BUYER IN ORDINARY COURSE OF BUSINESS UNDER ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE* (AND RELATED MATTERS)

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A security interest in inventory[1] held for sale is, to a certain extent, a vulnerable security interest. For when the debtor, who is a dealer, sells an item of the inventory, the security interest is usually discontinued as to that item, under the provisions of article 9 of the Uniform Commercial Code:[2] either because the sale was authorized by the secured party[3] or because the sale was to a "buyer in ordinary course of business" under section 9-307(1).

Thus, the protective value of "perfection"[4] of a security interest in inventory held by the debtor for sale is subject to such an important qualification that the term "semi-security" may be appro-

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1. "Inventory" is defined in section 9-109 of the Uniform Commercial Code:

> Goods are
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> . . . .
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> (4) "inventory" if they are held by a person who holds them for sale or lease or to be furnished under contracts of service or if he has so furnished them, or if they are raw materials, work in process or materals used or consumed in a business. Inventory of a person is not to be classified as his equipment.

UNIFORM COMMERCIAL CODE § 9-109 [hereinafter cited as CODE], (unless otherwise specified all sections referred to in this article are sections of the 1962 version).

2. The Uniform Commercial Code has been enacted in all states but Louisiana. Article 9 covers security interests in personal property and fixtures, with the exclusions of section 9-104. In 1972 the sponsoring bodies recommended enactment of substantial revisions to Article 9. Throughout this article, references are to the 1962 version, unless otherwise indicated, but cognizance may be taken of 1972 recommended changes. Enactment of the 1972 version would have little impact upon the themes of this article.

3. CODE § 9-306(2).

4. Perfection of a security interest is usually achieved by the filing of a proper financing statement in the proper place or places. *See* CODE §§ 9-302, 9-401-404.

priate: the security interest remains good against the debtor himself and various third party claimants, including the debtor's trustee in bankruptcy, should he appear on the scene, but not good against certain bona fide purchasers—the authorized buyer or the buyer in ordinary course of business.

Section 9-307(1), of the Uniform Commercial Code provides:

> A buyer in ordinary course of business (subsection (9) of Section 1-201) other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence.[5]

So, enter the "buyer in ordinary course of business," one of the favorites in the dramatis personae of the UCC. He takes his place beside the holder in due course of negotiable instruments,[6] the bona fide purchaser of negotiable documents,[7] the bona fide purchaser of investment securities,[8] the bona fide purchaser of chattel paper,[9] and others in a select circle of bona fide purchasers of certain kinds of property who are privileged characters. Buyer in ordinary course of business is the goods-purchasing counterpart. While no two characters in the group are quite the same, they have in common the fact that they all acquire rights better than the rights of some kinds of claimants who did not authorize the transfer.

"Buyer in ordinary course of business" is defined in section 1-201(9):

> Buyer in ordinary course of business means a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. "Buying" may be for cash or by exchange of other property or on secured or unsecured

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5. The 1972 Amendments to section 9-307 add to subsections (1) and (2) a new subsection (3):

> A buyer other than a buyer in ordinary course of business (subsection (1) of this section) takes free of a security interest to the extent that it secures future advances made after the secured party acquires knowledge of the purchase, or more than 45 days after the purchase, whichever first occurs, unless made pursuant to a commitment entered into without knowledge of the purchase and before the expiration of the 45 day period.

CODE § 9-307(3) (1972 version). This provision applies to buyers not in ordinary course of business. The buyer in ordinary course of business needs no such provision: He takes free. No changes are made in section 9-307(1) by the 1972 Amendments.

6. CODE § 3-302.
7. *Id.* § 7-501(4).
8. *Id.* § 8-302.
9. *Id.* § 9-308.

> credit and includes receiving goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.[10]

Thus a special kind of bona fide purchaser of goods is described—he must buy "in good faith" (naturally) and "in ordinary course" (whatever that means) "from a person in the business of selling goods of that kind."

As section 1-201(9) makes clear, buying may be for cash or on secured or unsecured credit. It matters not. The buyer takes free of the security interest created by the seller in the collateral which is the subject of sale. However, if the sale is on secured credit, the party with the security interest created by the seller acquires under section 9-306 a compensatory proceeds security interest in the "chattel paper," which includes the security interest created by the buyer. Again, if the sale is on unsecured credit, the party with the security interest created by the seller acquires under section 9-306 a compensatory proceeds security interest in the "account," *i.e.*, the buyer's personal obligation.[11] At least under the 1972 version of section 9-203 it is not necessary that the security agreement expressly provide for rights in proceeds.

If, on the other hand, the sale is for cash, the secured party has no claim against the buyer in ordinary course of business; he must look to the seller only for satisfaction.

Protecting a buyer who takes in a sale which was authorized by the secured party needs no explanation. Protecting a buyer who takes in an unauthorized sale but who is a buyer in ordinary course of business rests on principles of justice and utility. The

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10. The 1972 amendments add: "All persons who sell minerals or the like (including oil and gas) at wellhead or minehead shall be deemed to be persons in the business of selling goods of that kind." *See* CODE § 9-103(5) (1972 version).

11. The buyer becomes the "account debtor" to the secured party with the proceeds security interest. Where the security interest in proceeds is perfected section 9-306(3) prevents section 9-301 claimants from subordinating the security interest. *See* Security Nat'l Bank v. Olins of New York, Inc., 4 UCC REP. SERV. 965 (N.Y. Sup. Ct., Nassau Cty. 1968). (Section 9-306(3) is changed by 1972 amendments in various ways).

However, the inventory secured party should bear in mind that if it comes to questions of priority between his proceeds security interest in proceeds-collateral and a conflicting original security interest in the same collateral, he may not fare well. *See* CODE § 9-312(3) (1972 version). The 1972 version makes it explicit that he may have special priority in cash proceeds only. For a discussion of the situation under the 1962 version, see KRIPKE, BRAUCHER, COOGAN, GILMVRE & HAYDOCK, PROBLEMS OF LENDERS, BORROWERS AND SELLERS UNDER THE UNIFORM COMMERCIAL CODE 83 (1968) [hereinafter cited as PROBLEMS OF LENDERS, BORROWERS AND SELLERS]. *See also* CODE § 9-308, which subordinates the proceeds security interest in chattel paper to an original security interest in the chattel paper, under the conditions set forth therein.

collateral involved, the inventory, is of such kind that the debtor's ability to dispose of it in the usual course of business may be important so that he may continue his business as a going concern, and, let us hope, pay his indebtedness to the secured party. These considerations may go so far as to suggest that the secured party should, and perhaps did, authorize his debtor to sell. But even if this is not so—the security agreement, for example, may speak to the contrary—the secured party who permits a dealer to have possession of the collateral, runs the risk that a buyer taking from the dealer, and reasonably supposing that the sale to him is in order, may qualify as a "buyer in ordinary course of business," even if he knows of the existence of the security interest.

Further, there may be a simple public policy favoring the safeguarding of sales transactions over the safeguarding of secured transactions in this case. The result is especially appealing where the buyer is an uninformed retail consumer buyer.

In the normal course of affairs, the seller-dealer will properly account to his secured party for disposition of the collateral. But whether he does or doesn't is of no concern to the buyer in ordinary course of business. The seller-dealer may abscond with the proceeds; he may divert them or deplete them; still the buyer in ordinary course of business is protected under section 9-307(1). It is the secured party who takes the risk of the Wheeler-Dealer.

In the master plan of article 9, the question whether a buyer attains the status of buyer in ordinary course of business usually involves the application of section 9-307(1). Much of the discussion that follows, therefore, will focus on the application of this section and its limitations. However, buyer in ordinary course of business status under article 9 may be important to the solution of other problems. Thus this discussion will consider the relationship of section 9-307(1) to cases arising in the context of the following: section 2-403(2); motor vehicle title laws; transfer of goods by documents of title; and section 9-307(2). Then security interests in "farm products," expressly excluded from the operation of section 9-307(1), will be examined. Finally, we shall consider how the contest between a dealer's wholesale and retail financers over rights in chattel paper may depend upon the status of the buyer who signed his name to the chattel paper.

I. BUYER IN ORDINARY COURSE OF BUSINESS UNDER SECTION 9-307(1)

A. Background

The comment to section 9-307(1) cites as "prior uniform statutory provisions" section 9 of the Uniform Conditional Sales Act, and section 9(2) of the Uniform Trust Receipts Act[12] and states "policy

12. The Uniform Conditional Sales Act (UCSA) dealt with conditional

of prior acts continued."

Section 9 of the Uniform Conditional Sales Act had provided:

> When goods are delivered under a conditional sale contract and the seller expressly or impliedly consents that the buyer may resell them prior to the performance of the condition, the reservation of property shall be void against purchasers from the buyer for value in the ordinary course of business, and as to them the buyer shall be deemed the owner of the goods, even though the contract or a copy thereof shall be filed according to the provisions of this Act.[13]

On its face, this provision of the Uniform Conditional Sales Act does not seem to go as far as section 9-307(1) since section 9-307(1) does not require a finding that the secured party expressly or impliedly consented to sale of the collateral by the debtor. However, the Commissioners' Notes to section 9 of the Uniform Conditional Sales Act go further than the text and establish its antecedent relationship to section 9-307(1): "That the goods have been put into the retailer's stock with the consent of the wholesaler [the secured seller] is conclusive evidence that they are there for sale and that the retailer has title or the right to convey."[14] This idea

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sales of goods transactions that are the type of purchase money security interest now described in section 9-107(a) of the Code and not secured lending transactions. Section 9 of the UCSA was concerned with conditional sales for resale—most especially conditional sales of inventory. The Uniform Trust Receipts Act (UTRA) was chiefly concerned with secured financing by lenders of a dealer's acquisition of inventory—the type of purchase money security interest now described in section 9-107(b) of the Code. It had no application to security interests retained by sellers. These compartmentalizations are typical of the fragmentized state of the law of security interests in personal property before the enactment of Article 9. UCSA and UTRA did not occupy the entire area of security interests in inventory. Some transactions, for example, were governed by the law of pledge and chattel mortgage, and Factor's Lien Acts had been widely enacted in pre-Code days.

13. This provision may be viewed as an antecedent of section 9-306(2) of the Code, insofar as both sections stress the secured party's express or implied consent. But beyond the common base of implied or express consent, section 9 of UCSA and section 9-306(2) go different ways. The theme of section 9 UCSA is the rights of a "purchaser for value in the ordinary course of business;" as to him, implied or express consent means that the "buyer shall be deemed the owner of the goods." The Commissioners' Notes state that the term does not include a mortgagee or pledgee of the goods; that, in effect, only a "buyer" can qualify as taking in the ordinary course of business—(though section 1 defines "purchaser" to include mortgagee and pledgee). The effect of implied or express consent upon the conditional seller's rights in other situations presumably depends upon general principles of the law of agency, waiver and estoppel. Section 9-306(2) of the UCC, on the other hand, states a broader statutory rule: it is implied that *any* "disposition" of the collateral by the debtor to which the secured party has expressly or impliedly consented results in the discontinuance of the security interest in favor of the authorized transferee.

14. 2 U.L.A. *Conditional Sales* 16 (1922).

was illustrated in *Savage v. Pratt*,[15] where the Wisconsin Supreme Court held for the conditional seller of a juke box against a subvendee because the evidence fell short of establishing that the buyer, who was in the business of selling TV sets, was also in the business of selling juke boxes. Section 9 was viewed as resting on common law principles of estoppel, which would preclude a conditional seller from asserting his title against a subvendee, if the seller knew of his buyer's intent to resell or if he had "constructive notice" of such intent through knowledge that the buyer was in the business of selling goods of that kind.

The idea that a "buyer in ordinary course of trade" should take free of a security interest in inventory was also contained in the Uniform Trust Receipts Act—an inventory-lender's act and not a conditional seller's act.[16]

Section 9-2 of the Uniform Trust Receipts Act was a direct antecedent of section 9-307(1). Section 9-2(a) provided:

> (i) Where the trustee [i.e., the debtor], under the trust receipt transaction, has liberty of sale and sells to a buyer in the ordinary course of trade, whether before or after the expiration of the thirty day period specified in Subsection 1 of Section 8 of this act, and whether or not filing has taken place, such buyer takes free of the entruster's [i.e., the lender's] security interest in the goods so sold, and no filing shall constitute notice of the entruster's security interest to such a buyer.
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> (ii) No limitation placed by the entruster on the liberty of sale granted to the trustee shall affect a buyer in the ordinary course of trade, unless the limitation is actually known to the latter.

Section 9-2(c) provided:

> (c) Liberty of Sale. If the entruster consents to the placing of the goods subject to a trust receipt transaction in the trustee's stock in trade or in his sales or exhibition rooms, or allows such goods to be so placed or kept, such consent or allowance shall have like effect as granting the trustee liberty of sale.

Thus section 9-2(c) of the Uniform Trust Receipts Act made explicit what was at best only implicit in section 9 of the Uniform Conditional Sales Act: If the lender consented to the debtor's

15. 272 Wis. 170, 74 N.W.2d 635 (1956).

16. Section 1 of UTRA provided:

"Buyer in the ordinary course of trade" means a person to whom goods are sold and delivered for new value and who acts in good faith and without actual knowledge of any limitation on the trustee's liberty of sale, including one who takes by conditional sale or under a pre-existing mercantile contract with the trustee to buy the goods delivered, or like goods, for cash or on credit. "Buyer in the ordinary course of trade" does not include a pledgee, a mortgagee, a lienor, or a transferee in bulk.

placing trust receipted goods in his stock in trade, the lender risked loss of his security interest to a buyer in ordinary course, regardless of restrictions on sale set forth in the security agreement, by virtue of the concept of "liberty of sale."

These provisions did not spring full grown from the head of Zeus. Rather, they represented an outgrowth of what some would call the best of the common law. Without the aid of statute some courts were becoming increasingly impatient with the equivocal conduct of a party who held a security interest in inventory under a security agreement providing that the debtor-dealer was not to sell without the secured party's prior consent, but who at the same time knew that the dealer intended to exhibit for sale and probably sell the inventory without contacting the secured party in advance.[17] The limitation on sale in the security agreement might be invoked by the secured party only if the dealer did not pay up. Section 9-2(c) of the Uniform Trust Receipts Act was hardly a radical innovation.

B. The Coverage of Section 9-307(1)

1. SECURITY INTEREST MUST BE CREATED BY BUYER'S SELLER

Section 9-307(1) is concerned solely with security interests *created by the seller who sells* to a buyer in ordinary course of business. Security interests in the goods created by someone other than the seller are not affected by section 9-307(1).

EXAMPLE

A sells to *B*, a retail buyer, on credit and by a written and signed security agreement reserves a security interest in consumer goods perfected without a filing under section 9-302(1)(d). *B* without authority from *A* subsequently sells the chattel to *C*, a dealer in goods of that kind. *C* sells to *D*, a retail buyer. Though *D* may qualify as a buyer in ordinary course of business, he is not protected from *A* by section 9-307(1).[18]

The phrase "created by his seller" is a key limitation upon the operation of section 9-307(1) that cannot be easily manipulated or interpreted away. It represents a basic decision to confine the

17. *See* Bordman Inv. Co. v. People's Bank, 320 S.W.2d 72, 76 (Mo. App. 1958).

18. As to whether *D* is protected by section 9-307(2) *see* National Shawmut Bank v. Jones, 108 N.H. 386, 388, 236 A.2d 484, 4 UCC REP. SERV. 1021, 1024 (1967); *infra* notes 126-148 and accompanying text. But where, known to the secured party, the debtor and the seller are alter egos, as where the seller is a company wholly owned by the debtor and customarily selling the debtor's goods, the secured party is precluded from asserting his interest against one buying in ordinary course of business from the seller. United States v. Hext, 444 F.2d 804, 814; 9 UCC REP. SERV. 321, 336 (5th Cir. 1971).

loss-of-right principle to a case where some responsibility may be assigned to the secured party because it was *his* debtor who sold to the buyer in ordinary course of business.[19] It matches in this respect the entrustment provisions of section 2-403(2) and (3),[20] and is also consistent with the loss-of-right provisions of section 7-205.[21]

In one situation, the term "created by his seller" can be confusing.

(1) Suppose *A*, a dealer, sells to *B*, a retail buyer, on time, and the conditional sales contract provides that *A* "retains" a security interest (to use the language of section 9-107(a)) in the goods until *B* pays in full. Question: who "created" the security interest, *A* or *B*? Answer: *B*, the debtor. Without his signature, there would be no enforceable security interest.[22]

(2) Then suppose *A* assigns the conditional sales contract to *C*, a finance company. As assignor, *A* is the debtor in the chattel paper transaction,[23] which includes the assignment of the security interest in the goods. Suppose, on *B*'s default, *A* comes into possession of the goods and resells to *D*, a buyer in ordinary course of business. Does *D* take free of *C*'s acquired security interest in the goods?

If we relied solely on section 9-307(1), with its language "created by his seller," we would be faced with a conundrum. It was *B* who created the security interest in the goods, but it was *A*, the dealer who resold, who created the security interest in the chattel paper which gave *C* the security interest in the goods. The conundrum is resolved by section 9-306(5). *A* is in possession of returned or repossessed goods. Section 9-306(5)(b) provides that where the debtor in a chattel paper transaction acquires returned or repossessed goods, "an unpaid transferee of the chattel paper has a security interest in the goods *against the transferor*," by operation of law (emphasis is supplied). Thus, if *A* resells to *D*, the sale strips *C* of his security interest in the car, since it was, by operation of section 9-306(5)(b), "created" by *A*.[24]

19. In an opinion subsequently withdrawn, this limitation was overlooked, and error was committed. Osborn v. First Nat'l Bank, 6 UCC REP. SERV. 1106 (Lincoln Cty. Ct. Okla. 1969), *opinion withdrawn*, 472 P.2d 440, 7 UCC REP. SERV. 908 (Okla. 1970).

20. *See* notes 85-100 *infra* and accompanying text.

21. *See* notes 111-119 *infra* and accompanying text.

22. CODE § 9-203.

23. *Id.* § 9-105(1)(d).

24. In General Electric Credit Corp. v. Western Crane and Rigging Co., 184 Neb. 212, 166 N.W.2d 409, 6 UCC REP. SERV. 67 (1969), a dictum suggested: "If the UCC were applicable to a case in which A made a conditional sale of a truck crane to B, assigning its interest to C, and thereafter B delivered the crane to A for repair and repaint and A sold the crane to D, a buyer in the ordinary course of business, D would prevail over C's security interest." (as summarized in syllabus). *Id.* at 212, 166

Section 9-306(5)(d) provides that "a security interest of an unpaid transferee asserted under paragraph (b) or (c) must be perfected for protection against creditors of the transferor and purchasers of the returned or repossessed goods." This contemplates a filing *as to the goods* naming the dealer as debtor. But under section 9-307(1) or section 2-403(2)[25] such filing will still not protect *C*, the chattel paper assignee, against *D*, if *D* is a buyer in ordinary course of business.[26]

Another situation where the term "created by his seller" may cause problems arises when a dealer sells the goods of another. For example, where goods are entrusted to a dealer by the owner for purposes of sale and the dealer sells as agent for his undisclosed principal, this may have consequences in determining whether buyer takes free of a security interest created by the principal.[27]

N.W.2d at 409, 6 UCC REP. SERV. at 67. Since in the case posited A has the goods for repair and is probably not in the role of having returned or repossessed goods within the meaning of section 9-306(5), the dictum is questionable. An Editor's Note to the case as printed in 6 UCC REP. SERV. at 67 remarks, "Section 9-307(1), which the court cites, provides that a buyer in ordinary course of business 'takes free of a security interest created by his seller.' Query whether plaintiff's security interest was 'created by' Fingham [A] within the meaning of this section."

25. For a discussion of CODE § 2-403(2) see notes 85-100 *infra* and accompanying text.

26. A riddle for the reader: Section 9-306(5) deals with the continuance of a security interest in returned or repossessed merchandise coming into the possession of a debtor who is a dealer. The original security interest involved may be that of a party secured as to a debtor's inventory, or as to his accounts or chattel paper. Point 4 of the comment to section 9-306 states:

> In cases of repossession by the dealer and also in cases where the chattel was returned to the dealer by the voluntary act of the account debtor, the dealer's position may be that of a mere custodian; he may be an agent for resale, but without any other obligation to the holder of the chattel paper; he may be obligated to repurchase the chattel, the chattel paper or the account from the secured party or to hold it as collateral for a loan secured by a transfer of the chattel paper or the account.
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> If the dealer thereafter sells the chattel to a buyer in ordinary course of business in any of the foregoing cases, the buyer is fully protected under Section 2-403(2) as well as under Section 9-307(1), whichever is technically applicable.

Quaere: When is which "technically applicable?" *See* Osborn v. First Nat'l Bank, 472 P.2d 440, 442, 7 UCC REP. SERV. 908 (Okla. 1970); Commercial Credit Corp. v. Associates Discount Corp., 246 Ark. 116, 436 S.W.2d 809, 6 UCC REP. SERV. 82 (1969).

27. In Godfrey v. Gilsdorf, 86 Nev. 714, 476 P.2d 3, 8 UCC REP. SERV. 316 (1970), one Godfrey, owning a car subject to Commercial Credit's perfected security interest, delivered the car to a used car dealer for sale, and the dealer sold it, without turning over the proceeds to Godfrey. Godfrey subsequently paid off Commercial Credit, and refused to indorse the title certificate to the buyer, and then sued to obtain possession from the

2. NOT APPLICABLE IF SECURED PARTY AUTHORIZES SALE

Section 9-307(1) is unnecessary if the case is covered by section 9-306(2).[28] Section 9-306(2) provides:

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buyer. The buyer won. The opinion observed:

> When the used car dealer sold the Toyota to Gilsdorf, the Commercial Credit Corporation enjoyed a perfected security interest in the vehicle, to wit, legal title. At this point, the purchaser, under the entrustment provisions of NRS 104.2403(2), *acquired only the rights of the entruster-seller subject to the security interest of Commercial Credit.* [emphasis supplied] At least, such appears to be the case if we look only to 104-2403(2). However, sections of the U.C.C. found elsewhere, particularly 104.2103(1)(d) defining 'seller,' and 104.9307 [section 9-307(1)] of Article 9, may be construed to mean that the buyer took the car free of the perfected security interest of Commercial Credit. We need not resolve this problem in the case at hand since the seller, Godfrey, paid off his debt to Commercial Credit, and acquired the ownership certificate before filing suit. Thus, we are concerned only with the propriety of applying an estoppel against the seller to achieve the purposes of 104.2403(1)(3).

Id. at 718, 476 P.2d at 6, 8 UCC REP. SERV. at 319. Under the facts, the dealer was in the role of agent for an undisclosed principal (Godfrey), though the buyer no doubt supposed the dealer was the real owner. One cannot quarrel with the conclusion that Godfrey was the seller; this being the case, Commercial Credit's security interest was created by "his seller" in the language of section 9-307(1). And the dealer was "in the business of selling goods of that kind." Tying the two together, the buyer bought from one in the business of selling goods of that kind (the dealer-agent) and the real seller (the undisclosed principal) created the security interest. However, the buyer probably still does not come within the section 1-201(9) (and so section 9-307(1)) because in reality he did *not* buy from the dealer, but rather from Godfrey, who was not "in the business." A nice question which, if answered as the opinion suggests, would put all security interests in consumer goods in great jeopardy.

28. *See* Pieper v. First Nat'l Bank, 453 S.W.2d 926, 930, 7 UCC REP. SERV. 858, 863 (Mo. 1970); First Fin. Co. v. Akathiotis, 110 Ill. App. 2d 377, 380, 249 N.E.2d 663, 665, 6 UCC REP. SERV. 946, 948 (1969); Farnum v. C.J. Merrill, Inc., 264 A.2d 150, 152, 7 UCC REP. SERV. 625, 629 (Me. 1970).

An inventory security agreement may expressly authorize sale to a "buyer in ordinary course of business." Thus, in Sterling Acceptance Co. v. Grimes, 194 Pa. Super. 503, 168 A.2d 600, 1 UCC REP. SERV. 487, 489 (1961) a trust receipt security agreement was involved which provided:

> Debtor further agrees to hold the Goods for the sole purpose of processing or preparing them for sale, and of selling them; . . . that its right to sell any item of Goods is limited to a sale to a buyer in the ordinary course of business and for a price not less than the then unpaid balance of the Note which is applicable to said item; that on the same day Debtor sells any such item, (i) it will pay Co. an amount equal to the then unpaid principal balance of the Note applicable to the item, or (ii) if Co. requests, it will turn over to Co. the proceeds of sale, in precisely the form received, and transfer the same to Co. . . . . In addition to all rights provided for herein Co. shall have rights with respect to the goods, and the proceeds thereof, which are provided for in the Uniform Commercial Code (Pa.).

In determining the rights of the buyer, the opinion relied on section 9-307(1), and not section 9-306(2), perhaps because the lender by retaining possession of a title certificate on which its security interest was noted

> Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof by the debtor . . . .[29]

An obvious, important exception follows: "[U]nless his action was authorized by the secured party in the security agreement or otherwise . . . ."

Under this proviso, it is not necessary that the buyer qualify as a buyer in ordinary course of business; it is not necessary that the debtor be in the business of selling goods of that kind. As Point 2 to Comment to section 9-307(1) brings out:

> The limitations which this section imposes on the persons who may take free of a security interest apply of course only to unauthorized sales by the debtor. If the secured party has authorized the sale in the security agreement or otherwise, the buyer takes free without regard to the limitations of this section. Section 9-306 states the right of a secured party to the proceeds of a sale, authorized or unauthorized.[30]

If the sale of the collateral was "authorized" by the secured party, and section 9-306(2)'s proviso discontinues the security interest, that is the end of the matter.[31] However, section 9-306(2) does not state under what circumstances the sale will be found to have been "authorized." Sale may be "authorized by the security party in the security agreement or otherwise"—for example, by course of dealing or usage of trade, at least if not inconsistent with the terms of the security agreement.[32] Suppose the secured party says

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manifested its intention that the buyer should not receive a clear title certificate until the lender was paid by the dealer.

29. Priority between conflicting security interests in the same collateral is governed by section 9-312 and related sections. Section 9-312(5)(a) gives the normal priority rule: where conflicting security interests are both perfected by filing, the first-to-file has priority, even though it may not be the first perfected. *See* CODE § 9-312. The 1972 amendments, by eliminating section 9-312(5)(b), make first-to-file even more important. *See* CODE § 9-312(5) (1972 version).

30. Except for deleting the statement "Policy of prior acts continued (subsection 1)," the comments to the 1972 version of section 9-307(1) are the same as the 1962 comments.

31. However, a court might play it both ways, holding, in effect, that under given facts a buyer was protected as buying in a sale authorized by the secured party, or under section 9-307(1). McFadden v. Mercantile-Safe Deposit & Trust Co., 273 A.2d 198, 8 UCC REP. SERV. 766 (Md. Ct. App. 1971).

32. *See* Garden City Prod. Credit Ass'n v. Lannan, 186 Neb. 668, 673, 186 N.W.2d 99, 103, 8 UCC REP. SERV. 1163, 1168 (1971); Clovis Nat'l Bank v. Thomas, 77 N.M. 554, 560, 425 P.2d 726, 730, 4 UCC REP. SERV. 137, 141 (1967). Section 9-306(2) may be viewed as containing a "codification of the common law of waiver" Swift & Co. v. Jamestown Nat'l Bank, 426 F.2d 1099, 1104, 7 UCC REP. SERV. 788, 794 (8th Cir. 1970). Section 9-306(2) and section 1-103 may be viewed as separate routes. *See* United States v. Greenwich Mill & Elevator Co., 291 F. Supp. 609, 613, 6 UCC REP. SERV. 965, 968 (N.D. Ohio 1968).

to the debtor: "Yes, you can sell *your* interest." Or, "you may sell the collateral, but I will not be bound by the sale, unless you remit the proceeds of sale to me." Or, "you may sell the collateral provided the buyer pays the proceeds directly to me."[33] Are the precise terms of the actual authority to govern, unless the conduct of the secured party, manifested to the buyer and inducing the buyer to rely, sets up an estoppel?

3. APPLICABLE TO PERFECTED AND UNPERFECTED SECURITY INTERESTS

Section 9-307(1) applies both to *perfected and unperfected* security interests created by the seller. In either case, the buyer in ordinary course of business takes free of the security interest. As to other buyers of goods: if the buyer is *not* in ordinary course of business other sections of the Code become applicable. If a security interest is *perfected* and the buyer is not in ordinary course of business, the security interest continues, unless the sale was authorized under section 9-306(2). If a security interest is *unperfected* and the buyer is not in ordinary course of business, section 9-301(1)(c) gives such buyer better rights than the secured party to the extent that the buyer gives value and takes delivery without knowledge of the security interest and before it is perfected. Section 9-301(1)(c) is, however, subject to section 9-301(2) which provides that if a transfer in bulk is made after the attaching of a purchase money security interest and before its perfection, the rights of the transferee in bulk may become subordinate to the rights of the secured party if the security interest is perfected by filing within ten days after the debtor comes into possession of the collateral.

4. PRIMARILY APPLICABLE TO INVENTORY

Does section 9-307(1) apply *only* to security interests in inventory? Until 1956 the subsection read:

> In the case of inventory, and in the case of goods as to which the secured party files a financing statement in which he claims interest in proceeds, a buyer in ordinary course of business takes free of a security interest even though perfected and even though the buyer knows of the terms of the security agreement.

In recommending that this language be changed, the Editorial Board for the Uniform Commercial Code stated:

> The former opening language has been omitted because the definition of "buyer in ordinary course of business" limits subsection (1) to inventory cases. The other changes are for clarification.[34]

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33. *See* Lisbon Bank & Trust Co. v. Murray & Meier, 206 N.W.2d 96, 12 UCC REP. SERV. 356 (Ia. 1973).

34. PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, RECOMMENDATIONS OF THE EDITORIAL BOARD FOR CHANGES IN THE TEXT AND

While the stated reason for change takes its place as part of the drafting history of section 9-307(1) and is material bearing on its interpretation, the stated reason is argumentative and not completely satisfying.

As to the suggestion that the definition of buyer in ordinary course "limits subsection (1) to inventory cases": it is true that subsection (9) of section 1-201 requires that the buyer buy from a "person in the business of selling goods of that kind," and such goods would normally be inventory of the seller. But there is no explicit language in this provision that requires that section 9-307(1)'s terms apply only to defeat *security interests in inventory*. Perhaps a distinction is in order.

EXAMPLE

S is in the business of selling new and used refrigerators. *S* buys from *X* a new refrigerator and gives *X* a security interest in that refrigerator to secure the balance of the purchase price. The security interest is perfected by filing. *S* buys the refrigerator for *use* in his business establishment. Thus, the security interest is in equipment under section 9-109(2). Without any authority from *X*, *S* later places this refrigerator in his stock and sells it to *B*, who takes in good faith and without knowledge that the sale to him is in violation of *X*'s security interest.

Now the fact that *S* placed this refrigerator in his stock means that as to *S* the refrigerator was inventory. But this does not change the status of *X*'s security interest—it remains a security interest in *equipment*.[35] Despite this, there appears to be no reason why section 9-307(1) should not protect the buyer in this case. The buyer seems to qualify as a buyer in ordinary course. He bought from one who was in the business of selling goods of that kind. Since the security interest was created by his seller, the way seems clear for a decision in his favor.[36]

COMMENTS OF THE UNIFORM COMMERCIAL CODE OFFICIAL DRAFT, TEXT AND COMMENTS EDITION 284 (UCC Editorial Bd. April 20, 1956) [hereinafter cited as RECOMMENDATIONS].

35. Semantics: At this point, there seems to be some confusion. While the position is taken that the security interest is still to be considered a security interest in equipment, there is little help from article 9 provisions. The definitions in section 9-109(2) and (4) do not clearly answer the question, as to whether goods originally held by a debtor as equipment should be treated as inventory when subsequently held by the debtor for sale without consent of the secured party. However, what we are concerned with here is not so much the classification of goods, but of security interests in goods, and the point sought to be made is that a security interest in equipment continues as such notwithstanding the debtor's subsequent placing of that item in his inventory. This view is compatible with section 9-401(3) which provides that the effectiveness of an original filing is not impaired by a change in the use of the collateral.

36. Since the facts suggest that *X* knew or should have known that he

The comment to section 9-307(1), tying into section 1-201(9), states that the section applies "primarily" to inventory. There can be no quarrel with that.

5. EXCLUDED TRANSACTIONS

For a variety of reasons certain transactions may not come under section 9-307(1). Where goods are covered by a document of title issued by a bailee in possession of the goods, there are special obstacles in the way of a person claiming protection under section 9-307(1). Situations involving documents of title require special treatment.[37]

Buyers of "farm products" taking from a person "engaged in farming operations" are not protected by section 9-307(1).[38] This problem will also be considered separately.

Additionally, section 9-307(1) cannot control, of course, where federal law is construed to protect a security interest from claims of the buyer in ordinary course of business.[39] For example, the Federal Aviation Act may be construed to deny protection to a person buying an airplane subject to a security interest properly recorded under the procedures authorized by that Act, although such buyer would have been protected if section 9-307(1) applied.[40]

Finally, the possibility must also be considered, as discussed below, that a state statute apart from the Uniform Commercial Code, *e.g.*, a motor vehicle title certificate act, may be construed to deprive the buyer of the protection of section 9-307(1) within the

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was taking a security interest from a debtor in the business of selling goods of that kind, there is no need to belabor the question whether such fact is essential to a decision for *B*. *Cf.* United States v. Hext, 444 F.2d 804, 9 UCC REP. SERV. 321 (5th Cir. 1971), where FHA had lent to a farmer who it knew was also the sole owner of a gin company which marketed cotton. The court held that FHA's security interest in the cotton, though given by the debtor as a farmer, should be treated as if it were given by the debtor as a gin company, so that section 9-307(1) should apply without the exception as to farm products. It was said:

> We think this situation is directly analogous to one where a secured party takes a security interest in goods purchased by the debtor as consumer goods or equipment, knowing the debtor to be in the business of selling goods of that kind, and the debtor then puts the goods in his inventory and sells them to a buyer in ordinary course. Professor Gilmore has suggested that in such situation the buyer should take free of the security interest under the provisions of § 9-307(1). We agree.

Id. at 814, 9 UCC REP. SERV. at 336.

37. *See* notes 109-125 *infra* and accompanying text.

38. *See* notes 149-186 *infra* and accompanying text.

39. The supremacy clause U.S. CONST. art. VI controls. Congress has not enacted the CODE as national legislation. Congress has, however, legislated it for the District of Columbia.

40. *See, e.g.*, Dowell v. Beech Acceptance Corp., 3 Cal. 3d 544, 550, 476 P.2d 401, 405, 91 Cal. Rptr. 1, 7, 8 UCC REP. SERV. 274, 279 (1970).

area covered by the separate statute.[41]

6. TO QUALIFY UNDER SECTION 9-307(1) BUYER MUST BE BUYER IN ORDINARY COURSE OF BUSINESS

To be protected by section 9-307(1), the buyer must qualify as a buyer in ordinary course of business as defined in section 1-201(9):

> Buyer in ordinary course of business means a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. "Buying" may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.[42]

a. Attainment of the status of "buyer"

To be a "buyer in ordinary course of business" a person must be a "buyer" of goods.[43] Not all "purchasers" of goods are buyers, and thus not all purchasers of goods are protected. For example, a secured party may be a "purchaser," as the term is used in the UCC, but would still not qualify as a buyer.

Buyer's Rights Prior to Delivery: Section 1-201(9) does not state when a particular person who contracts to buy goods becomes a "buyer" of goods. Although section 2-103(1)(a) defines "buyer" as "a person who buys or contracts to buy goods," this does not necessarily mean that an "executory buyer" qualifies as a "buyer in ordinary course of business," as soon as the contract for sale is made. Let us consider the case of the financing buyer, for he may have much at stake turning on the answer to this by no means academic question. Suppose *A* contracts to buy specified goods to be manufactured to his order by *B* and per contract makes progress payments to *B* as the fabrication of the goods proceeds. Sup-

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41. See notes 103-108 *infra* and accompanying text.

42. CODE § 1-201(9). For a careful presentation of the pre-Code background of Section 1-201(9) and a thoughtful analysis of its language, see 1 NEW YORK LAW REVISION COMM'N., STUDY OF THE UNIFORM COMMERCIAL CODE 227 (1955).

43. Buyer in ordinary course of business appears only in a goods transaction. But insofar as a construction contract involves the supplying of goods which are fixtures, perhaps a real estate owner paying the contractor may qualify as a buyer in ordinary course of business of fixtures bought by the contractor under a security agreement. *See* Leary & Rucci, *Fixing Up the Fixture Section of the U.C.C.*, 42 TEMP. L.Q. 355, 394 (1969).

pose C holds a prior perfected security interest in B's inventory (including goods in process). Timewise, when may A qualify as a buyer in ordinary course of business?

(a) as soon as the contract for sale is made?

(b) or, when the goods have been "identified to the contract" and the buyer acquires a "special property" under section 2-501?

(c) or, when title passes to the buyer under the terms of the contract?

(d) or only when the buyer receives delivery from the seller?

In *Chrysler Corporation v. Adamatic, Inc.*,[44] the Wisconsin Supreme Court considered the problem and held the financing buyer, Chrysler, who had obtained goods-in-process from the insolvent seller under a prejudgment writ of replevin, liable to a party with a perfected security interest in the seller's inventory. Why? Because, it was held, Chysler had not yet qualified as a buyer in ordinary course of business, and thus section 9-307(1) was inapplicable. This was so, the court ruled, because title to the goods had not passed to Chrysler. The court noted that the definitional language of section 1-201(9), "when reasonably construed, limits buying in ordinary course of business to those situations where a 'sale,' defined by section 402.106(1) as 'the passing of title from the seller to the buyer for a price,' has occurred."[45] The buyer may have had replevin rights under section 2-716, since the facts suggest that the goods were identified to the contract and "cover" was unavailable.[46] However, the opinion emphasized section 2-402(3)(a), which provides: "Nothing in this Article shall be deemed to impair the rights of creditors of the seller (a) under the provision

44. 59 Wis. 2d 219, 208 N.W.2d 97, 12 UCC REP. SERV. 849 (1973).

45. *Id.* at 239, 208 N.W.2d at 106, 12 UCC REP. SERV. at 863. The brief for Lakeshore Commercial Finance Corporation at 27, Chrysler Corp. v. Adamatic, Inc. *supra* (the inventory secured party) argues that:

> To sustain Chrysler's position, the statute would have to be amended to read as follows: "Buyer in ordinary course of business" means a *buyer* who in good faith and without knowledge that the *contract for sale with* him is in violation of the ownership rights or security interest of a third party in the goods buys *or contracts to buy* in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. "Buying" may be for cash or by exchange of other property or on secured or unsecured credit but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt." (indicating amendments possible.)

46. While the opinion questions whether the goods had been identified to the contract, the secured party seems to have conceded that they had been. The making and taking of progress payments dependent on stages of fabrication of specific goods in process would seem to imply an obvious identification by conduct of the parties.

of the Article on Secured Transactions . . . ."[47]

The opinion recognizes that the decision arrived at (judgment for secured party), though seemingly supported by scholarly writings,[48] seems harsh: "From the viewpoint of equity, this is an unsatisfactory result, for the record shows that, prior to the replevin, Chrysler had substantially paid the contract price for all the goods involved."[49] It further appears from the record that these progress payments had been turned over to the secured party. Nevertheless, Chrysler was held liable to the secured party for the entire value of the goods taken, without allowance for the previous payments.[50]

In holding that Chrysler had not attained the status of buyer in ordinary course of business, perhaps the court cannot be faulted.[51] But, one may be surprised that Article 2, with its

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47. CODE § 2-402(3)(a). In another part of the opinion, Chrysler's right to other goods on which it had received delivery was upheld under section 9-307(1), although it had subsequently redelivered the goods to Adamatic under a bailment agreement for purposes of Adamatic doing further work on them. It was found that Chrysler's treatment of the goods while in its possession constituted an acceptance of the goods, and in redelivering the goods, Chrysler was not rejecting or revoking its acceptance. Chrysler Corp. v. Adamatic, Inc., 59 Wis. 2d 219, 232, 208 N.W.2d 97, 103, 12 UCC REP. SERV. 849, 859. Note: if Chrysler had been in the position of rejecting the goods or revoking its acceptance, its "security interest" on account of its payments to the seller (section 2-711(3)) would, upon redelivery to the seller, have run afoul of section 9-113.

48. *See, e.g.*, Gordon, *The Prepaying Buyer: Second Class Citizenship Under Uniform Commercial Code, Article 2*, 63 NW. U.L. REV. 565, 571 (1968); Speidel, *Advance Payments in Contracts for Sale of Manufactured Goods: A Look at the Uniform Commercial Code*, 52 CALIF. L. REV. 281 (1964).

49. Chrysler Corp. v. Adamatic, Inc., 59 Wis. 2d 219, 241, 208 N.W.2d 97, 108, 12 UCC REP. SERV. 849, 865 (1973).

50. With regard to giving the secured party the full value of the collateral without deduction for its receipt of progress payments: section 9-306(2) provides that in the case of unauthorized disposition by the debtor the security interest continues in the original collateral and also continues "in any identifiable proceeds including collections received by the debtor." While nothing is said about the need for the secured party to elect between following the original collateral, and going after the proceeds, it seems fair to hold that the secured party should not have his cake and eat it too.

51. Undiscussed in the opinion, however, was the question of the role of estoppel, waiver and consent, *see* CODE §§ 1-103, 9-306(2). Was the "sale *or other disposition*" of the collateral (the goods in process of fabrication) "authorized by the secured party in the security agreement or otherwise"—to use the language of section 9-306(2)? If so, then the buyer, even though he was not a buyer in ordinary course of business, should prevail as to the collateral, leaving the secured party with rights in the proceeds, i.e., the purchase price. Chrysler's contract with Adamatic was entered into in April 1970. In the preceding February:

> personnel from Lakeshore [the inventory secured party] and Adamatic met with Chrysler in Detroit to discuss the financing of the

avowed mission to downgrade the title route in determining rights in goods in the transitional period from contract to performance, should leave such an important area as the present to the title tests of section 2-401.[52]

Emphasis upon a title-passing test means that *until* title passes, either according to the contract[53] or through seller's delivery of

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second transaction. At that time, Chrysler was informed of Adamatic's shaky financial condition and the fact that Lakeshore held a security interest in Adamatic's inventory. Lakeshore told Chrysler that it was prepared to lend up to $300,000 to Adamatic if Chrysler would make progress payments on the proposed, second contract.

59 Wis. 2d at 225, 208 N.W.2d at 100, 12 UCC REP. SERV. at 854.

An ambiguous situation is suggested by this state of the evidence. While it is clear that the secured party was consenting to the making of the contract for sale, provided progress payments were stipulated, it is not so clear that in its direct conversations with the tentative buyer it was consenting impliedly to the subordination or loss of its security interest vis-a-vis Chrysler. One might think it was, particularly in view of the fact that it subsequently received and applied the progress payments toward its debtor's obligation. But the fact that it also committed itself to make substantial further advances to the debtor may militate against an inference that it was in effect waiving its security interest claim vis-a-vis Chrysler. Moral: Face-to-face preliminary negotiations between the secured party and the would-be buyer, in a case like this, should leave nothing to doubtful inference. *See* Draper v. Minneapolis-Moline, Inc., 100 Ill. App. 2d 324, 241 N.E.2d 342, 5 UCC REP. SERV. 972 (1968) (buyer's position upon identification protected; section 9-307(1) held inapplicable because sale by dealer was authorized and section 9-306 controlled.)

52. Use of the idea of title is also minimized under article 9. CODE § 9-202 provides:

> Every provision of this Article with regard to rights, obligations and remedies applies whether title to collateral is in the secured party or the debtor.

However, while this provision shows the draftsmen's interest in downgrading the concept of title, it only pertains to title to the *collateral.* It does not seem to apply to the question whether a buyer of the collateral must have title in order to qualify as a buyer in ordinary course of business.

53. Perhaps the buyer's position will be enhanced by an explicit provision in the contract for sale making the time when title passes anterior to the time provided by the normal rules of section 2-401, as well as an explicit provision governing the time when goods are identified to the contract under section 2-501 (especially important in view of section 2-401(1) which provides that "title to goods cannot pass under a contract for sale prior to the identification to the contract. . . .")

But Speidel, *supra* note 48, at 287, after first recognizing that the buyer's interest in identified goods is subject to "any security interest in the identified goods created by the seller" (citing section 2-402(3)(a)), takes up the question of the efficacy of a term in the contract for sale which would provide for identification and passage of title before the time that would otherwise apply under sections 2-401 and 2-501, thereby affecting rights between the parties and other third party claims. "It is perfectly clear, for example, that the parties may agree that completion of conforming goods by the seller results in both identification and passage of title [citing sections 2-401(1) and 2-501(1)]. The emergence of the buyer's possessory remedies can perhaps be accelerated by this." *Id.* at 290. As

the goods, the "executory buyer's" status is in jeopardy. He is subject to the superior rights of an inventory secured party and runs the risk of being advised that the sale to him is in violation of the security agreement, so that he may never become a buyer in ordinary course of business. Can this be right? If so, something seems to be lacking. One is reminded of the hortatory admonition of the comment to section 1-102:

> The Act should be construed in accordance with its underlying purposes and policies. The text of each section should be read in the light of the purpose and policy of the rule or principle in question, as also the Act as a whole, and the application of the language should be construed narrowly or broadly, as the case may be, in conformity with the purposes and policies involved.

Brave words! But oh, for a clear light on what the "purposes and policies involved" are, in particular cases!

Were the draftsmen of articles 2 and 9 more concerned with protecting secured lenders than financing buyers, at least buyers who did not join the article 9 club? Until and unless more is revealed by future decisions, all such buyers had better assume so, and take the necessary precautions, including joining the club and entering into the necessary participation or subordination agreements and security agreements. The buyer is in good shape, of course, if he attains buyer in ordinary course of business status—but when does that occur?

So, in the case of the financing buyer vis-a-vis the perfected

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to an agreement going beyond this, in accelerating the time of identification and acquisition of buyer's special property and replevin rights to an earlier stage in seller's performance; while seemingly effective between the parties, a different question is posed when third party claims are involved:

> The real question is the effect of this agreement on third parties who assert claims to the same goods. The short answer is that unless the requirements of article 9 are met the agreement will have no effect.
>
> Why is this so? Although not expressly stated in section 1-102 (3), there is little doubt that seller and buyer cannot by agreement impair or destroy the rights of third persons not parties to the contract . . . . Further, although a "special property" interest under article 2 does afford some protection to the "financing" buyer's creditor interest, there is a point at which the use of the property interest to achieve security results becomes improper. That point is reached where the "special property" interest is asserted in a way that conflicts with rights given to creditors and purchasers under article 2 or other provisions of state law. Beyond this point the planned transaction arranged exclusively under article 2 is ineffectual. Thus, in order to create a security interest in goods which will be effective against the seller and third parties, the "financing" buyer must meet the requirements of article 9.

Id. at 291.

Section 2-401(2) provides that contract provisions regarding passage of title are subject to Article 9. *See also* CODE § 1-105(2).

security interest in inventory created by his seller, the buyer may not receive the protection given to a buyer in ordinary course of business by section 9-307(1) if at the critical time title to the goods has not passed under the contract—at least so holds *Chrysler Corporation v. Adamatic, Inc.* This may result from a literal reading of section 1-201(9), construed to require a "sale," though section 1-201 allows a certain tolerance in the application of its definitions by its introductory phrase "unless the context otherwise requires." The fact that the goods may have already been identified to the contract and the fact that the buyer may have replevin rights, are not of themselves enough. Title must be in the buyer, if he is to qualify as a buyer in ordinary course of business, at least according to *Chrysler Corporation v. Adamatic, Inc.*

Another set of problems arises if the title *has* passed, and the buyer qualifies as a buyer in ordinary course of business but the seller is still in possession. Must the buyer have specific rights *in the goods* which he could enforce against the seller? The buyer's "special" property interest enforceable by replevin depends upon his inability to make cover, (section 2-716), for article 2 absurdly seems to require him in a preshipment situation (with the limited exception in section 2-502) to get the same goods elsewhere if he can make a reasonable cover—even if he had already paid the seller. In other words, he must pay twice and attempt to recoup the loss with a claim against the seller for damages or restitution, for breach of contract. He may sometimes enforce his rights through an equitable action for specific performance (section 2-716) where the remedy at law is, for some reason approved by the court, considered to be inadequate. It is questionable, however, when this potential right to specific performance will be accorded so as to put him in the same position vis-a-vis third parties as the right of replevin. It is doubtful that prepaying the seller will raise a sufficient equity, since section 2-502 deals with the buyer's rights on prepayment in such a grudging manner.

As to *unsecured creditors* of the seller, section 2-402(1) may be read to imply that unless the buyer has rights under section 2-502 or section 2-716 that he could enforce against the seller, the unsecured creditor can by levy achieve a superior right.

But it does not follow that a *secured creditor* of the seller can achieve the same advantage, once title has passed.

One thing seems obvious: section 1-201(9) does not require that the buyer receive delivery of the goods before he can qualify. Nor does section 9-307(1)—unlike section 7-205, another Code section which gives protection to a buyer in ordinary course of business.

But, you may ask, how may the buyer in ordinary course of business, with the seller still in possession, assert his rights against his seller's secured creditor, if he does not have property rights under sections 2-716 and 2-502? (These rights do not accrue to

the buyer merely because title has passed.) By an action based in appropriate cases on conversion? By an equitable decree? The answer must be, by some remedy under section 1-106(2) to carry out section 9-307(1). However, if the court decides that he is a buyer in ordinary course of business without rights in identified goods which are enforceable, the buyer is a man without a remedy until he receives delivery. This, it is contended, is not right.

If this analysis is correct, the buyer in ordinary course of business with his seller still in possession may sometimes paradoxically be in a better position if the counterclaimant is his seller's secured creditor rather than his seller's lien creditor, and, as in *Chrysler Corporation v. Adamatic, Inc.*, sometimes in a worse position.

Perhaps the secured creditor cannot complain if he is sometimes worse off than the unsecured creditor—after all, section 9-307(1) is addressed to him, not to unsecured creditors of the seller. But let's face it: This section 2-402 at the center of the picture is no more nor less than a s[t]inking quagmire. Can *anybody* really speak confidently as to its meanings? When it comes to dealing with the rights of third parties in the goods, article 2 is less than "perfectly clear," (to borrow a phrase), and section 2-402 is a prime example of opaque prose.[54]

b. "In the business of selling goods of that kind"

To be a "buyer in ordinary course of business," under section 1-201(9), the buyer must buy from a person "in the business of selling goods of that kind."[55] The phrase is intended to refer to professional sellers as distinguished from nondescript sellers who

54. Thus, when section 2-402(1) speaks of the "rights of unsecured creditors of the seller with respect to goods which have been identified to a contract for sale," it is assumed the reference is to "lien creditors," for the unsecured creditor is normally a no account until he attains stature as a lien creditor by making his nasty levy.

Perhaps any unsecured creditor may have rights if there is a kind of fraudulent conveyance—back we go to *Twynes Case* (seller's retention of possession as a badge of fraud). But section 2-402 provides that state law apart from the Code shall determine whether a transaction in which the seller remains in possession is a fraudulent conveyance "except that retention of possession in good faith and current course of trade by a merchant-seller for a commercially reasonable time after a sale or identification is not fraudulent." This provision of section 2-402 seems to protect all who are buyers in ordinary course of business, since a buyer would hardly buy "in ordinary course of business" if the seller's retention of possession did not come within the above quoted language.

For discussion of buyer's rights in the goods, see R. NORDSTROM, HANDBOOK OF THE LAW OF SALES §§ 158-60 (1970).

55. *See* National Bank of Commerce v. First Nat'l Bank & Trust Co., 446 P.2d 277, 279, 5 UCC REP. SERV. 947, 949 (Okla. 1968); Al Maroone Ford, Inc. v. Manheim Auto Auction, Inc., 205 Pa. Super. 154, 158, 208 A.2d 290, 292, 2 UCC REP. SERV. 595, 597 (1965).

don't make it a business to sell such goods. The distinction is clear at the edges but blurs in the middle. Buying a refrigerator from an appliance dealer handling refrigerators with a fixed place of business would clearly qualify; buying a refrigerator from your neighbor at his "garage sale" would not—your neighbor is a sort of "one shot" seller.[56] The imagination can run riot in conjuring up in-between cases. Some help comes by considering that the sold goods must be "of that kind" which the seller is in the business of selling. Still, there are dealers who may undertake to procure and sell almost any kind of goods which a buyer may desire.

A question for the philosophers: why this emphasis upon buying from one kind of seller rather than another? It must be that one who buys in normal trading channels is entitled to a greater measure of protection than one who does not. A person who buys at the market place may reasonably believe that the marketman owns or has authority to sell. But may not a person who buys at his neighbor's garage sale also reasonably believe? But ah, you say, he trusts the person, and not the institution. Further, you may add, favoring the buyer who buys from a seller "in the business" encourages commerce, though you admit, perhaps, that complete acceptance of the "market overt" approach would be going too far and lead to thieves' markets.

The requirement of buying from one "in the business of selling goods of that kind" means, of course, that section 9-307(1)'s principal impact is upon security interests in *inventory*, since collateral other than inventory would rarely be "of that kind." But only *certain kinds* of inventory, as defined in section 9-109(4), would be included. Security interests in the kind of inventory which is goods held for sale (merchandise) clearly come under section 9-307(1).[57] But a manufacturer would probably not be "in the business" of selling such inventory as "raw materials, work in process, or materials used or consumed in a business." The manufacturer would, of course, be in the business of selling *finished goods.*

Under section 9-109(4), "inventory" also includes goods "held by a person who holds them for . . . lease or to be furnished under contracts of service . . . ." A debtor who gives a security interest in this kind of inventory is, it seems, primarily in the business of leasing, or using such goods in a contract for service, and *not* in selling such goods. (In fact, it may seem to have been an error to have included such categories in the first place in the definition of inventory.) But periodically, as the goods wear down, the debtor may need replacements and will sell the old goods. *Quaere*: in

56. Section 9-307(2) deals with this situation.
57. *See* CODE § 9-109(4) (Definition of "Inventory").

so doing, is he "in the business of selling goods of that kind?"

In *Hempstead Bank v. Andy's Car Rental System, Inc.*[58] it appeared that a car rental company which had given a bank a security interest in its cars, at various times had sold one or more of its used cars for a fair price in cash—a total of 13 in a six month period—to Auto Buyers, Inc., which in turn had resold them to retail buyers. Plaintiff Bank sued Auto Buyers for conversion. In defense, Auto Buyers asserted that it was a buyer in ordinary course of business. Plaintiff's motion for a "partial summary judgment" was denied. The lower court held that the issues raised by the pleadings required a trial. In dealing with the question whether defendant bought "from a person *in the business* of selling goods of that kind," the court stated that, "The papers reveal, and it is not disputed, that the normal and usual conduct of an auto rental business includes periodic turnover of its equipment. [sic] The conclusion is inescapable that the transaction involved was normal and made in the regular course of the business of Andy's."[59]

Upon review, however, the appellate division of the Supreme Court of New York took the position that the sales though periodic were "merely incidental to its leasing or rental business" and concluded that the seller was not "in the business" of selling cars. Therefore, buyer was not protected under section 9-307(1) as a buyer in ordinary course of business.[60] (The case was, however, remanded for trial on the question whether plaintiff, the secured party, had impliedly authorized the sales under section 9-306(2)).[61]

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58. 3 UCC REP. SERV. 962 (N.Y. Sup. Ct. Nassau Cty. 1966).

59. *Id.* at p. 963.

60. Hempstead Bank v. Andy's Car Rental Sys., Inc., 35 App. Div. 2d 35, 39, 312 N.Y.S.2d 317, 321, 6 UCC REP. SERV. 932, 936 (1970). In American Nat'l Bank & Trust Co. of Chicago v. Mar-K-Z Motors & Leasing Co., Inc., 11 Ill. App. 3d 1046, 1049, 208 N.E.2d 209, 211g, 13 UCC REP. SERV. 142, 144 (1973), it was held that a used car dealer buying from a seller primarily in the business of leasing qualified as a buyer in ordinary course of business, since the evidence established that the seller was also in the business of selling "cars that were turned off a lease." Perhaps the basic question is how frequently and regularly the debtor sells.

61. The court observed:

> Apart from the provisions of § 9-307, however, a secured party may lose his security interest in the collateral upon a sale thereof by the debtor if the debtor's action "was authorized by the secured party in the agreement or *otherwise* [emphasis added] (U.C.C., § 306, subd. [2]); and "a claim to proceeds in a filed financing statement might be considered as impliedly authorizing sale or other disposition of the collateral, depending upon the circumstances of the parties, the nature of the collateral, the course of dealing of the parties and the usage of trade (see Section 1-205)" (Official Comment to U.C.C., § 9-306 . . . ."

35 App. Div. 2d at 40, 312 N.Y.S.2d at 322, 7 UCC REP. SERV. at 937.

The official comment quoted above is a source of confusion, since it

One can only speculate as to whether the appellate division would have taken the same position had the defendant buyer been a retail consumer buyer rather than a dealer.

c. Good faith

To be a "buyer in ordinary course of business," the buyer must buy in "good faith." "Good faith" is defined in general in section 1-201(19) as "honesty in fact in the conduct or transaction concerned." To this should be added the Comment to section 1-201(19):

> [I]n the Article on Sales, Section 2-103, good faith is expressly defined as including in the case of a merchant observance of reasonable commercial standards of fair dealing in the trade, so that throughout that Article wherever a merchant appears in the case an inquiry into his observance of such standards is necessary to determine his good faith.

So, under section 2-403(2), it has been held that in the case of a merchant-buyer, section 2-103(1)(b) controls the good faith requirement.[62] Then what about the merchant-buyer under section 9-307(1)? Is it fair to conclude that if section 2-104(1)(b) good faith applies to section 2-403(2), it applies likewise to section 9-

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gives *some* weight to a claim for proceeds in a financing statement as evidence of implied consent to sale. *See* McFadden v. Mercantile-Safe & Deposit Trust Co., 260 Md. 601, 273 A.2d 198 (1971). However, a claim to proceeds may simply be inserted in a financing statement so as to perfect a proceeds security interest in the event the debtor without authority sells the collateral. Perhaps the comment is a lingering remnant of the provision in the 1952 version of section 9-307(1) which placed emphasis upon a claim to proceeds. In any event, the 1972 version drops this comment, and also Section 9-306(3) makes it unnecessary to claim proceeds in the financing statement in order to perfect the proceeds security interest. (There is a special provision in the 1972 version regarding proceeds of cash proceeds.)

62. *See* Mattek v. Malofsky, 42 Wis. 2d 16, 20, 165 N.W.2d 406, 408, 6 UCC REP. SERV. 277, 279 (1969).

In this case, the owner had authorized putting his car on a dealer's lot for display purposes. The court disqualified the dealer buyer who had failed to insist on compliance with the transfer requirements of the Motor Vehicle Code. Invoking section 2-104(3), it was observed:

> In the observance of reasonable commercial standards, however, a merchant is chargeable with the knowledge or skill of a merchant.
>
> [E]vidence of custom and usage of automobile dealers contrary to the Statute cannot be used to defeat the rights of a third party whatever the value of such evidence may be in adjusting disputes between dealers . . . .

Id. at 21, 165 N.W.2d at 408, 6 UCC REP. SERV. at 280.

But on somewhat similar facts, another court decided that the dealer was a buyer in ordinary course of business, without considering the application of section 2-103(1)(b). Medico Leasing Co. v. Smith, 457 P.2d 548, 6 UCC REP. SERV. 786 (Okla. 1969).

307(1)?[63] After all, sales of goods are the subject of both sections.

Nothing in section 1-201(9) or section 9-307(1) indicates that only consumer-buyers come within the terms, or denies that a dealer may qualify as a buyer in ordinary course of business who can take free of the security interest created by his seller.[64] Nevertheless, application of section 2-103(1)(b) could enable a court to set higher standards for such buyer than for the ordinary retail consumer buyer.

However, application of the section 2-103(1)(b) good faith standard to section 9-307(1) problems involves different considerations than those involved in its application to section 2-403(2) problems. In the article 2 setting, a dealer-buyer's claim may be against a victimized owner who, not fully appreciating the possible consequences, in a single instance entrusted the goods to an unscrupulous merchant-bailee. In an article 9 setting, it is typically the case of a dealer-buyer versus a professional inventory secured party. Perhaps more should be required of the professional buyer in the first case than in the second.

The question whether section 2-103(1)(b) good faith applies to the merchant-buyer in a section 9-307(1) setting was thoroughly

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63. A dealer's failure to check the public records for filings is not indicative of lack of good faith. *See* Hempstead Bank v. Andy's Car Rental Sys., Inc., 35 App. Div. 2d 35, 38, 312 N.Y.S.2d 317, 320, 7 UCC REP. SERV. 932, 934 (1970); *see also* Bank of Utica v. Castle Ford, Inc., 36 App. Div. 2d 6, 9, 317 N.Y.S.2d 542, 545, 8 UCC REP. SERV. 910, 913 (1971). *But see* Swift v. J.I. Case Co., 266 So. 2d 379, 381, 11 UCC REP. SERV. 191 (Dist. Ct. App. Fla. 1972). Close-connectedness of seller and buyer through interlocking ownership and management can disqualify. Taylor Motor Rental, Inc. v. Associates Discount Corp., Inc., 196 Pa. Super. 182, 186, 173 A.2d 688, 690, 1 UCC REP. SERV. 539, 541 (1961).

64. "Even transactions between automobile dealers have been held to be protected under proper circumstances by the terms of the Uniform Commercial Code." C. Jon Dev. Corp. v. Pand-Rorsche Corp., 69 Ill. App. 2d 469, 473, 217 N.E.2d 416, 417 (1966); cited with approval in Osborn v. First Nat'l Bank, 6 UCC REP. SERV. 1106, 1108 (Okla. 1969). *Accord* Associates Discount Corp. v. Rattan Chevrolet, Inc., 462 S.W.2d 546, 548, 8 UCC REP. SERV. 117, 118 (Tex. 1970); Bank of Utica v. Castle Ford, Inc., 36 App. Div. 2d 6, 9, 317 N.Y.S.2d 542, 544, 8 UCC REP. SERV. 910, 912 (1971) (illustrating that the security agreement may authorize the debtor to sell only at retail so that the buyer cannot invoke section 9-306(2) as an alternative position). A great deal of the litigation involving buyer in ordinary course of business under section 9-307(1) is concerned with cases where the buyer is a dealer, and not a retail buyer. As to the possible reasons, see Skilton, *Cars for Sale: Some Comments on the Wholesale Financing of Automobiles*, 1957 WIS. L. REV. 352, 399. One objection to treating a dealer as a buyer in ordinary course of business is that the price he pays the debtor may be much lower than the retail price. As to this objection, see Skilton, *supra* for discussion under UTRA, at 402, citing Oldfather, *Survey of Kansas Law 1953-1955: Sales*, 9 KAN. L. REV. 217, 219 (1955).

litigated in *Sherrock v. Commercial Credit Corporation.* The Delaware Superior Court found that it did,[65] and accordingly disqualiified a dealer who had bought two new model cars from another dealer, and paid for them, but allowed the selling dealer to delay delivery for a few days in order to enable that dealer to display the new models on "announcement day." About a week after the cars had been bought and paid for, the selling dealer's inventory financer repossessed all cars, including the two in question. The court found that it was highly unusual for one dealer to buy and pay for a car from another dealer before getting delivery and to permit the selling dealer to retain possession particularly when they had had no previous dealings, and found further that the buying dealer should have known that floor plan financers rely on the continued presence of cars in a dealer's stock in making their floor checks. The Court ruled that the buying dealer had failed to observe "reasonable commercial standards," and could not defeat the secured party's claim to the cars.[66]

Here the Court held against the buying dealer because, as a favor, he permitted the seller to retain the cars for a rather brief time after paying him—although the evidence was clear as to the buying dealer's honesty in fact, and his ignorance of any indications that the selling dealer intended to renege on any security agreement he might have with an inventory financer, by failing to pay off a loan on the cars. Perhaps the Court's finding that the buyer lacked section 2-103(1)(c) good faith was, under all the circumstances, stretching it.

In any event, the Delaware Supreme Court reversed in a provocative opinion:[67]

> The error we find here lies in the Trial Court's misapplication of the Sales Article definition of "good faith," set forth in §2-103(1)(b), instead of the Secured Transaction Article definition of "good faith," set forth in §1-201(19). In so doing, the Trial Court found that, although the appellants were honest in fact, they did not act "in a commercially reasonable manner." The Trial Court reasoned that, in substance, this secured transaction revolved around a sale of the automobiles; that since Article 2 of the Code deals with the sale of goods, the definition of "good faith" in that Article must be applied; with the result that a merchant-buyer's "good faith" is to be distinguished from the "good faith" of a consumer-buyer under Article 9 of the Code. In the view of the Trial Court, it was not reasonable to conclude that the drafters of the Code intended to apply

65. 269 A.2d 407, 408, 8 UCC REP. SERV. 123, 126 (Del. Super. Ct. 1970) (on motion for summary judgment).

66. 277 A.2d 708, 713, 9 UCC REP. SERV. 294, 303 (Del. Super. Ct. 1971) (after trial on the merits).

67. — Del. —, 290 A.2d 648, 10 UCC REP. SERV. 523 (1972).

more than one standard of "good faith" to the same individual in related transactions and that, therefore, the definition in §2-103(1)(b) must be applied to merchant-buyers throughout the entire Code. See 269 A.2d 407 [8 UCC Rep. 123]. We are unable to approve that rationale.

Article 2 of the Code concerns itself with the rights and obligations of buyer and seller, one to the other. Here we are concerned with the rights and obligations of buyer and secured creditor, one to the other—a transaction expressly controlled by Article 9.

The course to be followed in arriving at the definition of "good faith" within the meaning of Article 9 is charted clearly in the Code. There is no room for judicial interpretation. In our view, an application of an Article 2 definition to an Article 9 transaction is unwarranted by anything in the Code for the following reasons: (1) §9-105(4) of Article 9 provides that "Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article"; there is no similar reference to Article 2 as a source for any definition applicable to Article 9. (2) As noted, §9-307 expressly refers to §1-201(9) of Article 1 for the definition of "buyer in the ordinary course of business." (3) The "Definitional Cross References" in the Delaware Study Comment (5A Del. C. p. 535) refer to specific sections of Article 1 for definitions of terms found in §9-307, including a reference to §1-201 for the definition of "buyer in ordinary course of business"; there is no similar reference to Article 2. (4) There is an express limitation in Article 2 of the definitions contained in Article 2 including the §2-103(1)(b) definition of "good faith" here involved.

We find no basis anywhere for the conclusion that the drafters of the Code intended to make it permissible to "cross over" to Article 2 for the definition of the term "good faith" as incorporated by reference in Article 9.[68]

As matters now stand, a split of authority may be developing.[69]

But if one bears in mind that section 2-103(1)(b) calls for "the observance of reasonable commercial standards of *fair dealing* in

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68. *Id.* at 650-51. Wolcott, J., dissented.

For a thorough analysis criticising the *Sherrock* decision adversely, see Note, *Uniform Commercial Code—Secured Transactions—Article 2 Definition of "Good Faith" Not Applicable to Merchant-Buyer Under Section 9-307(1)*, 10 GEORGIA STATE BAR J. 110 (1973).

69. In Hempstead Bank v. Andy's Car Rental Sys., Inc., 35 App. Div. 2d 35, 38, 312 N.Y.S.2d 317, 320, 7 UCC REP. SERV. 932, 934 (1970), the court, in a section 9-307(1) problem, referred to the good faith standards of section 9-103(1)(b) as controlling, where buyer was a merchant. *See also*, Swift v. J.I. Case Co., 266 So. 2d 379, 381, 11 UCC REP. SERV. 191, 192 (Dist. Ct. App. Fla. 1972); Bank of Utica v. Castle Ford, Inc., 36 App. Div. 2d 6, 9, 317 N.Y.S.2d 542, 545, 8 UCC REP. SERV. 910, 913 (1971).

the trade," and not simply "reasonable commercial standards," the gap between "honesty in fact" under section 1-201(19) and "good faith" under section 2-103(1)(b) tends to narrow. Our judgment as to whether a person was honest in fact is bound to take into account the state of a person's business knowledge and experience. He cannot close his eyes to the obvious, and what should be obvious to an experienced, professional buyer may not be so to the random man on the street. An empty-headed merchant with a white heart? With the three little monkeys as a paperweight? No obligation at all to be somewhat activist in your honesty? Come, now!

Here, as with other questions involving sections 9-307(1) and tie-in section 1-201(9), the kind of buyer involved may be a very operative fact.[70]

d. Effect of knowledge

Combining sections 9-307(1) and 1-201(9), a buyer may be in "good faith" though he may know there is a security interest in the goods—"even though the buyer knows of its existence." However, this cannot include "knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods . . . ."[71] So, in general, a buyer has a right to assume that his seller is authorized to sell free of the security interest by agreement between the secured party and the seller, even though the buyer is *aware* that his seller has created a security interest. In some cases, however, knowledge of the existence of a security interest may be tantamount to knowing that a sale by the debtor would be in violation of the security agreement. This may be particularly so where the buyer is a professional buyer, and the buyer acquires such knowledge from the *secured party* under circumstances which should enable him to conclude that a sale free of the security interest was not authorized.[72]

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70. *See* Al Maroone Ford Inc. v. Manheim Auto Auction, Inc., 205 Pa. Super. 154, 159, 208 A.2d 290, 293, 2 UCC REP. SERV. 595, 598 (1965):

> Moreover, the facts that the car was a substantially new car, purchased for resale many miles away from the place of business of the sellers, by an auctioneer who has had experience with foreign security interests in automobiles, without any inquiry, so far as the agreed facts show, as to the existence of any such interest, all tell against the contention that the appellee was a buyer in ordinary course.

71. So, *e.g.*, where the buyer knew that the seller was authorized to sell only at retail, and buyer was not a retail buyer, he cannot qualify. O.M. Scott Credit Corp. v. Apex, Inc., 97 R.I. 442, 198 A.2d 673, 2 UCC REP. SERV. 92 (1964).

72. *See* Cash Loan Co. v. Boser, 34 Wis. 2d 410, 149 N.W.2d 605, 4 UCC REP. SERV. 342 (1967). The facts of the case may illustrate that when a person has sufficient *notice* he will be held to have *knowledge*.

e. In ordinary course of business

To be a "buyer in ordinary course of business" buying must be "in ordinary course." "Ordinary course" is not defined but some transactions are expressly excluded: buying by "pawnbrokers,"[73] transfers "in bulk,"[74] and transfers "as security for or in total or partial satisfaction of a money debt."[75] Other than these, what

73. The concluding phrase in the first sentence of section 1-201(9) "but does not include a pawnbroker" makes hard reading, since the immediately preceding phrase is "a person in the business of selling goods," whereas the subject of the sentence is "buyer in ordinary course of business." Is "pawnbroker" referred to as a seller, or as a buyer? In other words, is one *buying from* a pawnbroker ruled out as a buyer in ordinary course of business? Referring back to the 1952 version of the Code makes it clear that pawnbrokers are referred to as buyers. In 1952 the concluding phrase read: "But does not include a pawnbroker or a person buying goods from a farmer." The 1956 amendments deleted the phrase "or a person buying goods from a farmer," and changed section 9-307(1) to insert the idea there. The point that the pawnbroker phrase refers to pawnbrokers as buyers is further supported by Supplement No. 1 to the 1952 Official Draft (Jan. 1955) at page 93:

> It has been urged that the definition be broadened to include pawnbrokers and pledgees generally. This suggestion cannot be accepted since under the Code a buyer in the ordinary course of business is given greater rights than the ordinary good faith purchaser; he may prevail over a prior legal interest, and will often prevail over a perfected security interest, even though he takes with knowledge of it: see Section 2-403(2) and 9-307.

That a pawnbroker should buy from a seller in the business of selling goods of that kind would seem to be such an unusual situation as to be unworthy of the attention given. *See* White-Sellie's Jewelry Co., Inc. v. Goodyear Tire & Rubber Co., 477 S.W.2d 658, 10 UCC REP. SERV. 888 (Tex. Ct. Civ. App. 1972).

74. What constitutes a "transfer in bulk" under section 1-201(9)? "Transfer in bulk" is not defined in the UCC. Section 6-102(1) states that "A 'bulk transfer' is any transfer in bulk and not in the ordinary course of the transferor's business of a major part of the materials, supplies, merchandise or other inventory (Section 9-109) of an enterprise subject to this Article." *One Theory*: "transfer in bulk" in section 1-201(9) means "bulk transfer" as the term is used in article 6. But why bother to state this, since section 1-201(9) excludes transfers not "in ordinary course of business?" Perhaps because certain transactions—those referred to in section 6-102(1)—should be excluded as a matter of law. (Note that section 6-102(1) speaks of "the ordinary course of the *transferor's* business"—not quite the same as the "ordinary course" language of section 1-201(9)). *See* First Nat'l Bank v. Crone, — Ind. App. —, 301 N.E.2d 378, 13 UCC REP. SERV. 542 (1973). It is contended that a grain elevator operator buying all of a farmer's wheat crop may qualify as a buyer in ordinary course of business: Coogan & Mays Jr., *Crop Financing and Article 9*, 22 MIAMI L. REV. 13, 22 (1967). *Another Theory*: The direct antecedent of section 1-201(9) is UTRA's definition of buyer in ordinary course of trade. That definition also excluded transfers in bulk. Section 1 of UTRA defines this term: " 'Transferee in bulk' means a mortgagee or pledgee or a buyer of the trustee's business substantially as a whole." The definition of transferee in bulk in UTRA gives meaning to the term transfer in bulk in section 1-201(9). Compare section 3-302(3) and point 3 to comment to section 3-302.

75. CODE § 1-201(9). A transfer "as security for . . . a money debt"

transactions are or are not "in ordinary course"? Obviously, emphasis seems to be upon the regularity and ordinariness of the transaction, but there are unanswered questions: How unusual must the transaction be, so as not to be "in ordinary course"?[76] Must it be in ordinary course to the buyer or to the seller, or to both?[77] Questions of "good faith" and in "ordinary course" may tend to intermix, particularly if the buyer is a merchant.

"Ordinary course" may involve questions relating to time, place, and manner of sale. As to place of sale—buying at a retail store seems surely within the concept; buying from a street peddler raises questions.[78] As to consideration for purchase—buying at the

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rules out the taking of the usual article 9 security interest from the concept of "buying." Section 9-307(1) was not intended to deal with priorities among conflicting security interests in the same collateral. In Philadelphia Nat'l Bank v. Irving R. Boody Co., 1 UCC REP. SERV. 560, 565 (1963), arbitrator Carl Funk stated: " 'buying' does not include a transfer as security. Wagman is merely a 'purchaser,' as that term is defined in Section 1-201 (32) and (33), as a pledgee may be a purchaser. Hence Section 9-307 does not control this case."

Ruling out transfers "in total or partial satisfaction of a money debt" means that transfers for an antecedent debt are excluded, and seems to imply that the buyer must give "new value," though "buying . . . includes receiving goods or documents under a preexisting contract for sale." Regarding antecedent debt as excluded, see Stephenson Finance Co. of Augusta, Inc. v. Bruce, 254 S.C. 249, 174 S.E.2d 750, 7 UCC REP. SERV. 944 (1970); United States v. Greenwich Mill & Elevator Co., 291 F. Supp. 609, 5 UCC REP. SERV. 965 (N.D. Ohio 1968).

In Evans Products Co. v. Jorgensen, 245 Ore. 362, 421 P.2d 978, 3 UCC REP. SERV. 1099 (1966), an unpaid seller who had rights under section 2-507 and 2-702 on account of veneer sold on credit, received plywood from the buyer. It was held that he took the plywood for an antecedent debt, where the facts did not support the theory that he was exchanging his rights under section 2-507 and 2-702 for the plywood. In Stephenson Finance Co. of Augusta, Inc. v. Bruce, 254 S.C. 249, 174 S.E.2d 750, 7 UCC REP. SERV. 944 (1970) a seller had sold cars to a dealer on open account and some weeks later reacquired them in return for the buyer's worthless checks. A finding that the seller did not reacquire the cars in the ordinary course of business and had knowledge that the sale to him was in violation of the security interest was held amply supported by competent evidence. *See also* Bank of Madison v. Tri-County Livestock Auction Co., 123 Ga. App. 768, 9 UCC REP. SERV. 53 (1971).

76. *See* Whitmire v. Keylon, 12 UCC REP. SERV. 1203, (Tenn. Ct. App. 1973) (sale by dealer of ½ interest in houseboat held not a sale in ordinary course of the dealer's business).

77. Note that section 9-308 says "in ordinary course of *his* [the purchaser of the chattel paper] business." Section 6-102 (bulk transfer) speaks of transfers "not in the ordinary course of the transferor's business." Perhaps the draftsmen of section 1-201(9) intentionally left the question open.

78. In Rhode Island Hospital Trust Co. v. Leo's Used Car Exchange, Inc., 314 F. Supp. 254, 255-56, 8 UCC REP. SERV. 93, 94 (D. Mass. 1970), the court, in deciding that a used car dealer could not take free under section 9-307(1), observed (after quoting section 1-201(9)):

> These provisions will exonerate defendant only if its purchase of the cars was a transaction in the ordinary course of business. The sale of the cars took place at the usual place of business of

currently prevailing price seems surely within; buying at a big discount raises questions. Buying for entirely new value is acceptable; buying for entirely antecedent debt is bad. But a sale partly in satisfaction of an antecedent debt and partly for new value does not necessarily result in a buyer qualifying under section 1-201(9) only to the extent of the new value he gave. One court has held in a section 2-403(2) situation that a buyer is either 100 percent or zero percent a buyer in ordinary course of business—he is not partly so, partly not.[79] As to buying from a seller not in possession of the goods, if the goods are not future goods, who then has possession? And why? This too raises questions.[80]

f. *Problems of Proof*

Whether a buyer buys in ordinary course of business may be a mixed question of law and fact, but often chiefly of fact,[81] as are other issues that may arise in the application of sections 9-307(1) and 1-201(9): "good faith," "without knowledge," etc.

While the UCC is not explicit on this point,[82] it would seem that a buyer claiming rights as a buyer in ordinary course of business has the "burden of establishing" all key facts which would qualify him (or his predecessor in title) as a buyer in ordinary course of business, whether the buyer is in the role of plaintiff or defendant. He has the burden of "persuading the trier of fact that the existence of the fact is more probable than its nonexistence."[83]

In this respect, the buyer's position seems to be analogous to one who claims the rights of a holder in due course of a negotiable instrument. Here the UCC is explicit. Section 3-307(3) provides:

> After it is shown that a defense exists a person claiming the rights of holder in due course has the burden of establishing that he or some person under whom he claims is in all respects a holder in due course.

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neither the buyer nor the seller, but on the auction lot of a third party located in a state in which neither buyer nor seller was doing business. On these bare facts it cannot be held that the transaction was one in the ordinary course of business.

See also Al Maroone Ford, Inc. v. Manheim Auto Auction, Inc., 205 Pa. Super. 154, 208 A.2d 290, 2 UCC REP. SERV. 595 (1965).

79. *See generally* General Electric Credit Corp. v. R.A. Heintz Const. Co., 302 F. Supp. 958, 6 UCC REP. SERV. 1137 (D. Ore. 1969). The opinion is supported by reference to decisions under UTRA, as well as independent reasoning.

80. *See* DePaulo v. Williams Chevrolet-Cadillac Inc., 3 UCC REP. SERV. 600 (Lebanon Cty. Pa. 1965). *See also* text accompanying notes 121-26 *infra*.

81. Associates Discount Corp. v. Rattan Chevrolet, Inc., 462 S.W.2d 546, 550, 8 UCC REP. SERV. 117, 122 (Tex. Sup. Ct. 1970).

82. As to usage of trade, see section 1-205(2) and (6). Quaere whether these provisions are applicable, since the buyer is not trying to establish ordinary course of business for the purpose of interpreting an agreement.

83. *See* CODE § 1-201(8).

If we were to work from this guide, we would say that first a party must establish that he has a perfected security interest in goods which subsequently came into the hands of a buyer and that the obligation for which the security interest was created is still owing. Then the buyer claiming to take free of the security interest would have the burden of establishing that he, or some person under whom he claims, acquired the goods from the debtor in a sale which was authorized by the secured party, or that he acquired the goods as a buyer in ordinary course of business, or that for some other legally sufficient reason the secured party is precluded from asserting his rights under sections 9-306(2) and 9-201.[84] However, we can only speculate as to when the buyer's evidence is sufficient to make out a prima facie case thereby shifting the burden to the secured party to bring forth the evidence to rebut the buyer's proof of taking in good faith, ordinary course of business, etc.

Beyond the issue of burden of proof are larger questions concerning the predictability of decision making. To the extent that the issues raised by sections 9-307(1) and 1-201(9) are issues of fact, and are resolved as such by a jury, or a judge sitting without a jury, it is obvious that one cannot uniformly predict the outcome of the evaluation of evidence, nor account for the individualization of decision making as to good faith, ordinary course of business, etc.

However, even to the extent that issues raised by sections 9-307(1) and 1-201(9) are questions of law—and some issues are more apt to be such than others (must the buyer have title to qualify, when is a security interest "created by his seller," and, perhaps, whether the seller is in the business of selling goods of that kind)—a court, in interpreting and applying the statutory language, may entertain a variety of considerations it considers relevant, though not dictated by the statute. So, the law part of a question as to "good faith," or ordinary course of business, is subject to some judicial tailoring, depending for example, upon who the person is who claims to be a buyer in ordinary course of business—is he an experienced dealer or an uninformed layman?

Indeed, as we get closer and closer to actual law making, we are well below the level of tightly stated generalities and suspect

84. Damages: if the secured party has seized a car, for example, and buyer can establish that he takes free of the security interest, buyer can recover, in an action based on wrongful taking the value of the car and, in appropriate cases, consequential damages. Draper v. Minneapolis-Moline, Inc., 100 Ill. App. 2d 324, 241 N.E.2d 342, 5 UCC REP. SERV. 972 (1968). He may also recover punitive damages. Franklin Investment Co. v. Homburg, 252 A.2d 95, 6 UCC REP. SERV. 60 (D.C. Ct. App. 1969). If the secured party wins, and the buyer is still in possession, secured party is generally entitled to recover the value of the collateral, not in excess of the obligation.

that at the working level the Uniform Commercial Code is not so uniform after all, at least with respect to some of the material here considered.

II. OTHER BUYER IN ORDINARY COURSE OF BUSINESS PROBLEMS AS THEY RELATE TO ARTICLE 9

A. Section 2-403(2)

Section 9-307(1) is not the only place in the Code where the buyer in ordinary course of business is accorded preferred treatment. There is, for example, section 2-403(2) and (3).[85] Section 2-403(2) provides that "[a]ny entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business." Subsection (3) defines entrusting to include "any delivery and any acquiescence in retention of possession regardless of any condition expressed between the parties . . . ."

Section 2-403(2) is a *tour de force*—almost a last minute creation of the draftsmen of article 2, with no common law or pre-Code statutory counterpart. That is, as applied to some situations. We put to one side the voidable title situations (with their long history) which are dealt with in section 2-403(1).[86] Some pre-Code background to section 2-403(2) may be found in Factor's Acts[87] and common law principles of ostensible ownership and apparent authority. But there is no pre-Code source for its broad principle that a bailment to a merchant gives the merchant power-without-right to transfer title to a buyer in ordinary course of business. True, the doctrine of "market overt" went even further, for there not even a bailment by the owner to the merchant was required; but market overt, a curious exception to the rule that a purchaser deriving his title from a thief takes subject to the claim of the victimized owner, is confined to City of London shops and a few other places in England.[88]

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85. Other Code provisions, Sections 7-205, 7-503, 7-504, are discussed in notes 111-125 *infra* and accompanying text.

86. CODE § 2-403(1) provides, *inter alia*,

> "A person with voidable title has power to transfer a good title to a good faith purchaser for value," and then specifies some situations in which the good faith purchaser for value prevails: (a)(b)(c) and (d). In keeping with Section 2-403(1), subsection (3) of Section 2-702 provides: The seller's right to reclaim under subsection (2) is subject to the rights of a buyer in ordinary course *or other good faith purchaser* under this Article (Section 2-403). (Emphasis supplied)

87. The comments to section 2-403 and section 2-326 invite the retention of Factor's Acts, which in some instances may give greater rights to third parties dealing with the consignee. *See* O.M. Scott Credit Corp. v. Apex, Inc., 97 R.I. 442, 198 A.2d 673, 2 UCC REP. SERV. 92 (1964).

88. 30 HALSBURY, STATUTES OF ENGLAND 21 (3d ed. 1969). The following is from the Law Reform Committee, Twelfth Report (Transfer of Title to Chattels) presented to Parliament by the Lord High Chancellor on Com-

The comment to section 2-403 argues:

> The many particular situations in which a buyer in ordinary course of business from a dealer has been protected against reservation of property or other hidden interest are gathered by subsection (2)-(4) into a single principle protecting persons who buy in ordinary course out of inventory. Consignors have no reason to complain, nor have lenders who hold a security interest in the inventory, since the very purpose of goods in inventory is to be turned into cash by sale.
>
> Finally, the policy is extended, in the interest of simplicity and sense, to any entrusting by a bailor . . . .

It probably goes without saying that section 2-403(2) is not needed if sale by the entrusted merchant is authorized by the entruster in the entrustment agreement or otherwise. Accordingly, where an owner of goods sends them to an agent with authority to sell them—a consignment situation—obviously a sale by the agent to a buyer in ordinary course of business should usually raise no question as to the buyer's right to prevail against the consignor, which cannot be answered under ordinary principles of agency law.[89] And even a buyer not in ordinary course of business would prevail if the consignee-agent sold with actual or apparent authority.[90]

Section 9-307(1) may be viewed as merely an application to se-

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mand of Her Majesty, April, 1966:

> There is a long-standing exception to the rule that where goods are stolen the innocent purchaser acquires no title. Where goods are sold in market overt according to the usage of the market the buyer will acquire a good title provided he buys in good faith and without notice of any defect or want of title on the part of the seller. This rule, now codified in Section 22 of the Sale of Goods Act 1893, had its origin in the early days of the common law and is today of comparatively little practical importance. The law about market overt has never applied in Wales. It does not apply to privately owned markets (which account for more than half of the livestock markets in England and Wales) and it does not affect the law relating to the sale of horses. Its value today is perhaps greatest in the City of London for, by custom of the City of which judicial notice is taken, that part of every shop within the City to which the public is admitted is treated as market overt for the sale by the shopkeeper of such goods as he professes to deal in. The rule does not protect the purchaser of stolen goods where the thief has been prosecuted to conviction, for in such case the property in the goods automatically revests in the person from whom they were stolen: Section 24(1) of the Sale of Goods Act of 1893.

Quoted in J. HONNOLD, LAW OF SALES AND SALES FINANCING 421-22 (3d ed. 1968). Subsection 2 of Section 22 of the Sale of Goods Act was repealed by the Criminal Law Act of 1967. It provided: "Nothing in this Act shall affect the sale of horses." Section 22 does not apply to Scotland. 30 HALSBURY, *supra*.

89. *See* CODE §§ 2-403(1) and 1-103; Kranich & Bach v. Miller, 3 UCC REP. SERV. 449 (Westchester Cty., N.Y. 1966).

90. The real problem in these transactions is that creditors of consignees in possession may also have rights. *See* CODE § 2-326.

cured transactions of the more general provisions of section 2-403(2):[91] first, section 2-403(2)'s "entrusting" concept is matched in a section 9-307(1) situation where the secured party acquiesces in the debtor's retention of possession;[92] second, section 2-403(2) requires that the entrustee be a "merchant who deals in goods of that kind," but this seems to add nothing to the requirement common to both that the buyer be a buyer in ordinary course of business as defined in section 1-201(9);[93] third, section 2-403(2)'s provision that entrusting to a dealer gives the dealer power to transfer all rights of the entruster to a buyer in ordinary course of business is matched by section 9-307(1)'s provision that such buyer takes free of a security interest *"created by his seller."* Finally, the 1956 revisions to section 9-307(1) inserted "created by his seller," to correlate section 9-307(1) with section 2-403(2).[94]

91. The correlation is not perfect. Buyers of farm products from a farmer are not protected by section 9-307(1), whereas there is no such limitation in section 2-403(2), once the court decides that a farmer is a "merchant." Schizophrenia? Point 2 to the comment to section 2-403 advises: "As to entrusting by a secured party, subsection (2) is limited by the more specific provisions of Section 9-307(1), which deny protection to a person buying farm products from a person engaged in farming operations."

92. While neither section 9-307(1) nor tie-in section 1-201(9) stipulates that the debtor who has created the security interest must be in possession of the collateral, there is a serious question as to whether a buyer dealing with a seller not in possession can qualify as a buyer in ordinary course of business-more later.

93. *See* Toyomenka, Inc. v. Mount Hope Finishing Co., 432 F.2d 722, 727, 8 UCC REP. SERV. 21 (4th Cir. 1970).

The phrase "merchant who deals in goods of that kind" seems to have been inserted to differentiate him from a merchant with specialized knowledge as to business practices. *See* CODE § 2-104(1) and point 2 to comment to that section.

94. The present version of Section 9-307(1) resulted from comments and recommendations of the New York Law Revision Commission. *See* RECOMMENDATIONS, *supra* note 34, at 66-67. After recommending that 1952 Section 1-201(9) be amended to preclude a buyer from qualifying who knows of the terms of a security agreement restricting the debtor's right to sell, it was further observed:

> The Commission has also noted as a criticism that while the definition of "buyer in ordinary course" in Section 1-201(9) supplies the requirement that the person who sells to a buyer in ordinary course must be "in the business of selling goods of that kind," neither Section 1-201(9) nor Section 9-307(1) requires that such person be in possession or have power to give possession at the time of sale to a buyer in ordinary course, nor does Section 9-307(1) require that the secured party whose interest is cut off shall have consented to possession by that person. Section 9-307(1) is confusing in applying only to "inventory" or to goods as to which the secured party files a financing statement claiming proceeds, since the parallel provisions of Section 2-403(2) are broad enough to cut off a security interest in any goods. There is a further question under Sections 1-201(9), 2-403(2) and 9-307(1) whether the sale to a buyer in ordinary course must be made by the debtor, or can be made by a third person, who is a merchant engaged in selling goods of that kind, if the secured party "entrusted" the goods to that person.

NEW YORK LAW REVISION COMM'N, REPORT RELATING TO THE UNIFORM COM-

While section 9-307(1) deals specifically with the secured party's rights against the buyer in ordinary course of business, there can be times when a secured party not affected by section 9-307(1) may still lose under section 2-403(2).[95]

The question arises, to what extent are buyer-in-ordinary-course cases under section 2-403(2) relevant to problems under section 9-307(1)?

For example, Greenfield, J., in *Atlas Auto Rental Corporation v. Weisberg*[96] interpreting the entrusting provisions of section 2-403(2) and (3), opined that it is not enough that an owner has delivered his goods to a person who deals in goods of that kind and not enough that the buyer takes from such a dealer. It must further appear that the "entruster" knew that the person to whom he delivered *was* a dealer and that the buyer believed that he was buying from a dealer. Thus the parties involved must be conscious of the status of the dealer:

> Defendant offered in evidence an invoice he had received from Schwartzman in a prior transaction headed "Herb Schwartzman, Wholesale Automobiles," but this would not suffice to establish the fact, and certainly would not have indicated to plaintiff that Schwartzman was in fact a merchant. Since the "entrusting" provisions of UCC §2-403 are an extension of the principle of estoppel, it would appear to be essential that the actual vocational status of the merchant be established, but also that the original owner and the ultimate purchaser must be shown to have been

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MERCIAL CODE 67 (1956).

Reacting, it seems, to such comments, the Editorial Board dropped "in the case of inventory" from Section 9-307(1) and added "created by his seller". *See* RECOMMENDATIONS, *supra* note 34.

95. *See* Commercial Credit Corp. v. Associates Discount Corp., 246 Ark. 118, 126, 436 S.W.2d 809, 813, 6 UCC REP. SERV. 82, 87 (1969).

96. 54 Misc. 2d 168, 281 N.Y.S.2d 400, 4 UCC REP. SERV. 572 (New York City Ct. 1967). Atlas, a car rental concern, had offered one of its used cars for sale. Schwartzman acquired possession of the car and left his check for purchase price with Atlas. Atlas said it had refused to accept the check for the purchase price because it was not certified. Exit Schwartzman and car. Car traced to Weisberg, a licensed auto wrecker, who had paid Schwartzman $300 for car (says he was going to pay a balance) which is worth $1200. Weisberg had acquired car without being shown a bill of sale or registration certificate (New York was not a title certificate state). Weisberg claims Schwartzman's invoice in a prior transaction indicated Schwartzman was *dealer* and invokes section 2-403(2) as well as claiming to be a bona fide purchaser with Schwartzman having "voidable title"—section 2-403(1). Judgment for Atlas: Defendant is neither a buyer in ordinary course under section 2-403(2) nor a bona fide purchaser under section 2-403(1). The evidence is against Defendant. "Certainly if he was not working with him, he had every reason to be skeptical of Schwartzman's claim of ownership. The Uniform Commercial Code protects the innocent purchaser, but it is not a shield for the sly conniver, the blindly naive, or the hopelessly gullible." *Id.* at 173, 281 N.Y.S.2d at 405, 4 UCC REP. SERV. at 576.

> aware of that status. An owner entrusting his goods to another cannot be said to have conferred the indicia of ownership and apparent authority to deal with the goods unless he knows he has transfered possession to a dealer. Similarly the ultimate purchaser can demonstrate reliance and invoke the statutory provision only if he believed he was buying from a dealer. The proof here is wholly lacking in both respects.[97]

A view like this can have implications in cases governed by section 9-307(1).

While the opinion zeroed in on the entrustment "to a merchant who deals in goods of that kind" phraseology of section 2-403(2) and there is no similar language in section 9-307(1), section 9-307(1) depends upon section 1-201(9) with its language "buys in ordinary course from a person in the business of selling goods of that kind." For aught that appears, Judge Greenfield would have made the same points if he had rested his analysis upon the requisites of "buyer in ordinary course of business" under section 1-201(9). The special language of section 2-403(2) adds nothing to the typical case.

Perhaps in some cases a restrictive interpretation of section 2-403(2) may be expected,[98] since the statute is a departure from common law and has no direct statutory antecedents. Section 2-403(2) is innovative, and it will take a lot of arguing to convince a court that its application to some cases involving simple bailments to merchants is sound. Thus, as in *Atlas Auto Rental Corporation v. Weisberg*, we should not be surprised if a court asked for evidence that the so-called entruster at least knew that he was entrusting to a merchant-dealer, and perhaps, too, that the buyer knew and relied on the fact that he was buying from a merchant-dealer. Perhaps we may expect a court in a section 2-403(2) case to give the buyer a pretty thorough testing out before qualifying as a buyer in ordinary course of business.[99] On the other hand, it can be contended that section 9-307(1) should be liberally construed,

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97. *Id.* at p. 172, 281 N.Y.S.2d at 404, 4 UCC REP. SERV. at 575.

98. *See* DePaulo v. Williams Chevrolet-Cadillac, Inc., 3 UCC REP. SERV. 600, 604 (Lebanon Cty., Pa. 1965).

The typical case involving section 2-403(2) to date seems to be one involving delivery of a chattel to a dealer for purposes of sale or inviting bids, so that a court could find that the entruster was estopped. Thus in Palmer v. Booth & Cowley, Ltd., 7 UCC REP. SERV. 182 (N.Y. Cty. Ct. 1970) where the defendant delivered a car to a dealer so that the dealer could find a buyer, but said he never gave authorization for sale, and retained all evidence of ownership, the court, after citing section 2-403(2), observed, "Defendant Hallett, having invested the Corporation with apparent authority to dispose of the automobile and plaintiff in good faith, having dealt on the face of such apparent authority, is estopped from asserting title. . . ." The court cited a pre-Code case.

99. *See* Linwood Harvestore Inc. v. Cannon, 427 Pa. 434, 438, 235 A.2d 377, 380, 4 UCC REP. SERV. 920, 922 (1967).

since results favoring buyer (at least if buyer is a consumer) can be justified as a risk borne by a professional lender—the typical secured party. Section 9-307(1) may be viewed as a further step in an orderly progression from common law and statutory antecedents, not subject to implied limitations based on common law estoppel considerations. Whether this view will prevail we must wait and see.

Thus while buyer-in-ordinary course decisions under section 2-403(2) are often relevant to buyer-in-ordinary course of business questions under section 9-307(1), the competing values may differ.[100]

On the one hand, there is much to be said for the proposition that the question whether a person is a buyer in ordinary course of business should be answered irrespective of its setting under section 2-403(2) or 9-307(1). On the other hand, whether a person is or is not a buyer in ordinary course of business is a question not deliberated on in a vacuum.

EXAMPLE

A gives *B* a security interest in a refrigerator which *A* buys on time from *B*, and *B* delivers the refrigerator to *A*'s home. A financing statement is filed. Unknown to *B*, *A* is a refrigerator dealer. Without consent or knowledge of *B*, *A* then takes the refrigerator to his place of business, and sells it to *C*, a consumer, who buys in good faith in ordinary course of business and without knowledge of *B*'s interest. May *B* assert his security interest against *C*?

Does section 9-307(1) apply only to a case where the secured party knows he is dealing with one in the business of selling goods of that kind?

Nothing in the black letter of section 9-307(1) seems to require such scienter on the part of the secured party, nor does the text of section 1-201(9) defining "buyer in ordinary course of business."

The acknowledged statutory antecedents of section 9-307(1), section 9 of the Uniform Conditional Sales Act and section 9-2 of the Uniform Trust Receipts Act, both contained language which tended to restrict their application to cases where the secured party knew (or at least should have known) that he was dealing with a dealer: The "expressly or impliedly consents that the buyer may resell" language of section 9 of the Uniform Conditional Sales Act; and the consent by the entruster to the trustee's placing the goods in his stock or showroom which would constitute "liberty of sale" under the Uniform Trust Receipts Act.

100. *See* notes 53 and 54 *supra* and accompanying text.

No such language explicitly limits the application of section 9-307(1).

The question, however, is whether there should be an implied qualification, read into the black letter to comport with common law ideas. In other words, the basis of section 9-307(1), it may be contended, rests on estoppel. Thus, if *B* dealt with *A* not knowing that *A* was a dealer in refrigerators, one-half of the two halves of estoppel is lacking: *B*'s conduct leading to *C*'s reliance. In this case, it may be contended, a decision for *C* would be inequitable.

However, regardless of the character of *B*'s conduct, the extent of *C*'s reliance would be the same. All *C* knew was that he was buying goods from *A*, a dealer. With this is mind, the question becomes: As between two innocent parties, *B* and *C*, who takes the risk of *A*'s misdeeds? If we decide for *C*, we would be saying to *B*, "Know your debtor!" *C* bought in a commercial transaction, in the mainstream of commerce, and, as a consumer-buyer, he is an increasing object of the law's concern and protection. Is he not entitled to invoke section 9-307(1) without our reading in qualifications adverse to him?[101]

One might add that *C* must know that he is dealing with a dealer; if it just happens that *A* is a dealer, but *C* does not know this, *C* is not entitled to protection. In most cases like this, however, *C* might not be buying "in ordinary course" since presumably the purchase would not be made at a regular place of business. Beyond this the person making the argument has the burden of going forward.[102] If *C*, the buyer, is a professional buyer, however, it may be reasonable to require more of him.

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101. 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY, § 26.8 (1965) suggests that the secured party should not be protected [section 9-307(1)] where "he should know when he enters the financing transaction that he is financing goods of a type which the seller can sell to a 'buyer in ordinary course of business.'"

102. For a decision giving the benefit of the doubt to the buyer, see Michigan Nat'l Bank v. Grandberry, 11 UCC REP. SERV. 193 (Tenn. Ct. App. 1972). Exhibiting consideration for the small-time buyer ("The appellee Grandberry is twenty-seven years of age with a fifth grade education; he is married and has six children." *Id.* at 195.), the court upheld the fact findings of the lower court:

> R.C. Moore, Jr. [for the secured party] testified that Boales [the seller] was not in the business of selling house trailers, but that he rented house trailers. Moore knew that Boales had some six or eight house trailers in his backyard at Collierville, Tennessee, and that Boales had some house trailers on a lot at Red Bank, Mississippi. Moore testified these trailers were occupied by tenants. Moore proved he charged retail sales tax on the sale to Boales, which he said he would not have charged had Boales been a retailer of house trailers.
>
> . . . .
>
> The purpose of TCA § 47-9-307 is to protect a buyer in ordinary course of business. The record is clear that Grandberry purchased the house trailer in good faith and without knowledge of the encumbrance previously perfected thereon by the seller Boales. There

B. Effect of Motor Vehicle Title Laws

Do the provisions in some motor vehicle acts relating to transfer of title and perfection of security interests in motor vehicles result in depriving a buyer of the protection of section 9-307(1) in certain cases? The question often involves the sale by a dealer of a used car, which in the vast majority of states has a title certificate. A new car, on the other hand, generally is not required to have a title certificate before sale to the first retail buyer.

So far as the rights of buyers in ordinary course of business are concerned, the difficulty is with certain language in some motor vehicle laws. Some laws may say that notation of a security interest on a title certificate (or presentation of a proper application for notation) makes the security interest valid against subsequent purchasers from the debtor, seemingly without exception. Further, some laws could be read to mean that no title or right can be acquired by a transferee of a motor vehicle without compliance with the transfer-of-title provisions. Typically, statutory procedure relating to transfer of title to a used car requires the surrender of the old certificate. An unpaid secured party in possession of the old certificate may refuse to surrender it and argue that his security interest continues and that the buyer has no rights in the car, absent compliance with the statutory procedure.[103]

> was evidence that Boales had sold at least two other house trailers to people in the vicinity of the Grandberry farm. *Grandberry testified that he did not know whether Boales held himself out as in the business of selling house trailers or not.* [emphasis supplied] There is no proof that this particular trailer was ever rented or offered for rent; there is proof that it was offered for sale and sold. There is proof Boales showed the Grandberrys, and that they looked at for the purpose of buying, three house trailers at Collierville and two at Red Bank. The legislative intent to protect the buyer in ordinary course of business is not to be defeated by the renting of three or four trailers, and offering five others for sale.

Id. at 194-96.

In upholding the buyer's rights, the opinion seems to put the secured party's case in the least favorable light and the buyer's case in the most favorable. There is little or nothing to indicate that the secured party should have known he was lending to one in the business of selling goods of that kind, and the buyer admitted that he did not know whether he was dealing with a dealer. And the case is not particularly strong on the basic point that the seller must in fact be one in the business of selling goods of that kind.

Perhaps the case teaches that in high level discussions one should not neglect people and circumstances.

Would the court have decided as it did if the buyer had been a professional?

103. The states which do not have motor vehicle title certificate laws providing for perfection of security interests in motor vehicles by notation or presentation for notation on the certificate are rapidly dwindling in number. For example, New York, an important holdout, has recently joined the ranks of complete title certificate states. N.Y. VEH. & TRAF. § 2101 *et seq.* (McKinney Supp. 1973).

The Uniform Motor Vehicle Title Certificate Act dodges the issue of

Nevertheless, courts have been blithely interpreting their way over the hurdles of language in motor vehicle laws to give the buyer in ordinary course of business section 9-307(1) protection against the inventory secured party.[104]

Take the case of *Stroman v. Orlando Bank and Trust Co.*[105] Florida Statutes section 319.22(1) provided:

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the rights of a buyer in ordinary course of business. Section 3 provides that: "This Act does not apply to or affect—(c) a security interest in a vehicle created by a manufacturer or dealer who holds the vehicle for sale" and leaves it optional for enacting states to add [but a buyer in the ordinary course of trade from the manufacturer or dealer takes free of the security interest]. With the enactment of the U.C.C., section 9-307 (1) seems to supply the answer without need to include the optional language. The Wisconsin statute makes it clear that the buyer in ordinary course of business prevails over the party with a perfected security interest in a debtor's car inventory. WIS. STAT. § 342.02(3) (1971).

In some states, manufacturers certificates of origin are required to be issued for new cars. And in some states new car dealers may obtain dealer's certificates for new cars, on which an inventory security interest may be noted. In Sterling Acceptance Co. v. Grimes, 194 Pa. Super. 503, 506, 168 A.2d 600, 601-02, 1 UCC REP. SERV. 487, 489-91 (1961), it appeared that in addition to perfecting its security interest in a car dealer's inventory by an article 9 filing:

> The acceptance company also had Homish make application to the Bureau of Motor Vehicles for a dealer's certificate of title to the automobile in question. The certificate was duly issued in the name of Homish and had noted thereon an encumbrance in favor of the acceptance company in the amount of $2,614.14. It will be noted that the certificate of title was a "DX" certificate which is issued to a dealer, not an "A" certificate normally issued to a purchaser of a new vehicle. This certificate was kept in the possession of the acceptance company as security . . . .
>
> Section 201(b) of the Vehicle Code of 1929 . . . provided that dealers were not required to obtain certificates of title for new vehicles until and before sale thereof . . . .

The acceptance company, not being paid by the dealer, refused to release the certificate to a buyer in ordinary course of business. The court gave judgment for the buyer under section 9-307(1). The Pennsylvania Motor Vehicle Code at that time provided:

> The outstanding certificate of title, when issued by the secretary showing a lien or encumbrance, shall be adequate notice to the Commonwealth, creditors, subsequent mortgagees, lienors, encumbrancers and purchasers that a lien against the motor vehicle, trailer or semitrailer exists, and failure to transfer possession of the vehicle . . . shall not invalidate said lien or encumbrance.

PA. STAT. ANN. tit. 75, § 203(b) (1971).

104. *See* 2 G. GILMORE, *supra* note 101, at § 26.9. Couch v. Cockroft, 490 S.W.2d 713, 12 UCC REP. SERV. 280 (Tenn. Ct. App. W. Sec. 1973), *cert. denied*, Tenn. Sup. Ct., Feb. 5, 1973 (decided under section 2-403(2)); Godfrey v. Gilsdorf, 86 Neb. 714, 476 P.2d 3, 8 UCC REP. SERV. 316 (1970); Medico Leasing Co. v. Smith, 457 P.2d 548, 6 UCC REP. SERV. 786 (Okla. Sup. Ct. 1969) (a section 2-403(2) case); General Motors Acceptance Corp. v. Keil, — Ia. —, 176 N.W.2d 837, 7 UCC REP. SERV. 835 (1970); Correria v. Orlando Bank & Trust Co., 235 So. 2d 20, 7 UCC REP. SERV. 937 (Fla. Dist. Ct. App. 1970). *But see* First Nat'l Bank & Trust Co. v. Smithloff, 119 Ga. App. 284, 167 S.E.2d 190, 6 UCC REP. SERV. 400 (1969).

105. 239 So. 2d 621, 8 UCC REP. SERV. 395 (Fla. Dist. Ct. App. 1970).

> Except as provided in §§319.21 and 319.28, no person acquiring a motor vehicle from the owner thereof, whether such owner be a dealer or otherwise, hereafter shall acquire a marketable title in or to said motor vehicle until he, she, or it shall have had issued to him, her or it a certificate of title to said motor vehicle, . . . except as otherwise provided herein, no court in any case at law or in equity shall recognize the right, title, claim or interest of any person in or to any such motor vehicle, hereafter sold or disposed of, or mortgaged or encumbered, unless evidenced by and on a certificate of title duly issued, in accordance with the provisions of this law.

It appeared in this case that a dealer had sold a car to Stroman, and Stroman had relied on the dealer to transfer the title. Instead, the dealer took his title certificate to a bank and obtained a loan, and the bank's interest was noted on the outstanding title certificate held by the dealer. In rendering judgment for Stroman against the bank, the court observed:

> This statute . . . does not prevent passage of valid title to a purchaser from a dealer where the purchaser has received possession of the vehicle and in good faith relies on the dealer to perform his statutory duty to secure a proper title certificate in the purchaser's name.[106]

Where the buyer is an ordinary retail consumer buyer, it is unrealistic to expect him to check on the whereabouts of a title certificate before he buys. Even if he should learn that the title certificate is being held by a lender and has a security interest notation on it, this should not matter. No distinction should be made between new cars without title certificates and used cars with. The dominant fact, it would seem, is that uninformed retail consumer buyers rely on the dealer to process the transfer and obtain a new title certificate, and, if necessary, to clear the title by paying off the inventory financer.[107]

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106. *Id.* at 623, 8 UCC REP. SERV. at 397.

107. In *Sterling Acceptance Co. v. Grimes*, 194 Pa. Super. 503, 168 A.2d 600, 1 UCC REP. SERV. 487 (1961) it was held that a buyer in ordinary course of business took free of a perfected security interest in a new car (though the security interest was noted on a title certificate issued to the dealer). But prior Pennsylvania decisions holding that such buyer took subject to a security interest noted on the title certificate of a used car were distinguished (and seemingly approved) on the basis that a title certificate was required for a used car, whereas for new cars dealer's certificates "were not required and generally were not issued." *Id.* at 509, 168 A.2d at 603, 1 UCC REP. SERV. at 491. The distinction made in the *Sterling Acceptance* case has not attracted a following, and should be laid to rest. The distinction was rejected in *Kapral v. Hanover Nat'l Bank*, 1 UCC REP. SERV. 781 (Ct. C.P., Luzerne Cty., Pa. 1962). More difficulty may perhaps exist in states which have adopted alternative A of section 9-302(3)(b) rather than alternative B, which provides that an article 9 filing perfects a security interest in car inventory.

The 1972 amendments to article 9 amend section 9-302(3) by dropping

Where the buyer is another dealer, however, perhaps he should not be such a simple soul.[108]

C. *Buyer in Ordinary Course of Business in Documentary Transactions*

In what way is the application of section 9-307(1) affected if

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alternative A. It is stated:

> The revision also covers a point which is dealt with in the existing section only in Alternative B for subsection (3), namely, that Code filing should be required for security interests in inventory, because there is no reason that the Code's carefully worked out provisions for inventory to protect buyers in Section 9-307(1) and as to rights in proceeds in Section 9-306 should be confused by perfection under a certificate of title or other non-Code system. While the Code's sponsoring organizations cannot amend certificate of title laws, it is hoped that certificate of title laws will be amended or construed so that the Code filing system for inventory will be exclusive and will not be duplicated by the certificate of title system. There are indications in recent case law that the courts are already so construing certificate of title laws.

PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE FINAL REPORT 238 (April, 1971).

108. A curious distinction between dealer-buyers and consumer-buyers is found in section 9-103(2) of the 1972 amendments to article 9, dealing with cars moved from state A to state B. Subsection (d) provides:

> If goods are brought into this state while a security interest therein is perfected in any manner under the law of the jurisdiction from which the goods are removed and a certificate of title is issued by this state and the certificate does not show that the goods are subject to the security interest or that they may be subject to security interests not shown on the certificate, the security interest is subordinate to the rights of a buyer of the goods who is not in the business of selling goods of that kind to the extent that he gives value and receives delivery of the goods after issuance of the certificate and without knowledge of the security interest.

CODE § 9-103(2)(d) (1972 proposed amendment).

This provision is explained in Rohner, *Autos, Title Certificates and UCC 9-103 The Draftsmen Try Again*, 27 BUS. LAWYER 1177, 1183-86 (1972). Rohner thinks that excluding a dealer-buyer from protection under the circumstances may be unfairly discriminatory:

> [I]f that certificate does not even indicate that the car has an out-of-state origin, it is questionable whether the new provision properly discriminates between dealers and others. If the car has also been registered and carries local tags as well as a clean certificate there is nothing to put even the most conscientious dealer on notice of an actual or possible foreign security interest.

Id. at 1185. Application of new section 9-103(2)(d)'s protection to a consumer buyer is not likely to arise in Wisconsin, which issues a distinctive caveat type title certificate for a car first registered in Wisconsin which has come from a non-title certificate state, and which requires surrender of the outgoing state's title certificate, if it is a title certificate state, as a condition to issuance of a Wisconsin title certificate. In New Jersey, however, at least at the time of First Nat'l Bank v. Stamper, 93 N.J. Super. 150, 225 A.2d 162, 3 UCC REP. SERV. 949 (1966) the state issued a clean title certificate for a car coming from New York, then a non-title certificate state, and there was nothing to indicate that the car was subject to an outstanding security interest perfected in New York, except the fact that the certificate number ended with "Z"—the department's symbol to indicate that the car had been registered in another state. It was held

goods are covered by a document of title?[109] We must look to article 7 and see what it has to say, as well as considering article 9 and article 2, and try to make them all work together rather than go their separate ways as they might be inclined to do without a strong interpretive hand at the reins.

Goods in the possession of a "bailee" may be covered by a "document of title,"—for example, a warehouse receipt issued by a warehouseman, or a bill of lading issued by a carrier. The document of title may be either negotiable or non-negotiable.[110]

Documents of title may be transferred by a seller to a buyer in performance of a preexisting contract for the sale of goods. Thus, in an overseas *C.I.F.* contract for the sale of goods, the seller, as part of his performance, procures a set of negotiable bills of lading upon delivery to the carrier and transfers this set with proper endorsement to the buyer upon the buyer's paying the price or accepting a time draft. In another situation, a seller and buyer may agree to a contract for sale of a commodity in storage, and the seller in performance may transfer the warehouse receipt covering the goods to the buyer. The buyer may choose to have the goods remain in the warehouse until he obtains a customer; when he does, he may direct the warehouseman to ship directly to the customer.

Documents of title can also be dealt in as articles of commerce. Thus an importer who has received negotiable bills of lading may sell these documents or pledge them as collateral for a loan while the goods are still at the port of shipment or at sea. In these cases, it is the documents, rather than the goods, which are the primary subject matter of the transaction. But, of course, in selling or pledging the documents, the importer is also selling or pledging the goods covered by the documents.

In a sense, all of the above cases are documentary transactions. Article 7 applies and apparently does not distinguish between cases

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that the New Jersey buyer who thereafter bought the car within four months of its coming into the state took subject to the New York security interest and was liable in conversion. It does not appear whether this buyer was a dealer or a consumer buyer. (If he was a consumer, 1972 section 9-103(2)(d) would obviously reverse the decision.) If he was a dealer, perhaps he should have known what "Z" meant, as part of his knowledge of trade practices.

109. "Document of title" is defined in CODE § 1-201(15):

> [I]ncludes bill of lading, dock warrant, dock receipt, warehouse receipt or order for the delivery of goods, and also any other document which in the regular course of business or financing is treated as adequately evidencing that the person in possession of it is entitled to receive, hold and dispose of the document and the goods it covers. To be a document of title a document must purport to be issued by or addressed to a bailee and purport to cover goods in the bailee's possession which are either identified or are fungible portions of an identified mass.

110. CODE § 7-104.

where the transferee's rights in documents are acquired in performance of a preexisting contract for the sale of goods and cases where there was no such contract, as far as the transferee's rights are concerned.

Of particular interest is how the provisions of article 7 affect the position of buyer in ordinary course of business.

Section 1-201(9), the definition of buyer in ordinary course of business, obviously includes a case where a person buys goods in a documentary transaction, where the goods are in the possession not of the seller, but of a bailee: "Buying . . . includes receiving goods or *documents of title* under a preexisting contract for sale . . . ." [Emphasis supplied]

The joker is, however, that in some cases the buyer's rights in the *goods* may depend upon his rights in the document covering the goods, and if he has no rights in the document, what then?

Two questions may arise in documentary transactions: First, what are the buyer's rights in the document? and second, what are his rights in the goods covered by the document? To answer these questions we must turn our attention to article 7 and separately consider negotiable and non-negotiable documents of title.[111]

1. GOODS COVERED BY NEGOTIABLE DOCUMENTS OF TITLE

Where goods are covered by a negotiable document of title, section 7-502 supplies the general rule:

> (1) Subject to the following section and to the provisions of Section 7-205 on fungible goods, a holder to whom a negotiable document of title has been duly negotiated acquires thereby:
>
> (a) title to the document,
>
> (b) title to the goods;
>
> . . . .

To be such holder, the mechanics of negotiation specified in section 7-501 (1)-(3) must be complied with, and there must be a "due negotiation," meeting the standards of section 7-501(4):

> A negotiable document of title is "duly negotiated" when it is negotiated in the manner stated in this section to a holder who purchases it in good faith without notice of any defense against or claim to it on the part of any person and for value, unless it is established that the negotiation is not in the regular course of business or financing or involves receiving the document in settlement or payment of a money obligation.

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111. Article 2 focuses upon dealings in *goods* covered by a document of title. *See, e.g.,* CODE §§ 2-503(4), 2-320, 2-515. Article 7 focuses upon dealings in *documents of title* covering goods.

Compare the "buyer in ordinary course of business"—section 1-201(9)—with this person who takes under section 7-501(4). The most striking difference is that a section 7-501(4) person may include a pledgee as well as a buyer of the documents. In this respect he is like the holder in due course of a negotiable instrument —section 3-302. A more subtle difference: A buyer of goods in ordinary course of business must buy "from a person in the business of selling goods of that kind," and presumably the burden is upon the buyer to establish this fact,[112] whereas a buyer of documents of title can qualify under section 7-501(4) (all other conditions being met) "unless it is established that the negotiation is not in the regular course of business or financing. . . ."

The comment to section 7-501 explains that:

> There are two aspects to the usual and normal course of mercantile dealings, namely, the person making the transfer and the nature of the transaction itself. The first question which arises is: Is the transferor a person with whom it is reasonable to deal as having full powers? In regard to documents of title the only holder whose possession appears, commercially, to be in order *is almost invariably a person in the trade.* [Emphasis supplied] No commercial purpose is served by allowing a tramp or a professor to 'duly negotiate' an order bill of lading for hides or cotton not his own, and since such a transfer is obviously not in the regular course of business, it is excluded from the scope of protection of subsection (4).

Thus, the concept of "regular course of business or financing" has much in common with the concept of "buyer in ordinary course of business." Sometimes, but not always, a person who qualifies under section 7-501(4) as to the document of title may also be, as to the goods covered by the document, a buyer in ordinary course of business. For example, if *S*, a merchant-seller, in fulfilling his contract with *B*, delivers to *B* a negotiable bill of lading covering the goods, upon *B*'s payment of the invoice price, *B* may qualify as a buyer in ordinary course as to the goods, as well as a section 7-501(4) purchaser of the negotiable document. But whether he is or is not a buyer in ordinary course of business will not affect his rights in the goods, provided section 7-502 applies, for his rights in the document carry with it rights in the goods.[113]

To establish rights in the goods under section 7-502, the section

112. *See* notes 81-84 *supra* and accompanying text.

113. Section 7-502 correlates with section 7-403(1), which provides that "The bailee must deliver the goods to a person entitled under the document who complies with subsections (2) and (3) unless and to the extent that the bailee establishes any of the following (a) delivery of the goods to a person whose receipt was rightful against the claimant; . . ." Subsection (4) provides: "person entitled under the document means holder in the case of a negotiable document . . . ."

7-501(4) person must get by the obstacles of section 7-503 which provides:

> (1) A document of title confers no right in goods against a person who before issuance of the document had a legal interest or a perfected security interest in them . . . .

(So, when a thief of goods stores them and gets a negotiable warehouse receipt for them and negotiates it, the transferee acquires no rights in the goods as against the victimized owner, even though there was a "due negotiation" of the document and the transferee qualified under section 7-501(4)).

Section 7-503's opening statement is followed by:

> [A]nd who neither (a) delivered or entrusted them or any document of title covering them to the bailor or his nominee with actual or apparent authority to ship, store or sell or with power to obtain delivery under this Article (Section 7-403) or with power of disposition under this Act (Section 2-403 and 9-307) or other statute or rule of law; nor
>
> (b) acquiesced in the procurement by the bailor or his nominee of any document of title.[114]

EXAMPLE

X holds a perfected-by-filing security interest in *D*'s inventory consisting of merchandise. *D* without authority from *X* stores the goods and obtains negotiable warehouse receipts made out to *D*'s order. Then *D*, in a sales transaction, negotiates a receipt covering some of the merchandise to *Y*. *Y* qualifies under section 7-501(4) as a person to whom the document is duly negotiated. Under the same facts, *Y* also qualifies as a buyer of the goods (covered by the document) in ordinary course of business. Since *D* had "power of disposition under this Act"—section 9-307(1)—section 7-503 does not stand in Y's way, and *Y* has rights in the goods as against *X* under

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114. The situations set forth in section 7-503 which preclude a person who is not the bailor from setting up his ownership or security interest claims are rather cryptically jammed together in a single sentence. It seems an obvious attempt to compact the range of precluding circumstances based on actual authority, apparent authority and estoppel. Because it is so compacted, it is not an easy matter to apply section 7-503 in some cases.

EXAMPLE

X holds a perfected-by-filing consumer-goods security interest in *B*'s furniture. *B* then stores the furniture in a warehouse and obtains a negotiable warehouse receipt. A month later he decides to sell the furniture to *Y*, and does so by negotiating the receipt to *Y*. Assume *Y* qualifies under section 7-501(4) (even though *B* is not a merchant). Now except for the fact that the goods had been warehoused, *X* would clearly prevail over *Y* as to rights in the goods. Then does *Y* win because he took in a documentary sale? Should the answer depend upon whether *D* had "actual or apparent authority" to store his furniture? And, by the way, "apparent" to whom? to *D*? to the warehouseman? to *Y*?

section 7-502(1). The warehouseman's duty to deliver therefore runs to Y under section 7-403.

Note that the result is the same as it would have been had *D* not stored the goods before selling to Y.[115] In that case, X would have lost his security interest to Y by direct application of section 9-307(1).

Then why not treat this as a simple section 9-307(1) case, emphasizing that Y is a buyer of the goods in ordinary course of business, and skip over the fact that the goods are covered by a document of title? Can't do. Section 9-309 stands in the way:

> Nothing in this Article limits the rights of a holder in due course of a negotiable instrument . . . or a holder to whom

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115. In *United States v. Hext*, 444 F.2d 804, 9 UCC REP. SERV. 321 (5th Cir. 1971), it appeared that Farmers Home Administration had acquired a perfected security interest in the cotton crop of one Hext, on account of a loan, and knew at the time of financing him that Hext owned a gin company and that after harvesting he would deliver the cotton to this company for ginning and marketing. He did, and after processing, the gin company delivered the cotton to a warehouseman in return for negotiable receipts. The gin company thereafter sold the cotton to a bona fide purchaser in the ordinary course of business, and delivered the receipts to him. In a suit by the United States against the warehouseman for delivering the cotton to the purchaser, and against the broker who arranged the sale, on the theory of conversion, judgment was rendered against the government. The defendants were let off the hook because the court found that the buyer was a buyer in ordinary course of business, and section 9-307(1) applied. Since the government knew that the debtor and the gin company were tied together, the situation was the same as if the gin company had created the security interest, and when it received possession, the cotton was no longer "farm products," but "inventory" (the gin company was not a farmer).

In a footnote the opinion considers the documentary aspects of the transaction:

> The same result would obtain under Article 7 of the Code if the transactions here be viewed as involving the purchase of negotiable documents of title (warehouse receipts) rather than the purchase of the cotton itself. See Uniform Commercial Code § 9-309. Article 7, in § 7-503(1), requires that the holder of a negotiable warehouse receipt obtains 'no right in goods against a person who before issuance of the [receipt] had . . . a perfected security interest in them' unless the secured party either (a) entrusted the goods 'to the bailor or his nominee with actual or apparent authority to . . . store' them or with power of disposition under § 9-307; or (b) 'acquiesced in the procurement by the bailor or his nominee of any document of title.' Under this section it is clear that in the circumstances of the instant case the cotton was entrusted to the possession of Hext (the bailor) and that he had apparent authority to store the cotton with Harlingen. Further, as we have held supra, Hext had power of disposition of the cotton under § 9-307(1). As Professor Gilmore has pointed out: "The cross reference to § 9-307 [in § 7-503(1)] means . . . that there is nothing a secured party can do to protect himself against the contingency of a fraudulently procured document with respect to collateral which is inventory held by a debtor for sale. . . ." (G. Gilmore, 2 *Security Interests in Personal Property*, § 25.4, at 666 (1965)). . . .

Id. at 814-15 n. 34, 9 UCC REP. SERV. 321, 337 n.34.

> a negotiable document of title has been duly negotiated . . . . and such holders take priority over an earlier security interest even though perfected. Filing under this Article does not constitute notice of the security interest to such holders . . . .

Although this provision does not affect the result of the above example, it does seem to make section 9-307(1) unavailable to defeat the rights of a pledgee of negotiable documents who qualifies under section 7-501(4) and acquires rights in the goods under section 7-502. This reading of section 9-309 is supported by the fact that section 7-502(1) begins by saying "subject to the following section [Section 7-503, already treated] and Section 7-205," but does not additionally refer to section 9-307(1).

Section 7-205 provides:

> A buyer in the ordinary course of business of fungible goods sold and delivered by a warehouseman who is also in the business of buying and selling such goods takes free of any claim under a warehouse receipt even though it has been duly negotiated.

Observe that in the situation covered by section 7-205 the buyer of the goods is buying from the warehouseman in possession, and the warehouseman is "in the business of buying and selling such goods." This is a special case, applicable to fungible goods only.

Putting sections 7-502 and 7-205 together, one concludes that except for the situation covered by section 7-205, a pledgee to whom a negotiable document of title has been duly negotiated has rights in the goods which cannot be defeated by one who claims to be a buyer in ordinary course of business. Section 9-307(1) does not seem to apply. Perhaps the rationale behind this apparent rule is that one buying goods which are in the possession of a bailee holding those goods for a third party pledgee rather than the seller cannot qualify as a buyer in ordinary course of business anyway.

In the example above (immediately following note 114 in the text) where the warehouse receipt was issued to *D*, fortunately *Y*, and not someone else, is the person to whom the document of title has been duly negotiated. It is *that* person who defeats *X*'s security interest in the goods.[116] To illustrate and summarize

116. But in *Hendries, Inc. v. American Express Co.*, 35 App. Div. 2d 412, 316 N.Y.S.2d 554, 8 UCC REP. SERV. 852 (N.Y. Sup. Ct., App. Div. 1970), the court seemed to think it was important to say that a letter of credit bank which had acquired negotiable documents of title (bills of lading) in its own name from the shipper was the "owner" of the documents, rather than a pledgee with a security interest, in order to avoid the impact of section 9-307(1). While it is true that the letter of credit bank "succeeds" to the seller's interest (*see* PROBLEMS OF LENDERS, BORROWERS AND SELLERS, *supra* note 11, at 77,) the seller's interest is a "security interest" (section 2-505). The opinion does not cite any sections of article 7, and thus does not meet the fundamental question whether a buyer can invoke section 9-307(1) as against a pledgee of negotiable documents.

the point:

EXAMPLE

D warehouses his merchandise and obtains negotiable warehouse receipts issued by the warehouseman. He duly negotiates the receipts to *X* as a pledge for loan. *X* qualifies under section 7-501(4). *D* then, without consent or knowledge of *X*, contracts to sell some of the merchandise in the warehouse to *Y*. *Y* takes subject to *X*'s security interest. Section 9-307(1), it seems, does *Y* no good here.[117]

But shuffle the cards, and the result may change. If a pledgee of the warehouse receipts, a lender, for example, *authorizes* the dealer-debtor to enter into contracts for the sale and delivery of goods from a warehouse, the pledgee of the receipts could hardly rightfully refuse to cooperate in performance by directing the warehouse to deliver the goods to the buyer.[118]

Conceivably with respect to the handling of some kinds of inventory a trade custom exists of having the pledgor-dealer make contracts for delivery of goods from a warehouse, perhaps without obtaining the prior consent of the pledgee—it being tacitly understood by most pledgors and pledgees dealing with the kind of inventory involved that this is a proper procedure, provided at the end the pledgee is a joint payee of the buyer's check. Would this mean that any pledgee in this trade area is entrusting his pledgor with the badge of apparent authority, so as to be disabled from frustrating the consummation of a contract for sale?

The reality to keep in mind is this: Allowing inventory covered by pledged receipts to sit indefinitely in a warehouse will not serve the interests of the lender-pledgee or the borrower-pledgor; the inventory has got to be moved; often the debtor, experienced in selling the kind of inventory involved, is the proper party to negotiate the sales.

Interject facts establishing actual authority, trade usage, estoppel and the like, and you have really shuffled the deck. But it is these facts, and not section 9-307(1), which may determine the outcome against the pledgee of the receipts.[119]

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117. Section 9-304(5) permits a pledgee with a perfected security interest in documents to deliver the goods out of the warehouse to the pledgor for purposes of transportation, sale, etc., and still retain a perfected security interest for 21 days without filing. If such pledgor in possession of the inventory makes an unauthorized sale of the goods to a buyer in ordinary course of business, section 9-307(1) clearly applies.

118. If the holder of the negotiable receipt permits a merchant-debtor to make contracts for sale involving the goods, or to act as ostensible owner, and contributes to the appearance that he, the merchant, is able to effect delivery from the warehouse, a basis for loss of right may be found, on some theory or another. *See* Hendries, Inc. v. American Express Co., 35 App. Div. 2d 412, 316 N.Y.S.2d 554, 8 UCC REP. SERV. 852 (N.Y. Sup. Ct., App. Div. 1970).

119. *See* CODE § 9-306(2).

2. GOODS COVERED BY NON-NEGOTIABLE DOCUMENTS OF TITLE

Section 7-504(2) explicitly recognizes the possibility that where goods are covered by a non-negotiable warehouse receipt there can be a buyer of the goods in ordinary course of business. Section 7-504(2) provides:

> [U]ntil but not after the bailee receives notification of the transfer, the rights of the transferee may be defeated (b) by a buyer from the transferor in ordinary course of business if the bailee has delivered the goods to the buyer . . . or received notification of his rights . . . .

This provision ties in with section 2-503(4) (b) (dealing with the sale of goods covered by a non-negotiable document of title) which provides that where the goods are to be delivered without being moved: "receipt by the bailee of notification of the buyer's rights fixes those rights as against the bailee and all third persons . . . ."

Under these sections, a buyer of the *goods* in ordinary course of business may have to run a race with a transferee of the document, in the event a seller dishonestly sells the goods to one person and transfers the document to another. So, occasionally, persons who buy goods covered by non-negotiable documents may, if buyers in ordinary course of business, prevail over persons with rights in the goods through being transferees of the documents covering the goods.[120]

But, in general, a buyer dealing only in goods, with the non-negotiable documents outstanding, buys perilously.

EXAMPLE

D stores his inventory consisting of merchandise in a field warehouse established on his premises by an independent field warehouse company. Assume the warehouseman maintains "possession" and control of the goods and the validity of the warehouse may not be successfully attacked. The non-negotiable receipts issued by the warehouseman to *D* are transferred to *X* as security for a loan made to *D* by *X*, and the warehouseman is duly notified of the transfer. *X* thus perfects his security interest by vicarious possession of the collateral as provided for in section 9-305. Under the terms of the security agreement, all releases from the warehouse require the prior consent of *X*, and the warehouseman has been instructed to that effect. Then *D*, without the knowledge or consent of *X*, contracts with *Y* for the sale of some of the goods which are in the field warehouse. Even though *Y* may qualify

120. Further, section 7-504(3) provides:
> A diversion or other change of shipping instructions by the consignor in a non-negotiable bill of lading which causes the bailee not to deliver to the consignee defeats the consignee's title to the goods if they have been delivered to a buyer in ordinary course of business . . . .

as a buyer of the goods in ordinary course of business (since goods are in warehouse, questions may arise as to whether buying is "in ordinary course"), it seems that *Y* does not take free of *X*'s security interest.[121]

Y is not protected under section 7-504(2) since the warehouseman had been notified of *X*'s interest before *D* sold to *Y*.

In contrast, if the goods had *not* been field warehoused and *X* held a perfected (by filing) security interest in the goods, *Y would* have prevailed under section 9-307(1), if a buyer in ordinary course of business.

Thus, section 7-504(2) seems to give *X*, the secured party, as a transferee of the non-negotiable document who by notifying the bailee has perfected his security interest in the warehoused goods, better protection against *Y*, buyer, than he would have had if there was no third party bailee and *X* had held a perfected (by filing) security interest in inventory with the debtor in possession. Anomalous? Or simply illustrative of a basic point, that a possessory security interest with the secured party at the helm has more built-in protection than a nonpossessory security interest with the debtor at the helm?

Why should it make a difference that the goods were field warehoused? Perhaps, because it is assumed that under the circumstances *Y* cannot qualify as a buyer in ordinary course, for *Y* would either buy sight unseen or be alerted to the fact that possession of the merchandise was not in his seller. The posting of the field warehouse premises by the warehouse company is designed to inform visitors that the storer does not have control of the goods in the field warehouse space.[122] This being the case, arguably *Y* should then as a matter of course ascertain from the warehouseman whether it had been notified of transfer, and thus was holding the goods as bailee for someone other than the storer. Even if *Y* is in "good faith"—this could be difficult to establish *if* section 2-103(1)(b) applies—a court could rule as a matter of law that *Y*'s purchase was not in ordinary course.

Further, in all cases where goods are held by a bailee, questions can arise as to whether title passed to the buyer under section

121. Example of the application of section 7-504: In *Lofton v. Mooney*, 452 S.W.2d 617, 7 UCC REP. SERV. 824 (Ky. Ct. App. 1970), a creditor of the storer attached goods in the possession of a field warehouse company. A non-negotiable receipt covering the goods (corn) had previously been issued, at the instance of the storer, *directly* to a bank as security for a loan made by the bank to the storer. It was held that the bank's interest in the stored goods was superior to the attaching creditor's. While this result would be consonant with section 7-504, as the opinion observed, it was held that section 7-504 was inapplicable to this case, since no transfer of the receipt was involved.

122. *See* Skilton, *Field Warehousing As A Financing Device, Part I*, 1961 WIS. L. REV. 222, 260.

2-401. Taking the view of *Chrysler Corporation v. Adamatic, Inc.*,[123] a court may hold that a buyer may not qualify as a buyer in ordinary course of business until he gets title. In the usual case title passes when the seller "completes his performance with reference to the physical delivery of the goods," and if the seller is obligated to ship the goods to the buyer, title passes upon shipment.[124] This leaves only the case where buyer and seller agree as to goods in a warehouse that the seller has no obligation to deliver a document of title and no obligation to ship—in such case title may pass upon the making of this contract, as to goods already identified.[125] (Obviously, this possibility exists only if the goods are covered by a non-negotiable document of title, since the buyer must depend on the seller's cooperation to effect delivery of goods covered by a negotiable document of title, until the seller transfers the negotiable document to him.)

As much as possible, differences between documentary sales and sales of goods not covered by documents should be toned down, at least as far as the rights of a buyer in ordinary course of business are concerned. The relevant provisions of articles 2, 7 and 9 should be construed together and earnest efforts made to harmonize them and avoid inharmonious applications.[126]

D. Section 9-307(2)

Section 9-307 (1962) has two subsections, and so far, we have considered only section 9-307(1), which provides that a buyer in ordinary course of business takes free of a security interest created by his seller. The question we now turn to is whether subsection (1) occupies the entire area of buyer in ordinary course of business protection against perfected security interests, or whether, on the other hand, protection may occasionally be found under section 9-307(2), in a case not covered by section 9-307(1).

123. *See* Chrysler Corp. v. Adamatic, Inc., 59 Wis. 2d 219, 208 N.W.2d 97, 12 UCC REP. SERV. 849 (1973).

124. CODE § 2-401(2).

125. CODE § 2-401(3).

126. It is believed that section 9-307(1) protects buyers who acquire rights in goods as transferees of non-negotiable documents, as well as buyers who buy goods in a nondocumentary transaction. Since the "Nothing in this Article limits" language of section 9-309 does not apply to persons claiming rights under non-negotiable documents, it would seem clear that the only time a secured party could head off such buyers (if in ordinary course of business) from claiming rights under section 9-307(1) would be by taking an assignment of the document and giving prior notification to the bailee, or having a receipt issued in his name, before a buyer in ordinary course of business notified the bailee or had the goods delivered to him. And so, if instead the secured party perfected by filing as to the goods, and the debtor stored the goods and transferred the non-negotiable receipt to a buyer, that person should as a transferee of the receipt qualify under section 9-307(1) if he fulfilled the requirements of section 1-201(9). Whether the debtor sold the goods to him without first warehousing them

Section 9-307(2) provides:

> In the case of consumer goods and in the case of farm equipment having an original purchase price not in excess of $2500 (other than fixtures, see Section 9-313), a buyer takes free of a security interest even though perfected if he buys without knowledge of the security interest, for value and for his own personal, family or household purposes or his own farming operations unless prior to the purchase the secured party has filed a financing statement covering such goods.[127]

For our purposes, the principal question to be considered is whether this subsection affords or denies protection to a buyer in ordinary course of business, in the following situation not covered by section 9-307(1): Suppose *B-One* buys consumer goods on a conditional sales contract, agreeing to pay the price in installments, and *S*, the seller, has a purchase money security interest which is perfected without filing by virtue of section 9-302(1)(d). *S* does not file. *B-One*, without *S*'s knowledge or consent, and contrary to the terms of the conditional sales contract, sells to *D*, a dealer, who buys without knowledge of *S*'s security interest. Dealer then sells to *B-Two*, a consumer-buyer, who qualifies as a buyer in ordinary course of business.

Section 9-307(1) does *not* protect *B-Two*, since the security interest was not created by *B-Two*'s seller—the dealer. But does section 9-307(2)? Before we examine this question in detail, let us come to some understanding of the application of section 9-307(2) in run-of-the-mill cases.

EXAMPLE 1

D, a dealer, sells a refrigerator to *B*, for household use. *B* signs a retail installment contract which gives *D* a security interest in

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or sold the goods after warehousing and as part of the sale transferred a non-negotiable receipt to the buyer should make no difference. However, section 7-504(1) is a source of confusion, in providing that the transferee of a non-negotiable document of title "acquires the title and rights which his transferor had or had actual authority to convey." Point 2 of the comment interprets this to mean "only" such rights. I take issue with this comment in Skilton, *Some Comments to the Comments to the Uniform Commercial Code*, 1966 WIS. L. REV. 597, 621-24. Surely section 7-504(1) should not prevent a buyer from barring a secured party under section 9-307(1) merely because the transfer of the goods is effected by transfer of the receipt and the sale was unauthorized by the secured party. Perhaps footnote 30 in *United States v. Hext*, 444 F.2d 804, 813, 9 UCC REP. SERV. 321, 330 (5th Cir. 1971), can be read to suggest that the transferee does not have the advantage of section 9-307(1). If so, it should not be approved.

127. The 1972 Amendments to section 9-307(2) and 9-302 drop the farm equipment provisions. Under those amendments a purchase money security interest in farm equipment, regardless of amount, can be perfected only by filing or possession. Section 9-307(2) becomes applicable only to purchase money security interests in consumer goods.

the refrigerator until *B* completes the installment payments. A financing statement meeting the terms of section 9-402 is properly filed in accordance with section 9-401 on the same day. A few months after delivery, *B* sells the refrigerator to *N*, his neighbor, who also buys for household use.

N takes subject to *D*'s perfected security interest. Section 9-307(2) does not protect *N* because *D* had filed before *N* had bought.[128]

EXAMPLE 2

Same facts as Example 1, except that *no financing statement* is filed. Answer: *N* takes free of *D*'s security interest, even though *D* held a purchase money security interest[129] that is perfected without filing or possession-in-*D* of the collateral.[130] Since *N* bought for household use, he comes within section 9-307(2).[131] *D* has, of course, rights against *B* on *B*'s personal obligation to pay.

EXAMPLE 3

D, a dealer, sells farm equipment, price $10,000, to *F*, a farmer, on credit terms. *F* signs a retail installment contract which gives *D* a security interest in the farm equipment until *F* completes the installment payments. No financing statement is filed. *F* thereafter sells the equipment, without the consent of *D*, to *X*, a dealer, who buys for value and takes without knowledge of *D*'s security interest.

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128. *See* National Shawmut Bank v. Jones, 108 N.H. 386, 236 A.2d 484, 4 UCC REP. SERV. 1021 (1967). The standard 1962 version of the Code is assumed in the examples; Wisconsin provides $250 instead of $2500 for farm equipment, and limits section 9-302(1)(d)'s provision to $500.

CAVEAT: This answer is based solely on article 9. The transaction between *D* and *B* is a consumer transaction, and is subject to the federal Truth-In-Lending Act, and may also be subject to an "all-goods" installment contract law of the state whose law applies, and in any event may soon be subject to Uniform Consumer Credit Code (UCCC) or some other like statute, such as the Wisconsin Consumer Act. The extent to which such statutes may give *N* (or *B* and *N*) a complete or partial defense in an action brought by *D*, or *D*'s assignee, is not here considered. *See* CODE § 9-201.

129. CODE § 9-107.

130. Under section 9-302(1)(d), filing is not required to perfect a purchase money security in consumer goods except motor vehicles and fixtures. (Some changes made in 1972 version). "Consumer goods" are defined in section 9-109(1) as goods "used or bought for use primarily for personal, family or household purposes."

131. *See* Balon v. Cadillac Autmobile Co., — N.H. —, 303 A.2d 194, 12 UCC REP. SERV. 397 (1973). *N* cannot, of course, claim protection under section 9-307(1). Though the security interest was created by his seller, *B*, *N* is not a "buyer in ordinary course of business," since *B* was not *in the business* of selling goods of that kind (section 1-201(9)). An *isolated* sale (though a business transaction) does not suffice to establish that the seller is "in *the* business of selling goods of that kind."

X acquires free of *D*'s security interest. *D*'s security interest was unperfected since the purchase price was in excess of $2500[132] and *X* prevails under section 9-301(1)(c).

The most obvious case involving section 9-307(2) is Example 2 where a consumer buyer who holds goods subject to a perfected-without-filing purchase money security interest sells directly to another consumer buyer—certainly a transaction not in the main stream of commerce. As to this transaction, clearly section 9-307(2) imposes the risk of loss of security interest upon the nonfiling purchase money secured party.

But how about a case where there is an intermediate sale to a dealer (*B-One* sells to *D* and *D* sells to *B-Two*) and *B-Two*, though buying for consumer purposes, does not buy directly from the debtor in the consumer-goods secured transaction? To date, the courts have been unanimously declaring that for *B-Two* to be protected by section 9-307(2) he must buy from another consumer—*B-One*.

Views like this (1) do not support consumer buyers, but rather support security interests, and (2) since the consumer buyer is also a buyer in ordinary course of business under facts assumed, do not support a buyer who buys in the mainstream of commerce—taking from a dealer—whereas his position seems to be at least as reasonable and entitled to protection as that of a buyer who buys directly from another consumer.

It is submitted that the restrictive interpretation of section 9-307(2) that seems to be acquiring wide acceptance is ill-considered and unnecessary. Perhaps it is a product of cases without much facts-appeal.

In *National Shawmut Bank v. Vera*[133] a judgment creditor had caused property of the debtor to be seized and sold at execution sale and had himself purchased the property at the sale for his family use. The property was subject to a purchase money security interest in consumer goods, perfected without filing (conditional sales contract transaction). Plaintiff, as assignee of the conditional sales contract, sued the purchaser at the execution sale for conversion. Defense: section 9-307(2). The Court held for plaintiff.

Defendant did not, by becoming *a lien creditor*, subordinate plaintiff's perfected-without-filing security interest. Could defendant improve his position by purchasing at his own execution sale? Well, hardly, opined Cutter, J. for the Court. Besides, "dicta'ed" Cutter, J., section 9-307(2) requires that not only must the *buyer* be a consumer *buyer*, but his *seller* must also be a consumer *seller*.

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132. CODE § 9-302(1)(c).
133. 352 Mass. 11, 223 N.E.2d 515, 4 UCC REP. SERV. 1 (1967).

Defendant buyer fared no better in *Everett National Bank v. DeSchuiteneer.*[134] Russo had bought a car, signed a conditional sales contract, and then disappeared. The car was eventually located in possession of the defendant, who had purchased it from Saia, Saia purporting to be agent for a car dealer. Seller's assignee brought replevin. "It was agreed that the defendant had no notice of the existence of a conditional sales contract and that he purchased for family use. There is no indication in the agreed statement of facts as to how the automobile got from Russo to Saia."[135] Who knows? The car may have been stolen. A new trial was ordered to ascertain, among other things, whether the car had been held by Saia as inventory or as consumer goods:[136]

> The trial concentrated on the use to which the defendant was putting the goods rather than on the use to which the seller Saia was putting the goods. According to the interpretation of §9-307(2) supported by the authorities, the goods must be consumer goods in the hands of both buyer and seller in order to fall under §9-307(2). There is no evidence in the agreed statement of facts to support the conclusion that the automobile was consumer goods in the hands of Saia, nor is there any evidence that Saia was not a dealer's agent, from which it could be inferred that Saia was a consumer. Saia's identity as a dealer's agent or as a consumer was not considered to be important at the time of the trial, therefore this case must be remanded for a proper determination of Saia's identity and a *classification of the automobile either as inventory or consumer goods in the hands of Saia.*[137]

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134. 109 N.H. 112, 244 A.2d 196, 5 UCC REP. SERV. 561 (1968).

135. *Id.* at 133, 244 A.2d at 197, 5 UCC REP. SERV. at 562.

136. The purchase money security interest was created in Massachusetts whose version of section 9-302(1)(d) does not exclude motor vehicles. The car was purchased by the defendant in New Hampshire. Plaintiff filed in New Hampshire within 4 months of the time the car was brought into New Hampshire.

The tangled webs woven by Russell Saia were also involved in *Balon v. Cadillac Automobile Co.*, — N.H. —, 303 A.2d 194, 12 UCC REP. SERV. 397 (1973).

137. Everett Nat'l Bank v. DeSchuiteneer, 109 N.H. 112, 115-16, 244 A.2d 196, 199, 5 UCC REP. SERV. 562, 564 (1968) (emphasis supplied). The opinion observed:

> As pointed out in paragraphs 1 and 2 in the Comments on § 9-109: The classification [of goods] is important in many situations: it is relevant, for example, in determining the rights of persons who buy from a debtor goods subject to a securing interest (Section 9-307) . . . The classes of goods are mutually exclusive; the same property cannot at the same time and as to the same person be both equipment and inventory, for example . . . goods can fall into different classes at different times; a radio is inventory in the hands of a dealer and consumer goods in the hands of a householder. As the use of the goods changes the category in which the goods fall may also change. 1 Gilmore, Security Interests in Personal Property § 12.3 (1965), "It will be observed that the definition of 'consumer goods' used in Article 9 does not depend upon physical characteris-

So the court rationalized that if the car was *inventory* to Saia, then section 9-307(2) does not apply.

In *New England Merchants Bank of Boston v. Auto Owners Finance Company, Inc.*,[138] *B* bought a car on time. Financing Bank acquired a purchase money security interest in the car. There was no filing. *B*, without consent of Bank, sold the car to *K*, a car dealer, *K* buying without knowledge of Bank's security interest. *K* sold to *P*, *P* buying for personal and family use. Finance Company financed *P*'s acquisition. Finance Company took a purchase money security interest and filed. *P* defaulted; Finance Company repossessed. Bank, locating car, sued Finance Company for conversion. Decision: for Bank.[139]

This was hardly a likely case to produce sentiment for protecting the consumer buyer. The hassle was between Bank and Finance Company.

The opinion posed the issue as follows:

> The decisive issue is whether when Mrs. Peters as an innocent purchaser for value, acquired the automobile from Kennedy, she took free of the plaintiff's unrecorded security interest and could transfer her unimpaired title to the defendant. The plaintiff argues that under GLC 106, §9-307(2) Kennedy, a dealer, was selling from 'inventory' and hence the automobile was not 'consumer goods' in its hands.
>
> The crucial point is whether under §9-307(2) the seller as well as the buyer must be a consumer [quoting Section 9-307(2)].[140]

And then the opinion makes the "clincher" argument:

> [c]areful reading of the entire subsection leads to the conclusion that the opening phrase, 'in the case of consumer goods,' must require that the seller as well as the buyer be a consumer. *If the buyer alone has to be a consumer, the opening phrase would be surplusage because of the subsequent provision that the buyer purchase 'for his own personal, family or household purposes,' which is nothing more than a repetition of the definition of consumer goods in §9-109(1).*[141]

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tics of the goods. The pivotal language in the definition is 'used or bought for use.' Thus, it is the function which the goods are performing or are being purchased to perform which is crucial." Strasheim, Art. 9 of the Uniform Commercial Code as it Relates to Secured Transactions in Which the Collateral is Consumer Goods or Equipment, 43 Neb. L. Rev. 826, 838 (1964).

Id. at 114, 244 A.2d at 198, 5 UCC REP. SERV. at 562-63.

138. 355 Mass. 487, 245 N.E.2d 437, 6 UCC REP. SERV. 58 (1969).

139. Another car case, —again illustrating how Massachusetts toleration of perfected-without-publicity purchase money consumer goods transaction is significantly and troublesomely more encompassing than standard version § 9-302(1)(d).

140. 355 Mass. 488, 245 N.E.2d 437, 438, 6 UCC REP. SERV. 58, 59 (1969).

141. *Id.* (emphasis supplied).

Finally, there is *General Motors Acceptance Corporation v. Troville.*[142] Plaintiff, assignee of a conditional sales contract, brought replevin to recover possession of a car. In this case, the defendant was not a lien creditor who bought in at his own execution sale (*Vera*), nor a defendant who bought from a questionable source which had somehow obtained possession of the car and maybe title (*DeSchuiteneer*), nor another finance company, (*Owners Finance Co.*). The defendant was a consumer buyer who had bought from a genuine car dealer who had bought from plaintiff's debtor. The defendant had "facts appeal."

And yet the opinion adds nothing new to what has already been said:

> The vital question is whether this is a 'case of consumer goods,' the car having been bought by Troville from a dealer. GMAC argues that in the hands of the dealer it was inventory (c. 106, §9-109(4)), and not susceptible to being classified at the same time as consumer goods, even though when sold originally by Connelly Pontiac to Wasil it fitted into that classification. The text of the opinion in the *National Shawmut Bank of Boston v. Vera* . . . seems to support GMAC's contention.[143]

Why are the views expressed in these cases not convincing?

(1) The argument that the language "in the case of consumer goods" is mere surplusage unless construed to require that the seller be a consumer is based on a misconception. This phrase has another purpose. It should be read as a short hand way of saying, "in the case of purchase money security interests in consumer goods perfected under section 9-302 without filing or possession." Point 1 of the Comment to section 9-307(2) makes this clear.

> (a) This construction is supported by what follows in section 9-307(2): "in the case of farm equipment having an original purchase price not in excess of $2500 . . . ." The $2500 limitation makes sense only when considered in connection with section 9-302(1)(c) (1962 Version) with which it is obviously interconnected. Thus *pari passu* the reference to "consumer goods" in section 9-307(2) leads directly to section 9-302(1)(d).
>
> (b) Section 9-307(2)'s phrase "in the case of consumer goods" dates back to a time when section 9-307(1) began with the phrase "in the case of inventory"—a phrase dropped from section 9-307(1) in 1956. In the case of consumer goods was designed to set off the subject matter of section 9-307(2) from the subject matter of section 9-307(1). Just as (it is believed) in the case of inventory was intended to mean "in the case of security interests in inventory," so "in the case of consumer

142. 6 UCC REP. SERV. 409 (Mass. App. Div. N. Dist. 1969).

143. Id. at 413. This view is also supported by dicta in *Muir v. Jefferson Credit Corp.*, 108 N.J. Super. 586, UCC REP. SERV. 273 (1970).

goods" was intended to mean "in the case of security interests in consumer goods."

(c) The definition of "consumer goods" in section 9-109, like the other classificatory definitions in this section, is, it would seem, designed as a classification of a kind of security interest.[144] "Consumer goods" it seems, is tested by the purposes for which a "debtor" buys or uses the goods. Section 9-105(1)(d) defines a "debtor" as a "person who owes payment or other performance of the obligation secured . . . ." Thus, the debtor is the buyer who created the security interest and not someone to whom this buyer resells.

(2) A security interest in consumer goods remains a security interest in consumer goods even though the debtor sells without authority to a dealer who treats the goods as part of his inventory.

(a) The classification of security interest does not change, as far as the secured party and the debtor are concerned. Thus the dealer holds these goods subject to a consumer goods security interest—if that interest has been perfected, as in a section 9-302(1)(d) case.[145] The analyses of the New Hampshire and Massachusetts courts thus rest on a false premise.

(b) Point 2 of the comment to section 9-109 which states that "goods can fall into different classes at different times; a radio is inventory in the hands of a dealer and consumer goods in the hands of a householder" needs to be read in context. If a dealer is the debtor, a security interest in the radio is and remains a security interest in inventory; if a consumer is the debtor, a security interest in the radio is and remains a security interest in consumer goods.

(c) So, if *B-One* sells goods to a dealer and the goods are subject to a perfected purchase money security interest in consumer goods under section 9-302(1)(d), the dealer takes subject to this interest since he is not a section 9-307(2) buyer.[146] But if dealer then sells to *B-Two*, a bona fide

144. It is contended that this definitional section should more properly be entitled "Classification of Security Interests in Goods," rather than "Classification of Goods." The focus seems to be on the relationship between the "debtor" and the goods, and not the purpose some third party may put the goods to.

145. Franklin Inv. Co., Inc. v. Homburg, 252 A.2d 95, 6 UCC REP SERV. 60 (D.C. Ct. App. 1969).

146. The purchase money secured party can hold the dealer-buyer who resold in conversion. *See* National Shawmut Bank v. Corcoran Motor Sales, Inc., 10 UCC REP. SERV. 273 (Mass. App. Div., Boston Mun. Ct. 1971); Rockland Credit Union, Inc. v. Gauthier Motors, Inc., 5 UCC REP. SERV. 637 (Mass. App. Div. So. Dist. 1967); Mahaley v. Colonial Trading Co., 6 UCC REP. SERV. 746 (Pa. Ct. C.P., York Cty. 1969); United Gas Improvement Co. v. McFalls, 18 Pa. D. & C. 2d 713, 1 UCC REP. SERV. 508 (Pa. Ct.

purchaser who takes for personal, family or household purposes, *B-Two should* be protected under section 9-307(2).

(3) From an equitable point of view, *B-Two* deserves protection more than the secured party. All the secured party had to do to head off this situation was to file. *B-Two*'s *equity* on the other hand is in fact *stronger* (having bought from a dealer as a buyer in ordinary course of business) than if he had bought from *B-One* directly. To *B-Two*, the transaction was most regular. Secured party still has rights against dealer for conversion. That should be enough.

The real question is, what risks should be imposed upon secured party for not filing? A secured party's decision not to file is a business judgment within his control. He may decide not to file because filing is deemed not worth the while, after balancing the risk of not filing, including the amount involved, the cost of undoing filing by termination statements, and the annoyance to seemingly dependable customers in making a public record of relatively minor transactions. However, *B-Two* might not have gotten into the predicament *if* the secured party *had* filed. Dealer might not have bought from *B-One* if a financing statement had been filed against *B-One*, since he might have been alerted by a search of the records.

Why limit his risks to losing his security interest in a direct sale from *B-One* to *B-Two*?

Of course, in the end, this problem boils down to a question as to who should bear the risk of *B-One*'s and dealer's insolvency. If *B-Two* takes subject to the security interest, he has rights against dealer for breach of title warranty, and dealer has same rights against *B-One*. As for the secured party, he has rights against *B-One* and conversion claims against the dealer. But if *B-One* and the dealer are insolvent, such rights don't mean much.

(4) *B-Two* is a buyer in ordinary course of business (under assumed facts), taking from a seller in the business of selling goods of that kind. He is a special kind of buyer—a *consumer* buyer in ordinary course of business, since that is the only kind of buyer protected by section 9-307(2). While section 9-307(1) affords him no protection, since the security interest was not created by "his seller," section 9-307(1) does not govern all contests between a buyer in ordinary course of business and the secured party. For example, a secured party who entrusts a dealer with possession of a repossessed chattel may, under section 2-403(2), lose to a buyer in ordinary course taking from the dealer, though the security interest was not created by the dealer-seller.[147]

C.P., Lancaster Cty. 1959); White-Sellie's Jewelry Co., Inc. v. Goodyear Tire & Rubber Co., 477 S.W. 2d 658, 10 UCC REP. SERV. 888 (Tex. Ct. Civ. App. 1972).

147. Commercial Credit Corp. v. Associates Discount Corp., 246 Ark. 118, 436 S.W.2d 809, 6 UCC REP. SERV. 82 (1969).

Likewise, *B-Two*, a buyer in ordinary course taking from a dealer who has bought a chattel from the debtor, *B-One* should, under section 9-307(2), take free of a section 9-302(1)(d) security interest though the security interest was not created by his seller. Such interpretation of section 9-307(2) comports with the idea that "buyer in ordinary course of business" is a favorite of the Uniform Commercial Code and is entitled to the benefit of any doubt in the construction of Code provisions.[148]

E. The Farm Products Exception

1. RATIONALE AND SCOPE

In their wisdom, the draftsmen of article 9 excluded from the protection of section 9-307(1) "a person buying farm products[149]

148. While discussion has been addressed to security interests in consumer goods coming under section 9-307(2), the observations seem equally pertinent to security interests in farm equipment with purchase price not over $2500 (*See* CODE § 9-302(1)(c)). The section 9-307(2) buyer in this case is one who buys for his own farming operations. The legal questions are discussed in PROBLEMS OF LENDERS, BORROWERS AND SELLERS, *supra* note 11, at 54-56 (1968).

149. "Farm products"—one of the four classifications of goods in section 9-109—is defined:

> Goods are . . .
> (3) 'farm products' If they [goods] are crops or livestock or supplies used or produced in farming operations or if they are products of crops or livestock in their unmanufactured states (such as ginned cotton, wool-clip, maple syrup, milk and eggs), and if they are in the possession of a debtor engaged in raising, fattening, grazing or other farming operations. If the goods are farm products they are neither equipment nor inventory.

"Farm products" become "inventory," it seems, when the farmer delivers possession of them to a third party, such as a marketing cooperative under an agency-to-sell arrangement or a sale to the cooperative. In any event the exclusion of section 9-307(1) applies only to cases where the buyer in ordinary course of business buys "from a person engaged in farming operations."

Chief reason for setting up a separate classification of goods as "farm products" seems to be to define the exclusion in section 9-307(1). "*Crops*," a kind of farm product, come in for special treatment in sections 9-203(1)(b), 9-204(2)(a), 9-204(4)(a), 9-312(2), and 9-402(1) and (3). Besides section 9-307(1), section 9-401 (Place of filing) seems to be the only other section which takes cognizance of the classification "farm products."

Taking the exclusion from the definition of buyer in ordinary course of business and putting it in section 9-307(1) disrupted section 9-301(1)(c). That subsection subordinates an unperfected security interest to the rights of "a person who is not a secured party and who is a transferee in bulk or *other buyer not in ordinary course of business* . . ." (emphasis supplied); but what about a buyer of farm products who *is* a buyer in ordinary course of business? A purely literalistic reading is that he cannot subordinate an unperfected security interest in farm products! This anomaly is removed by the 1972 amendment to section 9-301(1)(c) by adding "or is a buyer of farm products in ordinary course of business." However, such buyer of farm products is protected "to the extent that he gives value and receives delivery of the collateral without knowledge of the se-

from a person engaged in farming operations." Until 1950, drafts of the Code had provided that a buyer of farm products from a farmer was not a buyer in the ordinary course of business, as defined in section 1-201(9). In 1950 the exclusion was taken out of section 1-201(9) and inserted into section 9-307(1). Thus the Code now concedes that a person buying farm products from a farmer may be a buyer in ordinary course of business, but insists that such status will not entitle him to take free of a security interest created by the farmer-seller in the farm products.

"Farm Products" cease to be "farm products" and become inventory" when they come into the possession of a person not engaged in farming operations. So a security interest created by that person comes within the general rule of section 9-307(1).[150]

Why are buyers in ordinary course of business who buy farm products from a farmer not covered by section 9-307(1)? Is there something special about the marketing of farm products?[151] Per-

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curity interest and before it is perfected"—because he is put in the section 9-301(1)(c) slot, instead of being given, as a distinguished citizen, a separate slot of his own under section 9-301.

150. So, it has been held that a buyer in ordinary course of business buying cotton from a cotton gin company did not buy from "a person engaged in farming operations." United States v. Hext, 444 F.2d 804, 814, 9 UCC REP. SERV. 321, 336 (5th Cir. 1971).

151. Practices in cotton marketing are described in *United States v. Hext*, 444 F.2d at 811-12 & nn.23, 25, 9 UCC REP. SERV. 333-34 & nn.23, 25 (5th Cir. 1971) at footnote 25:

> The record establishes that the custom and practice in the cotton trade in Texas is for the individual cotton farmer to sell his cotton to a gin. The gin in turn gins the cotton, arranges for storage pending sale, markets the cotton by placing samples with a selling agent, and sells the cotton to buyers who make offers to the gin after examining the samples. Warehousemen, selling agents and buyers all deal with the gin and not with the individual farmer, and indeed frequently do not even know the identity of the individual farmer who originally raised the cotton. In the usual transaction the gin that deals with a farmer who has mortgaged his cotton to the FHA protects itself and satisfies the lien by issuing its checks in payment for the cotton jointly to the farmer and the FHA. As a matter of practice the FHA further protects its security by sending each season to the gins in the area a list of the farmers in whose crops it holds a security interest . . . .
>
> The record is unclear as to the precise nature of the typical transaction between the farmer and the gin. Evidently the farmer is sometimes paid outright for his cotton at the time he delivers it to the gin. Perhaps more frequently, payment by the gin to the farmer is not made until after the cotton is marketed. The farmer may or may not be consulted as to the acceptability of a particular offer to buy the cotton. In any event, the farmers apparently permit the gins to warehouse, market, and sell the cotton, and to keep possession of the negotiable warehouse receipts evidencing the cotton, pending sale. All parties appear to deal with the transaction between the farmer and the gin as a sale to the gin. . . .
>
> Similarly ambiguous transactions between producers and processors have been noted in other areas of agricultural commerce. See the discussion of "participation agreements" effected between growers and processors in the citrus fruit industry in Coogan and Mays,

haps the draftsmen were merely following the pre-Code lead.[152] However, subservience to pre-Code law was not one of the noteworthy characteristics of the architects of article 9. A more important point, it seems, is the strategic-practical consideration. Lending institutions dealing with farmers and cattlemen on the security of farm products have loud voices, and what they want tends to be what their clients, the farmer-borrowers, want. Such lending institutions do not take nicely to the idea that a buyer can strip them of their security interest in an unauthorized sale—even a buyer in ordinary course of business. The din of their demands for maximum protection of the security interest "makes a lot of sense" in some states. When draftsmen draft statutes, some draftsmen (strange to say) have been known to think in terms of "what can we get away with?" Ideologists, out—pragmatists in! The Committee for the Revision of Article 9 recently retraced the steps. First, there was the thought that the exclusion of farm product buyers from section 9-307(1) should be dropped. Then, perhaps it should be made optional. Finally, the Permanent Editorial Board discarded the idea.

The Final Report of the Committee goes over the ground:

> A comparable problem exists with respect to the provision of section 9-307(1) which makes inapplicable to farm products the usual rule of that Section protecting a buyer in ordinary course of trade [sic] who buys goods from a person engaged in selling goods of that kind and permitting him to take free of any security interest created by his seller. The existing Section reflects pre-Code practice in distinguishing between a farmer's inventory and inventory of any other kind of businessman, but it must be seriously questioned whether the pre-Code practice is still sound under modern conditions. Feelings run strong on this issue, as evidenced by the fact that the New Mexico Legislature amended other Sections of the Code to make sure that waiver would not nullify the rule excluding farm products from Section 9-307(1), as had been held in *Clovis National Bank v. Thomas*, 425 P.2d 726 (N.M. 1967). The federal government, an important farm lender, likewise insists on the preservation of its security interest on farm products as against buyers or auctioneers, in reliance on a federal rule independent of the state rule embodied in Section 9-307(1). See *U.S. v. McCleskey Mills, Inc.*, 409 F.2d 1216 (5th Cir. 1969).[153]

Crop Financing and Article 9: A Dialogue with Particular Emphasis on the Problems of Florida Citrus Crop Financing, 22 U. Miami L. Rev. 13, 49 (1967).

152. *See* CODE §§ 1-201(9), 9-307. The exclusion is, for example, in keeping with prior statutes in New York. *See* Mulvaney, *Buyer in Ordinary Course of Business* in 1 NEW YORK LAW REVISION COMM'N., REPORT ON UNIFORM COMMERCIAL CODE 227 (1955).

153. Courts are divided as to whether priority rights of federal lending agencies are a matter of federal law, or under article 9. *See* United States v. Hext, 444 F.2d 804, 9 UCC REP. SERV. 321 (5th Cir. 1971); United

> On the other hand, strong representations have been made to the Committee by food processors and by authors who have written on farm products under the Code that the inapplicability of Section 9-307(1) to farm products is anomalous and unfair. Georgia has amended the Section to protect auctioneers of livestock. Recognizing that the Committee recommendation is unlikely to induce the removal of the exception for farm products under Section 9-307(1) in all enacting jurisdictions, the Committee nevertheless recommends it as optional amendment 5. The Committee considered various possibilities, such as distinguishing between the first buyer and sub-buyers or between a buyer of an entire annual crop and multiple buyers of milk, eggs, and the like. But no solution was found. Differences of opinion on basic policy seem to be so sharp that they are unlikely to be resolved by an appeal to the goal of uniformity.

(In a footnote, we learn that "the Permanent Editorial Board deleted the Committee's optional recommendation. For states that are determined to change the present policy, it is recommended that this be done by deleting the words in section 9-307(1): 'Other than a person buying farm products from a person engaged in farming operations.' ")[154]

A few illustrations may help to present the legal situation.

CASE 1

Jones, a farmer, gives a security interest in his growing crops to the Ozee Bank, to secure a loan of $20,000 made by Ozee to Jones to assist him in his operations. The written signed security agreement provides that Jones may not sell the crops without the prior written consent of Ozee. A proper financing statement is duly filed in the proper place. Smith, a middleman, buys all of the crops from Jones after they are harvested. At this time Smith does not know that the crops are covered by Ozee Bank's security interest. May Ozee assert its security interest in the crops, now that they have been bought by Smith?

States v. McCleskey Mills, Inc. 409 F.2d 1216, 6 UCC REP. SERV. 273 (5th Cir. 1969).

Schizophrenia?

> One more point. On this issue of the Code the house divided against itself. That is, while it appears that under 9-307(1) you cannot ever sell products free of a lender's security interest, it seems equally clear under the sales article of the Code, 2-403, you can well sell farm products, livestock or anything else, free of any other type of ownership interests. So if you are in possession of and sell a bale or cattle subject to another ownership interest and a security interest of some third party and fraud is exposed, the owner's interest is cut off at 2-403 but the bank's security interest is good under 9-307. It is a sort of schizophrenic case under the Code.

Problems of Lenders, Borrowers and Sellers, supra note 11, at 53 (1968).

154. PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, FINAL REPORT 208-09 (April, 1971).

Answer: Yes. Even though Smith may be a buyer in ordinary course of business under section 1-201(9), he is not protected by section 9-307(1). Since no facts appear that Ozee consented to the sale,[155] or waived its security interest or is estopped,[156] Ozee's security interest prevails.[157] There is no need to weep for Smith under these facts. Since Smith bought directly from Jones and is a professional buyer, ordinary prudence should have led him to check for a filing in the proper place, and, if he had done so and discovered Ozee's claim, he could have cleared the transaction with Ozee before consummating it. Ozee Bank would probably have insisted that Smith make his check for the purchase price payable to Ozee and Jones jointly. Of course, Smith has rights against Jones (for what they are worth) for breach of warranty of unencumbered title.[158]

CASE 2

Same facts as above, except that Smith, the middleman-buyer from Jones, before Ozee's intervention, takes the crops to another state and sells them to Friend, a processor, who is an innocent purchaser for value. Upon discovering the facts, Ozee duly files in this other state.[159] May Ozee assert its security interest against Friend?

Answer: Yes. The security interest continues as to the subvendee. Although Friend may be a buyer in ordinary course of business and was not buying from a person engaged in farming operations, the security interest was not created by his seller (Smith), and so he is not protected by section 9-307(1). And while his seller, Smith, was a buyer in ordinary course of business, he is not protected under section 9-307(1) since he bought farm products from a farmer. So Friend may claim no protection via Smith.[160]

Weep for Friend. He did not know of Ozee's security interest at the time he bought, and he may have had no reasonable way of ascertaining that the crops he bought were covered by a security interest created by Jones.[161]

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155. CODE § 9-306(2).
156. CODE § 1-103.
157. CODE §§ 9-306(2) and 9-201. *See* United States v. Busing, 7 UCC REP. SERV. 1120 (E.D. Ill. 1970); United States v. Pete Brown Enterprises, Inc., 328 F. Supp. 600, 9 UCC REP. SERV. 734 (N.D. Miss. 1971); Overland Nat'l Bank v. Aurora Cooperative Elevator Co., 184 Neb. 843, 172 N.W.2d 786, 7 UCC REP. SERV. 11 (1969).
158. CODE § 2-312.
159. CODE §§ 9-103(3), 9-103(1) (1972 version).
160. *See* Garden City Prod. Credit Ass'n v. Lannan, 186 Neb. 668, 186 N.W.2d 99, 8 UCC REP. SERV. 1163 (1971).
161. *See* Platte Valley Bank v. Kracl, 185 Neb. 168, 174 N.W.2d 724, 7 UCC REP. SERV. 538 (1970).

CASE 3

Same facts, except that Ozee Bank, instead of going after Friend, sues Smith for conversion, on the theory that Smith, in selling to Friend, had wrongfully interfered with Ozee's security interest.

This is not directly an article 9 question. While article 9 tells us that the security interest was effective against Smith's claim to the crops, Smith's personal liability for conversion under the facts must be elsewhere determined.[162] Point 1 in Smith's favor is that Ozee Bank can still assert its security interest in the collateral now in the hands of Friend. Point 2 is that Jones could sell his interest in the collateral despite any provision in the security agreement to the contrary, and thus Smith could at least take and dispose of Jones's interest as provided in section 9-311. So Smith's act of selling, arguably, is not a conversion. Thus in *Midland Bank v. Peterson*[163]—a Wisconsin pre-Code case—a chattel mortgagee, whose mortgage had been duly filed, sought to hold a person like Smith liable in conversion after he had resold, but recovery was denied. The Wisconsin view seems to have been that the "special interest" of a chattel mortgagee not in possession was insufficient

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162. In *United States v. Hext*, 444 F.2d 804, 811 n.21, 9 UCC REP. SERV. 321, 322 n.21 (5th Cir. 1971) it is stated:

> It is true that the Code does not deal with the tort law of conversion which, under the Code scheme is essentially a remedy to be provided by other state law to one whose security interest has been violated. See Uniform Commercial Code § 9-306, Comment 3. Thus, in the fashioning of federal law, legal issues that may arise in respect of the tort doctrine of conversion must still be decided by federal courts with reference to the general common law. However, in the context of secured transactions, the basis for conversion liability does not exist until the party seeking to impose liability has the right to immediate possession of the mortgaged chattel. And under the Code the secured party's right to immediate possession does not arise until there has been a default, for example, by an unauthorized transfer of collateral in violation of the security agreement . . . .

In *United States v. McCleskey Mills, Inc.*, 409 F.2d 1216, 1219, 6 UCC REP. SERV. 273, 276 (5th Cir. 1969) (an auctioneer conversion case), the opinion, after citing section 9-306(2), states:

> The authors' official comment upon this section of the Code makes it clear that the secured party may in such cases maintain an action for conversion against the subsequent purchaser. This principle underlies the effective operation of any recording system: subsequent transferees, unless they are entitled to special protection, must be on notice of any recorded and hostile interest in the land or chattels they receive.

See also Murdock and Butkovich, dba P & B Oil Co. v. Blake, 26 Utah 2d 22, 8 UCC REP. SERV. 956 (1971).

Where the secured party is a seller retaining a purchase money security interest, there is the possibility that section 2-722 may be construed to recognize the secured party's right to sue for conversion in the instant case. *See* Draper v. Minneapolis-Moline Inc., 100 Ill. App. 2d 324, 241 N.E.2d 342, 5 UCC REP. SERV. 972 (1968) (section 2-722 applied on behalf of buyer suing secured party in conversion for wrongful repossession).

163. 229 Wis. 19, 281 N.W. 683 (1938).

to hold a person like Smith liable in conversion.[164] In some other states, courts have indicated that to sue a person like Smith for conversion, a chattel mortgagee would have to have an immediate right to possession under the mortgage at the critical time (*e.g.*, because of mortgagor's default).[165]

Just how viable these pre-Code cases might be now that the U.C.C. is in effect remains to be seen. Some courts continue to insist, it seems, that if a secured party is to maintain an action for conversion against a party in the position of Smith, he must have a right to immediate possession.[166] Under the Code, he has that right upon default under section 9-503, and the security agreement may give him the right prior to default. In the hypothetical case of *Ozee Bank v. Smith*, above, the security agreement provided that Jones, the debtor, was not to sell the crops without prior written consent; a security agreement with such an explicit provision would most likely provide that violation of this term (among others) would constitute a default and entitle the secured party to take certain remedial action, including taking possession of the collateral. So, it seems, according to the conversion liability rules of many states, Smith is liable to Ozee for the tort of conversion, and Ozee may recover judgment for the value of collateral or the amount of secured debt, whichever is less.

Perhaps the reader shares a feeling that the right of a secured

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164. In *United States v. Krantz*, Civil Action No. 550 W.D. Wis., September 24, 1954, the following facts were admitted as alleged in the complaint:

> That on or about May 3, 1949, the Hendersons, farmers and residents of Washburn County, in the Western District of Wisconsin, executed and delivered to plaintiff a chattel mortgage on their crops and cattle, which mortgage was recorded in the Register of Deeds Office of Washburn County on May 3, 1949. Thereafter, the Hendersons, the mortgagees [sic], without notice to or consent of plaintiff, sold to the defendants three cows, one bull and one calf, all covered by the chattel mortgage, which the defendants subsequently sold in the regular course of their business, without the knowledge or consent of the plaintiff, and without regard to the special interest of the plaintiff in said property; that all of the transactions referred to herein occurred within the State of Wisconsin.

Defendants' motion to dismiss the complaint was granted. The opinion applies the law of Wisconsin, as revealed in decisions, and concludes that since "for all practical purposes chattel mortgages are mere liens," the plaintiff "must pursue the mortgaged property," and "In the instant case there was no conversion of any right or property of the plaintiff."

Such rationale could lead to a contrary decision in conditional sales. Quaere as to whether it may be retained in conversion suits, consistently with the Uniform Commercial Code. *See* CODE § 9-202 (title to collateral immaterial) and comment thereto. *See also* point 1 to comment to CODE § 9-507.

165. Dawes v. Rosenbaum, 35 Neb. 607, 53 N.W. 585 (1899).

166. United States v. Hext, 444 F.2d 804, 9 UCC REP. SERV. 321 (5th Cir. 1971); United States v. Busing, 7 UCC REP. SERV. 1120 (E.D. Ill. 1970); Farmers State Bank v. Stewart, 454 S.W.2d 908, 7 UCC REP. SERV. 1367 (Mo. Sup. Ct. 1970); State Sec. Co. v. Swoboda, 172 Neb. 526, 110 N.W.2d 109 (1961).

party to sue a third party for interfering with the secured party's interest in the collateral should not be made to turn upon whether the secured party has an immediate right to possession at the time of the third party's interference.[167]

In any event, one cannot quarrel with Ozee Bank for pursuing Smith in an action based on conversion instead of following its security interest against Friend. Presumably, Smith is liable over to Friend, based on breach of warranty of title. Nor, under standard principles, will Smith's good faith and lack of knowledge that he was acting inconsistently with Ozee's interest be a defense.[168]

As to the measure of recovery: the proceeds of sale received by Smith may be good evidence of market value at the time of

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167. In First Nat'l Bank v. Stamper, 93 N.J. Super. 150, 225 A.2d 162, 3 UCC REP. SERV. 949, 955 (1966), Mariano, J., dealt with the question whether a secured party with a perfected security interest could hold a defendant who had bought the collateral from the debtor and resold it, for conversion liability, without the need to show that he, the secured party, had an immediate right to possession at the time the defendant dealt with the collateral. He quoted with approval W. PROSSER, LAW OF TORTS 96-97 (3d ed. 1964):

> The common law rule was extended to permit recovery by one who had the immediate right to possession as in the case of a bailor entitled to possession on demand, or a chattel mortgagee or conditional seller after default. But an owner who had neither possession nor the immediate right to it at the time of the conversion could not maintain trover. His remedy was an action on the case for the damage to his interest in the goods. Although the distinction persists today in a good many courts, it is an antique procedural survival, with nothing to recommend it. The important fact is that the man entitled only to future possession can recover, in whatever form of action, the full value of his interest in the goods which has been appropriated by the defendant, and no more. If this is not to be called conversion, it is at least the same thing by another name. There are a substantial number of courts which have discarded the procedural distinction, and have called the action one of conversion.

The opinion observed, however, that the debtor was in default under the security agreement, which made removal of the collateral to another county a default. Hence, "In any event, plaintiff was entitled to immediate possession . . . ." *Id.* It followed that the defendant's acts with reference to the collateral made him liable for the reasonable value of the collateral (the agreed sum was $1275).

See also White-Sellie's Jewelry Co., Inc. v. Goodyear Tire & Rubber Co., 477 S.W.2d 658, 10 UCC REP. SERV. 888 (Tex. Ct. Civ. App. 1972) (nothing said about secured party's right to immediate possession).

168. *See* First Nat'l Bank v. Stamper, 93 N.J. Super. 150, 157, 225 A.2d 162, 166, 3 UCC REP. SERV. 949, 954 (1966) quoting McGlynn v. Schultz, 90 N.J. Super. 505, 218 A.2d 408 (1966):

> The general rule is that one who exercises unauthorized acts of dominion over the property of another, in exclusion or denial of his rights or inconsistent therewith, is guilty of conversion although he acted in good faith and in ignorance of the rights or title of the owner. The state of his knowledge with respect to the rights of such owner is of no importance, and cannot in any respect affect the case . . . .

See also Commercial Credit Corp. v. Joplin Auto. Auction Co., Inc., 430 S.W.2d 44, 5 UCC REP. SERV. 899 (Mo. Ct. App. 1968).

the conversion. (But certainly Ozee's recovery should be for no more than the amount of the obligation for which the crops were security since in suing, Ozee Bank is not also representing Jones, who has no claim.)[169] However, recovery measured by the value of the collateral may sometimes be harsh and unfair.[170] Suppose, for example, that the secured party is still adequately secured, despite the conversion of the collateral—should Smith be held liable?[171] As soon as we leave a black letter rule and reexamine time-worn-thin postulates under the flickering flares of equitableness as we see it, the questions that arise are enough to boggle the mind.

CASE 4

Where cattle (a form of "farm products") are collateral,[172] the cattleman-debtor may deliver the cattle for sale to a person who conducts a cattle market—one of the many successors to the Chicago stock yards scattered throughout the country. Auctioneer does not know of Ozee Bank's perfected security interest in the cattle at the time he conducts the sale. Ozee Bank may seek to hold Auctioneer liable in conversion, on account of his involvement in an unauthorized sale.[173] Here again, as in the conversion case against

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169. *See* Proctor and Gamble Distrib. Co. v. Lawrence American Field Warehousing Corp., 22 App. Div. 2d 420, 255 N.Y.S.2d 788, 2 UCC REP. SERV. 464 (1965).

170. See the curious case of *Harvard Trust Co. v. Racheotes*, 337 Mass. 73, 147 N.E.2d 817 (1958), for an example of eggregious confusion and obfuscation in pre-Code law concerning injuries by third parties to goods covered by security interests.

171. For the tortuous path of decisions dealing with claims by real estate mortgagees for tortious injury by mortgagors and third parties—often turning upon whether the lien theory or the title theory prevails, *see* G. OSBORNE, MORTGAGES, 316 (1st ed. 1951). With respect to marshalling, see United States v. Pete Brown Enterprises, Inc., 328 F. Supp. 600, 9 UCC REP. SERV. 734 (N.D. Miss. 1971); Platte Valley Bank v. Kracl, 185 Neb. 168, 174 N.W.2d 724, 7 UCC REP. SERV. 538 (1970).

172. Banks have traditionally loaned money to ranchers in return for a promissory note and a consensual lien on livestock held by the rancher. The problems involved in using livestock as collateral are numerous, but critical among them is the problem of keeping account of the animals. . . . Since the collateral cannot be held by the lender, the security agreement typically includes a promise by the borrower assuring that the livestock will not be sold or transferred without the written consent of the secured party.

First Nat'l Bank & Trust Co. v. Atlas Credit Corp., 417 F.2d 1081, 1085, 6 UCC REP. SERV. 1223, 1228-29, (10th Cir. 1969) quoting Comment, *Commercial Law—Uniform Commercial Code—Security Interests in Livestock*, 8 NATURAL RESOURCES J. 183 (1968). Note: place to file will depend on the version of section 9-401 enacted in the state.

173. The cases holding auctioneers liable are seemingly premised on: (1) that the security interest was perfected at the time of the auction; (2) that the secured party has not impliedly or expressly consented to the debtor's sale of the collateral; and (3) that the buyer is not protected against the security interest.

Smith who bought and resold, Article 9 does not decisively answer the question of conversion liability. According to the weight of authority, the Auctioneer, as agent for the seller (the cattleman), is, it seems, protected only if his principal is protected, or if the buyer is protected.[174]

Thus, in Case 4, Auctioneer is liable, unless some objection to the conversion action is recognized, such as that the secured party had no immediate right to possession if the debtor was not in default under the security agreement at the time of the auction sale. Auctioneer's role as a mere agent or conduit may stir sympathy—it may seem harsh to impose liabilty for unknowingly aiding the conversion. However, decisions are running against him. By revealing to the bidders the identity of his principal, he may protect himself from liability to the buyer for breach of implied warranty of title. But this will not save him from liability to a secured party with a perfected-by-filing security interest,[175] if the sale was

174. A curious application of the shelter principle: It seems a seller's agent may be sheltered from an action brought against him for conversion if the buyer acquires a better right than the third party plaintiff, even though his principal may be effecting a wrongful sale. Thus, in *United States v. Hext*, 444 F.2d 804, 815-16, 9 UCC REP. SERV. 321, 338-39 (5th Cir. 1971) the United States failed to hold the seller's agent liable. The court said:

> Section 233(1) of the Restatement (Second) of Torts, cited to us by the government as authority to be followed in determining the federal rule of conversion applicable to this case, provides:
>
> . . . one who as agent of a third person disposes of a chattel *to one not entitled to its immediate possession in consummation* of a transaction negotiated by the agent or servant, is subject to liability for conversion to another who, as against his principal or master, is entitled to the immediate possession of the chattel. (Emphasis supplied)
>
> Accepting this as an authoritative statement of the law (and none of the other authorities cited by the parties are to the contrary), it is at once apparent that Harlingen and Marshall, to the extent they acted, in good faith and without knowledge of the Government's interest, as agents of the Gin Co. in facilitating the sale of the cotton to the buyers, cannot be liable as converters since the cotton was not transferred 'to one not entitled to its immediate possession.' Rather, since the buyers took free of the Government's security interest under § 9-307(1) of the Code, they were entitled to immediate possession, and the acts of Harlingen and Marshall in facilitating the transfer to them were not tortious . . . .

See also Charles S. Martin Distrib. Co., Inc. v. Banks, 111 Ga. App. 538, 142 S.E.2d 309, 2 UCC REP. SERV. 900 (1965).

175. *See, e.g.*, United States v. Big Z Warehouse, 311 F. Supp. 283, 7 UCC REP. SERV. 1061 (S.D. Ga. 1970); Commercial Credit Corp. v. Joplin Auto. Auction Co., Inc., 430 S.W.2d 44, 5 UCC REP. SERV. 899 (Mo. Ct. App. 1968). This liability may, of course, be removed by state statute, at least in cases not governed by federal law. Thus, chapter 120 GA. LAWS 1969 amends section 9-307 to include:

> (3) A livestock commission merchant who, without actual notice, shall sell goods for another for a fee or commission, shall not be liable to the holder of a security interest created by the seller of the goods where the sale is made in the ordinary course of business and given though the security interest is perfected.

See Editors' Note, 6 UCC REP. SERV. 273.

not authorized by the secured party.[176]

2. CONSENT, WAIVER, ESTOPPEL

So far, our consideration of farm products security interest situations has proceeded without taking into account the possibility that the secured party may have authorized the sale or have waived his security interest or have been estopped to assert it. In any such case, the buyer will acquire title free of the security interest. Section 9-306(2) plus section 1-103 will assure this result. The real question is what quantum of facts is necessary to result in a decision for defendant under sections 9-306(2) and 1-103? Here, confusion reigns supreme.

CASE 1

Bank had made various loans to Cattleman in 1963 and had, under three successive security agreements, each supplanting the former, obtained a security interest in the debtor's cattle (duly perfected). Each security agreement (it may be surmised) provided that Cattleman would not sell the cattle without prior written consent of Bank. Despite these provisions, at two times when the first two security agreements were in force, Bank had consented, but not in writing, to sales of the cattle by Cattleman and had applied the proceeds to such sales, when remitted by the debtor, to reduce the loans. At no time did the Bank insist that Cattleman obtain its prior written consent. This was the Bank's usual practice:

> [I]t was the custom and practice of plaintiff to permit a debtor, who has given cattle, as collateral, to retain possession and to sell the collateral without ever obtaining prior written consent of plaintiff . . . .
>
> It is true there was some testimony that the collateral was not relased from the lien until the debtor actually delivered the proceeds of the sale to plaintiff, but, as testified to by one of the plaintiff's officers, the debtor never contacts the plaintiff and secures permission to make a sale, but the sale is made and plaintiff relies upon the debtor to bring the proceeds to plaintiff to be applied on the indebtedness. This practice is followed because 99% of the people with whom plaintiff deals are honest and take care of their obligations.[177]

Then, while the third security agreement was in force, Cattleman sold cattle covered by the security agreement without the knowl-

176. The result obtains either under the Code or under a federal common law applicable to contracts in which the United States is a party. United States v. McCleskey Mills, Inc., 409 F.2d 1216, 6 UCC REP. SERV. 273 (5th Cir. 1969). *See* State Sec. Co. v. Swoboda, 172 Neb. 526, 110 N.W.2d 109 (1961).

177. Clovis Nat'l Bank v. Thomas, 77 N.M. 554, 558, 425 P.2d 726, 729, 4 UCC REP. SERV. 137, 141 (1967).

edge and consent of Bank. Cattleman did not remit the proceeds of sale to the bank. Bank now sues the Auctioneer who conducted the sale for conversion. Held, in *Clovis National Bank v. Thomas*,[178] the Bank had, through course of dealing, waived the requirement of prior written consent and thus Cattleman was authorized to sell. Therefore the Auctioneer, as agent for Cattleman, was not liable.[179]

A vigorous dissent pointed out that section 1-205(4) provides that where course of dealing or trade usage and the express terms of a contract conflict and cannot reasonably be construed as consistent with each other, express terms govern.[180]

But a literal application of section 1-205(4) to the facts of *Clovis*, so as to rule that the secured party's conduct under prior security agreements involving identical terms, had no bearing on his rights under the current security agreement, hardly seems to make sense. Such prior conduct should be evidence that a particular term in the current security agreement form was not really intended by the parties to be part of the current agreement, or at least was inoperative, until the secured party exercised his right to put it into effect by giving notice in advance of sale.[181]

178. 77 N.M. 554, 425 P.2d 726, 4 UCC REP. SERV. 137 (1967). On facts somewhat similar to *Clovis*, the secured party lost: *In re* Cadwell, Martin Meat Co., 10 UCC REP. SERV. 710 (E.D. Cal. 1970). *Contra*, First Nat'l Bank v. Calvin Pickle Co., — S.W.2d —, 11 UCC REP. SERV. 1245 (Okla. Ct. App. 1973), *rev'd on other grounds*, — S.W.2d —, 12 UCC REP. SERV. 943 (Okla. Sup. Ct. 1973). *See also* Blubaugh v. Ponca City Prod. Credit Ass'n, 9 UCC REP. SERV. 786, 791 (Okla. Ct. App. 1971), where it is stated in rejecting the majority view in *Clovis*, "the pre-Code doctrine of waiver should be held to be modified by 12 A OS 1961 § 1-205(4). . . ." *See* United States v. E.W. Savage & Son Inc., 343 F. Supp. 123 (D.S.D. 1972); Farmer's State Bank v. Edison Non-Stock Cooperative Ass'n, 190 Neb. 789, — N.W.2d —, 13 UCC REP. SERV. 728 (1973).

179. The New Mexico Legislature subsequently amended section 1-205 to repudiate the *Clovis* case. To subsection (3) is added "except that no security interest in farm products shall be considered waived by the secured party by any course of dealing between the parties or by any trade usage." To subsection (4) is added: "A security interest in farm products shall not be considered waived by the secured party by any course of dealing between the parties or by any trade usage." *See* N.M. STAT. ANN. § 50A-1-205(3), (4) (1971).

180. Clovis Nat'l Bank v. Thomas, 77 N.M. 554, 562, 425 P.2d 726, 734, 4 UCC REP. SERV. 137, 145 (1967). *See* Note, *Commercial Law—Course of Dealing and Usage of Trade Affect Express Terms*, 1973 WIS. L. REV. 934.

181. Perhaps one is reminded of the famous dispute over *Dixon, Irmaos & Cia v. Chase Nat'l Bank*, 144 F.2d 759 (2d Cir. 1944), *cert. denied*, 324 U.S. 850 (1945), where it was held that a letter of credit term "full set of bills of lading," was satisfied by presentation of one bill of lading accompanied by a bank guarantee, since the current custom of New York Banks was to accept such tender. For adverse criticism, see Backus & Harfield, *Custom and Letters of Credit: The Dixon, Irmaos Case*, 52 COLUM. L. REV. 589 (1952). In support of the decision, see Honnold, *Letters of Credit, Custom, Missing Documents and the Dixon Case: A Reply*

The next case presents a contrast in judicial attitude.

CASE 2

On March 9, 1967, Garden City Production Credit Association (PCA) obtained and perfected a security interest in the debtor's cattle to secure a loan. The security agreement between PCA and the cattleman provided that the debtor would not sell without prior written consent. As in the *Clovis* case, this security agreement was one of a series, and in the past the debtor had at various times sold cattle without getting PCA's prior consent and had turned over the checks received in payment to PCA, which had applied them to the indebtedness. PCA never objected to this practice. On June 15, 1967, the debtor and *A* entered into a contract negotiated by a broker for the delivery of cattle covered by the security agreement to *A* in another state in September 1967. The debtor informed PCA, and when he soon received a draft drawn on *A* for part payment (with purpose noted on the draft), he endorsed it to PCA, which applied the proceeds to reduction of the debt. In September 1967, the cattle were delivered to *A*, and the debtor turned over to PCA a draft drawn on *A* for the balance of the purchase price. PCA deposited the draft for collection and about two weeks later was notified that it had been dishonored. Meanwhile, *A* had sold the cattle to *L*, who paid *A* the purchase price in full. PCA soon discovered the whereabouts of the cattle and filed a proper financing statement in *L*'s state,[182] and demanded that *L* turn over the cattle. *L* refused and was sued by PCA.

In a 4-3 decision, the Nebraska Supreme Court held for PCA.[183] PCA, it was reasoned, did not, by failing to object to the sale by the debtor, "waive" its security interest. The majority opinion argued that since *L* did not know of "a private and undisclosed arrangement or course of dealing between the debtor and the lender alone," *L* was not entitled to "ignore the provisions of the code," by acting in disregard of PCA's perfected-by-filing security interest.[184]

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to Backus and Harfield, 53 COLUM. L. REV. 504 (1953). But while arguably custom may supply a special meaning to "full set," (one plus letter of indemnity) and section 1-205(4) will not stand in the way of showing a reasonable consistency between custom and express term, in *Clovis*, prior practice and custom, if relevant, would serve to wipe out or suspend, rather than explain the meaning of, the term—prior written consent.

182. CODE § 9-103(3); *see also* CODE § 9-103(1) (1972 version).

183. Garden City Prod. Credit Ass'n v. Lannan, 186 Neb. 668, 186 N.W.2d 99, 8 UCC REP. SERV. 1163 (1970).

184. According to this rationale, the innocent buyer could be worse off than the debtor! The court did not reach the question of the debtor's liability to the secured party:

> We are not called upon here to resolve a controversy between

The decision is indeed difficult to understand. The court seems to have held: (1) that a secured party who acquiesces in the debtor's proposed sale does not ipso facto consent to the sale being free of his security interest; and (2) that a secured party who receives a check and applies the proceeds knowing that it is drawn as a part payment for sale of the collateral does not thereby ratify passage of title free of the security interest, so as to be barred from following the collateral into the hands of a subsequent bona fide buyer in case the secured party is not paid off in full.

The facts are not just a repeat of the *Clovis* case which posed the question whether in view of section 1-205(4) the express terms of the security agreement prevailed over *prior* course of dealing between the parties and the secured party's general practice.[185] In *Clovis* the secured party was not aware of any sales by the debtor after the execution of the current security agreement. In *Lannon*, however, the secured party's conduct with reference to the very sale of the cattle in the suit was involved. Further, the defendant was an innocent buyer in another state who had not dealt directly with the farmer. As to such post-agreement conduct, section 1-205(4) has nothing to say. The normal principles of loss-of-right should apply.[186] And it would seem axiomatic (despite the view expressed in the majority opinion) that if the secured party is found to have waived his right as to the debtor to insist on written consent, he should be in no better position as far as

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> the lender and the debtor in which such agreement or arrangement or course of dealing might be relevant to the enforcement of a security interest against the debtor's property.

Id. at 674, 186 N.W.2d at 103, 8 UCC REP. SERV. at 1170.

185. In Lisbon Bank & Trust Co. v. Murray, — Ia. —, 206 N.W.2d 96, 99, 12 UCC REP. SERV. 356, 360 (1973), the opinion tried to narrow the difference between the *Clovis* and *Garden City* decisions: "*Clovis* and *Garden City* each recognize, in accordance with the general rule, that a finding of authority to sell may be implied from a prior course of dealing at least in the absence of a security agreement prohibition against sale without written consent." In *Lisbon Bank*, the court found consent to sell based on course of dealing, resulting in waiver of security interest upon sale, and "the fact that the purchaser had actual notice of the security interest and was unaware that it was waived does not alter the result." *Id.* at —, 206 N.W.2d at 99, 12 UCC REP. SERV. at 360. Since there was no clause in the security agreement requiring written consent, the problem presented by section 1-205(4) did not arise. It was observed: "This principle [of waiver by course of dealing] is unaffected by a finding such as was made here that the authority to sell was conditioned upon the debtor's agreement to apply the proceeds to the debt . . . . If the authority had been conditioned on the purchaser making payment to the secured party, it appears the lien would not be lost . . . ." *Id.* at —, 206 N.W.2d at 99, 12 UCC REP. SERV. at 360.

An obvious point: A secured party's rights under the security agreement are subject to the general good faith requirement of section 1-103, as well as to application of the principle of estoppel in appropriate cases under section 1-103. Universal C.I.T. Credit Corp. v. Skeels, 335 F.2d 846, 2 UCC REP. SERV. 256 (3d Cir. 1964).

186. CODE § 1-103.

the innocent buyer is concerned. It should not be necessary for the third party buyer to rest his case on estoppel, which would require proof that he knew of and relied on the secured party's conduct.

Perhaps *Lannon* can only be explained as stemming from the majority's concern to uphold the institution of agricultural lending by casting the risk of the debtor's failure to apply the proceeds of sale to reduction of the secured debt, upon those who buy the collateral—to the extent of refusing to apply principles of loss of right through waiver which would normally apply if the collateral were not farm products.

Is there something special about secured transactions in farm products?

III. SATELLITE RIGHTS: THIRD PARTY RIGHTS DEPENDENT ON BUYER'S STATUS

Up to this point, we have been concerned with the conditions a buyer of goods must meet in order to qualify as a buyer in ordinary course of business and the effect such status will have upon his own rights in the goods, if he does so qualify. Thus, where article 9 rules apply, he takes free of a security interest created by his seller—except in goods that are "farm products"—but not of a perfected security interest created by a transferor up-the-line, which will normally continue despite changes in ownership of the goods.[187] He takes subject to a perfected up-the-line security interest, with the possible exception of a perfected-without-filing purchase money security interest in consumer goods or farm equipment.

Now, switching the spotlight: will the fact that our buyer does or does not qualify as a buyer in ordinary course of business have bearing on the rights of third parties?

An obvious point quickly comes to mind: if the buyer takes free of a security interest created by his seller, so also should his transferees, unless some special circumstances exist. Section 2-403(1) incorporates the shelter principle in providing: "A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased." It follows that persons down the transfer line may be protected by the buyer's status as buyer in ordinary course of business.

Not so obvious are some other situations where the rights of parties who are not hand-in-glove with the buyer may perhaps be viewed as affected by or tied in with the buyer's status. Consider, for example, a case of two competing financers in the lucrative business of consumer finance, who may inadvertently find

187. CODE § 9-306(2), (3).

themselves in a legal clash because of some double-dealing dealer: *F-One* (as a so-called wholesale financer) has a perfected security interest in *D*'s inventory (and proceeds). *D* sells an item of inventory to *B* who agrees to pay the price in 12 equal monthly installments. *B* signs a security agreement giving *D* a security interest in the item sold, to secure *B*'s obligation to pay the purchase price. In disregard of *F-One's* proceeds security interest in this contract-chattel paper, on the same day *D* sells the contract to *F-Two* (retail financer). *F-Two* pays *D* cash and receives possession of the "chattel paper." *F-One* is not paid off by *D*.[188] *F-One* and *F-Two* both claim rights in the chattel paper. Question: In determining the relative rights of *F-One* and *F-Two* in the chattel paper, which includes both *B*'s obligation to pay and a security interest in the goods sold to *B*, is it important initially to determine whether *B* had acquired the goods from *D* in a sale which was authorized by *F-One*, or as a buyer in ordinary course of business?

CASE 1

Suppose *B* is a buyer in ordinary course of business. *B* then takes free of *F-One's* inventory security interest under section 9-307(1), and in lieu thereof *F-One* acquires a perfected *proceeds* security interest in the chattel paper (the security agreement signed by *B*) as provided in sections 9-306(2) and (3). *F-Two*, however, has acquired an *original* security interest in the chattel paper. Section 9-308 governs this kind of conflict between security interests in the same collateral:

> *Purchase of Chattel Paper and Non-Negotiable Instruments.* A purchaser of chattel paper or a non-negotiable instrument who gives new value and takes possession of it in the ordinary course of his business and without knowledge that the specific paper or instrument is subject to a security interest has priority over a security interest which is perfected under Section 9-304 (permissive filing and temporary perfection). A purchaser of chattel paper who gives new value and takes possession of it in the ordinary course of his business has priority over a security interest in chattel paper which is claimed merely as proceeds of inventory subject to a security interest (Section 9-306), even though he knows that the specific paper is subject to the security interest.[189]

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188. For a discussion of wholesale financer vs. retail financer in chattel mortgage settings and under UTRA, see Skilton, *Cars for Sale—Some Comments on the Wholesale Financing of Automobiles*, 1957 WIS. L. REV. 352, 412.

189. The 1972 amendments change section 9-308 to put purchasers of instruments on the same footing as purchasers of chattel paper.

In case #1, it looks as if *F-One's* security interest in the chattel paper is "merely as proceeds." If this is the case, *F-Two* prevails "even though he knows that the specific paper is subject to the security interest." If

So, if *F-Two*, as a purchaser of chattel paper, meets the conditions of this section—and it looks as if he does—*F-Two* prevails over *F-One*, as to rights in the chattel paper.

CASE 2

But suppose *B* is not a buyer in ordinary course of business and the sale is not authorized by the secured party. In this case, *F-One*'s security interest continues notwithstanding sale, though he acquires as well a security interest in the chattel paper.[190] While section 9-308 would, under its stated conditions, give judgment for *F-Two* if the contest involved rival rights in the chattel paper, section 9-308 may not dispose of the issue of *F-One*, as holder of a continuing perfected original security interest in the goods-collateral, versus *F-Two*, with a security interest in the goods as an assignee of the *chattel paper*. *If* judgment is for *F-One* in case 2, then it *is* important to determine whether in a given case *B* is a buyer in ordinary course of business (or takes in an authorized sale).

CASE 3

Let us distinguish these two cases from another, involving a direct application of the shelter principle: To assist Buyer to acquire an appliance from Dealer, Buyer's bank at his request pays Dealer the purchase price directly, in return for Buyer's note and a security agreement signed by Buyer making the appliance security. If Buyer is a buyer in ordinary course of business, (or takes in an authorized sale), Buyer takes free of the inventory security interest of Dealer's wholesale financer, and Bank's interest in the appliance is thus sheltered from the wholesale financer's claim to the appliance.[191]

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we are to accept the 1962 comment to section 9-308, "stamping or noting on the paper the fact that it has been assigned to him" will not protect an *F-One* who leaves the paper with the debtor against an intervening *F-Two*, if *F-One's* interest in the chattel paper is merely as proceeds, i.e. where *F-One* "has not by some new transaction with the debtor acquired a specific interest in the chattel paper." (The 1972 comment seems to agree.) The obvious purpose of preferring *F-Two* is to promote competition in consumer financing, and to prevent *F-One* from exploiting his strategic position as the dealer's wholesale financer to monopolize the business of acquiring the dealer's consumer paper and reaping the lucrative rewards of collecting the difference between the amount paid to the dealer for the paper and the amount the buyer is obligated to pay for his purchase on time.

190. CODE § 9-306(2).

191. *See* Hamilton County Bank v. Tuten, 250 So. 2d 17, 9 UCC REP. SERV. 511 (Fla. Dist. Ct. App., 1st Dist. 1971); Crystal State Bank v. Columbia Heights State Bank, — Minn. —, 203 N.W.2d 389, 11 UCC REP. SERV. 922 (1973). To avoid questions the buyer's secured party should perfect his security interest. If the buyer is not a buyer in ordinary course of business, a financer making a loan to the buyer on the security of the goods cannot claim protection under section 9-307(1), and it has been held that the

So, the question has been stated. There is nothing new about the problem. Pre-Code adjudications involving the relative rights of wholesale financer and retail financer in chattel paper had mulled over the question of the relationship of those rights to the status of the buyer, and, when deciding in favor of the retail financer, had sometimes stressed that the paper was created by a buyer in ordinary course of business.[192] With the Code, we have its special statutory language to deal with: the carry-over is not clear, but the central issues are for the most part unchanged.

And now, as then, this writer for one subscribes to the notion that the status of the buyer should not be controlling in this contest over chattel paper.[193]

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rights between the secured parties are governed by section 9-312(5), resulting in judgment for seller's secured party. National Bank of Commerce v. First Nat'l Bank and Trust Co., 446 P.2d 277, 5 UCC REP. SERV. 947 (Okla. 1968).

192. I considered the points involved, in a pre-Code setting, in Skilton, *supra* note 188, at 420-22:

> Another approach to the solution of the contest runs along these lines: a bona fide purchaser of the retail paper will be protected against the claims of the wholesale financer *if the buyer of the car is protected.* This view has resulted in sheltering the assignee of conditional sales contracts under the protection prevalently accorded the innocent consumer-buyer. The approach is appealing from a functional standpoint. The transfer of the chattel paper created by the buyer gives the dealer the equivalent of a cash sale. Functionally the arrangement is like a case where the buyer has paid the dealer in cash by getting a loan from a bank and giving the bank a chattel mortgage on the car. Surely the bank's chattel mortgage in that case would be at least as good as the buyer's title to the car. In each case the dealer is supplied with cash with which to pay off the wholesale loan, and in each case, it may be argued, the wholesale financer should bear the risk of the dealer's dishonesty. So, whether the financing be via buyer's mortgage to his bank, or buyer's mortgage to the dealer, or conditional sales contract, the result should be the same. The retail financer should win, at least if he is in good faith.
>
> The wholesale financer may vigorously contest the assertion that a retail financer acquiring conditional sales contracts should be protected in pari passu with the buyer in ordinary course of business. Counsel for G.M.A.C. have long contended that the position of the two is not the same . . . .

193. In reviewing the state of the law in pre-Code days, I observed: Skilton, *supra* note 188, at 422.

> If the rights of the bona fide purchaser of chattel paper stand or fall upon the status of the buyer of the car, the result will sometimes be unfavorable to the retail financer. The buyer's status may be assailable by the unpaid wholesale financer because for some reason the buyer is not a bona fide purchaser for value in the ordinary course. In this case the assignee of the buyer's conditional sales contract would also lose out. And where there is in fact no buyer at all, where the dealer has faked a conditional sales contract upon a car which remains in his possession, a decision against the retail financer would be *a fortiori* under this approach.
>
> Nevertheless, in the case of the sham sale some courts have recognized the rights of the retail financer in the car. Results like this must rest upon a separate and distinct analysis of the status of the retail purchaser of chattel paper. The retail financer may be viewed

In terms of article 9, the issue is this: Even if section 9-308 does not literally supply the answer to Case 2, as it does to Case 1, is Case 2 sufficiently like Case 1 so that the same result should be reached following a rule of liberal interpretation as prescribed by section 1-102 and comment thereto?

How are the decisions going?

First Decision: *Old Freeport Bank* had (in Pennsylvania) an inventory security interest in certain cars of Dealer (and proceeds). The security interest was noted on the DX (Dealer) certificates of title which Bank retained in its possession. Dealer sold an automobile to Buyer, who signed a bailment lease security agreement for the balance of the time price. Dealer sold and delivered the bailment lease contract to Associates Discount (hereinafter called Discounter). Dealer endorsed check, given by Discounter for the purchase, to Bank, and Bank cashed it and credited it to other obligation of Dealer to Bank, and refused to turn over the DX title to the car. Because Bank still held the DX title certificate, thus preventing Buyer from getting a title certificate, made out to him as owner, Bank induced Buyer to execute another bailment lease to it and then received subsequent monthly payments from Buyer. Associates sued Bank to recover the amount of Buyer's payments to Bank. Judgment for Discounter.[194] The Bank, the opinion reasoned, was a "constructive trustee for Discounter to the extent of the payments received."

Note how the steps to the conclusion involve section 9-307(1):

> When Buyer purchased the automobile in the ordinary course of business, he took free of the Bank's lien even though Bank had noted its security interest on the DX title. *Sterling Acceptance Co. v. Grimes*, 194 Pa Super 503, 168 A 2d 600 [1 UCC Rep 487] (1961). As was stated in the amicus brief filed in this case: "The policy in favor of free purchase by ordinary consumers from dealers which is fundamental in a credit economy and which underlies Section 9-307 of the Code would be seriously circumvented by any other result."
>
> Even though the Bank lost its lien by Dealer's sale to Buyer, Bank retained a security interest in the proceeds of the sale. Thus, the inventory financier [the Bank in this case] does not suffer by the loss of its security interest in the collateral. Part of the proceeds of sale was a bailment lease or chattel paper which dealer sold to Discounter.

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as the purchaser of an independent interest in the car, a buyer whose status does not necessarily depend on the status of the vendee. This is getting down to fundamentals. If a dealer has power to vest rights in a retail financer by transferring paper originated in a real sale, does he not have similar power where he creates paper in a faked sale? In each case he has power over the cars involved.

194. Associates Discount Corp. v. Old Freeport Bank, 421 Pa. 609, 220 A.2d 621, 3 UCC REP. SERV. 481 (1966).

> This sale of the chattel paper operated to deprive Bank of its security interest in the chattel paper, since the sale complied with §9-308. Thus again the security interest of the Bank was shifted, this time to the proceeds of the sale of the chattel paper to Discounter. Section 9-308 became operative since the check given by Discounter to Dealer was new value, Discounter had taken possession of the chattel paper and the transaction was the type of transaction which was in the ordinary course of its business.
>
> The notation on the DX title made by Bank did not prevent the loss of Bank's security interest in the chattel paper just as it did not prevent the loss of Bank's security interest in the automobile.
>
> The amicus brief in this matter clearly points out: "The DX title notation is not relevant to the chattel paper security interest and a purchaser of the paper who satisfies the requirements of Section 9-308 thus prevails over the inventory financer, while the inventory financer becomes entitled to the proceeds of the sale of the chattel paper. The action of [Bank] in obtaining a second bailment lease from [Buyer] in no way improves [Bank's] position."[195]

There you have it, syllogistic reasoning (1), (2), (3)—first point, that *B* was a buyer in ordinary course of business. Incidentally, the amicus brief was by the Pennsylvania Commissioners on Uniform State Laws.

Second Decision. D, a car dealer in New York, had floor planned his car inventory with Marine Midland Trust Co., under a security agreement giving Marine a "floating lien" security interest in D's car inventory and proceeds. The security interest was perfected. On February 16, 1966, Mrs. Sharp came to D's premises and sought to purchase a certain 1963 Chevrolet. After a favorable credit check had been made by Chrysler Credit Corp. (D's proposed retail financer) she signed a "retail installment contract" which recited that her down payment consisted of an allowance for a car which she traded in to D, plus $443 in cash. The contract reserved a security interest in the car until Mrs. Sharp paid the balance of the time price. A financing statement was duly filed. (New York was not then a title certificate state.) On the same day D assigned and delivered the "chattel paper" to Chrysler Credit, and received cash therefor, but did not turn over the cash to Midland. Unknown to Chrysler Credit, Mrs. Sharp *had not paid the $443 down payment as stated in the agreement.* Mrs. Sharp and D had orally agreed that she would complete this payment when she received

195. *Id.* 612-13, 220 A.2d at 623-24, 3 UCC REP. SERV. at 482-83. For a similar approach relating *F-Two's* rights to the status of the buyer, who was held to take in an authorized sale (section 9-306(2)), see Commercial Credit Corp. v. National Credit Corp., 251 Ark. 541, 473 S.W.2d 876, 10 UCC REP. SERV. 232 (1971); Commercial Credit Corp. v. National Credit Corp., 251 Ark. 702, 473 S.W.2d 881, 10 UCC REP. SERV. 285 (1971).

an income tax refund; in the meantime, D was to retain possession of the car. On March 18, 1966, Marine seized all of D's inventory, including the Chevrolet involved in the Sharp transaction. Chrysler Credit sued Marine for conversion. Judgment for Chrysler Credit.[196]

Counsel for Marine had taken the position that Mrs. Sharp was not a "buyer in ordinary course of business," contending that she could not qualify as such because dealer still had title to the car. Everyone seemed to think that the question of Mrs. Sharp's status was crucial to the case.

As to Mrs. Sharp's status: The fact that title may not have passed to her did not stop the court, which observed, "This court is inclined to feel that while title questions may be of significance in determining many issues under the UCC, the theory of the Act and its relation to the problem relegates the issue of title in this case to a subordinate position." The court felt that the Code should be liberally construed, to harmonize with commercial realities.[197] There was plenty of evidence that Mrs. Sharp was in good faith and that the transaction was not unusual:

> Applying the definitions to the evidence, it may be said that Mrs. Sharp entered into a specific written contract to purchase the car owned by the dealer. She gave valuable consideration in goods, she traded in her old vehicle, and she signed a binding installment contract. She agreed to pay in cash a down payment and a deferred payment. By agreement, orally, she specified the course of her down payment, an anticipated income tax refund, and she certainly, in good faith expected to receive the car and to make her payments upon the evidence, UCC §1-102(3). According to the testimony, she attempted to pay her cash deficiency a few days after the repossession by the bank, but, finding the car gone, abandoned her rights. The sales manager testified without contradiction, that they frequently took and negotiated contracts with the car to be held for a time for the cash down payment, that it was common practice in his twenty years experience in the car business to take contracts without actual receipt of the recited cash

196. Chrysler Credit Corp. v. Sharp, 56 Misc. 2d 261, 288 N.Y.S.2d 525, 5 UCC REP. SERV. 226 (N.Y. Sup. Ct., Erie Cty. 1968).

Serra, J. observed:

> In determining the rights of the parties, we are dealing with a question of first impression under the newly enacted Uniform Commercial Code (UCC), as to which neither party nor the court has uncovered any decisive interpretive case law on the issues herein in this or any other jurisdiction governed by the new Code. The UCC has been law in New York since September 27, 1964 (L 1962 c 553 as amended). Situations such as this are, moreover, commonplace according to counsel, in insolvent automobile dealerships and with major appliance dealers.

Id. at 263, 288 N.Y.S.2d at 528, 5 UCC REP. SERV. at 229.

197. *See* CODE § 1-102.

> down payment. He said he would fire a salesman who failed to do so and that in his experience and opinion a number of dealers would go out of business if they failed to follow this practice.[198]

And so, the court concluded, citing sections 9-308 and 9-306(5)(b)(c) and (d), "the plaintiff finance company, having furnished new value which has been paid to the dealer on the assignment, and having purchased the chattel paper in due course, is entitled to the returned or repossessed goods . . . ."[199]

So *F-Two* wins because Mrs. Sharp was a buyer in ordinary course of business? Yes? The opinion gets cagey:

> In making this decision, the court has, of course, by inference, determined that the buyer of goods was a buyer in the ordinary course of business out of inventory. A discussion of this has been left to the close of this memorandum by reason of the fact that the entire relation of the parties as indicated above relates to whether the irregularities of the transaction would make Mrs. Sharp other than such a buyer. As indicated at the beginning, UCC §1-102 requires a construction of all terms to carry out the underlying purposes and policies set forth in the statute, which is discussed at length in the practice commentaries of McKinney's and in the Official Comments. An interpretation of the entire transaction, where both the retail financer and bank entruster acted in good faith which became so technical as to abort the intention of the Act and where a dealer has acted in relation to all the other parties, buyer, entruster and financer, in such manner as to leave each with damage would undermine the ultimate success of the Act. If there is a usage of trade which exposes an entruster on floor plan

198. Chrysler Credit Corp. v. Sharp, 56 Misc. 2d 261, 267, 288 N.Y.S.2d 525, 531-32, 5 UCC REP. SERV. 226, 232-33 (N.Y. Sup. Ct., Erie Cty. 1968).

199. Taking note of the provision of section 9-306(5)(d) that "A security interest of an unpaid transferee asserted under paragraph (b) or (c) must be perfected for protection against creditors of the transferor and purchasers of the returned or repossessed goods," the court found that the requirement was satisfied—seemingly by the filing of the financing statement naming Mrs. Sharp as debtor—it cited section 9-401(1)(b) (that state not being a title certificate state).

But what does a filing naming Mrs. Sharp as debtor have to do with the creditors of the dealer? If filing as to the returned or repossessed goods is required by section 9-306(5)(d), the financing statement should name the dealer as debtor, since it is he who is in possession of the returned or repossessed goods. However, it is believed that no filing as to the car naming the dealer as debtor is required to protect a chattel paper assignee with priority under section 9-308 against the dealer's inventory financer. Section 9-306(5)(d) should be read in context with section 9-308; the dealer's inventory financer is not, it is believed, the kind of "creditor" of the dealer that section 9-306(5)(d) seeks to protect.

In a state which has a title certificate law making compliance with its procedures the way to perfect security interests in cars, the chattel paper assignee, by seeing that his security interest is noted on the certificate, may be able to achieve protection *in rem*.

> to certain risks, these are risks against which he can guard by audits and accounting procedures or he can refuse to knowingly expose himself to the risk with the particular dealer. To fail to place the exposure or such a risk with the entruster in such situation would make it impossible for retail finance companies to do business with any dealer unless the entruster were directly a participant. To hold otherwise, would expose the retail financer to a double loss as against at most a partial loss for both. The proliferation of paper work would be a giant step backwards in modern commercial practice. The court feels a buyer who makes a purchase on a printed form in good faith with a full understanding it is a binding contract, who knowingly signs a retail installment payment obligation and trades in an old car in addition must, *certainly as to a retail financer furnishing new value on the strength of such contract and as to an entruster giving the dealer wide latitude of sale goods* [sic], *be deemed a buyer in the ordinary course of business, without regard to the technicalities of when title* [*passes*] . . . .[200]

The italicized part of the opinion suggests the possibility that the court was thinking about flexing the "buyer in ordinary course of business" tests by taking into consideration who's suing whom? Thus, for purposes of the contest between *F-One* and *F-Two*, Mrs. Sharp was a buyer in ordinary course of business, but maybe she wouldn't be treated as such if it was Mrs. Sharp herself v. *F-One*. Would the court have recognized Mrs. Sharp's right to hold *F-One* liable for conversion or on some other basis though she had consented to allow the car to remain on the seller's premises for a long time? Who knows?

Did *F-Two* win because Mrs. Sharp was a buyer in ordinary course of business? Or, was Mrs. Sharp a buyer in ordinary course of business because *F-Two* won?

Flexing the tests of buyer in ordinary course of business depending on who's suing whom is, to put it mildly, a cause of confusion.

This tie-in with the buyer's status illustrated in *Chrysler Credit Corporation v. Sharp* is not completely persuasive. *F-Two* deals with the seller in acquiring the chattel paper. *F-Two* derives his rights as an assignee of the seller, not through the buyer. This is not a case where *F-Two* is a lending institution lending the purchase price to the buyer and taking a security interest from the buyer to secure the purchase loan. In that case, the shelter principle operates: if B is protected against *F-One*, so, of course, is *F-Two*, taking from B. Section 9-308 is not involved.

But in this case *F-Two* is not *sheltered* by the buyer's rights.

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200. Chrysler Credit Corp. v. Sharp, 56 Misc. 2d 261, 269-70, 288 N.Y.S.2d 525, 533-34, 5 UCC REP. SERV. 226, 234-35 (N.Y. Sup. Ct., Erie Cty. 1968) (emphasis supplied).

F-Two must run its own gauntlet under section 9-308: *F-Two* qualifies for priority only if *F-Two* takes possession of the chattel paper, for new value, and in the ordinary course of his business. If the chattel paper is "claimed merely as proceeds" by *F-One* as seems to be the case here, *F-Two* prevails under section 9-308 "even though he knows that the specific paper is subject to the security interest" of *F-One*. Must it, in addition, establish that the buyer takes free?

Unless *F-Two* should have visited the dealer's premises before taking the chattel paper, to discover whether the car was still there—usually a profitless thing to do—or unless we say that *F-Two* should check with every buyer directly before it takes the chattel paper, there is nothing that *F-Two* did or failed to do that should make its position of priority dependent on the kind of buyer Mrs. Sharp was. The question posed by section 9-308 is what is, or should be, the ordinary course of business for a retail financer like *F-Two*.

Did *F-One* bear the risk of its dealer-debtor misconduct, in case his dealer-debtor sold to a buyer in ordinary course, as far as *F-One*'s rights against *F-Two* are concerned? Yes, says section 9-308. It's not too much to say that *F-One*'s risk versus *F-Two* should likewise extend to the case where B is, unknown to *F-Two not* a buyer in ordinary course, since *F-One* already bears the burden of knowing his dealer and keeping an eye on him.

Third Decision. Middlesboro Motor Sales, Inc. was a corporation holding a Chrysler-Plymouth franchise in Middlesboro, Kentucky. The corporation was owned by James Sharp, President of the Company. It floor planned its cars under a security agreement with Universal C.I.T. The security agreement provided that dealer "shall have liberty to exhibit and to sell each chattel in the ordinary course of trade and for the respective principal obligations shown in the respective statements." The dealership became remiss in accounting to C.I.T. for proceeds of sales, and at the end of January, 1964, C.I.T. brought a claim and delivery action for all dealer's cars.

During the last month before the collapse of the business, there was some intra-company activity which accounts for the case being considered here. (1) Mason, chief salesman and Vice-President of the Middlesboro dealership, went to Bank #1 to borrow money to buy a new car from Middlesboro. At Bank's #1's instruction, Mason got from Middlesboro a conditional sales contract (signed by Dealer and Mason) for a certain new Valiant with security interest reserved, and Dealer assigned the contract (chattel paper) to Bank #1 which in return paid Dealer the stated purchase price of the car (the wholesale price.) Dealer did not pay C.I.T. the release value. "Mason kept this car at the place of business, with Dealer's tags on it and accounted for it on car checks" by C.I.T.

(2) Mary Sharp, wife of President of Middlesboro, went to Bank #2 and asked for a personal loan of $2,000 on the security of a 1963 Plymouth she said she owned. (This car was a trade-in on which C.I.T. had made an advance of $1750 to Dealer). Following up on her request, she had a registration receipt issued to herself, exhibited it to Bank #2, signed a security agreement covering the car, and got the $2,000 loan. She paid $1,000 to her husband and transfered a $750 value used car she owned to him, or at least so she said. Dealer did not pay C.I.T. the release value ($1750) for the 1963 Plymouth. The sheriff picked up the Mason and the Mary Sharp cars among the cars he seized on Dealer's premises in the claim and delivery action brought by C.I.T. These two banks, claiming better rights than C.I.T. in the two cars, intervene in C.I.T.'s claim and delivery action. Judgment for Banks.[201]

Osborne, J., observed:

> Though the entire history of these two transactions is riddled with questionable behavior on the part of Mary Sharp and Edward Mason, it is nowhere shown that the banks knew or should have known of anything wrong.
>
> The sort of transactions involved herein is not uncommon among the types of businesses involved. Generally with this type of inventory financing, the lien of the wholesale financer is automatically extinguished upon sale . . . [quoting Section 9-307(1)] KRS 355.2-403(2) provides that where goods are entrusted to a dealer, he can give good title, but this section again requires that the one to be protected must be "a buyer in ordinary course of business."
>
> Considering these sections alone, the banks prevail only if Mary Sharp and Edward Mason were 'buyers in ordinary course of business' and if they would have prevailed against C.I.T. The Code sets out very specific requirements for such a person. [Quoting Section 1-201(9)] . . . Obviously, Mary Sharp and Edward Mason do not meet these requirements. There is a definite question about their "good faith" in this situation. The Pennsylvania Supreme Court reached this result under similar facts in *Taylor Motor Rental, Inc. v. Associates Corp.*, 196 Pa Super 182, 173 A.2d 688 (1961).[202]

So, things look bad for the banks . . . but, a ray of light! The dealer's action in disposing of the collateral was "authorized by the secured party in the security agreement." (Dealer to have "liberty" to sell each chattel in the "ordinary course of trade," etc.).[203]

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201. Universal C.I.T. Credit Corp. v. Middlesboro Motor Sales, Inc., 4 UCC REP. SERV. 1126 (Ct. App. Ky. 1968).

202. *Id.* at 1131.

203. The opinion noted:

> The Bank's evidence shows that sales to officers and employees were common and usual among car dealers in the area. From this evidence we conclude that the sale was in the ordinary course of trade. They further presented evidence that the individuals involved paid the motor company the wholesale price of the cars

As a result, C.I.T.'s security interest was released by operation of section 9-306(2).

The opinion concludes on a provocative note:

> We do not hereby decide the issue of what would happen if the security agreement did not allow such sales. It could be that the section above referred to [Section 9-306(2)] is broad enough to protect a bank, who with no knowledge of violation of the agreement, loans money in this type situation in reliance on the apparent authority of the retailer to make the sales. The official annotation to the code and the case of Clovis National Bank v. Thomas, 77 N.M. 554, 425 P2d [4 UCCC Rep 137] seem to indicate that this might be the result under such a factual situation.[204]

In this case (also involving a Mrs. Sharp), the court decides in favor of *F-Two*, because the sales were 'authorized' by the security agreement between *F-One* and dealer. But would the court have decided as it did, if the *buyers* had been seeking to assert rights in the cars, against *F-One*? Would *they* be heard to say that the sales to them were authorized? Highly doubtful, in view of the court's opinion they weren't in good faith. Again, what the court may have done is to make its test depend on who's suing whom.

Again, it is submitted, the issues between *F-One* and *F-Two* should not have to depend on the status of B.

But suppose (as in one of the transactions in *Universal C.I.T.* case) the *F-Two* has lent directly to B, and taken a security interest from B, rather than dealing with S by taking an assignment of chattel paper from S? In this case, if B is not protected against *F-One*, then, of course, *F-Two* is not sheltered by B's rights. So, does *F-Two* lose to *F-One*? Not necessarily. Again, it depends on assessing the risks *F-One* should be said to assume in becoming the dealer's inventory financer.

> which is the Respective Principal Obligations referred to in the security agreement. This evidence was not seriously disputed, therefore, the Judge was not clearly erroneous in directing a verdict for the banks.

A footnote to the opinion observes that the term "sale in the ordinary course of trade" . . .

> [A]ppears to be deceptively like 'buyer in the ordinary course of business' referred to above. However, 'buyer in the ordinary course of business' is a specifically defined term in the code, and a reading of its definition shows that it specifically imposes several requirements in addition to a sale being in the ordinary course. For a definition of sales 'in the ordinary course of trade' when not specifically defined otherwise see Stemmons, Inc. v. Universal C.I.T. Credit Corp., 301 P.2d 212 (Okla. 1956). In that case, the court looked strictly to proof that the acts were common and ordinary practice among local businesses of the same type.

Id. at 1132, n.1. *See also* Crystal State Bank v. Columbia Heights State Bank, — Minn. —, 203 N.W.2d 389, 11 UCC REP. SERV. 922 (1973).

204. Universal C.I.T. Credit Corp. v. Middlesboro Motor Sales, Inc., 4 UCC REP. SERV. 1126, 1132 (Ct. App. Ky. 1968).

It's too bad that concentration on the ins and outs of Code language may sometimes seem to downplay the need to look at the merits of the cases.

IV. IN CONCLUSION

By upholding the rights of a buyer in ordinary course of business, section 9-307(1) and various other sections of the Uniform Commercial Code give a measure of quasi-negotiability to goods. In many cases, however, if all the facts were known, it would be unnecessary for a buyer to rely on section 9-307(1). In the security agreement or otherwise, the secured party may have authorized the dealer to sell free and clear. This is especially likely if the dealer sells to retail buyers. But proof of the secured party's authorization may be difficult for the buyer to establish. As a result, it may be simpler to rely wholly or in part on section 9-307(1).

The protection given by section 9-307(1) to the retail buyer is probably supported by the consensus of the business community that one who purchases at retail in the ordinary course of trade from a dealer has a right to count on not being harassed by the seller's inventory financer. Protecting such buyer is good business as well as seeming to be the fair thing to do. And who doubts that the general public would overwhelmingly support this view, provided they knew what it was all about?

While buyer in ordinary course of business litigation is considerable, a good many of the cases involve buyers who are not the run of the mill retail consumer buyers. It seems obvious that most responsible lenders taking inventory as security are not attempting to make the ordinary retail buyer suffer for the misdeeds of the dealer who was their debtor. A lender who does, runs the risk of being charged with irresponsible and unethical conduct.

There is a natural temptation for a writer who has spent time on a subject to attempt to justify his efforts with the claim that the subject is indeed of vast importance. There is something to be said for the claim in the present instance. Section 9-307(1) may be viewed as an aspect of consumer protection law. It deals with the question of what title the buyer gets. That's good—but title to what? Title to a hollow shell? Often more important is whether the buyer got what he bargained for, in terms of the quality of the goods. As to this section 9-307(1) says nothing. It remains for other provisions of the UCC, and, more importantly, separate legislation or regulation, or judges acting on their own, to assist the buyer in getting what he bargained for or affording him redress if he did not.

P.S. As this article goes to press, Governor Lucey has just signed 1973 S.B. 177, effective July 1, 1974, putting Wisconsin in substantial, but not complete uniformity with the 1972 official text of article 9.