Enforcing Article 9 Security Interests Against Subordinate Buyers of Collateral

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Table of Contents

I. Introduction .................................................. 512
II. The Secured Party's Right to Possession ................... 512
   A. Retaking Possession by Self-Help or by Action ........ 512
   B. Rights and Responsibilities Following Repossession .. 517
III. The Buyer's Liability for Converting the Original Collateral .............................................. 520
    A. Basis of the Buyer's Liability .......................... 520
    B. Measure of the Secured Party's Damages ............ 536
IV. The Buyer's Liability for Misdirecting or Misapplying "Proceeds" of the Original Collateral ..................... 539
    A. Paying Proceeds to Someone Other Than the Secured Party ............................................. 539
    B. Withholding Proceeds From the Debtor and the Secured Party ......................................... 548
V. Conclusion ................................................... 552

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I. Introduction

Article 9 of the Uniform Commercial Code (U.C.C. or the Code)\(^1\) regulates the creation of security interests in personal property and fixtures and details the enforcement of those security interests against defaulting debtors. Primarily, however, Article 9 is "concerned with the limits of the secured party's protection against purchasers from and creditors of the debtor."\(^2\) The predominant feature of Article 9 is an extensive collection of rules for determining the priority of claims to debtors' property. Yet the article is virtually silent on the privileges of priority. Article 9 does not spell out the rights and remedies of a secured party when a subordinate claimant asserts control over the collateral. A limited body of federal law provides for a secured party's protection in some instances.\(^3\) Usually, however, a secured party's protection in such a case depends on a marriage of rights inferred from Article 9 and of remedies borrowed from the common law and non-Code statutory law of the states. This article examines and explains the interdependence of Article 9 and extra-Code local law in effectuating the priority of a security interest in goods over which a subordinate buyer of the collateral has asserted control.\(^4\)

II. The Secured Party's Right to Possession

A. Retaking Possession by Self-Help or by Action

A debtor retains the power to sell or otherwise dispose of collateral, thereby transferring his interest in the property, despite provisions in the security agreement that purport to limit his ability to convey the property.\(^5\) The debtor's disposition of collateral, however, does not terminate the security interest attached to it: a security interest generally continues in collateral notwithstanding sale or other disposition.\(^6\) Although this rule does not prevent the debtor's interest in collateral from passing to his transferee, it does insure (except where Article 9 provides otherwise)\(^7\) that the property remains subject to

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1. All references and citations to the text and comments of the Uniform Commercial Code are to the 1978 Official Text with Comments, unless otherwise indicated.
2. U.C.C. § 9-101 comment.
3. The secured party's recourse is clear, for example, if a debtor's trustee in bankruptcy claims the collateral under circumstances that preclude him from avoiding the security interest: typically, the secured party files a complaint requesting relief from the automatic stay of actions to enforce a lien on the debtor's property. See 11 U.S.C. § 362(3) (Supp. III 1979). Standard remedies are also available when collateral has been seized by the federal government pursuant to a subordinate tax lien. See 26 U.S.C. §§ 7425-7426 (1976 & Supp. IV 1980). For a succinct discussion of the options provided by these sections and other remedies of a senior claimant, see W. Plumb, Jr., Federal Tax Liens 255-84 (3d ed. 1972).
4. This article uses the words "buyer" and "purchaser" synonymously to mean a transferee who contracts with his seller and gives value in order to acquire the seller's title to goods. This definition of "purchaser" is narrower than the one given in U.C.C. § 1-201(32)-(33), which includes any person who takes any interest in property through a voluntary transaction.
5. U.C.C. § 9-311.
7. A security interest does not follow the property into the hands of a transferee if the secured party authorized disposition of the collateral either "in the security agree-
the security interest despite disposition by the debtor and thus continues to be collateral for the debt owed the secured party.8

When the debtor defaults under the terms of a security agreement, the secured party has the right to take possession of the collateral.9 The right to repossess is enforceable against a buyer or other transferee of the property either by peaceable self-help10 or by judicial action,11 including replevin and claim and delivery.12 To prevail in a

ment or otherwise." U.C.C. § 9-306(2). Under some circumstances, Article 9 gives buyers of collateral priority over secured parties, so that notwithstanding the absence of a secured party's consent to disposition, a buyer may take free of the security interest. See, e.g., U.C.C. §§ 9-103(2) (d); 9-301(1) (c); 9-307(1); 9-307(2).

8. See, e.g., Sturdevant v. First Sec. Bank, 606 P.2d 525, 528 (Mont. 1980); Production Credit Ass'n v. Nowatzki, 90 Wis. 2d 344, 351, 280 N.W.2d 118, 121 (Wis. 1979).


replevin action, the plaintiff ordinarily must show both title to the goods sought or a special interest in them and an immediate right to possess them.13 A security interest is a sufficient interest in property to support the replevy of collateral,14 and the debtor’s default triggers a secured party’s right to possess the property.15 Alternatively, a secured party can pursue his collateral through judicial foreclosure, a typical means of enforcing chattel mortgages under pre-Code law16


In a replevin action, a successful plaintiff can ordinarily recover damages for detention and depreciation if he can prove such losses. See J. COBBEY, A PRACTICAL TREATISE ON THE LAW OF REPLEVIN § 853 (1890); RESTATEMENT (SECOND) OF TORTS § 922 comment b (1976); see, e.g., Garoogian v. Medlock, 592 F.2d 997, 1001-02 (8th Cir. 1979); White Motor Credit Corp. v. Sapp Bros. Truck Plaza, 197 Neb. 421, 427-28, 249 N.W.2d 491, 494 (1977). But see Strick Corp. v. Eldo-Craft Boat Co., 479 F. Supp. 720, 726 (W.D. Ark. 1979); Higgins v. Guerin, 74 Ariz. 187, 193, 245 P.2d 956, 957 (1952). Guerin highlights a fundamental difficulty with awarding a secured party damages for detention when he replays collateral from a transferee: to recover, the plaintiff must show that he had a right to use the property and that he would have used it during the time the defendant detained it. 74 Ariz. at 191-92, 245 P.2d at 958-59. A secured creditor, however, ordinarily repossesses collateral to dispose of it, not to use it. For a collection of pre-Code cases discussing this issue, see Annot., supra 3 A.L.R.2d 774 (1954).


15. U.C.C. § 9-503; see supra text accompanying note 9.

16. “A bill in equity is the proper and ordinary mode of foreclosing a chattel mortgage . . . .” 2 L. JONES, supra note 10, § 776, at 548. Judicial foreclosure in equity was a cumulative remedy that existed in addition to any right the mortgagor had to sell the property himself and any other statutory method of foreclosure. Id. §§ 777-778, 781; 4 J. POMEROY, A TREATISE ON EQUITY JURISPRUDENCE § 1230, at 687 (5th ed. 1941). An action to foreclose a chattel mortgage was considered an equitable proceeding. See, e.g., Greer v. Goeings, 54 Ariz. 488, 492, 97 P.2d 218, 219 (1939); McKinney v. New Rocky Grocery Co., 176 Ark. 463, 465-66, 3 S.W.2d 295, 296 (1923); Application of Finn, 155 Cal. App. 2d 705, 708, 318 P.2d 816, 818 (1957); Commonwealth Co. v. Fauer, 169 Neb. 795, 797, 101 N.W.2d 150, 152 (1960); Judson Mills v. Norris, 166 S.C. 422, 423, 164 S.E. 919, 919 (1932); Consolidated Wagon & Mach. Co. v. Kay, 51 Utah 595, 594, 21 P.2d 836, 840 (1933). Even though a chattel mortgage had remedies other than judicial foreclosure, including the remedies at law of recovering the collateral or of damages for conversion of the collateral, see, e.g., Strode v. Holland, 150 Ark. 122, 126-27, 233 S.W. 1073, 1074 (1921); Speizman v. Guilt, 202 S.C. 496, 507, 25 S.E.2d 731, 735 (1943), a defendant generally could not demur to a bill to foreclose on the ground that the plaintiff had an adequate legal remedy, see, e.g., J.E. BUTLER & CO. v. A.G. HENRY & CO., 202 Ala. 155, 156, 79 So. 630,
that remains available to an Article 9 secured party. A secured party's right to possession either by self-help or by action is not only enforceable against the debtor's immediate transferee; it may survive further dispositions of the collateral and be enforced against remote buyers of the property as well.

Confronted by the attempts of some previous owner's secured party to take possession of goods, a buyer will probably seek first to defend his rights in the property and, if that defense fails, to recoup his losses from the seller. The buyer can defend his possession by arguing that the goods are not collateral—the only property subject to a secured party's right of possession under the Code—because


18. Upon the debtor's default, the secured party may repossess "the collateral." U.C.C. § 9-501; see supra text accompanying notes 9, 15. Collateral is "property subject to a security interest . . . ." U.C.C. § 9-105(1)(c). There are two principal reasons why property may not be subject to a security interest despite the creditor's belief that he is secured by it. First, the U.C.C. § 9-203(1) (c) requisites for the creation of a security
no security interest ever attached to them or, if one attached initially, it did not survive the property's sale because the secured party had authorized the disposition.20 If a security interest attached to the goods and survived their sale, the buyer can argue that his interest in the collateral has priority over the interest of the secured party.21 Finally, the buyer can defend his possession of property subject to a security interest despite the inferiority of his claim by arguing that the secured party has no immediate right of possession because the debtor has not defaulted under the security agreement.22 If a buyer's interest may not have been satisfied and, therefore, no security interest attached to any of the debtor's property. The most common deficiency is the lack of a written security agreement sufficient under U.C.C. §§ 9-203(1)(a) and 9-110. Without such a writing, no security interest attaches to intended collateral unless it is possessed by the creditor, and no security interest in such property is enforceable against either the debtor or third parties. See U.C.C. § 9-203(1)(a), (2), comment 5. Second, even if a security interest is enforceable against some of the debtor's property, the particular goods purchased by the buyer may not be included because they are not within the scope of the description of collateral in the security agreement. A security interest attaches only to property that is described in the agreement and, where the property is subsequently acquired by the debtor, attaches only if the security agreement covers after-acquired property of the type described in the agreement. See U.C.C. § 9-204(1); Nickles, A Localized Treatise on Secured Transactions — Part II: Creating Security Interests, 34 Ark. L. Rev. 559, 638-41 (1981). Even if goods later acquired by the debtor are within the definitional scope of an after-acquired property clause in the security agreement, the secured party will have no interest in the goods and no right to repossess them unless the debtor acquires rights in the property sufficient to support a security interest. See U.C.C. § 9-203(1)(c); Towe Farms, Inc. v. Central Iowa Prod. Credit Ass'n, 528 F. Supp. 500, 503-04 (S.D. Iowa 1981).

20. See U.C.C. § 9-306(2), discussed supra note 7; see, e.g., Long Island Trust Co. v. Porta Aluminum Corp., 44 A.D.2d 118, 126, 354 N.Y.S.2d 134, 142-43 (1974); Bank of Beulah v. Chase, 231 N.W.2d 738, 744 (N.D. 1975); see also cases cited infra note 42, holding that a buyer of collateral is immune from conversion liability if the secured party authorized disposition. But see Weisbart & Co. v. First Nat'l Bank, 568 F.2d 391, 396 (5th Cir. 1978) (security interest is not waived simply because secured party consents to a contract of sale of collateral).

For discussions regarding waiver of security interests under U.C.C. § 9-306(2), see Nickles, supra note 19, at 658-64; Nickles, Rethinking Some U.C.C. Article 9 Problems — Subrogation; Equitable Liens; Actual Knowledge; Waiver of Security Interests; Secured Party Liability for Conversion Under Part 5, 34 Ark. L. Rev. 1, 103-36 (1980) [hereinafter cited as Nickles, Article 9 Problems].


22. Ordinarily, a secured party is entitled to possession of collateral only upon the debtor's default under the security agreement, see U.C.C. § 9-503, and so is not entitled to repossess the property until this occurs. See, e.g., Associate Discount Corp. v. Woods, 41 Mass. App. Dec. 99, 103, 5 U.C.C. Rep. Serv. (Callaghan) 1286, 1270 (1968); First Nat'l Bank v. Sheriff of Milwaukee County, 34 Wis. 2d 535, 539-40, 149 N.W.2d 548, 549-50 (1967); see also Production Credit Ass'n v. Equity Coop. Livestock Sales Ass'n, 82 Wis. 2d 5, 10, 261 N.W.2d 127, 129 (Wis. 1978) (auctioneer exercising control over
cannot successfully make any of these arguments, he will forfeit possession of the collateral, but his failure to prevail over the secured party will not necessarily leave him without a remedy. The buyer may have a claim against his transferor for breach of warranty of title. Under Article 2 of the U.C.C., sellers impliedly warrant that goods are sold free from security interests unless the buyer knows or has reason to know of them or the contract of sale specifically excludes this warranty of title.23

B. Rights and Responsibilities Following Repossession

When collateral is bought from the debtor and a security interest continues in it, a subordinate buyer ordinarily acquires the debtor's interest in the property but not his obligation to repay the debt secured by the collateral.24 Thus, the secured party cannot sue the buyer for the secured debt as an alternative to repossessing the col-


A buyer is liable on the debt, however, if he not only purchasers the collateral but also assumes the debtor's obligation to the secured party. Such an assumption by the transferee of collateral is not ordinary, but does occasionally occur. See, e.g., Empire Fire & Marine Ins. Co. v. First Nat'l Bank, 26 Ariz. App. 157, 158-59, 546 P.2d 1166, 1167-68 (1976); Walter E. Heller & Co. v. Salerno, 168 Conn. 152, 155, 158, 362 A.2d 904, 905, 906-07 (1975). In many cases where a buyer of collateral assumes the secured debt, his liability will be based on third party beneficiary law. The secured party is an intended beneficiary of a promise to pay the debt made by the buyer to the original debtor-seller. As an intended beneficiary, the secured party can enforce the promise against the buyer and the original debtor remains liable as a surety. See RESTATEMENT (SECOND) OF CONTRACTS §§ 302, 304, 310, 318(3) (1979).
lateral. Once in possession of the property, the secured party must dispose of it pursuant to Part 5 of Article 9, usually through public or private sale. After disposing of the collateral, the secured party "must account to the debtor for any surplus." When property has been sold before repossession, however, "the debtor" is not the person obligated to repay under a security agreement — the debtor-obligor; rather, it is the buyer from whom the secured party repossessed the collateral. The buyer is a "debtor" under Article 9 as the owner of the collateral, so it is to the debtor-owner that the secured party must pay any surplus resulting from disposition of the collateral. Article 9 also provides, however, that "the debtor is liable for any deficiency" that may result from the secured party's disposition pursuant to Part 5. In this context, however, the term "debtor" must refer to the debtor-obligor, not the debtor-owner of the collateral. Except in an unusual case, the debtor-owner is not initially obligated for the secured debt and does not acquire any obligation merely by purchasing the collateral.

Although the buyer is free from liability on the secured debt and for any deficiency resulting from a foreclosure sale, as the owner of the collateral he retains an interest in the property that deserves protection when the secured party retakes the collateral and disposes of it after repossession. Until the collateral is sold by the secured party pursuant to Part 5 of Article 9, the property belongs to the buyer. Presumably, therefore, the debtor-owner enjoys certain

25. A secured party's options are to "sell, lease or otherwise dispose of ... the collateral," U.C.C. § 9-504(1), or in some cases "to retain the collateral in satisfaction of the obligation," U.C.C. § 9-505(2).


27. The term "debtor" is broadly defined to mean not only "the person who owes payment or other performance of the obligation" but also "the owner of the collateral" if he and the obligor are not the same person. U.C.C. § 9-105(1)(d). The drafters recognized that a transferee of collateral who did not assume the secured obligation is a debtor-owner, though not a debtor-obligor. See U.C.C. § 9-105 comment 2.

28. "Unless otherwise agreed, when a secured party knows that collateral is owned by a person who is not the debtor-obligor, the owner of the collateral is entitled to receive from the secured party any surplus ... under Section 9-504(1) ..." U.C.C. § 9-112, see also U.C.C. § 9-504 comment 3. There should be no doubt that U.C.C. § 9-112 is applicable in this context. See U.C.C. § 9-105 comment 2. U.C.C. § 9-112(1)(c) also gives the debtor-owner the right to prevent the disposition of the collateral by redeeming the collateral pursuant to U.C.C. § 9-505.

29. U.C.C. § 9-504(2).

30. U.C.C. § 9-112 expressly provides that when the obligor on a secured debt and the owner of the collateral are not the same person, "the owner of the collateral ... is not liable for the debt or for any deficiency after resale." See also supra note 24 and accompanying text.

31. Since a secured party's right to possession does not mature until the debtor's default, see U.C.C. § 9-503, supra note 22, a buyer of collateral is entitled to possession of the property as against the secured party unless and until the debtor-obligor defaults under the security agreement. A buyer should be protected from wrongful repossession by a secured party, i.e., action by a secured party in taking possession of collateral at a time or in a manner not sanctioned by Article 9 or the security agreement. For a discussion of acts constituting wrongful repossession and the usual remedy, which is a conversion action against an offending secured party, see Nickles, Article 9 Problems, supra note 20, at 136-43.

32. The buyer at the foreclosure sale becomes the next owner because "the disposition transfers to a purchaser for value all of the debtor's rights therein, discharges the security interest under which it is made and any security interest or lien subordinate thereto." U.C.C. § 9-504(4) (emphasis added).
rights of a “debtor” under Part 5 in addition to his right to any surplus resulting from a foreclosure sale.33 Included among these are the rights to receive prior notice of the secured party’s disposition34 or intention to retain the collateral in satisfaction of the secured debt,35 to have the secured party conduct a foreclosure sale in a commercially reasonable manner36 and otherwise in accordance with the provisions of Part 5 of Article 9, and to recover from the secured party any loss occasioned by a failure to comply with those provisions.37 Since all of the provisions of Part 5 deal with retaking and disposing of collateral, the meaning of the term “debtor” in these provisions must include the debtor-owner.38 Moreover, Article 9 specifically provides that when the owner of the collateral and the debtor-obligor are not the same person, the owner enjoys certain rights of a debtor-obligor, including protection from a secured party’s failure to comply with Part 5.39 Thus, although a secured party with priority over a

33. See supra notes 26-28 and accompanying text.
34. U.C.C. § 9-504(3).
35. U.C.C. § 9-505(2).
36. U.C.C. § 9-504(3).
37. U.C.C. § 9-507(1).
38. See Security Pac. Nat’l Bank v. Goodman, 24 Cal. App. 3d 131, 139-140, 100 Cal. Rptr. 763, 769-70 (1972); Maas v. Allred, 577 P.2d 127, 128 (Utah 1978); cf. Rushton v. Shea, 423 F. Supp. 468, 470 (D. Del. 1976) (owner of collateral was not the obligor but was a “debtor” because he deliberately furnished security for the obligor’s debt); Shultz v. Delaware Trust Co., 360 A.2d 578, 578-79 (Del. Super. Ct. 1976) (same); Long Island Trust Co. v. Porta Aluminum, Inc., 63 A.D.2d 669, 669, 404 N.Y.S.2d 682, 682 (1978) (transferee of collateral not liable for wrongful detention in replevin action by secured party because property had been recovered by secured party and sold without giving transferee notice of disposition). But cf. New Haven Water Co. Employees Credit Union v. Burroughs, 6 Conn. Cir. Ct. 709, 711-12, 313 A.2d 82, 82-83 (1973) (obligor who did not own the collateral was not entitled to receive notification of its sale under U.C.C. § 9-504(3) because non-owner obligor was not a debtor for purposes of that section).
39. U.C.C. § 9-112 provides:
[T]he owner of the collateral... has the same right as the debtor[-obligor]
. . . . (b) to receive notice of and to object to a secured party’s proposal to retain the collateral in satisfaction of the indebtedness under Section 9-505;
(c) to redeem the collateral under Section 9-506; (d) to obtain injunctive or other relief under Section 9-507(1) . . . .
Among the other relief available under U.C.C. § 9-507(1) is the right “to recover from the secured party any loss caused by a failure to comply with the provisions of this Part.” If an owner of collateral who is not the obligor is entitled to this relief, he must be entitled to have the secured party comply with all of Part 5’s provisions.

Though the meaning of “debtor” in Part 5 includes the buyer-transferee who is owner of the collateral, the obligor who sold the collateral to him may also be entitled to protection as a “debtor” under the same provisions. When circumstances require, the term “debtor” can mean both the debtor-obligor and the debtor-owner. U.C.C. § 9-105(1)(d); see supra note 27 and accompanying text. The owner of the collateral has a stake in the secured party’s disposition of the property because it belongs to him until the secured party sells it and he is entitled to any surplus that results from the disposition. See supra text accompanying notes 26-28. The obligor also has a stake even though he sold the collateral and no longer has an interest in it, for he is liable for any deficiency that remains after the secured party’s disposition. See supra text accompanying notes 29-30. Thus, like the owner, the obligor has a legitimate concern that the secured party conduct a proper sale and should be entitled to prior notice and all the other protections afforded a “debtor” under Part 5 of Article 9. This is true despite his
buyer of collateral can enforce his superior interest by repossessing and disposing of the collateral, he is nevertheless accountable to the junior claimant for the manner in which he deals with the property.

III. The Buyer's Liability for Converting the Original Collateral

A. Basis of the Buyer's Liability

A secured party may be reluctant to assume the risks of liability associated with retaking the collateral from a subordinate buyer and disposing of it, or he may discover that the buyer has already disposed of the collateral and be unwilling or unable to trace it to the ultimate transferee. In such cases, the secured party’s alternative to retaking the original collateral is to sue the buyer for having unlawfully converted it. Courts have in numerous cases recognized a conversion action as a means of enforcing an Article 9 secured party’s priority over a subordinate buyer of collateral. The drafters of Article 9 also recognized this alternative:

[W]hen a debtor makes an unauthorized disposition of collateral, the security interest, under prior law and under this Article, continues in the original collateral in the hands of the purchaser or other transferee. That is to say, since the transferee takes subject to the security interest, the secured party may repossess the collateral lack of any property interest in the collateral. Cf. First Ala. Bank v. Parsons, 390 So. 2d 640, 642-43 (Ala. Civ. App. 1980) (guarantors with no interests in collateral held entitled to notice under Part 5); First Nat'l Bank v. Cillessen, 622 P.2d 598, 600-01 (Colo. Ct. App. 1980) (accommodation co-makers entitled to notice); Roten v. United Va. Bank, 221 Va. 222, 225-28, 263 S.E.2d 781, 783-85 (1980) (co-maker or guarantor entitled to notice). In Cillessen, the court concluded that U.C.C. § 9-504(3) requiring the secured party to give notice of disposition “deals with both the collateral and the obligation and, accordingly, the term ‘debtor’ includes both the owner of the collateral and the obligor when . . . they are not the same person.” 622 P.2d at 601 (emphasis added).

Enforcing Security Interests
THE GEORGE WASHINGTON LAW REVIEW

from him or in an appropriate case maintain an action for conversion.\textsuperscript{41}

As the drafters' comment suggests, a buyer is not liable for converting the original collateral if the secured party authorized disposition of the property.\textsuperscript{42} Authorized sale terminates the security interest, so it cannot follow the property into the buyer's hands.\textsuperscript{43} Thus, the secured party has no interest in or claim to the property on which to base a cause of action against the buyer. Similarly, a buyer cannot be held liable if he has priority over the secured party, for then he would take the property free of the security interest.\textsuperscript{44} The drafters' comment suggests further that a conversion action will not always lie even when a buyer purchases collateral that is subject to a superior security interest; only "in an appropriate case" is a subordinate buyer liable to the secured party for conversion of collateral.\textsuperscript{45}

The Restatement (Second) of Torts defines conversion as "an intentional exercise of dominion or control over a chattel which so seriously interferes with the right of another to control it that the actor may justly be required to pay the other the full value of the chattel."\textsuperscript{46}

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\textsuperscript{41} U.C.C. § 9-306 comment 3 (emphasis added).


\textsuperscript{43} U.C.C. § 9-306(2). The authorization need not be express; courts interpret the "or otherwise" language to allow implied waiver of security interests. See cases cited supra note 42. But see Ark. Stat. Ann. § 85-9-306(2) (Supp. 1981) (nonuniform amendment providing that waiver of security interest in farm products shall not be implied from course of dealing or from trade usage); N.M. Stat. Ann. § 55-9-306(2) (1978 & Supp. 1982) (same). Express and implied authorizations to dispose of collateral that result in waiver and termination of a security interest are discussed in Nickles, supra note 19, at 658-64; Nickles, \textit{Article 9 Problems, supra} note 20, at 103-36.


\textsuperscript{45} U.C.C. § 9-306 comment 3, supra text accompanying note 41.

\textsuperscript{46} Restatement (Second) of Torts § 222A(1) (1976).
or the full value of the other's interest in the chattel. The elements of a conversion action according to this definition are the plaintiff's right to control the goods and the defendant's serious interference with this right. As a general rule of conversion law, a defendant in possession of a chattel is liable for conversion if he "refuses without proper qualification to surrender it to another entitled to immediate possession." An Article 9 secured party is usually entitled to control the collateral, that is to possess it, only upon the debtor's default under the terms of the security agreement. Therefore, a subordinate buyer cannot be liable to the secured party for conversion before the debtor defaults, but his liability is probable if he deals with collateral after the debtor defaults. Because a secured

47. When collateral has been converted, the secured party's recovery is usually limited to the value of the property at the time of the conversion or the value of his interest in the property, whichever is less. See infra notes 101-20 and accompanying text.


49. See U.C.C. § 9-503; supra text accompanying note 15.

50. See Production Credit Ass'n v. Equity Coop. Livestock Sales Ass'n, 82 Wis. 2d 5, 16-17, 261 N.W.2d 127, 132 (Wis. 1978); cf. cases cited supra note 22, holding that a secured party cannot replevy collateral from a transferee until the debtor defaults under the security agreement. Production Credit Association is unusual in that the debtor's sale of collateral was not in itself an event of default. In the typical case, the security agreement defines default to include the very act of transferring or disposing of collateral, and this provision is enforceable. See supra note 22.

party with priority is entitled to immediate possession of the collateral upon the debtor's default, a buyer is clearly liable for conversion if he subsequently holds the property and steadfastly refuses the secured party's demand for its return. In some cases, a subordinate buyer may also be liable for unlawfully converting collateral if he disposes of it after the debtor defaults.

51. See supra text accompanying notes 9-18.


55. See supra text accompanying notes 9-18.

Persons who sell collateral for debtors — auctioneers and commission merchants, for example — are frequently held liable to secured parties for converting the property. See Restatement (Second) of Torts § 233(1) (1976) (an agent who negotiates a transaction resulting in disposition of chattel to one not entitled to its immediate possession is subject to liability for conversion); see, e.g., United States v. Friend's Stockyard, Inc., 600 F.2d 9, 10 (4th Cir. 1979); United States v. Burnett-Carter Co., 575 F.2d 587, 588, 591-92 (6th Cir.), cert. denied, 439 U.S. 996 (1978); Duvall-Wheeler Livestock Barn v. United States, 415 F.2d 226, 228 (5th Cir. 1969); Cassidy Comm'n Co. v. United States, 387 F.2d 875, 879-80 (10th Cir. 1967); United States v. Sommerville, 324 F.2d 712, 717-18 (3d Cir. 1963), cert. denied, 376 U.S. 909 (1964); United States v. Chelsey's Sales, Inc., 523 F. Supp. 528, 529 (W.D. Pa. 1981); United States v. Gallatin Livestock Auction, Inc., 448 F. Supp. 616, 622 (W.D. Mo.), affd per curiam, 589 F.2d 353 (8th Cir. 1978); United States v. Topeka Livestock Auction, Inc., 392 F. Supp. 944, 947-48 (N.D. Ind. 1975); Hills Bank & Trust Co. v. Arnold Cattle Co., 22 Ill. App. 3d 138, 139-41, 316 N.E.2d 669, 671 (1974); Farmers State Bank v. Stewart, 454 S.W.2d 908, 915 (Mo. 1970); Blubbaugh v. Ponca City Prod. Credit Ass'n, 9 U.C.C. Rep. Serv. (Callaghan) 786, 793 (Okla. Ct. App. 1971). Many pre-Code cases support this rule. See generally Annot., 96 A.L.R.2d 205 (1964), and cases cited infra note 62. There are a number of exceptions to the rule, however. For example, an auctioneer is not liable to the secured party for conversion if (1) the secured party authorized the collateral's disposition, see, e.g., Security Nat'l Bank v. Belleville Livestock Comm'n Co., 619 F.2d 940, 944-45 (10th Cir. 1979) (requiring express consent to sale); United States v. Lindsey, 453 F. Supp. 445, 454-55 (N.D. Tex. 1978); North Cent. Kan. Prod. Credit Ass'n v. Washington Sales Co., 223 Kan. 689, 697-98, 577 P.2d 35, 41-42 (1978) (requiring express consent to sale); S & W Trucks, Inc. v. Nelson Auction Serv., Inc., 80 N.M. 423, 425, 457 P.2d 220, 222 (Ct. App. 1969); Mammoth Cave Prod. Credit Ass'n v. Oldham, 589 S.W.2d 833, 836, 838 (Tenn. Ct. App. 1977); (2) the auctioneer sold the collateral before the debtor's default under the security agreement, see Production Credit Ass'n v. Equity Cooper. Livestock Sales Ass'n, 62 Wis. 2d 5, 10, 261 N.W.2d 127, 129 (Wis. 1977); (3) he purports to sell only the debtor's rights in the property however they may be encumbered, see, e.g., Exxon Corp. v. Leonardo, 20 U.C.C. Rep. Serv. (Callaghan) 1411, 1412 (N.Y. Sup. Ct. 1977); (4) a special law gives auctioneers immunity from such liability, see Neb. Rev. Stat. § 69-109.01 (1981) (auctioneer not liable to secured party if he sells in good faith and without notice of security interest), which was applied in United States v. Chappell Livestock Auction, Inc., 523 F.2d 840, 840-41, aff'd en banc, 17 U.C.C. Rep. Serv. (Callaghan) 1098 (8th Cir. 1975); State Sec. Co. v. Norfolk Livestock Sales Co., 187 Neb. 446, 448-50, 191 N.W.2d 614, 616-17 (1971); or (5) the ultimate transferee of the collateral has a right to possess the property superior to the secured party's right, see United States v. Hext, 444 F.2d 804, 814-16 (5th Cir. 1971). In Hext, the United States sought to hold a warehouse company and a cotton broker liable for converting cotton in which it had a security interest. The United States knew that the farmer/debtor who grew the cotton also owned a company that ginned cotton, and that the farmer/debtor could, by ginning the cotton, transform it into inventory. The court considered the situation analogous to ones in which purchasers of certain types of inventory take goods free of a security interest. Since the ultimate purchasers would take free of a security interest, the court held that the intermediaries could not be liable for conversion. The court in Hext suggested that any subordinate transferee of collateral may escape conversion liability despite his disposition of the property after the debtor's default if the person to whom he delivers it has a right to possession that is superior to the secured party's right. There is specific doctrinal support for such a proposition, see Restatement (Second) of Torts § 233 comment d (1976) (when delivery is made to one entitled to possession, no conversion occurs since "possession has merely been surrendered to one who has a right to it"), but the decision in Hext to shield intermediaries from liability is not clearly supported by this doctrine. Restatement (Second) §§ 233 and 235 and accompanying comments imply that a defendant is immune from liability if he transferred the plaintiff's property to someone who has a pre-existing superior right to possession. In Hext, the persons to whom the intermediaries sold the collateral had no interest in or rights to the property until they purchased it. If the property had not been sold to them, they would have had no claim to it as against the secured party and no priority over it. Thus the reasoning used to protect the intermediaries in Hext is suspect.
Enforcing Security Interests
THE GEORGE WASHINGTON LAW REVIEW

edge of the security interest does not absolve him of liability. If the secured party is entitled to priority and possession under Article 9's rules, the converter's pure heart and clear conscience are ordinarily irrelevant. Moreover, the buyer cannot avoid liability on the ground that the debtor was not in default when the buyer acquired the collateral, because the buyer is under a duty not to interfere with the secured party's right to possession no matter when that right accrues.

A hard case is presented by a buyer whose only alleged interference with a secured party's rights is purchasing the original collateral after the debtor's default: the buyer has the property and is willing to return it, but the secured party insists on suing him for conversion.

Does a person unlawfully convert the original collateral simply by

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55. If the debtor had not defaulted prior to the sale of the collateral to the buyer and did not default by selling it, the purchaser's act of buying it is lawful in the sense that he does not convert the collateral simply by purchasing it. See U.C.C. § 9-503 and authorities cited supra notes 22 and 50. Yet the buyer's lawful purchase of the collateral does not protect him if the debtor thereafter defaults, the secured party's right to possession thus matures, and the buyer subsequently deals with the collateral in a manner that interferes seriously with the secured party's rights.

A person in possession of a chattel... may be liable [for conversion on the basis of demand and refusal]... in spite of the fact that he obtained possession of the chattel in a lawful manner. The conversion consists in the unlawful detention of the chattel, and not in the manner in which possession was originally acquired.

Restatement (Second) of Torts § 237 comment e (1976); see also, e.g., Production Credit Ass'n v. Nowatzski, 90 Wis. 2d 344, 353-54, 280 N.W.2d 188, 122-23 (Wis. 1979) (dictum). Presumably, this is true no matter what conduct forms the basis of the conversion action against the defendant. But "[w]here there has been no wrongful taking or disposal of the goods, and the defendant has merely come rightfully into possession and then refused to surrender them, demand and refusal are necessary to the existence of the tort." W. Prosser, Handbook of the Law of Torts § 15, at 89 (4th ed. 1971).

56. If the buyer has unlawfully converted the collateral, he cannot negate the tort simply by returning the property. In a conversion action:

The defendant cannot undo his wrong by forcing the goods back upon their owner, either as a bar to the action, or in mitigation of damages.

... In any case, return of the chattel, whether consented to by the plaintiff or compelled by the court, does not bar the action, but goes merely to reduce the damages.

W. Prosser, supra note 55, § 15, at 97 (footnotes omitted); see also Restatement (Second) of Torts § 922 (1976) (providing for mitigation of damages upon return of converted chattel).

1982]
buying it when the secured party is entitled to possession because of the debtor-obligor’s default under the security agreement? The cases do not provide a clear answer to this question. Often the reported facts fail to reveal the purchaser’s actions with respect to the collateral after buying it, or the courts neglect to specify the particular act that constituted the unlawful conversion.

For several reasons, however, the buyer probably does not unlawfully convert collateral simply by buying it after the debtor's default. First, to be liable for conversion for simply receiving possession of property in consummation of a transaction, the defendant must have intended to acquire a proprietary interest in the chattel which the transferor lacked the power to transfer.57 Only in a case where “the transaction is ineffective to give the actor [the defendant] the proprietary interest he intends to acquire” is he subject to liability for conversion to a person who is at the time entitled to immediate possession of the chattel.58 A purchaser of collateral ordinarily intends to acquire the debtor's title to the property — a title subject to the secured party's interest. Because section 9-311 of the U.C.C. expressly recognizes the power of an Article 9 debtor to transfer his rights in collateral,59 a debtor can effectively sell to the buyer the interest the latter ordinarily intends to acquire. Thus, section 9-311 seems to shield a buyer from liability when a conversion action is predicated solely on his purchase of collateral after a debtor's default.60

This result and reasoning are generally consistent with pre-Code law. Many courts recognized that before and after default, a chattel mortgagor or a conditional vendee retained some interest in the collateral that he could convey or encumber;61 yet in scores of cases

57. RESTATEMENT (SECOND) OF TORTS § 229 (1976).
58. Id. comment a.
59. See supra text accompanying note 5. The purpose of § 9-311 is “[t]o make clear that in all security transactions under this Article, the debtor has an interest (whether legal title or an equity) which he can dispose of. . . .” U.C.C. § 9-311 comment 1. As a rule, however, the debtor’s transfer of his interest does not extinguish the secured party’s interest in collateral. See supra text accompanying notes 5-6; see, e.g., Sturdevant v. First Sec. Bank, 605 P.2d 325, 328 (Mont. 1980); Production Credit Ass’n v. Nowatzki, 90 Wis. 2d 344, 350-51, 280 N.W.2d 118, 121 (Wis. 1979).
60. See Citizens Bank v. Perrin & Sons, 253 Ark. 639, 488 S.W.2d 14 (1972) (dictum). The court interpreted U.C.C. § 9-311 as changing the pre-Code rule that a buyer who purchased mortgaged personality without the mortgagee’s consent was liable for conversion. 253 Ark. at 640, 488 S.W.2d at 15. This was not the universal rule even under pre-Code law. See infra text accompanying notes 61-63.
transferees of such debtors were held liable to mortgagees or conditional vendors for conversion of the property. 62 Close examination of

the cases reveals, however, that the true basis of liability was seldom the simple act of buying encumbered property; also present in nearly all of the cases was an act of “dominion over the chattels to the exclud-


63. 2 L. JONES, supra note 10, § 490a. Compare this author's discussion regarding the conversion liability of purchasers from conditional vendees in terms of the "mod-
Like those pre-Code authorities, many Article 9 cases in which the courts' opinions either are unclear as to the basis of the buyer's conversion liability or appear to base liability solely on the buyer's purchase of collateral may actually have predicated liability on additional, more intrusive activity. At least in the typical case, the buyer's full range of conduct was such that the court probably could have pinpointed a more intrusive act as the basis of his conversion liability to the secured party. In Still Associates v. Murphy, for example, the Supreme Judicial Court of Massachusetts held that the conversion of collateral by a buyer occurred at the time of the property's sale to him by the debtor. The reported facts indicate, however, that the buyer refused the secured party's demand that the buyer return the collateral to him. In Pascack Valley Bank & Trust Co. v. Ritar Ford, Inc., the court held that the buyer's act of purchasing collateral while it was subject to a valid lien was a conversion. The buyer had, however, resold the property as well. In other cases implying that the act of conversion was the mere purchase of collateral, the facts also suggest that the defendant made repossession more difficult for the secured party by, for example, transferring the property to another, or by removing it to another state.

Disposition of the collateral by the buyers can be assumed in many cases because of the nature of the collateral or the nature of the transferee's business. The facts reported for other cases suggest

65. Id. at 761, 267 N.E.2d at 218.
67. Id. at 491, 276 A.2d at 802.
68. See, e.g., General Motors Acceptance Corp. v. Allstate Ins. Co., 77 Misc. 2d 849, 850, 355 N.Y.S.2d 78, 79 (Nassau County Dist. Ct. 1974) (insurer left car with the debtor for the purpose of realizing salvage value); Security State Bank v. Dooley, 694 P.2d 153, 154-55 (Okla. Ct. App. 1979) (two of the defendants resold the truck and the ultimate transferee, an automobile dealer, probably resold it also); Community Bank v. Jones, 278 Or. 647, 657, 566 P.2d 470, 477 (1977) (after purchasing cars from the debtor, Bruce transferred the bulk of the cars to Eil and presumably sold the remaining ones since they were inventory).
that although the buyers did not dispose of the collateral or destroy its identity, they probably made significant use of the property while it was in their possession. Moreover, the buyer in virtually every case paid the purchase price of the collateral to someone other than the secured party. There are cases for which the courts' opinions, the reported facts, and the attendant circumstances completely fail to suggest any basis for conversion other than the act of purchasing collateral, but they are few indeed.

A holding that a buyer is liable for converting collateral by merely purchasing it when the debtor is in default is, in addition to being inconsistent with pre-Code law, a transgression of the defensible maxim that conversion liability is appropriate only when the defendant's interference with the plaintiff's right to control the chattel is "serious, major and important." Liability is not appropriate for interference that is "temporary, trivial or unimportant."

The introductory provision of the chapter on conversion in the Restatement (Second) of Torts heralds the principle that a combination of factors must be considered before imposing liability. Other sections of the chapter detail a variety of specific ways one can commit conversion, but section 222A governs them all. Comment d of that section plainly directs that in determining liability, the consequences of a defendant's act are at least as important as its nature. Dean 212 N.W.2d 625, 627 (1973) (grain elevator operator purchased secured grain); Overland Nat'l Bank v. Aurora Coop. Elevator Co., 184 Neb. 843, 844, 172 N.W.2d 786, 787 (1969) (grain elevator operator purchased secured milo). Although disposing of collateral by reselling it may not in itself constitute conversion, see infra notes 85-94 and accompanying text, the commingling or processing of collateral is a conversion to the extent it destroys or materially alters the condition of the property or prevents its identification. See Restatement (Second) of Torts § 226 & comment d (1976).

71. See, e.g., McGehee v. Exchange Bank & Trust Co., 561 S.W.2d 926, 929-29 (Tex. Civ. App. 1978) (pleasure boat subject to security interest purchased by consumer); Chrysler Credit Corp. v. Malone, 502 S.W.2d 910, 911 (Tex. Civ. App. 1973) (automobile subject to security interest purchased by insurance agency). One can properly be held liable for conversion solely on the basis of using another's property, if that use seriously interferes with another's right to control the chattel. See Restatement (Second) of Torts § 227 & comment b (1976).

72. A secured party ordinarily has an interest in the purchase price as "proceeds" of collateral. See U.C.C. § 9-306(1)-(2). Mishandling proceeds can in itself be a basis for conversion liability, see infra notes 121-68 and accompanying text, and arguably can be considered along with other conduct of the buyer in determining the seriousness of his interference with the secured party's rights to collateral under Article 9.

73. See, e.g., Trans-Nebraska Corp. v. Cummings, Inc., 595 S.W.2d 922 (Tex. Civ. App. 1980). In Cummings, a purchaser of real estate acquired as part of the transaction a display sign in which a security interest continued. Did the buyer use the sign himself? Did he lose or destroy it? Or did the buyer simply refuse a demand by the secured party that the sign be returned to him? Nothing in or about the case offers any clues as to what, if anything, the buyer did with the collateral; one can reasonably infer that the only basis for conversion liability was the buyer's purchase of the collateral.

74. Restatement (Second) of Torts § 222A comment c (1976).

75. Id. § 229 comment b.

76. Id. § 222A (2).

77. The question is nearly always one of degree, and no fixed line can be drawn. There is probably no type of conduct with respect to a chattel which is always and under all circumstances sufficiently important to amount to a conversion . . . Not only the conduct of the defendant, but also its consequences, are to be taken into account. Id. § 222A comment d (emphasis added). This approach to determining conversion liability is perhaps more revolutionary than the drafters make it appear. The original Restatement is much different. It contains no provision comparable to the new § 222A;
Prosser agreed that the determining factor with respect to conversion liability is not the character of the defendant's act, but rather its effect.\textsuperscript{78}

When a buyer purchases collateral and is willing and able to return the property in substantially the same condition in which he received it, his dominion over the goods will in many cases have an inconsequential effect on the rights and interests of the secured party. The secured party could argue that delay in locating the buyer and the collateral caused him to suffer a loss, but any loss would usually be nominal. Presumably, the debtor knows the buyer's identity and, when contacted, the buyer is willing to return the collateral immediately. The buyer normally will not prolong the secured party's search for the collateral by having disposed of it himself\textsuperscript{79} and will not cause any further delay by resisting repossession efforts.\textsuperscript{80} If a secured party's right to possession is not significantly disputed, hampered, or prevented and if his collateral is recoverable intact, a buyer can credibly argue that justice does not require him to pay the full value of the property or the value of the secured party's interest in it.\textsuperscript{81} Thus, the buyer's interference with the secured party's right to possession arguably is not so serious as to constitute conversion of the collateral because the consequences of his conduct are insubstantial.

Of course, if the buyer has exercised substantially more control over the collateral than merely purchasing it after the debtor's default, the balancing of factors to be considered in deciding conversion liability\textsuperscript{82} may favor the secured party.\textsuperscript{83} For example, the buyer fre-
quently will have resold the collateral, so the secured party can sue him for conversion based on the resale and not simply on the purchase of the property from the debtor. Courts have routinely imposed liability on buyers who have resold collateral.84

It would be unsound to conclude that a buyer’s resale of collateral in itself always constitutes a conversion of the property, however. The general rule at common law is that “one who makes an unauthorized delivery of a chattel to a person not entitled to its immediate possession is subject to liability for conversion to another who is so entitled.”85 Undoubtedly, a prima facie case founded on this rule can be asserted against a buyer of collateral who sells the property after the debtor’s default because when default occurs, the secured party — not the buyer’s transferee — becomes entitled to immediate possession.86 Nevertheless, this rule cannot be considered absolute and applied blindly. As in all conversion actions, liability should be imposed only when the defendant’s actions constitute a serious interference with the plaintiff’s right to control the goods;87 whether the interference is serious must be judged by the consequences of the defendant’s conduct in each case, not simply by the nature of the conduct itself.88 Just as a buyer’s purchase of the collateral from the debtor may be inconsequential and therefore insufficient in itself to constitute conversion,89 his sale of the property, whether viewed alone or in conjunction with his acquisition of it, may not complicate matters sufficiently for justice to require the buyer to satisfy the secured party’s interest. Despite the buyer’s resale of the collateral, the security interest may continue in the property and the goods may remain readily accessible so that the secured party can easily repossess them intact from the ultimate transferee.90 Section 9-311 sup-

version liability. See supra text accompanying notes 46-55 and infra text accompanying notes 84-96. Other conduct by the buyer may also subject him to conversion liability. See supra notes 68-72. The buyer’s freedom from liability for having simply purchased the collateral does not shield him from liability for other conduct that in itself constitutes unlawful conversion. See generally supra note 55.

84. See cases cited supra notes 53 & 62.
86. See U.C.C. §§ 9-201, 9-503. See generally cases cited supra note 18.
87. See RESTATEMENT (SECOND) OF TORTS §§ 222A, 225 comment c (1976); supra text accompanying notes 74-75.
88. See RESTATEMENT (SECOND) OF TORTS § 222A comment d (1976); supra notes 77-78 and accompanying text.
89. See supra notes 58-81 and accompanying text.
90. Cf. Citizens Bank v. Perrin & Sons, 253 Ark. 639, 641, 488 S.W.2d 14, 15 (1972) (lien creditor not liable for selling collateral which was fully accessible to secured party); Black v. O.K. Radiator & Sheet Metal Works, 152 So. 782, 783 (La. Ct. App. 1934) (mechanic who sold collateral to satisfy repair bill not liable because record failed to show that chattel mortgagee was in any way damaged by the sale); Swift & Co. v. Cohen, 256 A.D. 996, 997, 10 N.Y.S.2d 484, 485 (1939) (junior secured creditor not liable for conversion when he repossessed and sold collateral because senior secured creditor failed to prove that this sale placed the property beyond his reach); Seaboard Consumer Discount Co. v. Landau’s, Inc., 167 Pa. Super. 180, 182-83, 74 A.2d 737, 738 (1950) (lien creditor not liable for seizing and selling collateral because senior secured creditor failed to prove that this sale placed the property beyond his reach); Seaboard Consumer Discount Co. v. Landau’s, Inc., 167 Pa. Super. 180, 182-83, 74 A.2d 737, 738 (1950) (lien creditor not liable for seizing and selling collateral because the secured creditor’s interest survived the sale); Muscatel v. Storey, 56 Wash. 2d 635, 641, 354 P.2d 931, 934 (1960) (lessee who rightfully retook possession of real estate from debtor did not convert mortgaged chattels present on the property even though reality and personality were relet to third party). In Citizens Bank v. Perrin & Sons, 253 Ark. 639, 488 S.W.2d 14 (1972), a subordinate lien creditor caused the execution sale of collateral and the se-
ports the argument that the buyer may resell without liability, for it explicitly recognizes that a debtor's rights in collateral may be sold:91 by owning the property, a buyer from the debtor-obligor is presumably a "debtor" himself within the scope of this section.92

Nevertheless, some courts have imposed liability in the absence of significant adverse consequences of resale, concluding, explicitly or implicitly, that resale in itself is a sufficiently serious exercise of dominion and control on which to found liability.93 This conclusion is

cured party sued the lienor for conversion. The court relied on the Arkansas codification of U.C.C. § 9-311 to support its holding that a "bare sale" of collateral is not a conversion as long as the property remains fully accessible in the hands of a buyer who purchased it subject to the secured party's interest. Id. at 641, 488 S.W.2d at 14. Nevertheless, a number of cases have permitted actions for conversion to be maintained against persons who exercised unauthorized acts of dominion over property without regard to the ease with which the secured party could reacquire the property. See, e.g., Cooper v. Citizens Bank, 129 Ga. App. 261, 262, 269 S.E.2d 369, 371 (1978); Marco Fin. Co. v. Solbert Indus., 354 S.W.2d 469, 474 (Mo. Ct. App. 1968); Teddy's Drive In, Inc. v. Cohen, 54 A.2d 898, 899, 386 N.Y.S.2d 20, 22 (1976); Murdock v. Blake, 26 Utah 2d 22-23, 242 N.E.2d 164, 169 (1971). For a discussion of most of these cases, see Production Credit Ass'n v. Equity Coop. Livestock Sales Ass'n, 82 Wis. 2d 5, 20 n.20, 261 N.W.2d 127, 132 (Wis. 1978). Some of the cases are also discussed in Justice, Secured Parties and Judgment Creditors — The Courts and Section 9-311 of the Uniform Commercial Code, 30 Bus. LAW. 435, 440-43 (1974). It is also instructive to compare the reasoning and result in Citizens Bank with cases in which a senior secured party sues a subordinate secured party for converting the collateral on the basis of the junior secured party's repossession and sale of the property. The subordinate creditor's sale of the collateral extinguishes his security interest and any junior ones, see U.C.C. § 9-504(4), but it does not extinguish a senior security interest. In a number of cases, subordinate secured parties who conducted foreclosure sales have been found liable to senior creditors for conversion of collateral. See, e.g., United States v. Minister Farmers Coop. Exch., 430 F. Supp. 566, 571 (N.D. Ohio 1977); Hillman's Emp. v. Cooper v. Citizens Bank, 1976)).

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Some of the cases are also discussed in Justice, Secured Parties and Judgment Creditors — The Courts and Section 9-311 of the Uniform Commercial Code, 30 Bus. LAW. 435, 440-43 (1975). It is also instructive to compare the reasoning and result in Citizens Bank with cases in which a senior secured party sues a subordinate secured party for converting the collateral on the basis of the junior secured party's repossession and sale of the property. The subordinate creditor's sale of the collateral extinguishes his security interest and any junior ones, see U.C.C. § 9-504(4), but it does not extinguish a senior security interest. In a number of cases, subordinate secured parties who conducted foreclosure sales have been found liable to senior creditors for conversion of collateral. See, e.g., United States v. Minister Farmers Coop. Exch., 430 F. Supp. 566, 571 (N.D. Ohio 1977); Hillman's Emp. v. Cooper v. Citizens Bank, 1976)).
unsound because it is premised on the assumption that the nature of the defendant's conduct alone can render him liable for conversion. Those who restated the law of torts disagreed: "There is probably no type of conduct with respect to a chattel which is always and under all circumstances sufficiently important to amount to a conversion...."94

Only serious consequences of the buyer's resale should warrant holding him liable for conversion. Resale may damage the collateral or render the secured party unable to locate it, for example; and even if the property is found intact, the secured party may suffer undue delay, inconvenience, or expense if he attempts to retake it from an ultimate transferee who resides far away or resists the secured party's efforts to repossess the property. In a rare case, the ultimate transferee may have taken the property free of the security interest through no fault of the secured party.95 Each of these possible consequences of a buyer's resale of collateral diminishes or destroys the value of the secured party's interest in it and his right to possess it immediately upon the debtor's default, and each grossly undermines the importance of the secured party's interest having priority over the buyer's. Thus, when such consequences occur, the buyer's resale of the collateral does seriously interfere with the secured party's rights, and courts can justly require the buyer to satisfy the secured party's interest.96

In defending a conversion action, a buyer who resold collateral might argue that any significant consequences of resale were caused not by his own conduct, but by the conduct of a subsequent transferee or by some other source not directly attributable to the buyer. This argument will normally be unpersuasive, for resale is a contrib


94. RESTATEMENT (SECOND) OF TORTS § 222A comment d (1976); see supra note 77.

95. In United States v. Hext, 444 F.2d 804 (5th Cir. 1971), the Fifth Circuit suggested that a subordinate transferee of collateral will escape conversion liability if the person to whom he delivers the collateral takes it free of the secured party's interest. Id. at 816. This suggestion is contrary to the proposition urged here that such a result renders the subordinate transferee liable for conversion. The court's reasoning in Hext is explained and criticized supra note 53.

96. RESTATEMENT (SECOND) OF TORTS § 222A(2) (1976) confirms that factors such as damage to the collateral, delay, inconvenience, and the like are important when determining the seriousness of interference with a secured party's rights. Moreover, the Restatement's drafters make clear that such factors must be considered when deciding the question of liability, even when liability is founded on the defendant's unauthorized disposition of the property claimed by the plaintiff. Id. § 235 comment c.
Enforcing Security Interests
THE GEORGE WASHINGTON LAW REVIEW

uting cause of damage to the secured party’s interest that occurs while the property is in the hands of a subsequent possessor: but for the buyer’s resale, the transferee would never have acquired the property. Further, a reselling buyer can foresee many potential actions of a subsequent transferee, so the act of selling the property can proximately cause the fate that subsequently befalls it. This reasoning accords with the law of conversion outside the context of security interests, under which a defendant can be liable when his acts alone do not amount to a conversion, but have combined with independent forces beyond his control to produce serious adverse consequences.97

Holding a reselling buyer liable for conversion based on the occurrence of events beyond his control and for which he is not directly responsible is equivalent to imposing on him the risk of loss after his transfer. This approach is a compromise between two extreme and undesirable alternatives. If consequences that ensue after the buyer transfers the collateral are not considered, buyers’ liability will depend almost entirely on whether courts hold resale in itself to constitute conversion. Labeling resale itself a conversion is tantamount to imposing absolute liability based solely on the character of an act—an approach that is not only inconsistent with the Restatement Second, but also unfair, for it would permit buyers’ liability even when plaintiffs could recover their collateral with reasonable effort and without any material loss or injury. Yet from the secured party’s perspective, complete immunity for the reselling buyer seems equally unfair, for by selling the collateral, the buyer has “set [it] afloat on a sea of persons, strangers to... [the plaintiff who] must go and chase it.”98

The compromise approach of considering post-resale consequences recognizes that the secured party’s chase may be either short and successful or long, expensive, and frustrated; it would hold the reselling buyer neither absolutely liable nor completely immune from liability.

In some cases, adverse consequences caused directly by the buyer’s transferee can render the transferee liable for conversion.

97. The consequences to the plaintiff “relate back to the [defendant’s] act and affect it, so that they may transform a mere trespass into a conversion.” Prosser, The Nature of Conversion, 42 CORNELL L.Q. 168, 184 (1957). In The Nature of Conversion, Prosser’s illustrations make it clear that a gust of wind or a spontaneous fire can change an innocent act into a wrongful conversion. See id. at 174-75, 180-81. For variations on the same theme, see RESTATEMENT (SECOND) OF TORTS § 222A comment d, illustrations 1-26 (1976).

Conversion, after all, is an intentional tort. If the defendant is liable, the reason is that he intended to do the act which turns out to be tortious. 1 F. HARPER & F. JAMES, THE LAW OF TORTS § 2.10 (1956). Although a foreseeable or close causal link between the converter’s act and the plaintiff’s injury is added reason for imposing liability, proximate causation is not a necessary element of the tort of conversion. Van Bibber v. Norris, 404 N.E.2d 1365, 1380-81 (Ind. Ct. App. 1980).

This should not absolve the reselling buyer of liability, though. Although a succession of conversions raises interesting questions regarding the plaintiff's measure of damages,99 a subsequent conversion of the same property does not erase or cure the wrong that another converter has already committed.100

B. Measure of the Secured Party's Damages

The usual statement of the measure of damages for conversion is "the value of the goods at the time of conversion,"101 but a more precise and accurate statement is that the plaintiff can recover "the value of the subject matter or of his interest in it" at the time and place of the conversion."102 The latter statement more closely resembles the rule of damages regularly recited in pre-Code secured transactions cases. A chattel mortgagee or conditional vendor could recover from a transferee or other person who converted collateral either the market value of the goods or the amount remaining due on the secured debt, whichever was less.103 Several courts have perpetuated


101. 1 F. HARPER & F. JAMES, THE LAW OF Torts § 2.36, at 190 (1956); see also D. DOBBS, HANDBOOK ON THE LAW OF REMEDIES § 5.14, at 403 (1973) (measure of damages for conversion is the value of the property at the time and place of conversion plus interest).

102. RESTATEMENT (SECOND) OF TORTS § 927(1) (a) (1976) (emphasis added).

this rule in Article 9 cases, and it undoubtedly reflects the proper measure of a secured party’s damage when he successfully sues a buyer of collateral for conversion. A secured creditor does not own the collateral, at least not fully; he has only a limited interest measured by the unpaid balance of the obligation which is secured by the property. To allow a secured party “to recover the total value of [the collateral] . . . would result in a windfall . . . since it owns only a security interest in the property.” Thus, the secured party should be awarded only “the value of its security interests in the property in question.”

If the collateral itself is worth more than the secured party’s interest, that is, the amount of the secured debt that remains outstanding, the excess belongs to the buyer, who owns the property subject to the security interest.

In many Article 9 cases where buyers are found liable for converting collateral, however, courts recite and appear to follow the general rule of damages that allows recovery for the full value of the goods. Presumably, in most of these cases, the secured party’s interest exceeded the worth of the collateral, so damages were properly limited to the value of the property. The buyer cannot be required to pay more because he is not ordinarily personally oblig-
gated on the secured debt. Therefore, once it is established that the secured debt exceeds the value of the collateral, the precise value of the secured party's interest is irrelevant in computing damages.

Occasionally, under both pre-Code law and Article 9, courts have deliberately and properly allowed the secured creditor to recover the full value of the collateral even though this amount exceeded the value of his interest. In these cases the defendant was not a buyer of the collateral or other owner of an interest in the property and thus was not entitled to any equity in the property. When the secured party recovers more than his interest in the collateral, however, he should be accountable to the debtor or the owner of the property at the time of its conversion for the excess.

Determining the collateral's value is necessary whenever a buyer of collateral is held liable for conversion, for this value must be compared with the value of the secured party's interest to determine which establishes the plaintiff's maximum recovery. If the property's worth is the lesser of the two values, it is the amount of principal compensatory damages that the secured party should be awarded together with other damages to which he may be entitled. The rationale of the rule of damages . . . which permits recovery of the full value of the property by a person having a limited interest in the property, is that the owner of the limited interest will be liable to the owner of the remaining interest for any amount the former received in the conversion action that exceeds the amount of his claim or indebtedness.

110. See supra text accompanying notes 24, 29-30; authorities cited supra note 24.
111. See, e.g., Hartford Fin. Corp. v. Burns, 96 Cal. App. 3d 591, 158 Cal. Rptr. 169 (1979); Massey-Ferguson, Inc. v. First Nat'l Bank, 27 U.C.C. Rep. Serv. (Callaghan) 1473, 1480 (Tenn. Ct. App. 1978). Hartford Fin. Corp. is a recent Article 9 case in which the debtor's real estate lessor seized collateral in which he had no interest of any kind. 96 Cal. App. 3d at 597, 158 Cal. Rptr. at 171. The court affirmed an award of damages against the landlord based on the full value of the property. "In an action for damages for conversion, it is the rule that the plaintiff, although owning but a limited or qualified interest in the property, may, as against a stranger who has no ownership therein, recover the full value of the property converted." Id. at 605, 158 Cal. Rptr. at 176 (emphasis in original) (quoting Camp v. Ortega, 200 Cal. App. 2d 276, 286, 25 Cal. Rptr. 973, 875 (1962)). Among pre-Code cases, see King v. Loeb, 93 Ga. App. 301, 305-06, 91 S.E.2d 532, 536 (1956) (conditional vendor suing debtor's lessor for refusing to deliver collateral placed in the leased premises to the vendor); Bell Fin. Co. v. Gefter, 337 Mass. 69, 72, 147 N.E.2d 815, 816 (1958) (secured creditor suing tortfeasor who damaged collateral); Carolina, C. & O. Ry. v. Unaka Springs Lumber Co., 130 Tenn. 354, 380-81, 170 S.W. 591, 598 (1914) (same). But see Harvard Trust Co. v. Racheotes, 337 Mass. 73, 76-77, 147 N.E.2d 817, 819-20 (1958) (mortgagee suing a tortfeasor limited to recovering value of security interest because the mortgagor was liable for contributory negligence).
112. The rationale of the rule of damages . . . which permits recovery of the full value of the property by a person having a limited interest in the property, is that the owner of the limited interest will be liable to the owner of the remaining interest for any amount the former received in the conversion action that exceeds the amount of his claim or indebtedness.

113. See supra text accompanying notes 102-07.
114. In addition to recovering the value of the property or of his interest in it, a plaintiff in a conversion action may recover damages for (a) the additional value of a chattel due to additions or improvements made by a converter not in good faith; (b) the amount of any further pecuniary loss of which the deprivation has been a legal cause; (c) interest from the time at which the value is fixed; and (d) compensation for the loss of use not otherwise compensated.

RESTATEMENT (SECOND) OF TORTS § 927(2) (1976). Regarding the recovery of interest,
value of converted property is ordinarily determined on the basis of its “exchange value,” which usually means its “market value.” The price the buyer paid for the collateral is evidence of its market value and has been the basis of recovery in several cases where a buyer's liability was based on conversion of the property that he purchased. But a secured party's recovery is not limited to damages based on the amount the buyer paid for the collateral. There may be other evidence of market value on which the fact finder can base a different award, including, for example, the price the defendant received if he resold the property. A secured party can recover damages based on the resale price, but compensatory damages generally should not exceed the amount of the secured obligation that remains unpaid.

IV. The Buyer's Liability for Misdirecting or Misapplying “Proceeds” of the Original Collateral

A. Paying Proceeds to Someone Other Than the Secured Party

A buyer of collateral is arguably liable to the secured party for misdirecting or misapplying “proceeds” in which a security interest conti-
ues, whether or not the buyer is liable for improperly dealing with the property that originally secured a debt. Proceeds are ordinarily created when collateral is transferred for value, and include "whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds." 121 A security interest in the original collateral continues in any identifiable proceeds, including collections received by the debtor. 122 As property subject to a security interest, proceeds are themselves collateral. 123 Therefore, a secured party has the right to possess proceeds upon the debtor's default or earlier if the security agreement so provides, 124 and can trace them into the hands of the debtor or others and force them to account for identifiable proceeds they have received. 125

The secured party need not elect between recovering proceeds and repossessing the original collateral; rather, he "may claim both proceeds and collateral, but may of course have only one satisfaction." 126 Frequently, the secured party will choose not to pursue either the

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121. U.C.C. § 9-306(1). This includes "[i]nsurance payable by reason of loss or damage to the collateral. . . except to the extent that it is payable to a person other than a party to the security agreement." Id.

122. U.C.C. § 9-306(2). Regarding the requirement of identifiability, see Nickles, supra note 19, at 670-72; B. CLARK, THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERICAL CODE ¶ 10.3 (1980 & Supp. I 1982). A security interest can continue in proceeds even if it does not continue in the original collateral because the secured party authorized disposition of the collateral or for some other reason the buyer takes free of the interest in the original collateral. See U.C.C. § 9-306(2) & comment 3; see, e.g., Commercial Credit Corp. v. Nat'l Credit Corp., 251 Ark. 541, 547-50, 473 S.W.2d 876, 879-81 (1971); Barnett Bank v. Applegate, 379 So. 2d 1284, 1286 (Fla. Dist. Ct. App. 1978), vacated on other grounds, 377 So. 2d 1150 (Fla. 1979); In re Yealick, 69 Ill. App. 3d, 353, 355-56, 387 N.E.2d 399, 401 (1979).


126. U.C.C. § 9-306(2) comment 3.
original collateral or its proceeds, suing instead the buyer of the original collateral for having unlawfully converted it.\textsuperscript{127} If a suit against a buyer on this theory is for some reason either impossible or undesirable, however, the misdirection of proceeds theory of liability may be a preferable alternative.

Some courts have suggested that a buyer of the original collateral or some other person dealing with it may be accountable to the secured party for having paid proceeds of collateral to someone other than the secured party. In \textit{Mammoth Cave Production Credit Association v. Oldham},\textsuperscript{128} for example, an auctioneer was sued for selling tobacco to which the plaintiff had attached a security interest. The secured party prevailed at trial, but the appellate court reversed the judgment and remanded the case, directing the trial court to clarify on remand the precise theory underlying the plaintiff’s cause of action.\textsuperscript{129} More important than the appellate court’s decision was its recognition of a theory of liability alternative to conversion of the tobacco by its sale: conversion of the proceeds by sale of the collateral and payment of value received to the debtor.\textsuperscript{130}

Few courts have so clearly recognized misdirection of proceeds as an alternative basis of liability, but many have implied the theory’s availability.\textsuperscript{131} Perhaps these courts have actually based liability on

\textsuperscript{127} See supra notes 40-120 and accompanying text.
\textsuperscript{128} 569 S.W.2d 833 (Tenn. Ct. App. 1977).
\textsuperscript{129} Id. at 838.
\textsuperscript{130} Id. at 840.

We have assumed through most of this opinion that plaintiff is suing for conversion of the tobacco. We realize, however, that a claim might be made for proceeds instead, and plaintiff ought to make clear on remand exactly which theory he is pursuing, though there is little difference in the outcome either way. An unauthorized disposition of the tobacco, coupled with defendants’ payment of the proceeds to [the debtor] would give plaintiff the right to a judgment for conversion of the proceeds in their money amount. \textit{Id.} (emphasis added). In this, as in most other cases, the proceeds of original collateral were in the form of money. Despite the \textit{Mammoth Cave} court’s suggestion to the contrary, conversion may not technically be the correct theory of liability when the alleged wrong is misdirecting money proceeds. \textit{See generally}, D. Dobbs, \textit{Handbook on the Law of Remedies} § 5.16, at 421-22 (1973) (discussing common law rule that there can be no action for conversion of money or certain other intangible choses in action). Misdirection of proceeds arguably is not covered by any traditional claim for relief — this in itself may be a reason for denying recovery to a plaintiff who complains about it, although in most cases, there are simpler reasons based on the language of Article 9 to deny a secured party relief when his complaint is predicated solely on the defendant-buyer’s mishandling of proceeds. \textit{See infra} text accompanying notes 143-84.

\textsuperscript{131} See, e.g., Utah Farm Prod. Credit Ass’n v. Dinner, 302 F. Supp. 897, 898 (D. Colo. 1969) (buyer paid $12,000 purchase price to debtor; court considered whether secured party or buyer would bear the $12,000 loss); North Cent. Kan. Prod. Credit Ass’n v. Boese, 2 Kan. App. 2d 231, 234-35, 577 P.2d 624, 827 (1978) (buyer liable with respect to “proceeds” of sale); Oxford Prod. Credit Ass’n v. Dye, 368 So. 2d 241, 242 (Miss. 1979) (buyer liable to secured party for sums paid to debtor); General Motors Acceptance Corp. v. Allstate Ins. Co., 77 Misc. 2d 849, 851, 355 N.Y.S.2d 78, 79-80 (Nassau County Dist. Ct. 1974) (at the time of the defendant’s “purchase,” the value of the collateral was nil, yet damages were awarded on basis of insurance paid to debtor); Production Credit Ass’n v. Columbus Mills, 22 U.C.C. Rep. Serv. (Callaghan) 228, 234 (Wis. Cir. Ct. 1977) (secured party sued to recover purchase price buyer paid debtor; conversion lia-
conversion of the original collateral, and only calculated damages from the proceeds, for the price the buyer paid for the original collateral is sometimes used to establish its value once conversion has been established.\textsuperscript{132} Nevertheless, courts have not plainly eliminated misdirection of proceeds as an independent basis of a buyer's liability, and the theory is logically sound. If property given in exchange for collateral is subject to a security interest, the proceeds themselves are collateral.\textsuperscript{133} From a subordinate buyer's liability in conversion for disposing of original collateral,\textsuperscript{134} one can logically infer that a person who disposes of collateral proceeds may also be liable for conversion or otherwise accountable to the secured party. By defining collateral broadly as property subject to a security interest,\textsuperscript{135} providing for a security interest to continue in identifiable proceeds from disposition of collateral,\textsuperscript{136} and entitling the secured party to possession of collateral — without qualification — upon the debtor-obligor's default,\textsuperscript{137} the Code offers no reason to treat those who deal with proceeds more leniently than those who deal with the original collateral.

This alternative basis of liability offers the secured party hardly anything new in the ordinary case, where a purchaser buys the original collateral from the debtor, pays him for it, and is then unwilling or unable to return the collateral to the secured party. Because the buyer in such a case is usually liable for converting the original collateral,\textsuperscript{138} basing liability on the misdirection of proceeds may conceivably affect the measure of damages or the difficulty of proving them but little else.\textsuperscript{139}

In other cases, the decision whether conversion of proceeds is a legitimate basis of liability may have more significant consequences, particularly when misdirecting proceeds is the secured party's only complaint against the defendant. If liability can be based solely on misdirection of proceeds, the buyer may present an impenetrable defense to conversion of the original collateral yet be held liable for transferring the consideration paid for it to someone other than the secured party. Although the court in Oldham suggested basing the buyer's liability on conversion of proceeds because they were mis-

\begin{footnotes}
\item[132] See supra text accompanying notes 113-20; authorities cited supra note 117.
\item[133] See supra text accompanying notes 121-23.
\item[134] See authorities cited supra note 53.
\item[135] See supra note 19.
\item[136] See supra note 122 and accompanying text.
\item[137] See U.C.C. § 9-503. In many cases, a default will have occurred because of the debtor's transfer of the original collateral. See supra note 22.
\item[138] See supra text accompanying notes 40-55.
\item[139] Even the measure of damages may be unaffected. A secured party's recovery of the value of original collateral converted by a buyer is sometimes measured in terms of the price paid for the property by the buyer. See authorities cited supra note 117. Therefore, whether the buyer's liability is based on conversion of the collateral or misdirection of the proceeds, the secured party's recovery may be exactly the same.
\end{footnotes}
directed and sale of the original collateral was unauthorized,\textsuperscript{140} the theory of liability is not conceptually dependent on the latter fact. A security interest need not continue in the original collateral for proceeds to become collateral to which a secured party is entitled;\textsuperscript{141} thus, liability based on a buyer’s misdirection of proceeds can redress a violation of a secured party’s right to possess them regardless of the termination of his right to possess the original collateral.\textsuperscript{142}

The proceeds theory is fatally flawed if the rights of a secured party are not violated when the buyer makes payment for original collateral to someone other than the secured party. Inextricably linked to the legality of the buyer’s payment is the time at which a security interest first attaches to proceeds, for the secured party cannot prevail on a misdirection of proceeds theory unless he can demonstrate that the consideration was subject to his security interest when the buyer transferred it. Whether the secured party can prove this depends largely on the interpretation of section 9-306(2), which provides that a security interest continues only in “identifiable proceeds including collections received by the debtor.”\textsuperscript{143} If “received by the debtor” modifies not only just “collections,” but also “proceeds,” then the property given in exchange for the original collateral is not subject to the security interest until the proceeds are paid to and received by the debtor — and the secured party is not entitled to possess them until receipt occurs. Because the secured party has no security interest in the proceeds before this time, he has no legitimate claim against the buyer for paying the proceeds to the debtor.

A more fundamental reason for denying the secured party’s claim is that property given in exchange for collateral simply cannot be “proceeds” before the property is received by the debtor. A security interest continues in payments under section 9-306(2) only if they are “proceeds” as section 9-306(1) defines that term: “whatever is received upon the . . . disposition of collateral or proceeds.”\textsuperscript{144} Courts seldom consider specifically whether property given in exchange for collateral must be “received” before it can be proceeds with a continuing security interest, but in \textit{Terra Western Corporation v. Berry & Co.},\textsuperscript{145} the Nebraska Supreme Court recently responded to this issue in the affirmative, holding that an insurer is not liable to a secured party for paying proceeds directly to the debtor when collateral insured against casualty is destroyed.\textsuperscript{146} Reasoning that Article 9 pro-

\textsuperscript{140} See Mammoth Cave Prod. Credit Ass’n v. Oldham, 569 S.W.2d 833, 836 (Tenn. Ct. App. 1977).
\textsuperscript{141} See U.C.C. § 9-306(2) and authorities cited supra note 122.
\textsuperscript{142} See supra text accompanying notes 133-37.
\textsuperscript{143} U.C.C. § 9-306(2).
\textsuperscript{144} U.C.C. § 9-306(1) (emphasis added).
\textsuperscript{145} 207 Neb. 28, 295 N.W.2d 693 (1980).
\textsuperscript{146} Id. at 33-34, 295 N.W.2d at 696-97.
ceeds cannot exist before their receipt, the court held that the insurance company could not be liable for conversion because the petitioner had not alleged facts showing that the insurer had "exercised a distinct act of unauthorized dominion over 'proceeds.'" 147 According to the court, the insurer had violated no property interest of the secured party in the money paid to the debtor, for no interest could arise in those funds as proceeds until the debtor received them. 148

The Supreme Court of Maine, by contrast, concluded in Farnum v. C.J. Merrill, Inc. 149 that consideration for the sale of collateral can be proceeds before it is received by the transferee. 150 In Farnum, the buyer of goods from an insolvent debtor was willing to pay the purchase price to either the debtor's secured party or his receiver. Thus, the case did not adjudicate the rights of a secured party against a subordinate buyer for conversion, but rather resolved the disputed priority among two competing creditors for property in the hands of a cooperative third party. The receiver's theory was much like the reasoning of the Nebraska court in Terra Western; he argued, inter alia, that because the debtor had received nothing from the buyer, no proceeds existed that the secured party could claim. 151 The Farnum court rejected this argument for two reasons. First, the buyer's obligation to pay was an intangible account receivable, itself proceeds in which the secured party had an interest. 152 Second, if the buyer had paid the purchase price to either the debtor or the receiver so that the actual funds would have been received, the secured party would have been entitled to the money. 153 The Maine court seems correct in

147. Id. at 34, 295 N.W.2d at 698.

It is clear that . . . insurance proceeds received by the insured are proceeds subject to the lien of a security instrument covering collateral which is the subject of a covered loss. That, however, does not answer the question of whether an insurer commits the tort of conversion when it pays the insurance proceeds directly to the insured.

... An examination of the language of the statute [section 9-306] shows that proceeds of an insurance policy covering destroyed property or other proceeds do not become "proceeds" within the meaning of the code until the money "is received." . . . The insurer does not receive the proceeds; it pays them.

148. Id. at 34, 295 N.W.2d at 698. For cases reaching the same result but for different reasons, see Judah AMC & Jeep, Inc. v. Old Republic Ins. Co., 293 N.W.2d 212, 214 (Iowa 1980); First Nat'l Bank v. Merchant's Mut. Ins. Co., 49 N.Y.2d 725, 402 N.E.2d 1168, 426 N.Y.S.2d 267 (1980) (adopting 65 A.D.2d 59, 61-62, 410 N.Y.S.2d 679, 690-81 (1978) (Larkin, J., dissenting)). Judge Larkin's dissent in Merchant's Mutual is based partly on the view that under the version of Article 9 applicable to the case, insurance payments are not proceeds. But see Nickles, supra note 19, at 669 n.751. Article 9 now expressly provides that such payments are proceeds to the extent they are payable to a party to the security agreement. U.C.C. § 9-306(1). That an insurer escapes liability for making payment to the debtor does not necessarily mean that the debtor is entitled to proceeds as against the secured party. Cf. Barton v. Chemical Bank, 577 F.2d 1329, 1336 (5th Cir. 1978) (issuing bank not liable to debtor for conversion for paying proceeds of certificate of deposit to secured party).

149. 264 A.2d 150 (Me. 1970).

150. Id. at 156.

151. Id. at 153.

152. Id. at 154.

153. Id. at 156.
observing that proceeds claimed by a secured party initially take the form of an intangible obligation to pay. This does not mean, however, that on the basis of such an analysis buyers are vulnerable for discharging this obligation by paying the debtor. Instead, the analysis suggests another approach to protecting such buyers.\(^{154}\)

A buyer may for some reason transfer property in exchange for original collateral to someone who is neither the secured party nor the debtor. Whether the buyer can be liable for misdirecting proceeds in this situation depends on the interpretation of the other critical language in section 9-306(2): "received by the debtor."\(^{155}\) A few courts have explored the significance of these words in cases where proceeds were paid by the buyer to someone other than the debtor-obligor. The issue these cases presented was whether a mere recipient of proceeds or a transferee of the original collateral who in turn sold the property and kept what he got in exchange, can be liable to the secured party for dealing with the proceeds. The conclusion in several cases is that property received by anyone in exchange for original collateral is proceeds in which a security interest may continue—even though the property is never received by the debtor-obligor.\(^{156}\) Thus, recipients of these proceeds can be liable to the se-

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\(^{154}\) See infra text accompanying notes 160-66.

\(^{155}\) U.C.C. § 9-306(2) (emphasis added).

\(^{156}\) See, e.g., In re Guaranteed Muffler Supply Co., 1 Bankr. 324, 328, 27 U.C.C. Rep. Serv. (Callaghan) 1217, 1223 (Bankr. N.D. Ga. 1979), further opinion, 5 Bankr. 236, 237, 29 U.C.C. Rep. Serv. (Callaghan) 285, 287 (Bankr. N.D. Ga. 1980) (U.C.C. § 9-306 protects a perfected security only in "identifiable" proceeds); El Paso County Bank v. Charles R. Millisen & Co., 622 P.2d 594, 596 (Colo. Ct. App. 1980) (security interest not extinguished when third party received proceeds from disposition of original collateral, but Colorado's U.C.C. § 9-306(2) was amended to delete the words "by the debtor"); Farnum v. C.J. Merrill, Inc., 264 A.2d 150, 156 (Me. 1970) (U.C.C. § 9-306(1) has an independent meaning broad enough to include property received by anyone in exchange for collateral); Production Credit Ass'n v. Melland, 278 N.W.2d 780, 788 (N.D. 1979) (U.C.C. § 9-306 does not require that debtor receive proceeds); Community Bank v. Jones, 278 Or. 647, 676-77, 506 P.2d 470, 487 (1977) (under U.C.C. § 9-306, third party recipient of identifiable proceeds is liable to holder of perfected security interest); Baker Prod. Credit Ass'n v. Long Creek Meat Co., 266 Or. 643, 650-51, 513 P.2d 1129, 1132-33 (1973) (identifiable proceeds are subject to perfected security interest even though they are paid to a third party and not to the seller or debtor); see also R. HENSON, HANDBOOK ON SECURED TRANSACTIONS § 6-1, at 197-98 (1979) (continuing security interest in identifiable proceeds should be recognized even though the proceeds are not received by the debtor); Nickles, supra note 18, at 856-70 ("If the secured party could have reached the original collateral in the hands of the transferee, it seems logical that he should be able to reach the proceeds of that property."). See also American East India Corp. v. Ideal Shoe Co., 400 F. Supp. 151, 167-68 (E.D. Pa. 1975) (security interest not protected if collateral is a contract right and the proceeds resulting from the performance of the contract are not received by the debtor); Get It Kwik of Am., Inc. v. First Ala. Bank, 361 So. 2d 568, 572 (Ala. Civ. App. 1978) (under Article 9, proceeds include the amounts received by the debtor from the sale of collateral, but not the amount received by the debtor's transferee upon a subsequent sale of the collateral); Beneficial Fin. Co. v. Colonial Trading Co., 81 York Legal Rec. 87, 88, 43 Pa. D. & C.2d 131, 132, 4 U.C.C. Rep. Serv. (Callaghan) 672, 673 (Pa. Ct. C.P. 1967) (secured party has no right of action in assumpsit against the purchaser.
cured party for conversion. Although these cases are significant, they do not resolve two more fundamental issues: whether the buyer of collateral who pays someone other than the debtor-obligor is liable for conversion of proceeds and whether property given in exchange for the original collateral can be proceeds to which a security interest is attached while the immediate buyer is transferring it.

If the Nebraska court’s answer to the latter question in *Terra Western* is correct,\(^1\) buyers of collateral who pay someone other than the secured party will in some cases completely escape liability for conversion with respect to both the original collateral and its proceeds. This result may be preferable when the buyer’s liability for converting the original collateral is predicated solely on his purchase of the property when the debtor was in default. In this rare case, the buyer arguably has not unlawfully converted the original collateral simply by purchasing it.\(^2\) It seems incongruent to decide that, nevertheless, he should be liable for converting the proceeds for performing his obligations under a contract of sale by paying the purchase price to someone other than the secured party. Because of this incongruity, protecting the buyer in such a case from conversion liability with respect to proceeds may be a desirable result. Protecting the buyer completely from conversion liability also seems a good result when the purchaser takes the original collateral free from the security interest because either the secured party authorized the disposition or for some other reason the buyer has priority over the secured party. Considering that the buyer does not convert the original collateral under these circumstances no matter what he does with it,\(^3\) holding him liable for converting proceeds simply because he paid the purchase price to someone other than the secured party would be paradoxical and would tend to undermine the significance of his superiority over the secured party with respect to the original collateral.

Even if property can be proceeds to which a security interest attaches before receipt, section 9-318 may protect buyers from liability for converting proceeds. When goods are sold, an “account”\(^4\) arises, and the buyer becomes an “account debtor.”\(^5\) If the goods were collateral, the account arising from their sale is “proceeds,”\(^6\) and the

\(^1\) The court’s answer is discussed supra at text accompanying notes 145-48.

\(^2\) See supra text accompanying notes 55-81.

\(^3\) See supra text accompanying notes 41-45; authorities cited supra notes 42, 44.

\(^4\) “‘Account’ means any right to payment for goods sold . . . which is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance.” U.C.C. § 9-105. In some cases, when formalized extensions of credit are involved, the buyer’s obligation may take the form of “chattel paper.” See U.C.C. § 9-105(1)(b). The following analysis is equally applicable to either type of case.

\(^5\) “‘Account debtor’ means the person who is obligated on an account, chattel paper or general intangible.” U.C.C. § 9-105(1)(a).

\(^6\) “‘Proceeds’ are "whatever is received upon the sale . . . of collateral . . . ."
secured party is arguably an assignee of this account by virtue of a clause in the security agreement giving him an interest in proceeds, or by the application of section 9-306(2), which gives him such an interest by operation of law. Thus, the secured party is entitled to payment of the account.\textsuperscript{163} As an account debtor, however, the buyer of the goods "is authorized to pay the assignor [the seller of the goods who is usually the debtor-obligor] until the account debtor receives notification that the amount due or to become due has been assigned and that payment is to be made to the assignee [the secured party]."\textsuperscript{164} The filing of an Article 9 financing statement does not deprive an account debtor of this authority.\textsuperscript{165} Therefore, notwithstanding perfection of the security interest, the buyer can lawfully pay proceeds to the debtor in the absence of notice and demand for payment by the secured party.\textsuperscript{166} Admittedly, this analysis has some con-

\textsuperscript{163} See U.C.C. § 9-306(1). Because this payment is received upon the collection of an account which is proceeds, it can be characterized as the proceeds of proceeds. See U.C.C. § 9-306(1).

\textsuperscript{164} U.C.C. § 9-318(3).

\textsuperscript{165} Cf. Judah AMC & Jeep, Inc. v. Old Republic Ins. Co., 293 N.W.2d 212, 214 (Iowa 1980) (account debtor who paid its insured directly had no obligation to search court records to avoid liability to secured, but otherwise undisclosed, creditor); Bank of Salt Lake v. Corporation of the President of the Church of Jesus Christ of Latter-Day Saints, 534 P.2d 887, 889 n.1 (Utah 1975) (notification of assignment to account debtor's low-level clerical employee insufficient notice to subject account debtor to liability to secured creditor of assignor).


1982]
ceptual weakness. It is difficult, for example, to label a buyer an account debtor if he pays for goods at the time he purchases them. The natural tendency is to associate accounts only with deliberate extensions of credit for a measurable term. An account presumably exists, however, if for any length of time—no matter how short—the seller has an unsatisfied right to payment for goods sold. The definition of account provided by section 9-106 requires only that a right to payment exist, not that one have existed for any minimum duration. In virtually every sales transaction, including those involving identified goods sold for cash, there is a period—perhaps only an instant—during which the seller has a right to payment that precedes the actual tendering of the purchase price by the buyer. For this period, as brief as it may be, there is an account and, thus, an account debtor. It may also seem unnatural to consider the secured party an assignee of an account when his only claim to the property is to proceeds of original collateral. Some commentators have argued that section 9-318 applies only when intangibles have been expressly assigned as original collateral. But the principal purpose of this section is to give certain rights and protections to an obligor. His ability to use them as defenses to liability should not depend on the basis of the secured party's claim to the obligation.

Thus, the conceptual impediments to applying section 9-318 analysis to subordinate buyers prove to be superficial when carefully scrutinized. Whatever reluctance they may still engender should be overcome by the defensible results the theory can yield. A secured party who, before the buyer pays, learns of the sale of collateral, notifies the buyer of the security interest, and demands that payment be made to him, the secured party, rather than to the debtor deserves to be protected from adverse consequences of the buyer's response. A buyer who ignores this demand should not easily escape liability for converting proceeds even if he takes the original collateral free of the security interest; the application of section 9-318 can make it virtually impossible for the buyer to disregard the secured party’s instructions with impunity.

B. Withholding Proceeds From the Debtor and the Secured Party

A buyer of original collateral from the debtor-obligor may decide to withhold the purchase price, offsetting it against an obligation the debtor owes him. Under these circumstances, courts generally hold that the buyer is accountable to the secured party for proceeds of the original collateral even though no money has been transferred to the debtor or anyone else. Some courts theorize that the buyer's obli-

167. See supra note 169.
Enforcing Security Interests

TE GEORGE
WASHINGTON LAW REVIEW

Enforcement to pay the purchase price is proceeds in which the secured party has an interest. Like a buyer charged with misdirecting proceeds, the buyer might defend against a secured party's claim by arguing that no proceeds exist because neither the debtor nor anyone else received property in exchange for the original collateral. For at least two reasons, however, this argument cannot shield the buyer from liability; indeed, this buyer's argument is weaker than when it is employed by a buyer sued under a misdirection theory. First, property was received in the sense that a credit was applied in a way that benefited not only the debtor, but also the buyer: an obligation of the debtor's was satisfied, and the buyer was repaid. By offsetting the purchase price of the collateral for the benefit of himself and the debtor, the buyer essentially received the purchase price on behalf of both of them. Second, the proceeds claimed by the secured party take the form of an intangible "account," an entity that can never be received by anyone in the usual sense. Yet Article 9 expressly provides that upon the debtor-obligor's default (or sooner if the security agreement so provides), a secured party with an interest in an account may collect it directly from the account debtor.

The buyer is thus relegated to arguing that the right of setoff he exercised is superior to the secured party's interest in proceeds of the original collateral. Courts have routinely rejected this argument without thorough analysis, concluding that an Article 9 security interest in proceeds is superior to other creditors' rights of setoff. When presented with this issue, the Tenth Circuit cited decisions holding that a bank's common-law right of setoff does not permit it to appropriate funds in a depositor's account if they are identifiable proceeds of collateral in which a secured party claims a prior, perfected security interest.

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171. See U.C.C. § 9-106 and cases cited supra note 162.

172. U.C.C. § 9-502(1).

173. See First Nat'l Bank & Trust Co. v. Iowa Beef Processors, Inc., 626 F.2d 764, 770 (10th Cir. 1980); Imperial NH3, Div. of W. Farm Serv. v. Central Valley Feed Yards, Inc., 70 Cal. App. 3d 513, 520, 139 Cal. Rptr. 8, 11-12 (1977); South Omaha Prod. Credit Ass'n v. Tyson's, Inc., 189 Neb. 702, 705, 204 N.W.2d 806, 809 (1973).

174. For cases involving priority disputes between secured parties with interests in proceeds and banks asserting a common law right of setoff, see supra note 125.

175. See First Nat'l Bank & Trust Co. v. Iowa Beef Processors, Inc., 626 F.2d 764, 769-
a secured party claiming proceeds in a debtor's deposit account and a bank that debits the account to satisfy an obligation the debtor owes it. A security interest is generally valid against all creditors of the debtor unless Article 9 provides otherwise,\textsuperscript{176} and none of its priority rules explicitly subordinates a security interest in proceeds to a bank's common law right of setoff.\textsuperscript{177}

Arguably, however, Article 9 establishes priority for a buyer of collateral who withholds proceeds to satisfy a claim he has against the debtor. A buyer's obligation to pay for goods is an account,\textsuperscript{178} and, until that obligation is satisfied, the buyer is an account debtor.\textsuperscript{179} According to section 9-318(1), an account debtor can assert against the assignee of the account any defense or claim arising from the terms of the contract between the assignor and account debtor and "any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives notification of the assignment."\textsuperscript{180} Although this section does not in itself give an account debtor a self-help right of setoff that he can exercise at will, when an assignee initiates litigation against an account debtor, the defendant can raise the claims and defenses available under this subsection. Therefore, a buyer of collateral can in some cases credibly argue on the basis of section 9-318(1) that he has a legitimate right to withhold proceeds from a secured party to reduce an obligation owed to him by the debtor from whom he bought the original collateral.

Several issues must be resolved before deciding that section 9-318(1) applies to the withholding of proceeds. Initial questions of statutory construction are whether in this context the secured party is an assignee and the buyer an account debtor whose reason for withholding proceeds is based on a claim or defense that section 9-318(1) permits. Even if the subsection's language can be construed to apply to a purchase price setoff, a broader issue remains: whether it should be applied since this interpretation would give an unsecured

\begin{footnotes}
\item[176] U.C.C. § 9-201.
\item[177] This was the precise basis of the court's holding in Citizens Nat'l Bank v. Mid-States Dev. Co., 380 N.E.2d 1243 (Ind. Ct. App. 1978), in which a bank, asserting a right of setoff to a debtor's account, lost in a priority dispute with a secured party claiming funds in the account as proceeds. \textit{Id.} at 1248.
\item[178] See U.C.C. § 9-106 and cases cited \textit{supra} notes 162, 170.
\item[179] See U.C.C. § 9-105(1) (a), quoted \textit{supra} note 161.
\end{footnotes}
creditor priority over a secured party — a result that appears to conflict dramatically with Article 9's priority scheme in general and section 9-201 in particular.\textsuperscript{181} In holding that a buyer of collateral cannot withhold the purchase price from a secured party, the Court of Appeals for the Fourth District of California reasoned that "[a]n unsecured creditor should not prevail over a prior secured creditor simply because he purchased the collateral. Since an unperfected security interest is subordinate to a prior perfected security interest, it follows that an unsecured creditor is subordinate to a creditor having a perfected security interest."\textsuperscript{182} This reasoning, however, ignores the possible effect of section 9-318(1) as a priority rule in itself. It also fails to consider that if, after selling goods or services, a debtor assigns the resulting account or chattel paper to a secured party, or if the secured party otherwise claims the account not merely as proceeds but as original collateral, the secured party's right to collect it will almost certainly be subject to the offsetting claims and defenses of the buyer-account debtor under section 9-318(1).\textsuperscript{183} The section should provide similar protection to an account debtor whose offsetting of the purchase price is challenged as interfering with a secured party's right to proceeds, for his ability to assert claims and defenses should not depend on the basis of the secured party's claim to the obligation he seeks to enforce.

Whether a buyer of collateral withholding the purchase price is protected by section 9-318 from a claim for proceeds will often be irrelevant, however. In many cases, the buyer will be liable for having converted the original collateral if he resells the property or refuses a demand for its return.\textsuperscript{184} A buyer in such a case cannot rely on sec-

\textsuperscript{181} U.C.C. § 9-201 provides in part that "a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors." The effect of this section as a rule of priority is described supra note 177.

\textsuperscript{182} Imperial NH3, Div. of W. Farm Serv. v. Central Valley Feed Yards, Inc., 70 Cal. App. 3d 513, 520, 139 Cal. Rptr. 8, 11-12 (1977) (citations omitted).


These cases recognize, pursuant to U.C.C. § 9-318(1), the right of an account debtor to raise against an assignee of the account any defense or claim, including a set-off, that the account debtor may have against the assignor.

\textsuperscript{184} See supra text accompanying notes 40-55.
tion 9-318 for protection because his liability is not based on an obligation to pay an account but rather on his handling of the collateral. Only if the buyer's alleged wrong is solely withholding proceeds can he escape liability completely or partially through section 9-318(1), which appears on its face to provide in some cases for a setoff against a secured party's claim.

V. Conclusion

A secured party is entitled to possession of the collateral upon the debtor's default so that he can dispose of the property and apply the proceeds of the disposition to satisfy the obligation owed him, and he can enforce this right against subordinate buyers of the collateral. If a buyer is unwilling or unable to return the property, the secured party can in many cases recover damages for conversion of the collateral. The basis of the buyer's conversion liability is not simply his purchase of the collateral; liability arises only when the buyer's conduct seriously interferes with the secured party's superior rights. The extent to which a buyer's conduct frustrates the secured party's efforts to take possession of the property should be a paramount consideration when judging the seriousness of the buyer's interference. This reasoning can help to justify the many cases holding that a buyer unlawfully converts collateral if he himself disposes of the property or refuses the secured party's demand for its return.

Another justification for holding a buyer liable when he resists repossessing the collateral or disposes of the property is that such conduct can substantially delay the secured party's ultimate recovery and disposition of the property. Delay increases the likelihood that the collateral's value will diminish to the extent that if the secured party eventually recovers the property, he will be unable to satisfy fully the secured debt with the proceeds of the collateral's disposition. The significance of a secured party's priority would be undermined if a subordinate buyer were allowed to escape liability for conduct tending to produce this result. Delay does not always result from a buyer's reselling collateral, however, because the property may remain readily accessible to the secured party and easily recoverable intact from the ultimate transferee. Under these circumstances, the reselling buyer arguably is not liable for conversion because his resale of the collateral has no significant adverse effect on the secured party's rights. In this case as in virtually all others where conversion is alleged, the defendant's liability should be judged on the basis of the consequences of his conduct, not simply by its nature.

When conversion liability is imposed on a buyer, he becomes accountable for the value of the property at the time of his unlawful act; in essence, the buyer becomes a surety for this amount not to exceed the value of the secured party's interest in the property. This is a sensible and fair measure of damages because to constitute conversion, the buyer's conduct with respect to the collateral will ordinarily have threatened the property's value and consequently the creditor's security. Having priority over a subordinate buyer therefore means
that despite the debtor's sale of the collateral, the obligation he owes the creditor remains secured by the property itself and by its proceeds, which the secured party can recover with or without judicial action. It also means that after the sale, the obligation becomes insured by the buyer's personal liability to the extent of the property's value, should his conduct with respect to the collateral amount to an unlawful conversion of it and, in some cases, by the buyer's accountability for proceeds of the collateral.