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When Does a Buyer Become a Buyer in Ordinary Course? U.C.C. §§ 1-201(9), 9-307(1): A Test and a Proposal

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When Does a Buyer Become a Buyer in Ordinary Course? U.C.C. §§ 1-201(9), 9-307(1): A Test and a Proposal

I. INTRODUCTION

Under section 9-201 of the Uniform Commercial Code a security interest in inventory is effective between the parties to a se-

1. The Uniform Commercial Code [hereinafter referred to as Code] has been enacted by all states except Louisiana. Article 9 covers all transactions where debts are secured by personal property with certain exclusions under § 9-104. In 1972, substantial amendments to article 9 were prepared by the Review Committee for Article 9, appointed by the Permanent Editorial Board of the Uniform Commercial Code. See D. Epstein & J. Landers, Debtors and Creditors 173-74 (1978). The Nebraska Legislature adopted these amendments during the 1980 legislative session. Act of Mar. 13, 1980, L.B. 621, 1980 Neb. Laws 337. However, the substance of this note is unaffected by the adoption of the 1972 version of article 9. Unless otherwise indicated, all references are to the 1972 version of article 9 rather than the 1962 version.

2. U.C.C. § 1-201(37) defines a security interest as:

[A]n interest in personal property or fixtures which secures payment or performance of an obligation. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (Section 2-401) is limited in effect to a reservation of a "security interest." The term also includes any interest of a buyer of accounts or chattel paper which is subject to Article 9. The special property interest of a buyer of goods on identification of such goods to a contract for sale under Section 2-401 is not a "security interest," but a buyer may also acquire a "security interest" by complying with Article 9. . . .

3. "Inventory" is defined in U.C.C. § 9-109 as follows:

Goods are

... .

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

While South Omaha Production Credit Ass'n v. Tyson, Inc., 189 Neb. 702, 204 N.W.2d 806 (1973) suggests that the definition of buyer in the ordinary course of business under U.C.C. § 9-307(1) ordinarily restricts the application of § 9-307(1) to a purchase from inventory, there is no express language in
security agreement against purchasers of the collateral and creditors. However, under the massive exception to this general provision contained in section 9-307(1), a buyer in the ordinary course of the seller's business takes the goods free of the security interest even if perfected and "even though the buyer knows of its existence." The protections afforded the buyer in ordinary course

U.C.C. § 1-201(9) which provides that the application of § 9-307(1) is limited to security interests in inventory. However, the requirement of U.C.C. § 1-201(9) that a buyer buy from "a person in the business of selling goods of that kind," suggests that such goods will typically be inventory of the seller.

4. U.C.C. § 9-307(1) provides:
   A buyer in ordinary course of business (subsection (9) of Section 1-201) other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence.
   One commentator has stated that in light of the extreme limitation placed on U.C.C. § 9-201 by U.C.C. § 9-307(1), a perfected security interest would be more appropriately called a "semi-security." Skilton, Buyer in Ordinary Course of Business under Article 9 of the Uniform Commercial Code (and Related Matters), 1974 Wis. L. Rev. 1.

5. U.C.C. § 1-201(9) defines buyer in ordinary course of business as:
   [A] person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. All persons who sell minerals or the like (including oil and gas) at wellhead or minehead shall be deemed to be persons in the business of selling goods of that kind. "Buying" may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.
   The issue of "buyer in ordinary course" arises under U.C.C. §§ 2-403(2) and 9-307(1). Although § 2-403 applies to sales of "entrusted" goods, both sections provide for the cutting off of third party property interests by buyers in the ordinary course of a seller's business and thus decisions under either section are analogous.
   No distinction is drawn here for § 9-307(1) purposes between purchase money and ordinary security interests. The special protections afforded a buyer in ordinary course under § 9-307(1) do not depend on a secured party's status as a purchase money financier.

6. Perfection of a security interest is generally achieved by filing a proper financing statement in the appropriate place or places. See U.C.C. §§ 9-302, 9-401 to -404. The clearest definition of "perfection" in the Code is contained in U.C.C. § 9-303 and Official Comment 1. Generally, under article 9, one set of rules governs filing (U.C.C. §§ 9-401 to -407) and one set governs the enforcement of the security interest (U.C.C. §§ 9-501 to -507).
   Where the security interest is not perfected the buyer takes free of the security interest regardless of the nature of the transaction. U.C.C. § 9-301(1).

7. U.C.C. § 9-307(1). The fact that a buyer has knowledge of a third party's security interest in purchased goods will not affect his status as a buyer in ordinary course. However, he will have failed the good faith requirement of U.C.C. § 1-201(a) if he is aware that the sale is in violation of the ownership
under section 9-307(1) are based on notions of fairness and commercial utility. Where an innocent buyer has relied on his seller's apparent authority to sell the goods, it is thought that such a purchaser has the right to avoid being harassed by his seller's inventory financier. Furthermore, where goods serving as loan collateral are held for sale, the seller must be given the power to sell if he is to meet the obligations imposed under the financing agreement.

The question of whether goods have been sold to a buyer in ordinary course is critical to a determination of the rights in the collateral of the buyer and the secured party. Where goods have been sold to a buyer in ordinary course, the secured party cannot exer-

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J. White & R. Summers, supra, at 1067, list six conditions which a buyer must meet in order to take goods serving as collateral for a loan free from a prior perfected security interest:

(1) He must be a buyer in ordinary course,
(2) Who does not buy in bulk and does not take his interest as security for or in total or partial satisfaction of a pre-existing debt (that is, he must give some form of "new value"),
(3) Who buys from one in the business of selling goods of that kind (that is, cars from a car dealer; i.e., inventory),
(4) Who buys in good faith and without knowledge that his purchase is in violation of others' ownership rights or security interests, and
(5) Does not buy farm products from a person engaged in farming operations, and
(6) The competing security interest must be one created by his seller.


8. Skilton, supra note 4, at 3.
9. Id. at 3, 4, 88.
10. Where a security interest is retained in goods held for sale, the secured party often holds what is referred to as a "floating lien," (or "continuing general lien" or "floating charge") where the lien "floats as to the property subject to the lien and the amount of debt secured thereby." D. Epstein & J. Landers, supra note 1, at 194. The authors state:

The debt secured may fluctuate from little to much or vice versa, and the collateral covered may include all of the personal property which the debtor from time to time owns, or all of a certain class or classes of that property, including assets not owned at the time the lien is created.

Id.
cise foreclosure and sale remedies against the defaulting seller's inventory to satisfy the seller's debt. On the other hand, if goods are sold to one who does not qualify as a buyer in ordinary course, the buyer has no claim to the seller's inventory and will be forced to recover any prior payments of the purchase price on the same basis as the seller's general creditors.

Section 9-307(1) presents two questions to the financer with a perfected security interest in inventory and to the purchaser of such inventory. The first is: who qualifies as a "buyer in ordinary course of business"? To this question section 1-201(9) supplies a fairly manageable definition. The second and much more difficult question is: at what point during the sequence of an ordinary sales transaction is the status of "buyer" to be determined?

11. When the seller is in default, part 5 of article 9 gives the secured party the following cumulative remedies:

(1) Foreclose its security interest under the state's non-Code foreclosure law—9-501(1)

(2) Use real estate mortgage procedure when both realty and personality are involved—9-501(4)

(3) Apply any special remedies provided in the security agreement—9-501(1), 9-501(2)

(4) Take judgment and levy execution on any non-exempt property of the debtor—9-501(1), 9-501(5)

(5) Collect accounts and instruments that are collateral—9-501(2), 9-502

(6) Foreclose security interest under Code procedure—9-501(2), 9-503, 9-504, 9-505

D. Epstein & J. Landers, supra note 1, at 209. See notes 63-66 & accompanying text infra.

12. Where a secured party seizes and sells inventory which has been sold to a buyer in ordinary course of business, the secured party will be liable to the buyer in a conversion action. See, e.g., Martin Marietta Corp. v. New Jersey Nat'l Bank, 612 F.2d 745 (3d Cir. 1979); Rex Financial Corp. v. Mobile America Corp., 119 Ariz. 176, 580 P.2d 8 (Ct. App. 1978); Herman v. First Farmers State Bank, 73 Ill. App. 3d 475, 392 N.E.2d 344 (1979); Chrysler Credit Corp. v. Sharp, 56 Misc. 2d 261, 288 N.Y.2d 525 (App. Div. 1968).


14. For a concise statement of the problem, see MANAGEMENT REPORTS, 14 Uniform Commercial Code Law Letter, No. 4 (June 1980).

15. See note 5 supra.

16. It has been suggested that the question of whether one is a "buyer" within the meaning of U.C.C. § 1-201(9) arises only rarely. J. White & R. Summers, supra note 7, at 1067-68 n.82. However, the number of courts confronted with the problem in the past decade suggests that the question is far from entirely academic. See, e.g., Martin Marietta Corp. v. New Jersey Nat'l Bank, 612 F.2d 745 (3d Cir. 1979); Rex Financial Corp. v. Mobile America Corp., 119 Ariz. 176, 580 P.2d 8 (Ct. App. 1978); O'Neill v. Barnett Bank, 360 So. 2d 150 (Fla. Dist. Ct. App. 1978); International Harvester Credit Corp. v. Associates Financial Services Co., 133 Ga. App. 488, 211 S.E.2d 430 (1974); Troy Lumber Co. v. Williams, 124 Ga. App. 636, 185 S.E.2d 580 (1971); Herman v. First Farmers State Bank, 73 Ill. App. 3d 475, 392 N.E.2d 344 (1979); Integrity Ins. Co. v. Marine Midland
Or to state it another way, precisely when has a purchaser sufficiently completed the process of "buying" to achieve buyer in ordinary course status and take free of the secured party's interest in the goods? To this question the language of section 1-201(9) is much less helpful, except perhaps for its use of the terms "buyer" and "sale." Beyond this, the Code has relegated the question to judicial innovation.

The most often applied alternatives for determining the point at which a buyer achieves ordinary course status include: (1) the initial contract date, (2) the identification date, or (3) the title date; however, other possibilities include: (4) the delivery date, and (5) the acceptance date as provided in section 2-606.

This Note will examine the decisions adopting the various alternatives for determining when a sale has progressed sufficiently to establish buyer in ordinary course status. An interpretational test under the present Code, and a Code amendment will be proposed for the determination of when a buyer becomes a buyer in ordi-


17. One court criticized the definitional language of U.C.C. § 1-201(9) as follows: "[I]t is unfortunate that the Code defines 'buyer in ordinary course' by using the exact words to be defined. By saying that a buyer in ordinary course is one who buys in ordinary course, the phrase seems redundant and thus meaningless." Martin Marietta Corp. v. New Jersey Nat'l Bank, 612 F.2d 745, 753 (3d Cir. 1979).

18. U.C.C. § 2-103(1)(a) defines the term "buyer" as "a person who buys or contracts to buy goods."

19. U.C.C. § 2-106(1) defines "sale" as "the passing of title from the seller to the buyer for a price."

20. Generally, whether a buyer has purchased in the ordinary course is a question of both fact and law which considers all the surrounding circumstances of the sale. See, e.g., International Harvester Co. v. Glendenning, 505 S.W.2d 320 (Tex. Civ. App. 1974); J. White & R. Summers supra note 7, at 145. This question typically involves an inquiry into only the nature of the transaction in order to determine whether the "ordinary course" requirement is met. The issue of when one becomes a buyer in ordinary course will not be reached if the transaction is not in the ordinary course of the seller's business. However, the two inquiries are interrelated and the presence of the latter may be determinative of the former. For example, if a transaction is considered in the ordinary course, a court may also conclude that the buying process has progressed sufficiently for purposes of U.C.C. § 9-307(1). See text accompanying notes 38 & 49 infra. For purposes of this Note, it is assumed that the requirements of U.C.C. § 1-201(9) have been satisfied and thus, the inquiry is limited to a discussion of when a sale in the ordinary course of the seller's business is sufficiently completed for the purchaser to achieve buyer in ordinary course status.
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I. THE ALTERNATIVES

A. The Initial Contract Date

Section 9-307(1) does not expressly protect an "executory buyer." However, the definitions of the terms "buyer" and "seller" under article 2 of the Code arguably sanction the initial contract date as the critical point for determining buyer in ordinary course status. Section 2-103(1)(a) defines "buyer" as "a person who buys or contracts to buy goods." Similarly, "seller" is defined in section 2-103(1)(d) as "a person who sells or contracts to sell goods." Additionally, section 2-106(1) provides that a "present sale" is "accomplished by the making of the contract." Thus, under these provisions the mere exchange of promises to buy and sell goods may create an enforceable contract which could

21. The question is open in Nebraska.
22. Skilton, supra note 2, at 15 (a buyer who has not yet completed the sale).
23. Article 2 provides a limited remedy for a buyer who has partially paid for identified goods from an insolvent seller. Under U.C.C. § 2-502(1) such a buyer may, upon tender of the unpaid portion of the purchase price, recover the goods (even if unshipped) if the seller becomes insolvent within 10 days after the first installment payment. Section 2-501(2) limits the buyer's recovery to goods which conform to the contract where identification is made solely by the buyer. Although this section provides some mechanism for protecting a buyer's contractual interest in goods prior to completion of the sale, it obviously affords no relief to the buyer who has not completed the sale nor to the buyer whose seller becomes insolvent more than 10 days after initial payment.
24. U.C.C. § 2-103(1)(a) (emphasis added).
25. Id. § 2-103(1)(d) (emphasis added).
26. Restatement (Second) of Contracts § 2 (1973) defines a promise as "a manifestation of intention to act or refrain from acting in a specified way, so made as to justify a promisee in understanding that a commitment has been made."
27. U.C.C. § 2-204 contains very liberal contract formation rules:
   (1) A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract.
   (2) An agreement sufficient to constitute a contract for sale may be found even though the moment of its making is undetermined.
   (3) Even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy.
   (emphasis added).
   "Agreement" is defined in U.C.C. § 1-201(3) as "the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided by this Act (Sections 1-205 and 2-208). Whether an agreement has legal
give rise to buyer in ordinary course status under section 9-307(1).

At first blush, the selection of an initial contract date, at least in the absence of identification of the goods to the contract may appear too early a date for establishing buyer in ordinary course status if a manageable application of section 9-307(1) is to be maintained. For example, a secured party attempting to exercise his default remedies under sections 9-501 to -507 will be uncertain as to what, if any, collateral has been "sold" to a buyer in ordinary course. Holding a bare agreement to buy and sell sufficient to trigger section 9-307(1), without the seller's recordkeeping or marking or labeling as sold the collateral remaining in the seller's possession, will make it difficult for the secured lender to avoid infringing upon the rights of purchasers of the collateral. However, the later in the sale sequence such status is determined, the greater will be the sacrifice of the buyer's (and seller's) legitimate expectations in the transaction.

There is judicial authority for determining buyer in ordinary course status based upon an initial contract date. In *Troy Lumber Co. v. Williams*, the court, in dicta, indicated that if the purchasing plaintiffs had attempted to enforce their agreement with the seller to purchase an unspecified mobile home, they would have qualified as buyers in ordinary course under section 9-307(1). The plaintiffs had signed a "proposal" with a mobile home dealership, agreed to purchase an unidentified mobile home, and made a $600 down payment. Shortly thereafter, the dealer's president absconded with all of the company's cash. Plaintiffs initiated an attachment proceeding against one of the mobile homes on the lot to satisfy their loss claiming they were buyers in the ordinary course.

It should be noted that a contract for the sale of goods of $500 or more requires a writing sufficient to indicate that a contract has been made and must be signed by the party against whom enforcement is sought. U.C.C. § 2-201(1).

These provisions when read together sanction the statement that a bare agreement to buy and sell which satisfies § 2-201(1) would be a "contract" within the Code's definition of the word and, even if oral, would be enforceable when less than $500.


course of the seller's business. The court disagreed, finding that plaintiffs had become lien creditors of the seller and had subordinated their claim to the manufacturer's perfected security interest. Nevertheless, the court indicated the buyer in ordinary course argument "would be a valid argument if the plaintiffs were in fact buyers, i.e., if they were either attempting to enforce the contract of sale or defending their right to free possession of the property after having performed under the contract."

The court cannot be criticized for refusing to protect the purchasers' contract rights because they elected not to seek contractual remedies. However, the court suggested that the process of buying has progressed sufficiently to support buyer in ordinary course status when there has merely been partial payment under a contract in unidentified goods.

Also sanctioning the initial contract date as determinative of buyer in ordinary course status in unidentified goods, at least where the buyer has fully performed, is Herman v. First Farmers State Bank. The facts of Herman fall squarely within the Troy Lumber dictum in which the court indicated that buyer in ordinary course status would be found where buyers attempt to "defend their right to free possession of the property after having performed under the contract."

In Herman, the plaintiff, claiming buyer in ordinary course status, brought an action against the seller's inventory financer to recover her payment for the future delivery of 40,000 pounds of unidentified liquid nitrogen fertilizer. The defendant had seized and sold all of the seller's inventory following the seller's default under its financing agreement with the defendant. In finding for the plaintiff, the court expressly rejected defendant's argument that goods must be identified and that title must pass under section 2-401 before the plaintiff achieves buyer in ordinary course status. The court stated the test as follows:

Whether the buyer is a buyer in ordinary course is not affected by whether there has been a completed sale or merely the making of the contract to sell, since the fact that title has not yet been transferred as between the dealer and the purchaser does not prevent the latter from being

30. Id. at 636, 185 S.E.2d at 582.
31. [T]he plaintiffs have, in effect, rescinded this contract by demanding refund of their down payment. They are not asking for a mobile home, they are asking for $600. That the sheriff levied upon a mobile home which will be sold by execution to satisfy the debt, does not make them buyers of the attached mobile home. Id. at 637-38, 185 S.E.2d at 582.
32. Id. (emphasis added).
34. 124 Ga. App. at 637-38, 185 S.E.2d at 582.
35. See U.C.C. § 2-501(1)(b).
regarded as a buyer in the ordinary course of business, insofar as the secured creditor of the dealer is concerned where the transaction between the dealer and the purchaser is ordinary or typical in the trade.\textsuperscript{36}

The court found that the transaction was customary in the seller's business, that plaintiff had previously purchased fertilizer on the same basis, and that plaintiff had fully performed by paying the purchase price to the seller. Those factors led the court to conclude that plaintiff "justifiably expected delivery" and "was a typical buyer in an ordinary business transaction with [the seller]" and thus was entitled to protection under section 9-307(1).\textsuperscript{37}

The Herman decision suggests a further factor relevant to determining whether buyer in ordinary course status should be deemed achieved upon the contract date. The court relied heavily on the fact that the transaction was typical in the seller's business. Although this finding is otherwise relevant to the "ordinary course of business" requirement of section 9-307(1),\textsuperscript{38} the Herman court utilized the "typical in the trade" nature of the transaction as a factor in determining that the process of buying had progressed sufficiently to warrant the conclusion that buyer in ordinary course status had been achieved.

A similar result, although in a different context, was reached in Chrysler Credit Corp. v. Sharp,\textsuperscript{39} where the court found that a contract to purchase identified\textsuperscript{40} goods with a partial down payment by the purchaser was sufficient to achieve buyer in ordinary course status. Chrysler Credit involved a dispute between an inventory financer who held a "floating lien"\textsuperscript{41} in the seller's automobile inventory, and a retail installment creditor who had been assigned chattel paper,\textsuperscript{42} evidencing the right to receive installment payments, and a security interest in a car sold to defendant Mrs. Sharp.\textsuperscript{43} Mrs. Sharp had signed a retail installment contract with the seller for the purchase of the car. The contract recited as con-

\textsuperscript{36} 73 Ill. App. 3d at 479, 392 N.E.2d at 346 (quoting ANDERSON, UNIFORM COMMERCIAL CODE § 1-201:25 (2d ed. 1970)). In light of the present case law perhaps Anderson should delete the words "is not" and insert instead the words "should not be."

\textsuperscript{37} 73 Ill. App. 3d at 479, 392 N.E.2d at 346.

\textsuperscript{38} See note 20 supra.

\textsuperscript{39} 56 Misc. 2d 261, 288 N.Y.S. 2d 525. (N.Y. Sup. Ct. 1968).

\textsuperscript{40} See note 53 infra.

\textsuperscript{41} See note 10 supra.

\textsuperscript{42} Section 9-105(1)(b) defines "chattel paper" as:

a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods, but a charter or other contract involving the use or hire of a vessel is not chattel paper. When a transaction is evidenced both by such a security agreement or a lease and by an instrument or a series of instruments, the group of writings taken together constitutes chattel paper.

\textsuperscript{43} Mrs. Sharp apparently abandoned her rights following seizure and sale of the
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consideration a trade-in allowance for her old car and a cash down payment of $443. The security interest was reserved until Mrs. Sharp paid the balance of the purchase price. The retail creditor, Chrysler Credit, paid the seller in full upon assignment of the chattel paper, but the seller failed to turn over the proceeds to the inventory financer. Although Mrs. Sharp traded in her old car, contrary to the recital in the agreement and unbeknownst to Chrysler Credit, she had not made the down payment but rather had orally agreed with the seller's sales manager to make the payment upon receipt of an expected income tax refund. The inventory financer seized and sold the seller's inventory before Mrs. Sharp made the down payment and took possession. Chrysler Credit then brought a conversion action against the inventory financer in which the right to the proceeds was at issue. The question of the buyer's status arose in this dispute because the retail creditor's right to receive payments was believed to be grounded on the buyer's status as a buyer in ordinary course.\(^4\) The court held for Chrysler Credit, concluding that since Chrysler had purchased the chattel paper in due course for new value from the seller, it was entitled to damages under sections 9-308(b) and 9-306(5)(b), (c), and (d).

In holding for Chrysler Credit, the court noted it had also found that Mrs. Sharp was a buyer in ordinary course. In addressing the buyer in ordinary course issue, the court rejected the inventory financer's argument that since the seller retained title to the car, Mrs. Sharp was precluded from qualifying as a buyer in ordinary course due to the passage of title rules of section 2-401. The court stressed the apparent good faith intent of Mrs. Sharp to purchase the automobile and the typicality of the transaction\(^5\) in the seller's car. Although she was made a party defendant she was never served with process. 56 Misc. 2d at 262, 288 N.Y.S.2d at 527.

\(^4\) Where the rights of a third party are dependent upon the buyer's qualification as a buyer in ordinary course, they have been referred to as "satellite rights." Skilton, supra note 4, at 76-88.

\(^5\) With respect to the typicality of the transaction the court stated:

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

The court feels a buyer who makes a purchase on a printed form in good faith with a full understanding it is a binding contract, who knowingly signs a retail installment payment obligation and trades in an old car in addition must certainly as to a retail financer furnishing new value on the strength of such contract and as to an entruster giving the dealer wide latitude of sale goods [sic], be deemed a buyer in the ordinary course of business, without regard to the technicalities of when title [passes]...

Although the court's holding adjudicated the rights of a retail creditor seeking a remedy against an inventory financer, it neverthe-
less recognized the existence of buyer in ordinary course status upon formation of the contract and partial payment.

Troy Lumber, Herman, and Chrysler Credit\textsuperscript{48} would all support the proposition that buyer in ordinary course status could be determined upon contract formation, at least where there has been partial or full payment for the goods and the transaction is typical in the seller’s business. The question is raised whether a buyer should be entitled to ordinary course status absent any payment under the contract. There appears to be no valid reason for conditioning buyer in ordinary course status on the presence of a payment if the presence of a contract is to be the controlling factor. Thus, if the buyer can demonstrate the existence of a valid contract\textsuperscript{49} and that the transaction is typical in the seller’s business, the executory buyer should prevail against the seller’s secured
tel paper for new value and the sale is either authorized or the purchaser is a buyer in ordinary course, U.C.C. § 9-308 governs the outcome of the dispute. \textit{Id.}

U.C.C. § 9-308 (1962 version) provides:

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

\textit{Id.} The section was rewritten in 1972 for clarity and to place purchasers of instruments on equal footing with purchasers of chattel paper. See U.C.C. § 9-308.

However, Skilton goes on to state that if the purchaser is not a buyer in ordinary course and the sale is not authorized by the inventory financer, the financer’s security interest in the collateral continues notwithstanding sale. Skilton, \textit{supra} note 4, at 84-85. Thus, although U.C.C. § 9-308 would require finding for the retail creditor in a dispute over rights to chattel paper, it would not resolve a dispute between the inventory financer holding an original, continuing, perfected security interest in the collateral and the retail creditor with a security interest in the goods as an assignee of the chattel paper. In order to render judgment for the retail creditor in this situation, the purchaser must have either participated in an authorized sale or achieved buyer in ordinary course status.

Despite the apparent validity of this reasoning, the courts have not generally recognized the distinction as to when the purchaser’s status is dispositive. \textit{But see} International Harvester Credit Corp. v. Associates Financial Services Co. 133 Ga. App. 488, 211 S.E.2d 430, 435-36 (1974) (noting the distinction).

\textbf{48.} For a discussion of an alternative analysis under the \textit{Chrysler Credit} case, see note 47 & accompanying text \textit{supra}.

\textbf{49.} See note 27 \textit{supra}. 
lender as a buyer in ordinary course and be entitled to the goods upon payment of the contract price.

The decision of *Rex Financial Corp. v. Mobile America Corp.* provides support for this view. In *Rex Financial*, the court held that a good faith intent to purchase a particular mobile home, as evidenced by the buyers' execution of an installment purchase agreement and a purchase money security agreement was sufficient to establish buyer in ordinary course status, even though the buyers made no down payment and did not take possession of the unit. The assignee of the seller, Mobile America, brought a conversion action against the seller's secured lender, Rex Financial, who had seized and disposed of the collateral. Rex Financial argued that since the buyers neither took possession of the mobile home nor made a down payment, Mobile America was precluded from asserting that they were buyers in ordinary course. The court rejected this argument and held that Mobile America could recover from Rex Financial the amount the former had paid the seller for the purchase money security interest. The court concluded that neither possession nor a down payment were necessary elements in establishing buyer in ordinary course status and went on to hold that a security agreement in favor of Mobile America attached upon execution of the installment and security agreements.

The determination of buyer in ordinary course status upon the initial contract formation date respects the legitimate transnational interest that the buyer has acquired in the goods, whether or not identified to the contract. The buyer is allowed the benefit of

51. Id. at 177, 580 P.2d at 9.
52. The buyers were not made parties to this litigation. Following the seller's default under its inventory financing agreement with Rex Financial, all the seller's inventory, including the mobile home, was seized and sold. The buyers apparently abandoned their contractual rights under the purchase agreement. Mobile America likewise abandoned efforts to collect the purchase price from the buyers.
53. Although the goods were identified in *Rex Financial* and *Chrysler Credit* there is no language in either case which indicates that the courts considered identification necessary to buyer in ordinary course qualification. As stated by the court in *Herman v. First Farmers State Bank*:

Defendant's attempts to distinguish *Chrysler* and *Rex Financial* are without merit. Defendant argues that the purchased goods in those cases were specific ones, which had been set aside or "identified" to the contract under section 2-401 so as to complete the sale and pass title to the buyer. . . . However, we find nothing in either of those opinions to suggest that the courts based their decisions on section 2-401 or any of the other provisions of Article 2 relating to passage of title and consummation of sales. In fact, . . . such an argument was specifically rejected in both cases.

his bargain, may pursue his contractual remedies, and, if specific performance is available, may avoid the search for a comparable transaction elsewhere. Furthermore, this early recognition of buyer in ordinary course status maximizes the seller's ability to dispose of goods held for sale in the ordinary course of business.

Nevertheless, it has been argued that recognizing the rights of an executory buyer "would make the entire concept of security on inventory unworkable, placing on any inventory security holder

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54. See generally, Hillman, Keeping the Deal Together After Material Breach—Common Law Mitigation Rules, The UCC, and The Restatement (Second) of Contracts, 47 U. Colo. L. Rev. 1 (1976). The buyer's potential remedies include damages or specific performance. The buyer's traditional measure of damages for a seller's total breach of contract is the difference between the market price and the contract price. J. CALAMARI & J. PERILLO, CONTRACTS 546-47 (1977). This rule has been codified in U.C.C. § 2-713(1), with the added option of "cover," i.e., the buyer may make a good faith purchase or contract to purchase substitute goods without unreasonable delay. See U.C.C. § 712(1). The buyer may then recover the difference between the cost of cover and the contract price. Id. § 712(2). Thus, the buyer should receive the difference between the market or cover price and the contract price. The Code contains adequate safeguards to protect against unreasonable damage awards. For example, U.C.C. § 1-108, Official Comment 1 makes "it clear that damages must be minimized." Section 1-203 imposes an obligation of good faith, and § 2-712(2) provides that the buyer's damages are reduced by the amount of expenses saved due to the seller's breach.

Specific performance is available under the Code where the goods are "unique or in other proper circumstances." U.C.C. § 2-716(1). The buyer is granted replevin rights where specific performance is decreed "for goods identified to the contract if after reasonable efforts he is unable to effect cover for such goods or the circumstances reasonably indicate that such effort will be unavailing." Id. § 2-716(3).

A better result will be accomplished where the buyer resorts to an action for specific performance. Here, the secured lender will not be left with a damage award following sale of the collateral. By enforcing the contract, the buyer retains his transactional expectations and the secured lender recovers at least a portion of his security interest through the § 9-306(2) right to proceed. However, where the goods are sold before the buyer can specifically enforce the contract, a damage award will be the buyer's only available remedy, provided the market or cover price is greater than the contract price.

55. See note 54 supra.

56. In many situations, a comparable sale cannot be found elsewhere, particularly where goods are identified or the buyer has agreed to purchase at a favorable yet commercially reasonable price. Resolution of the remedies issue could be reasonably accomplished within the spirit of article 2 by liberalizing the interpretation of when goods are considered "unique" or "other proper circumstances" are present to justify specific performance under U.C.C. § 2-716. For example, a secured party's exercise of § 9-503 rights to take possession of or render unusable the collateral of the seller would be considered "other proper circumstances" sufficient to allow the buyer to specifically enforce the contract. Section 2-716 was intended to expand the common law doctrine of specific performance of contracts of sale. U.C.C. § 2-716, Official Comment 1.
the impossible burden of accounting to numerous unknown creditors of the dealer who had made payments on account but never received their goods." To this contention, there are three responses. First, the buyer has acquired contractual rights in the goods in a transaction which is typical in the seller's business. Thus it may be argued that the secured party has in effect "consented" to all transactions of this nature, and therefore has no right to complain about a loss of his security interest in the collateral. Further, by extending credit to the seller, the secured party contemplated that the security interest was retained in goods held for sale. Thus, the secured party obtained a temporary interest in "quasi-negotiable" goods. Where a security interest is retained in inventory, the primary source for satisfaction of the seller's debt is the sales proceeds. The sale of goods in ordinary course and the periodic payment of proceeds to the secured party in order to obtain additional credit is facilitated by recognizing the interrelationship between sections 9-307(1) and 9-306(2).

Second, these cases typically involve a double-dealing seller who has improperly disposed of the sales proceeds in violation of the financing agreement. The inventory financer may well have an indication of the seller's probable compliance with sound commercial practices prior to the extension of the credit. It may be argued that the secured party should bear the loss for the conduct

57. Herman v. First Farmers State Bank, 73 Ill. App. 3d at 480, 392 N.E.2d at 347 (argument of defendant secured lender). However, by requiring the seller to maintain complete records of all goods sold, the secured party may protect himself from tort liability for conversion if he repossesses goods which, although remaining on the seller's premises, have been sold to a buyer in ordinary course. Thus, the secured party would be able to ascertain at any given date the amount of collateral available to satisfy the secured obligation in the event of default. Beyond this measure, the secured party may insist upon a provision in the financing agreement requiring the seller to indemnify, by insurance or otherwise, the secured party in the event the foreclosure and sale remedies are exercised against goods sold due to the seller's inaccurate and/or incomplete recordkeeping.

58. In fact, the buyer's reliance on § 9-307(1) may be unnecessary because many security agreements authorize the sale of the collateral "free and clear." Skilton, supra note 4, at 88. Where the sale is authorized, the secured party must relinquish its interest in the collateral and look to the identifiable proceeds since authorization of sale "in the security agreement or otherwise" discontinues the security interest in the collateral. U.C.C. § 9-306(2). However, a determination must be made that a "sale" has occurred. Thus, an inquiry, similar to that under section 9-307(1), is necessary to determine whether the transaction has sufficiently progressed to constitute a "sale" for purposes of section 9-306(2). Reference to article 2 may resolve this question more easily than the buyer in ordinary course issue. See U.C.C. § 2-106(1) ("sale" is "the passing of title from the seller to the buyer for a price").

59. Skilton, supra note 4, at 88.

of the seller with whom he has chosen to deal. Furthermore, the inventory financer is in the best position to guard its interests by inclusion of proper terms in the financing agreement. Such protection should include requiring the seller to maintain accurate and complete sales records, retaining the desired degree of control over the collateral, and inquiring into the seller's compliance during performance of the financing agreement.

Third, the secured lender is not without remedy. Although it would relinquish its interest in the collateral, it would have an interest in the proceeds under section 9-306(2) when the buyer pays the purchase price under the contract. Where the buyer is a buyer in ordinary course, the buyer should be afforded the option of either effecting a sale under his contractual agreement with the seller by paying in the contract price to the secured party, or ob-

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61. See note 57 supra. Within the confines of article 9 the parties to the security agreement are otherwise free to elect:
   (a) the kind of device or agreement to be used,
   (b) the kind of collateral in which the security interest is created,
   (c) the degree of protection (frequently including protection over and above protection against lien creditors) to be afforded the secured party,
   (d) the degree of control by the creditor of the collateral left in possession of the debtor, and
   (e) the amount of detail in the public notice to be given.


62. Rex Financial Corp. v. Mobile America Corp., 119 Ariz. 176, 580 P.2d 8 (Ct. App. 1978) (inventory financer in better position to guard against risk of financing than buyer or retail financer); Chrysler Credit Corp. v. Sharp, 56 Misc. 2d 261, 288 N.Y.S.2d 525 (1968) (risks of usage of trade to which inventory financer is exposed by dealing with seller should be borne by secured party). As stated by the court in Herman v. First Farmers State Bank:

   We believe that the risks involved in situations such as that at bar should be placed on the inventory financer, not only because it is better able to guard against those risks than the unwary buyer or retail financer, but also because a contrary rule would inequitably allow the inventory financer a double recovery.

73 Ill. App. 3d at 480-81, 392 N.E.2d at 346.

The court's reference to "double recovery" is apparently based on the fact that the secured party is already entitled to a security interest in the identifiable proceeds of the sale under U.C.C. § 9-306(2). Thus, to allow the financer his § 9-306 interest plus the right to dispose of the seller's collateral and satisfy the security interest would constitute a "double recovery." Under the Herman facts the seller had probably previously disposed of the proceeds of plaintiff's sale beyond the reach of the secured party. Although a holding for the defendant in that case would not actually effect a double recovery, it would in a theoretical sense.

63. U.C.C. § 9-306(2). This section provides that a "security interest . . . continues in any identifiable proceeds including collections received by the debtor." Id. See note 58 supra.
taining a refund of prior payments. Upon the latter event, the secured party would then exercise its foreclosure and sale remedies on the collateral. Thus, assuming the purchase price the buyer would be required to pay or the amount the secured party could recover from foreclosure and sale would be sufficient to satisfy the debt, the secured lender would be made whole. If the sale were for less than a fair price, if the seller retained possession of the goods without sufficient commercial justification, or if the sale constituted a fraud against the secured creditor, the secured party is not without alternative remedies.

Despite these considerations, it must be examined whether the Code requires, or fairness to the inventory financer demands, that goods be identified before an inventory financer's rights in the collateral are lost under section 9-307(1).

B. The Identification Date

The second alternative for buyer in ordinary course status is the identification date. The Code provides that identification has occurred where there has been “identification of existing goods as goods to which the contract refers.” Typically, a dispute as to whether goods are identified or not will arise only when the seller has retained possession. Obviously, where the buyer has taken possession, the goods will have been identified. Under U.C.C. section 2-501, upon identification of the goods the buyer acquires,

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64. The impact on the secured lender would be more favorable in the absence of partial payment assuming that any down payment could not be recovered from the seller. If the purchaser had made no down payment and had sought to enforce the contract to effectuate a sale, the full purchase price would have remained unpaid. Thus, under section 9-306(2), the secured party would have obtained a security interest in the full purchase price in order to satisfy the seller's debt.

65. It is of course assumed that the original contract was the result of an arms-length transaction resulting in a price at or about market value. One means to guard against a "bargain contract" would be to include a term in the financing agreement prohibiting the sale of goods below a certain level without the consent of the secured lender. This would prevent the possibility of the secured party having merely the proceeds of a bargain contract.


67. See U.C.C. § 2-402(2) which provides:

A creditor of the seller may treat a sale or an identification of goods to a contract for sale as void if as against him a retention of possession by the seller is fraudulent under any rule of law of the state where the goods are situated, except that retention of possession in good faith and current course of trade by a merchant-seller for a commercially reasonable time after a sale or identification is not fraudulent.


69. U.C.C. § 2-501(1).
(1) "a special property," and (2) "an insurable interest in goods." This is a sufficient interest to insure the goods and to provide the buyer a cause of action against a third party who injures the buyer through his dealing with the goods.

The fact that these rights accrue upon identification could support an argument that for section 9-307(1) purposes, the Code does not recognize an enforceable contractual interest in goods prior to identification and therefore a person cannot become a "buyer" until certain goods are specified as those to which the agreement refers. Thus, until the parties identify the goods, the Code does not require a court to accord any special deference to the interest in goods that a mere agreement to buy and sell would otherwise create.

The force of this argument is undercut by the fact that under section 2-501, identified goods need not conform to the contract, and the buyer may have an option to accept or reject identified goods. Further, identification may be made "at any time and in any manner explicitly agreed to by the parties." Official Comment 2 to section 2-501 states that "in view of the limited effect given to identification by this Article, the general policy is to resolve all doubts in favor of identification."

The view under article 2 of identification as a moment of decided unimportance should support the argument that identification should not serve so important a function as the determinative moment at which a security interest in collateral is severed under 9-307(1). However, the Court of Appeals for the Third Circuit, in Martin Marietta Corp. v. New Jersey National Bank chose identification as the determinative date.

In Martin Marietta, the plaintiff-buyer brought a conversion action against the secured lender who, upon the seller's default under the financing agreement, had taken possession of the

70. Id.
71. A typical example of such an injury would be conversion of the goods by a third party. See U.C.C. § 2-722.
72. U.C.C. § 2-501(1). "[T]here is no requirement in this section that the goods be in deliverable state or that all the seller's duties with respect to the purchase of the goods be completed in order for identification to occur." Id. Official Comment 4.
73. U.C.C. § 2-501(1).
74. Id. § 2-501, Official Comment 2. The identification provisions of § 2-501 may prove worthless to a secured party taking possession of a defaulting seller's collateral which may have already been sold to a buyer in ordinary course since identification can be made in any way agreed to by the buyer and seller. Thus, it can be inferred that providing notice to the secured party of third party interests in the collateral is not a purpose of identification. But see note 57 supra.
75. 612 F.2d 745 (3d Cir. 1979).
seller's 62,000 ton inventory of sand and ordered its sale. The plaintiff had orally contracted with the seller to purchase a large quantity of sand per month. In holding that the defendant's security interest in the inventory should take precedence over the plaintiff's rights, the district court concluded: (1) the buyer's attempted identification of the seller's inventory by placing signs near the sand was insufficient to create a legally cognizable interest against the defendant; and (2) the buyer failed the good faith requirement of section 1-201(9) by contracting to purchase with the intent to keep the seller solvent pending the buyer's decision to acquire the seller.\(^7\)

The court of appeals reversed the lower court on the identification issue. The court first stated as a general proposition that "where goods remain in the possession of the seller, the buyer cannot assert claims against third parties unless the goods are identified."\(^77\) The court then addressed the issue of whether the sand which remained on the seller's lot had been sufficiently identified to the contract by the signs placed near the sand by the buyer. The court found that a buyer can identify goods under section 2-501 even though that section arguably frames identification in the context of the seller's activity.\(^78\) The court stated:

> When a seller acquiesces by silence in the face of the buyer's clear assertion of ownership and then its subsequent course of conduct never indicates to the buyer that it feels the assertion of ownership was invalid, that seller should not be able to say the goods were not designated merely because it did not personally place the signs. To elevate the phrase "designated by the seller" into an absolute requirement of positive physical activity by the seller is to return to the formalism that the Code tries to escape.\(^79\)

With respect to the identification of an undivided portion of a fungible mass, the court held that "Hollander [the seller] and the plaintiff referred to a specific amount and mentioned the sand at Hollander's New Jersey plant . . . [and if] the sand existed in Sep-

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\(^7\) 612 F.2d at 748.
\(^77\) Id. at 749. However, the court found it unnecessary to decide the buyer in ordinary course issue, since a remand was required to determine whether the plaintiff's purchase fell within the bulk sales exclusion of the buyer in ordinary course definition. Under the U.C.C. § 1-201(9) buyer in ordinary course of business definition, "buying . . . does not include a transfer in bulk". Unfortunately, the court's opinion gives no explanation as to why it was "assuming without deciding this rule [identification under section 2-501] would apply to a buyer's claim vis-a-vis an Article 9 secured creditor." 612 F.2d at 749.

\(^78\) U.C.C. § 2-501(1)(b) ("designated by the seller"). But see U.C.C. § 2-501(2) in which the phrase "where the identification is by the seller alone" indicates that the Code contemplates that identification may be performed by persons other than the seller.

\(^79\) 612 F.2d at 750.
In view of the very liberal policy favoring identification expressed in the Code and *Martin Marietta*, one may question the utility of the identification date as a test for determining buyer in ordinary course status. The fact that both buyer and seller are able to identify may often result in confusion during the course of a sale as to whether a party has manifested a sufficient intent to identify the goods. The Code's attitude toward identification bolsters the argument that it should not be the linchpin of buyer in ordinary course determination. Furthermore, where a seller identifies without participation by the buyer, section 2-501(2) provides that the seller may, prior to default, insolvency, or notification to the buyer that the identification is final, substitute other goods for those identified. Thus, unless one of the three contingencies occurs, even a buyer of identified goods may be denied a sufficient interest to compel the purchase of specific goods. This would render an identification by the seller alone, under these circumstances, tantamount to no identification at all and further indicates the minimal interest the buyer acquires upon identification.

Perhaps most importantly, there is nothing in the Code which requires identification for purposes of resolving buyer in ordinary

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80. *Id.* at 749 (emphasis added). U.C.C. § 2-501(1) provides that: "In the absence of explicit agreement identification occurs (a) when the contract is made, if it is for the sale of goods already existing and identified." (emphasis added). The italicized portions indicate the circular nature of the identification definition. Thus, it is of little value in determining when identification of existing goods occurs. *But see* U.C.C. § 2-501, Official Comment 5: "The mere making of the contract with reference to an undivided share in an identified fungible bulk is enough under subsection (a) to effect an identification if there is no explicit agreement otherwise."

81. U.C.C. § 2-501, Official Comment 2 states: "It is possible . . . for the identification to be tentative or contingent. In view of the limited effect given to identification by this Article, the general policy is to resolve all doubts in favor of identification." Official Comment 4 states that: "In view of the limited function of identification there is no requirement in this section that the goods be in deliverable state or that all of the seller’s duties with respect to the processing of the goods be completed in order that identification occur." *Id.* Official Comment 4.

82. 612 F.2d at 750.

83. See note 81 *supra*. 
course status. A fair reading of section 2-501 indicates that identification impacts upon the rights of buyer and seller only, and was not intended to sever the secured lender's interest in collateral. Section 2-501 contains no requirement that the act of identification be communicated to the secured lender. Thus, a secured lender would not be apprised of the fact that certain loan collateral had been freed of the security interest due to identification. Therefore, little would be gained from the secured party's standpoint in fixing identification as the determinative factor under section 9-307(1) for buyer in ordinary course status. Unless notification of identification is provided to secured parties and the buyer is informed of his ability to identify, requiring identification to qualify as a buyer in the ordinary course will prove a technical trap for the unwary buyer, with the potential of frustrating justifiable transactional expectations in unidentified goods.

C. The Title Date

Those courts which have held that passage of title is necessary to achieve buyer in ordinary course status have generally reached this conclusion by referring to the Code's definition of "sale" as "the passing of title from the buyer to the seller for a price." The facts of the dispute are then compared to the detailed passage of title rules of section 2-401 or to the parties' agreement to determine whether the purchaser has received title under the contract. If so, the purchaser is a buyer in ordinary course and takes free of the security interest. If not, the buyer is held to have taken the goods subject to the security interest.

Conditioning buyer in ordinary course status on the passage of title has the advantage of providing a manageable and predictable method to resolve disputes between a buyer and his seller's secured lender. Passage of title normally will occur late in the sales transaction. Unless otherwise expressly agreed by the parties, "title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods." The later the title passes, the longer the secured lender will retain the security interest in the goods.

It should be noted, however, that there is no requirement in the Code that a purchaser obtain title to qualify as a buyer in ordinary course of business. On the contrary, the Code contains express

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84. See Section III infra.
86. U.C.C. § 2-106(1).
87. Id. § 2-401(2).
antipathy to the use of section 2-401 as a general problem solver.\textsuperscript{88} Despite these sentiments, the passage of title rules have received serious consideration by some courts in resolving the buyer in ordinary course issue.\textsuperscript{89} As will be seen, however, reliance on the passage of title rules may result in extreme hardship to the purchaser of collateral.

In \textit{Chrysler Corp. v. Adamatic, Inc.},\textsuperscript{90} the buyer (Chrysler) contracted with the seller (Adamatic) for the purchase of custom-manufactured equipment and, under a prepayment agreement, substantially paid the contract price prior to completion of its manufacture. Chrysler was aware of Adamatic's shaky financial situation and that its inventory was subject to a perfected security interest. Upon Adamatic's insolvency, Chrysler obtained the equipment (in various stages of completion) under a pre-judgment writ of replevin. The secured lender intervened, claiming a perfected security interest in the goods and disputing Chrysler's claim that it was a buyer in ordinary course of the equipment. In holding Chrysler liable to the lender, the court noted that the definitional language of section 1-201(9) "when reasonably construed, limits buying in ordinary course of business to those situations where a 'sale' defined by [section 2-106(1)] as the passing of title from the seller to the buyer for a price, has occurred."\textsuperscript{91} The court found

88. U.C.C. § 2-401, Official Comment 1 states that the passage of title rules "in no way alter the rights of either the buyer, seller, or third parties declared elsewhere in the Article." The title rules are said to be stated "in case the courts deem any public regulation to incorporate the defined term of the 'private' law." \textit{Id.} Thus it appears that the proper imposition of an income, property, or sales tax may depend on the passage of title but that the rights of parties to a sales transaction under the Code are not governed by passage of title. Official Comment 1 further states: "This Article deals with the issues between seller and buyer in terms of step by step performance or non-performance under the contract for sale and not in terms of whether or not 'title' to the goods has passed." \textit{Id.} Use of the concept of title is also minimized under article 9. U.C.C. § 9-202 provides: "Each provision of this Article with regard to rights, obligations and remedies applies whether title to collateral is in the secured party or the debtor." U.C.C. § 9-202, Official Comment restates and explains this provision as follows: "The rights and duties of the parties to a security transaction and of third parties are stated in this Article without reference to the location of 'title' to the collateral." \textit{Id.}

Although this provision shows an intent to downplay the concept of title under article 9, it may be argued that it pertains only to title in the collateral and thus does not apply to the question of whether a buyer of the collateral must have title in order to qualify as a buyer in ordinary course of business. \textit{But see} U.C.C. § 9-101, Official Comment which states broadly that: "Rights, obligations and remedies under the Article do not depend on the location of the title . . . ."

90. 59 Wis. 2d 219, 208 N.W.2d 97 (1973).
91. \textit{Id.} at 239, 208 N.W.2d at 106.
that title had not passed to Adamatic under the contract since the parties intended delivery to be an integral part of the title-passing process.

Additionally, the court relied on section 2-402(3)(a) which states that "[n]othing in this Article shall be deemed to impair the rights of creditors of the seller (a) under the provisions of the Article on Secured Transactions . . . ." Thus, the court found: "Chrysler must either return the goods or account for their value; and under [section 9-502(2)] Lakeshore [the secured lender] is obligated to account to the receiver, as the successor to Adamatic, for so much of the value of the goods as exceeds Lakeshore's interest." The court's result is harsh in view of the fact that Chrysler had substantially paid the contract price. The court noted that from an equitable standpoint the result was unsatisfactory since Adamatic had remitted Chrysler's progress payments to the secured lender as they were made. This double-recovery result has been criticized as follows:

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

It may be stated then that under the Chrysler holding, title must have passed to the buyer either under the contract or by delivery of the goods before the buyer will become a buyer in ordinary course under section 9-307(1). The fact that a buyer may have had replevin rights or that the goods have been previously identified will not suffice, even where substantial payment has been

92. Id. at 241, 208 N.W.2d at 107.
93. Id. at 243, 208 N.W.2d at 108. In another portion of the opinion, unrelated to the scope of this Note, the court held Chrysler entitled to other delivered equipment although the equipment had been returned to Adamatic for additional refinement under a bailment agreement. The court noted that Chrysler's initial possession constituted an acceptance and that Chrysler had not revoked its acceptance or rejected the goods by redelivering the goods to Adamatic for adjustment. Id. at 235-36, 208 N.W.2d at 104-05.
94. Id. at 241, 208 N.W.2d at 108. “From the viewpoint of equity, this is an unsatisfactory result, for the record shows that, prior to the replevin, Chrysler had substantially paid the contract price for all the goods involved.” Id.
95. Skilton, supra note 4, at 17 n.50.
96. See U.C.C. § 2-501(b) (identification of future goods occurs when “shipped, marked or otherwise designated by the seller as goods to which the contract refers.”) Although the court, in Chrysler, expressed some doubt, there seems
made.

However, the court did suggest that a financing buyer could avoid this precarious situation by arranging with the secured lender to subordinate the secured lender's security interest in the goods.97 This raises an important, related question as to whether the buyer and seller could agree to identify and pass title prior to the times otherwise provided under sections 2-501 and 2-401 and escape the Chrysler result. In reference to this question, one commentator has stated: "It is perfectly clear, for example, that the parties may agree that completion of conforming goods by the seller results in both identification and passage of title [under sections 2-401(1) and 2-501(1)]. The emergence of the buyer's possessory remedies can perhaps be accelerated by this."98

It is especially important to provide for early identification under section 2-501 since section 2-401(1) states that "[t]itle to goods cannot pass under a contract for sale prior to their identification to the contract."99 While apparently a buyer and seller could contractually agree to early identification and passage of title, a different question is presented where early identification and passage of title are intended to affect rights of secured parties. It has been stated that:

The real question is the effect of this agreement on third parties who assert claims to the same goods. The short answer is that unless the requirements of article 9 are met the agreement will have no effect.

Why is this so? Although not expressly stated in section 1-102(3), there is little doubt that seller and buyer cannot by agreement impair or destroy the rights of third persons not parties to the contract. . . . Further, although a "special property" interest under article 2 does afford some protection to the "financing" buyer's credit or interest, there is a point at which the use of the property interest to achieve security results becomes improper. That point is reached where the "special property" interest is asserted in a way that conflicts with rights given to creditors and purchasers under article 2 or other provisions of state law. Beyond this point, the planned transaction arranged exclusively under article 2 is ineffectual. Thus, in order to create a security interest in goods which will be effective against the seller and third parties, the "financing" buyer must meet the requirements of article 9.100

This reasoning would seem to be equally applicable to the nonfinancing buyer who makes an agreement with the seller for a

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97. 59 Wis. 2d at 242, 208 N.W.2d at 108.
99. U.C.C. § 2-401(1).
100. Speidel, supra note 98, at 291.
contractual term which provides for identification and passage of title intended to affect rights between the parties and secured creditors. However, in the more typical nonfinancing buyer scenario, the buyer claiming free ownership of the goods as a buyer in ordinary course is not attempting to create a security interest in the goods. Rather, he is merely claiming that under section 9-307(1) he has taken the goods free of the secured party's rights in the collateral.

To say that a "special property" interest is ineffectual if as-

101. It may also be possible to accelerate the passage of title by reference to a custom or usage of trade. But see Doppelt v. Wander & Co., 19 U.C.C. Rep. Serv. 503 (N.Y. Civ. Ct. 1976) (holding that proof of an alleged custom and usage among jewelry dealers that a sale is complete and that title is considered to pass when a buyer indicates to the seller that he is buying the merchandise is inadmissible to contradict the plain and unambiguous terms of the agreement).

102. In Rex Financial Corp. v. Mobile America Corp., 119 Ariz. 176, 176-77, 580 P.2d 89, (Ct. App. 1978), the court ignored a provision in the purchase agreement which recited that "even though physical delivery of the [mobile] home might not be made until a later date, title to the home passed to the [buyers] as of the signing of the security agreement."

103. Conversely, as an inventory financing planning option, there seems to be no direct Code prohibition to an inventory financer's insistence that the seller covenant to include a provision in all purchase agreements that a purchaser does not acquire an interest for § 9-307(1) purposes until a certain point in the sale sequence, i.e., contract date, identification, title passage, delivery, etc. Thus, the risk of loss under § 9-307(1) due to the seller's default would be shifted to the executory buyer, leaving him with a claim against the seller to recover partial payment under the contract.

Limitation of the prospective purchaser's § 9-307(1) rights until an ascertained point in the sale sequence under the above circumstances is distinguishable from the situation in which the buyer and seller unilaterally agree to accelerate buyer in ordinary course status. As the secured lender is not a party to this acceleration agreement, it is deprived, without assent, of vested rights against purchasers of the collateral under § 9-201. However, where the seller and a prospective purchaser contractually agree to limit buyer in ordinary course status to a certain point in the sale sequence, the purchaser is surrendering only a potential right which would not vest until buyer in ordinary course status is otherwise achieved under state law. Thus, the purchaser agrees only to a postponement of that status.

Where there is no case law which sanctions the practice, it appears that the buyer and seller would have wide discretion to contractually provide for the point at which buyer in ordinary course status is achieved under § 9-307(1). But see U.C.C. § 1-102(3) which provides:

The provisions of this Act may be varied by agreement, except as otherwise provided in this Act and except that the obligations of good faith, diligence, reasonableness and care prescribed by this Act may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.
asserted to conflict with the rights of the seller's creditors merely restates rather than resolves the problem. Conflict between the interests of secured creditors and purchasers of collateral is inherent in the operation of section 9-307(1). At some point, the secured party must surrender its security interest in the collateral in favor of the purchaser and look to the proceeds under section 9-306(2). Thus, the proper inquiry is not how to avoid conflict between the buyer in ordinary course and the seller's secured lender but rather how to seek a fair accommodation between these competing interests within the letter and spirit of the Code.

So where does this leave a purchaser of collateral if he may not accelerate identification and passage of title to protect himself against the holder of a perfected security interest? The harsh result reached in Chrysler and in other jurisdictions which have adopted passage of title as the determinative point for buyer in ordinary course status may be criticized in several ways. First, nowhere in the Code is there any indication that passage of title is necessary to achieve buyer in ordinary course status. Second, reliance on the acquisition of title is objectionable on the ground that it imposes an artificial barrier between the transactional expectations of the parties and commercial reality. It bears no reasonable relationship to buyer and seller expectations that a sale has been consummated and that the goods "belong" to the buyer. These expectations are not diminished merely because the purchaser is pursuing contractual remedies against a seller, his creditor, or his trustee in bankruptcy. Two examples will serve to illustrate the absurdity of extinguishing a purchaser's contractual rights in favor of a secured lender for the reason that there has not been a passage of title either by agreement of the parties or under section 2-401. Consider the situation where a buyer has purchased goods subject to a perfected security interest and, in violation of the agreement between the buyer and seller, the seller, prior to default and foreclosure, has inadvertently failed to place the goods on his shipping dock as agreed upon under the contract. The Code would mandate holding for the secured lender because, absent explicit agreement by the parties, title could not have passed for "the seller has not complete[d] his performance with reference

104. Speidel, supra note 98, at 291.
107. Id.
108. Id.
109. Id.
to the physical delivery of the goods." Or suppose that the parties expressly agreed that title was to remain in the seller until full payment for the goods was made, and that the buyer, as in Chrysler, has paid nearly all of the purchase price. If the seller defaults or becomes insolvent and the buyer cannot otherwise meet the requirements of sections 2-502 or 2-716 the buyer, not vested with title, will lose his interest in the collateral to the seller's secured lender.

In both examples, applying a passage of title test and allowing the secured party to obtain the collateral would contravene the Code's policy of liberal construction in order "to simplify, clarify, and modernize the law governing commercial transactions." This policy would be furthered in example one by allowing the purchaser to obtain the goods and require the secured lender to resort to the proceeds under section 9-306(2). And, as in example two, where a buyer has partially paid the purchase price under a contract for the sale of goods, he should be given the choice to either pursue appropriate remedies against the secured party to recover the amount already paid or pay in the remaining balance and preserve his rights in the goods, provided the transaction is ordinary or typical in the seller's business.

Two additional considerations suggest that the passage of title rules should not determine buyer in ordinary course status. First, in the usual scenario where a purchaser and a secured party are embroiled in litigation over the buyer in ordinary course issue, it is the conduct of the seller, with whom the secured lender has chosen to deal at the risk of default or insolvency, whose conduct has brought about the dispute. Second, under the "ordinary course of business" language of section 1-201(9), the proper inquiry is whether the seller's transaction with the buyer was in the ordinary course of the seller's business. Where the seller's disposition of the goods conforms to the seller's ordinary course of business, the secured lender should not be "unjustly enriched" through double recovery by claiming a security interest in the goods and the proceeds of amounts already paid. The artificiality and techni-

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110. U.C.C. § 2-401(2).
111. U.C.C. § 1-102(1).
112. Id. § 1-102(2)(a).
113. See notes 63-68 & accompanying text supra.
114. See notes 60-62 & accompanying text supra.
115. See note 20 & text accompanying notes 36-38 supra.
116. Equity is another ground which may be invoked to protect the buyer of collateral. Under the provisions of U.C.C. § 1-103, the drafters of the Code intended to reintroduce the general use of equitable principles into the law governing commercial transactions. See DePaulo v. Williams Chevrolet-Cadillac, Inc. 3 U.C.C. Rep. Serv. 600, 604 (Lebanon, Pa. C.P. 1966).
cality inherent in the title rules create a situation contrary to the spirit of promoting commercial transactions which is evident throughout the Code.\textsuperscript{117}

D. The Delivery and Acceptance Date

One area of judicial agreement in the buyer in ordinary course issue is that delivery and thus possession are unnecessary to qualify, even when passage of title is deemed the determinative point.\textsuperscript{118} Passage of title does not depend upon transfer of possession.\textsuperscript{119} Under the acceptance provisions of section 2-606, there is no provision for acceptance of title since, as Official Comment 2 states, “acceptance of title is not material under this Article to the detailed rights and duties of the parties.”\textsuperscript{120} Since there are no particularly compelling reasons for refusing to recognize buyer in ordinary course at much earlier stages of the transaction, there is much less reason for conditioning buyer in ordinary status upon delivery or acceptance.\textsuperscript{121}

\textsuperscript{117} See, e.g., U.C.C. § 1-102(1)-(2).
\textsuperscript{119} See U.C.C. § 2-401(2).
\textsuperscript{120} U.C.C. § 2-606, Official Comment 2.
\textsuperscript{121} However, one commentator has concluded that one cannot be a buyer in ordinary course prior to taking delivery of the goods. This conclusion was reached through analogy to U.C.C. § 9-301(1) which provides that where a secured party attempts to enforce his security interest against a buyer of the collateral, a buyer will defeat an unperfected security interest only if the buyer obtains possession. The author concludes that under U.C.C. § 2-402 (which generally provides for the rights of a buyer in the ordinary course of business who takes from a seller of entrusted goods) and U.C.C. § 2-403(2) (which empowers a seller to transfer all rights of an entruster to a buyer in ordinary course), a buyer must obtain possession before becoming a buyer in ordinary course. See Smith, Title and the Right to Possession Under the Uniform Commercial Code, 10 B.C. INDUS. COM. L. REV. 39, 60-61 (1968). The analogy seems a bit strained. Initially, it should be noted that U.C.C. § 2-403(2) makes no mention of possession as a requirement for a buyer of entrusted goods to qualify as a buyer in ordinary course. Further, U.C.C. § 9-301 deals not with a buyer in ordinary course of business but rather “a person who is not a secured party and who is a transferee in bulk or other buyer not in ordinary course of business.” U.C.C. § 9-301(1)(c) (emphasis added). Thus, U.C.C. § 9-301 should not be applicable to a determination of the rights of a buyer in ordinary course of business under U.C.C. § 9-301(1). See Chrysler Corp. v. Adamatic, Inc., 59 Wis. 2d 219, 230, 208 N.W.2d 97, 107 (1973) where the
III. A PROPOSED AMENDMENT

Under the present Code, where a buyer has contracted for a sale from inventory, the buyer should take free of a secured lender's perfected security interest in the collateral where the transaction is ordinary or typical in the seller's business. This result fairly accommodates the transactional expectations of the buyer and seller as well as the secured party's interest in goods held for sale in the ordinary course of the seller's business.

However, the most satisfactory resolution of the buyer in ordinary course issue may lie in an amendment to the Code. The present judicial tendency to resolve this issue under article 2 has provided secured parties and purchasers of collateral with little more than inconsistent decisions to answer the question of when the rights of a buyer in ordinary course attach under section 9-307(1). Utilization of article 2 concepts, beyond contract formation, is unsatisfactory in part because of the arbitrary manner in which section 9-307(1) disputes are resolved and also because of the absence in article 2 of any express guidance beyond the general concepts of contract formation, identification, and title. Harsh and inconsistent results can be expected to continue where the selection and application of rules can be supported by little more than their ease of application to varying factual circumstances.

There is some force to the view that a foreclosing secured lender should not incur liability to executory buyers in repossessing a defaulting seller's inventory. This is particularly compelling where consulting the seller's business records or inspecting the inventory would not inform the secured lender of the outstanding interests in collateral possessed by executory buyers. The ability to readily make such a determination is important, for where the secured party frustrates the transactional expectations of an executory buyer and the buyer initiates a conversion action against the secured party "[a] mistake of fact or law is no defense." 122

Utilizing language patterned after that in sections 9-501 to -507, the Code could be amended123 to provide that a contract which

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123. Section 1-201(9) would be amended to read as follows:
"Buyer in ordinary course of business" means a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods contracts to buy from a person in the business of selling goods of that kind but does not include a pawnbroker.

Section 9-307(1) would be amended to read:
meets the requirements of both article 2 and applicable state law is sufficient to allow the purchaser to take collateral free of a security interest.

(1) 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; provided, the buyer has contracted to buy the goods and
   (a) records kept in the ordinary course of the seller's business reasonably available to the secured lender; or
   (b) marking or labeling by the buyer or seller of goods which constitute the subject matter of the transaction would apprise a reasonably prudent secured lender exercising ordinary care that the goods are subject to the contractual interest of a buyer;

(2) Under subsection (1), if the secured party would not be so apprised of a buyer's contractual interest, the secured party shall not be liable to a buyer who has contracted to buy the goods against which the secured party has exercised the remedies provided under Part 5 of this Article; provided, that where the secured party has
   (a) actual knowledge of a buyer's contractual interest in the goods; or
   (b) a reasonably prudent secured party exercising ordinary care under subsection (1)(a) or (b) would be apprised of the buyer's contractual interest

the secured party shall, prior to disposition of the collateral, conduct reasonable efforts to notify such buyers that the goods are subject to the secured party's rights to sell, lease or otherwise dispose of the collateral pursuant to Part 5 of this Article and that the goods may be taken free of the security interest upon written notification of demand therefor and tender of the unpaid balance of the purchase price within a reasonable time following such notification efforts. If requested by the secured party, the holder of a contractual interest must seasonably furnish reasonable proof of his interest, and unless he does so, the secured party need not comply with his demand.

(3) When collateral is disposed of by a secured party after default and after a reasonable time since notification efforts have been made by the secured party where required under this section and where no buyer has made written notification of demand and tender under subsection (2) within a reasonable time after such notification efforts, the buyer shall have no right to recover from the secured party for any loss or damages caused by such disposition. Such disposition transfers to a purchaser for value all of the buyer's rights therein and the purchaser takes free of such rights even though the secured party fails to comply with the requirements of this section, or of any judicial proceedings
   (a) In the case of a public sale, if the purchaser has no knowledge of any defects in the sale and if he does not buy in collusion with the secured party, other bidders, or the person conducting the sale; or
   (b) in any other case, if the purchaser acts in good faith.

(4) If it is established that the secured party is not proceeding in accordance with the provisions of this section disposition may be ordered or restrained on appropriate terms and conditions. If the disposition has occurred in violation of the provisions of this section any person entitled to reasonable notification efforts prior to the disposition has a right to recover from the secured party any loss caused by
interest, provided, that upon the seller's default, records kept in
the ordinary course of the seller's business, or markings or label-
ings of the inventory would inform a reasonably prudent secured
lender that the goods have been "sold" for section 9-307(1)
purposes.\textsuperscript{124}

Prior to exercising his rights under part 5 of article 9, the se-
cured lender would have the opportunity to inspect the seller's
records and inventory to determine the amount of collateral avail-
able to satisfy the secured debt. Accordingly, the secured lender
would act at his own peril in seizing and selling inventory without
first conducting a reasonable inquiry to determine whether the col-
lateral was subject to the contractual interests of an executory
buyer. If the secured lender has actual knowledge of the contract-
ual interests of executory buyers or in the exercise of ordinary
care would, upon inspection of the seller's records and inventory,
be so apprised, the secured lender must make reasonable efforts to
notify the buyers that the goods are subject to the secured lender's
interest.

The proposed amendment provides a purchaser of collateral
special protection from a secured party and provides that a se-
cured party shall not be liable for claims by the buyer if the se-
cured party complies with the reasonable notification requirement
and a reasonable time has passed prior to disposition of the collat-
eral. The buyer has the burden of establishing a valid contract
with the seller and is given the opportunity, within a reasonable
time following the secured party's notification efforts, to enforce
his original contract by making demand and tendering payment of
the remaining contract price to the secured party. If the buyer
does not choose to do so, the secured party may sell, lease, or
otherwise dispose of the goods, free of liability to an executory
buyer.

The above changes to sections 1-201(9) and 9-307(1) strike a fair
balance between the competing interests of the buyer and secured
party in the collateral. The buyer can protect his contractual in-
est in the collateral by marking or labeling the goods to supple-
ment, or in cases of insufficient sales records, in place of, the
seller's records. A buyer who wishes to pursue his contractual in-

\textsuperscript{124} Thus, a buyer who "contracts to buy goods" would qualify as a buyer in ordi-
nary course. See U.C.C. §§ 2-103(1)(a), 1-201(11).
INTEREST in the seller's inventory may do so by making written demand and tender of the unpaid balance to the secured party within a reasonable time after notification efforts. The diligent secured party may exercise his foreclosure and sale remedies free from the fear of liability to an otherwise unaccounted for purchaser of the collateral.

IV. CONCLUSION

The question of when a purchaser of goods which serve as collateral for a loan qualifies as a buyer in ordinary course of business is too important a question to leave to determination by the courts without express guidance by the drafters of the Code. The decisions are far from agreement as to when the process of buying has progressed sufficiently for a purchaser to have achieved this protected status. The critical point at which buyer in ordinary course status is determined should reflect a consideration of which party is best able to bear the risk of its commercial dealings and which, in fairness, should bear that risk. Under the present Code, the seller's secured lender is that party. The choice of protecting an innocent purchaser's transactional expectations in the ordinary course of the seller's business should be held paramount to the secured lender's interest in collateral held for sale.

Under the present Code, if the parties have contracted to buy and sell in the ordinary course of the seller's business and the transaction is typical in the seller's business, the security interest in goods should be severed under section 9-307(1) and the buyer should be entitled to the goods free of the ownership claims of the secured lender. However, a better balance between the buyer's and secured lender's interests can be struck by adoption of the proposed Code amendments. Under the proposal, both parties are afforded the opportunity to protect their transactional expectations by dealing diligently with the seller and the collateral and without unduly restricting commercial activities.

Through both the suggested interpretation of the Code and the proposed amendment, section 9-307(1) properly operates as a buyer protection mechanism and promotes the Code's spirit of free-flowing commercial transactions. The added administrative burdens on the inventory financing industry are reasonable and, in the long run, will serve to better protect the legitimate concerns of all interested parties.

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125. See Skilton, supra note 4, at 88.