing personal property.

Should conversion be grouped with tort law because it provides a legal remedy for intentional interference with rights to personal property? Or should it be considered property law because it is the legal remedy for resolving conflicting claims to personal property? The law of conversion combines remedial and substantive elements. A remedy is generally assumed to simply answer the questions: what relief is to be given and what measure is to be used?\(^\text{33}\) The essence of conversion is the remedy—\(^\text{34}\)the market value of the converted property and the vesting of title in the converter. Vesting of title is very much a property dispute resolution concept. The substantive law rubric applies because conversion resolves whether the party has a right to be remedied. Its substantive elements, the questions of whether the plaintiff had the right to immediate possession necessary to maintain the action and whether the defendant had inappropriately interfered with that right, are questions often answered by substantive law governing personal property.\(^\text{35}\)

The effects of classification problems are evident in resolving personal property disputes. Because conversion is treated as part of tort law even though it applies to various separate bodies of law governing personal property, its rules have not developed to relate to the particular type of personal property transaction to which they will be applied.

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\(^\text{28}\) See, e.g., id.

\(^\text{29}\) \(\text{WARREN, supra note 17, at Foreword.}\)

\(^\text{30}\) \(\text{Id.}\)

\(^\text{31}\) Prosser, \(\text{supra note 27, at 168.}\)

\(^\text{32}\) \(\text{Id.}\)

\(^\text{33}\) \(\text{See DOBBS, supra note 10, at 2.}\)

\(^\text{34}\) \(\text{WARREN, supra note 17, at 3.}\)

\(^\text{35}\) \(\text{See infra notes 172-75 and accompanying text.}\)
III. THE LEGAL FRAMEWORKS

Understanding the interaction of Article 9 of the Uniform Commercial Code and the tort of conversion requires an exploration of the significant historical roots and relevant general concepts that underlie each of these bodies of law. In such an inquiry, comparisons between the laws governing personal property and real property law, particularly concerning which body of law has a more unified character, are occasionally instructive.

A. Framework of Article 9

A creditor obtains security as leverage for payment because it deems the right to sue the debtor for payment or performance insufficient protection in the event of default. Security provides the secured creditor with specific property against which it can enforce the unpaid or unperformed obligations. Article 9's policies and rules focus on obtaining, perfecting, and enforcing these interests in personal property security.

Article 9 consolidated several legal schemes that had developed to govern personal property security when failure to take possession had become a barrier to creditors. Its drafters also expanded the role of personal property as collateral by opting for several sweeping rules benefiting secured creditors with priority. The 1972 revisions to Article 9 continued this deference to the prior creditor's interests. Many of these expansive rights for secured creditors impact the rights of claimants of property subject to a security interest. A review of pertinent rules and policies establishes the relevant legal framework for personal property with which the remedy of conversion interacts. The Article 9 approach frequently diverges from the legal principles governing real property security.

1. Prior Creditor's Monopoly Power

Under the Code, a creditor can obtain a security interest in virtually all personal property its debtor now owns or will acquire in the future to

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35 A creditor's rights against the debtor on the obligation are governed by the body or bodies of law specific to the obligation. For example, Article 2 of the U.C.C. governs if the security is for an unpaid sales price, Article 3 governs collection of a secured negotiable instrument, and common law principles govern the collection of obligations not represented by negotiable instruments.

37 See generally 1 Grant Gilmore, Security Interests in Personal Property §§ 1.1-8.8 (1965) (reviewing the historical origins and growth of various personal property security devices before the Code).

38 U.C.C. § 9-204 permits all after-acquired personal property of the debtor to serve
secure pre-existing indebtedness, new value, and obligations which arise in the future.\textsuperscript{39} The Article 9 priority rules for future advances expand their utility.\textsuperscript{40} Buyers are subject to future advances made or committed to before the earlier of: (1) the date the secured party obtains knowledge of the purchase, or (2) 45 days after the purchase.\textsuperscript{41} A lien creditor is subject to future advances made or committed to before the later of: (1) 45 days after the date it becomes a lien creditor, or (2) the date the secured party obtains knowledge of the lien.\textsuperscript{42} Secured creditors are generally subject to all future advances.\textsuperscript{43}

The breadth of these priority rules depends on what constitutes a future advance. The Code does not define future advance explicitly, but its priority structure supports a very broad reading. Priority generally dates from the earlier of filing or perfection.\textsuperscript{44} Even though an advance must be made or committed to achieve perfection,\textsuperscript{45} an earlier filing may establish the date for priority.\textsuperscript{46} Thus, even without the priority accorded future advances by section 9-312(7),\textsuperscript{47} any advance should have priority from the time of filing as collateral for prior indebtedness, unless the collateral is consumer goods, which can have only a limited role as after-acquired collateral.

\textsuperscript{39} U.C.C. § 9-204(3) permits future advances to be secured by collateral transferred under a prior security agreement.


\textsuperscript{41} U.C.C. § 9-307(3).

\textsuperscript{42} \textit{Id.} § 9-301(4).

\textsuperscript{43} \textit{Id.} § 9-312(7) provides in pertinent part:

\textit{If future advances are made while a security interest is perfected by filing, or the taking of possession or under Section 8-312 on securities, the security interest has the same priority for the purposes of subsection (5) with respect to the future advances as it does with respect to the first advance.}

\textit{Id.} The three methods of perfection covered by the rule—filing, possession and under § 8-312—include the vast majority of security interests.

\textsuperscript{44} \textit{Id.} § 9-312(5).

\textsuperscript{45} \textit{Id.} § 9-303 provides that perfection occurs when the security interest has attached and when the step required by § 9-302 for perfection (filing in this example) has occurred. U.C.C. § 9-203 has three requirements for attachment: the debtor must have rights in the collateral, the creditor must have given value, and a security agreement must exist.

\textsuperscript{46} The drafters clearly understood this priority to cover situations in which the financing statement was on file for an extended period of time before the elements of attachment were met. \textit{A Practical Approach to the Uniform Commercial Code for the Practicing Lawyer}, 19 Bus. Law 5, 52 (1963) (transcript of an exchange on the subject between Peter Coogan and Homer Kripke).

\textsuperscript{47} Section 9-312(7) appears to have been added to the Code in 1972 to resolve
questions that had arisen under the 1962 Code regarding priority to future advances. See generally William C. Hillman, Documenting Secured Transactions, Practicing Law Institute §§ 6-3 to 6-6 (1991 & 1993 Supp.).

Courts have frequently limited a secured creditor's ability to rely on its collateral to secure future advances when issues regarding the breadth of the future advance concept have arisen. See, e.g., Dick Warner Cargo Handling Corp. v. Aetna Business Credit, Inc., 746 F.2d 126, 130 (2d Cir. 1984) (stating that future advances have to be placed at the disposal of the borrower and therefore do not include advances of overdue interest or preservation expenses); Texas Kenworth Co. v. First Nat'l Bank, 564 P.2d 222, 225 (Okla. 1977) (holding that the contract language "all other indebtedness from buyer to [secured party]" was not specific enough to secure future indebtedness). See generally Hillman, supra note 47, §§ 6-3 to 6-4 (discussing the "relatedness rule," which limits the effect of future advance clauses not related to the nature of the original security agreement); David G. Carlson & Paul M. Shupack, Judicial Lien Priorities Under Article 9 of the Uniform Commercial Code: Part I, 5 Cardozo L. Rev. 287, 352-59 (1984) (discussing the priority treatment of increases in secured debt); Duncans, supra note 40, § 2.05[2][c]; Julian B. McDonnell, The Priority of Future Advances and Other Future Obligations Under the Revised Article 9, in 1C Bender's U.C.C. Serv. (MB) ¶ 21B.02[6][a], [b] (Apr. 1986); Steve H. Nickles, A Localized Treatise on Secured Transactions—Part II: Creating Security Interests, 34 Ark. L. Rev. 559, 652-73 (1981) (discussing the security lien on collateral as it is sold, exchanged, or otherwise disposed of). Part of the support for this narrower construction comes from Grant Gilmore, who expresses support for pre-Code limitations to future advances. 2 Gilmore, supra note 37, §§ 35.2-35.4.

Another important issue concerns whether a future advance clause must be contained in the original security agreement. U.C.C. § 9-312(7) cmt. 7, ex. 5 states in pertinent part, "The same result would be reached even though A's April 1 advance was not under the original security agreement, but was under a new security agreement under A's same financing statement or during the continuation of A's possession." Compare Coin-O-Matic Serv. Co. v. Rhode Island Hosp. Trust Co., 3 U.C.C. Rep. Serv. (Callaghan) 1112, 1120 (R.I. Super. Ct. 1966) (stating that refinancing with new documents was not enough to claim earlier priority) with State Bank of Young America v. Vidmar Iron Works, Inc., 292 N.W.2d 244, 248-49 (Minn. 1980) (stating that original loan was paid at time second loan was renewed yet all future advances continued to be secured). Coin-O-Matic has been widely criticized. See, e.g., In re Will of Gruder, 392 N.Y.S.2d 203, 206 (N.Y. Ct. 1977); Hillman, supra note 47, § 6-2; James J. White & Robert S. Summers, Uniform Commercial Code 1135 (3d ed. 1988); Ronald DeKoven, Secured Transactions, 37 Bus. Law. 1011, 1026 (1982). It was also the subject of a proposed P.E.B. Commentary, which was ultimately decided to be unnecessary. Permanent Editorial Board for the Uniform Commercial Code Review Committee For Article 9 of the Uniform Commercial Code, Final Report, 226 (1971); see also Hillman et al., supra note 2, ¶ 21.01[2] (explaining
parsimony, the future advance concept retains considerable vitality and power.49

The after-acquired property and future advance provisions place a perfected secured creditor with priority in a very advantageous position. That creditor obtains a statutory situational monopoly as against creditors.50 The only protections for subsequent secured parties are the limited circumstances where the Code gives priority over the secured party with the prior filing.51 Lien creditors fare only slightly better. They can limit the magnitude of the security interest to which they will be subject, but they have no way of ascertaining it at the time they become lien creditors.52 Buyers are the only third parties with significant protection under the Code. If they do not qualify to take the property free of the security interest,53 buyers can limit the security interest to the amount outstanding or committed by giving the creditor notice of the purchase.54

In consequence of these future advance rules, the collateral becomes almost useless to junior creditors and something to be acquired cautiously for buyers not in the ordinary course of business. A party acquiring an interest in personal property subject to a security interest needs to assume priority will be accorded to all advances made by the prior creditor.

Personal property security differs significantly from real property security in the operation of these rules. Mortgagees of real property cannot acquire after-acquired real property, except fixtures.55 The advances for which a mortgagee has priority must be described in the mortgage and thus must have been made, committed to, or contemplated at the time the mortgage was recorded.56

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49 A secured creditor seeking maximum protection for future advances should be able to achieve that goal by careful drafting. Reciting that a note is secured by a particular security agreement should remove the obstacles raised by the narrower court decisions. E.g., Onawa State Bank v. Simpson (In re Estate of Simpson), 403 N.W.2d 791, 793-94 (Iowa 1987) (holding no securing of future advances existed where neither a note nor mortgage referred to the prior agreement); accord In re Airwest Int'l, 70 B.R. 914 (Bankr. D. Haw. 1987) (looking to the actual intent of the parties).


51 See Hakes, supra note 50, at 352, 383-84.

52 See U.C.C. § 9-301(4).

53 See id. §§ 9-306(2), 9-307(1), (2).

54 See id. § 9-307(3).

55 The recording system governing real property precludes such interests. Specific property must be described in a conveyance of real property. Any attempted conveyance before the transferor has a recorded interest creates a "wild deed."

56 See GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW §§
2. Doubling Security on Transfer

Despite the disincentives to acquire an interest in encumbered collateral, the Code facilitates the voluntary or involuntary transfer of the debtor's remaining rights, subject to the security interest regardless of whether the security agreement prohibits such transfer. The provision creating that power confirms rejection of the title theory of security interests by affirming that the debtor retains rights it can alienate. The elimination of the title concept is consistent with the Code's policy of encouraging commerce.

Article 9 attempts to establish workable rules for highly mobile collateral which facilitate secured lending without undue interference with transferability and mobility—an ambitious undertaking. In order to accomplish this, the Code creates expansive rights for the secured creditor if the collateral is transferred. Transfer extinguishes the security interest only in limited circumstances. Subsection 9-306(2) provides that the security interest continues notwithstanding sale, exchange, or other disposition of the collateral, unless the secured party consents or Article 9 provides to the contrary. The exceptions further the negotiability of certain types of collateral or support the Code's policy requiring perfection, but leave much collateral in the hands of third parties subject to the prior secured creditor's claim.

Subsection 9-306(2) further establishes the Code's scheme for personal property security by continuing the security interest in identifiable proceeds of the collateral. The provisions governing security interests in proceeds were clarified and liberalized in the 1972 version of

2.4, 12.7-8 (2d ed. 1985).

57 U.C.C. § 9-311.
58 Id. § 9-311 cmts. 1, 2.
59 See id. § 1-102(2)(b).
60 The most significant exception is U.C.C. § 9-307(1), which frees collateral from a security interest created by the seller if it is purchased by a buyer in the ordinary course of business (defined in U.C.C. § 1-201(9)) even if the buyer has knowledge of the security interest. Article 9 also protects: consumers purchasing from another consumer if there was no filing, id. § 9-307(2); certain purchasers of chattel paper, id. § 9-308; certain persons obtaining negotiable collateral, id. § 9-309; buyers at the foreclosure sale of a senior secured party, id. § 9-504(4); and persons acquiring rights if the security interest was unperfected, id. § 9-301. The limitations on priority for future advances in sections 9-307(3) and 9-301(4) also, in effect, limit the continuation of the security interest in transferred collateral.
61 U.C.C. § 9-306(1) defines proceeds as: "whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds."
the Code to eliminate any reading requiring express language in the
security agreement to achieve this claim to proceeds. The only
requirement for the security interest to attach to proceeds is that they be
identifiable. Courts have provided a tracing rule for the most common
challenge in identifying proceeds: proceeds commingled in a deposit
account.

The Code provisions continuing the security interest upon transfer and
providing a security interest in proceeds produce a variety of results
depending on the circumstances of transfer. The creditor's security
doubles if the proceeds are identifiable and the transferee failed to qualify
for an exception. The creditor's security disappears if the proceeds cannot
be identified and one of the exceptions to continuation upon transfer
applies. The creditor may retain only a claim to proceeds or only a claim
to the transferred collateral. The ultimate goal, of course, is to provide the
secured creditor with its bargained-for single recovery against the
collateral. This approach, resulting in collateral upon transfer producing
anywhere from nothing to double the security, may be a rational
accommodation of the mobility of personal property.

The rules governing security interests on transfer of collateral
significantly distinguish personal property security from real property
security. The claim of the real property mortgagee continues in trans-
ferrred property unless the mortgage is satisfied. A mortgagee has no
claim to proceeds of a sale of real property. Claims to rents or other
revenues produced by real property are treated as separate security

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U.L.A. 440 (1981). The 1962 version stated: "In describing collateral, the word 'proceeds'
is sufficient without further description to cover proceeds of any character." U.C.C. § 9-
203(b) (1962).

Subsection 9-203(3) now compliments § 9-306(2) so that a security interest attaches
automatically to proceeds by providing in pertinent part, "Unless otherwise agreed a
security agreement gives the secured party the rights to proceeds provided by Section 9-
306." U.C.C. § 9-203(3).

63 U.C.C. § 9-306(4).

64 E.g., Nation-Wide Check Corp. v. Forest Hills Dists., Inc., 692 F.2d 214, 216
(1st Cir. 1982); In re Intermountain Porta Storage, Inc., 59 B.R. 793, 796 (Bankr. D.
Colo. 1986), aff'd, 74 B.R. 1011 (D. Colo. 1987); Universal C.I.T. Credit Corp. v.
Sons, Inc. v. Sullivan Equip., Inc., 431 N.E.2d 370, 372-73 (Ill. 1982); General Motors
1988).

65 See NELSON & WHITMAN, supra note 56, §§ 5.1, 5.3, 7.2.

66 See id. § 4.12 (explaining that condemnation is an exception because it defeats the
mortgage but does not have priority).
requiring separate actions by the mortgagee to perfect its claims against competing claimants.⁶⁷

3. **Bifurcated Concept of a Debtor**

For several reasons, the Code defines debtor to include both the obligor on the secured obligation and the owner of the collateral for provisions relating to collateral.⁶⁸ This definition includes two important groups with interests in a secured transaction: guarantors giving the secured party collateral rather than undertaking a personal obligation; and subsequent transferees of the collateral, if the security interest has not been extinguished. Transferees classified as debtors include those purchasing at an execution or a foreclosure sale by a junior creditor and buyers not in the ordinary course of business.⁶⁹ The term debtor does not include levying creditors or junior secured parties because they are not owners of the collateral.⁷⁰

The bifurcated concept of debtor resolves the issue of what rights and obligations transferees have upon acquiring collateral subject to a security interest. Classification as a debtor gives transferees the rights of the debtor under the Code without creating liability for the secured obligation. This result is consistent with the concept of taking the property subject to the security interest without assuming the obligation. The secured creditor has no recourse against them on the debt, only a non-recourse right to the collateral. The distinction between taking property subject to an obligation and assuming the obligation is common in real property transactions where, absent express agreement to assume the mortgage obligation, the purchaser of property also simply takes it subject to a mortgage.⁷¹

4. **Irrelevant Knowledge, Inadequate Notice**

Constructive knowledge is the basic priority principle under Article 9.⁷² Actual knowledge of a prior interest in personal property is general-

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⁶⁷ See id. §§ 4.20, 4.23, 4.35 (stating that some right to rents from leases executed before the mortgage was recorded exists if the jurisdiction follows the title theory of mortgages).

⁶⁸ U.C.C. § 9-105(1)(d).

⁶⁹ Not all buyers not in the ordinary course of business will be owners of the collateral subject to a security interest. See supra note 60 and accompanying text.

⁷⁰ See Frisch, supra note 4, at 175 n.126.

⁷¹ See NELSON & WHITMAN, supra note 56, §§ 5.3, 5.4, 5.9, 5.10.

⁷² U.C.C. § 9-312(5) is the basic priority rule; it grants priority to the first to file or
ly irrelevant to priority. The Code's narrow exceptions are inapplicable to the vast majority of priority disputes affecting security interests.

Although constructive notice plays a central role in Article 9, priority sometimes exists without meaningful notice. Article 9 starts from the presumption that security interests are enforceable against third parties without any filing, recording, or other acts providing notoriety. The exceptions, however, virtually eliminate this presumption. More important are the significant number of situations contemplated by the Code in which one searching for evidence of the security interest either will be unable to find it or will be able to find it only after ascertaining the history of the collateral. Furthermore, filed financing statements perfect. Id.

73 See U.C.C. § 9-312 cmt. 3; Dan Coenen et al., Special Project, The Priority Rules of Article Nine, 62 CORNELL L. REV. 834, 848 (1977). But see HILLMAN ET AL., supra note 2, ¶ 24.04 (stating that unjust enrichment may subject a perfected creditor to a security interest of which it has knowledge); Coenen, supra, at 857 (noting that estoppel may cause a secured creditor with knowledge to lose priority).

74 U.C.C. § 9-301(4) (some future advances made with knowledge of property interests of lien creditors and transferees in bulk fail to obtain priority); id. § 9-307(1) (knowledge that the purchase violates a security interest precludes buyer in the ordinary course status as defined in U.C.C. § 1-201(9)); id. § 9-307(2) (knowledge of a security interest in consumer goods); id. § 9-307(3) (future advances made with knowledge of property interests of buyers not in the ordinary course of business fail to obtain priority); id. § 9-308(a) (knowledge of the prior interest precludes purchasers of chattel paper taking possession from achieving priority over certain prior secured parties); id. § 9-309 (certain knowledge precludes priority as a holder in due course of an instrument, a holder to whom a document of title has been negotiated, or a bona fide purchaser of a security); id. § 9-314(3) (knowledge of an earlier security interest in an accession precludes priority for a subsequent claimant of the whole chattel); id. § 9-401(2) (improperly filed financing statement effective against creditor with knowledge of its content).

75 U.C.C. § 9-201 provides that a security interest is enforceable against the debtor and third parties, unless otherwise provided in the Code. Under U.C.C. § 9-203, a security interest becomes enforceable when it attaches.

76 E.g., U.C.C. § 9-301 (exceptions include lien creditors, other secured parties, and buyers not in the ordinary course if the security interest is not perfected); id. § 9-307(1) (exception for buyers in the ordinary course of business).

77 Id. § 9-302(1)(d) (no filing necessary to perfect a purchase money security interest in consumer goods); id. § 9-302(4) (no filing necessary to perfect security interest in certain other collateral for short periods of time); id. § 9-314(1), (3) (unperfected security interest in accessions before they are affixed obtains priority over prior interests in goods to which affixed); id. § 9-403(1), (4) (despite the filing officer's obligation to file and index financing statements, lost, misfiled or misindexed financing statements still perfect a security interest). See generally Uniform Commercial Code Comm. of the Bus. Law Section of the St. Bar of California, Report Regarding Legal Opinions in Personal Property Secured Transactions, 44 BUS. LAW. 791, 795 (1989) (providing general
remain effective despite changes in the facts which determined where to file, requiring a person to know the relevant history to obtain constructive notice from the filing. This knowledge is available only from the debtor, who may not remember or may purposely withhold information to its advantage.

Knowledge and notice play significantly different roles in real estate transactions than in Article 9 transactions. Actual knowledge of an interest in real estate generally subjects the interest of the party with knowledge to the other interest. Constructive notice of real estate interests is created by recording in the real estate records, and the location of the appropriate records is easy to determine. Interests in real property typically must be recorded in those public records to be enforceable against third parties.

The rules governing knowledge and notice described in the preceding paragraphs make it far more likely with personal property collateral than with real estate collateral that a person will claim an interest in collateral in a good faith, albeit erroneous, belief that no prior interest in the collateral exists.

5. Code Remedies

An Article 9 security interest is not title to personal property. Rather, it is an interest in the nature of a lien. Part 5 of Article 9 creates

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observations of personal property law including perfection) [hereinafter Bar Committee Report]; Gerald T. McLaughlin, "Seek But You May Not Find": Non-UCC Recorded, Unrecorded and Hidden Security Interests Under Article 9 of the Uniform Commercial Code, 53 FORDHAM L. REV. 953 (1985) (discussing Article 9 of the Code and security interests which may be overlooked when determining priority).

78 U.C.C. § 9-103 (financing statements remain effective for four months after the facts change, determining the state law governing perfection); id. § 9-315 (security interest in part of the collateral extends to the whole upon commingling without further filing); id. § 9-401 (refiling generally unnecessary when the facts change, determining location of filing within a state); id. § 9-402(7) (transfer of collateral does not necessitate refiling and financing statement remains effective for collateral acquired within four months after any change in name, or corporate structure, unless change renders filing seriously misleading); id. § 9-402(8) (not seriously misleading standard validates financing statements containing errors); see also David Frisch, UCC Section 9-315: A Historical and Modern Perspective, 70 MINN. L. REV. 1 (1985).

79 Of course, knowledge of the existence of a filed financing statement does provide some protection as the secured creditor may make further inquiries before extending any credit to the debtor.

80 See NELSON & WHITMAN, supra note 56, § 7.13.

81 Id.

82 Any attempt to retain title to secure obligations is treated merely as a security interest. U.C.C. §§ 1-201(37), 2-401, 9-102.
and describes rights constituting a security interest. The rights are generally exercisable only upon a debtor's default,\(^3\) which is defined by the parties and not by the Code.\(^4\) The Code contemplates four types of rights: those established by the Code, those expressly permitted by the Code if included in the security agreement,\(^5\) those provided in the security agreement if they do not violate policies of the Code,\(^6\) and those provided by other law.\(^7\) Subject to minor Code limitations,\(^8\) the creditor is free to choose among these rights.\(^9\)

Most important to the present inquiry are the rights established by the Code and those provided by other law. The Code establishes a self-help right to repossess the collateral, provided no breach of the peace is committed.\(^10\) The only essential non-Code remedy for a secured party against a debtor is a mechanism for repossession if self-help fails.\(^11\)

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\(^3\) E.g., \text{id.} § 9-501(1) (introductory clause).

\(^4\) Courts will probably hold nonpayment of the secured obligation to be a default if no default provision was included in the security agreement. See Whisenhunt v. Allen Parker Co., 168 S.E.2d 827, 830 (Ga. Ct. App. 1969).

\(^5\) The Code expressly sanctions the following rights, if provided for by agreement: the right to collections prior to default, \text{U.C.C.} § 9-502; the right to recover reasonable attorneys' fees and legal expenses incurred in the enforcement of the security interest as part of the secured claim, \text{id.} §§ 9-504(1)(a), 9-506; the right to a deficiency with a sale of accounts or chattel paper, \text{id.} §§ 9-502(2), 9-504(2); and the right to require the debtor to assemble the collateral and make it available to the creditor at a reasonably convenient place, \text{id.} § 9-503.

\(^6\) \text{U.C.C.} § 9-501(3) provides in pertinent part: "To the extent they give rights to the debtor and impose duties on the secured party, the rules stated in the subsections referred to below may not be waived or varied except as provided with respect to compulsory disposition of collateral . . . and with respect to redemption of collateral . . . ." \text{Id.} Section 9-501(3) then refers to \text{U.C.C.} §§ 9-502(2), 9-504(2), (3), 9-505(1), 9-506, 9-507(1).

These contractually created remedies will have a limited affect on third parties. Certainly, they cannot be relied upon as a way to resolve disputes with a party not bound by the contract.

\(^7\) \text{U.C.C.} § 9-501(1) (stating that a secured party "may reduce his claim to judgment, foreclose or otherwise enforce the security interest by any available judicial procedure.").

\(^8\) \text{U.C.C.} § 9-505 precludes a creditor's access to strict foreclosure against consumer goods if 60% of the obligation has been paid by requiring resort to § 9-504 within 90 days of taking possession, unless the debtor waives the right in writing after default. That section also requires resort to § 9-504 if an appropriate party makes a timely objection to the creditor's strict foreclosure proposal. \text{Id.} If the secured party does not proceed in accordance with the provisions of Article 9, § 9-507 authorizes orders to dispose of or refrain from disposing of collateral.

\(^9\) \text{U.C.C.} § 9-501(1) provides that the rights and remedies are cumulative.

\(^10\) \text{Id.} § 9-503.

\(^11\) \text{U.C.C.} § 9-503 contemplates legal action if self-help is unavailable. This step requires the creditor to resort to the non-Code remedy of replevin or its equivalent.
Repossession simply starts the process of realizing the collateral's value in order to satisfy the secured debt. The Code provides three ways to realize the value: collect collateral involving rights to payment, retain the collateral in full satisfaction of the debt, or foreclose (sell, lease or otherwise dispose of the collateral). After applying foreclosure proceeds or collections, the Code permits the secured creditor to sue the debtor for any deficiency. The secured creditor limits this right by failing to proceed in accordance with its obligations under Article 9.

Finally, the Code contemplates the secured party's access to non-Code remedies. Absent the explicit reference to non-Code remedies in section 9-501, these remedies would be available under section 1-103 unless displaced by the Code. By making explicit reference, the drafters apparently tried to be as expansive as possible for the benefit of secured creditors, rather than simply contemplating other laws as gap fillers. This broad authorization is, at least in part, an attempt to permit Article 9 to change with changing needs of commerce. The Code specifically describes two non-Code remedies. The Official Comments to section Judicial foreclosure is another option. See Hillman et al., supra note 2, ¶ 25.01[2][a]. Conversion, which awards damages rather than possession, is another possible remedy.

Conversion, which awards damages rather than possession, is another possible remedy. See, e.g., C.I.T. Corp. v. Anwright Corp., 237 Cal. Rptr. 108, 110-12 (Cal. Ct. App. 1987); Wilmington Trust Co. v. Conner, 415 A.2d 773, 777 (Del. 1980); Bank Josephine v. Comm, 599 S.W.2d 773, 775 (Ky. Ct. App. 1980). The second approach presumes that the collateral was worth the amount of the debt; thus, no deficiency would have occurred if the creditor had proceeded appropriately. The creditor must rebut the presumption to obtain a deficiency. See, e.g., In re Nardone, 70 B.R. 1010, 1014 (Bankr. D. Mass. 1987); Connecticut Bank & Trust Co., N.A. v. Incendo, 540 A.2d 32, 37 (Conn. 1988); First Galesburg Nat'l Bank & Trust Co. v. Joannides, 469 N.E.2d 180, 183 (Ill. 1984); Mathias v. Hicks, 363 S.E.2d 914, 916 (S.C. Ct. App. 1987). Finally, the third approach is to reduce the creditor's deficiency judgment by the damages for non-compliance the debtor establishes under § 9-507(1). See, e.g., Gulf Homes, Inc. v. Goubbeaux, 664 P.2d 183, 186 (Ariz. 1983); Beneficial Fin. Co. v. Young, 612 P.2d 1357, 1359 (Okla. 1980).

Subsection 9-501(1) authorizes reducing a claim to judgment and foreclosing or enforcing the security interest by any available judicial procedure. This extra-Code foreclosure procedure may result in a lower priority under certain circumstances than would resort to the Code foreclosure procedure in § 9-504. Section 9-501(5) gives the lien
9-306 contain the only other specific reference to a non-Code remedy by providing that a secured party may in "an appropriate case maintain an action for conversion" against a transferee of the property. 98

The Code provides significant protections to all "debtors"100 and certain creditors. At any time prior to the completion of a foreclosure sale, debtors or junior creditors may redeem the collateral by paying the entire amount due with costs. 101 If the secured party is not complying with its Article 9 obligations, these parties under subsection 9-507(1) may bring a suit to enjoin the secured party or to order it to dispose of the property. If disposition has occurred, the right to damages for the secured party's failure to comply runs only in favor of debtors and persons "entitled to notification or whose interest has been made known to the secured party prior to the disposition." 102 Only the debtor has an express right to a conversion action in lieu of damages under section 9-507(1), if the secured party fails to foreclose within 90 days after it takes possession of consumer goods. 103

The secured creditor's duty to provide notice of a sale and proceed in good faith 104 provides some protection. However, the Code does not require the foreclosing creditor to notify junior or senior creditors, unless they requested notice. 105 Prior to the 1972 revisions to Article 9, notice was required to all secured creditors who had filed financing statements against the debtor in that state or of which the foreclosing creditor had knowledge. 106

100 See supra notes 68-71 and accompanying text.
101 U.C.C. § 9-506. The Article 9 Study Committee has recommended including lien creditors. Study Group Report, supra note 2, at 247.
102 U.C.C. § 9-507(1).
103 Id. § 9-505(1).
104 Id. § 9-504(3).
105 U.C.C. § 9-504(3) only requires notice to debtors and to any creditor who has requested notice. Whether a levying creditor has to provide notice to secured parties depends on the state's law governing judgment liens. See Frisch, supra note 4, at 152 n.14.
106 U.C.C. § 9-504(3) (1962) provided in pertinent part:
The rationale for reducing the notice requirement was to relieve the secured party from the burden of searching files and maintaining records of correspondence and telephone calls, because junior interests are fairly uncommon and equity for satisfaction of junior's claims is even less common. This rationale loses its force when a junior creditor forecloses. Why should a junior creditor be able to foreclose without notifying the senior creditor? Likewise, should there not be a duty to notify prospective buyers that the collateral continues to be subject to a senior security interest? The rationale that junior creditors are few in number is also suspect in light of the Code provisions creating junior creditors by establishing purchase money priority and the 1972 changes creating junior creditors out of purchase money creditors by changing priority rules as to proceeds of purchase money inventory collateral.

Buyers at foreclosure sales need assurances that they are receiving good title and are not vulnerable to defects in the sale in order for such sales to be facilitated. Buyers at a public sale obtain such protection if they are not in collusion with the secured party, any other bidders, or the one conducting the sale and if they are without knowledge of a defect in the sale. The sole remaining duty is to act in good faith. The Code comments disclaim any duty of the buyer to inquire into the sale. A buyer for value obtains all the debtor's rights to the collateral, the foreclosing creditor's security interest is discharged, and any lien or

[R]easonable notification of the time and place of any public sale or reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor, and except in the case of consumer goods to any other person who has a security interest in the collateral and who has duly filed a financing statement indexed in the name of the debtor in this state or who is known by the secured party to have a security interest in the collateral.

177 Uniform Commercial Code § 9-504 Official Reasons for 1972 Change, 3 U.L.A. 129 (1981) provides in pertinent part: "These burdens of searching the record and of checking the secured party's files were greater than the circumstances called for because as a practical matter there would seldom be a junior secured party who really had an interest needing protection in the case of a foreclosure sale." See also General Comment On The Approach Of The Review Committee For Article 9, § J-3 (1972 Official Text) (explaining the reason for the amendment to the § 9-504 notice requirements).

188 U.C.C. § 9-312(3) only gives a purchase money creditor in inventory purchase money priority over the original collateral and cash proceeds of cash sales. The proceeds of credit sales are subject to the claim of prior creditors. Id. § 9-312(5).

199 U.C.C. § 9-504(4).
200 Id. § 9-504(4)(a), (b).
211 Id. at cmt. 4.
security interest junior to the foreclosing security interest is dis-
charged.\textsuperscript{112}

The Code is silent regarding liens or security interests senior to the
foreclosing interest. Because such liens and security interests are not
extinguished by the foreclosure sale, the logical implication is that
foreclosure sales by junior secured parties are made subject to the senior
interests.\textsuperscript{113} This result is consistent with the common law derivation
principle governing interests in property—a subsequent taker can only
receive what its transferor had not already transferred.\textsuperscript{114}

6. \textit{Incomplete Rules on Meaning of Priority}

Against whom may an Article 9 security interest be enforced? The
Code authorizes enforcement once it has attached\textsuperscript{115} against the debtor
and third parties, unless otherwise provided.\textsuperscript{116} Numerous provisions in
the Code effectively immunize third parties from enforcement of the
security interest by granting them priority.\textsuperscript{117} Thus, enforcement against
third parties first requires the secured creditor to establish priority. Article
9 provides a relatively complete priority scheme for security interests.\textsuperscript{118}

The Code’s remedial scheme for a secured party to enforce its
security interest against its debtor is also quite complete. If the “debtor”

\textsuperscript{112} U.C.C. § 9-504(4).

\textsuperscript{113} U.C.C. § 9-306(2) also implies that the security interest continues because the
secured party did not consent to the disposition.

\textsuperscript{114} See, e.g., U.C.C. § 2-403 cmt.1; PEB Commentary No. 6 Section 9-301(1), 3B
U.L.A. 623 (1992); Barkley Clark, \textit{The Law of Secured Transactions Under the
Uniform Commercial Code \textsection 1.08[4]} (2d ed. 1988); Julian B. McDonnell, \textit{First to File
vs. Purchase Money: Competing Principles of Priority, in 1A Secured Transactions
Under the Uniform Commercial Code \textsection 7B.03[4]} (Peter Coogan et al., eds., 1991).

\textsuperscript{115} Attachment requires three elements: the debtor must agree to give a security
interest, the secured party must give value, and the debtor must have rights in the
collateral. U.C.C. § 9-203 (1).

\textsuperscript{116} Id. § 9-201.

\textsuperscript{117} E.g., id. § 9-301(1)(b) (stating that a lien creditor, including a trustee in
bankruptcy, prevails over an unperfected security interest); id. § 9-307(1) (stating that a
buyer in the ordinary course of business takes inventory free of any security interest
created by the seller); id. § 9-312(5) (stating that a secured party who has filed or
perfected earlier has preference over a subsequent secured party).

\textsuperscript{118} However, a number of potential priority contests are not clearly addressed by
Article 9: a security interest versus a non-possessory statutory or judicial lien; two
purchase money security interests in the same collateral; and two security interests in
the same collateral created by different debtors. These contests do not arise frequently and
the Code provides some basis for a rational resolution of the dispute.
is a third-party transferee of the collateral who did not take free of the security interest, the results regarding the collateral should not change. Although such debtors do not have monetary obligations to the secured party because they have not assumed the debt or obligations under the security agreement, they are subject to all property rights it created in the collateral. The following questions should be answered the same for a debtor transferee as for the original debtor. Can the secured creditor repossess the collateral and pursue its Article 9 remedies? Does sale or encumbrance of the collateral trigger rights of the secured party? Does the secured party have a security interest in the proceeds in its hands?

Article 9 fails, however, to provide any rules governing a secured party’s rights if the collateral is in the control of a third-party transferee who does not qualify as a debtor, such as another secured party or a lien creditor. Can the secured party vacate a levy? Does that depend on whether default occurred before or after the levy? If the levy is vacated, what rights does the levying creditor retain? Can a junior secured party repossess from a senior secured party? Can a senior secured party repossess from a junior secured party? Article 9 does not set forth the meaning of priority in these circumstances.

If the party having priority conducts a foreclosure sale under the Code, the buyer takes free of all subordinate security interests, liens and other interests, and the foreclosing creditor has first claim to the

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119 See U.C.C. § 9-112; HILLMAN ET AL., supra note 2, ¶ 25.01[2][b].
120 See U.C.C. § 9-501 (providing any judicial remedy, including replevin, upon default).
121 In the case of third-party buyers, this could include the unpaid purchase price from the buyer’s acquisition of the property because it constitutes proceeds. See HILLMAN ET AL., supra note 2, § 25.01[4][b].
122 See Frisch, supra note 4, at 152-54.
123 See id. at 183-87.
124 U.C.C. § 9-503 gives any secured party a right to possession upon default. Courts, however, are virtually unanimous in favor of the senior secured party. See HILLMAN ET AL., supra note 2, ¶ 25.02[2].
125 If the debtor is in default under both the junior’s security agreement and the senior’s security agreement, the Code provides no direct answer as to whether a senior can repossess from a junior secured party. U.C.C. § 9-503 appears to authorize this and such a right appears to be a minimum meaning of priority. See HILLMAN ET AL., supra note 2, ¶ 25.02[2][a]; Cynthia Starnes, U.C.C. Section 9-504 Sales by Junior Secured Parties: Is a Senior Party Entitled to Notice and Proceeds?, 52 U. PIT. L. REv. 563, 582-83 (1991).
126 See Frisch, supra note 4, at 191; HILLMAN ET AL., supra note 2, ¶ 25.01[1], 25.02[1].
127 U.C.C. § 9-504(4).
foreclosure proceeds. The same result probably obtains when the prior creditor claims an interest different than an Article 9 security interest, but the rationale is different. But the Code is silent on whether a subordinate secured creditor may foreclose first or whether an execution may occur first. It is also silent on the relative rights if the junior creditor does exercise its remedies first. Presumably the prior security interest is not extinguished, and the debtor is entitled to any sums exceeding the secured obligations and the costs and expenses enumerated in the Code if a junior secured creditor forecloses. But who has the right to the sale proceeds in the hands of the junior creditor? Can the prior creditor enjoin the execution or foreclosure proceedings? These questions often arise in the context of a conversion action.

B. Framework of Conversion

Establishing the legal framework of conversion requires inquiry into its history and current trends. This inquiry reveals a closer relationship with property concepts than tort concepts and simultaneously provides principles which, if properly applied, resolve critical issues in the application of conversion to security interests.

1. Common Law Conversion

Courts have struggled to establish a clear and widely accepted definition of conversion and have even suggested that the endeavor was futile. 

128 Id. § 9-504(2).
129 In Earthmovers, Inc. v. Clarence L. Boyd Co., 554 P.2d 877 (Okla. Ct. App. 1976), a creditor with a security interest in a used bulldozer was unable to block foreclosure of a mechanic’s lien. Id. at 877. The mechanic purchased at the non-judicial foreclosure sale to satisfy its possessory lien and acquired title free and clear of the prior security interest. Id. at 878. The court rejected the secured party’s contention that the debtor’s interest in the collateral was transferred at the foreclosure sale without any effect on the security interest, because U.C.C. § 9-310 gave the possessory mechanic’s lien priority over the prior security interest. Id; see Frisch, supra note 4, at 187-88 (stating that the execution sales do not terminate perfected security interests). 
130 This result is the negative implication of § 9-504(4) for foreclosures by junior secured parties. See Frisch, supra note 4, at 187-89 for a discussion of the continuation of prior security interests after execution.
131 See Frisch, supra note 4, at 174-79; HILLMAN ET AL., supra note 2, ¶ 25.02[4]; Starnes, supra note 125, at 572-74.
132 In a nineteenth century English case, Baron Bramwell concluded that “it seems to
Definitions were either too narrow or too general and vague. As reporter for the Restatement (Second) of Torts ("Restatement"), Prosser mused that the judicial consistency in applying the doctrine of conversion despite this lack of a definition was "as if the courts have arrived, more or less instinctively, at a tacit agreement as to the nature of this tort, which they have not succeeded in putting into words." Part of the difficulty results from two distinct applications for the doctrine of conversion. Conversion provides a means to resolve adverse claims to personal property and a remedy to property owners for serious tortious interferences.

### a. Historical Development

Conversion originated as a device for resolving property disputes. The modern tort of conversion descends from the action of trover which was used by a true owner to recover damages for goods a finder refused to deliver upon demand. In time, the action expanded to become available in situations where the defendant’s possession was wrongful from the beginning, including tortious interferences. The nature of the remedy distinguished conversion of chattels from trespass to chattels. With trespass, the owner had to accept a tendered return of the chattels and was compensated for loss of use and damages to the chattel; such results were consistent with tort concepts. With conversion, no obligation to accept a tendered return existed, the damages were the fair market value of the chattel at the time and place of conversion, and title was vested in the converter when the judgment was satisfied. Requiring the defendant to pay the fair market value of the property and vesting title in the defendant by operation of law created a forced sale of the property. The conversion remedy reflects its nature as a personal property dispute resolution device.

As courts in the United States applied the English common law of conversion, a shift in emphasis from protecting rights of ownership to protecting rights of possession occurred. This shift probably resulted from courts uncritically following old English commentary. As originally

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133 Prosser, supra note 27, at 168.
134 Prosser, supra note 27, at 169.
135 See 1 Fowler V. Harper et al., The Law of Torts § 2.7 (2d ed. 1986).
136 Prosser, supra note 27, at 170-73; see 1 Harper et al., supra note 137, §§ 2.11-.12; Warren, supra note 17, at 30.
137 Warren, supra note 17, at 4.
138 Id. Warren traced the focus on possession—rather than possession under a claim
applied, trover for conversion protected ownership interests in property, and those interests were most readily evidenced by possession. The language of the older English cases described the interest to be protected as possession under a claim of ownership. The shift from ownership to possession not only permitted persons without claims of ownership to maintain an action in conversion, but also created difficulties with the measure of damages.

By overlooking the claim of ownership aspect of the doctrine, courts in the United States reached some irrational results. Because the market value of the property had developed as the measure of damages to compensate for ownership interests, convoluted rules developed when the plaintiff had a possessory interest other than ownership to avoid unjust enrichment by having that party hold the damages in trust. Because a person in possession, a person entitled to immediate possession, and a person entitled to possession at a future time could each bring an action in conversion, the potential for multiple liability was created. Although some legal doctrines exist to preclude that result, they do not adequately resolve the problems.

Conversion has also expanded to include interference with the right to dominion and control over certain types of intangible property. That expansion began with intangible rights considered to have merged into a document; such as a negotiable instrument, stock certificate, warehouse receipt, or bill of lading, where possession of the document had legal significance in enforcing the right. The expansion continued to rights under insurance policies and savings account books where the writing is

of ownership—to a widely cited comment by the English annotator Serjeant Williams. See id. at 4-5.

Warren was of the opinion that without that measure of damages, the tort of conversion would lose its appeal. See id. at 3.

For example, an owner-bailor without an immediate right to possession could not maintain an action of conversion, due to the bailee's interest; however, the bailee could maintain the action for the full value of the property, but then was required to hold most of the proceeds for the bailor. See id. at 3-22.

See 1 HARPER ET AL., supra note 137, § 2.8, at 161.

This potential was clearly a concern of the judges in the early cases which found conversion in favor of someone other than the one with title to the chattel. See WARREN, supra note 17, at 12-13.

See 1 HARPER ET AL., supra note 137, § 2.8, at 162-64; RESTATEMENT (SECOND) OF TORTS §§ 895(2), 895 cmts. j, k, l (1979) (explaining that being subject to judgments in favor of multiple parties is not precluded by the principle of jus tertii, but a tortfeasor only has to pay for the chattel once).

See 1 HARPER ET AL., supra note 137, § 2.13.
important to protection of the rights.\textsuperscript{149} Without such expansion, conversion of the document would have resulted in damages based upon the value of the document itself plus special damages, not the value of the right the document represented.\textsuperscript{150} The Restatement, using the fiction that the document representing or useful to enforcing the right is a chattel,\textsuperscript{151} recognizes conversion of certain choses in action and contemplates continuing expansion of the doctrine in regard to intangibles.\textsuperscript{152} Tort commentators have expressed mixed views regarding the propriety of such developments.\textsuperscript{153}

\textbf{b. Tort and Property}

The attempts of commentators to define conversion and its elements significantly influenced the development of modern conversion law. The primary efforts in this regard are the Restatement of Torts\textsuperscript{154} and the Restatement\textsuperscript{155} which focus on the tort aspects of the doctrine and the work of Warren\textsuperscript{156} which was contemporary with the Restatement of Torts.

As the drafters of the Restatement searched the case law for an understanding of conversion, they found a frustrating absence of a clear definition.\textsuperscript{157} The Reporter noted that although hundreds of conversion cases were reported every year, “most of them are concerned only with the ownership of the disputed property, and the tort itself is not in issue.”\textsuperscript{158} Although conversion’s role in resolving property disputes underlies much of the Restatement’s discussion,\textsuperscript{159} the elements of

\textsuperscript{149} Id.
\textsuperscript{150} See id. § 2.13, at 178; \textit{Restatement (Second) of Torts} § 242(1) cmt. a.
\textsuperscript{151} \textit{Restatement (Second) of Torts} §§ 241A, 242.
\textsuperscript{152} Id. § 242 cmt. d, e, f.
\textsuperscript{153} Compare 1 \textit{Harper et al., supra note} 137, § 2.13, at 179-80 (expressing misgivings about the potential efficacy of this tort to adequately address the need for a legal remedy in connection with intangible property) \textit{with} Lester Rubin, Comment, \textit{Conversion of Choses in Action}, 10 \textit{Fordham L. Rev.} 425 (1941) (expressing the need for the tort doctrine to stay abreast of the expansion of intangible property as a source of wealth).
\textsuperscript{154} \textit{Restatement of Torts} (1934).
\textsuperscript{155} \textit{Restatement (Second) of Torts} (1965).
\textsuperscript{156} \textit{Warren, supra note} 17.
\textsuperscript{157} Prosser, \textit{supra note} 27, at 168.
\textsuperscript{158} Id.
\textsuperscript{159} Prosser’s article, \textit{The Nature of Conversion, id.}, sets forth illustrations used in the Restatement of Torts and authority, where available, to support the suggested outcome. The illustrations demonstrate some noteworthy features. First, the majority involve
conversion elaborated and elucidated in the Restatement reflect the natural bias toward tort terminology and tortious interferences.

Warren's work presents a valuable supplement to the Restatement of Torts. He described the elements of a conversion action as requiring that the defendant obtain possession of the property by misfeasance of a nature constituting a serious wrong and not involving circumstances that excuse the misfeasance. Warren viewed the requirement of misfeasance as necessary to eliminate negligent interferences with personal property. Warren categorized the serious wrongs under six headings: using force or fraud to obtain possession, withholding possession, transferring the property, altering the property, using the property, and denying the plaintiff's title to the property.

Warren's elaborations on these headings and the correlative excuses illuminate the basic nature of conversion as a property dispute resolution doctrine. The first, second, and sixth headings involved only adverse claims. Possession obtained by force or fraud involved a claim of title in the defendant or a denial of title in the plaintiff which was not excused by good faith or due care. The second heading, withholding possession, simply referred to cases involving a defendant who had power to deliver possession but who refused, without a justifying excuse, a demand for possession made by a plaintiff with a right to immediate possession. Warren expressly characterized such cases as trying title—conversion was the vehicle used to present the controversy to the court. The sixth heading, denying plaintiff's title, spoke for itself.

The other three headings were more consistent with tortious interferences, yet his discussion again supports the concept of property assertions of ownership or denial of the plaintiff's ownership. Second, for a number of them "no cases have been found." E.g., id. at 175 n.27, 181 n.63, 182 nn.75-76. Third, cited cases for illustrations not involving assertions of ownership occasionally involve factual circumstances quite different than the illustrations they are to support. E.g., id. at 175, illus. 3 (conversion due to loss of mistakenly taken hat is supported by dictum from a non-conversion case involving an agent, mistaking the identity of the owner and removing property from a locker; conversion by appropriation of cut grass in good faith belief of right to cut it).

169 WARREN, supra note 17, at 31.
170 Id. at 35-38; accord 1 HARPER ET AL., supra note 137, § 2.9-10.
171 WARREN, supra note 17, at 38.
172 Id. at 41.
173 Id. at 47 (explaining that the primary justifying excuse to avoid conversion was a qualified refusal to permit determination of the legitimacy of the demand, which, in practicality, required interpleader).
174 Id. at 44.
175 Id. at 46.
dispute resolution. He discussed only three transfers of property which constituted serious wrongs: a bailee selling or pledging without authority, a bailee misdelivering, and transfer of possession by a person having no rights in the property. Each such transfer is by one without legal power to transfer. Warren found little authority for the mere alteration of property, an interference that is more tortious than an adverse claim, constituting conversion. Conversion by using the property involves use beyond what is authorized, again implicating a dispute as to rights in the property. Warren found few cases and characterized the essential inquiry as determining whether the unauthorized use was of sufficient seriousness to justify a label of conversion. Such serious acts effectively justify an inference that the converter was asserting a paramount claim.

Finally, Warren observed that bona fide purchasers from one not having rights in the property were generally converters, while pledgees from one not having rights in the property were not because they were not claiming ownership. Pledgees, however, converted the property if they refused the true owner's demand for delivery.

Warren's discussion of conversion precedents fairly supports a conclusion that in order to be liable in conversion, a person must take such actions with property that can be justly characterized as an assertion of the rights of ownership. Conversion then provides an appropriate remedy for the true owner by forcing a sale of the ownership interest to the converter.

c. Elements and Principles of Conversion

The Restatement, the primary reference for conversion law today, defines conversion as: "an intentional exercise of dominion or control over a chattel which so seriously interferes with the right of another to control it that the actor may justly be required to pay the other the full value of the chattel." The definition's focus on the party's dominion

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167 Id. at 51.
168 Id. at 97-99.
169 Id. at 100-02.
170 Id. at 92-94, 103-05. Warren relied on the court's analysis of the issue in Leuthold v. Fairchild, 27 N.W. 503 (Minn. 1886), modified, 28 N.W. 218 (Minn. 1886). The justification for this departure from the rule of a purchaser being liable in conversion if its transferor had no power to transfer was to facilitate lenders taking security and thus facilitating commerce.
171 Id. at 51.
172 RESTATEMENT (SECOND) OF TORTS § 222A (1).
or control rather than "possession" in describing both the required acts of the tortfeasor and the interests interfered with could portend a broader reach than the common law. However, the remainder of the Restatement maintains the close tie to possessory interests. Except for plaintiffs with possessory rights, only limited references are made to a right to recover. Most of the specific acts of conversion discussed in the Restatement involve interference with possession.

The intent requirement refers to an intent to do the act, not an intent for the consequences that follow. In fact, intervening events may change an act not constituting conversion into a conversion. The Restatement does not describe acts establishing conversion per se, but only describes acts that may constitute conversion if other factors are present. Three types of these acts are significant to conversion of

173 Those who can maintain actions are those in possession, id. § 224A, those entitled to immediate possession, id. § 225, or those entitled to future possession, id. § 243.

174 See, e.g., id. § 222 (stating that dispossession seriously interfering with right of another to control chattel may also subject actor to conversion liability); id. § 227 (explaining that a use seriously violating another's right to control its use constitutes conversion); id. § 228 (noting that uses exceeding authority if another's right to control is seriously violated constitutes conversion); id. § 241A (stating that payment of a negotiable instrument over a forged endorsement is a conversion); id. § 242 (discussing that preventing the exercise of intangible rights merged in a document subjects one to liability similar to conversion even though the document is not itself converted).

175 See, e.g., id. § 223 (dispossessing another of a chattel); id. § 226 (destruction or material alteration of its physical condition to change its identity or character); id. § 229 (receipt of chattel with the intent to acquire proprietary interest which the other has no power to transfer); id. § 230 (receipt of possession for storage, safekeeping, or transportation with knowledge that another has right to immediate possession); id. § 231 (receipt of possession on behalf of principal for purpose of giving principal a proprietary interest); id. § 233 (agent delivering to another a chattel if agent negotiated the disposition, but not for mere delivery if the principal negotiated the disposition); id. §§ 234, 235 (certain misdeliveries of a chattel are conversions); id. § 237 (refusal to return on demand without proper qualification).

176 Id. §§ 224 cmt. a., 244.

177 See McCurdy v. Wallblom Furniture & Carpet Co., 102 N.W. 873 (Minn. 1905) (stating that bailee moving goods to another warehouse without notice to or consent of bailor is liable in conversion when the goods were destroyed by fire); Prosser, supra note 27, at 184. Compare Restatement § 222A cmt. d, illus. 5 with illus. 7 (illustrating that temporary storage of furniture is not a conversion, but intervening fire changes it to a conversion).

178 Restatement § 223 limits the acts described therein by use of the term "may." See id. cmt. a. That section cross-references all acts of conversion described in the Restatement except § 230 (receiving possession for storage, safekeeping or transportation) and § 235 (conversion by misdelivery as against one not a bailor).
security interests: taking possession,\textsuperscript{179} interference with the ability to take possession,\textsuperscript{180} and inappropriate use of the property.\textsuperscript{181}

Damages for conversion are the fair market value of the converted chattel at the time and place of conversion.\textsuperscript{182} If multiple acts of conversion have occurred or the property is customarily traded on an exchange, the injured party has a choice of the time for determining market value.\textsuperscript{183} The injured party is also entitled to interest, the value of additions to the property not made in good faith,\textsuperscript{184} and other loss caused by the deprivation.\textsuperscript{185}

A study of the Restatement reveals seven significant concepts that should influence application of conversion to security interests. First and foremost is a justice inquiry. A fundamental theme in the Restatement requires that the interference be sufficiently serious that "the actor may justly be required to pay the other the full value of the chattel."\textsuperscript{186} The justice theme is central because the remedy for conversion is a forced sale of the property.\textsuperscript{187} Although subsections 222 A (2)(a)-(f) of the Restatement list six factors to aid in the case-by-case inquiry of the seriousness of the interference and the justice of the forced sale, little substantive discussion of the justice inquiry follows. The frequent examples of

\begin{itemize}
\item These acts include non-consensual taking of a chattel from the possession of another, \textit{id.} §§ 221(a), 223(a); taking a chattel into custody of law, \textit{id.} §§ 221(e), 223(a); and receiving a chattel with intent to acquire it from one not having power to transfer, \textit{id.} § 229.
\item These acts include barring access to a chattel, \textit{id.} §§ 221(c), 223(a); and an unqualified refusal of a demand to deliver the chattel, \textit{id.} §§ 222 A(2)(b), 224 cmt. d, 237.
\item These acts include altering physical condition, \textit{id.} § 226 (comment d states that a purchaser of raw materials may convert by subjecting the raw materials to the manufacturing process, because the critical question is not ultimate value but the value in the hands of the owner in its original condition); use of a chattel, \textit{id.} § 227; and exceeding the authorized use of a chattel, \textit{id.} § 228.
\item \textit{id.} § 927(1)(a) (1979).
\item The injured party can choose the date of any conversion. \textit{id.} § 927 cmt. d. If a commodities market exists, damages equal the highest value within the reasonable period during which replacement might have occurred. \textit{id.} § 927(1)(b).
\item The additional damages for additions to the property depend on whether the converter had knowledge that the act of conversion was wrongful. \textit{id.} § 927 cmts. f, g.
\item \textit{id.} § 927(2).
\item \textit{id.} § 222A(1) (emphasis added). The drafters deemed the justice requirement to be of such importance that it is used as a qualification in the Comments to virtually all sections describing acts which amount to conversion. E.g., \textit{id.} §§ 222 cmt. a; 222A cmts. c, d; 223 cmt. a; 226 cmts. c, d; 227 cmt. b; 228 cmts. b, c, d; 234 cmt. a; 235 cmts. c, g; 237 cmt. a; see also Prosser, \textit{supra} note 27, at 172-74.
\item RESTATEMENT § 222A cmt. c.
\end{itemize}
interferences that do not rise to a conversion also fail to elucidate the justice component. In fact, the influence of these six factors is sometimes minimized by other provisions. For example, good faith of the tortfeasor is one of the six factors, but it apparently provides little support for an argument that an innocent converter should not be liable in conversion.

Second, the presence or absence of knowledge should be an important factor in determining whether conversion is just. Although knowledge that the act will effect a conversion is unnecessary, it can be a factor in establishing a serious interference. Knowledge of the interest of the property owner transforms minor interferences with property into acts of conversion. In addition, lack of knowledge protects agents, servants, and bailees from conversion liability in some circumstances.

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188 See, e.g., id. § 222A illus. 1, 5, 9, 12, 14, 18, 19, 21, 25.

189 E.g., id. §§ 222A cmt. d, illus. 7, 224 cmt. c. Although good faith is to be considered expressly in connection with mistake to determine if the interference is sufficiently serious to constitute conversion, id. § 244 cmt. b, no examples are presented in which good faith shields an actor who believes, due to a mistake of fact or law, that it is either justified in its possession or right to immediate possession, acting on the consent of the other, or acting under a privilege.

190 E.g., compare Prosser, supra note 27, at 177, illus. 14 with id. at 176-77, illus. 10-12; compare id. at 178, illus. 23 with illus. 22; compare id. at 180, illus. 34 with id. at 179, illus. 32.

191 RESTATEMENT § 230 (stating that receipt of possession on behalf of master is conversion only if there is knowledge or reason to know of third person’s right to immediate possession); id. § 231(1), (4) (explaining that receipt of possession by agent who negotiated for proprietary interest on behalf of its master is conversion, unless the agent becomes a holder in due course of the document or instrument received); id. § 231(2) (holding that no liability exists for negotiating for a proprietary interest for the principal if agent does not take possession, know, or have reason to know of another’s right to immediate possession); id. § 231(3) (stating that no liability attaches for receiving possession if agent did not negotiate for proprietary interest and has no knowledge or reason to know of right to immediate possession in another); id. § 233(2) (stating that negotiating to transfer proprietary interest from master to another is not a conversion if agent does not deliver possession or know of the immediate possessory right of another); id. § 233(3) (explaining that delivery of possession where master has negotiated transfer of a proprietary right is not a conversion unless there is knowledge or reason to know of another’s right of immediate possession); id. § 233(1), (4) (stating that no conversion exists if agent receives negotiable document or instrument where he or master qualify as holder in due course in delivering chattel to one with whom the agent negotiated a disposition as agent); id. § 234 (illustrating that no conversion exists if unauthorized delivery is made by agent to one entitled to immediate possession); id. § 235(2) (noting that no conversion occurs for redelivery by agent to principal unless one entitled to immediate possession has made an adverse claim on the agent); id. § 235(3) (stating that agent delivering pursuant to the principal’s instructions is not liable unless there is knowledge or reason to know that the principal is not authorized to so deliver).
Third, the agreement of the parties is relevant to whether an act constitutes conversion. Determination of whether the authorized use of a chattel was exceeded necessitates inquiry into the agreement between the parties. The Restatement contemplates no conversion liability if a third party consents to an act contrary to an agreement between the injured party and the third party, unless the actor had knowledge of the contractual restriction.

Fourth, negotiability laws should be followed when applicable. The Restatement provides important elaborations on conversion by receiving property by transfer from a transferor with the power but not the authority to transfer. The transferor has converted, but resolution of whether the transferee converted depends on the law governing negotiability of the property.

Fifth, damages should relate to the interest converted. The Restatement departs from the fair market value standard when a person with a right to future rather than immediate possession brings an action for harm caused to a chattel. Damages then equal the value of the interest of which the plaintiff has been deprived rather than fair market value. The Restatement expresses indifference as to whether such an action is called conversion or an action for damage to the future interest.

Sixth, support exists for a limited right to tender return and avoid conversion liability. Liability may be avoided if one entitled to possession recovers the converted chattel, but the defendant is generally not permitted to tender return of the chattel unless the injured party consents. However, if the conversion was in good faith and under a reasonable mistake and the tender was made promptly after discovery, the court has discretion to require the plaintiff to accept on equitable grounds, if the value is not substantially impaired. Some commentators favor

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192 Id. § 228 cmt. c.
193 Id. § 253 cmt. c.
194 Id. § 222 cmt. f.
195 Id. § 229 cmt. d.
196 Id. §§ 243 cmt. b, 895(3) cmt. l (1979).
197 Id. § 243 cmt. b.
198 See id. § 922 (1979); WARREN, supra note 17, at 107-10; see also 1 DOBBS, supra note 10, § 5.14(4), at 870-72 (noting that damages are reduced by the value of property recovered).
199 Because conversion requires a tortious interference of sufficient gravity that justice demands forcing the defendant to purchase the chattel, it is undesirable to permit such an easy defense for the converter. See 1 HARPER ET AL., supra note 137, § 2.11; WARREN, supra note 17, at 3.
200 See Rutland & Wash. R.R. v. Bank of Middlebury, 32 Vt. 639 (1850); RESTATE-
making tender of return a matter of right for an innocent converter desiring to mitigate damages. Exercising that option, if available, makes a conversion action a close alternative to replevin.

And seventh, certain qualifications and privileges preclude conversion liability. Qualifications justify refusing a demand for delivery if they are clearly communicated and a prompt and appropriate attempt is undertaken to eliminate the qualification by determining the right of the one making demand. Several privileges are significant to conversion and Article 9. Consent by the injured party to the interference precludes conversion liability. Exercising rights to repossess is privileged against the one in possession if the acts involved in repossessing are not tortious. Finally, acts pursuant to a court order valid on its face are privileged.

2. Conversion of Security Interests

Courts applied conversion doctrine to protect a creditor’s right to personal property before adoption of the Code. But such applications received little attention from commentators. Warren takes note of a case involving conversion of a security interest in passing, but his only discussion regarding conversion and secured creditors involves pledgees converting pledged property. The Restatement of Security briefly addresses conversion of a secured creditor’s interest in the context of a pledgee who had possession at the time of the conversion and describes the pledgee’s rights as more limited if it was not in possession or entitled...
to immediate possession at the time. 210 Other than noting that a secured creditor can maintain an action for conversion, 211 the Restatement, promulgated about the same time as the Code, gives no special consideration to the conversion of a security interest. 212 To a limited extent, this position reflects the fact that secured creditors may not have a right to immediate possession, but only a right to possession in the future. The Restatement expresses indifference as to whether interference with such interests constitutes denominated conversions. 213

It appears that the drafters of the Code gave little consideration to either the role of conversion as a secured party's remedy or the appropriateness of conversion doctrines when applied to security rather than ownership interests. The drafters were cognizant of conversion as a remedy of the secured party, as evidenced by Official Comment 3 to section 9-306 which provides that the creditor will have the right to possess the property from a transferee "or in an appropriate case maintain an action for conversion." 214 But that is the only reference to conversion of a secured party's interest in property contained in Article 9. 215 Similarly, Professor Gilmore devotes a section of his classic treatise to conversion by a secured creditor of the debtor's property, 216 but offers no discussion of conversion of the creditor's interest.

a. Early Applications

Into the nineteenth century, personal property could be used to secure a debt only through a pledge—the pledgee had possession. 217 Conversion of such interests was infrequent, and doctrines involving the deprivation

210 Compare RESTATEMENT OF SECURITY §§ 38(2), 39(c) (1941) with id. § 38 cmt. b.

211 RESTATEMENT § 243 cmt. c, illus. 2 (contrasting mortgagee with right to immediate possession with mortgagor's right to future possession).

212 The silence on the question of a secured party being entitled to maintain an action in conversion can be contrasted with the discussions of the right of agents, servants, and bailees to bring conversion actions and their liability for conversion. In that context, the Restatement abounds with specific rules and commentary. E.g., id. §§ 230, 231, 233, 234, 235. Much case law existed in this area and it had been a fruitful area for scholarly commentary. See WARREN, supra note 17, at 19-28.

213 RESTATEMENT § 243 cmt. b.

214 U.C.C. § 9-306 cmt. 3.

215 The Code is more explicit if the secured party is the converter. See supra note 103 and accompanying text.

216 2 GILMORE, supra note 37, § 42.13.

217 See id. § 2.1.
of current possession fit well. As non-possessory methods of obtaining personal property security developed, the issues surrounding a mortgagee’s claim of conversion increased. As discussed below, treatment of the cases varied depending on whether the jurisdiction followed the title theory or the lien theory of mortgages.

Title theory jurisdictions found conversion doctrines worked well. Mortgagees had title with the absolute right to possession upon the mortgagor’s default. Interference with possessory rights was interference with the mortgagee’s interest. In title theory cases, knowledge was generally irrelevant once the mortgagor’s right to redeem the property had been eliminated by default. Reference to knowledge in title theory cases appears to be directed to ensuring that the mortgage had been recorded (imparting constructive notice) and was therefore enforceable. Courts, however, departed from general conversion doctrine by awarding damages in the amount of the secured debt unless it exceeded the market value of the converted property.

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\[\text{\ldots}218\text{ See Robinson v. Bird, } 33 \text{ N.E. 391 (Mass. 1893) (stating that auctioneer in good faith and without knowledge was liable in conversion because its principal had no right of possession as against the mortgagee); Coles v. Clark, } 57 \text{ Mass. (3 Cush.) 399, 402 (1849) (explaining that since mortgagor had no power to transfer and no title that could be transferred, the sale by its agent was conversion); Kleinberger v. Brown, } 8 \text{ N.Y.S. 866, 867 (N.Y. Sup. Ct. 1890) (stating that demand and refusal were necessary before default to establish conversion liability, but after default, the transfer was a conversion because the mortgagor had no rights).}\]

\[\text{\ldots}220\text{ See Hudmon Bros. v. DuBose, } 5 \text{ So. 162 (Ala. 1888) (relying on constructive notice from the registration of the mortgage to find agent liable in conversion); Ross v. Menefee, } 25 \text{ N.E. 545 (Ind. 1890) (holding purchaser of property liable to the mortgagee in conversion because constructive notice of the mortgage existed); McFadden v. Hopkins, } 81 \text{ Ind. 459, 461-63 (1882) (stating that second mortgagee, which had expressly subordinated its interest, had both actual and constructive knowledge of the prior mortgage and converted by purchasing chattels from debtor and reselling them for credit against its debt); Duke v. Strickland, } 43 \text{ Ind. 494, 502 (1873) (overruling a demurrer because title had vested in the mortgagee and the recording of the mortgage had given constructive notice of its contents to a buyer in the ordinary course of business, but who refused to deliver wheat upon demand and sold it into a foreign market).}\]

\[\text{\ldots}221\text{ See Blanchard v. Farmer’s State Bank, } 124 \text{ S.E. 695, 696 (Ga. 1924); McFadden, } 81 \text{ Ind. at 462; Boydston v. Morris, } 10 \text{ S.W. 331, 332 (Tex. 1888).}\]
The traditional elements of conversion did not correlate nearly as well with the concept of a personal property security under a lien theory. In lien theory states, the courts reached similar results, but often pursuant to new but analogous remedies such as willful interference with superior property rights.\(^{222}\) In some lien theory cases, knowledge apparently played a greater role in ensuring that the defendant's actions were wrongful.\(^{223}\) Not all lien theory jurisdictions avoided the conversion label.\(^{224}\)

Fundamental issues surrounding conversion of security interests were raised by the dissenting opinion in *Eade v. First Nat'l Bank*,\(^{225}\) a 1926

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\(^{222}\) In *Harris v. Grant*, 23 S.E. 390 (Ga. 1895), the court, in a case of first impression, found a cause of action for a "willful violation" by a subordinate lienholder of the private right of a superior lienholder based on "general principles" and "analogies of the law." *Id.* at 391. Although the court cited conversion cases which relied on the title theory of mortgages, it did not purport to apply the law of conversion. *Id.* The same court in the syllabus of a later case, *Benton v. McCord*, 23 S.E. 392 (Ga. 1895), described the *Harris* remedy as permitting a mortgagee to maintain an action for damages in the amount of the impairment against a third party having "actual or constructive notice ... [of the mortgage and who] wrongfully or fraudulently" impaired the security. *Id.* at 392. Almost 30 years later, the same court sustained the cause of action in tort, required knowledge, but still did not label it a conversion. *Blanchard v. Farmers State Bank*, 124 S.E. 695 (Ga. 1924). See also *Randall v. Higbee*, 37 Mich. 40 (1877) (explaining that since a mortgage is a lien, no action existed in assumpsit for converting the property to money, but noting that an action might exist if defendant acted wrongfully and injured the security with knowledge of the lien); *Yates v. Joyce*, 11 Johns. 136, 140 (N.Y. Sup. Ct. 1814) (approving an action by a judgment creditor for "wilful" violation of a private right against one alleged to have removed buildings from a lot before the sheriff's execution sale of the lot).

\(^{223}\) *E.g.*, *Blanchard*, 124 S.E. at 696-97 (noting that sales made under actual knowledge of mortgage wrongfully impair lien); *Randall*, 37 Mich. at 40 (discussing how knowledge of the lien with wrongful action injuring security may give right of action); *Yates*, 11 Johns. at 140 (stating that defendant alleged to have knowledge committed "wilful" violation of a private right).

\(^{224}\) *E.g.*, *Eade v. First Nat'l Bank*, 242 P. 833, 833-34 (Or. 1926) (holding subsequent mortgagee liable in conversion for the repossession and sale of collateral at a public foreclosure sale when the prior mortgagee had a right to immediate possession upon breach); *Western Mortgage & Inv. Co. v. Shelton*, 29 S.W. 494, 495 (Tex. Civ. App. 1894) (holding sale of goods without making the sale subject to a chattel mortgage to be conversion under a provision in the chattel mortgage act). Compare *Boydston v. Morris*, 10 S.W. 331 (Tex. 1888) (upholding a damage judgment in favor of a chattel mortgagee of a corn crop against a buyer without referring to the action as conversion) with *Focke v. Blum*, 17 S.W. 770 (Tex. 1891) (allowing a lienholder or mortgagee to sue for conversion).

\(^{225}\) 242 P. 833 (Or. 1926) (Burnett, J., dissenting).
KENTUCKY LAW JOURNAL

case decided in a lien theory state. Because a mortgage was a lien, the
debtor still retained title and had a right to transfer its interest in the
collateral.\textsuperscript{226} The dissent expressed the view that conversion did not lie
where the subordinate lienholder's repossession and foreclosure on
collateral were rightful absent a demand for possession and a refusal to
deliver.\textsuperscript{227}

\textit{b. Current Applications}

Conversion actions by secured parties have become very common
since adoption of the Code. An examination of the elements of conver-
sion applied by the courts in these cases and of the factual circumstances
in which conversion liability is found facilitates understanding why
secured parties resort to conversion. It also establishes a basis for
determining whether changes are required to coordinate conversion with
Article 9 concepts and policies.

\textbf{(1) Elements of Conversion}

A significant number, perhaps even a majority, of the cases involving
conversion of a security interest have little or no discussion of the
elements of conversion.\textsuperscript{228} Cases that describe the legal rules either
simply cite section 222A of the Restatement\textsuperscript{229} or describe the elements
of conversion with language similar to the Restatement.\textsuperscript{230} It is not

\begin{itemize}
\item \textsuperscript{226} \textit{Id.} at 837-40.
\item \textsuperscript{227} \textit{Id.} at 837.
\item \textsuperscript{228} \textit{E.g.}, United States v. Winter Livestock Comm'n, 924 F.2d 986, 990 (10th Cir.
\textsuperscript{1991}) (holding that an agent without knowledge who sells in violation of principal's
security agreement converts); Hong Kong & Shanghai Banking Corp. v. HFH USA Corp.,
805 F. Supp. 133, 145 (W.D.N.Y. 1992) (stating that because the other creditor had
priority, the repossessing creditor is "liable for conversion of the goods as a matter of
law"); Hill v. Farm Credit Bank, 726 F. Supp. 1201, 1209 (E.D. Mo. 1989) (explaining
that because debtor no longer had rights in property, its use and sale constituted
conversion); United States v. Fullpail Cattle Sales, Inc., 640 F. Supp. 976, 980, 983 (E.D.
Wis. 1986) (holding that the right to possession and priority establish right to conversion
damages); International Harvester Credit Corp. v. Commercial Credit Corp., 188 S.E.2d
110, 112-13 (Ga. Ct. App. 1972) (noting that repossessing creditor without priority
converts senior's interest).
\item \textsuperscript{229} \textit{E.g.}, Harley-Davidson Motor Co. v. Bank of New England-Old Colony Nat'l Ass'n,
85 B.R. 1, 3 (D.R.I. 1988), aff'd in part and vacated in part, 897 F.2d 611 (1st Cir.
1990); De Kalb Bank v. Purdy, 562 N.E.2d 1223, 1232 (Ill. App. Ct. 1990); Central
\item \textsuperscript{230} \textit{E.g.}, General Elec. Co. v. Halmar Distribrs., Inc. (\textit{In re} Halmar Distribrs., Inc.), 968
apparent that any of those formulations create a different outcome than would be reached by reliance on the Restatement definition.

To maintain an action for conversion, a secured creditor must establish a superior right of possession.\textsuperscript{231} Section 9-503 of the Code creates a right to immediate possession upon default by the debtor.\textsuperscript{232}


\textsuperscript{231} E.g., Hong Kong & Shanghai Banking Corp. v. HFH USA Corp., 805 F. Supp. 133, 139 (W.D.N.Y. 1992); United States v. Fullpail Cattle Sales, Inc., 640 F. Supp. 976, 980 (E.D. Wis. 1986); see also Otto Farms, Inc. v. First Nat'l Bank at York, 422 N.W.2d 331, 336 (Neb. 1988) (holding that prejudgment interest is allowable in a conversion action where damages are liquidated); cf. Mack v. Newton, 737 F.2d 1343, 1354-55 (5th Cir. 1984) (holding that trustee in bankruptcy could not maintain an action for conversion because it had no ownership interest and was not in legal possession); City of Wichita Falls v. ITT Commercial Fin. Corp., 827 S.W.2d 6, 8 (Tex. Ct. App.) (holding that city with tax lien with statutory priority could not maintain an action against repossessing secured creditor for conversion without an ownership interest, possessor interest, or right of immediate possession), aff'd in part and rev'd in part, 835 S.W.2d 65 (Tex. 1992).

\textsuperscript{232} The right of possession in U.C.C. § 9-503 depends only upon attachment and default; perfection is not required. Courts are not always careful in determining whether the right to possession exists. The court in Blessing v. Norwest Bank Marion, N.A., 429 N.W.2d 142 (Iowa 1988), held that an unperfected secured creditor could not maintain
If the default provisions of the security agreement are inadequate to cover the event claimed as conversion, the secured creditor may not be able to maintain a conversion action. Unless the tortfeasor's possession is wrongful or demand is excused because delivery is impossible, a demand for delivery and a refusal are necessary. Any deferral of action on the demand for the purpose of investigating whether the secured party's claim is legitimate is limited to a reasonable period of time.

If the foregoing elements are satisfied, few defenses are available to the party charged with conversion. The tortfeasor's intent, good faith, and lack of actual knowledge are not available as defenses. Mistakes of a conversion action against a perfected secured creditor on the erroneous grounds that it did not have a right of possession. Id. at 144. Despite this error in reasoning, the court was probably correct in the outcome, because the unperfected creditor did not have priority and therefore its right to possession was subordinate to the right of the alleged converter.

See, e.g., In re Ayers, 25 B.R. 762, 775 (M.D. Tenn. 1982) (holding that no right to conversion action exists when security agreement does not include transfer of collateral as a default); First Nat'l Bank v. Sheriff of Milwaukee County, 149 N.W.2d 548, 549-50 (Wis. 1967) (explaining that secured party failed to establish a default before execution, thereby precluding replevin against the sheriff executing the levy); accord United States v. Fullpail Cattle Sales, Inc., 640 F. Supp. 976, 983 (E.D. Wis. 1986) (holding that existence of default established right to immediate possession); cf. Chadron Energy Corp. v. First Nat'l Bank of Omaha, 459 N.W.2d 718, 734 (Neb. 1990) (explaining that no default existed at time of conversion but apparently a right to possession for perfection did).

E.g., United States v. Fullpail Cattle Sales, Inc., 617 F. Supp. 73, 75 (E.D. Wis. 1985) (stating that demand and refusal requirement is not necessary where it would be impossible for the defendants to return the collateral); Bures v. First Nat'l Bank, Port Lavaca, 806 S.W.2d 935, 938 (Tex. Ct. App. 1991) (making an exception to the requirement that plaintiff make a demand if the demand would be useless or possessor's acts amount to clear repudiation of owner's rights).


law or fact do not preclude conversion liability. Available defenses include waiver, laches, and subsequent settlement between secured creditor and debtor.

conversion liability; Paris Am. Corp. v. McCausland, 759 P.2d 1210, 1215 (Wash. Ct. App. 1988) (explaining that wrongful intent is not required and good faith is not a defense).

E.g., Hill v. Farm Credit Bank, 726 F. Supp. 1201, 1209 (E.D. Mo. 1989) (noting that firm belief that foreclosure was improper did not excuse conversion by debtor).

E.g., General Elec. Co. v. Halmar Distrib., Inc. (In re Halmar Distrib., Inc.), 968 F.2d 121, 129 (1st Cir. 1992) (discussing waiver by acquiescence); First Interstate Bank, N.A. v. Interfund Corp., 924 F.2d 588, 593-95 (5th Cir. 1991) (stating that consent to take the collateral is waiver, but that neither waiver nor consent was present); Parkersburg State Bank v. Swift Indep. Packing Co., 764 F.2d 512, 514 (8th Cir. 1985) (explaining that buyer of collateral is not liable in conversion when creditor had never enforced its prohibition on sales of collateral); United States v. Security State Bank, 686 F. Supp. 733, 736 (N.D. Iowa 1988) (explaining that a settlement may occur when sale is within prior course of dealing between debtor and superior creditor, but none was found); Branch Banking & Trust Co. v. Columbian Peanut Co., 649 F. Supp. 1116, 1118-19 (E.D.N.C. 1986) (noting that buyer did not convert portion of crop purchased with secured creditor declining request for payment by joint check, but did convert portion of crop it purchased that was not specifically authorized); FS Credit Corp. v. Troy Elevator, Inc., 421 N.W.2d 537, 538-39 (Iowa 1988) (preventing the buyer from being liable in conversion because this was the first security agreement to require consent to sales and prior course of dealing had continued implicitly waiving the consent requirement); Citizens Nat'l Bank of Madeina v. Mankato Implement, Inc., 441 N.W.2d 483, 485-87 (Minn. 1989), aff'd 427 N.W.2d 23 (Minn. Ct. App. 1988) (holding that purchase money seller of new equipment taking trade-ins was not liable in conversion to secured party with security interest in old equipment because creditor had waived right to written consent to sales by giving oral consent); cf. De Kalb Bank v. Purdy, 562 N.E.2d 1223, 1229-31 (Ill. App. Ct. 1990) (stating that authorization of sale of collateral precludes conversion).


E.g., Farmers State Bank v. Easton Farmers Elevator, 457 N.W.2d 763, 765-66 (Minn. Ct. App. 1990) (holding that no conversion was committed by elevator purchasing grain under representations of no liens and paying a portion of price with credit against antecedent debt because a settlement agreement was said to have satisfied the debt, even though the settlement agreement expressly permitted the secured creditor to pursue conversion claims against third parties); Austin Farm Center, Inc. v. Austin Grain Co., 418 N.W.2d 181, 185-86 (Minn. Ct. App. 1988) (stating that purchaser of encumbered grain was not liable in conversion as a result of agreement between debtor and secured creditor in settlement of the secured debt because creditor cannot pursue collateral of an already settled debt); cf. RESTATEMENT (SECOND) OF TORTS § 895(2) (stating that a tortfeasor is relieved of all liability when a third person entitled to recover discharges the tortfeasor by settlement). But cf. United States v. Winter Livestock Com'n, 924 F.2d 986, 988 (10th Cir. 1991) (discussing a creditor who settled with debtor and reserved rights to obtain balance from all third parties, then later successfully sued debtor's sales
The measure of damages for conversion described in the Restatement is generally recognized by the courts in security interest cases, but if that amount exceeds the secured obligation, damages are limited to the secured obligation. Damages beyond the value of the converted property in the form of interest or the value of loss of use are awarded to compensate the secured party under certain circumstances. Interest, however, better describes the necessary compensation to a secured party.

In a few cases, the plaintiff had obtained possession of the disputed property, and the courts relied on "conversion" to award damages caused by the delay in obtaining agent).


E.g., Permian Petroleum Co. v. Petroleos Mexicanos, 934 F.2d 635, 652 (5th Cir. 1991); Rushmore State Bank v. Kurylas, Inc., 424 N.W.2d 649, 659 (S.D. 1988); accord Hong Kong & Shanghai Banking Corp. v. HFH USA Corp., 805 F. Supp. 133, 147 (W.D.N.Y. 1992) (identifying the issues on remand as being the value of the converted goods and the amount secured by them).

Compare Lafayette Prod. Credit Ass’n v. Wilson Foods Corp., 687 F. Supp. 1267, 1274, 1278 (N.D. Ind. 1987) (fair market value and interest); ITT Indus. Credit Co. v. H & K Mach. Serv. Co., 525 F. Supp. 170, 172-3 (E.D. Mo. 1981) (fair market value and interest); Farm Credit Bank of St. Paul v. F & A Dairy, 477 N.W.2d 357, 362 (Wis. Ct. App. 1991) (price plus interest), rev’d on other grounds, 482 N.W.2d 107 (Wis. 1992) with National Acceptance Co. v. Virginia Capital Bank, 498 F. Supp. 1078, 1087 (E.D. Va. 1980) (explaining that interest was not awarded because creditor would not have received the money immediately if the bank had not converted, as debtor was in financial trouble), aff’d in part and rev’d in part, 673 F.2d 1314 (4th Cir. 1981); Otto Farms, Inc. v. First Nat’l Bank of York, 422 N.W.2d 331, 336 (Neb. 1988) (explaining that interest was not to be included unless the damages were liquidated).


A thoughtful evaluation of interest as a component of damages for a converted security interest is contained in Permian Petroleum Co. v. Petroleos Mexicanos, 934 F.2d 635, 652-53 (5th Cir. 1991).
Because of its tort heritage, conversion results in punitive damages in the infrequent case where the secured party establishes malice, willful wrongdoing, or other wanton disregard of its rights.

A review of the cases establishes that some of the policies underlying conversion are not receiving significant discussion. Very few courts considering the conversion of security interests focus on inquiries set out in the Restatement to achieve justice and to assure that the acts are sufficiently serious. One court refused to find conversion absent unjust enrichment or wrongdoing by the converter, while others have articulated a need for the secured party to mitigate damages.

(2) Debtor and Secured Party

Conversion by a secured party of a debtor’s property is similar to any other conversion and provides an important remedy for the debtor.

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248 See, e.g., State Savings Bank v. Allis-Chalmers Corp., 431 N.W.2d 383, 387 (Iowa Ct. App. 1988) (awarding punitive damages because the purchase money creditor could not prove that all the proceeds of debtor’s bulk sale were proceeds of collateral in which it had a security interest).

The court’s award of punitive damages probably went beyond what was appropriate because the court did not require an affirmative showing of intentional disregard for whether the creditor had an appropriate claim to the proceeds.


253 Some minor differences exist. See supra notes 170-71 and accompanying text.
Extensive discussion of this use of conversion is beyond the scope of this Article, but a brief summary presents an important contrast between conversion of ownership interests and conversion of security interests. The debtor has ownership and the requisite right of possession, yet the secured party also has rights in the property, including a right to possession upon default. Secured parties may be liable in conversion for wrongful repossession, foreclosing on or applying proceeds of collateral not covered by the security interest or in violation of agreements with the debtor, refusal to return collateral or proceeds after the debt has been satisfied, or failure to properly care for collateral in their possession. The common element in each of these acts is the secured party exceeding the scope of its rights.

254 See supra note 205 and accompanying text; see, e.g., Barclays Bank of New York, N.A. v. Heady Elec. Co., 571 N.Y.S.2d 650, 653 (N.Y. App. Div. 1991) (holding an issue of fact to be whether self-help provisions of U.C.C. § 9-503 were violated when secured creditor deemed itself insecure, declared default, accelerated the loan, repossessed, and sold the collateral at auction), appeal dismissed, 576 N.Y.S.2d 221 (N.Y. 1991); cf. Mushitz v. First Bank of South Dakota, N.A., 457 N.W.2d 849, 855-56 (S.D. 1990) (holding that secured creditor’s action for replevin when debtor was not in default was not conversion only because property was in possession of the court).

255 Compare Johns v. Park, 773 P.2d 1328, 1331-32 (Or. Ct. App. 1989) (stating that foreclosure against inventory included in financing statement but not in the security agreement was a conversion) with Barton v. Chemical Bank, 577 F.2d 1329, 1333 (5th Cir. 1978) (holding conversion action alleging application of proceeds of a certificate of deposit to loan rather than to purchase a new certificate unsuccessful because a security agreement existed).

256 See, e.g., Chemical Sales Co. v. Diamond Chem. Co., 766 F.2d 364, 367, 369 (8th Cir. 1985) (remanding case where secured creditor managed the debtor’s business in which it had a security interest and the business foreclosed); Friendly Credit Union v. Campbell, 579 So. 2d 1288 (Ala. 1991) (holding that secured creditor foreclosing under pressure from regulatory agencies converted because it had agreed to deferred payments).

257 See, e.g., Pittston Warehouse Corp. v. American Motorists Ins. Co., 739 F. Supp. 904, 905 (S.D.N.Y. 1990) (holding that, upon cancellation of secured bonds, the creditor was liable for conversion of collateral); Trailmobile, Inc. v. Cook, 540 So. 2d 683, 687 (Ala. 1988) (stating that debtor was entitled to recover for decrease in value of trailers when creditor refused demand to return title to 12 trailers even though debtor still owed secured creditor $815); Lee County Nat’l Bank v. Nelson, 761 S.W.2d 851, 852 (Tex. Ct. App. 1988) (holding creditor liable in conversion for retaining title to vehicles after debt was paid despite claim that additional obligations were secured); Albrecht v. Zwaanshoek Holding En Financiering, B.V., 816 P.2d 808, 813 (Wyo. 1991) (entitling debtor to pursue conversion claim because no interest was to be paid on note—making retention of stock as collateral no longer authorized).

258 See, e.g., In re Biglari Import Export, Inc., 130 B.R. 43, 45-46 (Bankr. W.D. Tex. 1991) (discussing debtor who alleged loss of rugs in possession of secured party but was unable to prove lack of reasonable care).
Similarly, debtors sometimes convert the security interests they grant to creditors by violating rights given the creditor, either by failing to deliver the collateral or proceeds\(^{29}\) or by selling or dealing with the collateral in violation of the agreement.\(^{250}\) But why bother to sue the debtor in conversion when the debtor is already personally liable to the creditor on the secured obligation? The answers to that question help establish relevant inquiries in evaluating conversion as a secured party’s remedy. The debtor’s obligation becomes non-dischargeable in bankruptcy\(^{261}\) if the conversion constituted willful and malicious injuries to the

\(^{29}\) See, e.g., United States v. Edgmon, 952 F.2d 1206, 1208-09 (10th Cir. 1991) (failure to remit proceeds of collateral sales); Borg-Warner Acceptance Corp. v. Littleton (In re Littleton), 106 B.R. 632, 635 (Bankr. 9th Cir. 1989) (failure to report a sale and remit sales proceeds), aff’d, 942 F.2d 551 (9th Cir. 1991); United States v. Hintzman, 806 F.2d 840, 845 (8th Cir. 1986) (failure to remit proceeds); Vaughn v. Murray (In re Murray), 116 B.R. 473, 476 (Bankr. E.D. Va. 1990) (delivery of inventory to unperfected creditors and payments to unsecured creditors); Hill v. Farm Credit Bank, 726 F. Supp. 1201, 1209 (B.D. Mo. 1989) (grazing cattle and harvesting hay after creditor had acquired land at foreclosure); Fricke v. Valley Prod. Credit Ass’n, 778 S.W.2d 829, 833 (Mo. Ct. App. 1989) (conversion of proceeds of sales); Avocet Dev. Corp. v. McLean Bank, 364 S.E.2d 757, 761 (Va. 1988) (removal of proceeds from a savings account).

\(^{250}\) See, e.g., United States v. Edgmon, 952 F.2d 1206, 1208-09 (10th Cir. 1991) (sale of collateral); First Equip. Leasing Corp. v. Luce (In re Luce), 109 B.R. 202, 208 (Bankr. N.D. Tex. 1989) (misrepresentation to secured creditor that leased computer system had been delivered so that advances were made), aff’d in part and vacated in part, 960 F.2d 1277 (5th Cir. 1992); Lee Ludwig & Assoc., Inc. v. Seasport, Inc. (In re American Sports Innovations (ASI)), 105 B.R. 614, 618-19 (Bankr. W.D. Wash. 1989) (transfer of collateral to a partnership); Mercury Marine Acceptance Corp. v. Wheeler (In re Wheeler), 96 B.R. 201, 202-03 (W.D. Mo. 1988) (sale of repossessed boat subject to creditor’s security interest without notifying buyer of security interest); cf. Chase Manhattan Bank, N.A. v. J & L Gen. Contractors, Inc., 832 S.W.2d 204, 212 (Tex. Ct. App. 1992) (holding that transfer by successor owner of corporation of encumbered assets to a different corporation was not conversion because perfection was defective). Contra Braun v. Champion Credit Union (In re Braun), 141 B.R. 133, 135-37 (Bankr. N.D. Ohio 1992) (holding that sale of parts of a car was not conversion, as remainder of the vehicle was still available to the creditor as collateral), aff’d in part and rev’d in part, 152 B.R. 466 (N.D. Ohio 1993).

\(^{261}\) Mercury Marine Acceptance Corp. v. Wheeler (In re Wheeler), 96 B.R. 201, 203 (W.D. Mo. 1988); cf. Vaughn v. Murray (In re Murray), 116 B.R. 473, 476 (Bankr. E.D. Va. 1990) (stating that willful and malicious elements were met by using an implied malice standard, but reliance on advice of counsel precluded non-dischargeability); Borg-Warner Acceptance Corp. v. Littleton (In re Littleton), 106 B.R. 632, 634 (Bankr. 9th Cir. 1989) (stating that an attempt to achieve non-dischargeability failed because proceeds were not required to be deposited into a separate account), aff’d, 942 F.2d 551 (9th Cir. 1991).
property of another. In addition, conversion may occur after the debt has been discharged. The debtor may have violated criminal conversion statutes designed to protect the creditor. Finally, the creditor may seek punitive damages.

Significantly, the "debtors" sued in conversion may include third parties who would not otherwise have personal liability, such as a shareholder, family member, or other close associate. Such closely affiliated persons, to the extent their actions facilitate a wrong on the secured creditor, are certainly prime candidates for a policy favoring personal liability rather than a requirement that the creditor resort first to the collateral. The Code's bifurcated concept of a debtor, however, sets the stage for a more intriguing use of the remedy of conversion. The term "debtor" includes persons performing a guaranty function by giving the secured party collateral rather than taking on a personal obligation, persons purchasing at an execution or the foreclosure sale of a junior lien, and buyers who do not take free of the security interest. Such debtors have no personal liability to the secured creditor. If the creditor successfully pursues conversion against such a debtor, the tort creates personal liability to the secured party in the amount of the market value of the collateral.

266 See, e.g., Privitera v. Addison, 378 S.E.2d 312, 314-15 (Ga. Ct. App. 1989) (holding shareholder liable in conversion to corporation's creditor and to seller of shares for wasting assets by writing corporate checks to his benefit even though the purchase was under warranty that no liens on accounts receivable existed); Chase Manhattan Bank, N.A. v. J & L Gen. Contractors, Inc., 832 S.W.2d 204, 213 (Tex. Ct. App. 1992) (holding that conversion was committed by sister corporation which had encumbered the collateral, but was not liable on the secured obligation); Avocet Dev. Corp. v. McLean Bank, 364 S.E.2d 757, 761 (Va. 1988) (holding that conversion was committed by president and sole shareholder of debtor who indorsed the original notes and pledged the collateral, but did not indorse the renewal notes).
267 E.g., United States v. Edgmon, 952 F.2d 1206, 1208 (10th Cir. 1991) (convicting debtor's father of criminal conversion for selling collateral and not remitting proceeds).
268 See, e.g., Fricke v. Valley Prod. Credit Ass'n, 778 S.W.2d 829, 830-31 (Mo. Ct. App. 1989) (holding that conversion was committed by associate of debtor to whose benefit the sales proceeds were applied).
269 See supra notes 68-71 and accompanying text.
270 See infra notes 282-84 and accompanying text.
IV. ANALYSIS

Ascertaining the appropriate role of conversion as a secured party’s remedy requires reconciling the conceptual frameworks underlying conversion and Article 9. The right to possession is central to conversion doctrines, yet its remedy revolves around ownership. Article 9 involves a framework where relative rights depend on constructive notice and other statutory rules, rights to possession are divided between at least two parties, and the right to possession is generally separate from ownership. Thus, conversion actions by secured parties often involve defendants who also have possessory rights to the property, and a statutory scheme to resolve the rights exists. Careful evaluation of the conflicting possessory rights ensures that each is appropriately accommodated.

A. Conceptualizing Conversion

If more than one remedy is available for the same wrong, it is important to determine the appropriate role for each. In Warren’s view, conversion “deters serious wrongs to personal property, blocks dishonest men from profiting by their dishonesty, and makes for extremely careful methods of conducting important business matters.” The first two goals are generally irrelevant to conversions of security interests. Modifications to conversion as it relates to security interests should expand its role beyond encouraging careful business methods to include other salutary goals.

1. Property Remedy or Tort?

Despite the tort label, conversion at its heart resolves conflicting claims to property. Successful conversion claims force a sale of the personal property to the defendant, who acquires title upon satisfying the judgment. Its remedy of damages rather than possession results from the early English practice of only enforcing personal property rights in damage actions.

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271 Conversion doctrines developed when possession was the primary evidence of ownership. See supra notes 19-24 and accompanying text.
272 For example, Warren contrasted breach of contract remedies and conversion remedies when the wrong was a conversion and a breach of contract. He perceived that an important role for each exists, with conversion having the role of deterrent. WARREN, supra note 17, at 76-77.
273 Id. at 78.
274 Under early common law, possession under a claim of ownership was required to qualify as a plaintiff. See id. at 4-15.
275 See supra note 14 and accompanying text.
The expansion of conversion doctrines in the United States included a shift in focus from ownership to possession\(^{276}\) and an emphasis on tortious interferences. Such expansion enables conversion to be a much broader dispute-resolution device, but it also suggests close scrutiny in its development.\(^{277}\) Some courts characterize conversion as a strict liability tort.\(^{277}\) Usually, it is characterized as an intentional tort\(^{278}\) Although courts do not always require it, most definitions require that the converter's volitional act be wrongful.\(^{279}\) Even if those three characterizations are merely different attempts to describe the same constellation of court decisions, they portent different courses of development. The proper characterization probably differs if conversion resolves competing claims to property than if it compensates for tortious interferences with property. If the converter has an interest in the property that should be accommodated, the need for a wrongful act increases.

Pursuing one of two distinct paths for future development would benefit conversion doctrine. First, attention should be focused on its role in resolving competing property claims so that its principles may better accommodate that goal. Particular attention should be given to its use to protect property interests other than ownership and to accommodate property rights held by the competing claimant.

Second, a more radical, but perhaps ultimately necessary, path separates the property claim resolution role from the tortious interference role. For example, conversion could be limited to resolving competing property claims, and trespass to chattels could be expanded to cover tortious interferences that do not involve claims or interests in the property. This distinction would permit property concepts to become preeminent when the dispute involves conflicting property claims and would permit tort doctrines to focus on compensating for injuries to property interests.

Re-conceptualizing conversion as a damage remedy for a variety of interests in personal property and shaping its rules to track that conception eliminates many of the problems created by the doctrine.\(^{280}\) Instead of focusing on interference with possession, the focus could be on interference with the particular property interest of the plaintiff and any party with a property interest could bring the action. Damages could be

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\(^{276}\) See \textit{supra} notes 139-43 and accompanying text.


\(^{278}\) See U.C.C. § 223, 224 and comments.

\(^{279}\) This is consistent with the principles of \textit{RESTATEMENT} § 222A cmt. a.

\(^{280}\) See \textit{supra} notes 143-53 and accompanying text.
determined by a forced sale of the interest with which the defendant interfered rather than the ownership interest, so the plaintiff would only receive what it was due and the defendant would acquire only the plaintiff’s interest.

An important step down either path is a careful analysis of the compatibility of current conversion doctrines with resolving disputes between secured parties and other claimants of personal property. This application of conversion provides a useful starting point, because very important differences exist between security interests and ownership and other possessory interests in personal property. Such an analysis does not exist in the conversion literature. The ensuing discussion attempts to fill this void.

2. Coordination with Article 9

Answers to many questions about the meaning of priority to personal property collateral\(^{281}\) come from conversion actions. The questions arise because Article 9 not only unified diverse bodies of personal property security law, but also advanced it by creating new concepts and rights. Legal concepts like conversion which are historically linked to the concepts Article 9 expanded are unlikely to resolve these issues without significant modification. Moreover, the questions may be resolved most effectively by modifying the expansive concepts of Article 9 to facilitate just results. These considerations suggest incorporating the law of conversion, as it relates to security interests, into Article 9 to facilitate resolution of these issues.

The interrelationship between conversion and negotiable instruments law presents a valuable parallel. In the original promulgation of Article 3, section 3-419 set forth the measure of conversion damages and defined five situations which constituted conversion, two of which limited conversion liability.\(^{282}\) These statutory modifications and clarifications were designed to eliminate problems that had arisen and to clarify the

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\(^{281}\) See supra notes 122-33 and accompanying text.

\(^{282}\) U.C.C. § 3-419(1) (1962) provided that refusal of a drawee to return an instrument delivered for acceptance, refusal to pay or return an instrument delivered for payment, and payment over a forged indorsement constituted conversion. Subsection (3) limited conversion liability to proceeds remaining in the hands of a representative who in good faith and pursuant to reasonable commercial standards dealt with an instrument on behalf of someone who was not the true owner. Id. § 3-419(3). Subsection (4) precluded conversion liability for banks other than depositary banks if proceeds of a restrictively indorsed item are applied in contravention of the indorsement unless they are the immediate transferee of the indorser placing the restriction on the item. Id. § 3-419(4).
intended interaction between conversion and negotiable instruments law. The 1990 revision of Article 3 again modified the conversion rules. New section 3-420 affirms that the law of conversion applies to instruments, describes two broad sets of circumstances that constitute conversion, and describes two groups which cannot bring conversion actions. It explicitly limits damages to the plaintiff's interest in the instrument and provides a broader limitation on conversion liability when representatives deal with the instrument in good faith. The lengthy Official Comments to the revised section illustrate the importance of keeping development of conversion law relating to negotiable instruments consistent with other aspects of Article 3 and commercial practices and both the necessity for and the potential pitfalls of statutory rules to accomplish that goal.

The frequency with which conversion is invoked as a remedy in secured transactions and the unique issues raised by the conversion of security interests argue for taking a similar approach in Article 9. Regulating conversion in Article 9 would facilitate future development of conversion law governing security interests by increasing incentives to ensure that it remains consistent with Article 9 goals, policies, and principles.

B. Should Conversion Protect Security Interests?

A remedy should reflect the right being remedied as closely as possible to further the policies behind the right. A secured party's fundamental property right is to take control of property and sell or

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283 Two of the specific acts defined as conversion in the original Article 3, refusal to return an instrument delivered for acceptance and refusal to pay or return an instrument delivered for payment, are no longer included. The Official Comment explains that the old rule is inconsistent with some accepted practices. U.C.C. § 3-420 cmt. 1.

284 U.C.C. § 3-420(a).

285 Id. § 3-420(b), (c).

286 Id. § 3-420 cmt. 1 explains that some of the former section's rules on what constituted conversion were deleted because the general law of conversion would probably better resolve the issues in light of common business practices. That same comment explains that other portions of the section were either designed to resolve particular issues that could arise or to resolve a judicial split of authority in a manner consistent with Article 3 concepts. U.C.C. § 3-420 cmt. 2 explains that prior statutory provisions were modified because they had the potential of creating unnecessary issues. U.C.C. § 3-420 cmt. 3 describes one of the changes as resulting from rational judicial criticism of the prior Code rule.

287 See 1 DOBBS, supra note 10, § 1.7, at 27-30.
otherwise transform it to proceeds to be applied to the debt. Replevin closely reflects the secured party’s right by providing a means for obtaining possession. Conversion reflects the rights by transforming the property into proceeds to be applied to the debt in one action. Thus, conversion may be an ideal way to resolve competing claims in disputes regarding personal property collateral.

For justice to be served, however, a remedy should also be tailored to the wrong committed. Replevin requires the defendant to relinquish possession to one with a paramount possessory right, providing a close fit with the wrongful possession. Conversion, on the other hand, presents a more complicated situation. Rather than relinquishing possession, the defendant is forced to purchase the collateral. Conversion as a secured party’s remedy is appropriate only if the defendant’s wrong justifies requiring payment of fair market value for the collateral.

Rights to possession accompany very different interests in the property: the interests of an owner, bailee, lessee, secured party, or consignee. Several possessory rights can coexist and be transferred without creating immediate conflicts over possession. Failing to thoroughly examine the competing rights in personal property before vindicating one of them through conversion may miscarry justice. A defendant’s wrongful actions can be determined only after its rights in the property are understood. If the defendant’s actions are consistent with its rights and the secured party’s rights are unaffected or insignificantly affected, then conversion should not lie.

1. Security Interests vs. Ownership Interests

A precise description of what rights and powers in personal property constitute “ownership” is not readily available. If rights and powers to the property have not been divided, then ownership includes the right to dominion and control (possession if tangible property), the right to use and enjoyment, the right and power to transfer, the right to appreciation in value (and the risk of depreciation), and perhaps others. A person with those rights and powers can transfer many of them in whole or in part and still be considered the owner of the property. The essential rights and

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283 See supra notes 138, 242-43 and accompanying text.
284 See supra notes 186-89 and accompanying text.
285 The term “ownership” is used to convey the sense of primary or ultimate right to the property reflected in the common understanding of property having an “owner.” The term “ownership” rather than “title” is used because title or legal title has had historical meanings and uses that may create confusion.
powers constituting ownership of property are probably most generally understood to include at least reversionary rights to use, enjoyment, dominion, and control.

Applying traditional conversion doctrine to a serious interference with ownership rights is an appropriate remedy. The owner has either the right to current dominion, control, use and enjoyment or the reversionary interest in those rights. If those rights are paramount, the interfering party will be liable in conversion. The interfering party recompenses the owner by acquiring the ownership interest in a forced sale.

The basic rights to personal property encompassed in a security interest are discrete and readily definable: the right to obtain dominion and control (possession if tangible property) upon the debtor’s default, the right to transfer the debtor’s interest in the property for value, and the right to apply that value to the secured obligation. The secured party almost never has possession at the time of conversion, but merely has a right to it upon default. Its possession is also for a purpose other than use and enjoyment.

Traditional conversion doctrines do not correlate as well with the rights of a secured party. A secured party’s conversion action asserts its previously unasserted right to dominion and control and simultaneously relinquishes that right in exchange for its other rights in the property: receiving its value and applying it to the debt. In essence, conversion is an expedited foreclosure at maximum price to a “buyer” whose actions or interests may not include a claim of or desire for ownership. In addition, that buyer’s possession of the property may not seriously interfere with the secured party’s rights, if the property is still subject to its unasserted right to possession. Remedies to protect a security interest should not exceed the scope of the secured party’s rights if they derogate rights of another. Thus, it is critical to determine whether compelling purchase of the property serves justice.

2. Benefits to the Secured Party

Conversion may give the creditor greater rights than it had in the collateral. The secured party obtains the full benefit of its security interest without resorting to remedies provided in Article 9 and without the risk of liability for mistakes in exercising those remedies. It obtains the fair market value of the collateral, unless it exceeds the secured obligation. Fair market value is predictably higher than the amount obtained at

\[\text{291 See supra notes 96, 101-03 and accompanying text.}\]
a foreclosure sale. With a financially sound third party, conversion substitutes a solvent defendant for the debtor whose inability to pay necessitated recourse to the collateral. The secured party now has three options to satisfy its claim: the collateral, the proceeds, and the personal liability of a creditworthy third party. If the acts constituting conversion include the mere transfer of collateral, it could be exploited by a secured party pursuing the creditworthy entity, even if the collateral or the proceeds were readily accessible. Is this too solicitous of secured parties' rights?

A conversion action also creates an opportunity for exploitation of changes in the market. The secured party has the option of taking the market value at the time of conversion if the market has dropped, or of repossessing and foreclosing if the market has increased. Absent conversion law, the creditor could not obtain the value at the time of conversion unless it had declared default and completed foreclosure. In contrast, limiting conversion so the transferee could avoid personal liability does not encourage exploitation by the transferee. If the market has gone up, the secured creditor can use replevin and obtain the benefit. If the market has gone down, the transferee is better off relinquishing possession than incurring personal liability, but that advantage is not anticipated or created by the transferee. Any party with an interest in collateral risks declining value. Absent delay tactics by the transferee, no particular reason compels shifting this risk from the secured creditors to innocent transferees.

The potential for greater recovery through conversion than through traditional foreclosure remedies may argue for the measure of damages to be foreclosure rather than fair market value. However, many potential unfair advantages are eliminated if conversion rules encourage a secured party to act before a buyer's purchase or a junior creditor's foreclosure or execution. Delay by a secured creditor with timely knowledge of an impending sale or repossessions of its collateral should be a waiver of its

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[292] The facts of State Auto. Mut. Ins. Co. v. Chrysler Credit Corp., 792 S.W.2d 626 (Ky. Ct. App. 1990), illustrate the potential issues, although the creditor in that case, for some reason, pursued conversion rather than the then more valuable collateral. The defendant in the conversion action was a liability insurance company which paid $5,801.25 to the owner of the vehicle damaged by its insured and sold the totaled vehicle to a salvage company for $1,215.50. Id. at 627. A subsequent buyer restored the vehicle at a cost of $2,500.00 and resold it to the salvage company. The court found conversion by the insurance company in the amount of the salvage value and ordered title delivered to the owner upon payment of that judgment. Id. Seeking to enforce its security interest in the auto would have been the economically more advantageous course of action.
right to sue in conversion.\textsuperscript{233} Laches provides another possible protection, but its discretionary nature reduces its effectiveness.\textsuperscript{234} Some courts articulate a need for the secured party to mitigate damages,\textsuperscript{235} but that protection has not been widely adopted nor well developed.

3. \textit{Do Innocent Converters Deserve Protection?}

Innocent converters of security interests are those who in good faith exercise legitimate rights of dominion and control over the secured party’s collateral. Generally such parties derive those rights from the debtor, albeit subject to the security interest. If innocent converters’ property interests are subject to the security interest, do adequate justifications for limiting their liability for conversion exist? That question is addressed for four significant groups of innocent converters: junior secured parties, lien creditors, buyers who have not taken free of the security interest, and agents of the debtor.

\textbf{a. Junior Creditors}

Absent a subordination agreement, junior secured parties and lien creditors cannot take free of the prior security interest. Prompt notice of the lien by lien creditors only limits the secured obligation to the amount outstanding at the time of the lien plus advances made or committed

\textsuperscript{233} See General Elec. Co. v. Halmar Distribs., Inc. (\textit{In re Halmar Distribs., Inc.}), 968 F.2d 121, 129-30 (1st Cir. 1992) (explaining that purchase money creditor who acquiesced in payment of inventory proceeds into other creditor’s lockbox account thereby waived right to receive proceeds directly, but a demand and refusal reinstated right as to future collections); C & H Farm Serv. Co. v. Farmers Sav. Bank, 449 N.W.2d 866, 872 (Iowa 1989) (stating that creditor waived right to claim conversion because of knowledge of and acquiescence in a course of dealing contrary to the terms of the security agreement).

The bankruptcy court in \textit{In re Halmar Distribs., Inc.} had relied on the equitable doctrine of laches to achieve the same end, but waiver is the more precise doctrine on those facts. 116 B.R. 328 (Bankr. D. Mass. 1990), \textit{rev’d}, 968 F.2d 121 (1st Cir. 1992).

\textsuperscript{234} Laches requires passage of time and a resulting hardship. \textit{See supra} note 240 and accompanying text. The relevant statute of limitations for conversion may make the passage of time a significant barrier to the use of the doctrine. \textit{See, e.g.}, United States v. Security State Bank, 686 F. Supp. 733, 735-36 (N.D. Iowa 1988) (rejecting claim of reliance on a delay of over two years because the statute of limitations for conversion actions was six years); Associated Indus. v. Keystone Gem., Inc., 135 B.R. 275, 282 (Bankr. S.D. Ohio 1991) (holding that burden to sustain laches was not met in light of a four-year statute of limitations for conversion); \textit{see also supra} note 293.

\textsuperscript{235} \textit{See supra} note 252.
within forty-five days thereafter. Junior secured creditors are unable to place any limit on future advances against the collateral. In short, the Code-created monopoly position for the prior creditor is ameliorated only by subordination, which is generally not available.

The risks created by the monopoly position raise the question: Why does a junior creditor obtain its interest? Each possible answer implicates different concerns about the justice of conversion. The creditor may know of the security interest and tactically decide to obtain whatever security it can on the theory that anything is better than nothing. Provided there is equity in the collateral, these creditors deserve some protection of their interests.

The creditor may not know of the security interest, either because it relied on representations of the debtor and failed to search the files or because a reasonable search failed to disclose the security interest. The filing system affords greater protection to potential converters of security interests than ownership interests, because ownership interests generally are not filed. Requiring creditors to rely on the filing system enhances its integrity. Little incentive exists to provide additional protection to a creditor who fails to search.

The creditor who made a reasonable search, however, is more sympathetic. The notice system is far from perfect. A creditor may obtain encumbered property despite thorough inquiry and searching. The more attenuated the connection between the converter and the original debtor, the more difficult the task of obtaining knowledge of the security interest. The Code filing rules attempt to accommodate the needs of subsequent parties to learn of the security interest and the countervailing needs of the secured creditor to monitor changes and not be penalized for filing office errors. The accommodations placed the risk of filing office error and the burden to ascertain information about the collateral on subsequent parties. The debtor, of course, may misrepresent the required information to obtain an advantage.

An additional significant reason for a change is evident when considering a creditor with a junior interest. Frequently, a creditor justifiably assumes it has priority even though that assumption ultimately proves wrong. Such creditors present the most persuasive argument for modifying conversion doctrine.

296 U.C.C. § 9-301(4).
297 Id. § 9-312(7).
298 See supra text accompanying notes 50-54.
299 See supra notes 75-78 and accompanying text.
300 See supra notes 77-79 and accompanying text.
One significant group of such creditors are those who have security interests in after-acquired collateral other than inventory which, without their knowledge, is subject to a purchase money security interest. Even if the secured party learns of that subsequent interest, determining priority depends on information not in the public record: Was the value used to acquire the collateral? Was filing made within ten days of acquisition?  

In a number of other circumstances, a creditor’s good faith assumption of priority turns out to be wrong. Priority may turn on the resolution of a close issue. For example, in Thorp Commercial Corp. v. Northgate Industries, Inc. the lower court found a creditor collecting accounts receivable not liable in conversion because it had priority. On appeal, the court reversed the summary judgment on the grounds that the collecting creditor did not have priority because the other creditor’s earlier financing statement contained an adequate description of future accounts receivable.  

The priority question may be sufficiently involved to require litigation to resolve it. In Evergreen Marine Corp. v. Six Consignments of Frozen Scallops, repossessing creditors with priority to after-acquired property faced a conversion claim for refusing a demand for delivery by the issuer of a negotiable bill of lading who had delivered the collateral to the debtor without obtaining possession of the bill. The court reversed a summary judgment in favor of the creditors because it found the issuer of the bill of lading had priority.  

Other priority questions not only involve uncertain legal issues, but also cannot be resolved without ascertaining facts unavailable to the creditor at the time it enforces its interest. In Sears Consumer Financial Corp. v. Thunderbird Products, a prior creditor converted a boat by repossessing it from a boat dealer to which it entrusted the boat after a prior repossession. Without authority, the dealer sold the boat and a subsequent creditor financed the purchase. The buyer had not taken possession and the subsequent creditor had not properly recorded its lien.  

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301 U.C.C. § 9-312(4).
304 4 F.3d 90 (1st Cir. 1993).
305 Id. at 91, 93-96. The lower court had resolved the priority dispute under U.C.C. §§ 2-702, 2-403(1). This court relied on U.C.C. § 2-403(2). Although neither analysis is particularly compelling, the point is that the priority dispute is not readily resolved.
The repossessing creditor had no way of knowing about the buyer's or creditor's interests at the time of conversion.\textsuperscript{307}

Similarly, in \textit{Centre Re Bank, N.A. v. New Holland Division of Sperry Corp.},\textsuperscript{308} a seller of equipment on secured credit repossessed used equipment traded-in on equipment it sold the debtor. The seller's records showed no previous sale, but the debtor had sold the equipment to a bank which had leased it back to the shareholders of the debtor. They concealed the transaction from the seller\textsuperscript{309} and later delivered the leased equipment to the debtor to make the sale resulting in the trade-ins. Although both the majority and the dissent decided that the bank's purchase of the equipment defeated the prior security interest, the case required resolution of significant factual questions that could not be readily discovered or resolved by the repossessing creditor.\textsuperscript{310}

Because junior creditors have significant justifications for acquiring inferior interests, they deserve consideration for modifying conversion doctrines. Creditors acquire rights to satisfy a debt, not rights to use and enjoyment. Becoming obligated to buy the property is inconsistent with the rights they sought and claim. Holding a creditor personally liable to buy collateral merely because it guessed incorrectly on uncertain issues is inappropriate unless some higher policy is furthered by conversion rules.

\textbf{b. Buyers}

Applying the same analysis to buyers produces more straightforward and somewhat less compelling results. Buyers not in the ordinary course of business can take free of the security interest if the secured party consents to the transfer. If not, increase in the secured obligation can be limited to advances made or committed to before the date the secured party learns of the transfer.\textsuperscript{311} Again the question is raised: Why would any buyer aware of these risks acquire property subject to a security interest without either obtaining the consent of or giving notice to the secured party? The answers for buyers are easier.

\textsuperscript{307} The court held that the creditor's entrustment under U.C.C. § 2-403(3) gave title to the buyer free of the security interest as a buyer in the ordinary course of business. Loss of its security interest enabled the unperfected subsequent creditor to obtain priority. Determining buyer in the ordinary course status is difficult when the buyer has not taken possession. \textit{Thunderbird Products}, 802 P.2d at 1034.

\textsuperscript{308} 832 F.2d 1415, 1416-17 (7th Cir. 1987) (Eschbach, J., dissenting).

\textsuperscript{309} \textit{Id.} at 1417.

\textsuperscript{310} \textit{Id.} at 1417, 1425.

\textsuperscript{311} U.C.C. § 9-307(3).
The buyer may know of the security interest but tactically decide to proceed, either taking the value of the security interest into account or hoping it will not be enforced. Under these circumstances, conversion's forced sale is appropriate. The buyer sought ownership and either paid what it expected or lost its gamble to obtain title. Likewise, buyers without knowledge of the prior security interest because they failed to search the files and relied on debtor representations do not present a compelling case for additional protection.

However, buyers unable to find the prior interest due to inadequacies in the filing system deserve protection similar to creditors. This situation includes buyers who acquire the property at an execution or foreclosure sale of a creditor they reasonably believed had priority. They are in the same position as that creditor. Modifying conversion rules to limit personal liability may be warranted under these circumstances because, although the buyer sought ownership, it understood the interest to be unencumbered.

c. Seller's Agents

Agents selling collateral are generally held to the same standards for conversion as their principal. However, they frequently have no knowledge that the sale is wrongful. Agents claim only a right to sell the property, not title or a right to proceeds. They receive only a small fee for their services, yet they may be of sufficient financial strength to make them a desirable target for secured creditors seeking repayment of a delinquent debt.

However, these same arguments could be made regarding conversion of ownership interests. Do innocent agents deserve greater protection with regard to conversion of security interests than ownership interests? The agent facilitates deprivation of ownership rights by the mere sale. However, the secured party's rights are unaffected if the new buyer is located with reasonable effort and the security interest continues. In fact, sale of the collateral in these cases is in the best interests of the secured creditor, if it is the debtor's primary source of income. These factors support consideration of conversion rules that provide agents greater protection.

4. Appropriate Protection

Justifications exist for protecting an innocent converter's rights. But, what is the nature of those rights, and what protections are not inconsistent with the rights of the superior secured party? Just because a buyer's
or junior creditor’s rights are inferior does not mean they are non-existent. Each is entitled, but not required, to redeem the property. Conversion as a forced sale at the lesser of the property’s fair market value or the amount of the secured obligation is in essence a forced redemption. Why should an innocent junior creditor be forced to redeem and expend money on a debt that may not be collectible? Perhaps forced redemption is appropriate for an innocent buyer who intended to acquire an ownership interest. Yet if the senior repossessed and foreclosed, the innocent buyer could repurchase at the foreclosure price, an amount invariably less than fair market value. These factors suggest several accommodations: provide a way to avoid personal liability, ensure that a converter has recourse against other parties to vindicate its interest, and consider measuring damages by the value at a foreclosure sale rather than fair market value.

a. Avoiding Personal Liability

A meaningful protection from personal liability permits the innocent converter to relinquish possession. This modification to conversion doctrine creates no incentive to shirk inquiry and file searching because it does not alter the transferee’s risk of losing the collateral to the secured party. It simply avoids giving the innocent converter the additional risk of personal liability for debtor misconduct in misrepresenting the encumbered status of property or in failing to honor its obligations under the security agreement. Implementing this protection requires either changing the law regarding tender of delivery or expanding the requirements for refusal of a demand.

b. Allocating Ultimate Liability

An innocent converter should have legal recourse to pass the loss to the most culpable party, assuming the party can be served and any

\[312\] Limiting damages to the amount of the secured obligation if less than the fair market value of the collateral is virtually the only rule articulated by the courts to distinguish conversion of security interests from ownership interests. See Chamberlain v. Shaw, 35 Mass. (18 Pick.) 278, 283-4 (1836) (setting forth the rule long before the explosion of security interests in personal property known today).

\[313\] This position would be particularly true, as contrasted with being subject to replevin, if the property has become related to the buyer’s “personhood.” See Radin, *supra* note 13.

\[314\] See *supra* notes 198-201 and accompanying text.

\[315\] See infra notes 347-54 and accompanying text.
judgment enforced. Currently, the legal mechanisms to accomplish this vary with the nature of the converter's interest. An agent can pass the loss to its principal if it has a contractual right or if it successfully relies on equitable remedies, such as fraud, misrepresentation, mistake, or unjust enrichment.

An agent's rights after satisfying a conversion judgment depend on whether conversion of a security interest constitutes a forced sale of the ownership interest or the security interest. The court in *Chadron Energy Corp. v. First National Bank* characterized it as a forced sale of the security interest. By such a characterization, the converter, upon satisfaction of the judgment, acquires not title but, by subrogation, the rights of the prior secured creditor under Article 9 and its security agreement. If characterized as the sale of an ownership interest, the agent obtains title, but it has sold the property for the debtor so the good title presumably inures to the buyer's benefit. If characterized as the sale of a security interest, the agent obtains subrogation rights. These rights to the property do not help in an action against the buyer, because it would have defenses against the selling agent. If conceived broadly enough to include subrogation rights to the secured obligation, however, they would permit the agent to bring an action against its principal, the debtor.

Innocent buyers present a very different picture. They face equivalent risks if they are liable in conversion or if the property is taken in replevin. They either pay for the property and lose it or pay for it twice to satisfy different obligations and obtain rights in it. In either case, innocent buyers should be able to recover the purchase price from a more culpable seller. The Code's title warranty that the property is not subject to a security interest, lien, or encumbrance unknown to the buyer provides a potential mechanism. If that warranty is properly disclaimed, the buyer presumably knowingly assumed the risk of subsequent liability in the full value of the goods.

Buyers at execution or foreclosure sales assume a much greater risk. Section 2-312(2) of the Code excludes warranty of title in circumstances indicating that the person is selling only such right as he or a third person may have. That provision precludes buyers at execution sales from obtaining a warranty of title. Official Comment 5 describes the provision as covering sales in which liens are foreclosed. Does it cover Article 9 foreclosure sales, or does the provision in section 9-504(1)
that any foreclosure sale is subject to Article 2 control?\textsuperscript{320} Independent of the possible statutory loss of the warranty, foreclosing creditors often disclaim the warranty in any bill of sale. In any event, recourse to title warranty is uncertain for buyers at foreclosure sales. To the extent warranty protection is unavailable, buyers must rely on the equitable remedies described for agents.

The buyer's rights based upon satisfying the conversion judgment also differ if conversion of a security interest is a forced sale of the ownership interest rather than the security interest. With a forced sale of the ownership interest, the buyer has title but paid for the property twice. A forced sale of the security interest gives the buyer subrogation rights. The ramifications of this are not clear. The buyer has purchased both the debtor's equity in the property and the security interest. Does that mean they merge and the buyer has good title and no further rights? Does it mean the buyer may recover judgment against debtor on the subrogation claim but must return the security? Or does buyer have title and a subrogation claim against debtor in the amount of the security interest? Only the latter interpretation properly allocates rights and liabilities.

Changes to Article 9 suggested by other commentators would also protect buyers at foreclosure or execution sales. Ensuring that buyers have actual knowledge of prior security interests permits them to eliminate the risk.\textsuperscript{321} Ensuring that buyers at executions or foreclosure sales take title free of all security interests and liens also eliminates the risk.\textsuperscript{322}

The most troubling issues surrounding remedies for converters arise for junior creditors. Murdock v. Blake\textsuperscript{323} illustrates the problem. A judgment creditor received $2,821.63 from the execution sale.\textsuperscript{324} Although the court stated that the buyer would have the property subject to the prior security interest, the judgment creditor was liable to a prior secured party in conversion for $4,942.88, the value of the property at the time of sale. The judgment creditor was now out almost twice as much as before the levy and execution, yet by virtue of the execution sale its judgment had been satisfied. Here, the debtor is the more culpable party and should bear the loss. Unless rights of subrogation exist or the debt is deemed reinstated, the creditor is left only with equitable claims such as unjust enrichment.

Treating conversion as a forced sale of the ownership interest provides no protection. The good faith buyers at the execution sale presumably benefit

\textsuperscript{320} Section 2-312(2) also excludes the warranty when circumstances give the buyer reason to know the seller is not claiming title or only selling the title it or a third person may have. See Hillman et al., supra note 2, ¶ 25.02[5][a], at n.329.

\textsuperscript{321} See infra notes 426-28 and accompanying text.

\textsuperscript{322} See infra notes 435-37 and accompanying text.

\textsuperscript{323} 484 P.2d 164 (Utah 1971).

\textsuperscript{324} Id. at 166-69.
from the good title. Adopting the Chadron characterization\textsuperscript{325} of a forced sale of the security interest provides only limited protection. First, it subrogates the judgment creditor to the senior secured party's rights to the collateral in the hands of the buyers. The buyers, however, have defenses against the judgment creditor's claims. In Murdock, for example, because the buyers paid $2,821.63 for property worth $4,942.88, subject to a security interest of at least that amount,\textsuperscript{326} they apparently purchased without knowledge of the security interest. Election of a conversion action against the creditor rather than replevin or conversion against the buyers may effectively insulate them from attack.

Subrogation provides a second right—an action against the debtor on the secured obligation in the amount of the junior creditor's conversion liability. This claim is more theoretical than practical. It exceeds the judgment creditor's unpaid claim which necessitated levy against the debtor's property. These unfair consequences of conversion are eliminated only by limiting conversion to appropriate wrongful acts.

C. When Is a Security Interest Converted?

If protections for innocent converters are inadequate under current conversion law, what modifications would appropriately facilitate the suggested protections? This question is best answered by examining the current rules governing conversion of security interests and determining the circumstances under which they produce unsatisfactory results as well as what principles could be adopted or expanded to avoid those results.

Official Comment 3 to Uniform Commercial Code section 9-306 states that a secured party has the right to repossess the property from a transferee, "or in an appropriate case maintain an action for conversion."\textsuperscript{327} The drafters did not elaborate on what constitutes an appropriate case. Is it whenever the elements for the common law tort of conversion of other interests in property can be established?

Courts in security interest cases often cite the Restatement for the rules of conversion or use language similar to the elements set forth in the Restatement.\textsuperscript{328} The Restatement definition of conversion\textsuperscript{329} raises two significant questions: What interference is sufficiently serious? When should the converter "justly be required to pay?" The Restatement gives no

\textsuperscript{325} See supra note 316 and accompanying text.
\textsuperscript{326} 484 P.2d at 169-70.
\textsuperscript{327} No other reference to conversion of a secured party's interest in property is made in Article 9 or its comments.
\textsuperscript{328} See supra notes 172-206 and accompanying text.
\textsuperscript{329} See supra note 172 and accompanying text.
consideration to those questions in cases where a security interest is converted. Cases involving conversion of a security interest primarily discuss only priority, not the seriousness of the interference or the justice of the forced sale.\textsuperscript{330}

The injustice of finding conversion by innocent transferees has not gone unnoticed. Attempts to mitigate the problem, however, have swept too broadly. Louisiana adopted a non-uniform amendment to Article 9 in order to preclude personal liability of a purchaser of collateral unless conspiracy to defeat the security interest could be found.\textsuperscript{331} Because the term "purchaser" includes secured parties and lien creditors,\textsuperscript{332} this formulation protects most persons giving value to acquire interests in property. The Louisiana approach, however, sweeps too broadly by defining wrongful conduct too narrowly. Interferences not rising to the level of conspiracy with the debtor may also justify conversion liability.

A judicial attempt to avoid finding conversion of a security interest suffers from a similar deficiency. The trial court in United States \textit{v. Tugwell}\textsuperscript{333} limited the creditor to its Code remedy to recover proceeds despite defendant's improperly qualified refusal of the creditor's demand for delivery.\textsuperscript{334} First, the holding ignores the Code concept that the creditor can pursue either the collateral or identifiable proceeds.\textsuperscript{335} Second, it overlooks protection provided by the tort doctrine of qualified refusal to deliver.\textsuperscript{336}

If requiring collusion with the debtor is too narrow and requiring pursuit of collateral is too broad, what limitations are appropriate? Focusing on the nature of the act claimed to constitute conversion provides substance for the skeletal concepts of serious interference, and justice is thus established.

Interferences with property which are serious enough to justify conversion should exclude exercise of legitimate property interests of the actor. Buyers, junior secured parties, and lien creditors obtain possession for value from one

\textsuperscript{330} One notable exception is Installment Fin. Corp. \textit{v. Hudiburg Chevrolet, Inc.}, 794 P.2d 751 (Okla. 1990). The court found no wrongful conduct on the part of the alleged converter but expressly noted that it did not need to address whether the secured creditor could repossess. \textit{Id.} at 753. While justice and the seriousness of the interference were not expressly referred to, they are the essence of its holding.

\textsuperscript{331} \text{LA. REV. STAT. ANN.} § 10:9-306(2) (West 1993) provides in pertinent part:

A purchaser of collateral, however, incurs no personal liability on account of unauthorized transfer unless he has conspired with the debtor to defeat the interest of the secured party.

\textsuperscript{332} \text{U.C.C.} § 1-201(32), (33).


\textsuperscript{334} \textit{Id.} at 487-88.

\textsuperscript{335} \textit{See} \text{U.C.C.} § 9-306. The Fourth Circuit recognized this in reversing the trial court decision. \textit{Tugwell}, 779 F.2d at 7.

\textsuperscript{336} \textit{See supra} notes 202-03 and accompanying text.
legally empowered to transfer possession. Buyers have ownership of the property, albeit subject to a security interest. Unless they have acted wrongfully, they should not be personally liable to a secured party in conversion, but should be merely subject to replevin or its equivalent so that the secured party can enforce the security interest. Junior secured creditors and lien creditors have rights to possession, to dispose of the property, and to apply the proceeds to their obligations. Unless they have acted wrongfully, they should not be personally liable for the fair market value of the collateral, which is more than their disposition will bring, but should be merely subject to replevin or its equivalent or their disposition should be subject to the prior security interest. Requiring a wrongful act accommodates the converter's property interests.\footnote{337 The Restatement's definition of conversion includes the concept of wrongful conduct. \textit{Id.} at § 222A.}

1. Refusal of a Demand

One traditional wrongful act constituting conversion is refusal to deliver property on demand by a person with a paramount interest. Unqualified or improperly qualified refusals to comply with a demand to deliver the collateral constitute conversion.\footnote{E.g., \textit{General Elec. Co. v. Halmar Distribs., Inc. (In re Halmar Distribs., Inc.)}, 968 F.2d 121, 129-30 (1st Cir. 1992) (holding that junior creditor refusing to deliver proceeds it rightfully held in lockbox on demand by senior secured creditor was liable in conversion); \textit{First Interstate Bank, N.A. v. Interfund Corp.}, 924 F.2d 588, 591-93 (5th Cir. 1991) (explaining that second creditor decided not to buy a note and chattel paper that had been delivered to it by the first creditor but held it instead as security for another loan to the debtor and upon refusal of a demand became liable in conversion as the initial possession was rightful); \textit{United States v. Tugwell}, 779 F.2d 5, 7 (4th Cir. 1985) (holding that buyer of collateral without knowledge of security interest was liable for conversion for refusing to turn over collateral until storage charges were paid), rev'd 597 F. Supp. 486 (M.D.N.C. 1984); \textit{Lafayette Prod. Credit Ass'n v. Wilson Foods Corp.}, 687 F. Supp. 1267, 1274 (N.D. Ind. 1987) (holding buyer liable in conversion for failure to issue the joint checks when it had knowledge of this requirement); \textit{Modern Living, Inc. v. Niederhofer}, 751 S.W.2d 243, 245 (Tex. Ct. App. 1988) (holding that landlord's refusal to permit mobile home to be repossessed until back rent was paid was a conversion of the mobile home); \textit{Farm Credit Bank v. F & A Dairy}, 477 N.W.2d 357, 361 (Wis. Ct. App. 1991) (explaining that buyer of dairy products encumbered by a security interest was liable in conversion for refusal to pay price directly to the creditor); \textit{Lontree, Ltd. v. Resource Control Int'l, Inc.}, 755 P.2d 195, 196 (Wyo. 1988) (noting that buyer not in the ordinary course of business converted logs by refusing to surrender them to secured party).} Delivery precludes liability.\footnote{E.g., \textit{Harley-Davidson Motor Co. v. Bank of New England-Old Colony Nat'l Ass'n},}
If the converter believes in good faith that its interest is paramount, it needs an appropriate avenue to pursue in resolving that claim, without incurring conversion liability. Deferral of action to investigate the claim is limited to a reasonable period of time. Conversion liability after a refused demand turns on who has priority and because this determination is often difficult, an appropriate qualified refusal must permit the party to present the priority issue to a court for resolution. Interpleader should constitute a qualified refusal. Interpleader is available, even if the instituting party is an interested stakeholder and the interpledged property cannot be deposited with the court, as long as a bond is posted. Unless a converter with a property interest files a timely interpleader, it has two alternatives: deliver the collateral and file suit to regain possession (and thus lose control) or refuse the demand and put the claiming secured creditor to the effort and expense of a legal action (and thus risk liability for conversion).

Is an improperly qualified refusal of a demand sufficiently serious to justly find conversion? The demand creates actual rather than mere constructive knowledge of the security interest and its priority, and refusal

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85 B.R. 1, 4 (Bankr. D.R.I. 1988) (holding that junior creditor was not liable in conversion for holding certificates of title because it relinquished the certificates on demand of the prior creditor), aff'd, 897 F.2d 611 (1st Cir. 1990); Scholfield Bros., Inc. v. State Farm Mut. Auto. Ins. Co., 752 P.2d 661, 662-63 (Kan. 1988) (holding no conversion of secured creditor's interest by third party's insurance company who paid for car damaged in collision in exchange for title and sent title to secured creditor, who had refused to relinquish title).

340 See Messerall v. Fulwider, 245 Cal. Rptr. 548, 551 n.5, 553 (Cal. Ct. App. 1988) (stating that bailee only gets a reasonable period of time to investigate claim, not a right to demand a court order).

341 E.g., Polk County Bank v. Graven, 745 S.W.2d 793, 795 (Mo. Ct. App. 1988) (holding no conversion for secured creditor's refusal to deliver repossessed collateral to other secured party, because refusing creditor determined to have priority); First State Bank, N.A. v. Arsiaga, 804 S.W.2d 343, 345 (Tex. Ct. App. 1991) (noting that holder of statutory lien for repairs to truck had priority and was not liable for conversion for refusal to deliver to secured party). But cf. Messerall v. Fulwider, 245 Cal. Rptr. 548, 551-53 (Cal. Ct. App. 1988) (explaining that lien for repair and storage costs was extinguished by secured party's offer to pay so that further demand for court order was a conversion and right to the storage costs was lost).

342 See supra notes 302-10 and accompanying text.

343 See RESTATEMENT §§ 239 cmt. c, 240 cmt. e; WARREN, supra note 17, at 47-49.


345 See supra note 338 and accompanying text.
is an act inconsistent with the rights, so that the conduct is wrongful. Failure of the possessing party to return collateral puts the secured party at the effort and expense of a replevin action. Although a debtor is entitled to refuse reposssession under U.C.C. § 9-503 and force the creditor to use judicial remedies such as replevin, it generally has contractual liability for such costs. Thus, third-party liability for the refusal is consistent.

If a refused demand is sufficient for conversion liability, should it also be a necessary condition? Requiring demand and refusal for conversion of security interests is consistent with the nature of a security interest. If the debtor has possession, the secured party cannot exercise its rights without obtaining possession, which requires at least a demand for delivery or self help. The secured party should not be placed in a better position by a mere transfer. Requiring a demand permits the innocent converter to avoid personal liability by tendering possession, and it allows the secured creditor to receive the interest for which it bargained.

Moreover, requiring a demand and refusal more efficiently resolves the question of whether damages should be market value or foreclosure value. If the innocent converter avoids liability by acquiescing in the demand or interpleading, it achieves the same protection as the alternative valuation without the uncertainty of determining foreclosure value. In addition, if the demand is refused, the premium of market value over foreclosure value helps recompense the secured party’s additional costs and expenses.

2. Exceptions to Demand and Refusal

Are the two traditional exceptions to the demand and refusal requirement appropriate for conversion of security interests? The first exception is that demand is unnecessary if the converter’s possession is wrongful. What constitutes wrongful possession of property subject to a security interest? If the converter’s possession involves damaging the

346 See supra text accompanying note 291.
347 E.g., General Elec. Co. v. Halmar Dists., Inc. (In re Halmar Dists., Inc.), 968 F.2d 121, 129-30 (1st Cir. 1992) (holding that conduct was not wrongful until demand was refused); First Interstate Bank of Arizona, N.A. v. Interfund Corp., 924 F.2d 588, 591-93 (5th Cir. 1991) (explaining that second creditor decided not to buy a note and chattel paper that had been delivered to it by the first creditor, but instead held it as security for another loan to the debtor and upon refusal of a demand became liable in conversion, as the initial possession was rightful).
collateral, making changes to it that adversely affect its value, knowingly engaging in delay tactics adversely effecting the secured party’s rights, or conspiring with the debtor, it would not be appropriate to allow the converter to escape personal liability by tendering delivery. Refusing to pay for the collateral should also establish conversion without the necessity of another demand. In some cases finding wrongful possession, the converter is determined not to have an appropriate claim to the property, such as cases involving bailees without rights to the property or junior creditors without liens or security interests. In those cases, if the converter asserted rights with a good faith belief that they were legitimate, then requiring a demand is not an unfair burden.

The other exception to demand and refusal is if the collateral cannot be delivered by the converter. This situation clearly covers loss or destruction of the collateral. Interpreted literally, however, this exception could support a finding of conversion for a rightful transfer by a party rightfully in possession. Some commentators have relied on the existence of a subsequent transfer to explain cases which hold the mere transfer of collateral to be conversions, yet acknowledge that resale

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348 See supra note 331 and accompanying text.
349 E.g., Permian Petroleum Co. v. Petroleos Mexicanos, 934 F.2d 635, 651-52 (5th Cir. 1991) (stating that failure to pay for shipments by asserting offset rights is conversion of the security interest by precluding priority as a buyer).
350 E.g., United States v. Smoky Valley Bean, Inc., 673 F. Supp. 1551, 1552, 1554 (D. Kan. 1987) (stating that bailee of bean crop which was sold to pay storage charges and past due account without consent of debtor or secured party was liable to secured party in conversion); State Auto. Mut. Ins. Co. v. Chrysler Credit Corp., 792 S.W.2d 626, 627-28 (Ky. Ct. App. 1990) (holding that insurance company that paid debtor for totaled vehicle and buyer for scrap value were both liable to secured party for conversion because title never passed to them).
351 E.g., Associated Indus. v. Keystone Gen., Inc. (In re Keystone Gen., Inc.), 135 B.R. 275 (Bankr. S.D. Ohio 1991) (explaining that unsecured creditor who claimed title retention converted secured party’s collateral by assuming control over it in a warehouse); State Sav. Bank v. Allis-Chalmers Corp., 431 N.W.2d 383, 386 (Iowa Ct. App. 1988) (stating that purchase money secured creditor was liable to secured creditor for converting proceeds of the debtor’s bulk sale of collateral because it could not establish that the proceeds were of collateral in which it had a security interest).
352 E.g., United States v. Fullpail Cattle Sales, Inc., 617 F. Supp. 73, 75 (E.D. Wis. 1985).
standing alone does not justify conversion liability. The question of the wrongfulness of a subsequent transfer is identical to the question of the wrongfulness of the initial transfer. Unless the inability to deliver results from loss, destruction, or some other wrongful act of the converter, serious interference has not occurred. Absent such interference, the secured creditor's claim to the collateral should be first. The mere inability to deliver should not negate the need for a refused demand.

3. Are Collateral Transfers Wrongful?

In many cases, however, courts appear to merely use priority to determine liability for conversion. One of the problems may be judicial confusion of the paramount right to possession with the right to damages for conversion. The conversion question involves more than whether the prior creditor can regain possession in a replevin action. The right to possession is merely a question of priority. While priority is necessary for a creditor to maintain a successful conversion action, lack of priority is not wrongful. The interference must be of sufficient seriousness that justice requires a forced sale of collateral.

Is the mere transfer of collateral such an interference by either the transferor, the transferee, or both? Making that determination requires understanding the relative rights of the parties. A secured party’s right to possession generally requires default by the debtor. Prior to that time, the original debtor can rightfully sell and encumber its equity in the collateral, unless prohibited by the security agreement. Absent contractual prohibitions, the mere transfer of that equity is not wrongful and should not impose liability on either the transferor or transferee.

Do prohibitions on transfer generally contained in security agreements elevate the mere transfer to conversion by either the transferor or transferee? Courts have addressed several common transfers of collateral in conversion cases: good faith buyers; agents of the debtor selling

354 Hillman et al., supra note 2, ¶ 25.01[3][a][ii], at 25-18, 25.01[3][a][iii], at 25-21 to -23.

355 See, e.g., Hong Kong & Shanghai Banking Corp. v. HFH USA Corp., 805 F. Supp. 133, 135, 145 (W.D.N.Y. 1992) (stating that because the other creditor had priority, repurchasing junior is liable in conversion as a matter of law).


357 See supra notes 186-89 and accompanying text.
without knowledge of the security interest; and junior creditors obtaining a lien, possession, execution, or foreclosure. Some of the cases involve the liability of transferees, while others involve the liability of transferors. The rights and actions of transferors and transferees vary in important ways which requires different analyses, but the distinctions are generally not taken into account by the courts.

a. Impact of Section 9-311

Does validation by section 9-311 of the Uniform Commercial Code of voluntary and involuntary transfers of a debtor’s equity in collateral defeat claims that mere transfers in violation of the security agreement constitute conversion? The effect of section 9-311 on claims of conversion is not clear on the face of the statute. It does not elaborate upon the rights or interests obtained by a transferee. The Official Comments describe the section’s purpose only as eliminating the title theory of security interests.

Section 9-311 could be interpreted to give the debtor both the power and the right to transfer collateral. Under this interpretation, the transferor does not engage in a wrongful act, so acceptance by the transferee is not wrongful. The situation is identical to having no prohibition in the security agreement; thus, transfers, standing alone, are not conversions.

However, the terms of section 9-311 imply negation of contractual limitations only on a debtor’s power, not its right to transfer. This interpretation can be profitably compared to transfers affected by a negotiability statute. It provides no protection for buyers making subsequent transfers or agents of a transferor. The transferors acted

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358 U.C.C. § 9-311 cmts. 2 and 3 imply that lien creditors obtain enforceable rights to the collateral, but leave to case law the determination of the nature of the rights and their relationship to the security interest.

359 See supra notes 57-59 and accompanying text.

360 Cf. Peoples Nat'lBank & Trust Co. v. Excel Corp., 695 P.2d 444, 448 (Kan. 1985) (stating that consent to sell which was conditioned on subsequent application of proceeds protects a buyer without knowledge who has not breached a condition, even though seller fails to satisfy the condition).

wrongfully. Generally speaking, however, transferees taking from one not having authority to transfer have not converted if a statute creates rights of negotiability in the property—giving good title to good faith purchasers for value. The analogy is imperfect, however, because section 9-311, unlike a negotiability statute, does not give the transferee rights free of the security interest. Thus, section 9-311 supports, but does not compel, finding transferees of collateral not liable in conversion. Courts, however, have not provided support for interpreting section 9-311 as protecting buyers in conversion actions.

If the transferor is a junior creditor exercising its rights to the collateral, the analysis is different. Section 9-311 expressly approves creation of those rights. If their creation is not wrongful, is their mere exercise wrongful? Courts have not consistently applied section 9-311 to resolve the issue when either junior secured parties exercise dominion over collateral or judgment creditors obtain or enforce their rights. Many cases construing section 9-311 involve secured parties seeking to replevy collateral rather than seeking damages for conversion. If section 9-311 bars replevin, it certainly bars conversion. Courts also have failed to consistently resolve the relationship between section 9-311 and a secured party’s replevin action.

362 E.g., U.C.C. § 2-403.
363 Production Credit Ass'n v. Nowatzski, 280 N.W.2d 118, 121-22 (Wis. 1979), addressed the issue without resolving it because conversion occurred by a refusal of the secured party's demand for delivery.
364 Compare Harley-Davidson Motor Co. v. Bank of New England-Old Colony, N.A., 897 F.2d 611, 618-19 (1st Cir. 1990) (noting that transfer of certificates of title to the junior secured creditor, in contravention of the agreement with the senior secured party, without more did not constitute conversion because it is explicitly authorized by § 9-311) with United States v. Cohoon, 11 U.C.C. Rep. Serv. 2d (Callaghan) 316, 322 (E.D.N.C. 1990) (stating that § 9-311 did not compel dismissal of a conversion action by a senior secured party against junior secured party who had disposed of collateral). See HILMAN ET AL., supra note 2, ¶ 25.02[4][b].
365 Compare Citizens Bank of Lavaca v. Perrin & Sons, Inc., 488 S.W.2d 14, 15-16 (Ark. 1972) (stating that § 9-311 shielded a levy and execution sale from a conversion claim because the secured party's rights were not impaired); First Nat'l Bank v. Sheriff of Milwaukee County, 149 N.W.2d 548, 550 (Wis. 1967) (stating that § 9-311 supported levying creditor's actions because no default occurred prior to the levy giving a right to immediate possession) with Murdock v. Blake, 484 P.2d 164, 169 (Utah 1971) (stating that § 9-311 permitted levy and execution, but judgment creditor was liable in conversion).
Part of the judicial confusion results from failing to separate two distinct issues. The issue for conversion is whether the junior creditor's actions are wrongful. The issue for replevin is whether priority includes the paramount right to possession. While section 9-311 supports an argument that the junior creditor's actions in taking possession or enforcing its property interest are not wrongful, it does not support an argument that priority does not include the paramount right to possession.

The decision in *Murdock v. Blake* illustrates the judicial confusion on these issues. The court stated that a judgment creditor could levy and execute on the collateral because of section 9-311, with the buyer taking subject to the prior security interest. Because of the secured creditor's right to possession under U.C.C. section 9-503, however, the court held the levying creditor liable in conversion for $4,942.88, the full value of the property at the time of the execution, even though the execution sale brought only $2,821.63. If levy and execution are permitted by section 9-311, why is the secured party not obligated to pursue the collateral rather than the levying creditor? If the property was sold subject to the security interest and the security interest equaled or exceeded the fair market value of the property, why did the execution sale produce $2,821.63?

Although judicial support is equivocal, the better view treats section 9-311 as a shield to junior creditors in conversion actions based solely on enforcement of their rights and to transferees in conversion actions.  

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9-503 permitted secured party upon default to replevy car in possession of sheriff whose levy was validated by § 9-311; Grocers Supply Co. v. Intercity Inv. Properties, Inc., 795 S.W.2d 225, 226, 227 (Tex. Ct. App. 1990) (rejecting the argument that § 9-311 entitled a levying creditor to execute judgment with the sale subject to the security interest and permitting the perfected secured party to repossess) with Maryland Nat'l Bank v. Porter-Way Harvester Mfg. Co., 300 A.2d 8, 9, 12 (Del. 1972) (stating that § 9-311 authorized levy and execution, buyer took free of the security interest, and prior creditor's only claim was to foreclosure proceeds); Altec Lansing v. Friedman Sound, Inc., 204 So. 2d 740, 741 (Fla. Dist. Ct. App. 1967) (explaining that § 9-311 precluded secured party from dissolving the writ of execution, but that it had a right to pursue the collateral after the sale); General Motors Acceptance Corp. v. Byrd, 707 S.W.2d 292, 294-95 (Tex. Ct. App. 1986) (stating that § 9-311 supported the prohibition of the secured creditor from enjoining execution sale absent showing probability of removal, destruction, or injury to property).

567 See HILLMAN ET AL., supra note 2, ¶ 25.02[2][b], [c].

568 484 P.2d 164 (Utah 1971).

569 Id. at 169.

570 Id. at 169-70. The court simply stated that conversion required unauthorized acts of dominion without describing the unauthorized acts.

571 This position is similar to the result in early cases deciding that becoming a
based solely on the transfer. To hold otherwise nullifies the statute. If creditor’s rights can be created, but enforcement constitutes conversion, the effect is similar to prohibiting creation. Likewise, if power to transfer the debtor’s equity exists, but the transferee is liable in conversion, then the effect is the same as prohibiting transfer. The Article 9 Study Committee recommends a comment to support the view that mere repossession or foreclosure by a junior secured creditor should not constitute conversion. While this solution is certainly consistent with the foregoing analysis, it is not sufficient.

b. Conversion By Transferees

Are transfers in violation of contractual provisions wrongful acts constituting conversion by the transferee? Because conversion requires interference with possession, transfers that do not involve taking immediate possession, such as obtaining a security interest in contravention of a prohibition on encumbrances, are not conversions. Those transfers involve only unexercised rights to possession. When creation of the junior interest involves obtaining possession, as in the case of attachment or levy, courts often find conversion. Contrary authority

pledgee of property belonging to someone other than the pledgor was not conversion. Although this view departed from the rule holding a purchaser liable if its transferor had no power to transfer, it was justified as facilitating commerce by helping lenders take security. WARREN, supra note 17, at 92-94 (relying on the court’s analysis of the issue in Leuthold v. Fairchild, 27 N.W. 503 (Minn. 1886), modified, 28 N.W. 218 (Minn. 1886)).

Study Group Report, supra note 2, at 220-22.

Under § 228 of the Restatement, exceeding the authorized use of the chattel is an act likely to constitute conversion of a chattel. In determining whether the authorized use of a chattel has been exceeded, comment c directs inquiry to the nature of the agreement between the parties. RESTATEMENT § 228 cmt. c. In that context, however, the converter is probably a party to the agreement. Should this inquiry be limited in its effect to the parties to the agreement, or can it affect a third party’s conversion liability? See infra notes 393-95 and accompanying text.

The issue is rarely raised. It was raised and rejected by the court in Chadron Energy Corp. v. First Nat’l Bank of Omaha, 459 N.W.2d 718, 724, 732 (Neb. 1990). The Chadron court held the non-consenting juniors’ security interest was not converted by the senior’s delivery of six stock certificates to the debtor, so a single certificate representing the same number of shares could be transferred to a buyer whose acquisition was being financed by the senior creditor. By the delivery and transfer back to it, the creditor released its initial security interest and acquired a new security interest subject to the one held by the nonconsenting, formerly junior, creditors.

E.g., American Triticale, Inc. v. Nytco Servs., Inc., 664 F.2d 1136, 1139-40, 1146 (9th Cir. 1981) (reversing summary judgment because landlord attaching grain for rent payments may be liable to secured party in conversion); Grocers Supply Co. v. Intercity
involves a secured party's attempt to obtain possession rather than a conversion action.376 Some courts, however, confuse these two issues.377 Repossession of collateral by a junior secured creditor presents questions similar to those arising from attachment and levy and is held to constitute conversion.378 Although not required by the courts to establish conversion, several of these decisions involved a junior creditor which refused a demand for possession by the senior secured party.379

Inv. Properties, Inc., 795 S.W.2d 225, 227 (Tex. Ct. App. 1990) (relying on conversion precedents to find levying creditor who took possession of collateral with knowledge of security interest liable for damages in the amount of the costs to regain control).

376 E.g., Altec Lansing v. Friedman Sound, Inc., 204 So. 2d 740, 741 (Fla. Dist. Ct. App. 1967) (stating that since secured creditor was unable to dissolve a writ of execution, any sale would be subject to the security interest); First Nat’l Bank v. Sheriff of Milwaukee County, 149 N.W.2d 548 (Wis. 1967) (denying replevin against sheriff because U.C.C. § 9-311 precluded his possession being wrongful, and stating that buyer at the sale will be subject to the security interest).

377 E.g., Grocers Supply Co. v. Intercity Inv. Properties, Inc., 795 S.W.2d 225, 227 (Tex. Ct. App. 1990) (relying on precedents supporting the right of a secured creditor with priority to replevify collateral from a levying creditor in order to justify imposing damages based on conversion precedents).

378 E.g., Centerre Bank, N.A. v. New Holland Div. of Sperry Corp., 832 F.2d 1415, 1423 (7th Cir. 1987) (explaining that repossession of equipment was conversion of prior creditor's interest); Hong Kong & Shanghai Banking Corp. v. FFH USA Corp., 805 F. Supp. 133, 145 (W.D.N.Y. 1992) (explaining that junior creditor repossessing goods it sold was liable in conversion to senior creditor for the value of the goods); United States v. Fullpail Cattle Sales, Inc., 640 F. Supp. 976, 982-83 (E.D. Wis. 1986) (holding that repossessing purchase money creditor was liable in conversion because the other secured creditor had priority); Sears Consumer Fin. Corp. v. Thunderbird Prods., 802 P.2d 1032, 1034 (Ariz. Ct. App. 1990) (stating that repossessing prior creditor was liable to a subsequent creditor in conversion because U.C.C. § 2-403(3) gave good title via entrustment, despite sale being wrongful, to the debtor of the subsequent creditor whose lien was not properly recorded); General Elec. Credit Corp. v. Town & Country Mobile Homes, Inc., 574 P.2d 50, 53 (Ariz. Ct. App. 1977) (stating that repossessing consignor converted security interest with priority); International Harvester Credit Corp. v. Commercial Credit Corp., 188 S.E.2d 110, 112-13 (Ga. Ct. App. 1972) (explaining that repossessing junior creditor converted collateral); Merchants Nat’l Bank v. McCarthy, 16 U.C.C. Rep. Serv. (Callaghan) 1139, 1143 (Mass. Dist. Ct. 1975) (noting that time of conversion was time of repossession); National Bank v. International Harvester Co., 421 N.W.2d 799, 800, 803-04 (N.D. 1988) (subjecting purchase money creditors who had subordinated their interests to a bank to liability to the bank in conversion for repossessing inventory); Rushmore State Bank v. Kurylas, Inc., 424 N.W.2d 649, 659 (S.D. 1988) (stating that repossessing of the assets of a business by junior secured creditor constituted conversion of the prior creditor’s security interest); Barnett v. Everett Trust & Sav. Bank, 534 P.2d 836, 837-38 (Wash. Ct. App. 1975) (noting that repossession by junior was conversion because title had passed to senior by judicial forfeiture procedure).

379 E.g., Centerre Bank, N.A. v. New Holland Div. of Sperry Corp., 832 F.2d 1415,
None of the cases focus on the Restatement's principles that possession pursuant to a facially valid court order or repossession that is not tortious is not conversion. Transfer of possession to a buyer is another potential conversion of the collateral. Although some courts have found against conversion by the mere purchase of collateral, courts frequently hold that it constitutes conversion, even referring to the transfer as a wrongful taking which does not require the elements of demand and refusal. Justification for the inconsistent holdings is not readily available. Several conversion holdings rejected arguments like waiver or estoppel that could easily have been accepted to avoid conversion liability.


See supra notes 205-06 and accompanying text.


Although many of the conversion holdings involved farm products, that fact does not distinguish the two approaches. The ordinary course of business purchase of farm products is not free from security interests under U.C.C. § 9-307(1), so the issue is more likely to arise in that context.

The fact that a few courts refuse to find conversion for the mere purchase of collateral is evidence that the present rules do not always achieve justice. Cases relying on defective analyses to avoid conversion liability particularly support this thesis. The court in *United States v. Continental Grain Co.* held that a buyer of wheat purchasing from the person who purchased from the original debtor was not liable for conversion, because it was a buyer in the ordinary course of business. Section 9-307(1) of the U.C.C. protects buyers in the ordinary course of business; however, it only protects them from security interests created by their seller. Here, the security interest was created by the seller's seller.

Although not articulated in great detail, the appropriate analysis is illustrated in *Installment Finance Corp. v. Hudiburg Chevrolet, Inc.* In *Hudiburg*, a fraudulently obtained clean certificate of title was used to transfer a car to a good faith buyer. The court found that without actual or constructive knowledge of the lien, the buyer had not acted wrongfully. The focus on wrongfulness is noteworthy, because lack of knowledge and good faith of the purchaser are generally ineffective defenses to a conversion claim. However, the *Hudiburg* court noted that it was not ruling on whether the secured party, which had a valid lien, could repossess.

liable in conversion despite having requested and obtained a list of debtors from the secured creditor so joint checks could be issued, because filing of a financing statement precluded the defense of estoppel for the inaccurate list); *United States v. Midwest Livestock Producers Coop., 493 F. Supp. 1001, 1002 (E.D. Wis. 1980)* (holding purchaser liable in conversion despite claim that standard practice of selling dry, diseased, or injured cattle operated as implied consent of secured party); *Wabasso State Bank v. Caldwell Packing Co., 251 N.W.2d 321, 324-25 (Minn. 1976)* (stating that course of dealing in which sales in past transactions had not been objected to cannot be used to defeat requirement in security agreement that consent be in writing).


*Hudiburg,* 794 P.2d at 752.
Properly analyzed transfers standing alone do not justify conversion liability. In reliance on transfer prohibitions, the secured creditor, upon transfer of possession, can claim default, assert its rights to repossess, and exercise its other remedies whether the original debtor or a transferee possesses the property. Thus, possession by a transferee under a claim of right is consistent with a security interest continuing in the transferred property if the property remains unchanged and the secured party can reasonably locate and repossess it.

\[ \textit{c. Conversion by Transferors and Agents} \]

Do transfers by third parties of encumbered property in violation of prohibitions in the security agreement constitute wrongful acts justifying conversion? A demand and refusal requirement, unless excused, would preclude the secured party from suing transferors in conversion because they no longer have possession. Two groups which may have legitimate rights to transfer collateral are buyers making subsequent transfers and agents of the seller. Each group raises different concerns in determining whether demand and refusal should be excused.

\[ \textit{(I) Subsequent Transfers} \]

Does the subsequent transfer of collateral by a buyer justify conversion? Courts have relied on subsequent transfers to establish conversion, and commentators have found that it is a common element in many other fact patterns when buyers are found liable in conversion.\(^{393}\) Holding the mere transfer to be a conversion fails to address the fundamental question—does justice require a forced sale? The issues raised by subsequent transfers are generally the same as those raised by the liability of transferees. Subsequent transferors are “debtors” whose rights are subject to the security interest. However, they are not personally bound by the prohibitions on transfer unless they specifically agreed. If they are not bound, the subsequent transfer itself cannot be wrongful.\(^{394}\)

An additional question arises regarding the conversion liability of a buyer who transfers the property. Can the secured creditor claim the proceeds of that transfer? Strict application of the Code gives the secured creditor a claim to the proceeds as long as they are identifiable because

\[ \text{\textsuperscript{393} See supra note 353; HILMAN ET AL., supra note 2, \( \| \) 25.01[3][a][ii], [iii].} \]
\[ \text{\textsuperscript{394} Accord Beneficial Fin. Co. v. Colonial Trading Co., 43 Pa. D. & C.2d 131, 132 (1967) (stating that creditor had no right against purchaser who had resold the collateral); see also WHITE & SUMMERS, supra note 48, \$ 25-7.} \]
the transferor is a debtor under the Code, but there is contrary authority. A right to identifiable proceeds helps justify limiting the conversion liability of a subsequent transferor, absent wrongful conduct.

(2) Debtor’s Agents

The broad sweep of modern conversion law is illustrated by its application to the sale of collateral by agents, usually auctioneers of farm products, selling for debtors who have not obtained the secured party’s consent. The wrongful act is representing the debtor in violating the security agreement. These cases track the general rule that a selling agent is liable in conversion to owners, independent of actual knowledge. Agents are exculpated from liability under limited circumstances which rarely apply in these cases. Section 9-311 does not protect agents

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396 E.g., United States v. Winter Livestock Comm’n, 924 F.2d 986, 988, 994 (10th Cir. 1991) (holding livestock broker without knowledge of the security interest liable in conversion for selling debtor’s cattle and remitting the proceeds to the debtor, who failed to apply the proceeds to the loan); United States v. Burnette-Carter Co., 575 F.2d 587, 588-92 (6th Cir. 1978) (holding livestock broker in Tennessee without knowledge of the security interest liable in conversion to secured party perfected in Mississippi when debtor shipped for sale, within four-month grace period under U.C.C. § 9-103, without consent and did not apply proceeds to the loan), cert. denied, 439 U.S. 996 (1978); Duvall-Wheeler Livestock Barn v. United States 415 F.2d 226 (5th Cir. 1969) (holding auctioneer without knowledge of security interest liable to secured party in conversion for selling debtor’s cattle when written consent was required but not obtained and debtor did not remit proceeds to secured party); United States v. New Holland Sales Stables, Inc., 619 F. Supp. 1162, 1164-66 (E.D. Pa. 1985) (holding auctioneer liable to secured party in conversion); United States v. New Holland Sales Stable, Inc., 603 F. Supp. 1379, 1387 (E.D. Pa. 1984) (holding auctioneer without actual knowledge liable in conversion when cattle sold without consent of secured party); United States v. Equity Livestock Auction Mkt., 575 F. Supp. 1524, 1527 (E.D. Wis. 1983) (stating that good faith and lack of actual knowledge are not defenses available to auctioneer of cattle when debtor did not have consent to sell from secured party and demand by secured party was only required if the debtor’s sale was not wrongful); United States v. Holmes & Robinson, 575 F. Supp. 30, 30-31 (E.D. Wis. 1983) (denying livestock broker's motion to dismiss in claim of conversion for selling cattle subject to security interest); United States v. Chesley's Sales, Inc., 523 F. Supp. 528, 529 (W.D. Pa. 1981) (stating that good faith and lack of notice are not defenses available to auctioneer selling for debtor in violation of security agreement); Michigan Nat’lBank v. Michigan Livestock Exch., 439 N.W.2d 884, 893-95 (Mich. 1989) (holding auctioneer without actual knowledge liable to secured party in conversion unless the secured party had waived its security interest).

397 Compare United States v. Hext, 444 F.2d 804, 814-16 (5th Cir. 1971) (basing
because it does not immunize the debtor, and the converter is its agent. Its policy of facilitating such transfers in the face of contractual restrictions, however, should have as much relevance for agents as it does for transferees.

The court’s rejection of the agent’s estoppel defense in United States v. Riceland Foods, Inc., illustrates the potential legal misunderstandings of courts which apply conversion to security interests. In Riceland Foods, a broker of crops requested and obtained a list of debtors from the secured creditor so it could issue joint checks and avoid liability. The secured party neglected to include the name of a particular debtor. The court found conversion by relying on the fact that an effective financing statement was on file. Yet a financing statement is simply a notice document designed to induce further inquiry. The broker made inquiry and received a negative reply.

Liability due to constructive notice by a financing statement is misplaced. A financing statement may be on file even though the secured obligation has been satisfied. Moreover, even if a secured obligation exists, the security agreement may not require either joint payment or consent to sell the farm products, one of which is a necessary element of conversion. Finally, even if an agent searches before making a sale, that search will not reveal financing statements filed between the effective date of the search certificate and the time of the sale, a period that can be lengthy.

Disenchantment with the agent rule is fairly widespread. The Eighth Circuit has demonstrated dissatisfaction with the rule. In Federal Deposit Insurance Corp. v. Bowles Livestock Commission Co., that court


Id. at 1261-63.

U.C.C. § 9-404 requires the debtor to make a written demand before a secured creditor is obligated to provide a termination statement to the debtor in non-consumer transactions. The secured party has no obligation to file it. Termination statements are also subject to being lost or misfiled by the filing officer. Id.

See Bar Committee Report, supra note 77, at 827.

overturned the district court's decision following the federal common law rule that an auctioneer is liable in conversion. Although the auctioneer had notice that sales required secured creditor's permission, the court found no liability because the collateral was brought to the auctioneer by a third party to deceive it as to the identity of the actual seller. This holding evidences judicial discomfort with the justice of applying the general rule to security interests, because lack of actual knowledge and good faith are generally irrelevant. The Eighth Circuit in United States v. Progressive Farmers Marketing Agency was more innovative, if less convincing. The court found no conversion by a farmer's agent, who sold hogs without knowledge of the security interest and remitted all proceeds to debtor, by characterizing the agent as a buyer in the ordinary course of business.

Several state legislatures have ameliorated the agent rule's impact. Montana requires a special filing before auctioneers of cattle can be liable for conversion. Georgia has a non-uniform provision in U.C.C. section 9-307 which exempts commission merchants who sell livestock or agricultural products for a fee from liability to secured parties unless they have actual knowledge of the perfected security interest. Idaho, Iowa, Maryland, and Nebraska have adopted other non-uniform provisions with a similar impact.

Virtually all the agent cases arise out of the farm products exception to the buyer in the ordinary course rule in section 9-307(1). The wisdom of that exception was subject to debate, and it has been partially

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404 Id.
405 788 F.2d 1327, 1330-31 (8th Cir. 1986).
406 Id. To be a buyer in the ordinary course of business, the agent would have to buy and then resell. The facts of the case do not support such a characterization.
407 MONT. CODE ANN. § 81-8-301 (1993); e.g., United States v. Public Auction Yard, 637 F.2d 613, 614-16 (9th Cir. 1980) (applying the statute in holding that an auctioneer was not liable in conversion for selling a cow subject to a security interest because two filings were necessary to protect secured party from auctioneer).
408 GA. CODE ANN. § 11-9-307(3) (Michie 1982 & Supp. 1993). This section was adopted in lieu of the Official Text of subsection (3) relating to future advances.
409 IDAHO CODE § 28-9-307(1) (Michie 1980 & Supp. 1993) (stating that knowledge is irrelevant, but special registration is required and the security interest cannot be on a list distributed by the secretary of state); IOWA CODE ANN. § 554.9307(1) (West 1967 & Supp. 1993) (including agents in the definition of buyers in the ordinary course of business); MD. COM. LAW I. CODE ANN. § 9-307(1)(b) (1992) (holding knowledge of perfection to be irrelevant); NEB. REV. STAT. § 69.109.01 (1992) (stating that no liability exists for auctioneers acting in good faith without notice).
410 The farm products exception to U.C.C. § 9-307(1) is more of an historical relic than a well-reasoned exception. See 2 GILMORE, supra note 37, § 26-10, -11.
overturned by the Food Security Act of 1985.\footnote{7 U.S.C.A. § 1631 (West 1988). The act permits buyers in the ordinary course of business purchasing farm products from farmers to take free of security interests created by the farmer, unless limited exceptions are met, including an exception for complying with a state-created filing system meeting standards set forth in the act. The terms of the act explicitly include agents selling for the farmer. See White & Summers, supra note 48, § 24-14.} To the extent the exception survives, a key inquiry in determining the propriety of conversion liability for agents remains. Who should bear the risk, the secured creditor relying on farm products as collateral, or the agent facilitating sale and marketing of such products? Secured creditors in this industry reduce their risks by relying in part on notice to known dealers in farm products.\footnote{See, e.g., Paducah Burley Floors, Inc. v. Peoples First Nat'lBank & Trust Co., 757 S.W.2d 196, 198-99 (Ky. Ct. App. 1988) (finding that buyer of tobacco crop converted proceeds by failing to remit price to secured creditor as requested in a notice); Farm Credit Bank v. F & A Dairy, 477 N.W.2d 357, 361-62 (Wis. Ct. App. 1991) (stating that refusing to pay price of purchased dairy products to party with security interest which had requested payment was conversion). Notice to buyers and commission merchants or selling agents is one of the ways to avoid them taking free of the security interest under the Food Security Act of 1985, 7 U.S.C.A. § 1631(g) (West 1988).} In addition, some dealers protect themselves by communicating with known lenders to ensure that the farm products they sell are sold free of the security interests.\footnote{See United States v. Riceland Foods, Inc., 504 F. Supp. 1258 (E.D. Ark. 1981) (explaining that purchaser of crops requested and obtained a list of debtors from the secured creditor so joint checks could be issued).} Limiting conversion liability to conversion of proceeds by agents with actual knowledge who do not make requested payments to the secured party provides an effective way to encourage both of these market approaches to allocating risks and is consistent with the approach taken in the Food Security Act of 1985.\footnote{7 U.S.C.A. § 1631(g) (West 1988).}

d. Conversion by Execution or Foreclosure

The most complex issues involving transferors of encumbered property are raised by execution sales for levying creditors and foreclosure sales by junior secured parties. Courts have held that non-Article 9 creditors proceeding in violation of legal requirements lose priority and convert by taking wrongfully.\footnote{E.g., Newport News Shipbuilding Employees' Credit Union, Inc. v. B & L Auto Body, Inc., 400 S.E.2d 512, 515-16 (Va. 1991) (holding bailee with a prior statutory lien for repairs liable in conversion to secured creditor for defective notice and advertising as required by statute in its foreclosure procedure); Paris Am. Corp. v. McCasland, 759 P.2d 1210 (Wash. Ct. App. 1988) (stating that superior landlord's lien expired due to failure to comply with statutory procedure so that secured creditor had a viable conversion claim because creditor continued to hold the collateral).} That outcome is appropriate unless an adequate alternative
remedy exists. Because of the apparent adequacy of the damage remedy in U.C.C. section 9-507 together with the judicial enhancements barring deficiency judgments or creating presumptions,416 courts should not resort to conversion and defeat priority when a foreclosing secured party violates its Code obligations.417

Is it wrongful if creditors comply with legal requirements? Execution has been permitted by one court,418 but has been rejected by others.419 Courts have also split on whether a secured party's foreclosure constitutes conversion, with more courts answering in the affirmative.420 Courts finding no conversion421 protect the senior creditor by continuing its lien after the foreclosure sale.422

416 See supra note 96.


421 E.g., Leasing Serv. Corp. v. First Tennessee Bank Nat'l Ass'n, 826 F.2d 434 (6th Cir. 1987) (finding that second secured party did not convert collateral of first secured party by taking it and selling it and applying proceeds to its debt); cf. Chadron Energy Corp. v. First Nat'l Bank of Omaha, 459 N.W.2d 718, 731-33 (Neb. 1990) (finding that junior secured party had right to foreclose and retain foreclosure proceeds with sale being subject to the senior security interest and that the conversion was by breaching a bailment contract).

422 U.C.C. § 9-504(4) only extinguishes subordinate security interests, and U.C.C. § 9-306(2) continues security interests upon sale, exchange, or other disposition of the
The court holdings on whether it is wrongful for creditors to repossess and foreclose or obtain levy and execution are most charitably described as confused. Repossession by a junior secured creditor and levy on behalf of a lien creditor generally constitute conversion. Execution or foreclosure, however, sometimes does not constitute conversion. Because levy or repossession is almost always a prerequisite to execution or foreclosure, such rulings make little sense.

Is a right to sue junior creditors for conversion a necessary protection for senior secured parties? The appropriate outcome in conversion cases involving junior creditors depends not only on applying section 9-311 to protect the exercise of the rights it justifies creating, but also on resolving whether the Code contemplates junior creditors asserting rights to collateral before senior creditors.

The Code provides little guidance on the meaning of priority if the execution or junior foreclosure sale occurs first. The answers logically inferred from the Code are not always followed by the courts and do not necessarily produce satisfactory results. Under the Code, when a secured party forecloses, it has no obligation to identify other creditors and give them notice. Junior interests are extinguished and foreclosure proceeds are applied to (1) foreclosure expenses; (2) the secured debt; and (3) the debt of junior creditors who demanded payment, with any excess delivered to the debtor.

If those provisions imply a prohibition of execution sales or junior creditor foreclosures, then both having such sales and buying at such sales would be serious interferences with the interest of the senior creditor constituting conversion. That implication, however, generally is not drawn. Rather, those provisions appear to imply that execution and junior foreclosure sales are permitted with the buyer at the execution or foreclosure sale taking subject to the senior security interest.

In determining the appropriateness of conversion liability under this implication, three interdependent issues are raised. First, is a senior creditor adequately protected if a junior realizes on the collateral first? Second, is the concept of an execution or foreclosure sale subject to a security interest viable for personal property? Third, can a senior creditor claim priority to the proceeds of an execution or junior foreclosure sale?

collateral unless authorized by the secured party or defeated by a Code provision.

423 See supra notes 122-26 and accompanying text.

424 U.C.C. § 9-504(3) only requires notice to those creditors that have made a request. The survival of the senior's security interest is established from U.C.C. § 9-504(4) by negative implication, because it states that all subordinate security interests are extinguished. U.C.C. § 9-504(1) establishes the priorities for payment of proceeds.
Section 10. Security Interests

Protecting Senior Creditors

A senior creditor is adequately protected if it has notice of the junior creditor's action and can assert its prior rights to the collateral. The senior creditor's ability to assert its rights arises on default, which is defined in the security agreement. Security agreements commonly protect secured parties by enumerating encumbrance, transfer, and possession of the collateral by another creditor as events of default. In the absence of such provisions, the senior creditor cannot pursue the collateral and the junior creditor can proceed with its levy and execution or possession and foreclosure. Conversion liability is unavailable, because no right to immediate possession exists.\(^{425}\)

The senior creditor's need for notice, however, creates a more significant problem. Because a junior secured party is not required to give notice to the senior and a levying creditor may not be so required, the senior may not learn of the junior's actions even if they are defaults. Conversion liability, however, is a cumbersome way to remedy this problem. Much more direct would be a Code modification returning to the 1962 approach that required notice to other creditors who have filed.\(^{426}\) Seven states have already enacted non-uniform versions of U.C.C. subsection 9-504(3) requiring greater notice of Article 9 foreclosure sales. The most common additional requirement is notice to any secured party who has filed a financing statement,\(^{427}\) thus ensuring that most senior creditors get notice which enables them to protect their interests. This problem is also one that has been identified for revision by the Article 9 Drafting Committee.\(^{428}\)

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425 See supra note 233 and accompanying text.
426 See Byrne et al., supra note 4, at 1926-29; Starnes, supra note 125, at 600-01.
(2) Viability of Subject-to Sales

Permitting junior creditors to act first with the senior interest remaining in the collateral is analogous to the real property approach, but personal property implicates significantly different issues. Greater potential unfairness to the senior creditor exists with personal property collateral. With real property, the prior creditor's interest is not made more difficult to enforce; only the identity of the property owner changes. With personal property, however, the location also changes, so that finding the property and its new owner could become significant burdens.

If a junior creditor foreclosing on real estate searches the records and gives notice to the subordinate recorded interests, it has little risk in foreclosing. A creditor with a junior interest in personal property, however, faces a number of risks in exercising its rights first. Unless the buyer is aware of the existence of the senior interest, the junior could face a breach of warranty, fraud, or misrepresentation action. Under current law, the junior may incur conversion liability to the senior by enforcing its property interest or applying the proceeds to its debt. These risks are particularly unsettling to a creditor who in good faith assumed it had priority only to learn of a prior interest after the fact.429

Buyers at real estate foreclosures are also accorded more protection because they can identify the liens, claims, and encumbrances continuing against the property with more confidence. Unknown real estate interests will not be enforceable against the buyer unless recorded. Also, more certainty exists about where they are recorded. Moreover, unlike personal property, the amount of any real property lien will be ascertainable from the record. Personal property buyers have significant uncertainty in determining prior interests.

Resolving whether a junior creditor can exercise its rights first by simply relying on the negative implication of U.C.C. section 9-504(4) ignores realities of execution and foreclosure sales. Buying at such sales subject to a prior security interest may be a foolhardy venture, given the priority rule in section 9-301(4) as to future advances.430 Moreover, the Code has no mechanism for allocating secured obligations to particular collateral, making redemption prices under section 9-506 uncertain. If the collateral is part of a larger collateral pool securing a senior debt, redemption requires payment of the “obligation secured by the collateral-

429 See supra notes 301-09 and accompanying text.
430 See supra note 41 and accompanying text.
and thus involves paying the fair market value. Under such circumstances, no informed buyer would be willing to bid.\textsuperscript{42}

Do purchasers at junior foreclosure sales account for the interest of the senior in bidding on the collateral? Some commentators discussing the appropriate interpretation of the Code regarding such foreclosures fail to address the question.\textsuperscript{43} No buyer taking subject to a security interest is willing to pay the same price it would pay if the collateral were free and clear. Furthermore, buyers do not compute the bid by merely subtracting the amount of the continuing security interest\textsuperscript{44} from the price it would pay for clear title. They allow for risk and uncertainty. If the sale is subject to a prior security interest of uncertain magnitude, the only third person willing to buy would be one without knowledge of the prior security interest.

Encouraging maximum price at execution and foreclosure sales is an important policy. To accomplish this, the system must assure that buyers have knowledge regarding the interests to which the property will be subject. Execution and foreclosure sales by juniors inherently cause uncertainty in that regard. Uncertainty reduces the price an informed buyer will pay and disadvantages the debtor and all its creditors.

At least one group of commentators has suggested that the Code be restructured to provide that any foreclosure sale give the buyer unencumbered title.\textsuperscript{45} This approach maximizes the amount received at the foreclosure sale and resolves which party is entitled to the foreclosure proceeds. It works only if the Code requires notice to all creditors of record so they can protect their interests. A single sale conveying good title works best if the senior creditor controls it. To accomplish this, the

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\textsuperscript{41} U.C.C. § 9-506.

\textsuperscript{42} The problem is illustrated by Murdock v. Blake, 484 P.2d 164, 169 (Utah 1971), where the court stated that a judgment creditor could levy on and sell collateral, but the purchaser would take subject to a prior security interest. The court, however, held the levying creditor liable in conversion for $4,942.88, the value of the property at the time of sale, even though it had received only $2,821.63 at the execution sale. Id. at 166, 169-70. Here, the buyers apparently did not take the security interest into account, because the secured party was owed at least the fair market value of the collateral. No buyer with that knowledge should have been willing to buy at the execution sale.

\textsuperscript{43} The omission of this analysis is demonstrated by the assertion that "it is hard to imagine that the amount of proceeds will vary significantly depending on the fortuity of which secured party conducts the disposition." HILLMAN ET AL., supra note 2, ¶ 25.02[5][b], at 25-87. Starnes, supra note 125, also fails to address the issue.

\textsuperscript{44} That amount cannot always be ascertained with certainty.

\textsuperscript{45} Byrne et al., supra note 4, at 1926-31.
Code would have to provide for the senior creditor’s right to foreclose. Junior creditors could control the sale by redeeming the collateral and becoming the senior creditor.436

Buyers also could obtain clear title under a requirement that junior creditors redeem the collateral pursuant to section 9-506 either before foreclosing or by application of the proceeds. If the property does not have sufficient value to satisfy the senior and leave some equity for the junior, then the junior should not foreclose.

The issues surrounding dispositions of collateral by junior secured creditors have been identified by the Article 9 Study Committee as issues to be addressed by the Drafting Committee. However, the Study Committee was of the opinion that wholesale revision of Part Five of Article 9 may not be warranted even if necessitated by addressing those issues. In any event, it requested some accommodation. One question explicitly raised by the Study Committee was whether the junior should be allowed to sell free of the senior interest if the senior failed to control the collateral and disposition after receiving notice from the junior.437

The law needs revision in connection with junior creditors exercising rights prior to a senior secured party. However, Code revision, rather than conversion doctrine, is the effective method. Although conversion liability for exercising rights prior to a senior secured party discourages junior foreclosure and execution sales (thereby protecting buyers and senior creditors), it does not address other structural deficiencies. Moreover, determining whether the junior’s actions constitute conversion must depend on what actions the Code authorizes the junior creditor to take.

(3) Right to Proceeds

Is a senior creditor entitled to proceeds of the execution or junior foreclosure sale? Many courts permitting execution or foreclosure sales simply do not address the question of rights to the proceeds.438 The argument in favor of the senior creditor reasons that the prior creditor has a security interest in identifiable proceeds of the collateral and the junior creditor’s disposition generates such proceeds.439 The Code generally

436 U.C.C. § 9-506.
439 For a detailed argument of Article 9 support for this position, see HILLMAN, ET AL., supra note 2, ¶ 25.02[4][a], at n.265. See also id. ¶ 25.02[4][b].
SECURITY INTERESTS

protects the secured party upon the sale of collateral by providing a security interest in both the transferred collateral and its proceeds, thereby doubling the available security.

The counter-arguments are: (1) that the senior only has a claim to proceeds “received by the debtor,” not those received by a creditor; (2) that U.C.C. section 9-504 only provides a right to foreclosure proceeds for junior creditors; and (3) that such proceeds represent only proceeds of the unencumbered portion of the collateral, which is the debtor’s equity that the junior encumbered pursuant to section 9-311. The most powerful rejoinder to the debtor’s equity argument is that if the debtor sells to a buyer not in the ordinary course of business, then that buyer only purchased the equity, but all identifiable proceeds of that sale are still subject to the security interest. The debtor’s equity argument also assumes that the buyer only paid for that interest in the property. If the buyer had no knowledge of the senior’s interest and did not reduce its bid, perhaps the senior should be entitled to the proceeds.

Claims to proceeds of execution or foreclosure sales have engendered several divergent approaches. The appropriate approach under the Code appears to be that set forth in Chadron Energy Corp. v. First National Bank. That court recognized that the security interest continued in the collateral and in surplus foreclosure proceeds which must be returned to the debtor. This position is consistent with the Code definition of proceeds, which includes the phrase, “received by the debtor,” although the import of that phrase is uncertain.

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440 U.C.C. § 9-306(2) describes the proceeds to which a security interest attaches as “any identifiable proceeds including collections received by the debtor.” Id. Whether “received by the debtor” modifies only collections or proceeds is a subject of debate. Compare Centre Bank, N.A. v. New Holland Div. of Sperry Corp., 832 F.2d 1415, 1419-20 (7th Cir. 1987) (finding that security interest continued only in proceeds received by the debtor); HILLMAN, ET AL., supra note 2, ¶ 22.05[1][b], at 22-55 (stating that debtor’s receipt is a condition to continuation of the security interest in proceeds) with Farmum v. C.J. Merrill, Inc. 264 A.2d 150, 156 (Me. 1970) (stating that proceeds can be received by anyone); RONALD ANDERSON, UNIFORM COMMERCIAL CODE § 9-306:24, at 152 (3d ed. 1985) (finding no requirement that debtor receive the proceeds). See HILLMAN, ET AL., supra note 2, ¶ 25.01[4][a], at 25-34 to 25-37.

The Article 9 Study Committee has recommended deleting the received language to avoid this limiting interpretation. Study Group Report, supra note 2, at 112-13.


442 459 N.W.2d 718 (Neb. 1990).

443 Id. at 732-33.

444 See supra note 440 and accompanying text.
However, the court in *General Motors Acceptance Corp. v. Byrd* denied the senior secured party’s claim to surplus proceeds of the execution sale to be returned to the debtor and required it to pursue the collateral, so long as it was available. *Byrd* is unusual because the senior creditor was the buyer at the execution sale and claimed that the collateral was worth less than its secured debt. It paid $18,500, the judgment lien was only $7,677.98, and the senior creditor was owed $19,349.81. It is not clear why the senior creditor paid more than the judgment lien unless competing bidders were present. But why would they bid if they take subject to a security interest in excess of $19,000? The senior’s bid in excess of the judgment lien also was apparently made on the assumption that it would have access to the excess proceeds.

The opposite approach was taken in *Maryland National Bank v. Porter-Way Harvester Manufacturing Co.* where the court gave the purchaser at an execution sale title free and clear of a prior security interest and protected the prior secured creditor by subjecting the proceeds of the sale to the security interest. While this approach facilitates bidding at an execution sale by protecting the title of the buyer, it raises many questions. What becomes of the claim of the executing creditor when the proceeds are claimed by the senior creditor? Was its judgment satisfied by the sheriff’s sale? Can it bring a new action against the debtor?

If the secured party is given a right to proceeds of an execution or junior foreclosure as well as a continuing security interest in the collateral two injustices may result. The proceeds were to satisfy the

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446 Id. at 295. The lower court had ordered disbursement of the execution sale proceeds to satisfy the lien creditor with the remainder to the debtor. Id. at 294. Thus, the proceeds claimed would be “received by the debtor.”
448 Id. at 12.
449 The Code scheme of doubling the security interest upon transfer of the collateral is justified by explaining that only one satisfaction can exist. U.C.C. § 9-306 cmt. 3. That explanation is generally read to mean the creditor can recover both the proceeds and the collateral if both are necessary to satisfy the secured obligation. This result doubles not only the security but also the collateral. See Taylor Rental Corp. v. J.I. Case Co., 749 F.2d 1526, 1528-29 (11th Cir. 1985) (rejecting argument that double recovery was inappropriate where secured party foreclosed on inventory collateral and then sued supplier of inventory for conversion of collateral taken as trade-ins on inventory supplied under representation that no security interest in the trade-ins existed). That outcome has some negative consequences when applied to conversion. Consideration should be given to permitting only one recovery on collateral, whether it is by recourse to the collateral, recourse to the proceeds, or recourse via conversion.
junior's debt, but now are controlled by the senior who can also repossess, resell the collateral, and apply the proceeds of the second sale. Such double sales of collateral are an injustice to the buyer, unless it has recourse against the junior. Likewise, permitting the senior creditor to claim the proceeds of an execution or junior foreclosure sale is an injustice to the junior creditor, because its recourse against the debtor for the portion of the debt that had been satisfied by the proceeds now held by the senior creditor is uncertain.\footnote{See supra note 324 and accompanying text.}

If the Code contemplates junior creditors exercising rights subject to a security interest, then sales proceeds must be beyond the senior's reach. This resolution was proposed by Hawkland and adopted by Louisiana as an amendment to section 9-306(2) of the Code. It explicitly excludes from the definition of proceeds "receipts that are derived from the disposition of collateral by a secured party by way of public or private sale . . . or by way of judicial sale pursuant to applicable law."\footnote{LA. REV. STAT. ANN. § 10:9-306(1) (1993).} The Article 9 Study Committee has also recommended that proceeds of junior foreclosure sales be protected from claims of the senior secured party.\footnote{See Study Group Report, supra note 2, at 218-20.}

Such an amendment also validates as a Code concept junior creditors exercising rights first. Correspondingly, neither the junior's exercise of rights nor the application of execution or foreclosure proceeds to its debt should constitute conversion.

4. Are Transfers with Knowledge Wrongful?

If the mere transfer or exercise of rights is not wrongful, does actual knowledge of the security interest make it a conversion? Although knowledge of the paramount interest is not an element in establishing conversion,\footnote{Knowledge was irrelevant when possession was virtually synonymous with ownership, because an interference with possession was an interference with ownership.} it is relevant in certain contexts. Knowledge sometimes changes a rightful act to conversion.\footnote{See supra note 237 and accompanying text.}

Courts have relied on knowledge of violation of a security interest to establish conversion.\footnote{C & H Farm Serv. Co. v Farmers Sav. Bank, 449 N.W.2d 866, 872 (Iowa 1989); First State Bank v. Shirley Ag Serv., Inc., 417 N.W.2d 448, 453 (Iowa 1987).} Knowledge sometimes helps establish conversion when banks set off debts against proceeds in bank accounts.\footnote{See Brown & Williamson Tobacco Corp. v. First Nat'l Bank, 504 F.2d 998 (7th Cir. 1974) (finding that bank's knowledge of creditor's demands was a factor in
determining whether exercise of contractual rights constitutes conversion. Conver-
sely, a senior creditor’s knowledge of a junior’s application of proceeds helps establish waiver if the senior does not act.

If knowledge can change a mere transfer to conversion, what knowledge is sufficient? Knowledge of the existence of a security interest should be irrelevant for junior creditors and transferees. Junior creditors exercise legitimate rights and transferees receive legitimate rights. Knowledge that they are subject to a security interest does not imply a serious interference. If the prior secured obligation is satisfied without default, then the secured creditor’s right to possession never becomes choate and no interference occurs. Knowledge that transfers are prohibit-
ed has different implications. Transferees with such knowledge know the transfer probably constitutes a default giving the secured party a right to immediate possession. However, if for any number of reasons the creditor does not exercise this right, then no interference occurs.

However, knowledge of the security interest by buyer transferors and knowledge that transfers are prohibited by transferees and junior creditors when the secured party declares default are relevant to conversion. But,

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determining set-off not to be in the ordinary course of business); United States v. Security State Bank, 686 F. Supp. 733, 736-37 (N.D. Iowa 1988) (explaining that unsecured creditor with knowledge that waiver was conditioned on application of proceeds could not rely on waiver and converted by setting off debt against deposited proceeds of secured party). Knowledge is not a clear requisite to conversion liability for setting off bank accounts. See generally Frances A. Ruer, Comment, Conflicts Between Set-offs and Article Nine Security Interests, 39 STAN. L. REV. 235, 249-50 (1986) (discussing how set-off disputes should be resolved and how knowledge or notice affects that resolution).

457 See, e.g., Pioneer Commercial Funding Corp. v. United Airlines, Inc., 122 B.R. 871, 884-86 (S.D.N.Y. 1991) (finding that account debtor had been involved in the financing and at the time of set off was following the direction of the debtor for the benefit of the debtor); Central Washington Bank v. Mendelson-Zeller, Inc., 779 P.2d 697 (Wash. 1989) (finding that junior creditors with security interests in fruit crop to secure payments for services knew of prior security interest and were liable to senior creditor in conversion for retaining commissions from the sales proceeds).

458 E.g., General Elec. Co. v. Halmar Distribrs., Inc. (In re Halmar Distribrs., Inc.), 968 F.2d 121, 129-30 (1st Cir. 1992) (explaining that secured creditor originally waived right to receive proceeds directly and thus made junior creditor’s dominion in a lockbox account not wrongful); De Kalb Bank v. Purdy, 562 N.E.2d 1223, 1232 (Ill. App. Ct. 1990) (stating that secured creditor cannot maintain action for conversion of collateral when it had authorized the sale).

459 As a matter of right, this knowledge can only be obtained from the debtor. The secured creditor has no obligation to disclose facts regarding its security interest. U.C.C. § 9-208 states that only an obligation to provide the debtor with information on request exists. In fact, the creditor may incur liability to the debtor by disclosing information which is confidential or proprietary without the debtor’s consent.
standing alone, such knowledge is not sufficient for conversion. Requiring demand and refusal before holding third parties with such knowledge liable in conversion is not an unnecessary formality or burden. It is simply the mechanism whereby the secured party asserts its right to possession.

5. *Is Complicating Enforcement Wrongful?*

Does a transfer that burdens the secured party in locating and taking possession of the collateral constitute conversion? Courts have held that a buyer who makes the collateral difficult to locate has converted it. Requiring demand and refusal under these circumstances may deprive the secured party of its means to obtain compensation for its additional effort and expense. Yet, if the “converter” did not act wrongfully, should it bear that expense?

The critical question is whether lack of notice of the transfer to the secured party justifies conversion. Without knowing the identity of the transferee or location of the collateral, a secured creditor is burdened in enforcing its rights to the property. A buyer is well advised to request authorization of the transfer from the secured creditor to either take the property free of the security interest or limit its liability to future advances. Lien creditors also limit liability for future advances by giving the secured party notice.

Junior secured parties have no incentive to notify senior creditors of their foreclosure, but avoid problems with the buyer by giving notice of the senior security interest. The buyer, of course, has an incentive to notify the senior creditor.

If transferors or transferees with knowledge of the security interest fail to give notice and the secured party has no independent knowledge of the transfer, conversion liability may be appropriate. However, perhaps the most just resolution would still require demand and refusal, while imposing liability for the secured party’s costs, expenses, and delays in learning of the transfer.

A more difficult question arises when the transferor and transferee have no knowledge of the security interest and the secured party has no

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460 *E.g.,* Sumitomo Bank v. Product Promotions, Inc., 717 F.2d 215 (5th Cir. 1983) (holding that collateral that was commingled with property of corporation into which debtor merged rendered resulting corporation liable to secured party for conversion).

461 See supra notes 41, 311 and accompanying text.

462 See supra note 42 and accompanying text.

463 See supra note 320 and accompanying text.
knowledge of the transfer. Such a situation contains no wrongful act to justify conversion. Before the secured party can bring a conversion action, it must learn of the transfer. With that knowledge, adding a demand and refusal requirement is not an undue burden. In addition, under these circumstances, conversion liability allocates the risk of inadequacies in the filing system and uncertainties regarding priority to an innocent third party rather than a creditor who is not carefully monitoring its debtor and collateral. Such a shift is not a compelling reason to find conversion.

Other significant risks to the secured party involve events subsequent to the transfer that burden the secured party. Generally, subsequent events out of the control of the converter can change a non-tortious interference into conversion. On the other hand, the same impairment obtains if the subsequent event occurred with the security under the debtor’s control. Under these circumstances, the creditor is protected only if the event constitutes a default. The default, however, exists independent of who controls the collateral.

Should a transferee also become personally liable for the same occurrence? The appropriate analysis in these situations compares the impact of such events on the rights of the secured creditor with the impact if the original debtor had remained in possession. Such an analysis comports with the fact that the secured creditor purposely left the debtor in control of the property and only gains control upon taking definite steps after default. That analysis furthers the policy underlying section 9-311, which includes facilitating the transfer of the debtor’s equity in encumbered property.

6. Conversion of Proceeds

Three important issues arise in applying conversion law to security interests in proceeds. Can one convert intangible proceeds? Do the nature of proceeds and claims to them justify different rules for conversion? What principles should govern a senior secured party’s conversion claim to proceeds delivered to a junior secured party?

The expansion of conversion from a tort relating only to chattels to a tort encompassing intangible interests has continued into the arena of converting security interests. Third-party buyers and others have been held liable for the conversion of intangible proceeds of collateral taking the form of an account receivable, funds in a bank

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464 See supra note 177 and accompanying text.
465 E.g., Paducah Burley Floors, Inc. v. Peoples First Nat’l Bank & Trust Co., 757
account or monies due under an insurance policy. If proceeds take the form of money, which can be treated like a chattel, then courts often require specific identification of the money. Nothing appears to justify blocking the application of conversion doctrines, properly conceived, to intangible proceeds.

The nature of proceeds, however, raises different issues in determining the appropriate role of conversion doctrines. If the proceeds are cash proceeds, then obtaining possession is the same as recovering damages measured by their fair market value. Unless the converter is no longer in possession, replevin and conversion produce the same result.

Cash proceeds and other proceeds that are negotiable may be governed by different priority rules than those that governed the original collateral. This feature requires a more intricate conversion analysis, particularly if the negotiable proceeds are proceeds of proceeds. Is a junior creditor collecting accounts receivable which are proceeds of its inventory collateral protected from conversion if the accounts are paid

S.W.2d 196 (Ky. Ct. App. 1988) (finding that buyer of tobacco crop converted proceeds by failing to remit price to secured creditor as requested in a notice); Farm Credit Bank v. F & A Dairy, 477 N.W.2d 357, 361 (Wis. Ct. App. 1991) (finding that refusal to pay price of purchased dairy products to party with security interest in them was conversion by wrongful exercise of control).


E.g., First Nat'l Bank v. American Gen. Fire & Casualty Co., 927 F.2d 1126, 1127-28 (10th Cir. 1991) (reversing summary judgment because filing gave insurer constructive notice of security interest so payment of insurance proceeds to debtor, rather than secured creditor, may constitute conversion; they are proceeds when payable not when received by the debtor); Nationwide Ins. Co. v. Bank of Forest, 368 So. 2d 1273 (Miss. 1979) (holding tortfeasor's insurance company liable in conversion for paying value of damaged auto to debtor rather than to its secured party).


U.C.C. § 9-312(6) provides that the creditor has the same priority in proceeds as in the collateral, but § 9-312 only applies if another section of Article 9 does not provide a priority rule. U.C.C. § 9-309 provides that rule for negotiable collateral.
with money or negotiable instruments that the junior creditor takes as a holder in due course? Because the definition of proceeds includes "proceeds of proceeds," the outcome should not differ from the outcome if the negotiable collateral were simply proceeds. Such complexity requires a court to make a very careful analysis to avoid confusion.

If proceeds produce cash flow (accounts, instruments, and chattel paper), the value decreases each time an installment or a particular account is collected. This regularly diminishing value has two important ramifications. First, no double recovery can exist with this collateral. Second, any collections by a junior creditor necessarily limit the recovery by the senior creditor. No meaningful choice between pursuing the collateral or the proceeds exists, because the collateral becomes less valuable by the amount of the proceeds.

These features make it more difficult to establish the appropriate role of conversion for proceeds. They support the argument that a senior creditor should recover proceeds in the hands of the junior, including proceeds of "foreclosure." They are also consistent with the concept of only having one foreclosure on personal property collateral and then applying the proceeds in accordance with priority principles. On the other hand, the Code automatically creates the security interest in proceeds, thereby giving each secured party a right to dominion and control.

Most courts find the junior creditor who receives proceeds to be liable in conversion. Even exercising contractual or legal rights to

470 See Bank of the West v. Commercial Credit Fin. Servs., 655 F. Supp. 807 (N.D. Cal. 1987) (finding conversion by accepting checks the junior creditor held in due course because the underlying accounts were converted), rev'd, 852 F.2d 1162 (9th Cir. 1988).

471 See supra notes 429-37 and accompanying text.

472 See supra notes 61-64 and accompanying text. Courts readily find conversion if the creditor receiving proceeds is determined not to have had a security interest in the collateral, because the right to proceeds then fails. E.g., Centerre Bank, N.A. v. New Holland Div. of Sperry Corp., 832 F.2d 1415, 1423 (7th Cir. 1987) (finding that assignment of a sales contract as proceeds constituted conversion upon determination that the junior's security interest had terminated); State Sav. Bank v. Allis-Chalmers Corp., 431 N.W.2d 383 (Iowa Ct. App. 1988) (holding creditor liable for converting proceeds of the debtor's bulk sale because it could not establish they were from its collateral).

473 Compare Thorp Commercial Corp. v. Northgate Indus., Inc., 654 F.2d 1245 (8th Cir. 1981) (reversing summary judgment that held creditor collecting proceeds of accounts receivable did not convert on the grounds that the collecting creditor did not have priority because the earlier creditor's financing statement contained an adequate description), rev'g 490 F. Supp. 197 (D. Minn. 1980); Leasing Serv. Corp. v. Hobbs Equip. Co., 707 F. Supp. 1276 (N.D. Ala. 1989) (holding that junior creditor with mistaken belief that its security interest had priority was liable to senior creditor for conversion of the proceeds.
monies constituting proceeds may subject the junior secured party to conversion liability. Although courts have not articulated it as a different rule for the conversion of proceeds, knowledge of a requirement that payments be remitted to the secured party appears to be necessary before failure to remit constitutes conversion. Knowledge under these circumstances may simply be the equivalent of a refusal to deliver upon a demand.

If dominion and control are rightful, should all claims for conversion of proceeds be subject to a demand and refusal requirement? Demand and refusal resolves the issue of wrongfulness, but focuses on our final inquiry. Because the debtor often decides which creditor receives the proceeds as payment on the debt, what limits a senior creditor from recovering all proceeds ever paid to the junior creditor? Conversion is avoided by establishing that the funds have not yet acquired or have lost the status of proceeds.

A security interest continues in proceeds only so long as they are from sale of collateral delivered to it by the debtor, *aff'd in part and rev'd in part*, 894 F.2d 1287 (11th Cir. 1990); Farmers State Bank v. Production Credit Ass'n, 755 P.2d 518 (Kan. 1988) (finding that creditor with knowledge of the senior's interest converted proceeds of sales by debtor by receiving them); Farmers & Merchants Nat'l Bank v. Fairview State Bank, 766 P.2d 330 (Okla. 1988) (holding that creditor to whom Payment in Kind Diversion Program ("PIK") payments had been assigned and paid was liable to secured creditor with priority in the crop that was not harvested in order to receive the PIK payments because they were proceeds); with Harley-Davidson Motor Co. v. Bank of New England-Old Colony Nat'l Ass'n, 897 F.2d 611 (1st Cir. 1990) (stating that junior creditor may not be liable in conversion for applying sales proceeds if it received them from commingled account in the ordinary course of business).

474 *E.g.*, Pioneer Commercial Funding Corp. v. United Airlines, Inc., 122 B.R. 871, 884-86 (S.D.N.Y. 1991) (finding conversion where an account debtor, at the debtor's request, exercised set-off rights in connection with paying an account to be paid directly to the secured party); C & H Farm Serv. Co. v. Farmers Sav. Bank, 449 N.W.2d 866 (Iowa 1989) (finding that application of identifiable proceeds of grain sales to overdrawn account was conversion of secured creditor's collateral); Central Washington Bank v. Mendelson-Zeller, Inc., 779 P.2d 697 (Wash. 1989) (holding junior creditors with security interests in fruit crop to secure payments for services liable to senior creditor in conversion for retaining commissions from the sales proceeds).

475 *E.g.*, Paducah Burley Floors, Inc. v. Peoples First Nat'l Bank & Trust Co., 757 S.W.2d 196 (Ky. Ct. App. 1988) (stating that buyer of tobacco crop converted proceeds by failure to remit price to secured creditor as requested in a notice); Farm Credit Bank v. F & A Dairy, 477 N.W.2d 357, 361 (Wis. Ct. App. 1991) (explaining that knowing refusal to pay price of purchased dairy products to party with security interest in them was conversion by wrongful exercise of control).

476 *E.g.*, C & H Farm Serv. Co. v. Farmers Sav. Bank, 449 N.W.2d 866 (Iowa 1989) (stating that only those proceeds in the bank account that were identifiable could be the subject of conversion); Chadron Energy Corp. v. First Nat'lBank of Omaha, 459 N.W.2d 718, 732 (Neb. 1990) (finding that proceeds of junior foreclosure were proceeds subject to senior security interest only to the extent they were surplus to be received by the
identifiable. Payment of proceeds in the ordinary course of business has been held to terminate the security interest in them. Thus, payment of proceeds to a junior creditor may be protected if the junior can establish that the payment was in the ordinary course of business. The Article 9 Study Committee suggests that a Code comment be added to explain that good faith collection of proceeds without knowledge of the senior's security interest should be immune from claims to the proceeds by the senior secured party. This suggestion appears to be a close equivalent of stating that such collections are in the ordinary course of business.

The doctrine of waiver also provides some appropriate limitations. The prior secured party loses a claim to conversion if it waives its right to receive and apply the proceeds. If demand is not made in a timely manner after the secured creditor has knowledge of the application of proceeds, then failure to demand should be deemed a waiver.

V. CONCLUSIONS AND RECOMMENDATIONS

Conversion, although classified as a tort, reflects resolution of conflicting property claims in its origins, remedial mechanisms, and...
typical applications. Acknowledging this characteristic of conversion should enhance future doctrinal development by facilitating the articulation of divergent principles when appropriate to further policies underlying its different applications. Property and priority rules and policies are critical to appropriate conversion rules when resolving disputes between claimants with conflicting property interests. Similarly, tort and compensation principles and policies should exert greater influence on its rules when resolving interferences with property interests not based upon conflicting claims of right.

Resolving conflicting property claims in conversion actions requires a focus on the nature of the interest converted and on the property rights of the converter. In applying conversion to security interests, the interest protected should be the secured creditor's right to dominion and control. This conception permits remedying interferences with intangibles as well as with possession—dominion and control—of tangible property. When conversion remedies interference with a security interest, a converter satisfying the judgment should be treated as having acquired the security interest, not the title to the property.

Focusing on the rights of the converter requires determining whether a forced sale of the security interest is just. An analysis of justice and the rights of transferees of property subject to a security interest suggests modifying current conversion rules to require that converters act wrongfully before incurring personal liability for conversion. Transfers of property subject to a security interest, standing alone, are not wrongful, and thus conversion liability should not lie. Determining whether transfers of collateral were wrongful and constitute conversion should begin with a requirement that the converter refuse the prior secured party's demand for the collateral. This requirement gives the secured party a way to exercise its right to dominion and control and provides the party with a conflicting interest an opportunity to avoid personal liability by relinquishing possession or interpleading the property. Demand and refusal should be excused only when the converter's conduct was wrongful and the secured party would be injured by the return of the collateral (it has been damaged or modified to reduce its value), or delivery has been precluded (through loss or destruction), or possession by the secured party knowingly has been made more difficult (through use of delay tactics with actual knowledge of the prior interest or collusion with the debtor).

Because conversion provides an important remedy for secured parties and often provides the vehicle for addressing unresolved issues regarding the meaning of priority under Article 9, development of conversion doctrines must be coordinated with resolution of related issues under Article 9. This need is particularly apparent with regard to the rights of
junior creditors. Including key conversion rules relevant to security interests in Article 9 would both facilitate the reconciliation of inconsistencies between conversion doctrines and Article 9 concepts and coordinate future development.

A. Judicial Accommodations

Section 9-311 of the U.C.C. should be interpreted to preclude the finding that the mere transfer of collateral or the mere creation or enforcement of a lien or security interest in collateral constitutes wrongful dominion or control over personal property which in turn constitutes conversion. Refusal by the transferee with dominion and control of a demand for delivery by the secured creditor should be required to establish conversion. Exceptions to that requirement should be limited to loss, damage, or destruction of the property; collusion with the debtor; or failure to notify the secured party of the transfer if the party converting had actual knowledge that the transfer violated the security agreement.

Claims that a junior secured party converted proceeds raise sensitive issues, particularly if the junior received proceeds as payments from the debtor. Requiring demand and refusal for proceeds is an important starting point, but some demands may be inappropriate. The rule that proceeds paid in the ordinary course of business become unidentifiable and lose their status as proceeds needs to be carefully developed and applied to avoid enforcing unjust demands for delivery of proceeds.

Courts also need to carefully develop comprehensive waiver rules to preclude reliance on conversion by secured parties in circumstances that provide them an unfair advantage over innocent converters. Well-defined waiver rules are particularly important when the conversion claim involves proceeds. Failure to proceed against third parties in a timely manner after obtaining actual knowledge of transfer should preclude conversion actions. Finding waiver when the senior secured party knowingly acquiesces in payments or collections helps achieve a just balance.

B. Legislative Accommodations

The most effective coordination of conversion doctrines with Article 9 principles and policies involves addressing conversion in the Code. This goal can be accomplished by setting forth basic rules for conversion of security interests that correlate with Code principles in a provision analogous to U.C.C. section 3-420 relating conversion to negotiable
instruments.\textsuperscript{42} Perhaps the most appropriate location of such a provision would be a new subsection to section 9-311. The following provision is suggested:

(2) The law of conversion applies to interferences with security interests. Transfer of collateral subject to a security interest does not constitute conversion by any person who obtained dominion and control of the collateral, unless that person makes an unqualified or improperly qualified refusal to relinquish the collateral on demand by a secured party with priority and a current right to dominion and control. Demand is unnecessary if: (i) the collateral has been lost, destroyed, or materially damaged while in the person's dominion and control; (ii) the person no longer has dominion and control due to its wrongful act; or (iii) dominion and control was obtained with actual knowledge that the transfer violated the security agreement and the secured party was not notified of the transfer or was obtained in collusion with the debtor. A person satisfying a judgment of conversion acquires thereby an assignment of the security interest converted.

Various revisions to Article 9 recommended by the Study Committee will also help rationalize the interaction of conversion and Article 9. Of particular importance will be revisions expanding the notice requirements upon foreclosure and elaborating on the rights and remedies in connection with foreclosures by junior secured parties.

\textsuperscript{42} See supra notes 282-86 and accompanying text.