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INVOLUNTARY TRANSFERS UNDER UCC SECTION 9-311

by Carolyn Sortor

ARTICLE 9 of the Uniform Commercial Code¹ governs secured transactions. Section 9-311 of the Code states that a debtor has rights in collateral that may be transferred despite any provision in the security agreement prohibiting transfer or making transfer a default.² Although section 9-311 was part of the original draft of article 9 and has never been revised,³ courts began to apply the section consistently only within the last decade.⁴ This Comment reviews involuntary transfers under section 9-311 in four steps. First, the Comment discusses the meaning and purpose of section 9-311. Second, the interests and policy considerations involved in involuntary transfers are analyzed to determine desirable and undesirable effects of possible applications of section 9-311. Third, the Comment surveys the different applications of section 9-311 to involuntary transfers⁵ in jurisdictions that have adopted the Code⁶ and evaluates the

1. Hereinafter referred to as the Code. All sections cited are from U.C.C. (1978) (that is, the 1972 revised version) unless otherwise indicated.

2. U.C.C. § 9-311 (1978).

3. Some sections of article 9 were revised in 1972. See SELECTED COMMERCIAL STATUTES 807-80 (West 1983 ed.).

4. For a summary of cases in which § 9-311 was or should have been invoked as of 1975, see Justice, *Secured Parties and Judgment Creditors—The Courts and Section 9-311 of the Uniform Commercial Code*, 30 BUS. LAW. 433, 435-44 (1975).

5. Although this Comment discusses involuntary transfers, its survey of decisions that invoked or should have invoked § 9-311 includes cases involving voluntary transfers because several issues are common to both kinds of transfers. For a discussion of cases involving voluntary transfers, see Nickles, *Enforcing Article 9 Security Interests Against Subordinate Buyers of Collateral*, 50 GEO. WASH. L. REV. 511 (1982).

6. American Samoa, the Canal Zone, Guam, and Puerto Rico have not adopted the Code. The Virgin Islands and every state except Louisiana have adopted the Code with minor variations. The state provisions corresponding to § 9-311 are: ALA. CODE § 7-9-311 (1984); ALASKA STAT. § 45.09.311 (1984); ARIZ. REV. STAT. ANN. § 44-3132 (Supp. 1984-1985); ARK. STAT. ANN. § 85-9-311 (1961); CAL. COM. CODE § 9311 (West Supp. 1985); COLO. REV. STAT. § 4-9-311 (1973); CONN. GEN. STAT. § 42a-9-311 (1983); DEL. CODE ANN. tit. 6, § 9-311 (Supp. 1984); D.C. CODE ANN. § 28:9-311 (1981); FLA. STAT. ANN. § 679.9-311 (West 1966); GA. CODE ANN. § 109A-9-311 (1979); HAWAII REV. STAT. § 490:9-311 (1976); IDAHO CODE § 28-9-311 (1980); ILL. ANN. STAT. ch. 26, § 9-311 (Smith-Hurd 1974); IND. CODE ANN. § 26-1-9-311 (Burns 1974); IOWA CODE ANN. § 554.9311 (West 1967); KAN. STAT. ANN. § 84-9-311 (1983); KY. REV. STAT. ANN. § 355.9-311 (Bobbs-Merrill 1972); ME. REV. STAT. ANN. tit. 11, § 9-311 (1964); MD. COM. LAW CODE ANN. § 9-311 (1975); MASS. ANN. LAWS ch. 106, § 9-311 (Michie/Law. Co-op. 1984); MICH. COMP. LAWS ANN. § 440.9311 (West 1967); MINN. STAT. ANN. § 336.9-311 (West 1966); MISS. CODE ANN. § 75-9-311 (1981); MO. ANN. STAT. § 400.9-311 (Vernon 1965); MONT. CODE ANN. § 30-9-311 (1983); NEB. REV. STAT. § 9-311 (U.C.C.) (1980); NEV. REV. STAT. § 104.9311 (1979); N.H. REV. STAT. ANN. § 382-A:9-311 (1961 & Supp. 1983); N.J. STAT. ANN. § 12A:9-311 (West 1969); N.M. STAT. ANN. § 55-9-311 (1984); N.Y.U.C.C. § 9-311 (McKinney 1964); N.C.

applications in terms of the previous discussion of desirable and undesirable effects. Finally, the Comment examines emerging trends in the application of section 9-311 and recommends certain changes.

I. INTRODUCTION TO SECTION 9-311

A. Section 9-311: What It Does and Does Not Mean

Uniform Commercial Code section 9-311⁷ states that a debtor's rights in collateral⁸ may be transferred. Transfers may be voluntary⁹ or involuntary¹⁰ and may be effected despite any provision in a security agreement¹¹ purporting to prohibit transfer or making transfer constitute a default.¹² Section 9-311 thus permits a debtor to make an effective gift or sale of his interest in collateral¹³ and allows creditors seeking property on which to levy to obtain

GEN. STAT. § 25-9-311 (1965 & Supp. 1983); N.D. CENT. CODE § 41-09-32 (1960); OHIO REV. CODE ANN. § 1309.30 (Page 1979); OKLA. STAT. ANN. tit. 12A, § 9-311 (West 1963); OR. REV. STAT. § 79.3110 (1984); PA. STAT. ANN. tit. 13, § 9311 (Purdon 1984); R.I. GEN. LAWS § 6A-9-311 (1970); S.C. CODE ANN. § 36-9-311 (Law. Co-op. 1977); S.D. CODIFIED LAWS ANN. § 57A-9-311 (1980); TENN. CODE ANN. § 47-9-311 (1979); TEX. BUS. & COM. CODE ANN. § 9.311 (Tex. UCC) (Vernon 1968 & Supp. 1985); UTAH CODE ANN. § 70A-9-311 (1981); VT. STAT. ANN. tit. 9A, § 9-311 (1966); V.I. CODE ANN. tit. 11A, § 9-311 (1965); VA. CODE § 8.9-311 (1965); WASH. REV. CODE ANN. § 62A.9-311 (1966); WIS. STAT. ANN. § 409.311 (West 1964); WYO. STAT. § 34-21-940 (1977).

7. U.C.C. § 9-311 (1978):

§ 9-311. *Alienability of Debtor's Rights: Judicial Process.*

The debtor's rights in collateral may be voluntarily or involuntarily transferred (by way of sale, creation of a security interest, attachment, levy, garnishment or other judicial process) notwithstanding a provision in the security agreement prohibiting any transfer or making the transfer constitute a default.

8. Collateral is property pledged as security for the satisfaction of a debt. BLACK'S LAW DICTIONARY 237 (5th ed. 1979). The Code provides that collateral includes accounts, contract rights, and chattel paper that have been sold. U.C.C. § 9-105(c) (1978).

9. Voluntary transfers include creation of a junior security interest, sale, and gift. See *Clark Jewelers v. Satterthwaite*, 8 Kan. App. 2d 569, 662 P.2d 1301, 1304 (1983) (possession of bridal set resulting from gift not wrongful because debtor may voluntarily transfer his rights in collateral).

10. Involuntary transfers include attachment, levy, garnishment, and "other judicial process." U.C.C. § 9-311 (1978). One court held that other judicial process under § 9-311 includes a division of community property in a divorce proceeding. *Goetz v. Goetz*, 567 S.W.2d 892, 895 (Tex. Civ. App.—Dallas 1978, no writ).

11. The Code defines a security agreement as an agreement that creates or provides for a security interest. U.C.C. § 9-105 (1978). A security interest is an interest in personal property or fixtures that secures payment or performance of an obligation. U.C.C. §§ 1-201(37), 9-102 (1978). Black's Law Dictionary defines security agreement as an agreement granting a creditor a security interest in personal property. BLACK'S LAW DICTIONARY 1217 (5th ed. 1979). A security interest is an interest in property, acquired by contract for the purpose of securing payment or performance of an obligation. *Id.*

12. U.C.C. § 9-311 (1978).

13. *E.g.*, *Citizens Bank v. Perrin & Sons, Inc.*, 253 Ark. 639, 488 S.W.2d 14, 15 (1972) (Code abrogated restrictions upon alienation of encumbered property); *Layne v. Fort Carson Nat'l Bank*, 655 P.2d 856, 857 (Colo. Ct. App. 1982) (debtor could transfer interest but bank not required to consent); *Decatur Prod. Credit Ass'n v. Murphy*, 119 Ill. App. 3d 277, 456 N.E.2d 267, 274 (1983) (transfer of interest in growing crops in which a secured party had a prior interest was valid); *Clark Jewelers v. Satterthwaite*, 8 Kan. App. 2d 569, 662 P.2d 1301, 1304 (1983) (debtor's gift of bridal set to defendant not wrongful since debtor may transfer collateral); ME. REV. STAT. ANN. tit. 11, § 9-311 comment (1964) (debtor can transfer his right in collateral without secured party's consent and despite agreement permitting secured party to repossess collateral if transferred).

a transfer of the debtor's interest.¹⁴ In the case of involuntary transfer a third party attempts to stake a claim in collateral in which the secured party and the debtor have pre-existing rights. Although section 9-311 refers to attachment, levy, garnishment, and other judicial process,¹⁵ the section leaves to non-Code law the substantive and procedural details of how to resolve any conflict among competing interests in the collateral.¹⁶ Consequently, treatment of similar fact situations under section 9-311 varies among the states and sometimes among cases within a single state.¹⁷

Under article 9 parties to a secured transaction may define in a security agreement the events that will constitute default.¹⁸ Section 9-311, however, provides that a transfer of the debtor's rights in the collateral is effective even if the parties agree that such a transfer constitutes a default. The secured party may bring an action for breach of the agreement or may resort to its remedies under article 9,¹⁹ but the secured party may not prevent or annul the transfer. According to the official comment to section 9-311, one purpose of the section is to change the pre-Code rule in some jurisdictions that if title to collateral remained in a mortgagee²⁰ or conditional seller,²¹ other creditors could not reach the collateral.²²

14. *E.g.*, *American Heritage Bank & Trust v. O. & E., Inc.*, 40 Colo. App. 306, 576 P.2d 566, 568 (1978) (debtor's rights in collateral may be involuntarily transferred under § 9-311); *Dick Warner Cargo Handling Corp. v. Aetna Business Credit, Inc.*, 700 F.2d 858, 863-64 (2d Cir. 1983) (funds held by secured party that are due to debtor subject to condition subsequent are garnishable); *New Jersey Bank v. Community Ass'n/ Farms, Inc.*, 666 F.2d 813, 819 (3d Cir. 1981) (judgment creditor of real estate developer may levy on fund held by secured party bank); *Murdock v. Blake*, 26 Utah 2d 22, 484 P.2d 164, 168-69 (1971) (purpose of § 9-311 is to provide without equivocation that debtor's interest in collateral remains subject to claims of creditors).

15. U.C.C. § 9-311 (1978).

16. *Id.* comment 2 (states left to determine "appropriate process" that allows creditors to reach debtor's rights in collateral).

17. *Compare William Iselin & Co. v. Burgess & Leigh, Ltd.*, 52 Misc. 2d 821, 276 N.Y.S.2d 659, 662 (Sup. Ct. 1967) (secured party had right to possession of collateral, therefore lien creditor's levy vacated), *with Roehmer & Zeller, Inc. v. Ace Transmission Center, Inc.*, 114 Misc. 2d 415, 454 N.Y.S.2d 377 (Sup. Ct. 1982) (junior secured party entitled to replevy and sell collateral because senior secured party may not protect debtor's assets from seizure).

18. Although the Code provides definitions for many terms, *see* §§ 1-201 and 9-105, the Code does not define default. A security agreement should, therefore, define the term. Standard events constituting default include: (1) sale or encumbrance of collateral; (2) death or dissolution of the debtor; (3) insolvency or bankruptcy of the debtor; (4) judgment against the debtor; (5) attachment, execution, or other judicial process on the collateral; (6) nonpayment; (7) breach of any of the debtor's warranties in the agreement. Henderson, *The Judicial Creditor Versus the Article Nine Secured Party*, 17 IDAHO L. REV. 193, 198 (1981); *see also* Riegert, *Secured Transactions Part III*, 1984 COM. L.J. 127 (events typically defined to constitute default).

19. Part V of article 9 sets forth secured parties' remedies on default by the debtor. *See infra* notes 106-13 and accompanying text.

20. A mortgagee is one who takes or receives a mortgage. BLACK'S LAW DICTIONARY 912 (5th ed. 1979). A mortgage is an interest created by a written instrument providing security for the performance of a duty or payment of a debt. *Id.* at 911.

21. A conditional sale is one in which the transfer of title depends upon the performance of a condition, usually the payment of the purchase price. *Id.* at 1200.

22. U.C.C. § 9-311 comment 2 (1978); *see* *Citizens Bank v. Perrin & Sons, Inc.*, 253 Ark. 639, 488 S.W.2d 14, 15 (1972) (under pre-Code law in Arkansas debtor's interest in mortgaged personalty held not subject to sale by attachment or execution); S.C. CODE ANN. § 36-9-311

Section 9-311 interacts with other Code provisions. Although this Comment generally discusses the relation of section 9-311 to other Code sections as they arise in context,²³ three Code sections warrant immediate attention. First, insofar as section 9-311 permits transfer despite a prohibition in the security agreement, the section creates an exception to the general rule of section 9-201.²⁴ The general rule provides that a security agreement is effective according to its terms between the parties to the agreement, against other creditors of the debtor, and against purchasers of the collateral.²⁵ Second, section 9-306(2)²⁶ states that, except as otherwise provided by article 9, a security interest continues in both the collateral and in any identifiable proceeds notwithstanding disposition of the collateral, unless the secured party authorized the disposition. This section strongly suggests that, despite a valid transfer of the debtor's rights under section 9-311, a security interest continues in the collateral and in the proceeds.²⁷ Third, section 9-301 provides inferential support for the proposition that section 9-311 applies to both perfected²⁸ and unperfected security interests. Section 9-301 subordinates an unperfected security interest to the interests of several other kinds of parties, including lien creditors,²⁹ and thus would render section 9-311 superfluous in part if section 9-311 applied only to unperfected security interests. Section 9-311, however, is not a priority rule.³⁰ Section 9-311 pertains when parties dispute the validity or effect of a transfer of an interest.

comments (Law. Co-op. 1976) (§ 9-311 may change pre-Code law prohibiting involuntary transfer of debtor's interest in chattel mortgage).

23. See *infra* the following notes and accompanying text: note 61 (§ 9-504(4)); note 185 (§ 9-402(7)); note 193 (§ 9-307(3)).

24. U.C.C. § 9-201 (1978).

25. *Id.*

26. U.C.C. § 9-306(2) (1978); see also *infra* note 93 and accompanying text (1972 revision deleted apparent requirement that disposition be by the debtor in order for security interest to continue in collateral and proceeds).

27. See U.C.C. § 9-306(2) comment 3 (1978). When a debtor makes an unauthorized disposition of collateral the security interest usually continues in the collateral, and the transferee takes subject to the security interest. In some cases the secured party may repossess the collateral or recover for conversion. The secured party may claim both the collateral and proceeds from the disposition of the collateral, but may obtain only one satisfaction. Code sections 9-301 (persons who take priority over unperfected security interests), 9-307 (protection of buyers in ordinary course of business), 9-308 (purchase of chattel paper and instruments), and 9-309 (protection of purchasers of instruments, documents, and securities) state the circumstances in which a transferee may take free of a security interest. The comment to § 9-306(2) appears to suggest that the secured party will have a right to proceeds in these circumstances.

28. A perfected security interest arises when a secured party takes the necessary steps to give the security interest priority over holders of other interests in a property. The steps necessary for perfection depend on the type of collateral and are described in U.C.C. §§ 9-302, -303, and -305 (1978). To perfect an interest in most types of collateral, a secured party must file a financing statement in a public record or take possession of the collateral. U.C.C. § 9-302 (1978).

29. See 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 38.5 (1965) (although § 9-311 does not expressly provide that transfer is effective even if security interest is perfected, the section would be pointless unless applicable to perfected interests, since creditors and purchasers take free of unperfected interests under § 9-301, and other secured parties take free under § 9-312(5)).

30. The rules governing priority in article 9 include § 9-201 (general rule; see *supra* text accompanying note 24), § 9-301 (secured party versus lien creditor), § 9-307 (secured party

In some cases, however, the operation of priority rules may render transfer issues under section 9-311 moot.³¹

B. Fact Pattern and Alternative Treatments

Because section 9-311 abstains from prescribing means for resolving the competing interests in involuntarily transferred collateral, several alternative treatments exist. These alternatives arise from variations in state procedural law, contingencies of fact, and courts' interpretations of section 9-311. Part II of this Comment discusses the alternative treatments in detail. This subpart introduces the type of fact pattern in which section 9-311 may apply and briefly sketches the alternative treatments that the section allows.

Secured Party agrees to lend money to Debtor for the purchase of collateral. The parties execute a security agreement³² under which Secured Party acquires a security interest³³ in the collateral. The security agreement contains a provision specifying that any transfer of the collateral will constitute a default³⁴ by Debtor. The agreement further provides that transfer includes any attachment,³⁵ levy,³⁶ garnishment,³⁷ or other judicial process on the collateral. Subsequently, Creditor obtains a judgment against Debtor and, seeking property of Debtor on which to levy, learns of the collateral. Under section 9-311 Creditor may reach Debtor's rights in the collateral³⁸ by means of appropriate process.³⁹ Creditor will want to levy on the collateral, especially if the value of Debtor's rights in the collateral exceeds the amount of Secured Party's secured debt.⁴⁰ If Creditor levies on the collateral,⁴¹ this

versus purchaser), and § 9-312 (secured party versus secured party). Part III of article 9 contains other priority rules governing special situations.

31. For example, some cases presented the question of whether a lien creditor could garnish a particular interest of the debtor. See *Dick Warner Cargo Handling Corp. v. Aetna Business Credit, Inc.*, 700 F.2d 858 (2d Cir. 1983); *New Jersey Bank v. Community Ass'n/Farms, Inc.*, 666 F.2d 813 (3d Cir. 1981). If the lien creditor in these cases had established that the secured party had not properly perfected its interest, then the lien creditor would have had priority over the secured party as to the whole collateral. Instead, the courts limited the lien creditors to merely the debtor's rights in the collateral. U.C.C. § 9-311 (1978). See *infra* note 197 for discussion of the debtor's rights.

32. For the definition of security agreement, see *supra* note 11.

33. For the definition of security interest, see *supra* note 11.

34. The Code does not define default. Parties to a secured transaction may define default in their agreement. See *supra* note 18 for a list of standard default provisions.

35. Attachment constitutes an ancillary remedy by which a plaintiff may acquire a lien on property of the defendant for satisfaction of a judgment ultimately to be entered in the action. BLACK'S LAW DICTIONARY 115 (5th ed. 1979).

36. Levy means to assess, execute, exact, or collect; a levy is a seizure or exaction. *Id.* at 816. In the context of this Comment "levy" usually refers to a taking of property into custody of the court. See *infra* note 41 for a summary of levy and execution in Texas.

37. Garnishment is a statutory proceeding whereby a court applies defendant's property in the possession of a third party to payment of a debt owed to the plaintiff. BLACK'S LAW DICTIONARY 612 (5th ed. 1979).

38. U.C.C. § 9-311 (1978).

39. *Id.* comment 2.

40. If Secured Party failed to perfect its interest, then the priority rule in § 9-301(1)(b) preempts § 9-311 and Creditor will prevail. See *supra* notes 29 and 31 and accompanying text. If Secured Party did perfect its interest, however, then under most interpretations of § 9-311 Secured Party's interest will continue in both the collateral and in any proceeds from disposition. U.C.C. § 9-306(2) (1978). In this event Creditor ordinarily will not gain any satisfaction

event constitutes a default by Debtor under the security agreement. On default section 9-503⁴² entitles Secured Party to take possession of the collateral.

At this point section 9-311 permits at least five alternative outcomes. The outcome depends on what the parties do, on the applicable state law, and on which legal claims the parties choose to assert. First, state law may provide that execution terminates any security interest in the collateral.⁴³ Under this alternative Secured Party cannot take possession of or otherwise enforce its⁴⁴ interest in the collateral, but Secured Party will probably have priority in the distribution of any proceeds.⁴⁵ If the proceeds prove insufficient to repay the secured debt, Secured Party may or may not have recourse against Debtor⁴⁶ or Creditor.⁴⁷ Second, statutory law or a court may require Creditor to satisfy the secured debt in order to levy on the collateral.⁴⁸ Third, if Secured Party learns of the levy before execution, a court may allow Secured Party to prevent execution on the collateral. The court, however, may order Secured Party to dispose of the collateral and distribute the proceeds according to priority.⁴⁹ Fourth, Creditor may obtain execution on the collateral, but the

from the collateral unless the value of the collateral exceeds the amount of the secured debt. If the amount of the secured debt exceeds the value of the collateral and the security interest continues in the collateral, then a sale of the encumbered property will produce only a small sum, if anything. If the security interest continues in the proceeds, satisfaction of the secured debt will likely exhaust the proceeds and leave little or nothing for Creditor. The security interest may continue in the collateral, in the proceeds, or in both, depending on various factors discussed *infra* in Part II of this Comment.

41. A description of levy and execution procedures may be helpful. Although these procedures vary among the jurisdictions, the following summary of Texas execution procedure provides an example. See TEX. R. CIV. P. 621-56; 5 W. DORSANEO, TEXAS LITIGATION GUIDE ch. 132 (1977 and Supp. Mar. 1984). A creditor who prevails in an action against a debtor, thus becoming a judgment creditor, may obtain a writ of execution, a process of the court issued to enforce the judgment of that court. The creditor delivers the writ to a sheriff or other officer, who must then proceed to levy execution on property of the debtor. A lien arises when the officer levies on the property, and the creditor becomes a lien creditor. Levy occurs when the officer brings the property under the control and custody of the court. See *supra* note 36 for a definition of levy. The officer holds an execution sale to obtain funds to satisfy the judgment. The sale, usually public, is preceded by notice to specific parties and general notice by publication. If the creditor buys the property at the sale, the creditor may resell privately to try to realize the amount owed by the debtor. If the proceeds from the sale of the first property levied upon do not satisfy the judgment, the officer begins the process again.

42. U.C.C. § 9-503 (1978) states that unless otherwise agreed, a secured party has the right to take possession of the collateral on default by the debtor.

43. See *infra* notes 91-115 and accompanying text.

44. Use of the pronoun "it" denotes the fact that secured parties are often institutions. See Jackson & Kronman, *Secured Financing and Priorities Among Creditors*, 88 YALE L.J. 1143, 1161 (1979).

45. See U.C.C. § 9-306 comment 3 (1978).

46. Under U.C.C. § 9-502(2) (1978) if the security agreement relates to an indebtedness, as opposed to a sale of accounts or chattel paper, the debtor remains liable for any deficiency unless otherwise agreed. See Nickles, *supra* note 5, at 518-20.

47. Under IOWA CODE ANN. § 626.41 (West 1950 & Supp. 1984-1985) if an execution sale does not realize enough to pay the secured debt, interest, and costs of sale, the judgment creditor is liable for the deficiency. Cf. WASH. REV. CODE ANN. § 6.20.050 (1963 & Supp. 1984-1985) (if claimant establishes superior right to possession of collateral, court will tax costs to creditor seeking execution on collateral).

48. See *infra* notes 116-36 and accompanying text.

49. See *infra* notes 137-51 and accompanying text.

purchaser of the collateral will take the property subject to the security interest.⁵⁰ If Debtor ceases to make payments to Secured Party, as Debtor is likely to do once he is deprived of the collateral, the purchaser may have to assume the payments in order to retain possession of the property.⁵¹ In some jurisdictions, even though the execution sale constitutes a valid transfer under section 9-311, Secured Party may recover against Creditor or the purchaser for conversion.⁵² Fifth, a court may not allow Creditor to reach the collateral at all on the ground that a default has occurred that entitles Secured Party to possession of the collateral.⁵³

C. Factors Relevant for Evaluating Treatments

The desirability of the alternative treatments of involuntary transfers under section 9-311 ultimately depends on how well each treatment accommodates the interests of the parties and the relevant policy considerations. This subpart examines the interests of each party and the policy concerns and develops criteria by which Part II of this Comment evaluates the alternative treatments. First, a secured party is ordinarily an institution that produces profit by making loans.⁵⁴ A secured party usually prefers that debtors also make profits with which to repay the loans. Insofar as levies on a debtor's assets threaten to disrupt the debtor's business,⁵⁵ the levies also threaten the secured party's interests, even if the levy is not on the secured party's collateral. If the debtor is in financial trouble, seizure of its assets may push the debtor into insolvency.⁵⁶ For better security the secured party may obtain a security interest in as much of the debtor's property as the secured party can demand.⁵⁷

50. See *infra* notes 152-202 and accompanying text.

51. As a practical matter, under this alternative a purchaser at an execution sale buys little more than the debtor's right to redeem. *Smith v. Guzman*, N.Y.L.J., Feb. 14, 1975, at 17, col. 5 (N.Y. Sup. Ct.); see also *Cooper v. Citizens Bank*, 129 Ga. App. 261, 199 S.E.2d 369, 372 (1973) (bank may foreclose security interest in hands of purchaser if secured debt exceeds recovery from creditor for conversion and bank is unable or *unwilling* to recover balance from debtor). The latter decision produces rather extreme consequences. Courts should not deem subsequent purchasers of the collateral to assume the secured obligation in the absence of an express novation. *Nickles*, *supra* note 5, at 516 n.24. The secured party's recovery is based solely on conversion in cases such as *Smith v. Guzman*, N.Y.L.J., Feb. 14, 1975, at 17, col. 5 (N.Y. Sup. Ct.). Therefore, courts should not hold a relatively innocent purchaser liable for conversion when the secured party can recover the debt from the original debtor, but simply refuses to do so.

52. See *infra* notes 166-77 and accompanying text.

53. See *infra* notes 203-09 and accompanying text.

54. See *Jackson & Kronman*, *supra* note 44, at 1161-78.

55. For effects of attachment on the debtor's business in the context of a discussion of § 9-311 involuntary transfers under Idaho statutes, see *Henderson*, *supra* note 18, at 217-19.

56. *Id.* at 234.

57. This end is often attained by means of "after-acquired property" clauses in the security agreement that extend the security interest to collateral acquired after execution of the agreement. U.C.C. § 9-108 comment 1 (1978); see, e.g., *Houchen v. First Nat'l Bank (In re Taylorville Eisner Agency, Inc.)*, 445 F. Supp. 665, 669 (S.D. Ill. 1977) (secured party need not file new financing statement in order to retain perfected security interest in after-acquired property despite transfer of property to new owner); *American Heritage Bank & Trust Co. v. O. & E., Inc.*, 40 Colo. App. 306, 576 P.2d 566, 568 (1978) (after-acquired property clause effective to give senior secured party right to property acquired by junior secured party that

If default by the debtor is inevitable, the secured party wants to foreclose its interest in the collateral in the most efficient and inexpensive manner possible.⁵⁸ The secured party has the right to possession of the collateral⁵⁹ and will ordinarily want to liquidate its interest by selling the collateral.⁶⁰ The secured party can obtain more for the collateral in a private sale than in an execution sale because the secured party can use its own business expertise or tap that of its contacts in deciding when, where, and how to sell the collateral. In addition, a private sale avoids the costs of obtaining a judgment and execution. The secured party can sell the collateral free of its own security interest, and under section 9-504(4) the sale will discharge any subordinate interests as well.⁶¹ Thus, without the interference of other creditors, the secured party can efficiently minimize costs and maximize proceeds. If the secured party cannot prevent execution on the collateral, the secured party may have a strong interest in the identity, location, and creditworthiness of anyone who acquires possession of the collateral or who assumes responsibility for the secured debt.⁶²

A debtor's interests also favor efficiency and economy. On one hand, the debtor remains liable to either the creditor or the secured party for any deficiency remaining after an execution sale of collateral.⁶³ On the other hand, if proceeds from the sale of the collateral exceed the total claims against it, the debtor may claim the excess amount.⁶⁴ Thus, the debtor wants the collateral to sell for the highest possible price. The debtor may prefer that the secured party rather than a lien creditor dispose of the collateral for two reasons.⁶⁵ First, a secured party may best be able to maximize proceeds

had assumed possession and operation of debtor's business); *Smiley v. Wheeler*, 602 P.2d 209, 211 (Okla. 1979) (debtor cannot destroy perfected security interest in after-acquired property by transferring property). Another means of enhancing security is a "dragnet clause." A dragnet clause makes a particular piece of property serve as collateral for all future advances. See *Sturdevant v. First Bank*, 186 Mont. 91, 606 P.2d 525, 528 (1980) (purchaser of airplane could not take property free of security interest by retiring loan for that airplane because dragnet clause made airplane collateral for all subsequent loans to original debtor).

58. For a discussion of factors that affect the secured party, see *Riegert, supra* note 18, at 128-30.

59. U.C.C. § 9-503 (1978).

60. A secured party may liquidate its interest under U.C.C. § 9-504 (1978). For a discussion of why it may want to do so, see *Riegert, supra* note 18, at 129-31.

61. Under U.C.C. § 504(4) (1978) foreclosure of a security interest by sale of the collateral discharges any subordinate interests in the collateral. See *Sturdevant v. First Bank*, 186 Mont. 91, 606 P.2d 525, 528 (1980) (creditor has right to determine who shall be debtor in possession); *Poydan, Inc. v. Agia Kiriaki, Inc.*, 130 N.J. Super. 141, 325 A.2d 838, 842-43 (Super. Ct. Ch. Div. 1974) (secured party entitled to determine who shall be debtor in possession since unreliable debtor may remove or conceal collateral or allow collateral to deteriorate), *aff'd*, 139 N.J. Super. 365, 354 A.2d 99 (Super. Ct. App. Div. 1976).

62. See U.C.C. § 9-502 (1978). For an example of a state statute providing that the debtor is liable for any deficiency, see TEX. REV. CIV. STAT. ANN. art. 3827a (Vernon Supp. 1985).

63. U.C.C. § 9-502 (1978) (unless otherwise agreed, debtor liable for deficiency remaining after disposition by secured party); for an example of a state statute, see TEX. REV. CIV. STAT. ANN. art. 3827a (Vernon 1966 & Supp. 1985).

64. See U.C.C. § 9-502 (1978); TEX. REV. CIV. STAT. ANN. art. 3827 (Vernon 1966).

65. Under § 9-207 and part V of article 9 a secured party owes several duties to a defaulting debtor. Briefly, § 9-207 requires the secured party to use reasonable care to preserve collateral in its possession and makes the secured party liable for any loss caused by its failure to meet these requirements. Sections 9-502(2) and 9-504(2) require the secured party to account

from disposition.⁶⁶ Second, article 9 explicitly makes the secured party liable to the debtor for any failure to fulfill its Code duties to the debtor.⁶⁷

An unsecured judgment creditor⁶⁸ seeking to levy on collateral commonly asserts a claim that is smaller than the secured obligation. Because the unsecured creditor is less likely than the secured party to be a large institution, the unsecured creditor frequently cannot afford either to write off the debt or to invest large amounts of additional money or credit to recover on the original debt.⁶⁹ The unsecured creditor possibly indirectly benefits the secured party by extending credit to the debtor that increases the longevity of the debtor's business operations.⁷⁰ Nevertheless, once the unsecured creditor reduces the debtor's account to a judgment, the unsecured creditor may find that the secured party's interest encumbers the debtor's assets. The unsecured creditor may attempt to circumvent the secured interest, if possible, in order to get its money out of the debtor's assets quickly and easily.⁷¹ Although the unsecured creditor may share with the debtor and secured party an interest in maximizing proceeds, if the unsecured creditor engages in a business related to that of the debtor, the unsecured creditor may wish to purchase the debtor's assets at a low price.⁷² In either case, however, the

to the debtor for any surplus proceeds from disposition of the collateral. Section 9-504(3) requires that the secured party give the debtor reasonable notification of the intended disposition and that the disposition be made in a commercially reasonable manner. Section 9-505(1) requires the secured party to dispose of the collateral within ninety days of taking possession of it if the debtor has paid 60% of the loan. If the debtor has not paid 60% of the loan, § 9-505(2) permits the secured party to retain the collateral. In the latter case the secured party must notify the debtor that the secured party intends to retain the collateral in satisfaction of the debt. Under § 9-506 the debtor may redeem the collateral at any time before the secured party has incurred a binding obligation for disposition of the collateral. Section 9-507 describes the secured party's liability to the debtor for any loss caused by the secured party's failure to fulfill its duties under part V. A debtor's rights against a lien creditor depend on non-Code state law and may not be as extensive or as well-defined as a debtor's rights against secured parties.

66. See *supra* note 61 and accompanying text.

67. U.C.C. § 9-507 (1978).

68. For purposes of this Comment, junior secured parties share the same interests and policy concerns as unsecured creditors insofar as both are subordinate to a senior secured party. See U.C.C. §§ 9-301, -312 (1978).

69. See Henderson, *supra* note 18, at 213-14.

70. On the other hand, the secured party's loan benefits the debtor's other creditors in a similar way, perhaps by making the debtor's business possible.

71. In several cases a lien creditor knew or should have known that a senior secured party had an interest in collateral, yet the creditor proceeded to execute on the collateral, presumably with the hope of gaining an unfair advantage over the secured party. See *Cooper v. Citizens Bank*, 129 Ga. App. 261, 199 S.E.2d 369, 372 (1973) (landlord liable in conversion for levying on and selling tenant's car in which bank had perfected security interest); *Smith v. Guzman*, N.Y.L.J., Feb. 14, 1975, at 17, col. 5 (N.Y. Sup. Ct.) (purchasers of restaurant equipment at execution sale knew of security interest in equipment and were liable for conversion); *Murdock v. Blake*, 26 Utah 2d 22, 484 P.2d 164, 169 (1971) (lien creditors who levied on and sold service station assets despite notification by secured party of its prior perfected interest were liable for conversion). For a discussion of *Murdock*, see *infra* notes 171-77 and accompanying text. The lien creditors in these cases were held liable for conversion.

72. Lien creditors have purchased collateral at their own execution sales and at prices below market value. See, e.g., *Paccar Fin. Corp. v. Harnett Transfer, Inc.*, 51 N.C. App. 1, 275 S.E.2d 243, 246 (1981) (one person controlled both debtor corporation and repairing corporation; debtor corporation bought truck at sale held by repairing corporation to foreclose its mechanic's lien for price representing repair bill; court held security interest not discharged);

unsecured creditor may be less able and less likely than either the secured party or the debtor to take a long-term view of the situation.

Since the secured party needs nothing from the unsecured creditor, the unsecured creditor cannot expect much assistance or cooperation from the secured party.⁷³ If the value of collateral greatly exceeds the amount of the secured debt, the unsecured creditor may want to satisfy the debt in order to execute freely on the collateral. Even if the unsecured creditor does not want to satisfy the secured debt before obtaining execution on collateral, the amount of the debt will determine whether execution on the collateral will be economically worthwhile.⁷⁴ In either case the unsecured creditor needs to know the amount of the secured debt to decide whether to pursue its claim against collateral, and means should exist by which an unsecured creditor can extract an account from an uncooperative secured party.⁷⁵ Some unsecured creditors could also benefit from means to obtain a hearing to contest the secured party's priority.⁷⁶ Finally, in the case of disposition by a secured party, an unsecured creditor will want access to any proceeds re-

Earthmovers, Inc. v. Clarence L. Boyd Co., 554 P.2d 877, 878 (Okla. Ct. App. 1976) (bulldozer purchased within year for \$14,365; repairing corporation recovered bulldozer from pond and purchased it at sale foreclosing its mechanic's lien for price representing its repair bill, \$2,449) (see *infra* notes 225-37 and accompanying text); *Murdock v. Blake*, 26 Utah 2d 22, 484 P.2d 164, 166-67 (1971) (lien creditors purchased collateral with alleged fair market value of \$4,943 at their own execution sale for \$2,822) (see *supra* note 7 and *infra* notes 171-77 and accompanying texts).

73. Several Code provisions assure to the debtor or to junior secured parties help from a senior secured party; these provisions might have assured the same help to lien creditors but do not. Section 9-208 assures to the debtor, but not to a lien creditor, access to information from the secured party about the amount of the indebtedness or about the collateral. See 1 G. GILMORE, *supra* note 29, § 15.3, at 473. Under §§ 9-504(1)(c) and 9-504(2) a junior secured party who has given written notice of its interest to a senior secured party foreclosing on the collateral must be given notice by the senior secured party about the intended sale and will be entitled to have any excess proceeds applied to its claim. No similar provision is made for creditors. U.C.C. § 9-504(3) (1978) requires a secured party to send notice of sale to the debtor and to the junior secured parties but not to other creditors; § 9-505(2) (1978) requires a secured party to send notice of proposal to retain collateral in satisfaction of debt to the debtor and to the junior secured parties but not to other creditors. See 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 BUFFALO L. REV. 373, 388 (1983) (lien creditor has no right under UCC to compel sale of collateral by secured party that proposes to retain the collateral in satisfaction of secured debt); see also *id.* at 393-94 (procedure should exist for hearing to resolve any priority dispute; if secured party found to have priority, it should be compelled to dispose of collateral and to distribute proceeds to itself, junior secured parties, lien creditors, and the debtor, in that order); Henderson, *supra* note 18, at 214-30 (lien creditor should have means to learn amount of remaining secured debt; lien creditor should be able to obtain hearing to contest priority of security interest; secured party should be required to make excess proceeds from disposition available to lien creditors).

74. Generally, if the security interest is to be satisfied out of the proceeds of an execution sale, the unsecured creditor will probably receive only what remains. If the security interest is not to be satisfied out of the proceeds, the price paid for the collateral will probably be less, reflecting the fact that the secured party may foreclose on the collateral in the purchaser's hands.

75. See Henderson, *supra* note 18, at 214-16, 225.

76. For example, if the secured party had not properly perfected its interest before the unsecured creditor obtained a lien against the collateral, under U.C.C. § 9-301(1)(b) (1978) the unsecured creditor would have priority over the secured party.

maining after satisfaction of the secured debt before the secured party returns that remainder to the debtor.⁷⁷

The Code sets forth some general purposes and policies, and one can infer additional policies from the Code's provisions. The Code explicitly states that its overall purposes and policies are to simplify, clarify, and modernize the law of commercial transactions, to permit the continued expansion of commercial practices, and to make the law uniform among the jurisdictions.⁷⁸ The comment to article 9 states that the article provides comprehensive treatment for various species of security interests that formerly were governed by different bodies of law.⁷⁹ One purpose of article 9 is to create a unified structure with a single filing system in order to enhance certainty and reduce costs.⁸⁰

The overall plan of article 9 promotes efficient conduct of business by rewarding providence and diligence.⁸¹ Article 9 further promotes efficiency by ensuring the availability of information to those who have a legitimate need for it.⁸² Article 9 reflects a policy favoring free alienability of property rights.⁸³ The article removes restrictions on debtors' ability to encumber or transfer their interests in collateral.⁸⁴ In particular, section 9-311 ensures that a debtor cannot make himself judgment-proof merely by granting security interests in all of his property.⁸⁵

Thus, treatment of involuntary transfers under section 9-311 should balance a number of often incompatible interests and policy considerations. Several features, however, appear generally desirable. First, treatment of involuntary transfers should preserve as many of debtors' and secured parties' rights under article 9 as possible.⁸⁶ Second, any treatment should maximize proceeds by offering clear title to prospective purchasers.⁸⁷ Third, a treatment should minimize costs and inconvenience. Fourth, parties should have

77. Cf. U.C.C. § 9-504(1)(c) (1972) (junior secured parties may submit claims against proceeds in hands of senior secured party).

78. U.C.C. § 1-102(1)-(3) and comment 1 (1972).

79. *Id.* § 9-101 comment 2 (1978).

80. *Id.*

81. *Id.* As in other recording systems, prompt filing is rewarded with priority unless overriding policy considerations are present. The rules governing priority are set forth in § 9-210 and in part III of article 9. For a discussion of economic justifications for article 9's priority scheme, see generally Jackson & Kronman, *supra* note 44.

82. U.C.C. § 9-208 (1978) gives the debtor access to information from the secured party about the amount of the indebtedness and the collateral covered by the security agreement. Section 9-402 gives the requirements for information to be contained in the financing statement, which is filed in a public record. See also 1 G. GILMORE, *supra* note 29, § 15.1.

83. See Henderson, *supra* note 18, at 197 (debtor's right to encumber everything he has or ever will own and his right to transfer under § 9-311 exemplify theme of free alienability of property rights).

84. *Id.*

85. *Id.*; see also *Humble Oil & Ref. Co. v. Pathological & Diagnostic Laboratories, Inc.*, 11 U.C.C. Rep. Serv. 386 (Callaghan) (N.Y. Civ. Ct. 1972) (secured parties who were parents of debtor could not shield debtor's assets from other creditors).

86. This statement assumes that the means and ends of article 9 are in fact desirable.

87. See Justice, *supra* note 4, at 434 (continuation of security interest in collateral may dampen enthusiasm of potential bidders and prevent realization of full value of debtor's equity).

access to information that pertains to their interests. For example, a secured party should receive notice of a judgment creditor's intent to execute on collateral, and a judgment creditor may want to know the amount of the secured party's interest in the collateral.⁸⁸ Fifth, treatment should not permit a secured party to lock up any value in the collateral in excess of the security interest; rather, that excess should be freely transferable.⁸⁹ When claims exist against the same property right, the conflict must be resolved on the basis of policy considerations.⁹⁰ The treatments of involuntary transfers under section 9-311 among the various jurisdictions effect various compromises among the competing concerns.

II. A SURVEY OF ALTERNATIVE TREATMENTS

A. Execution Cuts Off Security Interest in Collateral

Perhaps because the section states so little, courts and commentators have tended to over-interpret section 9-311. Some early commentators construed section 9-311 to void any provision in a security agreement making transfer a default.⁹¹ The original version of section 9-306 appeared to support this construction. Section 9-306 generally states that a secured party's interest continues in both the collateral and in any identifiable proceeds after disposition of the collateral.⁹² Before the 1972 Code revision section 9-306 referred only to dispositions by the debtor.⁹³ Thus, some courts concluded that section 9-306 applied only in cases of voluntary transfers.⁹⁴ Doubt regarding the continuation of a security interest under section 9-306 despite involuntary transfer may have exacerbated confusion about the effect of section 9-311.⁹⁵

The Delaware Supreme Court has held that execution at the instance of a

88. See *supra* note 75 and accompanying text.

89. U.C.C. § 9-311 (1978) and comment. See *Roehmer & Zeller, Inc. v. Ace Transmission Center, Inc.*, 114 Misc. 2d 415, 454 N.Y.S.2d 377, 378 (Sup. Ct. 1982) (secured party may not unilaterally protect debtor's assets from seizure); *Marine Midland Bank v. Conerty Pontiac-Buick, Inc.*, 77 Misc. 2d 311, 352 N.Y.S.2d 953, 961 (Sup. Ct. 1974) (debtor cannot immunize himself against subsequent creditors merely by agreeing to future advance clause in security agreement).

90. See *supra* notes 78-85 and accompanying text.

91. See IND. CODE ANN. § 26-1-9-311 comment (Burns 1974); N.J. STAT. ANN. § 12A:9-311 comment 1 (West 1962). Courts in Indiana and New Jersey, however, have followed the better construction that § 9-311 does not void provisions making transfer a default. See *Enloe v. Franklin Bank & Trust Co.*, 445 N.E.2d 1005, 1010 (Ind. Ct. App. 1983); *Poydan, Inc. v. Agia Kiriaki, Inc.*, 130 N.J. Super. 141, 325 A.2d 838, 842-43 (Super. Ct. Ch. Div. 1974), *aff'd*, 139 N.J. Super. 365, 354 A.2d 99 (Super. Ct. App. Div. 1976). For discussion of why this interpretation of § 9-311 is better, see *Henderson, supra* note 18, at 199. Two legislatures statutorily validated provisions making transfer a default. See ARIZ. REV. STAT. ANN. § 44-3132 (1967 & Supp. 1983-1984); CAL. COM. CODE § 9311 (West 1964 & Supp. 1984).

92. U.C.C. § 9-306 (1978).

93. See SELECTED COMMERCIAL STATUTES 834-37 (West 1983 ed.) (1972 revisions to § 9-306).

94. See *Quigley v. Caron*, 247 A.2d 94, 96 (Me. 1968); *Universal C.I.T. Credit Corp. v. Prudential Inv. Corp.*, 101 R.I. 287, 222 A.2d 571, 575 (1966). For a summary of this issue as of the time of the 1972 article 9 revisions, see *Hawkland, The Proposed Amendments to Article 9 of the U.C.C. Part II: Proceeds*, 77 COM. L.J. 12 (1972).

95. See *supra* notes 26-27 and accompanying text.

judgment creditor terminates a security interest in collateral.⁹⁶ Delaware adopted this approach on the ground that section 9-311 leaves state law free to determine the appropriate process by which creditors may reach the debtor's rights in the collateral.⁹⁷ Under prior Delaware law a purchaser at an execution sale took title free of all liens or other interests.⁹⁸ Thus, the appropriate process in Delaware afforded no means for continuation of the secured party's interest in the collateral.⁹⁹ Although no other jurisdictions follow this approach, a few courts have relegated the secured party to an equally unfavorable position. A California court held that marshalling¹⁰⁰ applied to remove a security interest from collateral if necessary to enable a junior creditor to satisfy its judgment, provided that no risk of loss was imposed on the senior secured party.¹⁰¹

The Delaware approach offers several advantages. By offering prospective buyers a clear title, the Delaware approach should enhance proceeds from

96. See *Maryland Nat'l Bank v. Porter-Way Harvester Mfg. Co.*, 300 A.2d 8, 12 (Del. 1972). The court also distinguished its decision from other decisions by Florida and Wisconsin courts on the ground that the legislatures in those states at the time of adoption of the Code had enacted statutes to supplement § 9-311. *Id.* at 12; see *Altec Lansing v. Friedman Sound, Inc.*, 204 So. 2d 740, 741 (Fla. Dist. Ct. App. 1967) (FLA. STAT. § 679.9-203 (1966) creates lien in favor of secured creditor); *First Nat'l Bank v. Sheriff of Milwaukee County*, 34 Wis. 2d 535, 149 N.W.2d 548, 550-51 (1967) (Wis. STAT. § 272.26 (1957) makes execution sale subject to secured creditor's interest). Delaware, however, had also enacted supplementary legislation. See DEL. CODE ANN. tit. 6, § 9-306 (1974) (originally enacted in 1953).

97. *Maryland Nat'l Bank v. Porter-Way Harvester Mfg. Co.*, 300 A.2d 8, 11 (Del. 1972).

98. *Id.*

99. *Id.*

100. Marshalling involves ranking and disposing of competing claims or interests to secure justice to all interested parties and to provide the largest possible satisfaction to each. The equitable doctrine of marshalling holds that a creditor who has two funds available to satisfy his debt may not defeat another creditor who has resort to only one fund. BLACK'S LAW DICTIONARY 878 (5th ed. 1979).

101. *Shedoudy v. Beverly Surgical Supply Co.*, 100 Cal. App. 3d 730, 733, 161 Cal. Rptr. 164, 166 (1980). The court relied upon comment 3 to U.C.C. § 9-311, which states that when the value of the collateral clearly exceeds the amount of the secured debt, then "[p]rocedures such as marshalling may be appropriate." *Id.* at 736-37, 161 Cal. Rptr. at 168; U.C.C. § 9-311 comment 3 (1978). The Nebraska supreme court reached a different result regarding the use of marshalling in *Platte Valley Bank v. Kracl*, 185 Neb. 168, 174 N.W.2d 724 (1970). In that case the Nebraska court held that marshalling assets, thereby requiring a senior secured party to look to other collateral rather than to the only collateral available to a junior creditor, is an equitable doctrine that may not be invoked to defeat a secured party's statutory rights under the UCC. 174 N.W.2d at 728. The court further held that a junior creditor may not invoke the marshalling doctrine if the other collateral available to the secured party would not satisfy either obligation and would inconvenience the secured party, deprive the secured party of its rights under the contract, or require the secured party to undertake speculative, independent legal action. *Id.* at 729; cf. *Kansas and New Hampshire statutes permitting judicial sale of the collateral over a secured party's objection if the property can be sold for more than the total claims against it*, KAN. STAT. ANN. § 60-2406 (1983); N.H. REV. STAT. ANN. § 512.29 (1983).

Note that if a secured party fails to provide in the security agreement that transfer constitutes a default, the secured party may lack a remedy when transfer occurs. See *Production Credit Ass'n v. Nowatzki*, 90 Wis. 2d 344, 280 N.W.2d 118, 122 (1979) (U.C.C. § 9-311 does not avoid provision making transfer a default; transferee takes subject to the secured party's rights); *Production Credit Ass'n v. Equity Coop. Livestock Sales Ass'n*, 82 Wis. 2d 5, 261 N.W. 2d 127, 132 (1977) (if security agreement did not provide that sale of collateral constituted default, secured party did not have right to immediate possession).

the sale of collateral.¹⁰² The approach attains the goal of section 9-311 to allow alienation of the debtor's rights in the collateral.¹⁰³ Unlike the Delaware approach, treatments that give the secured party a continuing interest in the collateral permit subsequent actions of the purchaser to affect detrimentally the secured party's interest and the debtor's liability for any deficiency.¹⁰⁴ Furthermore, disruption of the purchaser's enjoyment of the property may occur under non-Delaware approaches if the debtor defaults or the secured party elects to foreclose under the security agreement.¹⁰⁵ Since the Delaware approach permits the secured party to look only to the debtor for any deficiency, the subsequent interests of the secured party, the debtor, and the purchaser do not depend on the conduct of others.

The Delaware approach, however, deprives the secured party of most of its rights under part V of article 9. Part V gives the secured party the following remedies:¹⁰⁶ the secured party may foreclose its interest in the collateral by means of judicial process;¹⁰⁷ the secured party may take collections from account debtors¹⁰⁸ or obligors¹⁰⁹ or take control of proceeds;¹¹⁰ the secured party may take possession of the collateral without judicial process;¹¹¹ the secured party may dispose of the collateral in a commercially reasonable manner;¹¹² or the secured party may propose to retain the collateral in satisfaction of the secured obligation.¹¹³

Thus, under part V the secured party largely controls the time, place, and

102. See *Maryland Nat'l Bank v. Porter-Way Harvester Mfg. Co.*, 300 A.2d 8, 10 (Del. 1972); *supra* note 87 and accompanying text.

103. See U.C.C. § 9-311 comment 1 (1978).

104. If the purchaser damages or disappears with the collateral, foreclosure of the security interest will either bring less proceeds or be impossible. In either case, since the debtor usually remains liable for the debt, the secured party may look to the debtor for any deficiency although the debtor might have been discharged had the secured party been able to satisfy the debt out of the collateral. *Cf. Nickles, supra* note 5, at 516-20 (rights after repossession).

105. The debtor remains liable under the security agreement. The secured party must look first to the debtor for satisfaction of any part of the secured obligation outstanding. *Legg v. Kelly*, 412 So. 2d 1202, 1205 (Ala. 1982); *Clark Jewelers v. Satterthwaite*, 8 Kan. App. 2d 569, 662 P.2d 1301, 1304 (1983); *Smiley & Wheeler*, 602 P.2d 209, 212 (Okla. 1979). In the likely event that the debtor fails to make payments on collateral that he no longer possesses, the secured party may foreclose its interest in the collateral in the purchaser's hands. *E.g., Midland-Guardian Co. v. Hagin*, 370 So. 2d 25, 27 (Fla. Dist. Ct. App. 1979); *Enloe v. Franklin Bank & Trust Co.*, 445 N.E.2d 1005, 1008 (Ind. Ct. App. 1983); *Powell v. Whirlpool Employees Fed. Credit Union*, 42 Mich. App. 228, 201 N.W.2d 683, 685 (1972). One court has stated that a secured party may foreclose its security interest in collateral in the hands of a purchaser if the secured party cannot or will not recover the balance owed from the debtor. *Cooper v. Citizens Bank*, 129 Ga. App. 261, 199 S.E.2d 369, 372 (1973).

106. These remedies apply on default by the debtor. See *supra* note 18 for standard events of default.

107. U.C.C. § 9-501 (1978).

108. An account debtor is a person who is obligated on an account, chattel paper, contract right, or general intangible. U.C.C. § 9-105(1)(a) (1978).

109. An obligor is a promisor; the person who has committed to perform some obligation. BLACK'S LAW DICTIONARY 971 (5th ed. 1979).

110. U.C.C. § 9-502 (1978).

111. *Id.* § 9-503.

112. *Id.* § 9-504.

113. *Id.* § 9-505. If the debtor has paid 60% of the cash price of consumer goods, this remedy is unavailable.

manner of disposition. Alternatively, the secured party may keep the collateral under certain conditions. In either case the secured party can minimize its risk, expense, and inconvenience. The law provides the secured party with these rights because, unlike the unsecured creditor, the secured party exercised sufficient providence to obtain a security interest before extending itself for the debtor's sake. The Delaware approach, by depriving the secured party of its part V rights, both works an injustice against the secured party and disrupts the overall plan of article 9.¹¹⁴ A factor mitigating the apparent harshness of the Delaware treatment toward the secured party is that a creditor is unlikely to press for execution on the collateral unless the creditor expects the execution sale to produce more than enough to satisfy the secured debt.¹¹⁵ The large majority of states decline to treat the secured party so harshly, as the discussions of the remaining treatments under section 9-311 will reveal.

B. Unsecured Creditor Must First Pay Secured Debt

Several states provide that a secured party cannot prevent execution on the collateral, but an unsecured creditor must pay the secured debt in order to obtain execution.¹¹⁶ Statutes in these states afford desirable procedural devices. For example, an Idaho statute provides that an unsecured creditor may take physical possession of collateral if he obtains the written consent of the secured party.¹¹⁷ If the secured party does not consent, the attaching creditor must tender the amount of the secured obligation to the secured party before a sheriff may take possession of the collateral.¹¹⁸ Once the creditor pays the debt, the creditor is subrogated¹¹⁹ to the rights of the secured party under the security agreement.¹²⁰ Alternatively, the creditor may attach the debtor's equity of redemption without taking possession of the collateral by serving notice on the secured party, the debtor, and the party in possession,¹²¹ and by filing notice in the same place where filing is required to perfect a security interest.¹²²

114. See *supra* notes 78-85 and accompanying text.

115. Since the secured party will take priority in the distribution of any proceeds, if no excess is realized over the amount of the secured obligation, the lien creditor will gain nothing for its trouble.

116. Idaho, Iowa, Maine, Massachusetts, and New Hampshire follow this treatment. See statutes cited *infra* notes 117-18, 120-24.

117. IDAHO CODE § 8-506A(b) (1979). For a detailed discussion of Idaho statutes governing transfers within U.C.C. § 9-311, see Henderson, *supra* note 18, at 210-33.

118. IDAHO CODE § 8-506A(b) (1979).

119. Subrogation is the substitution of one person in the place of another in such a manner that the one person succeeds to the rights of the other in relation to a lawful claim and its remedies. BLACK'S LAW DICTIONARY 1279 (5th ed. 1979).

120. IDAHO CODE § 8-506A(b) (1979).

121. *Id.* § 8-506A(c). The statute accommodates the possibility that someone other than the debtor may have possession of the collateral; e.g., a lessee from the debtor.

122. *Id.* Similarly, Iowa statutes provide that an unsecured creditor must pay off a security interest within ten days after levying on the collateral. IOWA CODE ANN. § 626.34.41 (West 1950 & Supp. 1984-1985). New Hampshire provides that a creditor may obtain execution on collateral if he pays off the secured debt. N.H. REV. STAT. ANN. § 511:26 (1983). In Massachusetts a secured party may demand payment of its secured debt within a reasonable time

Statutes in other states furnish other useful devices. Two states provide that an unsecured creditor may require a secured party to give an account of the remaining secured debt.¹²³ One state provides that if the sheriff sells the collateral for less than the amount owed to the secured party plus costs of process, the creditor is liable for the deficiency.¹²⁴ If the sale yields a surplus, however, the surplus belongs to the secured party.¹²⁵ A New York court took a similar approach in *Ford Motor Credit Co. v. Shapiro*.¹²⁶ In that case the secured party secured a loan to the debtor with an interest in a 1977 Continental Mark V. The City of New York Parking Violations Bureau obtained a judgment against the debtor for \$12,465 for outstanding parking tickets and levied on the car. The claims against the car, however, exceeded the car's value. The court held that the Parking Violations Bureau must either yield possession of the car to the secured party or pay off the secured debt before applying any remaining proceeds from its sale to satisfy the lien.¹²⁷

Apart from the fact that none of the above schemes supplies all procedural needs, the schemes raise two concerns. First, enabling a subordinate creditor to extinguish a security interest by paying off the secured debt partly abrogates the secured party's rights under article 9.¹²⁸ Given the conflicting interests involved, however, this treatment does not unreasonably compromise the secured party's interests.¹²⁹ Second, some legitimate creditors may not have the resources to pay off the secured debt in advance.¹³⁰ Such creditors already may have incurred expenses in carrying and pursuing an unpaid debt and may be unwilling or unable to stake additional funds or credit on less than certain proceeds.¹³¹ Yet the credit extended by these creditors indirectly may have helped to enhance the secured party's position.¹³²

This treatment, however, has considerable virtues. First, the treatment protects the interests of the secured party and the debtor relatively well.¹³³

after attachment. MASS. ANN. LAWS ch. 223, § 75 (Michie/Law. Co-op. 1974). The attaching creditor must tender the amount of the debt within ten days of the secured party's demand. *Id.* § 74.

123. IOWA CODE ANN. 626.42 (West 1950 & Supp. 1984-1985); N.H. REV. STAT. ANN. § 511:27 (1983).

124. IOWA CODE ANN. § 626.41 (West 1950 & Supp. 1984-1985).

125. *Id.* Under U.C.C. § 9-504(2) (1978) the secured party must account to the debtor for any surplus proceeds from a disposition. Section 9-504 does not state whether the secured party must account only after a disposition by the secured party under § 9-504 or also after a disposition by a third party, but the former interpretation seems most likely.

126. N.Y.L.J., Mar. 14, 1979, at 10, col. 2 (N.Y. Sup. Ct.).

127. *Id.*

128. See *supra* notes 107-13 and accompanying text.

129. Since U.C.C. § 9-504(2) requires the secured party to account to the debtor for any excess proceeds if the secured party disposes of the collateral, the secured party cannot gain by personally disposing of the collateral instead of receiving payment from a lien creditor. Given that § 9-311 precludes a secured party from shielding a debtor altogether from the claims of other creditors unless the secured party undertakes to pay off other creditors' claims, requiring a lien creditor to pay off the secured debt is fair to the secured party.

130. See *supra* note 69 and accompanying text; Henderson, *supra* note 18, at 213-14.

131. Henderson, *supra* note 18, at 194, 213-14.

132. See *supra* note 70 and accompanying text.

133. See *supra* notes 54-90 and accompanying text.

Second, provisions permitting an unsecured creditor to obtain an account of the remaining secured debt further equity and economy by ensuring that unsecured creditors will neither pursue nor abandon claims unnecessarily. Third, by permitting the execution purchaser to take clear title, this treatment minimizes complexity of relations among the parties.¹³⁴ Finally, at least theoretically, an unsecured creditor may reach excess value¹³⁵ in the collateral if both the existence of the excess and the creditor's entitlement to the excess can be readily established.¹³⁶

C. Secured Party Can Prevent Execution, but May Be Compelled to Liquidate

In two cases a secured party successfully prevented execution, but the court required the secured party to dispose of the collateral. In *North Bank v. F & H Resources, Inc.*¹³⁷ the court held that the trial court had authority under Illinois procedural law to order a secured party to sell the collateral and to distribute the proceeds first to itself in satisfaction of the secured debt, then to costs, and finally to judgment creditors.¹³⁸ The court also held that the supplementary proceeding¹³⁹ out of which the order issued constituted "other judicial process" within the meaning of section 9-311.¹⁴⁰

In *American Heritage Bank & Trust v. O. & E., Inc.*¹⁴¹ the debtor, a wine shop, granted to a senior secured party an interest in the shop's present or future inventory, furniture, fixtures, and equipment. Subsequently, the debtor defaulted on obligations to both the senior and a junior secured party. The junior secured party took possession of the shop¹⁴² and continued to operate it, failing to notify the senior secured party that the junior secured party proposed to retain the collateral.¹⁴³ The appellate court held that the senior secured party must sell the collateral and apply the proceeds first to costs, then to satisfaction of its interest, and finally to the interest of the

134. The Delaware treatment also offers this advantage. See *supra* notes 102-05 and accompanying text for explanation.

135. Excess value refers to value in the collateral in excess of the amount of the remaining secured debt.

136. Theoretically, a creditor who establishes the existence of substantial value in property on which he intends to execute and his entitlement to satisfy a claim out of the proceeds could obtain a loan on that basis to pay off the secured party's interest.

137. 53 Ill. App. 3d 950, 369 N.E.2d 174 (1977).

138. 369 N.E.2d at 176.

139. See ILL. ANN. STAT. ch. 110, § 73 (Smith-Hurd 1968 & Supp. 1983-1984) (supplementary proceedings whereby judgment creditor may discover and reach debtor's assets).

140. 369 N.E.2d at 177. The secured obligation was in the form of demand notes that could be called in at any time. *Id.* at 176. A demand note is a note containing the unconditional promise of the maker to pay a sum certain in money on the demand of the payee. BLACK'S LAW DICTIONARY 956 (5th ed. 1979).

141. 40 Colo. App. 306, 576 P.2d 566 (1978).

142. The junior secured party exercised this right under U.C.C. § 9-503 (1978).

143. 576 P.2d at 568. Under U.C.C. § 9-505 (1978) a secured party may propose to retain the collateral in satisfaction of the obligation rather than dispose of it. Generally, if a secured party wishes to dispose of the collateral, it must give written notice to the debtor and to any other secured party from whom it has received written notice of a claim in the collateral. U.C.C. § 9-505(2) (1978).

junior secured party.¹⁴⁴

Several points remain unanswered by these two cases. If the proceeds do not satisfy the senior secured obligation, the holdings do not indicate whether the security interest continues in the collateral in the hands of the purchaser or terminates.¹⁴⁵ If the security interest terminates, a further issue arises as to whether the secured party would have any recourse against either the judgment creditor or the debtor for the deficiency.¹⁴⁶

Assuming that sale by the secured party will bring a return as large or larger than an execution sale would have produced and that the proceeds will satisfy the secured debt, compelling the secured party to dispose of the collateral has several advantages. Disposition by the secured party is just as neat as by a lien creditor under the Delaware approach.¹⁴⁷ Under section 9-504(4)¹⁴⁸ a purchaser takes all of the debtor's rights, and the sale discharges the secured party's interest and all subordinate interests. This treatment protects the interests of the secured party and the debtor reasonably well.¹⁴⁹ The secured party retains its rights under article 9 to control disposition of the collateral.¹⁵⁰ This treatment, by compelling the secured party to dispose of the collateral, avoids requiring a judgment creditor to produce a large amount of cash in advance of sale to pay off the security interest.¹⁵¹ Most of these advantages, however, obtain only if the value of the collateral exceeds the amount of the secured debt.

D. *Transfer Is Subject to the Security Interest*

In the large majority of states a secured party cannot prevent voluntary or involuntary transfer of the collateral, but transfer is subject to the security interest.¹⁵² The meaning of "subject to" varies. The remedies sought and the

144. 576 P.2d at 568. The court prescribed a different order of priority for distribution of proceeds than in *North Bank*.

145. If treated as a transfer within § 9-311, the security interest should continue in the collateral under § 9-306. If treated as a disposition by the secured party within § 9-504, the purchaser should take free of the security interest under § 9-504(4), and the secured party would have recourse against the debtor for any deficiency under § 9-504(2). See KAN. STAT. ANN. § 60-2406 (1983) (if secured party objects to execution at the instance of a judgment creditor, sale shall not be completed unless for an amount in excess of the senior interest as determined by the court).

146. Cf. IOWA CODE ANN. § 626.41 (West 1950 & Supp. 1984-1985) (if execution sale does not yield enough to pay secured debt, interest, and costs of sale, judgment creditor shall be liable for deficiency).

147. See *supra* notes 104-05 and accompanying text.

148. U.C.C. § 9-504(4) (1978).

149. See *supra* notes 54-65 and accompanying text.

150. See *supra* notes 107-13 and accompanying text.

151. See *supra* note 69 and accompanying text.

152. See *Citizens Bank v. Perrin & Sons, Inc.*, 253 Ark. 639, 488 S.W.2d 14, 15 (1972); *El Paso County Bank v. Charles R. Milisen & Co.*, 622 P.2d 594, 596 (Colo. Ct. App. 1980); *Midland Guardian Co. v. Hagin*, 370 So. 2d 25, 27 (Fla. Dist. Ct. App. 1979); *Cooper v. Citizens Bank*, 129 Ga. App. 261, 199 S.E.2d 369, 372 (1973); IDAHO CODE § 8-506A, 11-203 (1979); *Decatur Prod. Credit Ass'n v. Murphy*, 119 Ill. App. 3d 277, 456 N.E.2d 267, 274 (1983); *Clark Jewelers v. Satterthwaite*, 8 Kan. App. 2d 569, 662 P.2d 1301, 1304 (1983); *Powell v. Whirlpool Employees Fed. Credit Union*, 42 Mich. App. 228, 201 N.W.2d 683, 685 (1972); *Memphis Bank & Trust Co. v. Pate*, 362 So. 2d 1245, 1247 (Miss. 1978); *Sturdevant v.*

particular facts of each case shape the holdings.¹⁵³ Some decisions merely state that the transferee takes no more than the debtor had or that the transfer is subject to the secured party's interest.¹⁵⁴ A majority of courts, however, have clearly indicated that a secured party may enforce its interest in collateral in the hands of an execution purchaser¹⁵⁵ or the debtor's transferee.¹⁵⁶

*El Paso County Bank v. Charles R. Milisen & Co.*¹⁵⁷ illustrates this approach. In *Milisen* the debtor entered a security agreement with El Paso County Bank. The secured debt exceeded \$45,000, and the collateral included all of the debtor's accounts receivable. Subsequently, another creditor of the debtor, Charles R. Milisen & Co., obtained a judgment against the debtor and served a writ of garnishment on a party that owed \$4,247 on account to the debtor. El Paso notified the trial court presiding over the garnishment proceedings of its security interest in all of the debtor's ac-

First Sec. Bank, 186 Mont. 91, 606 P.2d 525, 528 (1980); *Shaw Mudge & Co. v. Sher-Mart Mfg. Co.*, 132 N.J. Super. 517, 334 A.2d 357, 360 (Super. Ct. App. Div. 1975); *Ryan v. Roland*, 434 F.2d 353, 357 (10th Cir. 1970) (applying New Mexico law); *Georgia-Pacific Corp. v. Lumber Prods. Co.*, 590 P.2d 661, 665 (Okla. 1979); *Fliegel v. Associates Capital Co.*, 272 Or. 434, 537 P.2d 1144, 1148 (1975); *Mammoth cave Prod. Credit Ass'n v. Oldham*, 569 S.W.2d 833, 836 (Tenn. Ct. App. 1977); *Goetz v. Goetz*, 567 S.W.2d 892, 895 (Tex. Civ. App.—Dallas 1978, no writ); *Murdock v. Blake*, 26 Utah 2d 22, 484 P.2d 164, 168-69 (1971); *Production Credit Ass'n v. Nowatzski*, 90 Wis. 2d 344, 280 N.W.2d 118, 121 (1979).

153. Secured parties have brought actions for discharge or vacation of levy (*Shaw Mudge & Co. v. Sher-Mart Mfg. Co., Inc.*, 132 N.J. Super. 517, 334 A.2d 357, 358 (Super. Ct. App. Div. 1975); *William Iselin & Co. v. Burgess & Leigh, Ltd.*, 52 Misc. 2d 821, 276 N.Y.S.2d 659, 660-61 (Sup. Ct. 1967)), for replevin (*Midland-Guardian Co. v. Hagin*, 370 So. 2d 25, 26 (Fla. Dist. Ct. App. 1979); *Platte Valley Bank v. Kracl*, 185 Neb. 168, 174 N.W.2d 724, 726 (1970); *Roemer & Zeller, Inc. v. Ace Transmission Center, Inc.*, 114 Misc. 2d 415, 451 N.Y.S.2d 601 (Sup. Ct. 1982); *Karp Bros., Inc. v. West Ward Savings & Loan Ass'n*, 440 Pa. 583, 271 A.2d 493, 494 (1970)), for conversion (*Cooper v. Citizens Bank*, 129 Ga. App. 261, 199 S.E.2d 369, 370 (1973); *National Shawmut Bank v. Vera*, 352 Mass. 1, 223 N.E.2d 515, 515-16 (1967); *Farmers State Bank v. Stewart*, 454 S.W.2d 908, 909 (Mo. 1970); *Mammoth Cave Prod. Credit Ass'n v. Oldham*, 569 S.W.2d 833, 835 (Tenn. Ct. App. 1977); *Murdock v. Blake*, 26 Utah 2d 22, 484 P.2d 164, 166 (1971); *Production Credit Ass'n v. Nowatzski*, 90 Wis. 2d 344, 280 N.W.2d 118, 120 (1979)), and on a written instrument (*Clark Jewelers v. Satterthwaite*, 8 Kan. App. 2d 569, 662 P.2d 1301, 1303 (1983)).

154. *Clark Jewelers v. Satterthwaite*, 8 Kan. App. 2d 569, 662 P.2d 1301, 1304 (1983); *Memphis Bank & Trust Co. v. Pate*, 362 So. 2d 1245, 1247 (Miss. 1978); *Goetz v. Goetz*, 567 S.W.2d 892, 895 (Tex. Civ. App.—Dallas 1978, no writ).

155. See, e.g., *Citizens Bank v. Perrin & Sons, Inc.*, 253 Ark. 639, 488 S.W.2d 14, 15 (1972) (since secured party could foreclose interest in tractor in hands of execution purchaser, bank that obtained execution held not liable to secured party for conversion); *Midland-Guardian Co. v. Hagin*, 370 So. 2d 25, 27 (Fla. Dist. Ct. App. 1979) (assignee of secured party entitled to replevy mobile home from purchaser at public sale); *Cooper v. Citizens Bank*, 129 Ga. App. 261, 199 S.E.2d 369, 372 (1973) (although purchaser not liable for conversion, secured party may foreclose its interest in automobile in hands of purchaser); *Powell v. Whirlpool Employees Fed. Credit Union*, 42 Mich. App. 228, 201 N.W.2d 683, 685 (1972) (secured party entitled to claim truck since execution sale purchaser takes no more than debtor had and has duty to make reasonable inquiry).

156. See, e.g., *Houchen v. First Nat'l Bank*, 445 F. Supp. 665, 669-70 (S.D. Ill. 1977) (secured party may foreclose interest in assets of grocery store since debtor's transferee takes no more than debtor had and has duty to inquire into source of title); *Sturdevant v. First Sec. Bank*, 186 Mont. 91, 606 P.2d 525, 528 (1980) (secured party may foreclose interest in airplane because purchaser from debtor took subject to security interest).

157. 622 P.2d 594 (Colo. Ct. App. 1981).

counts receivable.¹⁵⁸ The trial court ordered the \$4,247 to be paid to Milisen and refused to allow El Paso to intervene in the proceedings.¹⁵⁹ The appellate court held that El Paso's security interest followed the collateral.¹⁶⁰ The appellate court cited section 9-311 in its rationale, but stated that the section did not defeat the interest of a senior party.¹⁶¹ Under section 9-306, according to the appellate court, the security interest continued in the collateral despite transfer.¹⁶² The court also noted that the 1972 revision to section 9-306 broadened that section to include transfers effected by persons other than the debtor.¹⁶³ In ruling for El Paso¹⁶⁴ the court did not consider if or how Milisen might have reached any excess value if the amount of the account receivable had exceeded the amount of El Paso's security interest.

In cases holding that transfer is subject to a security interest either a debtor had already defaulted on his obligations to a secured party at the time of an attempted transfer or the attempted transfer itself constituted a default under a provision in the security agreement. The secured party's right to foreclose its interest in collateral in the hands of the transferee arises from default by the debtor, although courts do not always state this fact.¹⁶⁵ In a related group of cases courts held that unauthorized transfer coupled with default entitled the secured party to recover for conversion of the collateral.¹⁶⁶ Courts have allowed claims for conversion against a lien creditor,¹⁶⁷ a factor¹⁶⁸ of the debtor,¹⁶⁹ and a purchaser of the collateral.¹⁷⁰

158. An account receivable is a claim of an enterprise against a debtor, usually for sales or services rendered, arising in the course of business and not supported by commercial paper. BLACK'S LAW DICTIONARY 17 (5th ed. 1979).

159. The trial court denied El Paso's motion to intervene on the ground that it was not timely. 622 P.2d at 595.

160. *Id.* at 596. Although Colorado law permitted a party claiming an interest in property being garnished to intervene if it did so prior to conclusion of the garnishment proceedings, COLO. R. CIV. P. 103(m) (Supp. 1984), the party was not required to do so and was free to seek enforcement of its interest by other means. 622 P.2d at 596.

161. 622 P.2d at 596.

162. *Id.*

163. *Id.*; see U.C.C. § 9-306 comment 3 (1978). For 1972 revision, see *supra* note 26.

164. 622 P.2d at 596.

165. See *Production Credit Ass'n v. Equity Coop Livestock Sales Ass'n*, 82 Wis. 2d 5, 261 N.W.2d 127, 132 n.19 (1978) (since security agreement did not make transfer a default, security interest continues in collateral despite transfer, leaving secured party without present remedy against either debtor or transferee).

166. See *Empire Fire & Marine Ins. Co. v. First Nat'l Bank*, 26 Ariz. App. 157, 546 P.2d 1166, 1168 (1976); *Cooper v. Citizens Bank*, 129 Ga. App. 261, 199 S.E.2d 369, 371 (1973); *Farmers State Bank v. Stewart*, 454 S.W.2d 908, 915 (Mo. 1970); *Smith v. Guzman*, N.Y.L.J., Feb. 14, 1975, at 17, col. 5 (N.Y. Sup. Ct.); *First Pa. Banking & Trust Co. v. Liberati*, 422 A.2d 1074, 1077 (Pa. Super. Ct. 1980) (dictum); *Mammoth Cave Prod. Credit Ass'n v. Oldham*, 569 S.W.2d 833, 838 (Tenn. 1977); *Murdock v. Blake*, 26 Utah 2d 22, 484 P.2d 164, 169 (1971); *Production Credit Ass'n v. Nowatzki*, 90 Wis. 2d 344, 280 N.W.2d 118, 122 (1979).

167. See *Empire Fire & Marine Ins. Co. v. First Nat'l Bank*, 26 Ariz. App. 157, 546 P.2d 1166, 1168 (1976); *Murdock v. Blake*, 26 Utah 2d 22, 484 P.2d 164, 169 (1971).

168. A factor is a commercial agent employed by a principal to sell on behalf of the principal, but usually in the factor's name, merchandise consigned to the factor and entrusted to his possession and control of the goods, and being remunerated by a commission. BLACK'S LAW DICTIONARY 532 (5th ed. 1979).

*Murdock v. Blake*¹⁷¹ typifies the reasoning in these cases. In *Murdock* the debtor leased a service station from the secured party. Defendants, unsecured creditors of the debtor, obtained a judgment against him for \$5,204 and levied on assets from the service station. The secured party notified the defendants that it had a prior perfected security interest in the assets. Nevertheless, the defendants proceeded to sell the assets for \$2,821. The secured party alleged that the market value of the assets at the time of the sale was \$4,942. The court noted section 9-311,¹⁷² but construed the section in the light of section 9-503,¹⁷³ which gives the secured party the right to take possession of the collateral on default by the debtor.¹⁷⁴ The debtor had defaulted on his obligations to the secured party prior to the time the defendants obtained their judgment against the debtor. Therefore, under the security agreement and section 9-503, the secured party had an immediate right to possession.¹⁷⁵ Utah law provides that one who has an immediate right to possession of property may recover for conversion against another who has exercised unauthorized acts of dominion over the property.¹⁷⁶ The court thus concluded that the secured party could recover damages from the defendants for conversion, measured by the value of the collateral at the time of the sale.¹⁷⁷

Some authorities argue that a finding of tortious liability based on mere transfer of the collateral conflicts with the policy of section 9-311.¹⁷⁸ Apart from arguably inappropriate overtones of wrongdoing, however, the conversion action serves an important function.¹⁷⁹ Furthermore, the action meshes well with article 9. Like section 9-202 of article 9, the conversion action

169. *Farmers State Bank v. Stewart*, 454 S.W.2d 908, 915-16 (Mo. 1970); *Mammoth Cave Prod. Credit Ass'n v. Oldham*, 569 S.W.2d 833, 840 (Tenn. 1977).

170. *Smith v. Guzman*, N.Y.L.J., Feb. 14, 1975, at 17, col. 5 (N.Y. Sup. Ct.); *Production Credit Ass'n v. Nowatzski*, 90 Wis. 2d 344, 280 N.W.2d 118, 123 (1979).

171. 26 Utah 2d 22, 484 P.2d 164 (1971).

172. 484 P.2d at 168.

173. *Id.* at 169.

174. U.C.C. § 9-503 (1978).

175. 484 P.2d at 169.

176. *Id.* at 169.

177. *Id.* at 169-70.

178. See *Henderson*, *supra* note 18, at 209-10, 233 (transfer without more not a wrongful conversion); *Justice*, *supra* note 4, at 441-43 (since execution sale authorized by § 9-311 cannot be wrongful, conversion remedy should apply only to interferences with right of possession sufficiently serious to justify forcing defendant to pay for the property); *Wechsler*, *supra* note 73, at 402, 409-12 (conversion recovery from purchasers of collateral too harsh because some purchasers may have no opportunity to learn of security interest). In support of this argument, *Wechsler* cites § 9-302(1)(d) (security interest in consumer goods may be perfected without filing); however, under § 307(2) in many cases a buyer of consumer goods takes free of a security interest, despite perfection, if he buys without actual knowledge of the security interest, unless the secured party has filed a financing statement. Article 9 is generally consistent in tying priority to opportunity for others to learn of that priority.

179. When a lien creditor chooses to execute on collateral in disregard of a perfected security interest, the secured party should be able to force the lien creditor to buy out the secured party's interest in the collateral. The secured party's recovery, however, arguably should extend only to the amount of the security interest and not to the full market value, including any value corresponding to the debtor's interest in the collateral. For further discussion of this issue, see *infra* notes 230-33 and accompanying text.

disregards the issue of title.¹⁸⁰ In addition, the action provides a remedy based on a present right to possession, which section 9-503 furnishes to the secured party on default by the debtor.¹⁸¹ Absent a default under the terms of the security agreement, however, the secured party has no right under article 9 to take possession and therefore should not recover for conversion.¹⁸²

In the preceding cases involving transfers subject to a security interest transfer had already occurred and the secured party sought to enforce its interest in the hands of the transferee or to recover damages. In a last group of cases the secured party sought the court's aid to prevent execution on the collateral before transfer. The courts in these cases, although stating that any transfer would be subject to the secured party's interest, held that the secured party could not prevent execution on the collateral.¹⁸³ The value of the collateral in these cases usually exceeded the amount of the secured obligation.

Persuasive reasons have led a majority of jurisdictions to hold that collateral remains subject to a security interest after transfer.¹⁸⁴ These reasons arise from both doctrinal and policy considerations. Several sections in article 9 furnish doctrinal support for holding that a section 9-311 transfer is subject to a security interest. First, section 9-402(7)¹⁸⁵ states that a filed financing statement remains effective despite transfer by the debtor.¹⁸⁶ Since an effective financing statement would serve no function if transfer defeated the interest that the financing statement recorded, this section reinforces the inference from section 9-306 that a security interest continues in the collat-

180. U.C.C. § 9-202 (1978) states that the provisions of article 9 regarding obligations, rights, and remedies apply whether the secured party or the debtor holds title to the collateral. The tort of conversion constitutes a major interference with a chattel, so serious as to justify forced sale to the defendant. W. PROSSER, HANDBOOK OF THE LAW OF TORTS 80 (4th ed. 1971). Historically, title to the chattel has been irrelevant, and a chattel mortgagee or conditional seller has had standing to recover in conversion after default by the debtor. W. PROSSER & P. KEETON, PROSSER & KEETON ON TORTS § 15, at 102-04 (5th ed. 1984) [hereinafter cited as PROSSER & KEETON].

181. U.C.C. § 9-503 (1978). To recover in conversion the plaintiff must establish right of possession of the chattel at the time of the conversion. PROSSER & KEETON, *supra* note 180, at 102. The most common variety of conversion involves the unauthorized transfer of possession of goods to one not entitled to them. *Id.* at 96. Such a transfer usually constitutes a serious interference with the plaintiff's right to control the goods, since the defendant has "set the goods afloat upon a sea of strangers"; good faith does not excuse the defendant. *Id.* (no source given for quotation). For a discussion of how to measure damages for conversion, see RESTATEMENT (SECOND) OF TORTS § 927(1)(a) (1976) (damages measured by value of the subject matter converted or of the plaintiff's interest in it).

182. See *Production Credit Ass'n v. Nowatzki*, 90 Wis. 2d 344, 280 N.W.2d 118, 122 (1979).

183. See *Dick Warner Cargo Handling Corp. v. Aetna Business Credit, Inc.*, 700 F.2d 858, 861 (2d Cir. 1983) (applying Connecticut law); *New Jersey Bank v. Community Ass'n/Farms*, 666 F.2d 813, 818 (3d Cir. 1981) (applying New Jersey law); *U. S. Indus., Inc. v. Gregg*, 540 F.2d 142, 146 (3d Cir. 1976) (applying Florida law); *Roemer & Zeller, Inc. v. Ace Transmission Center, Inc.*, 114 Misc. 2d 415, 451 N.Y.S.2d 601, 603 (Sup. Ct. 1982); *Lipkowitz & Plaut v. Afrunti*, 95 Misc. 2d 849, 407 N.Y.S.2d 1010, 1014 (Sup. Ct. 1978); *Production Credit Ass'n v. Nowatzki*, 90 Wis. 2d 344, 280 N.W.2d 118, 122 (1979).

184. See *supra* note 50 and accompanying text.

185. U.C.C. § 9-402(7) (1978).

186. *Id.*

eral despite transfer.¹⁸⁷ As in section 9-306, however, the language in section 9-402(7) does not clearly indicate whether a security interest continues despite involuntary transfer.¹⁸⁸ Second, section 9-503, which gives the secured party the right to take possession of the collateral on default by the debtor, makes no exceptions for cases in which the collateral has been transferred.¹⁸⁹ Thus, courts have construed the section to support the secured party's rights against lien creditors or transferees in actions for replevin or conversion.¹⁹⁰ Although the language in sections 9-306, 9-402(7), and 9-503 does not unequivocally include involuntary as well as voluntary transfers, this omission probably results from oversight rather than design.¹⁹¹ Third, section 9-307(3) provides additional doctrinal support for the survival of a security interest despite transfer. Section 9-307(3) states that a buyer other than a buyer in ordinary course¹⁹² takes collateral free of any security interest to the extent that the interest secures advances after the secured party learns of the purchase, or more than forty-five days after the purchase, whichever occurs first.¹⁹³ This provision negatively implies that a buyer not in ordinary course otherwise takes subject to a security interest.

Section 9-311, however, provides the strongest doctrinal support for concluding that a security interest continues in the collateral despite involuntary transfer. In stating that only the debtor's rights may be transferred by voluntary or involuntary means, the section indicates that the secured party's interest in the collateral should not terminate as under the Delaware approach.¹⁹⁴ The language of section 9-311, however, does not preclude requiring the unsecured creditor to pay off the secured debt before execution¹⁹⁵ or compelling the secured party to liquidate,¹⁹⁶ treatments discussed previously in this Comment.

Policy considerations support the "subject to" approach less strongly than

187. See *supra* notes 26-27 and accompanying text.

188. U.C.C. § 9-402(7) (1978).

189. *Id.* § 9-503.

190. See, e.g., *Midland-Guardian Co. v. Hagin*, 370 So. 2d 25, 27 (Fla. Dist. Ct. App. 1979) (secured party or its assignee has right of replevin under § 9-503); *Farmers State Bank v. Stewart*, 454 S.W.2d 908, 916 (Mo. 1970) (secured party has right to possession under § 9-503 and thus may sue auctioneer for conversion); *State v. Jones*, 181 N.J. Super. 549, 438 A.2d 581, 586 (Super. Ct. Law Div. 1981) (under § 9-503 secured party may repossess car from state on debtor's default); *Paccar Fin. Corp. v. Harnett Transfer, Inc.*, 51 N.C. App. 1, 275 S.E.2d 243, 248 (under § 9-503 secured party has right to possession on debtor's default and thus may obtain claim and delivery from buyer at public sale); *Production Credit Ass'n v. Nowatzki*, 90 Wis. 2d 344, 280 N.W.2d 118, 122 (1979) (§ 9-503, giving secured party right to possession on debtor's default, shows that § 9-311 does not void provision in security agreement making unauthorized transfer a default).

191. Cf. *Hawkland*, *supra* note 94, at 12-13 (policy reasons for including involuntary dispositions).

192. U.C.C. § 1-201(9) (1978) provides a detailed definition of a buyer in ordinary course. Generally, a buyer in ordinary course is one who buys goods in good faith and without knowledge of any third party's interest in the goods from a seller in the business of selling goods of that kind.

193. U.C.C. § 9-307(3) (1978).

194. See *supra* text accompanying notes 91-115.

195. See *supra* text accompanying notes 116-36.

196. See *supra* text accompanying notes 137-51.

other treatments. Although the "subject to" approach preserves all of the secured party's rights under article 9, the secured party may prefer a different treatment because the continuation of its interest in the collateral despite a number of voluntary and involuntary transfers creates a potentially unwieldy situation.¹⁹⁷ The purchaser of the collateral may lose possession if

197. Consecutive transfers of the whole collateral may cause difficulty to the secured party in pursuing its interest in collateral in the hands of the transferees and in the enforcement of contractual rights and duties under the original security agreement. Another potential source of complexity is transfer of subsets of rights in collateral. U.C.C. § 1-201(36) (1978) defines "right" by stating that the term includes remedies. *Id.* § 1-201(34) defines "remedy" as any remedial right to which a party is entitled with or without resort to a tribunal. *Id.* § 2-201 comment 34 merely adds that the purpose of the section is to clarify that "rights" and "remedies" include the self-help remedies given by the Code. The Code does not define "rights in the collateral." *Id.* § 9-203 states that the debtor must have rights in the collateral in order for a security agreement to become enforceable. The general rule given by the cases is that, for purposes of § 9-203, possession by the debtor coupled with at least contingent rights of ownership constitute rights in the collateral. *See, e.g.,* Amfac Mortgage Corp. v. Arizona Mall, 127 Ariz. 70, 618 P.2d 240, 244 (Ct. App. 1980) (construction lender prevailed over subcontractor because debtor had obtained possession pursuant to agreement); Morton Booth Co. v. Tiara Furniture, Inc., 564 P.2d 210, 214 (Okla. 1977) (rights sufficient for attachment when debtor gains possession pursuant to agreement giving him any interest more than naked possession).

Several courts have stated that the debtor's right of redemption under U.C.C. § 9-506 (1972) is transferable. *E.g.,* Sturdevant v. First Sec. Bank, 186 Mont. 91, 606 P.2d 525, 528 (1980) (purchaser of airplane could redeem, but only by paying off obligations secured under dragnet clause); Fitchburg Yarn Co. v. Wall & Co., 46 A.D.2d 763, 361 N.Y.S.2d 170, 172 (1974) (debtor's equity of redemption may be attached); Smith v. Guzman, N.Y.L.J., Feb. 14, 1975, at 17, col. 5 (N.Y. Sup. Ct.) (purchaser at sheriff's sale buys nothing more than debtor's right to redeem). Redemption is the repurchase of property by paying off a secured obligation. BLACK'S LAW DICTIONARY 1149 (5th ed. 1979). Under U.C.C. § 9-506, a debtor may redeem collateral taken into possession by a secured party after default by paying off the secured debt before the secured party has disposed or entered into a commitment to dispose of the collateral.

In *U.S. Indus., Inc. v. Gregg*, 540 F.2d 142 (3d Cir. 1976), the Third Circuit held that a pledgor of stock certificates retained a seizable interest in those certificates even though the pledgor had only a contingent right to their return if and when the secured debt was paid. *Id.* at 147; *cf.* Lipkowitz & Plant v. Affrunti, 95 Misc. 2d 849, 407 N.Y.S.2d 1010, 1013 (1978) (assignor of notes retained interest in any excess proceeds that could be transferred). A pledgor is a party delivering or who has delivered goods in pledge. A pledge is a bailment of goods to a creditor as security for an obligation. BLACK'S LAW DICTIONARY 1038 (5th ed. 1979). The court in *Gregg* noted that under § 9-506 the debtor retained a right to the return of the collateral upon discharge of the underlying obligation. *Cf.* U.C.C. § 9-404 (1972) (debtor may require secured party to file termination statement when all underlying obligations have been fulfilled). The *Gregg* court stated that the debtor's rights under article 9 are in the collateral itself and that a creditor could reach those rights under § 9-311. 540 F.2d at 146. The court offered no authority for this assertion. Since § 9-311 authorizes transfer only of the debtor's rights "in the collateral," the question remains whether creditors may reach rights of the debtor not in the collateral. The answer should be yes, unless those rights are encompassed by a prior security interest.

In *Sheffield Progressive, Inc. v. Kingston Tool Co.*, 10 Mass. App. 47, 405 N.E.2d 985 (1980), the plaintiff unsecured creditor alleged that the debtor and his secured creditors had arranged a transfer of the debtor's assets to one of the secured creditors for one third of the market value of the assets in order to defraud the unsecured creditors. The court held that under U.C.C. § 9-507 (1978) a debtor may recover from a secured party for any failure by the secured party to fulfill its obligation under U.C.C. § 9-504(3) (1978) to dispose of the collateral in a commercially reasonable manner. 405 N.E.2d at 988. Under § 9-311 unsecured creditors could reach and exercise the debtor's right to recover against a secured party for the loss caused by the secured party's misconduct. *Id.*

Article 9 gives the debtor several other rights not yet discussed in cases involving § 9-311. *See supra* note 65 for debtor's rights under U.C.C. §§ 9-207, 9-502(2), & 9-504(2); *see also id.*

the secured party forecloses its interest.¹⁹⁸ The continuing security interest in the collateral will likely hinder sale and diminish proceeds.¹⁹⁹ The debtor may be liable for a larger deficiency if proceeds are diminished.²⁰⁰

Despite these disadvantages a majority of courts have followed the "subject to" approach perhaps primarily because the approach remains consistent with the language of section 9-311 and courts can implement this approach with a minimum of judicial innovation and oversight,²⁰¹ although not necessarily a minimum of litigation. In effect this treatment leaves the parties to litigate their rights after the fact of transfer, instead of providing means to resolve conflicts before transfer occurs. Unlike other approaches discussed in previous sections of this Comment, the "subject to" approach does not require notice to the secured party before execution on collateral. Without notice a secured party cannot protect its interest. Creditors such as those in *Murdock* may feel chagrined when found liable for a conversion award that is larger than the amount of proceeds from the execution sale.²⁰² Yet without any provision for reconciliation of competing claims before execution, the secured party may have no other remedy.

E. Unsecured Creditors Have No Recourse to Collateral

Only two cases have clearly denied unsecured creditors any resort to collateral in which a secured party held a prior interest, and these cases have not been followed by other courts. In *William Iselin & Co. v. Burgess & Leigh, Ltd.*²⁰³ the court vacated an unsecured creditor's levy on the grounds that the secured party had priority and that, since the debtor had defaulted, the secured party had a right to take possession of the collateral.²⁰⁴ In *Harrison Music Co. v. Drake*²⁰⁵ the court held that since the debtor had de-

§§ 9-404, *supra*, 9-504(2), *supra* note 125 (secured party must account to debtor for any proceeds of disposition), 9-505, *supra* note 113 (debtor may require repossessing secured party to dispose of consumer goods if debtor has paid sixty percent of the cash price).

198. *See supra* note 105.

199. *See supra* note 87 and accompanying text.

200. *See supra* notes 63, 104 and accompanying text.

201. Absent the necessary statutory provisions, alternative treatments such as those discussed *supra* in the text accompanying notes 116-51 would require courts to invent means by which an unsecured creditor could obtain an accounting of the secured debt in order to execute freely on the collateral, or by which the court could compel a secured party to dispose of the collateral and apply any excess proceeds to the unsecured creditor. In contrast, courts can effectuate the "subject to" approach merely by holding that the secured party's rights survive transfer.

202. *See supra* notes 171-77 and accompanying text. For discussion of why unsecured creditors should be required to notify secured parties before executing on collateral and should be able to obtain a hearing to contest priority to the collateral, see Wechsler, *supra* note 73, at 393-95.

203. 52 Misc. 2d 821, 276 N.Y.S.2d 659 (Sup. Ct. 1967). *Contra* *Roemer & Zeller, Inc. v. Ace Transmission Center, Inc.*, 114 Misc. 2d 415, 454 N.Y.S.2d 377, 378 (Sup. Ct. 1982) (junior secured party had right to sell collateral because senior secured party may not unilaterally protect debtor's assets).

204. 276 N.Y.S.2d at 663.

205. 43 Pa. D. & C.2d 637 (C.P. Allegheny County 1967). *But cf.* *First Pa. Banking & Trust Co. v. Liberati*, 282 Pa. Super. 198, 422 A.2d 1074, 1078 (1980) (secured party could not garnish collateral validly transferred to creditor); *see* discussion *infra* notes 216-24 and accompanying text.

faulted under the security agreement, the secured party could obtain a discharge of a levy on the collateral.²⁰⁶ Although the results in these cases may have been equitable on the facts,²⁰⁷ the decisions rested upon a faulty assumption. The courts assumed that, once the debtor had lost the right of possession of the collateral through default, the debtor lost all other rights in the collateral that could be reached by his other creditors under section 9-311.²⁰⁸ Two states require the value of the collateral to exceed the amount of the security interest before a subordinate creditor may obtain execution.²⁰⁹

III. THE RELATIONSHIP BETWEEN SECTION 9-311 AND PRIORITY RULES

One authority has suggested that a secured transaction under article 9 creates a kind of co-ownership in which the interests of the debtor and the secured party are separate and complementary.²¹⁰ Theoretically, as a debtor repays a secured debt the amount of the security interest decreases and the debtor's equity or interest in the collateral increases.²¹¹ This description may be misleading, however, in that it suggests that the secured party's and the debtor's interests are mutually exclusive. A better description would represent the two interests as co-extensive and undivided. In effect, both interests comprehend the whole collateral, but the security interest has priority over the debtor's interest until the security interest is discharged.²¹² One purpose of section 9-311 is to prevent the secured party from improperly locking up excess value in the collateral.²¹³ To permit transfer of more than the excess, however, merely forces the secured party to sue to gain satisfaction of the prior interest.²¹⁴ As a practical matter, therefore, courts

206. 43 Pa. D. & C.2d at 641.

207. If the value of the collateral did not exceed the amount of the secured debt, then the court reached an equitable result because no excess value existed in the collateral to which subordinate creditors should have had resort.

208. See *supra* note 197.

209. KAN. STAT. ANN. § 60-2406 (1983) (sale shall not be completed unless for an amount in excess of the senior interest as determined by a court). See also N.H. REV. STAT. ANN. § 512:29 (1961 & Supp. 1983) (court may appoint receiver to dispose of property only if the property will sell for more than the claims against it).

210. Henderson, *supra* note 18, at 194; cf. U.C.C. § 9-202 (1978) (provisions apply whether title is in debtor or secured party).

211. The debtor's equity increases if the value of the collateral either increases or decreases more slowly than the amount of the remaining secured debt.

212. Even if the debtor has already paid more than the value of the collateral, if he defaults, the secured party may foreclose its interest in the collateral, and all of the debtor's rights in the collateral will be transferred to the purchaser. U.C.C. § 9-504(4) (1978).

The debtor has rights in the collateral, other than his equity interest, that may be transferable. See *supra* note 197.

213. See *supra* note 89 and accompanying text.

214. This statement simplifies the outcome in that the secured party may not sue in all cases. If either the debtor or the transferee of the collateral are uncooperative, however, the secured party may incur considerable expense in attempting to locate the collateral or foreclose its security interest. Cf. Nickles, *supra* note 5, at 390 (right of secured party to repossess collateral from execution purchaser not sufficient to make secured party whole because of additional inconvenience, costs, and risk that secured party may be unable to locate collateral).

should construe the debtor's rights in the collateral to comprise only the value in excess of the security interest.²¹⁵

The court in *First Pennsylvania Banking & Trust Co. v. Liberati*²¹⁶ treated the secured party's and the debtor's interests as if they were separate and mutually exclusive. Liberati, a construction contractor, entered a security agreement with the plaintiff bank. In exchange for the bank's promise to make loans from time to time, Liberati granted the bank a security interest in all of his present and future accounts receivable. Liberati also entered an agreement with Reliance Insurance Co. in which Reliance agreed to act as surety for Liberati. The bank made a loan to Liberati of over \$200,000. A township subsequently engaged Liberati to construct a sewer system. After problems arose during construction, arbitration fixed Liberati's compensation at \$63,000, and Reliance feared that it would be liable for a large sum. Reliance asked the township to withhold payment on its account receivable for Liberati until an arrangement could be made to reimburse Reliance for its expense. The township, Reliance, and Liberati reached an agreement specifying that the township would make payment to Liberati's attorneys, with \$25,000 of the amount to be accepted on behalf of Reliance. After receipt by Liberati's attorneys but before distribution to Reliance and Liberati, the secured party bank attempted to garnish the entire amount. The appellate court held that the garnishment was invalid as to the \$25,000 accepted on behalf of Reliance,²¹⁷ reasoning that Liberati's attorneys accepted the \$25,000 as agents of Reliance.²¹⁸ According to the court Liberati had effected a valid transfer of his interest in the \$25,000 to Reliance under section 9-311.²¹⁹ The bank's rights as garnishor extended only as far as its debtor's, and since Liberati no longer had any interest in the \$25,000, the bank could not garnish the money.²²⁰ Even if the bank's security interest in the money continued under section 9-306 despite the transfer, the court stated that garnishment was not a proper procedure to pursue collateral in the hands of a transferee or its agent.²²¹

The court did not hold that the debtor's transfer of his own interest in the collateral cut off the security interest. The court reasoned that the bank sought to reach its own interest in the collateral and not Liberati's interest. Since the garnishment procedure permits a creditor to reach the debtor's interest in property,²²² the court held that the bank could not use that proce-

See also id. at 386 (state law does not usually require notice to secured party of levy on collateral); *id.* at 396 (no record kept of identity of purchaser at some execution sales).

215. Either alternatively or in addition, imposition by state law of a requirement that unsecured creditor notify secured parties before executing on collateral would alleviate this problem. *See Weschler, supra* note 73, at 393; *see also infra* notes 238-44 and accompanying text.

216. 282 Pa. Super. 198, 422 A.2d 1074 (1980).

217. 422 A.2d at 1076-78.

218. *Id.* at 1076.

219. *Id.* at 1077.

220. *Id.*

221. *Id.* at 1077-78. The court cited U.C.C. § 9-306 comment 3 (1978) as support for its reasoning. 422 A.2d at 1077.

222. *See supra* note 37 for definition of garnishment.

ture to reach its own interest in the collateral.²²³ The court's decision in *Liberati* defeats an important purpose of a security interest. When collateral is not sufficiently valuable to satisfy both the secured party's and the debtor's interests, article 9 provides for the secured party to receive payment in full and for the debtor to receive only the remainder.²²⁴

Under the better interpretation of section 9-311, the secured party in effect has priority over the debtor as to the whole collateral. Similarly, when article 9 gives priority to a third party over the secured party, the third party takes priority as to the whole collateral. The court in *Earthmovers, Inc. v. Clarence L. Boyd Co.*²²⁵ followed this construction. In that case the debtor granted to Boyd a security interest in a bulldozer to secure a loan of \$14,365. The debtor subsequently engaged Earthmovers to extricate the bulldozer from a pond and restore it. Earthmovers' bill for services and parts amounted to \$2,257. When the debtor failed to pay the bill, Earthmovers asserted a statutory mechanic's lien,²²⁶ gave statutory notice to the debtor and to Boyd, and held a public sale. Earthmovers bought the bulldozer for \$192 more than its bill. Boyd sought to foreclose its security interest in the bulldozer, arguing that under section 9-311 foreclosure of a statutory lien operated only to transfer the debtor's rights and did not affect the secured party's interest, which continued in the collateral. Earthmovers argued that its mechanic's lien had priority over Boyd's security interest under section 9-310.²²⁷ The court held that section 9-311 did not apply to foreclosure of a statutory lien;²²⁸ therefore, the sale foreclosing Earthmover's mechanic's lien discharged Boyd's security interest in the collateral.²²⁹

Earthmovers presents the question of whether courts should construe section 9-311 to limit the subject matter transferred to the debtor's rights, or should consider the section inapplicable in cases in which priority rules or statutes purport to permit transfer of the whole collateral. This issue is buried in cases following the "subject to" approach discussed in Part II of this Comment.²³⁰ The language of section 9-311 implies that transfer is subject to the security interest because only the debtor's rights in the collateral may be transferred and not the secured party's interest.²³¹ Under this reading of section 9-311 the issue of the secured party's priority in relation to a trans-

223. 422 A.2d at 1078. The court indicated that the bank might have prevailed in an action for replevin or conversion. *Id.* at 1077.

224. U.C.C. § 9-504(1)-(2) (1978).

225. 554 P.2d 877 (Okla. Ct. App. 1976).

226. See OKLA. STAT. ANN. tit. 42, § 91 (West 1979) (lien on personal property for service thereon).

227. U.C.C. § 9-310 (1978) states that when a person in the ordinary course of his business furnishes services or materials with respect to collateral, a lien on the collateral for such services or materials has priority over a perfected security interest.

228. 554 P.2d at 879.

229. *Id.* at 880; cf. *Enloe v. Franklin Bank & Trust Co.*, 445 N.E.2d 1005, 1010 (Ind. Ct. App. 1983) (transfer was default under security agreement; agreement required the debtor, not the secured party, to maintain collateral; therefore, transferee had no claim against secured part for cost of repairs).

230. See *supra* notes 152-202 and accompanying text.

231. U.C.C. § 9-311 (1978).

feree of the collateral never arises because the secured party and the transferee claim rights in different properties. This rationale was the basis of Boyd's argument in *Earthmovers* and underlay the Court's decision in *Liberati*.²³² Under this analysis, although the mechanic's lien concededly has priority as to the debtor's rights in the collateral, the mechanic's lien may not affect the secured party's interest. If Boyd's security interest comprehended the whole value of the bulldozer, as the security interest must have since the secured debt remained near \$14,000 and the bulldozer sold for only \$2,257, the debtor had no equity in the bulldozer that *Earthmovers* could reach. This interpretation makes sense because a purchaser of the bulldozer in an ordinary sale should expect to have to pay off any secured debt and to pay for necessary repairs. Another consequence of this interpretation is that if the value of the collateral exceeds the amount of the secured debt, a secured party should not be entitled to recover more than the amount of the debt.²³³

Under the alternative reading of section 9-311 transfer is effective as to the whole collateral, including the security interest, which survives under section 9-306. the issue of priority of the security interest in relation to other claims then arises. Although a perfected security interest is superior to most other claims under sections 9-201,²³⁴ 9-301,²³⁵ and 9-307,²³⁶ according to this interpretation the court in *Earthmovers* could properly conclude that a mechanic's lien has priority under section 9-310. In this case the secured party takes any proceeds in excess of the amount of the lien. This result makes sense because the mechanic may have salvaged property that all parties might otherwise have had to write off as a total loss. The mechanic does not gain at the secured party's expense; rather, the secured party may be able to reach a residue in the proceeds when it would otherwise have recovered nothing.

Despite the implication of section 9-311 that only the debtor's rights may be transferred, the court's decision in *Earthmovers* appears correct in light of the overall plan of article 9. The priority rules would have little meaning if

232. *Earthmovers, Inc. v. Clarence L. Boyd Co.*, 554 P.2d at 879.

233. This interpretation avoids the harsh result of holding a creditor who obtained a valid transfer under § 9-311 liable in conversion for the value of the whole collateral when the security interest in the collateral was relatively small. Theoretically the debtor should receive from the secured party any proceeds from the conversion recovery in excess of the secured debt. The creditor might then seek to levy on that excess in the hands of the debtor. This treatment is obviously less efficient than simply limiting the secured party's recovery from the creditor to the value of the security interest. See *Royal Store Fixture Co. v. New Jersey Butter Co.*, 114 N.J. Super. 263, 276 A.2d 153, 155 (Super. Ct. App. Div. 1971) (applying Pennsylvania law to allow a secured party recovery for conversion limited to the amount of the remaining secured debt).

234. U.C.C. § 9-201 (1978) (security agreement effective against purchasers of the collateral and against other creditors).

235. *Id.* § 9-301 (unperfected security interest subordinate to rights of one who becomes a lien creditor before the interest is perfected).

236. *Id.* § 9-307 (buyer in ordinary course takes free of security interest). This provision is generally considered inapplicable in cases involving involuntary transfers because an execution sale is not within the ordinary course of business. Cf. 30 AM. JUR. 2D *Executions* §§ 428-30 (1967) (doctrine of caveat emptor applies; execution purchaser buys only what debtor had and is under duty to inform himself of limits of debtor's interest in property).

their effect were limited to the debtor's rights in the collateral.²³⁷ The drafters of article 9 probably intended transfers effected by parties having priority under the priority rules to be effective as to the whole collateral. The results may be unsatisfactory, however, when the secured party did not have notice of the sale or failed to anticipate that sale might cut off its interest. Thus, in two other cases involving mechanic's liens, the courts reached the opposite result from the court in *Earthmovers* by inventing special rules.

In *Paccar Financial Corp. v. Harnett Transfer, Inc.*²³⁸ one person served as stockholder, director, and president of both the debtor corporation and another corporation, Harnett Transfer. Harnett Transfer performed repairs on the collateral, a truck, but the debtor corporation failed to pay the bill. Harnett Transfer then asserted a mechanic's lien. The debtor corporation purchased the truck at the foreclosure sale for an amount close to the amount of the repair bill. The court held that when a purchaser of the collateral buys at a sale foreclosing a statutory mechanic's lien for a bill that the purchaser failed to pay, and the price essentially represents the unpaid bill, then the sale does not discharge the security interest.²³⁹

In *First National Commerce & Finance Co. v. Indiana National Bank*²⁴⁰ the debtor granted a security interest in an airplane. Another corporation performed repairs worth \$900 on the airplane. The debtor failed to pay the bill and defaulted on its payments on the secured debt, of which \$76,279 remained. The court held that, although under section 9-310 a statutory mechanic's lien takes priority over a security interest, the purchaser at the foreclosure sale takes subject to the security interest, at least when the secured party did not have notice of the sale.²⁴¹ To hold otherwise, the court stated, would deprive the secured party of due process.²⁴² The security interest was subordinate only to the extent of the amount of the mechanic's claim against the collateral.²⁴³ *Paccar* and *First National* illustrate the need for a requirement that unsecured creditors give notice to secured parties before executing on collateral.²⁴⁴

IV. CONCLUSION

The majority of courts have successfully avoided two plausible misreadings of section 9-311. One misreading allows third parties to pre-empt a security interest by effecting an involuntary transfer and thereby terminate

237. For example, a mechanic's lien on a recently purchased car might be worth little if limited to the debtor's equity in the car. See generally Jackson & Kronman, *supra* note 44, at 1161-78.

238. 51 N.C. App. 1, 275 S.E.2d 243 (1981).

239. 275 S.E.2d at 248.

240. 360 So. 2d 791 (Fla. Dist. Ct. App. 1978).

241. *Id.* at 796-97.

242. *Id.*

243. *Id.* at 796. The dissent objected to judicial imposition of a requirement of actual notice. *Id.* at 797 (Carroll, J., dissenting).

244. See *supra* note 215 and accompanying text.

the security interest in collateral.²⁴⁵ The other misreading allows the secured party to limit transfer to only the debtor's rights in the collateral even if the third party had priority.²⁴⁶ The emerging majority rule holds that if a secured party has priority, the secured party has a right to the whole collateral. Other creditors may reach the debtor's rights in the collateral, but their claims are subordinate and subject to discharge by foreclosure of the security interest. If, however, another creditor has priority over the secured party,²⁴⁷ the creditor has a superior right to the whole collateral. The security interest may continue in the collateral, but the interest is subordinate and may be discharged by sale. This interpretation of section 9-311 is consistent with the language of that section, with the overall plan of article 9, and with the underlying purposes of the Code. One of the policies of article 9 is to further the free alienability of property rights.²⁴⁸ Article 9 tends to remove restrictions on debtors' ability to encumber or transfer their interests.²⁴⁹ In particular, section 9-311 enables a debtor to deal more freely with his property rights and ensures that the debtor is not made judgment-proof by a financing arrangement with a secured party.²⁵⁰ The majority approach furthers these policies by allowing transfer without sacrificing priority.

Because the trend toward this interpretation is likely to continue, revision of section 9-311 appears unnecessary. Since the section explicitly speaks of transfer of only the debtor's rights, however, inclusion in the official comment to section 9-311 of a statement or example to the effect that transfer need not be limited to the debtor's rights if the transferee has priority over the secured party might be helpful.

Section 1-102 of the Code states that the underlying purposes of the Code are to simplify and modernize the law, to permit continued expansion of commercial practices, and to make the law uniform among the various jurisdictions.²⁵¹ Insofar as state procedural law continues to vary, making the procedural details of involuntary transfers under section 9-311 uniform will remain difficult. The lack of prescribed procedures leaves courts great flexibility.²⁵² The best direction for changes in state law is toward providing the procedural tools needed to resolve competing claims more equitably and efficiently. One important purpose of article 9 is to promote the efficient con-

245. This is the approach taken by Delaware. *See supra* notes 96-115 and accompanying text.

246. This approach is the one argued for by the secured party in *Earthmovers*. *See supra* notes 225-33 and accompanying text.

247. *E.g.*, U.C.C. §§ 9-301, -307, -308, -309, -310, -312 (1978).

248. *See supra* note 83 and accompanying text.

249. *Id.*

250. *See supra* note 85 and accompanying text.

251. *See supra* note 78 and accompanying text.

252. For example, in *Dick Warner Cargo Handling Corp. v. Aetna Bus. Credit Inc.*, 700 F.2d 858 (2d Cir. 1983), the district court held that a fund possessed by the secured party could not be garnished, since the debtor had only a contingent right to return of the money, and under Connecticut law a contingent interest could not be garnished. *Id.* at 861. The circuit court, openly seeking a way to permit a transfer in accord with § 9-311, reversed, holding that the fund was due but subject to a condition subsequent and therefore garnishable.

duct of business by rewarding providence and diligence.²⁵³ Article 9 also promotes efficiency by ensuring the availability of important information to those who have a legitimate need for it.²⁵⁴ State law should require notice to a secured party before allowing execution on the collateral to be completed.²⁵⁵ Some of the more desirable treatments, such as allowing the secured party to dispose of the collateral if disposition must be made,²⁵⁶ may be impossible in the absence of notice. Also, state law should provide means for an unsecured creditor to obtain an accounting of the remaining secured debt²⁵⁷ or to contest a secured party's priority.²⁵⁸ Without such means, unsecured creditors may abandon some claims and pursue others to no purpose.²⁵⁹

253. *See supra* note 81 and accompanying text.

254. *See supra* note 82 and accompanying text.

255. *See supra* notes 215, 238-44 and accompanying text, and text accompanying note 202.

256. *See supra* notes 137-51 and accompanying text. Another treatment that requires notice to the secured party is when the judgment creditor pays off the secured debt before or shortly after execution. *See supra* notes 116-36 and accompanying text. Most important, however, is that notice gives the secured party a chance to monitor disposition of the collateral and protect its interest.

257. *See supra* notes 74-75 and accompanying text.

258. *See supra* note 76 and accompanying text and text accompanying note 202.

259. *Id.*