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PROTECTING THE BUYER OF PREVIOUSLY ENCUMBERED GOODS: ANOTHER PLEA FOR REVISION OF UCC SECTION 9-307(I)

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As every law teacher knows, the law is full of little opportunities for student surprise (and therefore instructor triumph), whereby the student can be led to see the inexorable power of logic or the irresistible force of careful reading, as opposed to the tempting but treacherous lure of visceral reaction based on a layman's knowledge or a law student's half-knowledge. Unfortunately, the existence of such surprising outcomes tends to reveal more about the infirmities of the law itself than about the shortcomings of law students¹ as generations of hypothetical flagpole climbers have long since demonstrated. Another example can be found in the failure of *Uniform Commercial Code* [UCC] section

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1. See RESTATEMENT (SECOND) OF CONTRACTS, Reporter's Note to § 12 (Tent. Drafts Nos. 1-7, 1973), which suggests that the true offer for a unilateral contract exists in few cases. It seems in retrospect hardly surprising that any legal principle best exemplified by the offer which the Wizard of Oz made to Dorothy should prove in fact to be of limited applicability.

9-307(1)² to protect the innocent marketplace-buyer of goods against unknown (and, to the buyer, undiscoverable) security interests in those goods created previously by persons other than the seller. This article will examine that failure after describing other situations in which the buyer is protected against outstanding interests, and will suggest reasons for extending this protection.

INTRODUCTION: THE PROBLEM CASE

In 1962, in Massachusetts, Raymond Borelli bought a car. To finance his purchase, Borelli borrowed the money he needed from the New England Merchants National Bank. To secure its right to repayment, the bank took a security interest in Borelli's new car. As the bank's agreement with Borelli created a "purchase money security interest" under Article 9 of the UCC³, the bank was not required by the Massachusetts version of the Code to file a financing statement.⁴ After making only two payments on the loan, Borelli traded the car to another dealer, Kennedy-Rambler, Inc., apparently without telling Kennedy-Rambler that \$1,952.46 remained unpaid to the bank under his security agreement. After acquiring the car from Borelli, Kennedy-Rambler resold it to Geraldine Peters, an individual buying for personal use. Mrs. Peters financed her purchase by a similar security agreement with Auto Owners Finance Co. Thereafter, both Borelli and Kennedy-Rambler went bankrupt, and Mrs. Peters defaulted on her obligation to repay Auto Owners Finance Co. The finance company therefore repossessed the car, pursuant to the terms of its security agreement, and resold it for \$1,130. The question before the court, in a suit by the bank against the finance company, was simply this: who is entitled to the proceeds from the latest sale of this car, where the bank and the finance company are each still owed under the respective loan agreements a sum in excess of \$1,130?

Three courts in Massachusetts successively faced that question, and

2. This subsection provides as follows:

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. (emphasis added).

No change in this subsection was made by the official revision of the Code in 1972. Various changes were made in other parts of section 9-307, however, as well as in other parts of Article 9. Unless otherwise indicated, all references to the Uniform Commercial Code [hereinafter cited as UCC] will be to the Official 1962 version, as amended in 1966, rather than to the 1972 version.

3. UCC § 9-107.

4. Massachusetts, in its version of UCC section 9-302(1)(d), omits the "or for a motor vehicle required to be licensed" limitation on the filing exemption for a purchase money security interest in consumer goods. MASS. GEN. LAWS ANN. ch. 106, § 9-302(1)(d) (1963). See text accompanying notes 71-73 *infra*.

three different opinions were expressed. A Boston Municipal Court judge found that the bank, claiming under its security agreement with Borelli, had a superior claim under UCC section 9-307(1), presumably because the security interest asserted by the bank was not "created by" Kennedy-Rambler, the one who sold it to Mrs. Peters (through whom the finance company asserted its claim).⁵ The Appellate Division, however, found for the defendant. Two of the three judges on that court were of the opinion that, Mrs. Peters having purchased the car as "consumer goods" for her own "personal, family or household purposes," she (and thus the finance company) took free of any unrecorded security interest under UCC section 9-307(2).⁶

In *New England Merchants National Bank v. Auto Owners Finance Co.*,⁷ the Supreme Judicial Court of Massachusetts reversed. Without discussing the applicability of section 9-307(1), the court held that section 9-307(2) did not give either Mrs. Peters or the finance company a right superior to that of the bank. Basing its decision on construction of section 9-307(2), on the authority of other decisions,⁸ and on the writings of leading scholars,⁹ the court held that the consumer-buyer, in order to be protected under section 9-307(2) against an outstanding security interest, must have bought from one who was also a "consumer" with respect to the goods in question. That section would have protected Mrs. Peters had she bought directly from Borelli, but it did not where she bought from Borelli's vendee, Kennedy-Rambler. Thus no basis existed for giving her secured creditor, the finance company, a better right than Borelli's unpaid secured creditor, the bank.¹⁰

It must be conceded at the outset that the decision of the Supreme Judicial Court of Massachusetts was a "correct" one, in most ways in which that word is used by lawyers. UCC section 9-307(1) does by its terms protect a buyer only against a security interest which was "created by his seller." Section 9-307(2), while hardly a model of clarity, is more reasonably construed as applying only to the consumer-consumer transaction.¹¹ And in the absence of any other applicable rule, the Code does give priority to the holder of a properly perfected secu-

5. *New England Merchants Nat'l Bank v. Auto Owners Fin. Co.*, 40 Mass. App. Dec. 59, 61-62, 5 UCC Rep. Serv. 904, 905 (1968).

6. *Id.*

7. 355 Mass. 487, 245 N.E.2d 437 (1969).

8. *National Shawmut Bank v. Vera*, 352 Mass. 11, 223 N.E.2d 515 (1967); *Everett Nat'l Bank v. Deschuiteneer*, 109 N.H. 112, 244 A.2d 196 (1968).

9. Including Professors Coogan, Gilmore and Vernon. See 35 Mass. at 489, 245 N.E.2d at 438.

10. *Accord*, *General Motors Acceptance Corp. v. Troville*, 43 Mass. App. Dec. 96, 104, 6 UCC Rep. Serv. 409, 412 (1969).

11. See text accompanying notes 93-100 *infra*.

rity interest (even an unfiled one, where filing was not required for its perfection) as against a person who buys from the debtor in an unauthorized sale.¹²

It must also be conceded that, on its face, the dispute between Borelli's and Peters' creditors has little to arouse even the interest (much less the fervor) of anyone whose interest in the law of personal security is grounded primarily in a desire to secure just treatment for the consumer in the marketplace. No consumer lost by the decision, since both Borelli and Peters had forfeited their claims to the auto; even the dealer (Borelli's vendee and Peters' vendor) had become insolvent, so that the litigation was simply to decide who should bear a now-irrecoverable loss, a bank or a finance company—hardly a dispute to enlist the passions of the populace on either side.

Nevertheless, the way in which such a dispute is resolved has important consequences for all consumers. The way the *Uniform Commercial Code* resolves it, as correctly exemplified in the final disposition of the *New England Merchants* case, is "wrong" in a very real sense—wrong because it ignores economic and social realities, wrong because it misallocates an unavoidable risk inherent in the financing of goods, and wrong because it fails to follow the logic of the Code itself.

These points are not new.¹³ Justification for another extended treatment, however, may be found in the 1971 recommendations for the revision of Article 9.¹⁴ Despite the earlier advancement of well-reasoned arguments for change, neither the Special Committee to Review Article 9 nor the Permanent Editorial Board for the UCC¹⁵ has seen fit to recommend any change in the relevant portions of section 9-307.¹⁶ Despite the lateness of the hour, a further word in opposition to the status quo on this point seems to be in order.

In order to place the problem in proper perspective, let us hypoth-

12. UCC § 9-306(2). Indeed, that section apparently provides for preservation of all security interests, perfected or otherwise; cut-off of unperfected interests is covered by section 9-301. See text accompanying notes 62-73 *infra*.

13. See Vernon, *Priorities, the Uniform Commercial Code and Consumer Financing*, 4 B.C. IND. & COM. L. REV. 531, 533-41 (1963); Note, *Section 9-307(1) of the UCC: The Scope of Protection Given a Buyer in Ordinary Course of Business*, 9 B.C. IND. & COM. L. REV. 985 (1968). See also J. WHITE & R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE* § 25-13, at 942-43 (1972).

14. PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, *FINAL REPORT OF THE REVIEW COMMITTEE FOR ARTICLE 9* (April 25, 1971) [hereinafter cited as *FINAL REPORT OF THE REVIEW COMMITTEE FOR ARTICLE 9*].

15. *Id.* at 101.

16. The only recommended changes in that section are the removal of "farm equipment" from the buyer-protection in subsection (2) (to correspond to the added requirement of filing for such interests under section 9-302(1)(c), see note 70, *infra*) and a new subsection (3) relating to "future advances" made after a third party has bought from the debtor. *FINAL REPORT OF THE REVIEW COMMITTEE FOR ARTICLE 9, supra* note 14 at 101-02.

esize a person whose interests will be at stake. Like Mrs. Peters, she¹⁷ is a "good faith purchaser for value."¹⁸ That is, under the relevant portions of the UCC, she has taken by "purchase"¹⁹ goods for which she has given "value,"²⁰ being in all "honesty" ignorant "in fact"²¹ of outstanding claims against those goods on the part of someone other than her seller. The goods, whatever their nature, are valuable enough to make a lawsuit over their ownership an economically practical possibility; thus they are probably some single high-cost item such as an auto, a boat, a mobile home or at least an expensive electrical appliance. Although the buyer may herself be engaged in business of some kind, she is with respect to this transaction a "consumer"²²—that is, she has purchased these goods for her own "personal, family or household purposes."²³

Our buyer is also, apparently like Mrs. Peters in the Massachusetts case discussed above, a "buyer in ordinary course [BIOC]."²⁴ That is, she has "bought" these goods from someone "in the business of selling goods of that kind." Since "buying" under the UCC does not include taking in satisfaction of a preexisting debt, but does include paying cash or buying on credit,²⁵ she might have received the goods in return for her mere promise to pay for them. To put the case more clearly, however, let us assume that she has paid the seller in full, in cash. To assume these characteristics for our hypothetical buyer may beg a few issues of law which could otherwise arise under the UCC, but it serves to frame the issue of consumer justice more precisely; if a buyer as innocent and vulnerable as this one should lose her rights in the goods to a particular third-party claimant, then clearly a variety of other hypothetical buyers a little less deserving would fare no better.

17. The hypothesis of a female buyer is not designed to be either sexist or *anti*-sexist, and reflects no assumption about relative roles of males and females as consumers or merchants. It does, however, conform to the facts of the problem case, and it permits (particularly in the three-party cases discussed in the text) consistent use of the female, male and neuter pronouns for the buyer, debtor/seller and owner/creditor, respectively.

18. See UCC § 2-403(1).

19. *Id.* § 1-201(32), (33).

20. *Id.* § 1-201(44).

21. *Id.* § 1-201(19).

22. This term is not defined in the UCC except by implication from the definition of "consumer goods" in section 9-109(1). Cf. UNIFORM CONSUMER CREDIT CODE §§ 2.104, 2.106, 3.104; UNIFORM CONSUMER SALES PRACTICES ACT § 2 (definitions).

23. UCC § 9-109(1).

24. *Id.* § 1-201(9).

25. *Id.* See *General Elec. Credit Corp. v. R.A. Heintz Constr. Co.*, 302 F. Supp. 958 (D. Ore. 1969) (part of price was cancellation of debt, part new value; transferee held a "buyer"). See also *Sherman v. Roger Kresge, Inc.*, 67 Misc.2d 178, 180, 323 N.Y.S.2d 804, 806, 9 UCC Rep. Serv. 858 (Co. Ct. 1971), where the transferee dealer was held not to be a BIOC where he paid by cancelling his transferor's debt; the opinion seems to overlook the possibility that even as a mere "purchaser" the transferee might have had rights against the reclaiming plaintiff under UCC section 2-403(1).

To better understand the rival policies at stake when the court is asked to decide between a buyer of goods and some competing third party with an assertedly superior right, it seems helpful first to examine a number of different types of claims, and the Code's treatment of them. The discussion which follows will focus on several situations where some third party has a claim against a seller of goods, pursuant to which that third party could have asserted rights against the goods in question had the sale to our hypothetical buyer not taken place. Assuming the validity of that underlying claim, to what extent can the third party pursue the goods into our buyer's hands, and claim rights in them superior to hers?

RIGHTS OF THE BUYER IN COMPETITION WITH CLAIMANTS AGAINST HER SELLER

General Creditors

Typically, an attempt to recover the goods from our hypothetical buyer based on a prior claim against her seller would have arisen out of a transaction between that claimant and the seller involving the particular goods in question. Suppose, however, that general creditors of the seller—or some representative of such creditors, such as a trustee in bankruptcy—should attempt to recover the goods from our buyer to satisfy their claims. Could such an attempt succeed?

The answer appears pretty clearly to be no, given the assumed nature of our buyer. If the sale to our buyer had been for less than a fair price,²⁶ if possession of the goods had been left by her with the seller without sufficient commercial justification²⁷ (particularly if she had been a merchant, not a consumer),²⁸ or if she had been guilty of anything else which could be labeled a fraud against either the seller or his creditors,²⁹ then the answer might be different, and those creditors or their representative might be able to pursue the goods into her hands. Had she bought on credit, her seller's creditors or their representative might have succeeded to, and enforced, the seller's right to *payment* under her contract of purchase.³⁰ On the facts as originally

26. *First Security Bank v. Vrontikis Bros.*, 26 Utah 2d 422, 490 P.2d 1301 (1971); 11 U.S.C. §§ 107(d)(2)(a)-(c) (1970); UNIFORM FRAUDULENT CONVEYANCE ACT §§ 4-6.

27. *Dot Records, Inc. v. Freeman*, 247 Cal. App. 2d 204, 55 Cal. Rptr. 455 (1966); *Burnett County Abstract Co. v. Eau Claire Citizens Loan & Inv. Co.*, 216 Wis. 35, 255 N.W. 890 (1934). See UCC § 2-402(2), which states that retention of possession by a merchant-seller for a commercially reasonable period of time after sale, in good faith and current course of trade, is not fraudulent (otherwise deferring to local law).

28. *Sherrock v. Commercial Credit Corp.*, 277 A.2d 708 (Del. Super. 1971), *rev'd* — Del. —, 290 A.2d 648 (1972).

29. 11 U.S.C. § 107(d)(2)(d) (1970); UNIFORM FRAUDULENT CONVEYANCE ACT § 7.

30. Such a third-party claim would result in no prejudice to the buyer. Even if the seller had sold to her on credit and also retained a security interest in the goods,

assumed, however, the buyer's right to her goods appears to be secure.

The Seller's Defrauded or Unpaid Vendor

A greater threat to our buyer is posed by someone with a prior interest in the goods themselves. One such person could be the one from whom her seller acquired them. The seller may have been guilty of some fraud in that transaction, or he may simply have failed to pay the full price to his vendor. Can that disappointed vendor pursue the goods into the hands of our buyer?

1. *Nonpayment.* Although reasonable arguments might be made for a different rule of law, the need for finality in sale-of-goods transactions and the disinclination to prefer one type of general creditor (an unpaid seller of goods) over others (an unpaid provider of services, for instance) have apparently combined to make the buyer's title to goods generally secure against a claim by the one from whom her seller purchased the goods, even though that vendor has never been paid.³¹ Therefore, for our buyer to be subject to the claim of her seller's unpaid vendor, there must be more basis for that claim than mere nonpayment on the seller's part.

2. *Fraud.* Section 1-103 of the UCC states that the Code is to be supplemented by "the principles of law and equity," including, specifically, "fraud." As between vendor and vendee, then, a sale of goods should be voidable in any case where under pre-Code law the vendee's fraud would have had such effect, even in the absence of any specific Code section so providing. There is no such provision, nor is there any provision which in general terms deals with resales by fraudulent vendees. Section 2-403(1) does provide, however, that "a person with voidable title has power to transfer a good title to a good faith purchaser for value." This provision appears intended to preserve the pre-Code law that a fraudulent vendee can convey to his subsequent transferee a title to the goods in question which will be secure against claims by his defrauded vendor, so long as that transferee meets the requirements of a "good faith purchaser for value."³²

the fact that his creditors might eventually succeed to his rights under that contract of sale (and thus acquire a security interest in the goods) would have no effect on the buyer unless she were unwilling or unable to pay the remainder of the price, in which case she would still be no worse off than if the seller himself were the enforcing party. The substitution of a strict creditor for a lenient one may be unpleasant and onerous for the debtor, but is not considered sufficient legal cause to invalidate an assignment of rights. G. GRISMORE, PRINCIPLES OF THE LAW OF CONTRACT § 248 (J. Murray ed. 1965).

31. Indeed, although some doubt may be raised by the reference in UCC section 2-703 to an unpaid seller's right to "cancel," the unpaid vendor of goods apparently cannot recover the goods even from the vendee without first acquiring a judgment for the debt and then levying on the goods pursuant to that judgment. R. NORDSTROM, HANDBOOK OF THE LAW OF SALES § 165 (1970).

32. 3 S. WILLISTON, THE LAW GOVERNING SALES OF GOODS § 650 (Rev. ed. 1948).

Each of the relevant terms in this phrase, though familiar to pre-Code law, is itself a term of art defined in the Code. Thus, "good faith" means at least "honesty in fact,"³³ and in the case of a "merchant"³⁴ may also mean "the observance of reasonable commercial standards of fair dealing in the trade."³⁵ A "purchaser"³⁶ is one who takes by "any . . . voluntary transaction creating an interest in property."³⁷ The definition is broad enough to include taking by gift,³⁸ although a pure donee cannot qualify as a "good faith purchaser for value," not having given value. "Value" is rather broadly defined, however; in an apparent departure from prior law,³⁹ it extends to a taking "in total or partial satisfaction of a preexisting claim," and also—shades of peppercorns, of hawks, horses and robes!—includes "any consideration sufficient to support a simple contract."⁴⁰

Section 2-403(1), with its reference to "voidable title," also attempts to put to rest some questions, hotly disputed in pre-Code law, about the acquisition of such title by certain types of fraudulent vendees. The vendee is stated to have power to convey a good title to good faith purchasers for value in a case where "the transferor was deceived as to the identity of the [vendee]"⁴¹ as well as cases where "the delivery was procured through fraud punishable as larcenous under the criminal law."⁴² Assuming, therefore, that our buyer did not buy from an outright "thief,"⁴³ she will be able to satisfy the Code's definition of a "good faith purchaser for value," and thus to resist any claim by her seller's defrauded vendor.

3. *Insolvency.* One situation where the pre-Code unpaid vendor of goods might have been able to recover them on the basis of "fraud" is specifically dealt with in another section of Article 2. Where the vendee, in order to induce the vendor to sell to him, has made a specific

33. UCC § 1-201(19).

34. *Id.* § 2-104(1).

35. *Id.* § 2-103(1)(b). Whether this standard of good faith applicable to a merchant under Article 2 should also be applied where a merchant claims the benefit of a "purchaser's" or "buyer's" rights under one of the priority rules of Article 9 has been the subject of some dispute. See note 85 *infra*.

36. UCC § 1-201(33).

37. *Id.* § 1-201(32).

38. *Id.*

39. See *Stratton Sale Barn, Inc. v. Reed*, 28 Agri. Dec. 677, 6 UCC Rep. Serv. 922 (1969).

40. UCC § 1-201(44)(d).

41. *Id.* § 2-403(1)(a). This subsection apparently refers to earlier cases distinguishing between face-to-face impersonation and fraudulent orders by mail or telephone. Cf. Warren, *Cutting Off Claims of Ownership Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 469, 476-77 (1963).

42. UCC § 2-403(1)(d). This subsection is apparently intended to extend the section's protection to anyone whose seller acquired the goods by "fraud" rather than by "theft," whether or not his "fraud" would be classified under other rules of law as "larceny". *Id.*, Comment 2.

43. See text accompanying notes 105-07 *infra*.

representation as to his intention or ability to pay, this representation, if material and untrue, would at common law be fraud sufficient to render the vendee's title a voidable one.⁴⁴ Section 2-702 of the UCC permits the disappointed vendor in such a case to recover the goods from the vendee, thus avoiding competition with the insolvent vendee's other creditors,⁴⁵ only if the vendee was actually "insolvent"⁴⁶ at the time of his receipt of the goods.⁴⁷ This special treatment of the insolvent vendee's case poses no additional threat to our hypothetical buyer, however. The unpaid vendor's right under section 2-702 is a narrowly circumscribed one, even where the goods are still in the hands of the vendee himself; where they have been transferred to a good faith purchaser for value, that purchaser will have acquired good title to the goods, cutting off the unpaid vendor's right to their return.⁴⁸

4. *Dishonored Check.* Another situation in which the unpaid vendor of goods can claim to have been in a sense "defrauded" occurs when it takes the vendee's check in payment, only to have that check dishonored by the drawee bank. Whether or not the giving of a check amounts to a "written misrepresentation of solvency" for purposes of section 2-702⁴⁹ (and indeed even if the vendee neither intended nor

44. 3 S. WILLISTON, *supra* note 32, at § 636. Pre-Code decisions had gone far to find such fraud even in cases where the vendee on credit merely made (or took delivery pursuant to) the contract of purchase knowing that he was probably not going to be able to pay the price of the goods. *E.g.*, *In re Henry Siegel Co.*, 223 F. 369 (D. Mass. 1915); see 3 S. WILLISTON, *supra* note 32, at § 637.

45. Whether the Bankruptcy Act permits the seller to avoid a contract of sale under UCC section 2-702 and recover the goods from the buyer's trustee in bankruptcy has been a matter of considerable dispute. Compare *In re Kravitz*, 278 F.2d 820 (3d Cir. 1960) (trustee entitled to retain goods under Pennsylvania law) with *In re Royalty Homes, Inc.*, 8 UCC Rep. Serv. 61 (E.D. Tenn. 1970) (seller entitled to recover goods under Tennessee law). The recommendation that the words "or lien creditor" be deleted from the official version of section 2-702(3) in 1966 was intended to strengthen the seller's position in such a case. PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, Report No. 3, 3 (1967). See generally R. DUESENBERG & L. KING, SALES & BULK TRANSFERS UNDER THE UNIFORM COMMERCIAL CODE § 13.03[4][d] (Bender's Uniform Commercial Code Service vol. 3, 1973).

46. UCC § 1-201(23).

47. The vendor's right of reclamation is likely to be exceedingly short-lived. Return of the goods must be demanded within 10 days after their receipt by the vendee, unless a written misrepresentation of solvency was made to the vendor within 3 months before delivery. *Id.* § 2-702(2). Although application of the section does not specifically depend on an express misrepresentation by the vendee, the comment makes it clear that the policy basis for such a right in the vendor is the "tacit business misrepresentation of solvency" that is implicit in an insolvent vendee's receipt of goods on credit. *Id.* § 2-702, Comment 2.

48. *Id.* §§ 2-702(3), 2-403. It is not clear whether the cross reference in section 2-702(3) is intended to imply that the insolvent buyer under section 2-702 has the equivalent of "voidable title" under section 2-403(1), or just that the seller is to be deemed an "entruster" under section 2-403(2). The former is the more reasonable reading, since it is in line with pre-Code law in this situation. R. DUESENBERG & L. KING, *supra* note 45, at § 13.03[4][d][i]. The cases appear to confirm this interpretation. See *First-Citizens Bank & Trust Co. v. Academic Archives, Inc.*, 10 N.C. App. 619, 179 S.E.2d 850 (1971); *Evans Prods. Co. v. Jorgensen*, 245 Ore. 362, 371, 421 P.2d 978, 983, n.4 (1966) (dictum).

49. See *Theo. Hamm Brewing Co. v. First Trust & Sav. Bank*, 103 Ill. App. 2d 190, 242 N.E.2d 911 (1968).

anticipated that his check would be dishonored), the vendor's receipt of that check may give it a better claim to return of the goods than an ordinary unpaid vendor could assert. Section 2-511 of the UCC, restating the general law of constructive conditions as it applies to a sale of goods,⁵⁰ provides that the vendor need not (absent any contractual provision to the contrary) make delivery of the goods until payment is tendered by the vendee. Under section 2-507(2), where payment is "due and demanded" by the vendor at the time of delivery of the goods, "[the vendee's] right as against the [vendor] to retain or dispose of them is conditional upon [the vendee's] making the payment due." Since, under section 2-511(3), payment by check is itself "conditional," and is "defeated . . . by dishonor of the check," when the check bounces the vendee loses its right to retain the goods as against the vendor.

Some aspects of the vendor's rights in the dishonored check situation are unclear under the Code.⁵¹ What is clear is that, under section 2-403(1)(b), whatever the vendor's rights may be against the goods in the hands of the vendee, those rights are cut off when the vendee transfers to a "good faith purchaser for value."⁵² Here again, our hypothetical buyer, who more than satisfies the minimal requirements for such a purchaser, will be immune from such an unpaid vendor's claim against the goods in her possession.

Secured Creditors

The preceding discussion centered on the rights of a vendor who did not attempt expressly to reserve a property interest in the goods sold, but nevertheless claims under some rule of law a right against those goods in the hands of the vendee. As we have seen, the UCC in every case permits a good faith purchaser from that vendee to take the goods free of any claim by the disappointed vendor. What if the vendor goes a step farther, and in the contract of sale expressly provides that no title to the goods is to pass to the vendee until the price is

50. RESTATEMENT OF CONTRACTS § 267 (1932).

51. It is not clear, for instance, whether the courts will follow the suggestion in Comment 3 to section 2-507 that the vendor should be subject to a 10-day limitation similar to that which section 2-702 imposes on the vendor to an insolvent buyer. See R. NORDSTROM, *supra* note 31, at § 166, and cases cited at n.7 therein. Where a check is treated as a written misrepresentation of solvency, of course, the problem is avoided. See text & note 49 *supra*.

52. For a general comparison of the UCC rule in bad check cases and pre-Code law, see Hudiberg Chevrolet, Inc., v. Ponco, 17 Wis. 2d 281, 285, 116 N.W.2d 252, 254-55 (1962). Use of the term "purchaser" means that a secured party may acquire rights superior to those which its debtor had. Stephenson Fin. Co. v. P.L. Bruce & Co., 254 S.C. 249, 174 S.E.2d 750 (1970). The secured party has been held to prevail as a section 2-403(1) transferee even though its interest is unperfected. See Guy Martin Buick, Inc. v. Colorado Springs Nat'l Bank, — Colo. App. —, 511 P.2d 912 (1973).

paid? Can the vendee (fraudulent or otherwise) be thus deprived of his power to pass title to a good faith purchaser?

In Article 9, the drafters of the UCC brought together and simplified a vast amount of pre-Code law relating to various devices for creating and enforcing security interests in goods.⁵³ The Code unifies both terminology and theory: whenever a security interest in personal property is created pursuant to Article 9, the location of "title" is immaterial,⁵⁴ and the creditor ("secured party")⁵⁵ simply has a "security interest" in that property.⁵⁶

Another change from prior law made by the drafters of Article 9 was to reduce substantially the importance of the distinction between seller-creditors and lender-creditors. Where that distinction previously might have been crucial in classifying a transaction as conditional sale or chattel mortgage, for instance,⁵⁷ it is now reflected only in the provision for a separate class of "purchase money" security interests.⁵⁸ The distinction between purchase money and ordinary security interests has great importance under the Article 9 priority rules.⁵⁹ In the case we are examining, however, it appears to be of no importance at all; the priority rules relating to good faith purchasers and buyers in ordinary course do not depend on the secured party's status as a purchase money financier.⁶⁰

Whatever its reason for extending credit to the seller, the secured party must comply with the formalities of Article 9 to have a security interest enforceable against anyone, the debtor included. Since our hypothetical buyer has possession of the goods in question, the secured

53. UCC § 9-101, Comment. See generally 1 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY §§ 1.1-8.8 (1965), which describes in detail a number of pre-Code security devices. Some of these devices, such as the conditional sale, at least in their early period of development permitted the vendor of goods to reserve "title" until the price had been paid in full. *Id.* at § 3.2. Others provided for only an "equitable title" or a "lien" in the secured creditor, and the theory of ownership under a particular device might vary among jurisdictions. See *id.* at § 11.8.

54. UCC § 9-202.

55. *Id.* § 9-105(1)(i).

56. *Id.* §§ 9-102, 1-201(37). Indeed, Article 2 provides that when a vendor has made delivery of goods to his vendee, any ownership or "title" he has purported to reserve by the contract of sale can amount to no more than a security interest. *Id.* § 2-401(1); *First Nat'l Bank v. Smoker*, 287 N.E.2d 788, 789-90 (Ind. Ct. App. 1972). Once the goods are lawfully in the hands of the vendee, that security interest is governed by the provisions of Article 9, UCC § 9-113, Comment 3, including its perfection requirements, see text accompanying notes 62-72 *infra*.

57. 1 G. GILMORE, *supra* note 53, at § 3.3.

58. UCC § 9-107. The distinction made by this section is actually between sale-credit (whether extended by the seller or by another lender), which may give rise to a purchase money interest, and all other loans, which do not.

59. *Id.* §§ 9-312(3), (4).

60. The 10-day grace period for filing provided in UCC section 9-301(2) applies only with respect to intervening bulk transferees and lien creditors. Sections 9-301(1)(c) and 9-307 have no similar provision. The requirements for perfection, however, may differ where purchase-money interests are concerned. See text accompanying notes 68-72 *infra*.

party can have no enforceable interest unless it has a written security agreement signed by the debtor.⁶¹ Assuming this minimal formality was complied with, how good are its rights against the debtor's transferee, our buyer?

1. *Unperfected Security Interest.* In order to have rights to the goods against the world at large corresponding to its rights as against the debtor himself, the secured party must "perfect"⁶² its security interest. In the ordinary case the action required to perfect is one which will give some actual or constructive notice to the world at large that the debtor himself does not have unencumbered ownership of the collateral; where the collateral consists of goods, perfection usually requires either taking possession of them,⁶³ or filing a financing statement.⁶⁴ In our hypothetical case the buyer has received possession of the goods, so any perfected status originally earned by possession would since have been lost.⁶⁵ To have a perfected security interest now, the creditor would in most cases have to have filed a proper financing statement⁶⁶ in the appropriate public office.⁶⁷

Where consumer goods are concerned, however, the drafters of the Code have conceded that the large number and relatively small individual value of consumer goods credit sales make the filing requirement oppressive and inappropriate.⁶⁸ In general, therefore, the secured party who sells (or lends for the purchase of) goods which in the hands of the debtor are "consumer goods" is exempt from the filing requirement.⁶⁹ Such a security interest is deemed to be perfected by attachment alone.⁷⁰ The practical importance of this filing exemption for our purposes is that anyone, consumer or dealer, who purchases consumer goods from a consumer-owner has no way of discovering

61. UCC § 9-203(1).

62. The closest thing to a definition of this term is found in UCC section 9-303, Comment 1.

63. UCC § 9-305.

64. *Id.* § 9-302.

65. *Id.* § 9-305.

66. *Id.* § 9-402.

67. *Id.* § 9-401.

68. *Cf.* 1 G. GILMORE, *supra* note 53, at § 19.4.

69. UCC § 9-302(1)(d).

70. This filing exemption is one of only two such exemptions where nonpossessory security interests in goods are concerned. The other is an exemption for farm equipment having a purchase price not in excess of \$2,500. UCC § 9-302(1)(c). The latter provision is deleted from the 1972 official text of the Code, to facilitate use of farmers' equipment as loan collateral. *See* FINAL REPORT OF THE REVIEW FOR ARTICLE 9 *supra* note 14, at 84.

As others have pointed out, one practical effect of a filing exemption for purchase money interests in consumer goods is to discourage banks and other lenders from making nonpurchase money loans against the security of such goods, since it cannot be determined beyond doubt that no previous security interest is outstanding. Vernon, *Priorities, the Uniform Commercial Code and Consumer Financing*, 4 B.C. IND. & COM. L. REV. 531, 537-38 (1963).

through the examination of public records the existence of a prior, unsatisfied security interest in those goods.

There is in nearly every state, however, one particularly significant limitation on the exemption from filing for purchase money security interests in consumer goods: the "motor vehicle required to be licensed."⁷¹ With respect to this most valuable and most traded of widely used consumer goods, perfected status is achieved only by filing or, where state law so provides, by indication of the security interest on a certificate of title issued by the appropriate public official.⁷² Even with this important limitation on the filing exemption, it is obvious that in most cases a security interest in consumer goods will have been perfected. If the interest is *nonpurchase* money, however, or attaches to a motor vehicle, and the requisite steps for perfection have been omitted or were defective, the secured party may at the time of a sale by its debtor have had only an unperfected security interest. In this event, the rights of the subsequent purchaser are clearly set forth in UCC section 9-301(1)(c): An unperfected security interest is subordinate to the rights of a "buyer . . . to the extent that he gives value and receives delivery of the collateral without knowledge of the security interest and before it is perfected." Assuming that our hypothetical buyer has paid the price in full and received delivery of the goods before perfection of the security interest, she would, under section 9-301(1)(c), take the goods free of any claim by the secured party.⁷³

71. UCC § 9-302(1)(d). This category may include trailers and other wheeled goods as well as automobiles. *Albany Discount Corp. v. Mohawk Nat'l Bank*, 28 N.Y. 2d 222, 269 N.E.2d 809, 321 N.Y.S.2d 94 (1971); *Castleberry, Mobile Home Financing*, 5 St. MARY'S L.J. 259, 259-60 (1973) (Texas law).

72. UCC §§ 9-302(3), (4). Motor vehicle disputes have comprised the bulk of cases reported under section 9-307(1), and the statutes regulating the issuance of certificates of registration for motor vehicles may even override section 9-307(1) in litigation between secured parties and subsequent transferees. *E.g.*, *Morris Plan Co. v. Moody*, 266 Cal. App. 2d 28, 72 Cal. Rptr. 123, 5 UCC Rep. Serv. 1026 (1968). This does not mean, however, that the rule of section 9-307(1) is of little practical importance. In the first place, the security interest may have been created by one dealer who then sold the car to another dealer, the subsequent vendor to a BIOC. If the car when bought by the BIOC was still a "new" one, local motor vehicle certificate laws have been held not to require the issuance of a certificate for it in the dealer's hands, and thus not to defeat the rights of a buyer who received no certificate from his seller. *E.g.*, *Rockwin Corp. v. Kincaid*, 124 Ga. App. 570, 184 S.E.2d 509 (1971); *Sterling Acceptance Co. v. Grimes*, 194 Pa. Super. 503, 168 A.2d 600 (1961). Second, the secured party may itself have been guilty of some failure to comply with the certification statute, or of conduct which will estop it from relying on the statute. *E.g.*, *Muir v. Jefferson Cred. Corp.*, 108 N.J. Super. 586, 262 A.2d 33 (1970); *Select Motors, Inc. v. Kemp*, 42 Pa. D. & C.2d 603, 4 UCC Rep. Serv. 720 (1967). Finally, a substantial number of courts have held that failure to receive a proper certificate of title even where state statute apparently requires it will not prevent a BIOC from acquiring good title under sections 9-307(1) or 2-403(2). *See Couch v. Cockroft*, — Tenn. App. —, 490 S.W.2d 713 (1972) (citing cases to the same effect from several other jurisdictions). *But cf. Mattek v. Malofsky*, 42 Wis. 2d 16, 165 N.W.2d 406 (1969) (holding the merchant-buyer to a higher standard of "good faith" in such a case).

73. The standard employed in UCC section 9-301(1)(c) appears in some ways different from the simple "good faith purchaser for value" test used in section 2-403(1),

2. *Authorized Sale by the Debtor.* The discussion so far has assumed that the secured party would and could claim that the security agreement expressly preserved its security interest despite any disposition of the collateral by the debtor. But this will not necessarily be the case. Where consumer goods or equipment are the collateral, the security agreement almost certainly will forbid sale by the debtor. Where the collateral is goods held for sale by a merchant, however, the parties clearly contemplate that sales will be made, and indeed probably that such sales will be the principal source from which payment of the secured obligation is made. For this reason, it is unlikely that the agreement will flatly prohibit all sales by the merchant-debtor, and any particular sale of "inventory" collateral is likely to be an authorized one. There may be exceptions, however. For instance, the security agreement may contain restrictions on the time, place or manner of sale, the persons to whom sales are permitted, or the handling of proceeds from such sales. It may also provide that any sale shall be deemed unauthorized if made when the debtor is in default under some provision of the security agreement (which would of course include the obligation of repayment, but might also refer to other duties, such as the proper storage and handling of goods, the furnishing of sales reports or the payment over of proceeds). If the sale to her is indeed unauthorized, the buyer typically has no means of knowing this fact.

Assuming that the debtor's sale was authorized, either by the terms of the security agreement or by some applicable trade usage,⁷⁴ course of dealing⁷⁵ or performance,⁷⁶ or waiver,⁷⁷ the position of the buyer is apparently unassailable.⁷⁸ Indeed, the buyer in that case need not satisfy any standard such as "good faith purchaser for value" or the

discussed previously. See text accompanying notes 32-40 *supra*. The lack-of-knowledge requirement in section 9-301(1)(c), though phrased differently, is perhaps intended to be synonymous with the "good faith" requirement in section 2-403(1); as "knowledge" under the UCC means more than mere "notice," UCC § 1-201(25), absence of knowledge may be the same as the mere "honesty in fact" required for good faith. UCC § 1-201(19). However, nothing in the definition of "purchase" or "purchaser" appears to require that the transferee have actually received delivery of the goods at issue, as does section 9-301(1)(c). Finally, the reference in section 9-301(1)(c) to "value"—which by itself would import the minimal, "consideration" definition found in section 1-201(44)—is somewhat offset by use of the term "buyer," *cf.* UCC § 1-201(9) (which defines "buyer" narrowly, with respect to the value requirement), and by the statement in section 9-301(1)(c) that the buyer is protected against an unperfected security interest "to the extent that he gives value." (emphasis added). The confusion is hardly lessened by the fact that Comment 4 to section 9-301 refers to the transferees protected by section 9-301(1)(c) as "purchasers." Of course, inadequacy of price, even under the simple "good faith purchaser for value" test, may be evidence of bad faith. See, e.g., Lane v. Honeycutt, 14 N.C. App. 436, 188 S.E.2d 604 (1972).

74. See UCC § 1-205.

75. *Id.*

76. See *id.* § 2-208.

77. *Id.* §§ 2-208(3), 2-209(5).

78. First Fin. Co. v. Akathiotis, 110 Ill. App. 2d 377, 249 N.E.2d 663 (1969); Pieper v. First Nat'l Bank, 453 S.W.2d 926 (Mo. 1970).

like.⁷⁹ She has simply bought the goods in a transaction authorized by the secured party, and thus the secured party has no claim against her.⁸⁰

3. *Sale to a Buyer in Ordinary Course.* As against an unperfected security interest, or where sale to her was authorized, the buyer may take free of the security interest regardless of the nature of her seller, or the characterization (in Article 9 terms) of the goods in his hands. Assuming, however, that the security interest was perfected and the sale to her unauthorized, there are two other provisions of Article 9 which may give the buyer a better title than her seller had; these apply only to certain types of sales, made by certain types of sellers, to certain types of buyers. The first (and more important) is section 9-307(1), which protects the BIOC.

As suggested above, this short phrase describes, in Code terminology, all three aspects of the transaction. Not only must the transferee be a "buyer," she must buy "in ordinary course of business." This phrase, as elaborated upon in section 1-201(9), refers both to the nature of the seller (he must be "a person in the business of selling goods of that kind")⁸¹ and the nature of the sale (besides being a sale of goods which he ordinarily sells, it must be a sale *made* "in ordinary course").⁸² Thus, the goods sold must, in the hands of the seller, have

79. *Universal C.I.T. Credit Corp. v. Middlesboro Motor Sales, Inc.*, 424 S.W.2d 409 (Ky. App. 1968) (security agreement permitting sale "in the ordinary course of trade" held to authorize sale at wholesale price, for cash, to employees who could not qualify as buyers "in good faith and without knowledge . . . under § 9-307(1)").

80. Of course, the more extreme the circumstances of the case—the smaller the price paid in relation to market value of the goods, or the more intimate the buyer's knowledge of all the facts in a case where the existence of authorization is a close question of fact—the more likely that a court will find the sale to have been unauthorized, remitting the buyer to her rights under the two provisions next discussed.

81. The buyer occasionally fails to prove the "dealer" status of its seller. See *Al Maroone Ford, Inc. v. Manheim Auto Auction, Inc.*, 205 Pa. Super. 154, 208 A.2d 290 (1965). An interesting question under section 9-307(1) is whether the buyer, to be protected, must show that he *knew* the seller to be a dealer in goods of the kind at the time of his purchase. See, e.g., *Michigan Nat'l Bank v. Grandberry*, 11 U.C.C. Rept. Serv. 193 (Tenn. Ct. App. 1972), where the defendant in a replevin action (a 27-year-old father of six, with a fifth-grade education) had bought a trailer from the plaintiff's debtor, paying in cash \$2,300 of the \$2,500 purchase price. He then mounted it on concrete blocks, built a porch and steps, and lived in it until it was replevied by the plaintiff bank. The bank took repossession of the trailer, spent \$1,400 to have it repaired, and then sold it for \$1,900. The jury found for the defendant in the replevin action, awarding \$1,500 as the value of the trailer when replevied plus \$75 for property damages, and costs. Defendant's seller had been in the trailer rental business; there was some evidence that he had made other trailer sales, but not that he had held himself out to defendant as a trailer dealer. The appellate court held that the judgment should be affirmed "on the facts of the particular case." (Judgment for property damage reversed for want of proof.) *Id.* The result may do some violence to the policy of section 9-307(1), but I suspect that this bothered Mr. Grandberry even less than it bothers me.

82. In *Whitmire v. Keylon*, 12 UCC Rept. Serv. 1203 (Tenn. Ct. App. 1973), the seller/debtor-in-possession was in the business of selling boating supplies and motors but had apparently never sold a houseboat. The court held that his sale of a houseboat could be "in ordinary course," but that defendant's purchase of a half interest in the

been what the Code defines as "inventory,"⁸³ and the sale in question must have been one which was not in any material respect so unusual as to be "extraordinary" for this seller.⁸⁴

None of these problems is likely to affect the consumer-buyer, however. It will be the rare consumer who buys from a retail seller a quantity so large, or in a manner so unusual, as to raise questions about the "ordinary course" of her purchase. The only remaining substantive requirement for BIOC status under section 1-201(9) is that the buyer must have been "in good faith and without knowledge that the sale . . . is in violation of the ownership rights or security interest of a third party in the goods." At least so long as the buyer is a non-merchant,⁸⁵ the reference to good faith and the requirement that the

boat was not in ordinary course, in the absence of any showing that it is "ordinary" for a dealer to retain a half interest in the goods he sells. The defendant prevailed anyway, as a "good faith purchaser for value" under section 9-301(1)(c), because the plaintiff's security interest (being in inventory, not consumer goods) was unfiled, and therefore unperfected. 12 UCC Rept. Serv. at 1210.

83. UCC § 9-109(4). The term as there used is somewhat broader than "goods held for sale," however; it includes what might be termed "short-term business supplies." See *id.*, Comment 3. In one unusual situation, the goods bought by a BIOC might in fact be "equipment." This situation would arise when the goods are held for use by the seller but are goods of a type which he also is in the business of selling—*e.g.*, an auto dealer's "demonstrator."

84. Although the retail buyer-for-personal-use is perhaps the easiest ready example of the buyer in ordinary course, there is nothing in section 9-307(1) or the BIOC definition in section 1-201(9) to prevent a buyer of business equipment from qualifying as a BIOC, nor is there any reason why a retail merchant buying from a wholesale merchant should not, in the typical case, be classed as buying "in the ordinary course." *Bank of Utica v. Castle Ford, Inc.*, 36 App. Div. 2d 6, 317 N.Y.S.2d 542, 8 UCC Rep. Serv. 910 (4th Dep't 1971). The protected transferee must be a "buyer," however, not just (in Code terms) a "purchaser." See *Stroman v. Orlando Bank & Trust Co.*, 239 So. 2d 621 (Fla. App. 1970). The problem is more acute when the buyer and seller are both merchants at the same level (or levels) of distribution—in the used car market, for instance, where many dealers apparently buy and sell cars from and to the public and also buy and sell cars among themselves, singly or in lots. Some courts have expressed doubt that sales of used cars among dealers made at auto auctions are "in the ordinary course." *E.g.*, *Rhode Island Hosp. Trust Co. v. Leo's Used Car Exchange, Inc.*, 314 F. Supp. 254 (D. Mass. 1970); *Al Maroone Ford, Inc. v. Mannheim Auto Auction, Inc.*, 205 Pa. Super. 154, 208 A.2d 290 (1965). In the former case, the buyer had paid for the cars with a bouncing check; this might not have kept him from qualifying as a "buyer" under section 1-201(9), but it certainly couldn't have helped his case. Furthermore, where a merchant who normally sells only at retail sells a larger than usual lot of goods to another retailer (whether or not the sale qualifies as a "bulk transfer"), the buyer may well have difficulty qualifying for BIOC treatment. *Cf. O.M. Scott Credit Corp. v. Apex, Inc.*, 97 R.I. 442, 198 A.2d 673 (1964). There, however, the buyer apparently knew that sale to it violated the security agreement.

85. In UCC section 2-103(1), it is stated, "In this Article unless the context otherwise requires . . . (b) 'Good faith' in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." In a recent Delaware case, one dealer sold two cars to another. The buyer (who apparently knew that they had been subject to a security interest) permitted the seller to retain the cars on its lot for a few days. Before the buyer actually took possession, the secured party repossessed and resold all the cars on the seller's lot, including the subjects of this sale. The trial court held that the section 2-103(1)(b) standard of "good faith" applied to the buyer, and that leaving the cars in the seller's possession was not in fact acting with "commercial reasonableness." *Sherrock v. Commercial Credit Corp.*, 277 A.2d 708 (Del. Super. 1971). On appeal, the decision was reversed, *Sherrock v. Commercial Credit Corp.*, — Del. Ch. —, 290 A.2d 648 (1972),

buyer be without knowledge can be read as equivalents, making knowledge-in-fact (rather than "notice" or "reason-to-know") the issue. The harder question remains: What is it that the buyer must, in fact, honestly not know? Section 1-201(9) requires that she be without knowledge that her purchase "is in violation of the . . . security interest of a third party," while section 9-307(1), with possible inconsistency, permits the buyer to be protected "even though the security interest is perfected and even though the buyer *knows of its existence*."⁸⁶ The resolution of this seeming conflict, while perhaps an afterthought, is nevertheless persuasive: goods held for sale by merchants are frequently encumbered by security agreements, which typically contemplate and even authorize sales of the collateral, so the buyer is not in bad faith if she buys merely knowing that such an interest exists. To forfeit this protected status the buyer must have been aware that the seller was in fact exceeding his authority when he made the particular sale.⁸⁷ As very few buyers will have such knowledge, and few of those will be consumer-buyers, the good faith requirement is likely to pose no problem for consumer-BIOC's.⁸⁸

The remaining limitation on the protection of buyers under section 9-307(1) is of course the eventual subject of our inquiry. At this point, where the tripartite secured-party/debtor/buyer situation is under examination, we can merely note it in passing. The BIOC takes free of "a security interest created by [her] seller." She therefore does not—by implication at least—take free of a security interest created by anyone else.⁸⁹

on the basis that the only standard of good faith applicable under section 9-307(1) is that found in section 1-201(19). The decision was by a divided court, and has been the subject of critical comment, as to both its reasoning and its result. See 14 B.C. IND. & COM. L. REV. 343 (1972); 10 GA. ST. B.J. 110 (1973); 4 RUTGERS-CAMDEN L.J. 132 (1972).

86. Emphasis added.

87. UCC § 9-307, Comment 2.

88. See *Taylor Motor Rental, Inc. v. Associates Discount Corp.*, 196 Pa. Super. 182, 173 A.2d 688 (1961) (buyer held not to qualify as a BIOC; he was president of debtor corporation). Compare *Universal C.I.T. Credit Corp. v. Middlesboro Motor Sales, Inc.*, 424 S.W.2d 409 (Ky. App. 1968).

89. The "created by his seller" language was first added to the official text of the UCC in the 1957 version, pursuant to the 1956 Recommendations for Change, in which it was described as being "for clarification." 1956 RECOMMENDATIONS OF THE EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE 284 (1957). The change may have been a response to criticism presented to the New York State Law Revision Commission, in which it had been suggested that the Code in its earlier form did not clearly decide cases where the buyer's transferor was someone other than the debtor:

"[W]here the debtor is not himself engaged in selling goods of that kind, it might be thought that the secured party should not bear the risk of a fraudulent transfer to a person who is engaged in such business." 1 N.Y. LAW REV. COMM'N 1955 REPORT—STUDY OF THE UNIFORM COMMERCIAL CODE 243, N.Y. Leg. Doc. No. 65 (1955); cf. *United States v. Hext*, 444 F.2d 804 (5th Cir. 1971). In that case, the Farmers Home Administration sought to enforce its security interest in a cotton crop grown by Hext, who also operated, through a wholly-owned corporation, a cotton ginning business. After ginning, Hext's crop was marketed by the ginning company in the same

4. *Sale of Consumer Goods.* The second provision protecting the buyer against known security interests is found in section 9-307(2), which provides that:

In the case of consumer goods . . . 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 . . . unless prior to the purchase the secured party has filed a financing statement covering such goods.⁹⁰

Some limitations on the protection afforded by this section are immediately apparent. It is clear, for instance, that unlike the BIOC referred to in section 9-307(1), the "buyer" protected by section 9-307(2) cannot be a merchant buying for resale, or a business-buyer of equipment for business use. It is also clear that, unlike the BIOC, the protected consumer-buyer must be unaware that a security interest even *exists*.

No so clear is the extent to which the use of the term "buyer" increases the "value" requirement beyond the minimal level defined in section 1-201(44).⁹¹ Also not immediately clear, and certainly more significant, is the meaning of the phrase "In the case of consumer goods"⁹² Does this refer to the goods in the hands of the seller, or of the buyer?

manner as cotton purchased by it from other farmers. Applying the UCC by analogy as a source of federal law, the court held that section 9-307(1) operated to protect the buyers of the cotton and the broker who had marketed it for the ginning company. To reach this result, the court had to hold that the purchase of the cotton did not constitute "buying farm products from a person engaged in farming operations," while finding that the security interest of the government was "created by [the] seller." The court did so ingeniously, by observing that from the buyer's point of view, the cotton was not in the hands of "a person engaged in farming operations" (Hext) but rather in the hands of a ginning company, while from the government's point of view the security interest was indeed created by the seller, Hext, who was known to it to be engaged in ginning operations as well as farming. The court analogized the case to one where a debtor-merchant borrows against goods then held as equipment, and later puts those goods into his inventory for sale. *Id.* at 814. See note 83, *supra*. The court apparently believed that the strong policy favoring agricultural lenders should, in a borderline case, give way to the policy favoring BIOC's.

In *General Motors Acceptance Corp. v. Keil*, 176 N.W.2d 837 (Iowa 1970), the buyer of a car was held to be protected under section 9-307(1) despite the fact that the security interest had been created by the president of the auto dealer corporation, rather than by the corporation itself (which ostensibly sold the car to the buyer). In reaching its decision, the court used language which, while written with the peculiar facts of the case in mind, is susceptible of broader application: "[W]e refuse to hold that the legislature, which obviously intended broad protection to the consumer by enactment of section [9-307(1)], would anticipate the giving of preference to a lien because its creator was not as shown on the records, but another party under a confidential transaction of which the ultimate purchaser had no knowledge." *Id.* at 841.

90. UCC § 9-307(2).

91. See the definition of "buying" in *id.* § 1-201(9). See also the discussion of § 9-301(1)(c) in note 73, *supra*.

92. *Id.* § 9-307(2).

Desiring to protect an innocent consumer-buyer (or one claiming through her), the Massachusetts Appellate Division, in the *New England Merchants* case, reached the latter conclusion.⁹³ Reversing, the Supreme Judicial Court correctly noted that the lower court's broader construction would make the statute's later reference to buying "for . . . personal, family or household purposes" redundant, in light of the definition of "consumer goods" already set forth in section 9-109 (1).⁹⁴ More than that, the broader construction of section 9-307(2) would result in every sale by a merchant to a consumer being potentially the subject of both subsections 9-307(1) and (2), with their noncongruent requirements of innocence (and possibly value). Such an intention on the drafters' part is not inherently impossible, but it would bespeak drafting more inartful than any body so prestigious should readily acknowledge.⁹⁵

There is, moreover, still another provision of section 9-307(2) more limiting than any in section 9-307(1)—and its mere presence is probably enough both to settle the construction question and to suggest that subsection (2) is not likely to be of substantial benefit to many consumers. This is the secured party's ability to defeat the operation of section 9-307(2) merely by the timely filing of a financing statement. As Comment 3 to that section reminds us, there is an exemption from filing for purchase money interests in consumer goods.⁹⁶ The prospective absence of any public record of such interests led the drafters to conclude that, at least as to innocent consumer-buyers from other consumer-sellers (buyers who thus are clearly not BIOC's), there should be protection against such interests which no amount of diligence could necessarily disclose.⁹⁷ Section 9-307(2) is thus the direct offspring of the unusual filing exemption accorded to consumer-sales financiers under section 9-302(1)(d). For this reason, the drafters' eventual decision to deny section 9-307(2) protection in any case where filing nevertheless was made—despite the fact that consumer-buyers are almost certainly not going to consult those files—is, in Professor Gil-

93. *New England Merchants Nat'l Bank v. Auto Owners Fin. Co.*, 40 Mass. App. Dec. 59, 5 UCC Rep. Serv. 904 (1968).

94. *New England Merchants Nat'l Bank v. Auto Owners Fin. Co.*, 355 Mass. 487, 245 N.E.2d 437 (1969).

95. Professor Gilmore's commentary confirms the narrow reading of section 9-307(2), referring to it as protecting "amateurs—consumers buying secondhand goods from other consumers." 2 G. GILMORE, *supra* note 53, § 26.12, at 716. The ideal section 9-307(2) buyer would be one neighbor buying from another, in a completely noncommercial transaction—a "back-fence buyer," as it were.

96. UCC § 9-302(1)(d). *United Gas Improvement Co. v. McFalls*, 18 Pa. D. & C.2d 713, 1 UCC Rep. Serv. 508 (1959) (household laundry dryer); *White-Sellies Jewelry Co. v. Goodyear Tire & Rubber Co.*, 477 S.W.2d 658 (Tex. Civ. App. 1972) (television sets).

97. See generally 1 G. GILMORE, *supra* note 53, at §§ 19.4, -.5.

more's words, "as pointless as it is unjustifiable."⁹⁸ Where the value of a single item of consumer goods is high enough to make eventual litigation over its ownership worthwhile, filing is likely to be made. Moreover, filing (or certification) is nearly everywhere required, even for consumer goods, where a motor vehicle is the collateral.⁹⁹ The actual number of cases where a buyer who does meet all the requirements of section 9-307(2) is in fact challenged in court by the secured party will thus be small indeed;¹⁰⁰ like many hybrid animals, section 9-307(2) is unlikely to be notable for the number and quality of its progeny.

The Entruster of Goods to a Merchant

In one respect the UCC appears to go considerably beyond pre-Code law to give good title to persons who meet the definition of a "buyer in ordinary course of business." In section 2-403(2), the Code provides that "any 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." Section 2-403(2) expands the rights of the buyer over previous law¹⁰¹ in two im-

98. *Id.* § 19.5, at 537.

99. See text & note 71, *supra*.

100. The impotence of UCC section 9-307(2) can be seen from an examination of the reported decisions. Although occasionally cited and construed by a court in order to determine its inapplicability to the case at issue, the subsection has almost never been invoked successfully to protect an innocent buyer. One such rare instance, in which section 9-307(2) was successfully invoked, is *Balon v. Cadillac Auto. Co.*, — N.H. —, 303 A.2d 194 (1973). Two different buyers (a man and his stepfather) were there protected in their purchase of Cadillac cars from an individual who had previously purchased the cars from defendant dealer, using fictitious names and credit references. The court in *Balon* held that the cars had been purchased from the dealer as consumer goods, as evidenced by the fact that defendant had treated them as such, not filing financing statements to record its security interests. The sales were made in Massachusetts, which had no filing requirement for purchase money interests in any consumer goods, including automobiles. Had the sales been made in some other state, the security interests of the dealer would probably have been recorded, cutting off the operation of section 9-307(2). One of the leading cases for the proposition that the section 9-307(2) buyer must have purchased from a consumer-seller is *Everett Nat'l Bank v. Deschuiteneer*, 109 N.H. 112, 244 A.2d 196 (1968). The coincidence of names, dates and places suggests that the fraudulent debtor-seller in *Balon* must have also been the wrongdoer in *Deschuiteneer*; the buyer lost in the latter case because there was no evidence in the record that his seller had held the car as consumer goods.

It may be noted that section 9-307(2) has no "created by his seller" language; the consumer-buyer is simply said to take "free of a security interest even though perfected . . ." It therefore may be argued that section 9-307(2) is applicable to protect the ultimate buyer in the following case: secured party/consumer/dealer/consumer/consumer. (This assumes that the second consumer fails to take free of the security interest, for reasons developed at length in the text.) It is hardly surprising that such a case appears not to have arisen, given the paucity of even three-party cases (secured party/consumer/consumer) in the reports.

101. A number of pre-Code cases had held that one who buys from a merchant takes free of the claims of the true owner where the merchant did indeed have lawful possession of the goods together with authority to sell them on the owner's behalf, even if the merchant's sale did in fact violate some express limitation on that authority. See generally 2 S. WILLISTON, *supra* note 32, at §§ 310-17.

portant respects: (i) the owner need not have done anything by way of word or deed which would estop him from asserting ownership, beyond merely "entrusting" the goods to one who "deals" therein;¹⁰² (ii) the true owner need not even have given the merchant authority to sell the goods on his behalf, so long as he has in fact entrusted the merchant with their possession.¹⁰³

If (as seems proper) section 2-403(2) should be restricted in its application to cases where the innocent transferee could not also claim the protection of section 2-403(1) or section 9-307,¹⁰⁴ then its unique character becomes clear. The defrauded vendor, the vendor to an insolvent, the vendor who takes a bad check and the secured party financing a merchant or consumer all have in common the fact that, at the time an innocent transferee acquires rights in "their" goods, they do not have complete ownership of those goods. In that respect, the losing entruster under section 2-403(2) has a stronger equity than the claimants cut off by section 2-403(1) or section 9-307, because he may never have purported to convey any sort of title to his trustee. That such an owner may nevertheless, under section 2-403(2), lose

102. *Godfrey v. Gilsdorf*, 86 Nev. 714, 476 P.2d 3 (1970); cf. *Cosgriff v. Liberty Nat'l Bank & Trust Co.*, 58 Misc. 2d 884, 296 N.Y.S.2d 517, 6 UCC Rep. Serv. 65 (Sup. Ct. 1968) (plaintiff was an "entruster," but dealer's secured creditor not a BIOC).

103. *Commercial Credit Corp. v. Associates Discount Corp.*, 246 Ark. 116, 436 S.W. 2d 809 (1969). See also *Gallagher v. Unenrolled Motor Vessel River Queen*, 475 F.2d 117 (5th Cir. 1973).

Beyond this, it is not clear whether the owner, to be bound by section 2-403(2), must have known that the "trustee" was a dealer in goods of that kind, or, indeed, a dealer in goods of any kind. Some opinions appear to require, as a part of the buyer's case, that the owner be shown to have known that the trustee was a merchant dealing in such goods. E.g., *Atlas Auto Rental Corp. v. Weisberg*, 54 Misc. 2d 168, 171, 281 N.Y.S.2d 400, 404, 4 UCC Rep. Serv. 572, 575 (Civ. Ct. 1967). But see *Warren, Cutting Off Claims of Ownership Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 469, 473-74 (1963); Note, *The Good Faith Purchase of Goods and "Entrusting" to a Merchant Under the Uniform Commercial Code: Section 2-403*, 38 IND. L.J. 675, 691-92 (1963).

104. Section 2-403(2) occasionally has been invoked by courts to protect a BIOC whose seller had acquired the goods by giving a check not covered by sufficient funds. *Sherman v. Roger Kresge, Inc.*, 67 Misc. 2d 178, 323 N.Y.S.2d 804, 9 UCC Rep. Serv. 858 (Co. Ct. 1971). Use of that section in such cases seems unduly restrictive of the buyer's rights, however; as we have seen, those disputes can be dealt with under section 2-403(1), which does not require the innocent buyer to have the status of a "buyer in ordinary course." See text accompanying notes 49-52 *supra*. (It is there sufficient that the transferee be a "good faith purchaser for value.") In *Sherman v. Roger Kresge, Inc.*, *supra*, the defendant, an auto dealer, was held not to qualify for section 2-403(2) protection because it paid for the car by cancelling part of a debt owed it by the seller. The possibility that defendant could have qualified as a "good faith purchaser for value" was not discussed. Judge Greenfield's opinion in *Atlas Auto Rental Corp. v. Weisberg*, 54 Misc. 2d 168, 281 N.Y.S.2d 400, 4 UCC Rep. Serv. 572 (Cir. Ct. 1967), contains an excellent discussion of the differing antecedents, and requirements, of sections 2-403(1) and (2). Section 2-403(2) has also been cited in cases where the reclaiming "owner" was a secured party financing against inventory collateral. E.g., *Charles S. Martin Distrib. Co. v. Banks*, 111 Ga. App. 538, 142 S.E.2d 309 (1965); cf. *Rockwin Corp. v. Kincaid*, 124 Ga. App. 570, 184 S.E.2d 509 (1971). There again the use of section 2-403(2) (though it may not change the outcome) is inappropriate; section 9-307(1), being more specifically addressed to the priority dispute at issue, is the preferable basis for decision. UCC § 2-403, Comment 2; J. WHITE & R. SUMMERS, *supra* note 13, at § 25-15.

all his rights to a "buyer in ordinary course" testifies eloquently to the strength of the policy which, under the UCC, protects the expectations of undisturbed ownership which attend the buying of goods from a merchant. Our hypothetical buyer is, as we have assumed from the start, able to meet the requirements of a BIOC; thus under section 2-403(2) she would take free of the claim of any "real owner" who entrusted possession of the goods to the merchant from whom she bought them, whether or not they were entrusted for the purpose of sale.

Purchase from a Thief

Section 2-403(1)(d) and section 2-403(3) both refer to the possibility that an innocent (and therefore protected) transferee of goods may have acquired them from one whose possession was obtained by acts which would have been "larcenous under the criminal law." At first glance, these provisions might appear intended to reverse the long-standing policy of the Anglo-American common law that one who purchases goods from a thief—even if she buys in good faith, completely ignorant of the theft, and pays full value—can acquire no title superior to that of the true owner.¹⁰⁵ On inspection, however, both of these provisions have a more limited (and contrary) function. Together they demonstrate that the drafters gave crucial weight to the distinction between gaining title or even mere possession by "fraud," and gaining it by outright "theft"—i.e., by robbery, burglary or other forcible, unconsented taking of possession.¹⁰⁶ In the former case, the owner does in fact consent to the wrongdoer taking possession, however mistaken and ill-informed his consent may be. In the latter case he does not—the taking of possession must have been accomplished by force, by what is in one sense at least a "breach of the peace."¹⁰⁷ Possibly out of an assumed greater public interest in preventing crimes of force or violence, the Code apparently seeks to place a stronger deterrent against dealing with thieves than that erected against dealings with persons guilty only of fraud.

It is of course possible that one who loses property to a thief may by his own negligence or recklessness have made the theft an easy one, or even placed an irresistible opportunity before one who could have withstood less flagrant temptation. Nevertheless, it is probably also true that no person, no matter how careful and blameless, can completely protect household goods and other possessions against

105. The English exception for sale in "market overt" has never been a part of American law. 2 S. WILLISTON, *supra* note 32, at §§ 310, 311, 347. See generally Murray, *Sale in Market Overt*, 9 INT'L & COM. L.Q. 24 (1960).

106. See UCC § 2-403, Comment 2.

107. Cf. *id.* §§ 9-503.

the most determined burglar or robber. Possibly in recognition of this fact, the innocent victim of a theft traditionally has had a stronger legal position vis-à-vis later transferees than the equally innocent victim of fraud. This advantage is not destroyed by the Code, as the cases demonstrate.¹⁰⁸ Here—at last—is a three-party case where our hypothetical buyer will be forced by the law to surrender property for which, in innocence of the true owner's claim, she gave full value.

THE CASE FOR EXPANDED BUYER PROTECTION UNDER SECTION 9-307(1)

We now turn to an examination of the "created by his seller" language in section 9-307(1). Once analysis goes beyond the simple tripartite situations considered above, the number of combinations of possible transactions giving rise to a dispute between a secured party and a subsequent buyer may well be infinite. By limiting ourselves to four-party cases, however, we can hold down the number of variations to a manageable three. In each case we shall assume that a debtor-creditor relationship existed, and that a security interest in certain goods was created by the debtor to secure that obligation. The collateral remained in the debtor's possession, pursuant to the security agreement, but the interest was perfected as required by Article 9. At some later time, while the obligation remained unsatisfied, the debtor sold the collateral—in an unauthorized sale—to a merchant dealing in goods of the kind. That merchant has now resold the goods to our hypothetical buyer, the consumer-BIOC. The three variations of this situation discussed below will differ from each other in only one respect: the characterization of the goods as collateral in the hands of the debtor, before their sale to the dealer.

Different Debtors, Different Risks

Goods subject to security interests and relevant to our discussion¹⁰⁹ are classified by Article 9 in three categories: "inventory," "consumer goods," and "equipment."¹¹⁰ Ignoring the Code's slightly expansive

108. See, e.g., *Schrier v. Home Indem. Co.*, 273 A.2d 248 (D.C. Ct. App. 1971); *Lieber v. Mohawk Arms, Inc.*, 64 Misc. 2d 206, 314 N.Y.S.2d 510, 8 UCC Rep. Serv. 182 (Sup. Ct. 1970); *P.R. Autos, Inc. v. Truelson Motors, Inc.*, 6 UCC Rep. Serv. 672 (N.Y. Sup. Ct. 1969).

109. I exclude "farm products," UCC § 9-109(3), not out of snobbery, but because it is unlikely (although considering the recent meat shortage, not impossible) that a secured party would have occasion to pursue a substantial quantity of such goods into the hands of a consumer buyer. Moreover, section 9-307(1) even in its present form does not apply to the sale of encumbered farm products, and is not likely to in the near future. See *Hawkland, The Proposed Amendment to Article 9 of the UCC—Part I: Financing the Farmer*, 76 *COM. L.J.* 416, 418-21 (1971).

110. UCC § 9-109.

use of those terms¹¹¹ and concentrating on their principal applications, we can identify three debtors whose unauthorized disposition of goods may give rise to eventual dispute: the inventory-debtor (whose creditor has taken a security interest in merchandise the debtor holds for sale), the consumer-debtor (who, for reasons noted above,¹¹² was probably a buyer of these consumer goods, rather than a borrower against the security of goods already owned), and the equipment-debtor. Some differences among the three cases—in terms of the risks voluntarily assumed under present law by the secured party—should first be noted.

1. *The Inventory-Debtor.* When a creditor under Article 9 lends against the security of goods held for sale, he knows (or should know) that the debtor will have the power—despite any restriction on resale contained in the security agreement—to convey to any BIOC a good title to such merchandise, free of the secured party's claim. Where that debtor sells directly to a consumer-BIOC, therefore, there is little likelihood of a dispute arising. Yet section 9-307(1) limits its protection to BIOC's who buy directly from the debtor who *created* the security interest. If the debtor sells first to another dealer, who in turn resells to a BIOC, that buyer is just as innocent of knowledge about the security interest, and the equities in her favor seem similar to those of the buyer in the three-party situation. Why shouldn't she be protected?

One possible answer, of course, is that she may indeed be protected. The decisions establish that a merchant buying for resale can qualify under section 1-201(9) as a BIOC.¹¹³ If the dealer who buys from an inventory-debtor does so qualify, then that dealer takes free of the security interest under section 9-307(1). The dealer's subsequent transferee—be she BIOC, good faith purchaser for value, or even donee—therefore takes free also, under the "shelter" principle.¹¹⁴

This answer may suggest that the ultimate consumer-buyer under Article 9 has no real problem whenever the security interest at issue was originally created by an inventory-debtor. This is clearly not the case. There are many reasons why the dealer who buys from an inventory-debtor may fail to qualify as a BIOC. He may not have given

111. "Equipment" includes the equipment of a nonprofit organization, as well as farming equipment, and is also a "catch-all" for collateral not fitting into any other classification. *Id.* § 9-109(2). As to "inventory," see note 83 *supra*.

112. See note 70 *supra*. Compare the problem of lending against the security of previously-purchased farm equipment, discussed in the same note.

113. See note 84 *supra*.

114. Section 2-403(1) provides that "[a] purchaser of goods acquires all title which his transferor had or had power to transfer . . ." Cf. *Linwood Harvestore, Inc. v. Canno*, 427 Pa. 434, 438 n.1, 235 A.2d 377, 380 n.1 (1967).

“fresh value”¹¹⁵ for the goods; he may have purchased in bulk or otherwise out of “ordinary course”;¹¹⁶ he may have had actual knowledge of restrictions on the sale to him (or at least have had notice of circumstances which made his purchase not a “commercially reasonable” one, and thus not in “good faith”).¹¹⁷ Indeed, the dealer may have been in fraudulent collusion with the inventory-debtor; on the other hand, he may have been innocent, and able to meet the Code’s definition of a “good faith purchaser for value.”

The effect of any of these possibilities on our ultimate buyer is the same: Unless the dealer qualifies as a BIOC, he takes subject to the security interest, and so—despite section 9-307(1)—does his subsequent customer. Thus, if good title in the ultimate buyer is the desirable result, there are obvious defects in the existing form of section 9-307(1) even as applied to the inventory-debtor case. The acquiring dealer and his ultimate buyer may well not be *in pari innocentia*, yet the statute in its present form makes the buyer’s rights in such a case depend entirely on the circumstances of her dealer’s purchase, of which she almost certainly has no knowledge, and over which she clearly has no control.

2. *The Consumer-Debtor.* Where a secured party chooses to perfect by attachment rather than by filing (under the filing exemption for purchase money security interests in consumer goods), it thereby assumes the risk that its consumer-debtor will dispose of the collateral to another consumer-buyer, cutting off the security interest. If the goods do end up in the hands of such a consumer-buyer (as in our paradigm, the *New England Merchants* case), loss of the secured party’s interest would not exceed the risk it assumed. Furthermore, in this case the ultimate buyer could not—even if she knew enough to try—discover from any record available to her the existence of the outstanding interest. Here then is the clearest case for a result different from that presently dictated by the statute: the fortuitous intervention of a dealer as the third party in a four-party transaction should not deprive the ultimate consumer-BIOC of protection, where the added party has no impact at all on the relative equities of the secured party and the ultimate buyer.

Either out of necessity (because the collateral is a motor vehicle) or in a desire to avoid the risk of section 9-307(2), the secured party

115. This phrase is used to mean “value” sufficient to satisfy that aspect of the “buying” test in UCC section 1-201(9). It is used to avoid the term “new value,” as used in UCC section 9-108, which has a special meaning significant in “preference” questions under section 60 of the Bankruptcy Act, 11 U.S.C. § 96 (1970).

116. See text & notes 82-83 *supra*.

117. See note 85 *supra*.

may have recorded its interest, however. In that event, the equities of the parties are somewhat different. Whatever support the buyer may have derived from the analogy to section 9-307(2) has now been lost, because that section protects no one against a recorded security interest. The case then becomes virtually indistinguishable from that of the equipment-debtor, considered next.

3. *The Equipment-Debtor.* If there is a case for across-the-board revision of section 9-307(1), so as to cut off all prior security interests, this will clearly be its most difficult hurdle. Where the secured party lends against equipment, it cannot perfect its interest (assuming, as we must, a debtor in possession) without filing a financing statement.¹¹⁸ Moreover, the equipment-debtor under present law has not even a limited power to pass good title. Of course, the Code does provide for alienation by any debtor of the *debtor's* interest in the collateral, even where the security agreement provides otherwise.¹¹⁹ But satisfactory protection for the ultimate buyer of unencumbered goods does not lie in permitting her to succeed merely to whatever title her seller may have had. If the buyer is in fact to have a good title, she must take not just the seller's actual interest, but the interest he purported to transfer to her—a complete title to the goods.¹²⁰

Balancing the Equities: The Allocation of Risk

In each of the four-party situations under examination, the principal wrongdoer is clearly the original debtor, whose unauthorized sale of the collateral has led to the present dispute. Assuming that the debt has gone unpaid because that debtor is unable to pay (because insolvent) or unavailable (because absconding), this leaves a loss to be borne by one of the three parties remaining—the secured party, the

118. There is apparently only one exception to the statement in the text: A security interest in "farm equipment" which is neither fixture nor motor vehicle and has a purchase price not in excess of \$2,500 may be perfected without filing. UCC § 9-302 (1)(c). See note 70 *supra*.

119. UCC § 9-311. This section can be troublesome for students, because when read carelessly it appears to give every debtor the power to transfer an unencumbered title to the collateral. Read with care, however, the section apparently does not even prevent the security agreement from characterizing any transfer by the debtor as a "default," with whatever effect that might have on the rights of the transferee. See 2 G. GILMORE, *supra* note 53, at § 38.5.

120. This is not to suggest that succeeding to the debtor's interest is necessarily valueless. In *Security Pac. Nat'l Bank v. Goodman*, 24 Cal. App. 3d 131, 100 Cal. Rptr. 763, 10 UCC Rep. Serv. 529 (1972), the buyers had purchased a boat from a dealer with whom the debtor had placed it for sale. The boat was thereafter repossessed by the original debtor's secured party and, without notice to the buyers, redelivered to the debtor, who paid off the loan and resold the boat. The court held that the buyers had succeeded to the debtor's interest in the boat, and were entitled to recover from the secured party for conversion, under sections 9-504 and 9-507. The amount of the buyers' damage (to be determined on remand) was the amount by which the value of the boat at the time of its repossession exceeded the unpaid obligation of the debtor. *Id.*

dealer or the buyer. If the debtor's sale was indeed unauthorized, it is likely that the loss will ultimately be imposed on his vendee, the dealer. But the dealer, having initially passed the loss on to the ultimate buyer (by selling for cash), may also be absent or insolvent. Analysis of the competing rights of secured party and buyer will thus require consideration of two rival hypotheses: (1) The dealer is answerable to suit, is solvent, and can thus be forced by litigation to absorb the ultimate loss caused by the debtor's default; or (2) the dealer is either absent or insolvent, and the loss must therefore ultimately be borne by either the secured party or the buyer. Where one of two innocent persons must suffer, the law generally favors imposing the burden on the one whose act or omission made it possible.¹²¹ Accordingly, we will consider the relative innocence of the secured party and the buyer, and the extent to which either one can be said to have made the loss possible.

Certain equities are on the side of the buyer. First and most conspicuously, the buyer, as a BIOC, is a fortiori innocent of any wrongdoing or of any knowledge at the time of the sale that the sale to her was wrongful. Second, her expectation of receiving a good title to the goods she buys is deemed by the UCC to be a strong reason for protecting her against outstanding claims. In these respects she can make just as appealing a case as the BIOC now protected by section 9-307 (1).

In another respect, the buyer in this case has an even more favorable position. However unlikely it may be that she will avail herself of this power, any buyer can by searching the public records discover outstanding security interests granted by her seller. Where a security interest has been created by one other than her seller, as in the case we are examining, the buyer not only will not know the name of that debtor, she probably will have no way of finding it out. There is thus absolutely no reason to expect the buyer to protect herself against such an interest by searching the record; in this regard, she bears even less responsibility in fact for the resulting loss than does the BIOC now protected by the statute. Looking solely at her own conduct, therefore, the buyer's case for protection is a strong one; if nevertheless the secured party still should prevail, it must therefore be on the merits of its own actions.

Unlike the secured parties discussed above, the equipment-lender can be said to assume no conscious risk that its security interest will be lost by the debtor's unauthorized sale. Furthermore, though the

121. *Dissing v. Jones*, 85 Ariz. 139, 142, 333 P.2d 725, 727 (1958).

risk of debtor misbehavior can be lessened by thorough credit checks and scrupulous selection of debtors, human nature itself makes impossible the complete elimination of such risk. Therefore, although in some cases the carelessness or naivete of the secured party may justify assigning the loss to it,¹²² there will be many cases where the secured party cannot be faulted on such ground, and must be deemed "innocent." Should it nevertheless bear the loss? Although the answer here suggested is yes in all such cases, reasons may differ depending on the availability of the dealer to bear the ultimate loss.

1. *Dealer Available: Avoiding Circuity of Action.* Where a solvent dealer is available for suit by either the secured party or the buyer, the loss may ultimately fall on that dealer. Assuming that the dealer cannot himself qualify for the BIOC protection under section 9-307(1), the dealer will be liable to the secured party for conversion, based on his resale.¹²³ On the other hand, if the secured party is successful in pursuing the goods in the hands of the buyer, the dealer will be liable to the buyer for breach of warranty of title, express or implied.¹²⁴ The ultimate imposition of the loss being the same, there is good reason—particularly where the buyer is a consumer—to free her from the cost and expense of simultaneously defending and prosecuting a lawsuit, by forcing the secured party to sue the dealer directly, receiving as its remedy damages for conversion rather than possession of the goods.¹²⁵

Even assuming dealer availability, there are of course arguments for giving the secured party its choice among defendants. The argument in favor of permitting direct suit against the manufacturer in "product liability" cases, for instance, has not been thought to require as

122. *Muir v. Jefferson Credit Corp.*, 108 N.J. Super. 586, 262 A.2d 33 (1970) (secured party held estopped as against a later buyer where it had permitted the debtor to register the car and obtain possession of the certificate of title).

123. *E.g.*, *First Nat'l Bank of Bay Shore v. Stamper*, 93 N.J. Super. 150, 225 A.2d 162 (1966); *Mahaley v. Colonial Trading Co.*, 83 York L. Rec. 38, 6 UCC Rep. Serv. 746 (Pa. Com. Pl. 1969).

124. UCC § 2-312. *See generally* R. NORDSTROM, *supra* note 31, at §§ 58, 59. In *Casterline v. General Motors Acceptance Corp.*, 195 Pa. Super. 344, 171 A.2d 813 (1961), the dealer voluntarily refunded the price paid by his buyer, Leo Burns. Not every dealer will be so eager to placate its buyer, however, and not every buyer will so appear so worthy of placation as did the Reverend Father Burns.

One recent opinion appears to pyramid section 2-312 and section 2-403(2) to impose an implied warranty of title on any true owner deprived of his title by "entrusting" under the latter section. *Christopher v. McGehee*, 124 Ga. App. 310, 183 S.E.2d 624 (1971). The imposition of liability in that case may have been justifiable on principles of agency law, but as a rule of law applicable to all section 2-403(2) entrusters it makes no sense at all. To deprive an innocent bailor-to-a-merchant of title to his goods is harsh enough, without also making him answerable for any defect in his own title!

125. It may be noted that there is nothing in the four-party situation which makes it inherently unlikely that an "available" dealer will exist. In the three-party situations discussed earlier, however, if litigation occurs at all it is probable that the loss cannot or will not be borne by the debtor, leaving the secured party and the buyer as the only two contestants.

a corollary that the consumer should lose all right to sue the retailer; indeed, the availability of multiple defendants has appeared to many as a goal to be attained, rather than an inefficiency to be pruned for the sake of mere tidiness.¹²⁶ The case for eliminating "middleman" liability is stronger where the consumer is a superfluous defendant rather than a frustrated plaintiff; still, the argument based on avoiding circuitry of suit is not by itself completely persuasive. If the consumer-BIOC is to be protected against *all* unknown security interests, such a result ought to be justifiable even in a case like *New England Merchants*, where there is no dealer available to absorb the loss, and the choice is clearly between the secured party and the buyer.¹²⁷

2. *Dealer Unavailable: Enterprise Liability.* Assuming the utmost in good faith and non-negligence on the part of both secured party and buyer, the situation can be stripped to the following essentials: (1) Either the secured party or the buyer must ultimately bear a loss, which may equal the value of the goods at issue; (2) both are "innocent" of having caused that loss, except that (3) the secured party lent money to the debtor, on the security of goods in the debtor's possession, and (4) the buyer bought goods from a merchant, expecting to receive a good title to them. Do facts so sparse give a basis for allocating the loss? They do, if one inquires further into the characteristics of secured parties and buyers.

It could be argued that all we know for certain about our hypothetical disputants is that each at one time had a sum of money equal to the value of the goods (or, in the buyer's case, good enough credit to borrow such a sum). Even if we assume our buyer to be a consumer, we do not thereby learn the extent of her assets: Nelson Rockefeller and J. Paul Getty are, after all, sometime consumers. And it is perfectly possible for the secured party under Article 9 to be as poor as a churchmouse, and ignorant as a newborn babe.

Possible. But not likely. When law is made for deciding disputes between described classes of persons, that law must be based on accurate generalizations about the majority of the members of each class, not on speculation about eccentric but conceivable cases. One fact, known to anyone with any experience at all in our society, is that to a majority of consumers the loss of any item of goods which is valuable enough to litigate over is a substantial loss indeed—not to mention the cost of attorneys' fees, and the "psychic" cost of litigating for one

126. See W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 100, at 663-65 (4th ed. 1971).

127. Another case where the dealer was not available to bear the loss is *Godfrey v. Gilsdorf*, 86 Nev. 714, 476 P.2d 3 (1970).

to whom a lawsuit is an infrequent, perhaps once-in-a-lifetime event. Equally well known is the fact that the vast majority of secured parties under Article 9 are not unsophisticated, uncounseled or impecunious. They are the professional lenders of money: banks and finance companies.

With the facts thus stated, a basis for allocating risk becomes clear. A consumer in our society consumes to survive, and because consumption of goods and services is thought to be one means by which a full and satisfying life can be lived. A business enterprise enters into business transactions to make a profit. Where the normal conduct of an enterprise's business must inevitably create some risk of harm to innocent consumers, there is ample precedent for allocating the burden of that risk to the enterprise itself, rather than to the individual consumers affected.¹²⁸ Such allocation is justified by the greater ability of the enterprise to bear the collective risk, and the relative unlikelihood (or even practical impossibility) of that risk being adequately insured against at the consumer level.¹²⁹ The allotment of such a burden to the enterprise is thought proper even though its cost may eventually be passed on to all consumers (in the form of higher prices), because should that happen the risk will still be equitably shared by a class big enough to absorb its inevitable expense with relative ease, rather than being fortuitously visited in devastating amounts on unprepared individuals. If the nonpossessory security interest device carries with it an inevitable social cost in temporarily successful fraud committed by absconding or insolvent debtors, then that cost is just as surely a fair part of the secured lender's business expenses as the money it spends on television commercials or business lunches—or legal fees.

3. *UCC Policy: Comparison of the Competing Analogies.* The above conclusion can be justified also by reference to Code policies, as illustrated in the various three-party situations first examined. As we have seen, the policy in favor of protecting the expectations of a BIOC against competing claimants is strong enough to prevail in most cases: where the claimant is a defrauded vendee; where it is a perfected secured party lending against inventory security; even where it is the true owner, who did no more than entrust his goods to a dealer in goods of that kind. If in the entrusting situation section 2-403(2) is correctly to be construed as protecting the BIOC even where the true owner was unaware that the trustee was a dealer in such goods,¹³⁰

128. See generally W. PROSSER, *supra* note 126, at §§ 96-104.

129. See, e.g., *Escola v. Coca Cola Bottling Co.*, 24 Cal. 2d 453, 461, 150 P.2d 436, 440 (1944) (Traynor, J., concurring);

130. See note 103 *supra*.

then the policy in favor of the BIOC is clearly so strong that a nonpossessory secured party ought to be subject to it in the four-party cases.

Even if section 2-403(2) is not read so favorably to the BIOC, the same conclusion should follow. The equipment-secured lender may not have knowingly entrusted goods to a dealer, but it has been the victim of a kind of fraud. Indeed, by its voluntary act of permitting the debtor to retain possession plus at least a kind of title, the secured party has equipped the fraudulent debtor with the means to perpetrate a fraud on others. If the closest competing analogies under the UCC are the robbery victim and the con man's dupe, the secured party clearly is closer to the latter. However great its innocence and its sense of injury, the defrauded secured party, by choosing to extend credit on the strength of a nonpossessory security interest, has been a "cause" of its own loss in a way that the innocent consumer-BIOC—who has no choice but to deal in the marketplace available to her—has not.

COMPARISON OF POSSIBLE REVISIONS OF SECTION 9-307

If the above arguments have been persuasive, it remains only to consider what sort of change in section 9-307 they require.

One might conclude, as did the intermediate Massachusetts court in the *New England Merchants* case,¹³¹ that the protection of section 9-307(2) should simply be extended to all consumer-buyers (a change which could easily be effected by deleting the initial phrase, "In the case of consumer goods . . ."). Not only would this limit the additional protection to consumer-buyers (an issue debated below), it would fail to protect even the consumer-buyer unless the security interest at issue had been perfected only "by attachment." Since security interests in automobiles and other expensive consumer goods are likely to be protected by recording or by certificates of title,¹³² such a change would accomplish nothing except the ostensible bolstering of a provision that in fact is, and would remain, a virtual dead letter.

A much harder question is whether the additional BIOC protection under section 9-307(1) should extend to all BIOC's, or only to the consumer. Many of the arguments advanced above depend for their force on the contrast between the typical secured party and the typical consumer. Should a business buying equipment or a merchant buying for resale also take free of all prior security interests, if it meets the standards of a BIOC?

131. *New England Merchants Nat'l Bank v. Auto Owners Fin. Co.*, 40 Mass. App. Dec. 59, 5 UCC Rep. Serv. 904 (1968).

132. See text accompanying notes 96-99 *supra*.

The answer seems—less decisively—to be yes. My hesitation stems from the reduced likelihood of economic imbalance, the absence of likely inequality of business expertise, and the point that loss from debtor-fraud could be characterized as “one of the costs of doing business” for the buyer as well as for the secured party. The yes answer, however weakly voiced, is based on three factors: (1) simplicity (it is slightly easier to protect all BIOC’s under section 9-307(1) than to set up a rule which for some purposes distinguishes between consumer-BIOCs and all others; (2) business relation (losses resulting from use of the nonpossessory security device seems more appropriately allocable to the business of lending than to the business of the merchant-buyer); and (3) innocence (the BIOC in these cases, whether a consumer or a merchant, is equally without means to discover the outstanding interest). As to the latter point, the seeming reluctance of the courts readily to grant BIOC status to the merchant-buyer¹³³ suggests that the secured party may have a better chance to reclaim goods from such a merchant-buyer than from a consumer.¹³⁴

CONCLUSION

The words “created by his seller” should be deleted from section 9-307(1) of the Uniform Commercial Code. Their continued presence means that certain inevitable losses from nonpossessory secured lending will be passed on to innocent consumers and others ill-equipped to bear them. Of course, the wrongdoer should pay whenever he can be found and be made to pay—but when he cannot, the risks inherent in the business of money-lending should be borne by money-lenders, not by innocent buyers in the marketplace.

133. See generally *Atlas Auto Rental Corp. v. Weisberg*, 54 Misc. 2d 168, 281 N.Y.S.2d 400, 4 UCC Rep. Serv. 572 (Civ. Ct. 1967).

134. One development particularly helpful to the secured party here would be the application to every merchant-buyer of the standard of good faith contained in section 2-103(1)(b): not just “honesty in fact” but also “the observance of reasonable commercial standards of fair dealing in the trade.” *Mattek v. Malofsky*, 42 Wis. 2d 16, 165 N.W.2d 406 (1969) (Merchant standard applicable for section 2-403(2) purposes). See note 85 *supra*. *Contra*, *Sherrock v. Commercial Credit Corp.*, — Del. —, 290 A.2d 648 (1972) (merchant standard limited to Article 2 transactions, inapplicable to section 9-307(1)).