COURT OF APPEALS
DECISION
DATED AND FILED

February 2, 1999

Marilyn L. Graves
Clerk, Court of Appeals
of Wisconsin

NOTICE

This opinion is subject to further editing. If published, the official version will appear in the bound volume of the Official Reports.

A party may file with the Supreme Court a petition to review an adverse decision by the Court of Appeals. *See* § 808.10 and RULE 809.62, STATS.

No. 97-2060

STATE OF WISCONSIN **IN COURT OF APPEALS**
DISTRICT I

M&I BANK SOUTH CENTRAL,

PLAINTIFF,

SUPERVALU HOLDINGS, INC.,

INTERVENOR-PLAINTIFF-APPELLANT,

V.

NEIL C. LOFBERG,

DEFENDANT-RESPONDENT,

LOFBERG'S, INC., KEMPER SECURITIES, INC., AND DOUGLAS F. MANN, AS RECEIVER FOR LOFBERG'S, INC.,

DEFENDANTS.

APPEAL from an order of the circuit court for Milwaukee County: JACQUELINE D. SCHELLINGER, Judge. *Reversed and cause remanded with directions.*

Before Wedemeyer, P.J., Schudson and Hoover, JJ.

WEDEMEYER, P.J. Supervalu Holdings, Inc. (Supervalu) appeals from a final order of the trial court denying its motion for summary judgment, denying its motion for judgment against Neil C. Lofberg (Neil) for conversion, and releasing to Lofberg the sum of $150,000 in a Kemper Securities, Inc. account which had earlier been frozen by order of the court.

Supervalu claims: (1) the trial court's finding that Lofberg's, Inc. was not in default under the terms of the security agreements it had executed with Supervalu was clearly erroneous; (2) the trial court erred as a matter of law in ruling that Supervalu is not entitled to $150,000 by virtue of its superior security interest; and (3) Neil's withdrawal of $150,000 from his personal account was made in the "ordinary course of business."

Because material issues of fact exist as to whether Lofberg's, Inc. was in default in its obligations to Supervalu and whether improper dominion and control was exercised by Neil over inventory proceeds, we reverse and remand with directions.

I. BACKGROUND

Lofberg's, Inc. has for years operated grocery stores both within and without the State of Wisconsin. As pertinent to this appeal, it operated stores in Waukesha, Milwaukee (Bay View) and Janesville, Wisconsin. Supervalu supplied these stores with inventory and was Lofberg's, Inc. largest creditor. To facilitate

this relationship, Lofberg's, Inc. and Supervalu executed separate Security Agreements for each of the three stores. The agreements gave Supervalu a security interest in the stores' inventory and proceeds from the sale of inventory. All of the agreements were in effect and perfected by 1992. As pertinent to this review all three documents provided:

> 5. EVENTS OF DEFAULT: ACCELERATION. Any or all obligations shall, at the option of Super and notwithstanding any time or credit allowed by any instrument evidencing a liability, become immediately due and payable without notice or demand upon the occurrence of any of the following events of default:
>
> (a) Default in the payment or performance of any obligation, covenant or liability contained or referred to herein or in any note evidencing the same;
>
> (b) Any warranty, representation or statement made or furnished to Super by or on behalf of Debtor proves to have been false in any material respect when made or furnished;
>
> (c) Any event which results in the acceleration of the maturity of the indebtedness of Debtor to others under any indenture, agreement or undertaking;
>
> (d) Loss, theft, damage, destruction, sale or encumbrance to or of any of the Inventory, or the making of any levy, seizure or attachment thereof or thereon;
>
> (e) Death, dissolution, termination of existence, insolvency, business failure, appointment of a receiver of any part of the property of, assignment for the benefit of creditors by, or the commencement of any proceeding under any bankruptcy or insolvency laws by or against Debtor, or any guarantor or surety for Debtor.

In addition, all three security agreements contained similar provisions regarding the preservation and disposition of inventory and proceeds which in relevant part read:

> 3. PRESERVATION AND DISPOSITION OF INVENTORY AND PROCEEDS.
>
> (a) Debtor will keep the Inventory, contract rights with respect thereto, and proceeds of both free from any

> adverse lien, security interest or encumbrance, and in good condition and will not waste or destroy any of the same. Debtor will not use the Inventory in violation of any statute or ordinance.
>
> (b) Debtor will pay and discharge, promptly and before any penalty attaches thereto, all taxes, assessments and governmental charges or levies imposed upon or against the Inventory.

In April 1995, Lofberg's, Inc.'s financial condition became so tenuous that Supervalu required it to pay for all of its orders "cash on delivery." This action eliminated a cash float that existed between Lofberg's, Inc. and Supervalu. Neil, president of Lofberg's, Inc., decided to inject some fresh funds of his own into the company to alleviate its cash flow problems, and to provide a means to finance the purchase of inventory. On June 7, 1995, he loaned Lofberg's, Inc. $150,000. The source of the funds was Neil's personal Kemper Securities account. Contemporaneously, Neil executed an Interim Loan Financing Agreement with Lofberg's, Inc. The agreement acknowledged that he had a subordinate position to other existing secured creditors and that the funds advanced were not intended to be a capital contribution. The agreement further called for prompt repayment of the funds advanced on at least a weekly basis. Between June 28 and July 2, 1995, Neil filed appropriate documents to perfect his security interest. At or about the same time Neil began to use his personal checking accounts in Amerus Bank and M&I Bank South Central to deposit Lofberg's, Inc.'s business receipts. It was in these accounts that inventory proceeds were deposited and from which business expenses were paid. This practice continued from June until August.

Neil's efforts to save the company, however, were of no avail. The three stores closed on August 12, 1995. On August 14, 1995 in the morning, pursuant to Chapter 128, a receiver was appointed for Lofberg's, Inc. The order of

appointment enjoined Lofberg's, Inc.'s officers and agents from "transferring, encumbering or otherwise disposing of assets" of the corporation. The receiver informed Neil of the contents of this order by phone at approximately 3:35 p.m., but at 4:25 p.m., Neil issued himself a cashier's check for $150,000 from his personal M&I Bank South Central account, which he later deposited in his personal Kemper Securities account.

On August 21, 1995, M&I sued Neil to enjoin him from fraudulently transferring funds to himself. The trial court entered a temporary order freezing the $150,000 in the Kemper Securities account. Supervalu intervened alleging it had a perfected security interest in the same funds and, therefore, was entitled to the $150,000. M&I voluntarily dismissed its action against Neil. Supervalu then moved for a preliminary injunction freezing the $150,000 in the Kemper Securities account. On October 13, 1995, after a hearing, the request was granted.

On June 17, 1996, Supervalu moved for partial summary judgment claiming: (1) its security interest was superior to Neil's security interest and, therefore, it was entitled to the $150,000; and (2) Neil's payment to himself constituted a "voidable preference" and a "fraudulent transfer." Neil filed a cross motion for summary judgment, seeking to dismiss Supervalu's claims. A newly assigned trial court denied both motions. In doing so, it ruled: (1) Supervalu's security interest in the $150,000 was superior to Neil's security interest; (2) Neil's payment to himself was a "voidable preference;" (3) there was a question of fact whether Neil intended to defraud his creditors or whether he was a purchaser in "good faith." This factual issue would determine whether Neil's repayment qualified for the "new value" exception to the voidable preference and, therefore, Supervalu was not entitled to summary judgment; and (4) Neil's repayment of $150,000 to himself was a "fraudulent transfer." However, the trial court also

concluded that there was a factual issue: whether Neil was making a "good faith" effort to rehabilitate the corporation, which could establish an exception to the prohibition against fraudulent transfers.

Next, Supervalu filed a motion for judgment against Neil for conversion.[1] It argued that it was entitled to either possession of the $150,000 in dispute or a judgment for that amount because Neil had converted the money by retaining control over it. In March 1997, the court concluded that, prior to the appointment of a receiver on August 14, 1995, Supervalu had no right to immediate possession of the $150,000 in question despite its superior security interest because there had been no default to Supervalu as of August 14, 1995, the date the $150,000 was transferred from Neil's personal commingled account to his Kemper account.

The court further found that Neil has not exercised dominion and control over the funds as they had remained frozen in his Kemper account since October 1995 by order of this court. As a result, the court found Supervalu had no basis to prevail on its theory of conversion and that Neil had not converted proceeds of Supervalu's collateral. The trial court, however, ordered briefs on the question of whether there was a "new value" exception to the "fraudulent conveyance" and "preference" determinations it had made at the previous hearing and how such considerations might affect Supervalu's perfected security interest.

On June 17, 1997, the trial court, in issuing the second and final part of its ruling, held that Neil was entitled to possession of the $150,000. It based its

[1] This motion was not a request for summary judgment nor was any testimony taken, although it is clear from the record that the contents of depositions and testimony from the injunction hearings were available and considered.

decision essentially on four findings of fact: (1) Lofberg's, Inc. was not in default on any obligation owed to Supervalu; (2) no written notice of default was provided Lofberg's, Inc.; (3) Supervalu had no right to immediate possession of the proceeds from inventory sales; and (4) Neil did not transfer any of Lofberg's, Inc.'s assets, but rather assets from his own personal account.

The trial court concluded Supervalu was not entitled to the $150,000 in the Kemper Securities account despite its prior security interest because such funds were paid to Neil by the debtor corporation "in the ordinary course of business" and prior to receivership, and that Supervalu lacked standing to assert voidable preference and fraudulent conveyance claims. Supervalu now appeals.[2]

II. ANALYSIS

Supervalu first contends that the hearing court clearly erred when it found, as a matter of fact, that Lofberg's, Inc. was not in default on its obligations to it and consequently found that Neil did not exercise improper dominion over inventory proceeds of Lofberg's Inc.[3] This case involves the review of summary judgment and the trial court's findings of fact. The methodology for reviewing summary judgment is well-known and need not be repeated here. *See* ***Smith v. Dodgeville Mut. Ins. Co.***, 212 Wis.2d 226, 232, 568 N.W.2d 31, 34 (Ct. App. 1997). Review is *de novo*. *See* ***id***. Findings of fact are normally reviewed under the clearly erroneous standard. *See* § 805.17(2), STATS. Whether a trial court may act as a fact finder when ruling on motions such as are involved here, however, is

[2] Supervalu does not appeal the trial court's decision relating to standing to claim a preference or fraudulent transfer.

[3] We examine the question of "default" and "exercise of improper dominion" together because an appropriate fact-finding process should be utilized for their determination. Accordingly, we have re-framed the dispositive issue.

a question of law. We review legal questions *de novo*. *See* ***Ball v. District No. 4 Area Bd.***, 117 Wis.2d 529, 537, 345 N.W.2d 389, 394 (1984).

Before we begin our examination of the trial court's findings, it is useful to call to mind that § 409.306(2), STATS., provides: "Except where this chapter otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor." Further, § 409.503, STATS., allows a secured party the right upon default to take possession of the collateral without judicial process if such action can be achieved without breach of the peace. Lastly, § 409.311, STATS., authorizes a transfer of collateral by a debtor, but it is equally apparent that only the nature and extent of the debtor's rights in the collateral inure to the benefit of the transferee. Section 409.311 does not void a contract provision making a transfer of the collateral a default. *See* ***Production Credit Ass'n of Madison v. Nowatzski***, 90 Wis.2d 344, 350-52, 280 N.W.2d 118, 121-22 (1979).

Basic to contract formulation is the agreement of the parties as to the terms and conditions of the relationship. *See* ***Dykstra v. Arthur G. McKee & Co.***, 92 Wis.2d 17, 38, 284 N.W.2d 692, 702-03 (Ct. App. 1979), *aff'd*, 100 Wis.2d 120, 301 N.W.2d 201 (1981). Our Wisconsin statutes recognize this fundamental concept and have embodied such a practice in the statutes relating to security agreements. Sections 401.102(3), 409.501(1) & (2) and 409.503, STATS.,[4] permit

[4] Section 401.102(3), STATS., provides:

> The effect of chs. 401 to 411 may be varied by agreement, except as otherwise provided in chs. 401 to 411 and except that the obligations of good faith, diligence, reasonableness and care prescribed by chs. 401 to 411 may not be disclaimed by

(continued)

parties to define "default" and agree to the methodology for notice and demand procedures in their security agreements. William E. Hogan, *Pitfalls in Default Procedure*, 2 UCC L.J. 244, 246-47 (1970).

To assist our analysis, we quote at length from the the trial court's written decision and also refer the reader to page 5 of our decision for the first part of the trial court's decision in this matter. In reaching its ultimate conclusions in the disposition of these motions subject to this appeal, the trial court stated:

> agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.

Section 409.501(1) & (2), STATS., provides:

> (1) When a debtor is in default under a security agreement, a secured party has the rights and remedies provided in ss. 409.501 to 409.507 and except as limited by sub. (3) those provided in the security agreement. The secured party may reduce the claim to judgment, foreclose or otherwise enforce the security interest by any available judicial procedure. If the collateral is documents the secured party may proceed either as to the documents or as to the goods covered thereby. A secured party in possession has the rights, remedies and duties provided in s. 409.207. The rights and remedies referred to in this subsection are cumulative.
>
> (2) After default, the debtor has the rights and remedies provided in ss. 409.501 to 409.507, those provided in the security agreement and those provided in s. 409.207.

Section 409.503, STATS., provides:

> **Secured party's right to take possession after default.** Unless otherwise agreed a secured party has on default the right to take possession of the collateral. In taking possession a secured party may proceed without judicial process if this can be done without breach of the peace or may proceed by action. If the security agreement so provides the secured party may require the debtor to assemble the collateral and make it available to the secured party at a place to be designated by the secured party which is reasonably convenient to both parties. Without removal a secured party may render equipment unusable, and may dispose of collateral on the debtor's premises under s. 409.504.

Lofberg's Inc. was not in default on any obligation at the time it repaid Neil Lofberg's loan. There was no conversion of these funds because SuperValu, … had no right to immediate possession of the proceeds. Until default, Lofberg's Inc. was entitled to use the proceeds of sale in any lawful manner, regardless of its superior security interest. No provision in any of the security agreements … prohibited Lofberg's Inc. from collecting, commingling or expending funds in the ordinary course of business.… while Lofberg was actually aware of SuperValu's security interest, he did not take any money in violation of SuperValu's security interest because SuperValu had no right to the money pre-receivership.

In an effort to get around this conclusion, SuperValu contends that the real transfer … occurred on August 14, 1995, after the receiver had already been appointed, when Lofberg transfered $150,000 from his personal checking account into his Kemper Securities account. SuperValu concludes that because this transfer was made after the receiver had been appointed and after the court had enjoined Lofberg from transferring any of the corporation's assets, the transfer was not made in the ordinary course of business. In support of its argument, SuperValu relies in part on earlier testimony of Neil Lofberg in which he stated that the $150,000 transfer he made on August 14, 1995, was to repay a loan.

However, the evidence indicates that Lofberg did not transfer any of Lofberg's Inc.'s assets, but rather assets from his own personal accounts. These funds were never placed in a corporate account, but were advanced to the corporation as a loan in order as comtemplated in the interim financing agreement. While SuperValu had a security interest in Lofberg's Inc.'s inventory and proceeds of sale, it has never had a security interest in Lofberg's personal accounts. Nor did the court, in its appointment of a receiver, have any jurisdiction over these accounts. Accordingly, Neil Lofberg's transfer of $150,000 from one personal account to another was not in violation of any court order or against the instructions of the court appointed receiver.

Further, this transfer does not render the short-term loans and repayments outside the ordinary course of business. Rather, the undisputed documentation shows that Lofberg was repaid in full prior to the appointment of the receiver. The fact that prior testimony of Lofberg suggests that the $150,000 transfer on August 14, 1995 was repayment of a loan carries no weight with this court in light of the undisputed documentation indicating that

> Lofberg was fully repaid the $150,000 he loaned to the corporation prior to the receivership.

Because of the nature of the proceedings in which the trial court was engaged, we conclude, as a matter of law, that it was a clearly erroneous exercise of discretion to make findings of fact that Lofberg's, Inc. was not in default in its obligations to Supervalu and that Neil had not engaged in improper dominion over the sales proceeds of inventory.

To begin our analysis, we note that one significant element is uncontroverted. The three documents representing the security agreements between Supervalu and Lofberg's, Inc. provide that upon any event of default, no notice or demand is required to enforce the rights under the agreements. Thus, in the absence of any provision to the contrary in the agreements or in our statutes, upon an event of default, Supervalu would be entitled to immediate possession of its secured collateral. For the trial court to arrive at ultimate facts contrary to the terms of the agreement once an event of default had occurred is clearly erroneous.

We now consider whether an event of default occurred. The three security agreements expressly describe what constitutes an event of default: (1) default in the payment or performance of any obligation; (2) loss, damage, sale or encumbrance of any of the inventory; or (3) insolvency, appointment of a receiver of any part of the property of the debtor, or the commencment of any proceeding under any insolvency laws against the debtor.

The record reflects the following. As of August 14, 1995, Lofberg's, Inc. owed Supervalu over $600,000. It was delinquent in its rent payments and had not paid real estate taxes for 1994 in the sum of $67,000. Lofberg's, Inc. by its president, Neil, admitted that on August 14, 1995, the company owed Supervalu more than $150,000. The company, through its president, had further

encumbered the inventory proceeds by the Interim Financing Agreement executed with Neil. Lastly, the company was placed in receivership by an order of the court on August 14, 1995. Any one of these events could constitute an event of default under the terms of the security agreements depending on any defenses raised. Such determinations are for a proper fact-finding process, not for a court that is ruling on summary judgment motions or for a judgment on an undeveloped record.

The trial court, in its decision, divides the business activity of Lofberg's, Inc. and Neil into pre-receivership actions and post-receivership actions. As for the pre-receivership activities, the trial court reasons that until default, Lofberg's, Inc. was entitled to use the proceeds of the inventory in any lawful manner.[5] We find nothing erroneous about this determination to the extent it is expressed, but by overlooking two important provisions in the agreements, the trial court oversimplified the relationship between the parties. It is clear that the usage of the inventory or its proceeds cannot be for any purpose inconsistent with the purposes of the security agreements. Paragraph 5(d) (cited above at page 3) prohibits theft, sale or encumbrance "of any of the inventory" which includes the proceeds. Thus, for the purposes of determining whether a default occurred, the act of Lofberg's, Inc. in further encumbering the inventory or its proceeds by executing the Interim Loan Security Agreement with Neil, in his individual capacity, may be construed as an act of default unless agreed to or waived by Supervalu. At the very least, there is a material issue of fact as to whether Neil's

[5] Paragraph 3(d) of the security agreements provides: "Until default, Debtor may use the Inventory in any lawful manner not inconsistent with this Agreement…."

actions, either on his own behalf or on behalf of Lofberg's, Inc., were inconsistent with the purposes of the three earlier executed and perfected security agreements.[6]

As for the post-receivership activities of Neil, the trial court reasoned that, because Neil was operating from his personal account and because the funds with which he was functioning were advances he made for the benefit of Lofberg's, Inc., and thus not corporate assets, Supervalu had no secured interest in his personal account. The receivership, therefore, had no jurisdiction over him and there could be no event of default when he transferred the $150,000 from one personal account to another.

It is fundamental, as pointed out earlier in this opinion, that a perfected security interest continues in the collateral notwithstanding its sale and follows any identifiable proceeds received by the debtor. *See* § 409.306(2), STATS. It remains uncontroverted that Neil, as president of Lofberg's, Inc., for several months managed the financial affairs of the corporation from his own personal bank accounts. The trial court found that "Neil Lofberg did not transfer any of Lofberg's, Inc.'s assets." There is, however, sufficient evidence in the record to support an opposite determination. Inventory and proceeds from inventory are corporate assets and, as such, are traceable assets. Neil was using the assets to pay corporate expenses. Given these circumstances, there is a reasonable basis for the jurisdictional scope of the receiver and arguably the source of one more event of default.

[6] Before the motion court, Neil argued that Lofberg's, Inc. may have owed money to Supervalu, but the delinquencies did not constitute a "default." This reasoning flies in the face of paragraph 5(a) which defines a "default" as "default in the payment or performance of any obligation" contained in the agreements. That Supervalu did not choose to assert or exercise its ripened right upon an event of default does not make it any less so. Rather, whether default occurred presents a material issue of fact for a fact finder in a fact-finding setting.

When the trial court reviewed the request for judgment for conversion, it perforce examined the question of dominion. *See* WIS J I—CIVIL 2200. It first found that Neil did not exercise dominion and control over the funds because they remained frozen in his Kemper account by order of the court. Yet it is evident from the record that the funds Neil transferred on the afternoon of August 14, soon after the receiver's restraining order was issued, were funds over which he had dominion and control. Again, we find another disputed material issue of fact. Of further significance is the court's finding that Neil was repaid in full for his advances prior to the appointment of the receiver. If such is the truth of the matter, then on the afternoon of August 14, 1995, Neil had no reason to transfer funds from the proceeds of inventory maintained in his personal account. Again, we have another disputed material issue of fact relating to dominion and control and reasonably material to whether an event of default occurred.

The trial court draws support for its final disposition of this matter from the conclusion that Neil, in managing the financial affairs of Lofberg's, Inc., was operating "in the ordinary course of business." The existence of such a phenomenon is a mixed question of fact and law, i.e., the factual nature of the activities in which Neil was engaged and, then, whether those facts meet the legal standard for "in the ordinary course of business." *See* ***Antigo Co-op. Credit Union v. Miller***, 86 Wis.2d 90, 93, 271 N.W.2d 642, 644 (1978). In this regard, the record is of little assistance. It appears that the trial court was convinced that Neil acted in good faith in attempting to save Lofberg's, Inc. It further appears that the court believed that Neil did what any reasonable business man would do in the same position and, therefore, concluded that the cash advances, payments, readvances and repayments were all performed "in the ordinary course of business," regardless of their timing. The difficulty posed by this conclusion is

based in the record. There is expert testimony that transferring inventory proceeds to the personal account of the president of the company, and handling the financial affairs of the company from his personal account, were "out of the course of ordinary business." Thus, even in the examination of Neil's activities conducted ostensively "in the ordinary course of business" there are material issues of fact regarding the fairness and propriety of such actions. ***Harley-Davidson Motor Co., Inc. v. Bank of New England-Old Colony, N.A.***, 897 F.2d 611, 622 (1st Cir. 1990) (a conversion action relating to commingled funds).

As germaine to this appeal, the record consists of initial pleadings, pleadings for intervention, dismissal orders, restraining orders, testimony for an injunction, an order for the same, cross motions for summary judgment and their denial and finally, a motion for judgment for conversion and its denial. Succinctly, the issues on appeal relate to the orders denying summary judgment and the order denying the judgment for conversion. In the midst of all of these proceedings, without a trial, and perhaps unwittingly, fact-finding occurred outside of an appropriate fact-finding process. This ought not to have occurred. For this reason, we reverse the order of the trial court and remand for trial on the issues of default and ultimate facts constituting conversion and any defenses relating to either.[7]

By the Court.—Order reversed and cause remanded with directions.

Not recommended for publication in the official reports.

[7] Based on our disposition, we need not address any additional arguments raised. *See* ***Gross v. Hoffman***, 227 Wis. 296, 300, 277 N.W. 663, 665 (1938) (only dispositive issues need be addressed).

No. 97-2060(C)

SCHUDSON, J. *(concurring).* Although I agree that this case should be remanded, I do not join in the majority opinion.