1-1-1979

The UCC Framework: Conveyancing Principles and Property Interests

John F. Dolan
Wayne State University

THE U.C.C. FRAMEWORK: CONVEYANCING PRINCIPLES AND PROPERTY INTERESTS†

JOHN F. DOLAN*

I. INTRODUCTION

Many of the difficulties that confront courts and practitioners in applying the Uniform Commercial Code stem from their failure to treat the Code as an integrated statute. Commercial lawyers tend to study the eight substantive Articles as independent units, without relating them to each other or perceiving the basic themes that hold the Code together. A number of observers have gone so far as to conclude that the Code has come unstuck and that the Articles sometimes conflict with one another.[1]

The purpose of this article is to examine the Code as a single construct resting on four basic property interests and three basic conveyancing principles. The property interests—title, special property, security interest, and lien—are the starting point for effective Code analysis. We cannot properly invoke the Code's remedy and priority rules without first discerning which property interests the disputing parties enjoy. Ultimate reconciliation of the conflicting interests turns on application of the three conveyancing principles. Security of property—the notion that the taker receives exactly what his transferor had to give—serves as the standard. In some circumstances, estoppel considerations may justify departure from this standard. When a seller or his creditor engages in conduct that misleads a buyer, the good faith purchase principle will protect the buyer by allowing him to take more than his transferor had to convey. When the buyer engages in conduct that misleads the seller's creditors or other third parties, the principle of *Twyne's Case*[2] and the ancillary doctrine of ostensible ownership will force the buyer to take less than the seller might have given. To deviate from security of property, then, a party must fit his claim into one of these two categories.

This article begins by discussing the three conveyancing principles and the four property interests and by identifying their place in the Code. It then reviews several cases which demonstrate the prevailing tendency of courts and litigators to misperceive or ignore the Code's analytic frame-

* Professor of Law, Wayne State University Law School. I would like to express special thanks to my student research assistants, Barbara Grossman and Robert Seibert, who helped with the research for this article, and to my colleagues Professor Martin Adelman and Professor Steven Harris who reviewed portions of an early draft.

[1] *See, e.g.*, Dugan, Cash-Sale Sellers Under Article 2 and 9 of the Uniform Commercial Code, 8 Uniform Com. L.J. 330 (1975); Jackson & Peters, Quest for Uncertainty: A Proposal for Flexible Resolution of Inherent Conflicts Between Article 2 and Article 9 of the Uniform Commercial Code, 87 Yale L.J. 907 (1978); Kamp & Solove, Seller vs. Secured Party: Searching for an Intangible Something, 28 Mercer L. Rev. 625 (1977).

[2] 76 Eng. Rep. 809 (Star Chamber 1601). The rule of *Twyne's Case* is discussed in Section II C *infra*.

work. Throughout, the article emphasizes the economic and mercantile policies that the Code's conveyancing principles and property interests foster. It is those policies which suffer when courts fashion commercial rules without understanding the dynamics of the Code.

II. The Three Conveyancing Rules

The three conveyancing rules discussed here determine whether the purchaser or other taker receives an interest equal to, greater than, or less than the interest of the transferor.

A. *Security of Property: The Shelter Principle*

The Code's conveyancing rules, deferring to freedom of contract,[3] begin with the shelter, or umbrella, principle: the taker receives everything the transferor had to convey.[4] Through this security of property doctrine, a transferor may convey goods to a purchaser free and clear so long as the goods are not subject to any liens or other interests. Generally, the conveyance will be valid even though it may disappoint the transferor's creditors.[5] A necessary corollary of this first principle is that the taker's interest cannot rise any higher than the interest of the transferor.[6]

The shelter principle is an old rule, steeped in the notion of free alienability—that is, that full enjoyment of private property requires legal mechanisms which guarantee the owner's right to convey that property—as well as in the rigors of logic that one cannot give what one does not have.[7] It is a rule that acknowledges commercial realities. For example, the ownership rights of a good faith purchaser, who may receive *more* than his transferor had to give by operation of the good faith purchase rule dis-

---

[3] The Code acknowledges that freedom of contract serves as one of its basic policies. *See* U.C.C. § 1-102(2)(b).

[4] This general security of property principle is codified in U.C.C. §§ 2-403(1) (sale of goods), 3-201(1)-(2) (transfer of an instrument), 7-504(1) (rights acquired in absence of due negotiation), 8-301(1) (transfer of a security), and 9-201 (general validity of security agreements). Specific shelter rules include U.C.C. §§ 2-506(1) (rights of financing agency on purchase of shipping draft) and 9-206(1) (rights of seller's assignee against buyer or lessee).

[5] The Code does carve out an exception for such creditors in some instances where the buyer has misled them by leaving the goods with the seller. *See* U.C.C. § 2-402(2); Section II C *infra.*

[6] *See, e.g.*, U.C.C. §§ 2-402(1) (rights of seller's unsecured creditors are subject to buyer's right to recover goods), 2-403(1) (purchase of limited interest in goods), 3-306 (transferor who is not holder in due course takes subject to all claims and defenses), 6-110(1) (limitation on interest of transferee in defective bulk sales transfer), 8-301(2) (transfer of limited interest in securities), 9-318(1) (rights of seller's assignee are subject to claims and defenses of account debtor).

[7] *Non dat qui non habet. See, e.g.*, Barthelmess v. Cavalier, 2 Cal. App. 2d 477, 487, 38 P.2d 484, 490 (1934) ("Title, like a stream, cannot rise higher than its source."); Wheelright v. Depeyster, 1 Johns. 471, 479 (N.Y. 1806) ("[*N*]*emo plus juris in alium transferre potest quam ipse habet*"—No one can transfer more right to another than he has himself.); Cundy v. Lindsay, 3 App. Cas. 459, 463-64 (H.L. 1878) ("[B]y the law of our country the purchaser of a chattel takes the chattel as a general rule subject to what may turn out to be certain infirmities in the title.").

cussed below,[8] are not sufficiently protected unless he can subsequently transfer his full interest to a third party.[9]

The security of property doctrine has broad application to a variety of commercial transactions. Thus the shelter principle is a recurring theme throughout the Code. Both the Sales and Secured Transactions Articles adopt it as their basic premise. The former stipulates that "[a] purchaser of goods acquires all title which his transferor had . . . ."[10] The latter provides that "a security agreement is effective according to its terms . . . against purchasers . . . ."[11] The rules of Article 3 governing negotiable instruments also illustrate the principle. Through the security of property doctrine, a holder of a negotiable instrument, though not himself a holder in due course, may enjoy the benefits of his transferor's holder-in-due-course status. If, for example, a seller of defective goods negotiates the buyer's check to *A*, a holder in due course, *A* takes free of the buyer's contract defenses.[12] When *A* conveys the negotiable instrument to *B*, *B* succeeds to *A*'s superior rights even though *B* may not qualify as a holder in due course.[13] *B* takes what *A* enjoyed: rights in the instrument free from the defense of failure of consideration.[14] Corresponding shelter benefits apply to transactions covered by Articles 7 and 8. Any purchaser of negotiable documents of title who takes from a "qualified holder"[15] enjoys the rights of such qualified holder.[16] Similarly, a purchaser of securities who takes from a bona fide puchaser receives the protection of bona fide purchaser status, even though he himself does not satisfy the bona fide purchaser rule.[17]

B. *Good Faith Purchase*

The security of property principle manifested in these various shelter rules applies to all conveyances unless contrary, identifiable policies dictate limitations on it. Good faith purchase, the second of the three basic conveyancing principles, is the first such limitation.

In direct opposition to the security of property postulate that one cannot give what one does not have, the good faith purchase rule permits the taker

---

[8] *See* Section II B *infra.*

[9] *See* U.C.C. § 3-201, Comment 3.

[10] U.C.C. § 2-403(1).

[11] U.C.C. § 9-201.

[12] The doctrine of negotiability, a good faith purchase rule, gives *A* greater rights than his transferor enjoyed. *See* U.C.C. § 3-305(2); Section II B *infra.*

[13] *See* § 3-201(1) and Comment 3. Of course, *B* will not receive *A*'s superior rights if *B* was himself a party to any fraud or illegality in the original transaction. *Id.*

[14] *See, e.g.,* Perini Corp. v. The First Nat'l Bank, 553 F.2d 398, 418 (5th Cir. 1977); Bowling Green, Inc. v. State Street Bank and Trust Co., 425 F.2d 81, 83-84 (1st Cir. 1970); Third Nat'l Bank v. Hardi-Garden Supply, Inc., 380 F. Supp. 930, 944 (M.D. Tenn. 1974).

[15] This article uses the term "qualified holder" to mean a holder to whom a negotiable document of title has been duly negotiated. *See* U.C.C. § 7-502(1).

[16] *See* U.C.C. § 7-504(1).

[17] *See* U.C.C. § 8-301(1). In Gutekunst v. Continental Ins. Co., 486 F.2d 194, 196 (2d Cir. 1973), for example, a bona fide purchaser of stolen bearer securities wished to convey those securities to its insurance carrier. The shelter principle facilitated that transfer by giving the carrier the full protection that the purchaser had enjoyed, thereby enhancing the purchaser's protection.

to receive interests greater than those his transferor possessed. Courts have rationalized this departure from the logic of the shelter principle in two ways.[18] Some assert that it is a question of the fault or negligence of the true owner or his creditor. These cases emphasize the culpability of a property owner who does not take care to protect his interest in the property when introducing it into the channels of commerce. He thereby misleads an innocent purchaser who relies on the appearance that the owner's negligence has created.[19] Other courts view the issue as essentially an economic one. These cases opt for the good faith purchase principle as commercially convenient and regard indiscriminate use of the security of property approach as wasteful.[20]

Both doctrines evolved in response to perceived needs. The propertied classes reacted against the primitive rule that strength determined ownership. Staunch notions that a man should never be stripped of property without his consent[21] flowed naturally from the prairie frontier[22] and from high seas traversed by privateers,[23] and demanded the development of rules upholding security of property in the face of a lawless taking.[24] The good faith purchase doctrine responded to a different set of needs. It is no

---

[18] A third justification—based on the intent of the true owner—sometimes appears in cases involving the voidable title rule. This rule is a curious blend of good faith purchase and security of property doctrines. It applies when the true owner enters into a contract to convey goods to a person who defrauds him, often by uttering a bad check. The true owner, some courts say, intended to pass title to the fraudulent party, so that when the fraudulent party in turn conveys to the good faith purchaser for value, that purchaser takes good title. Thus for these courts, the rule turns on the question of the true owner's intent. If he intended to give good title to the fraudulent party, title passes and the fraud's purchaser obtains that title too. Absent such intent these courts would not give title to the good faith purchaser. *See, e.g.*, Phelps v. McQuade, 220 N.Y. 232, 234, 115 N.E. 441, 442, 143 N.Y.S. 822, 824 (1913); Cundy v. Lindsay, 3 App. Cas. 459, 465-66, 469 (H.L. 1878). *See generally* 3 S. Williston, The Law Governing Sales of Goods § 625(a), at 409 (rev. ed. 1948) and cases cited therein. The Code rejects this rationale. Section 2-403(1) recites four fact situations in which such intent is lacking but to which it applies the voidable title rule.

[19] *E.g.*, McNeil v. The Tenth Nat'l Bank, 46 N.Y. 325, 329 (1871) ("[The rights of bona fide purchasers] in such cases do not depend upon the actual title or authority of the person with whom they deal directly, but are derived from the act of the real owner, which precludes him from disputing, as against them, the existence of the title or power which, through negligence or mistaken confidence he caused or allowed to appear to be vested in the party making the conveyance."). *See* Pickering v. Busk, 104 Eng. Rep. 758 (K.B. 1812). *Cf.* U.C.C. § 3-406 (one who "by his negligence substantially contributes" to a material alteration or unauthorized signature on a negotiable instrument is precluded from asserting unauthorization as a defense).

[20] *See, e.g.*, McNeil v. The Tenth Nat'l Bank, 46 N.Y. 325, 339 (1871); Miller v. Race, 97 Eng. Rep. 398, 402 (K.B. 1758).

[21] *E.g.*, Fawcett v. Osborn, 32 Ill. 411, 424 (1863) ("[I]t is a universal and fundamental principle of the law of personal property, that no man can be divested of it without his own consent."). *See also* Cundy v. Lindsay, 3 App. Cas. 459, 470-71 (H.L. 1878).

[22] *See* Fawcett v. Osborn, 32 Ill. 411 (1863).

[23] *See* Wheelwright v. Depeyster, 1 Johns. 471 (N.Y. 1806).

[24] [W]hen notions of property were slight, a *bona fide* purchase of stolen goods gave good title against the original owner; but . . . in the progress of society, property acquired such stability and energy, as to affect the subject wherever found, and to exclude even an honest purchaser, when the title of his vendor was discovered to be defective.

Id. at 480.

accident that Lord Mansfield and others familiar with mercantile practices[25] readily accepted the argument that strict adherence to the security of property dogma would strangle commercial intercourse, whose advancement demanded freeing the buyer from the duty of costly title inquiry.

It is fair to say, then, that property owners preferred security of property while the merchant class preferred security of purchase. Much of the history of commercial law has been a dispute between these competing interests. The Code properly accepts the validity of both doctrines and uses first one and then the other pursuant to a well-defined pattern. Specifically, in the process of balancing the elements of fairness to the parties, culpability for ownership misunderstandings, and commercial celerity, the Code employs the good faith purchase principle to facilitate and protect transactions that are regular.[26]

The good faith purchase principle appears in a number of rules. One of the most commercially significant is the rule of negotiability, whereby a holder in due course takes a negotiable instrument free from all claims and from most of the obligor's defenses arising out of the underlying transaction.[27] Although this rule operates in favor of only those who meet the holder in due course definition,[28] that definition fits most persons who deal honestly in fact and who have no knowledge of the defense or claim. Thus, the rule fosters transactions that are regular.[29]

---

[25] For example, see Blackstone's defense of "market overt," an English good faith purchase rule never adopted in the United States, 2 W. Blackstone's Commentaries *449, and Lord Mansfield's strong support for the negotiability of bank notes in Miller v. Race, 97 Eng. Rep. 398 (K.B. 1758).

[26] Professor Gilmore stresses that the good faith purchase doctrine rests on commercial practices. Gilmore, The Commercial Doctrine of Good Faith Purchase, 63 Yale L.J. 1057, 1057 (1954). Professor Llewellyn points out that it does not find ready application to "housewives." 1 Rep. of the [N.Y.] Law Revision Commission for 1954, Hearings on the Uniform Commercial Code 108. Purchases by consumers out of a retailer's inventory are, of course, commercial in nature and would be covered by the good faith purchase principle. *See, e.g.*, U.C.C. § 9-307(1).

Good faith purchase rules designed to facilitate and protect regular transactions include U.C.C. §§ 2-403(2) and Comment 2 (goods entrusted to merchant who deals in such goods regularly), 2-506(2) (purchase of shipping draft by financing agency), 7-205 (fungible goods sold by warehouseman who deals regularly in such goods), 7-208 (purchase of altered warehouse receipt), 7-504(2)(b) (sale in ordinary course before bailee has received notice of transfer of document of title), 7-504(3) (consignor's diversion of delivery to buyer in ordinary course), 8-205 (good faith purchase of security with unauthorized signature), 8-206(1)(b) (good faith purchase of incorrectly completed security), 8-311 (good faith purchase of security with unauthorized endorsement or instruction), and 9-307(1)-(2) (priority of buyer in ordinary course over secured party).

[27] *See* U.C.C. § 3-305. For an early use of the rule of negotiability *see* Miller v. Race, 97 Eng. Rep. 398 (K.B. 1758), where Lord Mansfield commented that the court had no doubts about the negotiability of bank notes and that, although he would consider the authorities cited by the defendant, the court "would not wish to have it understood in the city, that the Court had any doubt about the point." *Id.* at 401. Thus the doctrine appears to have been firmly entrenched as early as 1758.

[28] U.C.C. § 3-302 defines the term "holder in due course."

[29] Other good faith purchase rules protecting buyers of negotiable instruments include U.C.C. §§ 3-119 (rights of holder in due course without notice are not affected by terms of extrinsic document), 3-207(2) (illegal, incompetent, or fraudulent negotiation not voidable against holder in due course), 3-406 & 3-407(3) (rights of holder in due course of materially

A similar concern for protecting the expectations of parties to regular transactions yields a good faith purchase rule that favors the buyer of goods from inventory. A "buyer in ordinary course"[30] will defeat both true owners[31] and perfected secured creditors[32] who permit the goods to remain in the hands of a person who sells such goods as part of his trade.[33] This rule balances the interests of the law's two most famous innocent parties, one of whom must bear the loss: the true owner or perfected secured creditor and the buyer in ordinary course. Less famous, and somewhat less innocent, than these antagonists are the creditor who fails to perfect his security interest and the good faith purchaser who does not buy in regular course. Again the Code strikes the balance for the bona fide purchaser, through the rule of voidable title[34] and through other general pro-buyer provisions.[35]

The pattern of protecting and facilitating regular transactions appears again in the good faith purchase rules of Articles 7 and 8. The bona fide purchaser of Article 8 securities cuts off claims and defenses,[36] as does the regular purchaser of negotiable documents of title, whom the Code inartfully dubs "a holder to whom a negotiable document of title has been duly negotiated."[37] Significantly, the Code views traffic in commodity paper as sufficiently confined to transactions between professionals that it limits application of the Article 7 good faith purchase principle to transactions in the ordinary course of "business or financing."[38]

C. *The* Twyne *Rule*

The third conveyancing principle embodies the notion that sometimes the purchaser must take less than his transferor had to convey. Just as fairness dictates that the true owner or creditor may not, by hiding his interest, mislead purchasers, so purchasers may not, by intentionally or

altered instrument), and 3-602 (holder in due course without notice is not subject to discharge of any party.)

[30] U.C.C. § 1-201(9) defines such a buyer.

[31] *See* U.C.C. §§ 2-403(2), 7-205.

[32] *See* U.C.C. § 9-307(1).

[33] The Code fashions a similar rule for those who acquire in the regular course of business or finance an interest in goods covered by negotiable documents of title. *See* U.C.C. §§ 7-501, 7-502, 7-503.

[34] *See* U.C.C. § 2-403(1); note 18 and accompanying text *supra.*

[35] U.C.C. § 9-301(1)(c)-(d) identifies those buyers not in ordinary course who will defeat unperfected secured creditors. Other Code provisions assisting good faith purchasers in transactions that may not fit within the definition of "ordinary course" include: § 2-702(3) (good faith purchaser defeats original seller's right to reclaim goods); § 2-706(5) (good faith purchaser defeats original buyer's rights on seller's resale); § 6-110(2) (good faith purchaser takes good title from transferee of a defective bulk sales transaction); § 7-210(5) (good faith purchaser at irregular sale to enforce warehouseman's lien defeats prior interests); § 7-308(4) (same rule for irregular sale to enforce carrier's lien); and § 9-504(4) (same rule for secured party's irregular sale).

[36] *See* U.C.C. § 8-302(1), (3). Other good faith purchase rules protecting buyers of securities are listed in note 26 *supra.*

[37] U.C.C. § 7-502(1). Other Article 7 good faith purchase rules are listed in notes 26 and 35 *supra.*

[38] *See* U.C.C. § 7-501(4).

negligently hiding the fact of sale, mislead creditors or other third parties. The doctrine originated to counteract deliberate deception of creditors but has been extended to situations where specific fraudulent intent is absent.

Examination of this third principle begins with *Twyne's Case.*[39] There the Star Chamber applied the Statute of Elizabeth[40] to convict Twyne of fraud for leaving goods with one Pierce, who had deeded them to Twyne in satisfaction of an antecedent debt. The justices agreed that the transfer had been for good consideration, but resolved that the secret nature of the sale—Twyne's leaving the goods with Pierce who had continued to exercise control over them as if they were his own—supported a criminal action for fraud against the purchaser.[41] Eventually, *Twyne's Case* came to stand for the principle that the defrauded creditor enjoys a cause of action against the buyer who leaves purchased goods with the seller.[42]

Although the Code does not explicitly incorporate the *Twyne* rule, it clearly contemplates *Twyne*'s continued vitality as an aspect of the conveyancing principle that sometimes the buyer takes less than the seller had to give. Section 2-402(2) defers to non-Code law and permits a seller's creditors to treat as void a sale accompanied by retention of possession if such conduct is considered fraudulent in the jurisdiction where the goods are located.[43] Most jurisdictions have adopted *Twyne* as part of their common law.[44] The Code refuses to mandate its use, however, and courts rarely invoke the rule in *Twyne's Case* even in situations on which its policy bears directly.[45]

---

[39] 76 Eng. Rep. 809 (Star Chamber 1601).

[40] 13 Eliz. 13, c. 5 (1570).

> By the [Statute of Elizabeth] for the avoiding of feigned, covinous, and fraudulent feoffments, gifts, grants, alienations, conveyances, bonds, suits, judgments, executions, &c. devised to the intent to delay, hinder, or defraud, creditors and others of their just and lawful actions, &c. it is enacted "that all and every feoffment, gift, grant, alienation, &c. and all and every bond, suit, judgment, and execution, for any intent or purpose before declared, shall be utterly void:" with a proviso that the Act shall not extend to any grants, &c. upon good consideration and *bona fide.*

Twyne's Case, 76 Eng. Rep. at 810 n.B.

[41] Twyne's Case, 76 Eng. Rep. at 814.

[42] *See, e.g.,* Sturtevant v. Ballard, 9 Johns. 337 (N.Y. 1811); Edwards v. Harben, 100 Eng. Rep. 315 (K.B. 1788).

[43] *See* U.C.C. § 2-402, Comment 1. *See generally* U.C.C. § 1-103. Section 7-504(2)(a) logically extends this protection to creditors of the transferor of a nonnegotiable document of title in certain circumstances.

Article 2 does impose one limitation on the use of the *Twyne* rule: retention of possession by a merchant seller in good faith for a commercially reasonable time is specifically exempted from attack as fraudulent. *See* U.C.C. § 2-402(2). The Code contains a parallel limitation in the area of security interests. Section 9-205 specifically states that it is not "fraudulent against creditors" for the secured party to allow the debtor to use, commingle, or dispose of the collateral. In this section, the Code drafters explicitly rejected the rule of Benedict v. Ratner, 268 U.S. 353 (1925), in which Justice Brandeis reviewed New York cases following the *Twyne* rule and determined that a security arrangement which allowed the debtor full dominion over the collateral was fraudulent and void as a matter of law. *See* U.C.C. § 9-205, Comments 1-4. Section 9-317 gives further protection to the secured party who permits the debtor to use and dispose of collateral by freeing the secured party from tort or contract liability for the debtor's acts or omissions in handling the collateral.

[44] *See generally* 2 S. Williston, *supra* note 18, § 1534, at 4315.

[45] For example, in the celebrated case of Tanbro Fabrics Corp. v. Deering Milliken, Inc.,

In contrast to section 2-402's deferential reliance on non-Code law to define fraudulent dispositions of purchased goods, other sections of the Code are more aggressive in penalizing buyers whose failure to take physical control of their purchases creates ostensible ownership in another. In these sections, the Code augments the protection afforded by the *Twyne* rule. The justices in *Twyne's Case* detected an inherent dishonesty in conveying all ownership rights in goods while retaining the possession and use of them.[46] Their decision emphasized that fraud arose because Pierce had made a "general"—*i.e.*, absolute—transfer of his interest to Twyne.[47] Thus, the common law rule developed that it was not fraudulent for the transferor to continue controlling the goods after a *conditional* conveyance.[48]

To the creditor relying on possession, however, the appearances, and the consequent danger of misreliance, are the same whether the prior conveyance was made with or without condition.[49] The Code responds to this practical consideration with several provisions that protect third party reliance on ostensible ownership created by possession, without regard to whether the actions of the buyer and seller suggest fraudulent intent. Article 2 defines "entrusting" to include "any acquiescence in retention of possession regardless of any condition expressed between the parties . . . ."[50] Under section 2-403(2), the purchaser who acquiesces in the

---

39 N.Y.2d 632, 350 N.E.2d 590, 385 N.Y.S.2d 260 (1976), the New York Court of Appeals does not refer to the *Twyne* rule and does not cite § 2-402(2) although both were directly relevant. *See* additional cases discussed in text accompanying notes 171-95 *infra;* Herman v. First Farmers State Bank, 73 Ill. App. 3d 475, 392 N.E.2d 344 (1979) (court rules in favor of buyer who left goods with seller, but opinion does not even mention § 2-402(2)).

Section 2-402(2)'s deference to non-Code law, its exception for some commercial sales, and the apparent reluctance of courts to impose the *Twyne* principle suggest a diminished role for this feature of conveyancing law. Diminished or not, the rule of *Twyne's Case* will provide some creditors with a viable argument against purchasers whose lax commercial practices may mislead.

[46] It should be noted that *Twyne* was not a case of a creditor relying to his detriment on the debtor's possession of goods which were not in fact his own. The creditor there had extended credit to Pierce *before* Pierce conveyed to Twyne. Thus the case cannot be explained as an example of judicial concern over the deceptive potential of ostensible ownership. Justice Brandeis, in *Benedict v. Ratner,* took pains to stress his view that the cases following *Twyne* were aimed at protecting the integrity of the idea of conveyancing—an integrity challenged by the transferor's continued dominion over the goods. 268 U.S. 353, 363 (1925). The concern of the Star Chamber and Justice Brandeis may merit more credit than commercial lawyers have given it. It is a fact, however, that most of them, more concerned with economics than with metaphysics, do not share that concern. *See, e.g.,* Brown v. Leo, 12 F.2d 350 (2d Cir. 1926), where Judge Learned Hand observed of a New York case applying the *Twyne* rule: "Just why this should be so we are not altogether clear." *Id.* at 351.

[47] Twyne's Case, 76 Eng. Rep. at 812-14.

[48] *See, e.g.,* Hamilton v. Russell, 5 U.S. (1 Cranch) 309, 316-17 (1803); Edwards v. Harben, 100 Eng. Rep. 315, 320 (K.B. 1788).

[49] For an early case recognizing this practical consideration and observing that continued possession by the seller is fraudulent "whether the sale be absolute or conditional," see Patten v. Smith, 5 Conn. 196, 200 (1824). The Connecticut Supreme Court emphasized that

> [i]t is so much of the essence of a sale, that there be a delivery of the possession, that to permit the chattels sold to remain in the hands of the vendor, is an extraordinary exception to the usual course of dealings, and requires a satisfactory explanation.

Id. at 199.

[50] U.C.C. § 2-403(3).

retention of goods by a merchant who deals in goods of that kind may lose to a buyer in ordinary course.[51] If the entrusting is to a bailor with actual or apparent authority to ship, store, or otherwise dispose of the goods, the buyer will lose to a qualified holder who subsequently obtains a bill of lading, warehouse receipt, or other document of title to the goods.[52]

The Code's most scrupulous protection of third party reliance on possession appears in Article 6.[53] This Article imposes strict limits on the alienability of goods sold in bulk. Unless he gives the seller's creditors at least ten days notice, the bulk sales buyer will lose to those creditors even though he takes prompt delivery.[54]

This third conveyancing principle, as manifested in the *Twyne* rule and in the Code's ostensible ownership rules, rests in large part on the premise that it is reasonable for third parties to make purchases or extend credit in reliance on goods in the possession of those with whom they deal. The modern practice in business financing of utilizing credit histories, financial statements and secured lending arrangements casts some doubt on the accuracy of that premise, at least so far as it applies to creditors.[55] Several provisions of the Code, moreover, render risky the practice of relying on the debtor's possession of inventory.[56] Nonetheless, creditors continue to make strident arguments against any moderation of the general principle that they should be able to rely on the debtor's possession,[57] and there is no merit to the proposition that because the commercial law fashions some exceptions to the ostensible ownership doctrine it must abrogate the doctrine altogether. There remains a measure of appeal to any commercial rule which resists practices that mislead. It is significant, moreover, that *Twyne* itself rests not on ostensible ownership reasoning, but rather applies absent any showing of reliance. *Twyne* protects the concept of conveyancing by refusing to divorce it completely from notions of possession or seisin.

---

[51] *Cf.* U.C.C. §§ 2-326, 9-114 (governing the rights of creditors of assignees and buyers in "sale on approval" and "sale or return" transactions).

[52] *See* U.C.C. § 7-503. *See also* U.C.C. §§ 7-209(3)(a) (when entrustor will be subject to warehouseman's lien or security interest), 7-307(2) (when entrustor will be subject to carrier's lien).

[53] The Bulk Transfers Article applies only to sales of "a major part" of the debtor's inventory but includes sales of a "substantial part" of the debtor's equipment if that sale is made in connection with the sale of "a major part" of the inventory. *See* U.C.C. § 6-102(1)-(2).

[54] *See* U.C.C. § 6-105. Advocates of the bulk sales rule contend that notice before disposition of inventory in bulk prevents traders, who buy on an open account, from selling out quickly and disappearing with the sale proceeds. *See generally* W. Hawkland, Sales and Bulk Sales (3d ed. 1976).

[55] *See* Gordon, The Prepaying Buyer: Second Class Citizenship Under Uniform Commercial Code Article 2, 63 Nw. U.L. Rev. 565, 577 (1968).

[56] Sections 9-301(1)(c), 9-306(2), and 9-307(1), for example, operate to protect many buyers of such inventory against creditors. An unsecured creditor who extends credit on the strength of inventory checks on Monday may be surprised to find empty shelves later in the week.

[57] See, for example, discussion of the amicus brief of the National Commercial Finance Conference in Chrysler Corp. v. Adamatic, Inc., 59 Wis. 2d 219, 240, 208 N.W.2d 97, 107 (1973).

D. *The Synthesis*

Although the Code carefully delineates three basic conveyancing principles, it nowhere provides explicit guidance in synthesizing them. That synthesis, however, is clear. It grows out of the history of these basic concepts.

At its most elemental level, property law seeks to allocate ownership interests according to an ordered system rather than according to force. Surely, the oldest ordering attempts accorded possession first place in that system.[58] In time, metaphysical concepts such as seisin and title modified primitive possession rules, and property law has gradually evolved to the extent that it occupies volumes. Yet historical experience, supported by simple logic, bears witness to the notion that security of property must assume the primary role.

We begin, then, with this first precept of property law, which rejects lawlessness and asserts that no man may be deprived of property without his consent. A taker receives all that the transferor enjoyed but no more. When, however, this first precept interrupts the flow of commerce by imposing commercial obstacles that true owners and creditors can more easily overcome than can purchasers, the law fashions a good faith purchase exception. Still later, when the first precept fosters misreliance by creditors to their detriment in situations that purchasers can more easily avoid, enter the *Twyne* doctrine.

Critical to this synthesis is the idea that any analysis must begin with security of property, the overriding principle. To ignore this presumption skews the inquiry. If the exceptions do not apply to the particular set of facts, security of property will govern. In short, if the purchaser does not fit within the parameters of one of the good faith purchase exceptions, he takes subject to any infirmities in his transferor's interest. By a similar token, if the unsecured creditor cannot bring his case within the requirements of the *Twyne* exception, he cannot successfully assert an interest in the goods.[59] They were free of his claim before the conveyance. Under security of property, they are free of it after the conveyance.

Before we can bring this synthesis to bear on a number of leading cases and trends in commercial law, there remains the task of identifying the property interests which the Code recognizes and which are the subject matter of conveyancing disputes.

---

[58] O. Holmes, The Common Law 206-13 (1881).

[59] It would be somewhat misleading to assert that the Code delineates all of the good faith purchase rules and all of the fraud rules. U.C.C. § 1-103, which incorporates the law of estoppel, and the Uniform Fraudulent Conveyances Act provide flexibility in the case of the former and a significant exception in the case of the latter. Both rules, however, involve unreasonable—if not egregiously fraudulent—conduct and fall outside the scope of this article, which deals, as most cases will, with disputes between two "innocent" parties.

III. The Four Property Interests

The several property interests fall into four separate categories: title, the special property, the security interest, and the lien.

A. *Title*

The discussion begins with title—the interest which technically counts for least in the Code, but which often causes the most trouble. The nearly universal adoption of the Code in American jurisdictions led some to believe that Professor Llewellyn had finally succeeded in his long effort to unseat title from its position as the first rule of personal property law.[60] Comments throughout the Code leave little doubt of the drafters' intent that the rights of the parties do not rest on the basis of "stereotyped presumptions as to the location of title."[61] Section 2-401 sets out a series of rules for ascertaining the location of title, but the preamble to that section carefully limits the relevance of those rules to issues where the governing Code provision specifically refers to the title concept by name.[62] Such references occur in only a few sections,[63] and these have a specific and limited scope. The only such provision that directly relates to conveyancing is the voidable title rule of section 2-403(1).[64] Thus, rather than undergirding the Code system of rights, obligations, and remedies, the location of title has significance only in certain fairly narrow issues and in such tangential questions as the larcenous nature of a taking and the liability for personal property taxes.[65] In short, the Code tries to confine the title concept to the most limited role.

As examination of recent cases will illustrate,[66] however, courts and commercial lawyers have resisted—unconsciously, if not with deliberate stubborness—the drafters' attempts to deprive them of a concept so central to their common law traditions and so responsive to the human longing to be able to say without condition, "This is *mine* and that is *yours*." For

---

[60] *See generally* Llewellyn, Through Title to Contract and a Bit Beyond, 15 N.Y.U. L.Q. Rev. 159 (1938). For criticism of this approach see Williston, The Law of Sales in the Proposed Uniform Commercial Code, 63 Harv. L. Rev. 561, 566-72 (1950).

[61] U.C.C. § 2-505, Comment 1. *See, e.g.*, U.C.C. §§ 2-706, Comments 3, 11 (title irrelevant to seller's resale right), 9-202, Comment (location of title irrelevant to Article 9 rights of debtor, secured creditor and third parties), 9-311, Comment 2 (debtor's rights in collateral can be reached by his creditors without regard to location of title).

[62] "Each provision of this Article with regard to the rights, obligations and remedies of the seller, the buyer, purchasers or other third parties applies irrespective of title to the goods except where the provisions refer to such title." U.C.C. § 2-401. Similarly, § 9-202 states: "Each provision of this Article with regard to rights, obligations and remedies applies whether title to collateral is in the secured party or in the debtor."

[63] *See* U.C.C. §§ 2-327(1), 2-326(3) (incidents of sale on approval); 2-312(1) (seller's warranty of good title and rightful transfer); 2-501(2) (creation of seller's insurable interest in goods); 2-722 (title holder's cause of action for injury to goods).

[64] "A person with voidable title has power to transfer a good title to a good faith purchaser for value." U.C.C. § 2-403(1).

[65] *Cf.* State v. Delta Airlines, Inc., 356 So. 2d 1205 (Ala. Civ. App. 1978) (court uses § 2-401 to determine applicability of sales tax); Elliot v. State, 149 Ga. App. 579, 254 S.E.2d 900 (1979) (court uses § 2-401 to determine whether defendant is guilty of theft).

[66] *See* Section IV B 2 *infra*.

example, lawyers frequently begin their analysis of a dispute between a seller's creditor and a purchaser by saying that the seller "sold" the goods or that the buyer "bought" them.[67] The use of the terms "bought" and "sold" implies that the goods belong to the buyer, that he enjoys title.[68] This implication clutters the inquiry from the outset with all sorts of title baggage. It too easily leads to an unacceptable, and incorrect, assumption that because the buyer has "title," other claimants must find a Code rule to defeat the buyer's title before they can prevail.

In fact, a precise analysis would begin by saying no more than that the seller and the purchaser entered into a contract for the sale of goods. It would proceed to recognize that the buyer, if he has *any* interest in the goods, has only that interest which his conveyor enjoyed. This recognition would then bring attention to the basic conveyancing corollary that the buyer who claims more must find a rule of good faith purchase to support that claim. This kind of analysis is often precluded by unthinking adherence to more traditional modes of approaching commercial disputes, and we are wrong if we think the Code has entirely freed us from title mischief.

B. *The Special Property*

After demoting title from its historical primacy, the Code fashions a different event to serve the role that passage of title formerly served. The event is "identification"[69] and the interest created is the "special property."[70]

The special property is an old concept in the common law.[71] It has always denoted an interest inferior to the general property, title,[72] but sufficient to give the owner of the special property some enforceable rights in the goods.[73] Even in days when title reigned supreme, those rights included replevin[74] and trover.[75] Despite these common law roots, courts did not encumber the concept of special property with the rigid theoretical accretions that they accorded the concept of title. Because of its flexibility, the special property is a concept that serves the Code pattern well. The interest arises at the point of identification and signals the beginning of the buyer's legally cognizable interest in the goods, but the dimensions of the interest

---

[67] *See, e.g.*, Tanbro Fabrics Corp. v. Deering Milliken, Inc., 39 N.Y.2d 632, 350 N.E.2d 590, 385 N.Y.S.2d 260 (1976).

[68] Under the Code, a buyer who has completed the purchase transaction would indeed hold title to the goods. *See* U.C.C. §§ 2-106, 2-401.

[69] U.C.C. § 2-501(1) delineates the manner in which identification occurs in the absence of "explicit agreement" by the parties.

[70] "The buyer obtains a special property . . . in goods by identification . . . ." *Id.*

[71] *See, e.g.*, Waterman v. Robinson, 5 Mass. 302, 303 (1809); Miller v. Race, 97 Eng. Rep. 398, 400 (K.B. 1758).

[72] Holmes calls it a "qualified interest" in goods. O. Holmes, *supra* note 58, at 244.

[73] *Id.* at 242-43.

[74] *See, e.g.*, Aircraft Acceptance Corp. v. Jolly, 141 Ind. App. 515, 519, 230 N.E.2d 466, 449 (1967) (pre-Code); Waterman v. Robinson, 5 Mass. 302, 303 (1809).

[75] *See, e.g.*, Ludden v. Leavitt, 9 Mass. 104, 105 (1812); Patten v. Dennison, 137 Me. 1, 2, 14 A.2d 12, 12 (1940); Wilbraham v. Snow, 86 Eng. Rep. 37, 37 (K.B. 1726).

depend to a significant degree on independent facts and on Code sections other than those that speak directly of the special property.[76]

The special property is a creature of Article 2. Although that Article contains no single, comprehensive definition of special property, several of its provisions suggest the parameters of this interest. The buyer's insurable interest in the goods arises at the point when he acquires a special property in them.[77] Subject to certain conditions, the special property gives the buyer a right to recover conforming goods on the seller's insolvency.[78] Similarly, on the seller's breach, the special property will support a right of replevin of goods for which the buyer is unable to effect cover.[79] These rights are explicitly accorded priority over those of the seller's unsecured creditors.[80]

The position of the buyer with a special property *vis-à-vis* the seller's secured creditors is not so clearly delineated.[81] As this article mentioned earlier, a buyer in ordinary course will defeat perfected security interests in inventory[82] and in goods that the secured party has authorized the transferor to sell or otherwise dispose of.[83] Courts have had some difficulty in determining the point at which a party who would otherwise qualify as a buyer in ordinary course has sufficient interest in the goods to defeat a secured creditor. Many have succumbed to the temptation of looking to delivery, because it is the point at which title passes. This article will explore later the problems engendered by such a conclusion;[84] it is enough to note here that the title approach is not a desirable way of integrating the special property into Article 9's interest priority scheme. Just as the buyer with a special property may lose that interest by operation of the third conveyancing principle if he leaves the goods in the seller's possession,[85] so should he be able to protect that interest by invocation of good faith purchase rules such as those of Article 9.

C. *The Security Interest*

The security interest is a vehicle for ensuring "payment or performance of an obligation."[86] The Code recognizes two broad kinds of security

[76] *See* U.C.C. § 2-401, Comment 3.

[77] *See* U.C.C. § 2-501(1). The buyer's right to inspect the goods also arises at this point in the transaction, *see* U.C.C. § 2-513(1), as does his standing to bring an action against a third party who damages the goods, *see* U.C.C. § 2-722(a) & Comment.

[78] *See* U.C.C. § 2-502.

[79] *See* U.C.C. § 2-716(3).

[80] *See* U.C.C. § 2-402(1).

[81] The Code makes it clear that "[t]he 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' . . . ." U.C.C. § 1-201(37).

[82] *See* U.C.C. § 9-307(1) (a buyer in ordinary course takes free of security interests created by his seller). A buyer in ordinary course is one who buys goods from one in the business of selling goods of that kind, *i.e.*, one who buys out of inventory. *See* U.C.C. § 1-201(9).

[83] *See* U.C.C. § 9-306(2) (a security interest does not follow goods in the event of "sale, exchange or other disposition" if the secured party authorizes the transfer).

[84] *See* text accompanying notes 230-49 *infra*.

[85] *See* U.C.C. § 2-402(2).

[86] U.C.C. § 1-201(37).

interests: those which are established by agreement of the parties and those which arise by operation of law. As a general rule, the former fall under the provisions of Article 9;[87] the latter arise under the provisions of Article 2 but may be subject to some Article 9 rules.[88]

Article 9 begins with the security of property principle that security interests are binding on the parties to the agreement and on all third parties.[89] The Code carves out of this basic precept a significant exception by rendering the general rule subject to all other inconsistent Code provisions.[90] Such provisions abound, not only in Article 9[91] but also in other parts of the Code,[92] and they generally involve variations of the good faith purchase principle.[93]

The creation of any security interest requires steps on the part of the secured party to provide proof of the existence of a security interest and to avoid misleading third parties. The party secured by either an Article 2 or an Article 9 security interest may satisfy both requirements by taking and maintaining possession of the goods.[94] Absent such possession, the secured party usually must obtain a signed agreement in order for the security interest to attach and become enforceable,[95] and must follow the appropriate Article 9 method—usually, the filing of a financing statement—to perfect the interest as against third parties.[96]

Less well-defined than the standard, consensual security interest is the nonconsensual type, which the Code calls a "security interest arising under the article on sales."[97] The most common Article 2 security interest arises when the seller ships goods "upon reservation" by common carrier. At common law, where the passage of title sometimes occurred on the seller's

---

[87] *See* U.C.C. §§ 9-102, 9-203(1). The Code satisfies commercial exigencies at some sacrifice of logical consistency by designating certain purchasers of chattel paper and accounts as "secured parties" under Article 9. *See* U.C.C. §§ 1-201(37), 9-102(1)(b). Security interests in investment securities are subject to the rules in § 8-321. The Code also provides for security interests in Articles 4 and 7. *See* U.C.C. §§ 4-208, 7-209(2).

[88] *See* U.C.C. § 9-113.

[89] *See* U.C.C. § 9-201. Thus, for example, a security interest, though unperfected, binds the administrator of the debtor's estate. Farmer's State Bank v. Yealick, 69 Ill. App. 3d 353, 387 N.E.2d 399 (1979).

[90] "[Section 9-201] contains the biggest 'except' clause in the history of statutory law in Western civilization." R. Speidel, R. Summers, & J. White, Teaching Materials on Commercial and Consumer Law 90 (2d ed. 1974).

[91] *E.g.*, U.C.C. §§ 9-301(1) (those who have priority over unperfected security interest), 9-306(2) (disposition authorized by secured party), 9-307 (buyer in ordinary course of goods), 9-308 (purchaser in ordinary course of chattel paper and instruments), 9-309 (holder in due course, holder of duly negotiated document of title, bona fide purchaser of securities), 9-310 (priority of statutory mechanic's lien), 9-312 (priority among conflicting security interests in collateral), 9-313 (priority among conflicting interest in fixtures).

[92] *E.g.*, U.C.C. §§ 3-305 (holder in due course), 7-502(1) (holder of document of title), 8-302(3) (bona fide purchaser of security).

[93] *E.g.*, U.C.C. §§ 3-305, 7-502(1), 8-302(1) & (3), 9-307(1), 9-308, 9-309.

[94] *See* U.C.C. §§ 2-505, 2-711(3), 9-203(1), 9-113.

[95] *See* U.C.C. § 9-203(1).

[96] *See* U.C.C. § 9-302.

[97] *See* U.C.C. § 9-113 & Comments.

delivery to the carrier,[98] such delivery could deprive the seller of all rights in the goods themselves, leaving him no recourse to goods still in the carrier's possession even though the buyer had breached. The Code preserves the common law rule as to the time title passes,[99] but stipulates that the seller who has properly arranged shipment so that the buyer will not be able to take possession without further action by the seller or his agent may thereby reserve a security interest in the goods.[100] Such a seller, then, retains possession through his agent, the carrier.[101] Through this retention of possession, the seller's security interest remains intact, and, on the buyer's default, the seller may repossess the collateral.[102]

The second Article 2, or nonconsensual, security interest is that created in the buyer who holds nonconforming goods to secure return of any prepayment and reimbursement of incidental expenses.[103] As do all Article 2 security interests, this one lasts only so long as the secured party—here, the buyer—has possession of the goods. Significantly, the buyer's security interest does not extend to damages he incurs as a consequence of the seller's failure to deliver conforming goods.[104] This last point underscores the basic difference between a security interest and a remedy. The former is essentially prophylactic; the latter is essentially compensatory.[105] While the existence of a security interest necessarily implies the availability of remedies for its vindication in case of the debtor's default,[106] the distinction between the two is significant. A security interest protects against future failure to perform. A remedy repairs damage from past failure to perform.[107] This functional difference becomes important in distinguishing the seller's Article 2 security interest from the seller's lien.

---

[98] *See, e.g.*, Louisville & Nashville R.R. v. United States, 267 U.S. 395, 400 (1924); Alberti v. Associated Fruit Co., 238 Ill. App. 11, 14-15 (1925).

[99] *See* U.C.C. § 2-401(2).

[100] *See* U.C.C. § 2-505.

[101] Section 2-505 permits the seller to reserve a security interest in two ways. First, he may deliver the goods against a negotiable document of title. *See* U.C.C. § 2-505(1)(a). In that event, the carrier will deliver only to the holder of the document. *See* U.C.C. § 7-403(4). Second, the seller may take a nonnegotiable document and designate himself or his agent as the consignee. *See* U.C.C. § 2-505(1)(b). In this case, the carrier will deliver only to the consignee or to another person designated by the seller. *See* U.C.C. § 7-403(4).

[102] *See generally* U.C.C. § 9-503 & Comment.

[103] *See* U.C.C. § 2-711(3) & Comment 2. *Cf.* U.C.C. § 7-209(2) (warehouse's security interest for money advanced and interest).

[104] *See* U.C.C. § 2-711, Comment 2.

[105] *See* U.C.C. § 1-106(1).

[106] Remedies that attend Article 2 security interests appear in part 7 of that Article. *See* U.C.C. §§ 2-703, 2-705, 2-706. Remedies protecting Article 9 security interests appear in part 5 of that Article. *See* U.C.C. §§ 9-501 through 9-507. *See generally* U.C.C. § 9-113. Some might argue that the security interest defined in § 2-711(3) belies the distinction made in the text between remedies and security interests. Section 2-711(3), however, creates an interest which secures the aggrieved buyer against the breaching seller's failure *in the future* to return the buyer's downpayment.

[107] The text assumes that anticipatory breach is functionally equivalent to past failure to perform. *See generally* U.C.C. § 2-610.

D. *The Lien*

The Code casts the lien in a residual role to include interests that do not fit into the categories of title, special property, or security interest.[108] The most common variety is the seller's lien,[109] which is, in essence, the right of the seller to resort to the goods. Counterbalancing the notion that "sale" passes full rights and title to the buyer,[110] the seller's lien principle teaches that the seller may delay delivery until the buyer tenders payment.[111] Several sections of the Code preserve this principle. If the buyer fails to make a required payment or repudiates the contract in whole or in part, the seller may refuse delivery of the goods.[112] In addition, even though the buyer has not repudiated or failed to make a predelivery payment, the seller may withhold the goods or stop delivery if he learns that the buyer is insolvent.[113]

The common law recognized that the seller's right to resort to the goods extended in some instances to situations where the buyer had fraudulently induced the seller to part with possession.[114] The Code continues that tradition by giving the seller the right to reclaim goods from a buyer who takes them in return for a bad check[115] or while he is insolvent.[116] Some commentators characterize this right to reclaim as an Article 2 security

---

[108] The Code recognizes the lien as a species of property interest in a variety of contexts. Section 1-201(32) defines "purchase" to cover all manner of conveyances including "taking by . . . lien." Similarly, "taking for value" includes a holder's acquiring "a lien on the instrument otherwise than by legal process." U.C.C. § 3-303(a). By contrast, "transfers in settlement or realization of a lien" are not considered bulk transfers under Article 6. *See* U.C.C. § 6-103(3). The seller's warranty of good title includes assurance that the goods are "free from any security interest or other lien or encumbrance." U.C.C. § 2-312(1)(b). A holder in due course will take free of "all liens, equities or claims of any other kind," U.C.C. § 3-305, Comment 2, while a holder not in due course will take subject to all valid "liens, equities, or other claims of right." U.C.C. § 3-306, Comment 2.

[109] Other varieties recognized by the Code include: the warehouse's lien, U.C.C. § 7-209(1); the carrier's lien, U.C.C. § 7-307; the lien of an issuer of investment securities, U.C.C. § 8-103; the mechanic's lien, to the extent that such is authorized by other statute, U.C.C. § 9-310; and the judgment creditor's lien, U.C.C. § 9-301(3).

[110] "A 'sale' consists in the passing of title from the seller to the buyer for a price . . . ." U.C.C. § 2-106(1).

[111] "There cannot be a doubt that after sale of the goods, the vendor has a lien on them for the price, so long as they remain in his possession, and this is a doctrine as old as any doctrine connected with the purchase and sale of goods." M'Ewan v. Smith, 9 Eng. Rep. 1109, 1117 (H.L. 1849).

[112] U.C.C. §§ 2-507(2), 2-703(a),(f), 2-705(1).

[113] U.C.C. §§ 2-702(1) & Comment 1, 2-705(1). *Cf.* Sawyer v. Dean, 114 N.Y. 469, 21 N.E. 1012 (1889) (pre-Code seller's lien case upholding seller's action in recalling goods from their delivery point, a railroad depot, because of buyer's refusal to pay without inspection).

[114] *See, e.g.*, John V. Farwell Co. v. Hilton, 84 F. 293 (C.C.E.D. Wis. 1897) (permitting defrauded seller to replevy goods). *Cf.* Standard Inv. Co. v. Town of Snow Hill, 78 F.2d 33, 36 (4th Cir. 1935) (in case involving sale of bonds, court held that "upon dishonor of the check, the seller may rescind the transaction and reclaim that with which he has parted."). *See generally* 3 S. Williston, *supra* note 18, § 567, at 207-09.

[115] U.C.C. §§ 2-507(2), 2-511(3), 2-703, Comment 3.

[116] U.C.C. § 2-702(2). *See, e.g.*, Federal's Inc. v. Matsushita Elec. Corp. of Amer. (*In re* Federal's Inc.), 553 F.2d 509 (6th Cir. 1977).

interest, and some courts have agreed.[117] The better view would seem to be that the right to reclaim is a remedy incident to the seller's lien. First, the right does not fit well into the security interest paradigm of securing against future breach. When the seller delivers goods against a bad check, or when the buyer takes delivery while insolvent, the fraud on the seller has in a sense already occurred. That fraud triggers a compensatory right to reclaim the goods.[118] In these instances, then, the right resembles a remedy rather than a security interest.

More significant is the fact that, in both of these instances, the seller has parted with possession of the goods. Continued possession by the seller is indispensable to the survival of an Article 2 security interest.[119] Once possession has been surrendered to the buyer, the seller's Article 2 security interest must merge into an Article 9 security interest if the seller is to retain the benefits of secured status.[120] Thus, if the seller's right to reclaim is really a species of security interest, the seller would be forced, upon delivery of the goods, to comply with Article 9 by taking a signed security agreement and by perfecting if he wishes to preserve his right to repossess the goods on default and to defeat the trustee in bankruptcy and lien creditors.[121]

In fact, of course, sellers do not knowingly deliver either against bad checks or to insolvent buyers. They will not anticipate the fraud which the Article 2 security interest analysis forces them to anticipate.[122] In short, the argument that a seller's right to reclaim is in fact an Article 2 security interest would seriously restrict the scope and effectiveness of that right.[123]

---

[117] *See* note 151 *infra*.

[118] At common law, both delivery on a bad check and delivery to an insolvent buyer gave the seller rights in the goods, and it was in reaction to such buyer misconduct that the courts fashioned the right to reclaim now codified in U.C.C. §§ 2-507(2) and 2-702(2). *See generally* U.C.C. §§ 2-507, Comment; 2-702, Comment 2; 2 S. Williston, *supra* note 18, § 346a, at 344-45.

[119] *See* notes 94-96 and accompanying text *supra*.

[120] *See* U.C.C. § 9-113.

[121] The trustee will argue either that failure to comply with the attachment rule of Article 9 renders the Article 2 security interest void—so that he then defeats the seller under the negative implication of § 9-301(1)(b)—or that the failure to perfect the interest under the rules of Article 9 renders the interest inferior to his rights as trustee under the same section. See also the Bankruptcy Code, 11 U.S.C.A. §§ 544, 546 (c) (West Supp. 1979), which limits the trustee's priority over a seller's right to reclaim but measures the seller's right by state law. If the right to reclaim is an Article 2 security interest that fails by virtue of non-compliance with Article 9 rules as § 9-113 requires, the trustee would arguably defeat it.

[122] I have commented elsewhere, *see* Dolan, The Uniform Commercial Code and the Concept of Possession in the Marketing and Financing of Goods, 56 Tex. L. Rev. 1147, 1175-77 (1978), on the position taken by some that the buyer who takes delivery in return for a bad check or while insolvent does not "lawfully obtain possession of the goods," so that the seller need not worry about § 9-113. That argument supports unfortunate consequences. It gives rise to a secret lien that would defeat certain good faith buyers in bulk, *see* U.C.C. § 9-301(1)(c), and good faith secured parties, *see* U.C.C. § 9-312(5)(a).

[123] This conclusion does not ignore the close relationship between the Article 2 security interest and the seller's lien. Section 2-505 codifies a rule protecting the seller who does not part with de facto control of the goods, and in that sense closely resembles the common law seller's lien. Significantly, however, § 2-505 restricts the security interest to "securing payment

It is more appropriate to consider the interest of the reclaiming seller as an extension of the seller's right to withhold delivery, *i.e.*, an extension of the seller's lien.[124] In the face of the buyer's fraud, the Code assures the seller an interest in the goods themselves.

IV. Application of the Code's Analytic Framework

These four property interests, along with the three principles which govern conveyances of them, form the analytic framework of the entire Code. Recognizing the components and the structural relationships of this framework not only enables us to harmonize the various Articles of the Code, but also allows us to resolve commercial disputes in a theoretically consistent and pragmatically sound method. The balance of this article discusses several recent cases and applies the analysis developed above to suggest ways in which these cases might have been better decided, or at least better reasoned.

A. *Recognizing the Interaction of the Conveyancing Principles*

The first two cases in this part, one from Article 5 and the other from Article 9, illustrate generally the proposed method of applying the conveyancing rules. The second group of cases continues the earlier discussion of the seller's right to reclaim and discusses the interplay of security of property and good faith purchase principles in determining the reclaiming seller's rights as against the buyer's trustee in bankruptcy. The final group of cases in this part considers the conveyancing principle forgotten by most courts and commercial lawyers—the *Twyne* rule.

1. General Applications: Letters of Credit and After-Acquired Property

In *Shaffer v. Brooklyn Park Garden Apartments*,[125] the Supreme Court of Minnesota wrestled with the concept of "pledging" letters of credit and with the argument of the "pledgee" that the letters were negotiable. In *Shaffer*, the original beneficiary of two standby letters of credit,[126] a limited partnership formed to construct an apartment complex, had pledged them to the plaintiff bank as security for a loan. Articles 5 and 9 anticipate that procedure,[127] and the court properly held that the pledgee bank had a

---

or performance," *see* U.C.C. § 2-505, Comment 1, and fails once the seller loses de facto control of the goods. *See* U.C.C. § 2-505, Comment 4. The seller's lien, on the other hand, under § 2-507(2) or § 2-702(2), may survive delivery to the buyer.

[124] This is Professor Kennedy's point. *See* Kennedy, The Interest of a Reclaiming Seller Under Article 2 of the Code, 30 Bus. Law. 833, 840 (1975).

[125] 311 Minn. 452, 250 N.W.2d 172 (1977).

[126] The credits were "standby" in nature. They provided that the issuing bank would honor the beneficiary's order for payment only on certification by the beneficiary that the bank's customers had failed to pay when due certain notes made by the customers in the beneficiary's favor. *Id.* at 455, 250 N.W.2d at 175.

[127] *See* U.C.C. §§ 5-116(2)(a) (delivery of letter of credit to assignee constitutes perfection of security interest), 9-305 (same rule).

perfected security interest in the right to receive the proceeds under the letters. It was clear from the facts in *Shaffer* that the promissory notes which the credits guaranteed were not due and, therefore, that the original beneficiary had no right to draw under the credits.[128] The pledgee bank argued, however, that it was a holder in due course of the credits and that it took free of any defense good against the original beneficiary.

The pledgee's choice of good faith purchase rule proved to be infelicitous. The holder in due course doctrine arises out of commercial paper law. The *Shaffer* court looked then to Article 3 and correctly determined that only one who holds a negotiable instrument may attain the status of a holder in due course.[129] It noted that in order to be negotiable an instrument must contain an unconditional promise or order to pay.[130] Because the letters of credit at issue contained conditions precedent to payment, the court concluded that they were not negotiable instruments.[131] The plaintiffs, therefore, could assert the failure of the condition against the pledgee bank.

This result is clearly correct, but the court's analytic justification is somewhat troubling. First, the reasoning appears superficial. The court does not discuss policy considerations or legislative purpose but rather applies definitions mechanically.[132] As a result, the opinion is not as persuasive as it should be, and other courts may well distinguish it on the grounds that preconditions in the letters of credit before them are *de minimis*, or not conditions at all.[133] Second, the next pledgee in such a case may eschew the holder in due course argument for a straight bona fide purchaser argument, and the *Shaffer* holding will offer scant support for denying the claim.

The analysis should begin with the security of property principle: the pledgee takes as much as the original beneficiary enjoyed and no more.

[128] The notes were payable either on 90% occupancy of the apartment complex or one year after F.H.A. endorsement of the project. At the time the pledgee bank tried to draw on the credit, construction had ceased and foreclosure of mechanic's liens and the mortgage had begun. Despite warning by the plaintiff's attorney that the conditions precedent to the maturity of the notes had not occurred, the pledgee bank obtained the requisite certification from the original beneficiary and presented the letters. Shaffer v. Brooklyn Park Garden Apts., 311 Minn. at 456, 250 N.W.2d at 175-76.

[129] *Id.* at 457-58, 250 N.W.2d at 176-77. The Code defines a holder in due course as one who takes an "instrument." *See* U.C.C. §§ 3-302, 3-305. Section 3-102(1)(e) defines "instrument" to mean a negotiable instrument.

[130] Shaffer v. Brooklyn Park Garden Apts., 311 Minn. at 458-59, 250 N.W.2d at 176-77. *See* U.C.C. § 3-104(1)(b).

[131] *See* United Tech. Corp. v. Citibank, N.A., 469 F. Supp. 473, 478 (S.D.N.Y. 1979) (letter of credit is not a negotiable instrument).

[132] Section 1-102(1) warns against such an approach by directing the court to apply the Code "to promote its underlying purposes and policies."

[133] Many standby credits are "clean," *i.e.*, they require only that the beneficiary present a draft identifying the credit by number. Such a condition does not differ markedly from the presentment requirements of Article 3. *See, e.g.*, U.C.C. § 3-504(4). Such requirements do not, of course, render instruments nonnegotiable. *See generally* U.C.C. §§ 3-501 (when presentment is necessary), 3-503 (time of presentment), 3-504 (how presentment is made). Of course, to be negotiable any instrument must contain words of negotiability. *See* U.C.C. § 3-104(1)(d).

The analysis ends there unless the pledgee can find a good faith purchase rule to support its claim of greater rights. As the *Shaffer* court recognized, the holder in due course rule is inappropriate, and a review of other specific good faith purchase rules in the Code reveals no more apposite provision.[134] There remains, nevertheless, the legislature's ubiquitous command that the court supplement the provisions of the Code with "the principles of law and equity, including . . . the law relative to . . . estoppel,"[135] unless these principles have been displaced by the provisions of the Code itself. Good faith purchase is judge-made doctrine with strong estoppel antecedents.[136] The pledgee, however, should not succeed in any attempt to have the court fashion a new good faith purchase rule for letters of credit. The structure of Article 5 reveals an intention to displace the common law's inclination towards protecting the good faith purchaser. More importantly, an examination of the policies served by this area of commercial financing reveals that good faith purchase treatment would not enhance, and might in fact discourage, the use of credits by investors.

Section 5-116, which governs the transfer of rights under credits, posits a straightforward scheme that does not include any good faith purchase features as part of the basic transfer pattern.[137] The only good faith purchase exceptions come in section 5-114, which permits the issuer to refuse payment under the credit when documents supporting the draft are facially valid but inherently defective[138] *unless* the demand comes from a person who is holding documents other than the credit and who is protected by the good faith purchase rules of Articles 3, 7, and 8—the "paper" articles. The design, then, is clear: the Letter of Credit Article eschews good faith purchase treatment for the transferee of a credit unless the transferee holds "paper" other than the credit and rises to the level of a

---

[134] The Article 3 good faith purchase rules—U.C.C. §§ 3-207(2), 3-305, 3-405, 3-406, 3-407, 3-602—all assume the presence of an "instrument." The good faith provisions of the Article on Bulk Transfers—U.C.C. § 6-110(2)—the Article on Documents of Title—U.C.C. §§ 7-205, 7-208, 7-209(3), 7-502(1), 7-504(2)(b)—and the Article on Securities—U.C.C. §§ 8-205, 8-206(1)(b), 8-302(3), 8-311—are clearly inapposite because of their subject matter. Article 2's good faith purchase provisions deal with entrustment of goods to dealers, U.C.C. § 2-403(2), voidable title, U.C.C. § 2-403(1), the rights of financing agencies who purchase shipping drafts, U.C.C. § 2-506(2), and the rights of good faith purchasers at seller's resale as against the original buyer, U.C.C. § 2-706(5). The good faith purchase rules of Article 9 define those transferees who have priority over the interests of unperfected secured creditors, U.C.C. § 9-301(1)(c)-(d), and perfected secured creditors, U.C.C. §§ 9-306(2), 9-307(1)-(2), 9-308, 9-309. The *Shaffer* case did not involve such priority questions.

[135] U.C.C. § 1-103.

[136] *See, e.g.,* Baldwin v. Childs, 249 N.Y. 212, 163 N.E. 737 (1928) (estoppel by document); White v. Garden, 138 Eng. Rep. 364 (C.P. 1851) (voidable title); Pickering v. Busk, 104 Eng. Rep. 758 (K.B. 1812) (entrustment); Miller v. Race, 97 Eng. Rep. 398 (K.B. 1758) (negotiable instrument). *See generally* Gilmore, The Commercial Doctrine of Good Faith Purchase, 63 Yale L.J. 1057 (1954).

[137] Section 5-116 distinguishes between the right to draw under a credit, *i.e.,* the right to order payment, and the right to payment itself. The latter is always assignable, the former only when the credit expressly permits. *Compare* U.C.C. § 5-116(1) *with* U.C.C. § 5-116(2).

[138] Section 5-114(2) permits the issuer of the credit to dishonor it if there is a breach of a transfer warranty, *see* U.C.C. §§ 7-507, 8-306, if one of the documents is forged, or if there is "fraud in the transaction."

holder in due course of a negotiable instrument, a "qualified holder" of a negotiable document of title, or a bona fide purchaser of a security. To accord good faith purchase treatment to others making demands on the credit undermines what appears to be the Code's plan for limiting such benefits.

Strict adherence to Article 5's limitation on good faith purchase treatment is justified in light of the business context in which letters of credit arise. As a general rule, the commercial law protects good faith purchasers not because their hearts are purer than those of the true owners or secured creditors they defeat, but because they are dealing with a kind of property, or in a type of situation, that makes it fairer or more economical for owners and creditors to protect their rights than for purchasers to protect theirs. For example, it would be wasteful to require purchasers of negotiable instruments or documents and buyers of goods from dealers who customarily sell such goods to inquire as to title when true owners and creditors can so easily prevent the appearance of ownership that another's possession creates. These kinds of transfers are staples of commerce, and commercial law should facilitate them in order to maximize efficiency and economy. In contrast, pledges of credits are not frequent, matter-of-course business transactions. Rather, they are usually part of complex financing packages involving knowledgable, professional lenders.

The series of transactions giving rise to the *Shaffer* case is a good example. The plaintiffs' bank, which issued the letters, had conditioned the credit on substantial completion of the apartment complex. The original beneficiary of the credits, the developer, wanted to use them to finance the project by pledging them to secure a series of loans. Such use by the developer would serve the interest of both the investors who caused the credits to issue and the developer itself. If, however, the *Shaffer* court had held that the developer's pledgee in such circumstances takes free of the investors' defenses, the commercial attraction of this financing device would suffer. The investors clearly did not want to pay unless the developer completed the apartments, and they carefully incorporated that condition into the credits they requested their bank to issue. They were not, however, in a position to ensure that money borrowed on the security of those credits would in fact go toward the construction. Thus, they could be protected only by a rule which subjected the pledgee's rights in the credit to fulfillment of the condition. Such a rule would not leave the pledgee without the means of safeguarding its interests, however. It could have stipulated that its loan to the developer was a construction loan to be used solely for completing the apartment complex;[139] it would thereby have placed itself in a position to ensure that the developer satisfied the condition of the credit.

---

[139] It is beyond the scope of this article to describe such an arrangement in detail. Suffice it to say here that construction lenders can fashion construction loans in a way which permits the lender to pay out the loan proceeds against lien waivers and other evidence of building construction. For an example of such a loan agreement, see Practicing Law Institute, Pub. No. 136, Construction Financing 305, 316-20 (1977).

The rule advanced by the pledgee in *Shaffer* served no purpose other than to destroy protection for investors. By contrast, the rule denying good faith purchase treatment to the pledgee forces it to limit the developer's use of the letters of credit to securing a construction loan. Such limitation facilitates realization of the parties' commercial expectations. Under this approach, the pledgee realizes repayment security, the developer obtains construction funds, and the investors acquire an apartment complex. The precautions required of the pledgee by such a rule are not unduly burdensome. Neither are they of a nature unknown to sophisticated lenders, and only such lenders should deal with pledges and other transfers of credits. A balancing of commercial costs makes it clear, therefore, that the *Shaffer* situation was not an appropriate occasion for creating a new good faith purchase rule under section 1-103. The rule of the *Shaffer* case is vindicated not by applying definitions mechanically, but by viewing the basic conveyancing structure of the Code against the needs of the mercantile transactions it was designed to promote.

Failure to perceive the commercial policies served by the interplay of security of property and good faith purchase principles in the Code may lead a court to stray from the Code pattern and fashion a commercially harmful rule. *International Harvester Credit Corp. v. American National Bank,*[140] a Florida case involving a standard after-acquired property financing arrangement, illustrates the problem. American National Bank had a perfected security interest in all of the debtor's after-acquired property. Subsequently, the debtor purchased a new item of farm machinery in which the seller retained a purchase money security interest. The seller then assigned this interest to International Harvester Credit Corporation. Although section 9-312 of the Code provides a specific mechanism which would have allowed the seller, as a purchase money creditor, to achieve priority over the bank, the seller had failed to make a timely filing in compliance with that provision.[141] On becoming assignee, International Harvester filed promptly, but the statutory period for achieving purchase money priority had long since expired. The bank argued, therefore, that the omnibus priority rule of Article 9[142] applied, and that the earlier filing entitled the bank to the defaulting debtor's machinery.

---

[140] 296 So.2d 32 (Fla. 1974). The complicated facts of this case appear in the opinion of the District Court of Appeal, 269 So.2d 726 (Fla. Dist. Ct. App. 1972). The text simplifies them for the purpose of discussion.

[141] A seller of collateral other than inventory can establish priority over other secured creditors if he files before, or within 10 days after, the debtor takes possession of the collateral. *See* U.C.C. § 9-312(4). A seller of inventory can establish priority by filing at or before the time the debtor receives possession and by notifying holders of conflicting security interests in writing of the purchase money security interest and the specific inventory it covers. *See* U.C.C. § 9-312(3).

[142] Section 9-312(5) sets forth the general rules for priority among conflicting security interests in the same collateral. Priority among perfected security interests is determined by the earlier of filing or perfection. Priority among unperfected security interests is determined by the time of attachment.

Although most courts and authorities have accepted the bank's reasoning,[143] the Supreme Court of Florida found such a result contrary to "contractual constitutional requirements and equitable principles."[144] The court adopted a strict security of property approach. If the seller retains a purchase money security interest, the court reasoned, the debtor's only interest in the machinery must be its "equity." The debtor can grant a security interest to the bank only to the extent of the debtor's interest; the bank, therefore, takes a security interest only to the extent of that equity.[145]

The court's analysis went no further than basic security of property reasoning. It failed to account for the fact that section 9-312 anticipates this kind of dispute and interdicts the pure security of property result. That section recognizes the prevalence of credit based on revolving inventory and other after-acquired property, as well as the need to protect the first position of such creditors. It achieves that protection by subordinating the security interest of the seller to that of the revolving lender unless the seller files a financing statement promptly and, in the case of inventory, notifies the lender seasonably. Prompt filing and notification protect the lender from relying on the debtor's after-acquired equipment or inventory that is subject to the purchase money security interests of other creditors.[146] In short, the Code interrupts security of property here and interjects a rule in the nature of good faith purchase. The secured lender who has no notice, via filing or actual notification, that new property has been acquired subject to the interest of another will have priority over that interest.[147] Such displacement of security of property principles should not shock the court's "constitutional" or "equitable" sensibilities any more than does the application of the Code's other good faith purchase rules—particularly where, as here, the displacement facilitates a desirable commercial financing practice[148] and applies only after the party has failed to take measures available to protect its interest.[149]

---

[143] *See generally* R. Henson, Secured Transactions Under the Uniform Commercial Code 127-28 (2d ed. 1979); J. White & R. Summers, Handbook of the Law Under the Uniform Commercial Code 919 (1972).

[144] International Harvester Credit Corp. v. American Nat'l Bank, 296 So.2d at 34.

[145] *Id.* at 34. The court explained its conclusion as follows:

> There really are no conflicting security interests in this situation. That security interest retained by the subsequent seller in the after-acquired property never passes to the buyer-debtor and thus never becomes subject to the earlier creditor's claim of security interest in such after-acquired property. On the other hand, the earlier (perfected) creditor does have his security in that interest which is after-acquired by his debtor.

Id. Comment 3 of § 9-312 explicitly rejects such reasoning.

[146] *See generally* 2 G. Gilmore, Security Interests in Personal Property § 29.3, at 784 (1965).

[147] *See* the fourth paragraph of Comment 3 to U.C.C. § 9-312.

[148] In explaining the necessity for a uniform, comprehensive statute governing the establishment and priority of security interests, the Code draftsmen specifically pointed to the fact that in many states creditors were unable to create enforceable security interests in inventory and stock in trade "although there was a real need for such financing." U.C.C. § 9-101, Comment.

[149] Significantly, the Florida legislature has attempted to correct the error of *International Harvester* with explicit Code amendments. *See* 1978 Fla. Laws 222.

2. The Rights of the Reclaiming Seller Against the Bankruptcy Trustee

This article has previously mentioned the distinction between a seller's reserved security interest and a seller's right to reclaim goods and has posited the view that the former is one of the Code's four property interests while the latter is a remedy incident to the seller's lien and consequent to the buyer's breach.[150] The distinction merits further discussion for two reasons. First, scholarly commentary and the cases are split.[151] Second, the efficacy of the seller's claim to the goods in bankruptcy proceedings depends upon the way courts characterize the right to reclaim. They should make this characterization, then, with regard for the Code's alternating reliance on security of property and good faith purchase principles.

The leading case, *Stowers v. Mahon (In re Samuels & Co., Inc.)*,[152] classified the right to reclaim as a security interest and concluded that the seller asserting that interest loses to the security interest of the buyer's financing company. The *Stowers* opinion contains language strongly supporting the idea that the perfected finance company prevails over the unperfected reclaiming seller.[153] Although the result in *Stowers* is correct, the court's analysis is troubling. In reaching its conclusion, the court relied on section 9-113, which requires a party holding an Article 2 security interest to comply with Article 9 once he loses possession of the goods.[154] The rules of Article 9, however, require not only that a creditor perfect his security interest, but also that he cause his security interest to attach.[155] Once a seller has relinquished possession by delivering the goods, his security interest can attach only if he obtains a security agreement that

---

[150] *See* text accompanying notes 114-24 *supra.*

[151] *Compare* Federal's, Inc. v. Matsushita Elec. Corp. of Amer. (*In re* Federal's, Inc.), 553 F.2d 509, 511 (6th Cir. 1977); Stowers v. Mahon (*In re* Samuels & Co., Inc.), 526 F.2d 1238, 1246 (5th Cir. 1976) *and* Peerless Equip. Co. v. Azle State Bank, 559 S.W.2d 114, 115 (Tex. Civ. App. 1977) *with* Guy Martin Buick, Inc. v. Colorado Springs Nat'l Bank, 184 Colo. 166, 519 P.2d 354 (1974) *and* Ranchers & Farmers Livestock Auction Co. v. First State Bank, 531 S.W.2d 167, 169 (Tex. Civ. App. 1975). For the divergence of scholarly view, *compare* Jackson & Peters, *supra* note 1, at 926; Kennedy, *supra* note 124, at 837; Wiseman, Cash Sellers, Secured Financers, and the Meat Industry: An Analysis of Articles 2 and 9 of the Uniform Commercial Code, 19 B.C. L. Rev. 101, 146 (1977) (articles supporting the security interest approach; Kennedy nonetheless supports most of the conclusions expressed in the text) *with* Braucher, Reclamation of Goods from a Fraudulent Buyer, 65 Mich. L. Rev. 1281, 1290 (1967) *and* Henson, Reclamation Rights of Sellers Under Section 2-702, 21 N.Y.L.F. 41, 49 (1975) (two articles supporting the characterization of the right to reclaim as a right or remedy other than a security interest).

[152] 526 F.2d 1238 (5th Cir. 1976).

[153] Since [the seller's] interest upon delivery of the cattle to [the buyer] was limited to a security interest subject to Article Nine, §§ 2.401(a); 9.113, the validity of [the finance company's] Article Nine interest becomes crucial. If [the finance company] is the holder of a perfected Article Nine interest in the collateral claimed by [the seller] through its unperfected § 2.401 interest, [the finance company's] interest will prevail over [the seller], § 9.312(e).

Id. at 1247.

[154] The *Stowers* opinion does not rely exclusively on the security interest analysis. The court also uses § 2-403 and notes the fact that the seller failed to demand return of the goods within 10 days as § 2-702(2) requires. *See id.* at 1244-45. Nevertheless, it is clear that the court regarded the security interest inquiry as "crucial" to the outcome. *See id.* at 1247.

[155] *See* U.C.C. § 9-203.

describes the collateral and is signed by the buyer.[156] Thus under the court's reasoning, the seller in *Stowers* is not only *unperfected,* he is *unsecured.*

Whether unsecured or merely unperfected, the seller would lose not only to the buyer's perfected secured creditors but also to the buyer's trustee in bankruptcy.[157] The priority of the trustee over the reclaiming seller exposes the problem with the *Stowers* approach. Most commentators who have considered the question conclude that the reclaiming seller should defeat the trustee.[158] The federal courts are split,[159] and the new Bankruptcy Code seems to leave the matter to state law.[160]

The Code's analytic framework supports the seller's priority over the trustee. Sections 2-702(2) and 2-507(2), which permit the seller to reclaim possession of the goods if he promptly asserts his claim,[161] preserve the common law right of the seller to avoid the effects of his delivery if the buyer was insolvent when he received the goods or if the seller delivers against a bad check.[162] These rules reflect the commercial judgment that sellers who sell on open account shortly before the buyer's bankruptcy, or who reasonably believe that they are delivering against the equivalent of

---

[156] *See* U.C.C. § 9-203(1)(a).

[157] U.C.C. § 9-301(1)(b) grants the trustee, as a lien creditor, priority over unperfected secured creditors. A fortiori, the trustee defeats unsecured creditors.

[158] *See, e.g.,* R. Henson, *supra* note 143, at 244-58; Braucher, *supra* note 151, at 1296; Kennedy, *supra* note 124, at 841.

[159] Bassett Furn. Indus., Inc. v. Wear (*In re* PFA Farmers Market Ass'n) 583 F.2d 992 (8th Cir. 1978); Federal's, Inc. v. Matsushita Elec. Corp. of Amer. (*In re* Federal's Inc.), 553 F.2d 509 (6th Cir. 1977); and Lewis v. Holzman (*In re* Telemart Enterprises, Inc.), 524 F.2d 761 (9th Cir. 1975), hold against the trustee. *In re* Kravitz, 278 F.2d 820 (3d Cir. 1960), and Robert Weed Plywood Corp. v. Downes (*In re* Richardson Homes, Corp.), 18 U.C.C. Rep. Serv. 384 (N.D. Ind. 1975), hold in favor of the trustee. To some extent, this split is attributable to the language of § 2-702(2), which is not uniform throughout the states. *See, e.g., In re* Goodson Steel Corp., 10 U.C.C. Rep. Serv. 387 (S.D. Tex. 1968). However, some district courts rely not on the language of their state's version of the Code, but rather on the language of the Bankruptcy Act. *See, e.g.,* Carnation Plastic Mfg. Co. v. Giltex, Inc., (*In re* Giltex, Inc.), 17 U.C.C. Rep. Serv. 887 (S.D.N.Y. 1975) (holding for the trustee); *In re* Good Deal Supermarkets, Inc., 384 F. Supp. 887 (D.N.J. 1974) (same).

[160] *See* 11 U.S.C.A. § 546(c)(1) (West Supp. 1979). The new Code expressly refers to the right to reclaim goods delivered to an insolvent buyer but does not mention the right to reclaim goods delivered against a bad check. The report of the House Judiciary Committee suggests that the purpose of the provision is to resolve in the seller's favor the controversy among courts over the question whether the trustee defeats the seller's right to reclaim under § 2-702(2). *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 371-72 (1977). The Report does not speak to the question whether the trustee defeats the right to reclaim under § 2-507(2). Given the purpose expressed in the Report, however, the courts would not be warranted in assuming that the Bankruptcy Code, by its failure to mention specifically the right to reclaim from a buyer who uttered a worthless check, renders the trustee's position superior to the latter right to reclaim.

[161] Section 2-702(2), relating to the buyer's insolvency, requires the seller to demand possession within 10 days of delivery, but removes that requirement if the buyer misrepresented in writing his solvency within three months preceding delivery. Section 2-507(2), relating to delivery on a bad check, does not contain an explicit promptness requirement, but Comment 3 to § 2-507 makes it clear that such a requirement is implicit, and several courts have agreed. *See, e.g.,* Stowers v. Mahon (*In re* Samuels & Co.), 526 F.2d 1238, 1246 (5th Cir. 1976); *In re* Helms Veneer Corp., 287 F. Supp. 840, 846 (W.D. Va. 1968).

[162] *See* cases cited in note 114 and accompanying text *supra.*

cash, should stand higher than other general creditors who may not look directly to the goods for satisfaction.

Given this rule, the Code must deal with the problem of whether third parties who have become transferees of interests in the goods before the seller's reclamation should take subject to the seller's reclamation rights. According to security of property analysis, the buyer receiving goods while insolvent or in return for a bad check would hold those goods subject to the seller's right to reclaim them and could give no greater rights to his transferees. Section 2-702(3) alters this result, however, by establishing a good faith purchase rule which subordinates the seller's reclamation right to the rights of buyers in ordinary course and to good faith purchasers under section 2-403.[163] The Code defines "purchase" broadly to encompass taking by "pledge, lien . . . or any other voluntary transaction creating an interest in property."[164] Thus, section 2-403, which permits a person with voidable title to transfer good title to good faith "purchasers," affords protection to good faith lenders as well as buyers.[165]

Subsequent buyers and lenders are sometimes caught in the wrangle between the original buyer, now insolvent, and the original seller, now trying to reclaim the goods. Such buyers and lenders deserve the good faith purchase benefit of section 2-702(3). Both may have been misled by the fact that the seller entrusted the original buyer with possession of the goods.[166] The trustee in bankruptcy, however, usually may not make this claim. Rather, he stands in the position of a lien creditor. He is not a good faith buyer and not a reliance creditor;[167] thus he is not within the class of third party transferees that section 2-702(3) was designed to safeguard.

In short, the conclusion that the reclaiming seller yields to bona fide buyers and secured lenders but prevails over the trustee in bankruptcy

---

[163] Similarly, Comment 3 to § 2-507 points out that the words "right as against the seller" in § 2-507(2) indicate that Article 2's bona fide purchaser rules protect third party transferees from the seller's claim.

[164] U.C.C. § 1-201(32).

[165] *See, e.g.,* United States v. Wyoming Nat'l Bank, 505 F.2d 1064, 1067 (10th Cir. 1974) (secured creditor is good faith purchaser); Morgan Guar. Trust Co. v. Third Nat'l Bank, 400 F. Supp. 383, 389 (D. Mass. 1975) (pledgee of treasury bills is a purchaser); House of Stainless, Inc. v. Marshall & Ilsley Bank, 75 Wis. 2d 264, 274, 249 N.W.2d 561, 566-67 (1977) (secured creditor is good faith purchaser).

[166] *Cf.* Howard Dodge & Sons, Inc. v. Finn, — Ind. App. —, 391 N.E.2d 638 (1979) (court rules for third party using traditional title theory without considering whether seller had right to reclaim or whether subsequent buyer was a good faith purchaser).

[167] *See, e.g.,* Ray-o-Vac Div. of ESB, Inc. v. Daylin, Inc. (*In re* Daylin, Inc.), 596 F.2d 853, 856 (9th Cir. 1979); Federal's, Inc. v. Matsushita Elec. Corp. of Amer. (*In re* Federal's, Inc.), 553 F.2d 509, 513 (6th Cir. 1977); French v. Debow, 38 Mich. 708, 712 (1878). For a contrary view, see *In re* Kravitz, 278 F.2d 820, 822 (3d Cir. 1960). The new Bankruptcy Code, 11 U.S.C.A. § 544(a)(1) (West Supp. 1979), gives the trustee the rights of a lien creditor who extends credit to the debtor at the time of the commencement of the case and suggests, thereby, that to some extent the trustee may be treated as a reliance creditor under the new Act. If it adheres to the *Federal's* reasoning, however, the Sixth Circuit would reach the same pro-seller result under the new Bankruptcy Code. *See* 553 F.2d at 514-15. *See also* 11 U.S.C.A. §§ 544(a)(3), 545(2) (West Supp. 1979) (giving trustee limited rights as a bona fide purchaser).

follows from a proper regard for the interplay of security of property and good faith purchase principles in the Code. It is a result that reflects commercial fact by distinguishing buyers and reliance creditors from nonreliance creditors. Perhaps not all good faith purchasers rely on possession, but many do, and the view advanced here permits them to rely on appearances without rewarding the nonrelying trustee. The rule advanced in *Stowers* fails to recognize this commercial distinction and creates a commercially unnecessary restriction on the right of the defrauded seller to reclaim his goods.

3. The *Twyne* Rule: A Neglected Weapon Against Practices That Mislead

The *Twyne* rule and the ostensible ownership doctrine which is ancillary to it have generated a measure of controversy among commentators.[168] One suspects that modern creditors rely less on a debtor's possession than did their mercantile ancestors, yet commercial lawyers may rue the day they scuttle a concept as ancient and practical as possession.[169] The Code has abandoned title,[170] and with good reason, but it has not abandoned possession and a concern for the fraud possession may foster. The mainspring of the entrustment rules of Article 2 and the perfection scheme of Article 9 is animus toward the secret lien; certainly the secret sale carries an equal, or greater, potential for misleading third parties.

McKenzie v. Oliver,[171] a recent Kentucky case, graphically illustrates the common nature of the secret sale and the secret lien, as well as the common danger they present to third parties. Davis borrowed $12,000 from plaintiff McKenzie, using his automobile as collateral for the loan. McKenzie failed to perfect this security interest. Davis subsequently ran into financial difficulties and, in order to save his car from creditors, entered into a sale and lease-back contract with a leasing company. Davis defaulted on the lease payments, and the leasing company repossessed the vehicle. Faced with the necessity of exercising the repurchase option or losing the automobile forever, Davis inveigled his friend Oliver to "buy" the car from the leasing company and leave it with Davis. Davis promised to rebuy it from Oliver when he had the money. Davis continued to use the car and remained the registered owner of it. Finally, McKenzie, the original secured party who had received no payments from Davis, made his move. He determined that Davis was still the registered owner of the vehicle and that

[168] *See, e.g.*, Coogan, Article 9—An Agenda for the Next Decade, 87 Yale L.J. 1012, 1030-36 (1978); Gordon, *supra* note 55, at 576-81.

[169] For a sampling of the continuing debate over the place of possession in modern commercial law, see Birnbaum, Section 9-307(1) of the Uniform Commercial Code Versus Possessory Security Interests: A Reply to Professor Kripke, 33 Bus. Law. 2607 (1978); Kripke, Should Section 9-307(1) of the Uniform Commercial Code Apply Against a Secured Party in Possession?, 33 Bus. Law. 153 (1977); Phillips, Flawed Perfection: From Possession to Filing Under Article 9 (pts. 1-2), 59 B.U.L. Rev. 1, 209 (1979).

[170] *See* U.C.C. §§ 2-401, 9-202.

[171] 571 S.W.2d 102 (Ky. 1978).

no liens were recorded against it. He sued Davis, obtained a default judgment, and levied on the vehicle. Oliver, the "buyer," then sued McKenzie for conversion and wrongful attachment, claiming to be the owner of the car. McKenzie raised a fraud defense, but based it on the state fraudulent conveyance statute which did not cover the conduct of Davis and his friend Oliver. In a confusing opinion which found, among other things, that title was in Davis but ownership was in Oliver,[172] the court ruled in favor of Oliver, the buyer.

Application of Code principles would have yielded a different result. There are two ways of characterizing the relationships among Oliver, Davis, and the leasing company, and both render Oliver's claim against McKenzie untenable. Under the definition of security interest in section 1-201(37), it appears that the lease-back contract between Davis and the leasing company gave the latter only a security interest in the car.[173] As a repossessing secured party, the leasing company had the power, under section 9-504(1), to sell the collateral to Oliver on Davis' default. Thus it could be argued that Oliver purchased the car *from the leasing company* and then resold it to Davis, with payment to be made at some future time when Davis had the funds. Under this interpretation, the only interest the Code permits Oliver to retain in the car is a security interest.[174] Because Oliver failed to perfect this interest—having neither retained possession nor filed—he loses to McKenzie who is a lien creditor.[175] In the alternative, it could be argued that Oliver purchased the car *from Davis* by paying off Davis' debt to the leasing company. Oliver then left the car in Davis' possession with the understanding that Davis would eventually buy it back. Under this characterization of the facts, McKenzie still wins. By leaving goods in the possession of the seller, Oliver will lose to the seller's creditor by operation of section 2-402(2) and the *Twyne* rule.[176] This analysis of *McKenzie* highlights the common rationale of the rule favoring the lien creditor over the unperfected secured creditor and the rule favoring the seller's creditor over the buyer who leaves the seller in possession. Both rules proceed from the premise that secrecy, whether by lien or by sale, offends notions of commercial fairness.

Courts, however, have often ignored the precept that parties who create a secret interest lose to the innocent creditor. One leading case, *Sherrock v.*

---

[172] *Id.* at 106.

[173] The pertinent section of U.C.C. § 1-201(37) states:

Whether a lease is intended as security is to be determined by the facts of each case; however, (a) the inclusion of an option to purchase does not of itself make the lease one intended for security, and (b) an agreement that upon compliance with the terms of the lease the lessee shall become or has the option to become the owner of the property for no additional consideration or for a nominal consideration does make the lease one intended for security.

[174] *See* U.C.C. §§ 1-201(37), 2-401(1).

[175] "[A]n unperfected security interest is subordinate to the rights of . . . a person who becomes a lien creditor before the security interest is perfected . . . ." U.C.C. § 9-301(1)(b).

[176] The text assumes that Kentucky courts have accepted the *Twyne* doctrine as part of the state's common law.

Commercial Credit Corp.,[177] presented a classic setting for invocation of the *Twyne* rule. The buyer, an automobile dealer partnership, entered into a contract to purchase two automobiles from another dealer. The buyer paid for the vehicles on the day the contract was made, but agreed to leave them in the seller's showroom for approximately a week. In the interim, the seller's secured creditor repossessed all automobiles on the showroom floor. The buyer then sued the creditor for wrongful possession of the two vehicles it had contracted to purchase.

The parties litigated the case as a question of whether the buyer qualified as a "buyer in ordinary course" who would prevail under section 9-307(1). The secured party argued that the buyer, an automobile dealer presumably aware that its agreement to delay delivery was in direct violation of trade practices,[178] had not acted in good faith and so could not avail itself of that good faith purchase section. The court disagreed and accorded good faith purchase protection to conduct to which the *Twyne* rule would have denied security of property protection.[179] The buyer advanced no explanation for its departure from trade practice, and those familiar with automobile floorplanning[180] might suspect a plot to deceive the seller's floorplanner. It is not necessary, however, to predicate application of the *Twyne* rule on a finding of actual fraudulent intent. Even if the delivery delay resulted from innocent procrastination, there is no legal or economic reason to protect a merchant buyer's right to procrastinate at the expense of a creditor who might act in reasonable reliance on possession. Section 2-402(2) and *Twyne*, then, should govern the result in *Sherrock*.

Rex Financial Corp. v. Mobile America Corp.[181] presented a fact pattern very similar to that of *Sherrock*, but with one significant variation. In *Rex*, *consumers* purchased a mobile home. They executed a retail installment contract granting the selling dealer a purchase money security interest and then left the vehicle on the dealer's lot. The dealer assigned the contract to a bank and, when the dealer's floorplanner seized the mobile home under its security agreement covering the dealer's inventory, the bank's successor in interest—Mobile American—sued.

The court's analysis was properly grounded on the assumption that Mobile American took whatever interest its transferors, the consumer

---

[177] 290 A.2d 648 (Del. 1972).

[178] The opinion of the dissenting justice in *Sherrock* points out that expert testimony at the trial indicated "quite conclusively" that the buyer's course of conduct did not conform to the usual trade practice in sales between two dealers. *Id.* at 652. Thus, the part of § 2-402(2) that stays the application of the *Twyne* rule when a merchant seller retains goods for a "commercially reasonable time" after sale would not be applicable in *Sherrock*.

[179] The *Sherrock* court's failure to discuss the *Twyne* rule is all the more puzzling in light of the fact that the lower court did. *See* Sherrock v. Commercial Credit Corp., 277 A.2d 708, 710-11 n.3 (Del. Super. Ct. 1971).

[180] Described briefly, "floorplanning" entails a creditor's financing of a dealer's purchases of inventory. The creditor takes a security interest in the inventory and may later buy from the dealer at a discount the chattel paper—promissory note plus security agreement—generated by customer purchases of the inventory.

[181] 119 Ariz. 176, 580 P.2d 8 (1978).

purchasers, had enjoyed. The court determined that the purchasers were buyers in ordinary course[182] who, by virtue of section 9-307(1), took free of the floorplanner's security interest.[183] It then held that Mobile American, as the purchasers' transferee under the assigned retail installment contract, succeeded to their unencumbered interest. This analysis is correct as far as it goes. The court did not go on to consider, however, whether the buyers, by leaving the goods with the dealer, exposed themselves and their transferee to the secret sale defense recognized by section 2-402(2).[184]

It may well be that the facts in *Rex* call for a different result from those in *Sherrock*. In the former case, nonmerchant buyers acquiesced in the seller's continued possession; in the latter case, professional dealers, who should have known better, were responsible for the seller's continued control over the goods. Perhaps the *Twyne* rule ought not be applied with equal vigor against consumers of personal, family, or household products. Courts should make such a determination, however, only after they acknowledge the role of section 2-402(2) in the Code's conveyancing scheme and confront the competing interests of consumers and creditors in such cases.

In *Sherrock* and *Rex*, the courts failed to recognize the applicability of section 2-402(2); in some cases, that failure results from the courts' distraction by an essentially irrelevant mode of analysis—most frequently, an obsession with locating title. *C.I.T. Financial Services Corp. v. First National Bank*[185] involved complicated facts. The plaintiff bank, assignee of a mobile home dealer's chattel paper, held a properly filed security interest in a mobile home. When the buyer defaulted, the bank repossessed the collateral, left it with the dealer and then, inadvisedly, cancelled its financing statement in anticipation that its credit insurance company would satisfy the deficiency. The latter event did not occur and, in the meantime, the dealer granted a security interest in its mobile home inventory to the defendant finance company (C.I.T.). C.I.T. properly filed an inventory financing statement. Ultimately, the dealer defaulted and C.I.T. took possession of the inventory, including the repossessed home which had remained on the dealer's lot.

The court ruled against C.I.T. using the following analysis: title to the mobile home had vested in the buyer by means of the dealer's original conveyance; absent reconveyance, title remained in the buyer; the dealer, therefore, had no interest in the vehicle at the time it tried to grant the

---

[182] It could be argued that this conclusion is unsound on the facts. The buyers in *Rex* had not paid anything down and had left the home with the dealer. Such conduct may not reflect good faith and may not constitute the "ordinary course" transaction § 9-307(1) protects.

[183] Note that the court implicitly held that the buyers need not have taken delivery of the home in order to qualify as buyers in ordinary course. To that extent, *Rex* supports the position taken earlier in this article that neither delivery nor passage of title is indispensable for the rules of § 9-306(2) or § 9-307(1) to apply. *See also* the authority cited in note 269 *infra*.

[184] This analysis assumes that since Mobile American is the secured creditor of the buyer, not the seller, § 2-402(3)(a) does not apply. For two recent cases that follow the trend of *Rex*, see Wickes Corp. v. General Elec. Credit Corp., 363 So. 2d 56 (Fla. Dist. Ct. App. 1978); Sebrite Corp. v. Transouth Fin. Corp., — S.C. —, 252 S.E.2d 873 (1979).

[185] 344 So. 2d 125 (Miss. 1977).

finance company a security interest; because the dealer had no rights in the collateral, the finance company's security interest never attached.

An analysis that eschewed concern with the location of title for application of the Code's conveyancing principles would yield a different result. The critical question is whether C.I.T.'s security interest attached,[186] and the fact that the buyer held title to the mobile home throughout is clearly immaterial.[187] Had the *buyer* left the home with the dealer, *Twyne* could have prevented him from asserting his "title" to defeat the dealer's creditors.[188] That the bank, rather than the buyer, left the goods with the seller arguably should not change this result. As a perfected secured party at the time of default and repossession, the bank had a right to dispose of the collateral.[189] Having placed the home in the dealer's possession,[190] the bank should be no more immune to the *Twyne* claim of a creditor than the buyer, the source of its interest, would have been.[191]

The Code leaves the state courts free to determine those instances in which *Twyne*'s anti-secret sale rule should be applied.[192] Certainly the *C.I.T.* court might have declined to use *Twyne* or to take it one step further and apply it to the conduct of one whose interest in goods is derived from the buyer. Yet, the manner of the inquiry sometimes determines the outcome. Had the court recognized the appropriateness of a *Twyne* analysis, it could have approached the case with a flexibility that the rigid title model did not permit. A balancing of the equities might have revealed to the court that the *C.I.T.* result conflicts with economic sense. The bank not only created a misleading situation by leaving the goods with the dealer, but also cancelled its financing statement, creating a clean record and aggravating the potential for deception of creditors. It would have cost the bank little to

---

186 Once it is established that C.I.T.'s security interest did attach, it seems evident that C.I.T. would prevail. The bank was no longer perfected at the time C.I.T. perfected its interest.

187 *See* the discussion of the *Zions* case, text accompanying notes 230-36 *infra*. The *C.I.T.* court's opinion is rife with title references, yet it seems to acknowledge that title in the debtor is not a necessary prerequisite for the debtor to create a security interest. The opinion refers to the fact that the dealer had "no title *or interest*" in the home. 344 So. 2d at 126 (emphasis added).

188 *See* U.C.C. § 2-402(2).

189 *See* U.C.C. § 9-504(1).

190 The analysis in the text assumes that the original transfer of the chattel paper from the dealer to the bank was on a nonrecourse basis. In that case, the dealer retained no interest in or liability for the vehicle. If, however, the bank left the goods with the dealer because, pursuant to the terms of the chattel paper transfer, the dealer ultimately had to satisfy any loss the bank suffered, then § 9-306(5) would control in determining priorities. Under § 9-306(5)(b), the bank has a security interest as against the dealer without further action on the bank's part, but, to prevail against third parties—such as C.I.T., who became a creditor of the dealer subsequent to the repossession—the bank has to refile or take possession. *See* U.C.C. § 9-306(5)(d). Thus even if the transfer had been on a recourse basis, C.I.T. should prevail.

191 Note that if the dealer had entered into a contract to *sell* the home while it sat on the lot, the bank would lose to a buyer in ordinary course, *see* U.C.C. § 2-403(2), or perhaps to any buyer, *see* U.C.C. § 2-402(1).

192 Section 2-402(2) defers to the anti-secret sale rules of "the state where the goods are situated."

leave its filing of record until its insurer paid the claim, and such a practice would have furthered Article 9's concern for protecting reasonable commercial expectations.[193] By using *Twyne* to vindicate C.I.T.'s claim to a security interest in the goods, the court could have avoided rewarding the bank in the face of its carelessness.

Section 2-402(2) invites the courts to exercise their common law prerogative to balance the equities of a case and weigh the fairness of leaving one in possession who has no interest in the goods.[194] Absent a legitimate commercial explanation or a countervailing policy such as consumer protection,[195] courts should discourage the practice, for it smacks of fraud. It is unfortunate that most lawyers fail to recognize, and most courts fail to use, the *Twyne* rule as a way to restrain such undesirable commercial conduct.

B. *Identifying and Reconciling the Property Interests*

The foregoing discussion illustrates that parties often litigate Code disputes without recognizing the interaction of the three conveyancing principles and without considering the commercial policies they foster. The rest of this article discusses cases which fail to identify the competing property interests involved. The first two cases in this part exemplify the problems that this failure creates. The remaining cases demonstrate that the major obstacle to effective property interest analysis is the tendency of courts and commercial lawyers to revert to pre-Code title theory in unraveling commercial disputes.

1. General Applications: Bailment and Drop-Shipments

Procter & Gamble Distributing Co. v. Lawrence American Field Warehousing Corp.[196] is an Article 7 bailment case that illustrates the importance of

[193] *Cf.* United States v. Ocean Elec. Corp. (*In re* Ocean Elec. Corp.), 22 U.C.C. Rep. Serv. 1270 (S.D. Cal. 1977) (bankruptcy court ruled against secured creditor who was perfected but had left goods in the hands of a third party, not the debtor).

[194] It is outside the scope of this article to consider whether it might be desirable for courts to extend the anti-secret sale rule beyond the situation where the buyer leaves the goods with the seller. I have contended elsewhere that the New York Court of Appeals should have done so in the case of Tanbro Fabrics Corp. v. Deering Milliken, Inc., 39 N.Y.2d 632, 350 N.E.2d 590, 385 N.Y.S.2d 260 (1976). *See* Dolan, *supra* note 122, at 1151-61. In Medomak Canning Co. v. William Underwood Co. (*In re* Medomak Canning Co.), 25 U.C.C. Rep. Serv. 437 (D. Me. 1977), Judge Cyr refused to extend the rule to a bailment. In *Medomak* the bailor caused supplies to be delivered to a food processor who processed them and held the finished goods. The processor's trustee in bankruptcy claimed the goods. Judge Cyr acknowledged that had the processor and its customer occupied a seller-buyer relationship, Article 2 would permit state ostensible ownership rules to apply. Since the relationship was one of bailor-bailee, however, he ruled that the doctrine was inapplicable, though he failed to discuss any policy rationale for refusing to extend the rule.

[195] Section 2-402(2) stipulates that *Twyne* should not apply to a merchant seller's retention of sold goods for a commercially reasonable period of time. Possibly, this provision of § 2-402(2) would permit courts to invoke the *Twyne* rule more stringently against merchant buyers than against consumers. As the discussion of the *Rex* and *Sherrock* cases suggests, a period during which it is reasonable for a consumer to leave a mobile home with the seller may not be reasonable for a merchant buyer to leave it with the seller.

[196] 16 N.Y.2d 344, 213 N.E.2d 873, 266 N.Y.S.2d 785 (1965).

differentiating property interests[197] carefully. The plaintiff (P&G) had entered into contracts to sell vegetable oil to Allied Crude Vegetable Oil Refining Corporation (Allied). Allied was speculating that the price of oil would climb, but it could not raise sufficient cash to pay in full for the oil it was buying. It therefore proposed to make a twenty percent downpayment, upon which P&G would deliver the oil to the defendant field warehouse (Lawrence American). The warehouse would in turn issue nonnegotiable warehouse receipts to P&G.

This proposal, a classic field warehouse arrangement, was accepted by P&G. Delivery of the oil directly to Allied would have jeopardized P&G's position. Such delivery would have constituted entrustment,[198] permitting Allied to transfer good title to its buyer-in-ordinary-course customers.[199] The only interest P&G could have retained, moreover, had it delivered the oil, would have been a security interest.[200] Even a perfected security interest would have fallen before the buyer in ordinary course rule of Article 9,[201] regardless of whether P&G had forbidden the resale.[202] Delivery to Allied, then, would have left P&G with precarious security for the balance of the purchase price.

By contrast, the field warehousing arrangement provided an efficient means for P&G to satisfy the requirements of Article 9[203] while precluding any opportunity for Allied to dispose of the oil. The sales contract itself could serve as the security agreement and cause the security interest to attach.[204] The issuance of the nonnegotiable receipts to P&G was sufficient to perfect the security interest.[205] Field warehousing provided an additional assurance to P&G. When the warehouse issued the nonnegotiable receipts to P&G, P&G became the "person entitled" to delivery of the oil.[206] Were the warehouse to have delivered the oil to someone other than P&G, the warehouse would have been liable.[207] In short, this field warehousing

[197] I have discussed the Article 7 conveyancing rules in a recent article. *See* Dolan, Good Faith Purchase and Warehouse Receipts: Thoughts on the Interplay of Articles 2, 7, and 9 of the U.C.C., 30 Hastings L.J. 1 (1978). The analysis offered there supports the text's analysis of *Procter & Gamble.*

[198] *See* U.C.C. § 2-403(3).

[199] *See* U.C.C. §§ 2-403(2), 7-205, 9-307(1). *See, e.g.,* First Nat'l Bank v. Crone, 157 Ind. App. 665, 301 N.E.2d 378 (1973).

[200] *See* U.C.C. §§ 1-201(37), 2-401(1). *See also* the discussion of the *Zions* case, text accompanying notes 230-36 *infra.*

[201] U.C.C. § 9-307(1). *See, e.g.,* American Nat'l Bank v. Mar-K-Z Motors & Leasing Co., 57 Ill.2d 29, 309 N.E.2d 567 (1974).

[202] Of course, if P&G authorized the resale, it loses its security interest to all purchasers under the rule of § 9-306(2). *See, e.g.,* Draper v. Minneapolis-Moline, Inc., 100 Ill. App. 2d 324, 328-29, 241 N.E.2d 342, 345 (1968).

[203] P&G's security interest must comply with Article 9 whether it arises under that Article or under Article 2. *See* U.C.C. § 9-113.

[204] *See* U.C.C. § 9-203. Arguably, there is no need for a signed security agreement. In a field warehousing situation, the possession by the field warehouse should satisfy § 9-203(1)(a). *See* U.C.C. § 9-205 & Comment 6.

[205] *See* U.C.C. § 9-304(3).

[206] *See* U.C.C. § 7-403(4).

[207] Section 7-403 states that the "bailee must deliver the goods to a person entitled under the document" unless the bailee can establish a "lawful excuse." Thus, misdelivery is a breach

arrangement benefited both Allied, the buyer, and P&G, the seller. Allied reduced its cash requirements. P&G made the sale, protected itself from the buyer's default by a perfected security interest, and shielded itself from the threat of buyers in ordinary course by ensuring the bailee's liability for delivery to anyone other than P&G or its designee. The arrangement, then, avoided the danger that Allied would convey the oil to third parties free of P&G's interest.[208]

This analysis of the transaction becomes important in resolving the dispute that arose between P&G and the defendant field warehouse when the oil disappeared. That Lawrence American must bear the loss is an inescapable conclusion, and the New York Court of Appeals so held.[209] There are different ways of arriving at that conclusion, however, and the measure of damages varies with the theory employed.

The court assumed that the issue was one of traditional bailment law, so that the market value on the date of conversion determined P&G's recovery.[210] It found that the value of the oil on that date was equal to the amount of the contract purchase price.[211] Allied, however, had already paid P&G twenty percent of that price—some $200,000. The court of appeals rejected the notion that Lawrence American, the bailee, should benefit from that downpayment. In reversing the lower court's ruling which had allowed an offset, the court assumed that Allied, or rather its trustee in bankruptcy, would see to it that P&G did not enjoy a double recovery of the twenty percent.[212] Analysis of the *Procter & Gamble* case in terms of property interests would yield a different result.

The theory of P&G's claim was conversion. It is an accepted precept of conversion law that

> [t]he bailor may recover the full value if he was entitled to immediate possession at the time of the conversion, but if he was then entitled only to future possession, he recovers only the damages he can prove to *his own interest* in the chattel.[213]

Article 9 indicates that P&G's interest in the oil consisted of a security interest to ensure payment of the purchase price. Issuance of the

---

of the warehouse's primary obligation. *Cf.* Koreska v. United Cargo Corp., 23 App. Div. 2d 37, 41, 258 N.Y.S.2d 432, 437 (1965) (same rule of liability for negotiable bills of lading).

[208] Note, however, that there is authority that Allied might convey the oil to a buyer in ordinary course if it is customary in the industry to sell oil in the possession of third parties. *See* Tanbro Fabrics Corp. v. Deering Milliken, Inc., 39 N.Y.2d 632, 350 N.E.2d 590, 385 N.Y.S.2d 260 (1976). For criticism of this view see R. Henson, *supra* note 143, at 134-35; Dolan, *supra* note 122; Kripke, *supra* note 169. For support of this view see Birnbaum, *supra* note 169; Gottlieb, Section 9-307(1) and Tanbro Fabrics: A Further Response, 33 Bus. Law. 2611 (1978).

[209] Procter & Gamble Dist. Co. v. Lawrence Amer. Field Warehousing Corp., 16 N.Y.2d at 350, 213 N.E.2d at 875, 266 N.Y.S.2d at 789.

[210] *Id.* at 352, 213 N.E.2d at 876-77, 266 N.Y.S.2d at 790.

[211] *Id.* at 352-53, 213 N.E.2d at 877, 266 N.Y.S.2d at 791.

[212] *Id.* at 355-56, 213 N.E.2d at 878-79, 266 N.Y.S.2d at 793-94.

[213] W. Prosser, Handbook of the Law of Torts 96 (4th ed. 1971) (emphasis added; footnotes omitted). *See* cases cited therein.

warehouse receipts notwithstanding, P&G was not entitled to repossess the oil unless Allied defaulted on the purchase contract.[214] Had P&G been able to repossess the collateral and sell it, P&G's rights in proceeds from the resale would have been limited to an amount equal to the balance of the indebtedness,[215] and Allied's prepayment had reduced that secured indebtedness to eighty percent of the purchase price. Thus, from an Article 9 perspective, P&G's interest in the oil was only as great as the amount of the contract price it had not yet received from the buyer.

The *Procter & Gamble* case demonstrates the importance of looking through the superficial features of the transaction and, especially, of avoiding automatic reliance on pre-Code characterizations. The New York court's analysis of P&G's claim as a straightforward bailment ignored the underlying credit nature of the transaction and yielded a result different from that which Article 9 would dictate. In essence, the P&G-Allied relationship was a credit sale, and the only property interest P&G had in the oil was a security interest. The Code rules relating to security interests, then, should have governed.[216] By permitting P&G to recover the full value of oil for which Allied had partially paid, the court ignored the intent of Article 9 to treat a security interest as an interest limited by the amount of the debt secured.[217] The *Procter & Gamble* ruling furthers no demonstrable policy. In the first place, P&G realized a windfall that arose from the happenstance of prepayment. Allied's trustee in bankruptcy may well have succeeded eventually in reclaiming that prepayment, but no policy is served by fostering a circuitous recovery route. Finally, by forcing the warehouse to pay P&G, who would then return the amount of the prepayment to Allied's trustee, the court deprived the warehouse of setoff rights against the trustee for claims it may have had against the bankrupt.

Procter & Gamble points up the necessity of beginning the analysis of a commercial dispute by identifying the property interests involved. The New York court bypassed such an approach for traditional bailment rules that did not reflect the overriding credit nature of the transaction. As a result, it arrived at a conclusion which is commercially unsound and statutorily incorrect. Sometimes courts reach the same outcome that recognition of the relevant property interests would have yielded. Those cases are less persuasive, however, when the courts fail to bring their reasoning within the Code framework. *Fuqua Homes, Inc. v. Evanston Building and Loan Co.*[218] is a good example of such a case.

---

[214] "A secured party *after default* may sell, lease or otherwise dispose of any or all of the collateral . . . ." U.C.C. § 9-504(1) (emphasis added). It was not clear when or how the bailee converted the oil. The court used the date of delivery as the conversion date for the purpose of determining damages. Thus we do not know whether Allied was in default at the time the conversion actually took place.

[215] "If the security interest secures an indebtedness, the secured party must account to the debtor for any surplus . . . ." U.C.C. § 9-504(2).

[216] Section 9-102 commands that Article 9 apply to "any transaction (regardless of its form) which is intended to create a security interest . . . ."

[217] *See* note 215 and accompanying text *supra*.

[218] 52 Ohio App. 2d 399, 370 N.E.2d 780 (1977).

In *Fuqua*, the plaintiff manufacturer supplied a modular home for a dealer who had entered into a retail contract with a consumer. The consumer borrowed the purchase price from the defendant building and loan company and gave it a security interest. Although the opinion is not absolutely clear on this point, it appears that the manufacturer made a drop-shipment, *i.e.*, it transported the unit directly to the consumer's lot. The consumer paid the dealer, but the dealer absconded without paying the manufacturer. The latter sued, claiming the goods. Faced with two innocent parties, one of whom had to bear the loss, the court held for the consumer and its creditor.

This result is emminently sensible. Buyers in ordinary course and the secured lenders from whom they obtain their credit should not be put to the expense of title inquiry. It is far less costly for the manufacturer to protect itself from dishonest dealers, by investigating the reputation of its dealers at the outset of the relationship, by insisting on payment before shipment of the goods, or by using the documentary draft in appropriate settings.[219] The *Fuqua* court's reasoning, however, is questionable. In denying the manufacturer's claim, the court relied on section 2-403(2), which applies to cases in which the true owner of goods "entrusts" them to a dealer in goods of that kind.[220] Application of section 2-403(2) to a drop-shipment, where the dealer never actually receives possession of the goods, strains the language of the entrustment provision. Thus, other courts faced with drop-shipment situations may not find *Fuqua* persuasive.

The result in *Fuqua* finds better support in analysis of the property interests involved. Once the manufacturer entered into a contract of sale with the dealer and identified the goods, the dealer obtained a special property interest in them. The manufacturer retained only a seller's lien and a security interest.[221] Upon delivery, he loses the seller's lien to third party good faith purchasers. His security interest falls to the consumer's lender. The dealer conveyed his special property to the consumer, and the security interest of the consumer's lender attached to that property interest.[222] In a contest between the manufacturer and the consumer's creditor, the manufacturer's security interest falls. Even if Fuqua had perfected its security interest by filing after relinquishing possession,[223]

[219] The first of these methods is the most common. When the seller deals with relatively few dealers, as most such sellers would, the cost of monitoring the creditworthiness of these dealers is relatively small. Generally, manufacturers and distributors are in a far better position to select dealers carefully than are consumers to select their retailers. Although the consumer will ultimately pay the costs of this selection process through increased prices, presumably it would cost him more to conduct such investigation himself everytime he purchases goods from each of his retail suppliers.

[220] "Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business." U.C.C. § 2-403(2).

[221] Of course, the manufacturer also retained the rights of reclamation that Article 2 affords him as a seller. *See* text accompanying notes 244-48 *infra*.

[222] This conveyancing analysis appears more fully in the discussion of *Zions First Nat'l Bank v. First Sec. Bank*, text accompanying notes 230-36 *infra*.

[223] Section 9-113 requires filing in order for Fuqua's Article 2 security interest to remain perfected after delivery of the goods. *See* U.C.C. § 9-113, Comment 3.

the buyer in ordinary course rule of section 9-307(1) provides good faith purchaser protection for the consumer, and thus for its creditor. This analysis of *Fuqua* avoids the necessity of straining the concept of entrustment to fit drop-shipments and thereby affords more complete protection to buyers who deserve it.

2. The Lingering Allure of Title

The Code's premise[224] that the location of title should not determine the rights of buyers, sellers, and their creditors appeals to commercial good sense. In most business transactions, title plays virtually no part. The parties seldom give any thought to title when they plan and execute a sale; the nature and location of title become important to them only if the transaction goes awry and they are forced to defend their position in legal proceedings. Such observations about title led Professor Llewellyn to argue that the rights and liabilities of the parties should turn on the realities of commercial practices rather than on abstract legal notions of title.[225] In adopting the Code, the state legislatures have accepted that argument.[226] It remains to be seen, however, whether Llewellyn's argument properly reckoned the psychological basis of the title concept, and whether indeed the Code has weaned commercial law from its emotional reliance on title reasoning. Evidence abounds that the Code effort has thus far fallen short. That failure manifests itself in opinions in which courts do not perceive the rules described in this article and resort instead to traditional title reasoning in order to fashion a result.[227]

The Reserved Security Interest Cases

Frequently, sellers who enter into a contract with a buyer must wait for payment. In such instances, the seller may attempt to structure the contract in such a way that it remains reversible until the buyer pays. The seller may think of the goods as remaining his "property" until he receives payment; sometimes he will try to incorporate such notions into the sale agreement. Classical title theory would view this arrangement as retention of title, and lawyers for these sellers continue to characterize it in that fashion. Whatever name the seller gives his retained rights, however, it is clear that the Code views them as a security interest.[228] The clear intention of the Code notwithstanding, many courts adhere stubbornly to the title approach.

To some extent, the *International Harvester Credit Corp.* case discussed above[229] reflects such reasoning, but *Zions First National Bank v. First*

[224] *See* U.C.C. §§ 2-401, 9-202.
[225] *See generally* Llewellyn, *supra* note 60.
[226] "[T]he rights and remedies of the parties to the contract of sale, as defined in this Article, rest on the contract and its performance or breach and not on stereotyped presumptions as to the location of title." U.C.C. § 2-505, Comment 1.
[227] The *C.I.T.* case discussed earlier is a prime example of reliance on title theory. *See* text accompanying notes 185-93 *supra*.
[228] *See* U.C.C. §§ 1-201(37), 2-401(1), 9-202.
[229] *See* text accompanying notes 140-49 *supra*.

Security Bank[230] serves as a more dramatic illustration of this departure from the Code scheme. In *Zions*, the seller entered into a contract with a buyer who had previously granted its bank a security interest in after-acquired inventory. The seller delivered the goods against drafts and checks that were subsequently dishonored. When the buyer defaulted on its obligations to the bank, the bank seized the goods pursuant to its properly filed security agreement. The seller, contesting this disposition, sued to recover the goods. The court, following title reasoning, found that the agreement between buyer and seller had contemplated that title would remain in the seller until payment; the court concluded, therefore, that no interest passed to the buyer when he failed to pay.[231] Once it had made that assumption, the court held that the bank's security interest did not attach because the debtor had had no interest in the collateral to which it could have attached.[232]

This holding disregards two features of the Code's pattern for conveyances. First, it ignores the special property; second, it accords title too much weight. The buyer and the seller having entered into a contract of sale, and the goods having been delivered, the buyer must have a special property in the goods.[233] The existence of that property interest belies the court's assertion that the debtor had no interest in the goods and contravenes the conclusion that the bank's security interest could not attach.[234] By clear application of security of property principles, the bank takes a security interest in that which its transferor enjoyed—here, the debtor's special property. Moreover, the court's view that a seller may retain title after delivery contradicts the legislative command that "[a]ny retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest."[235] Proper attention to that command would have yielded a result different from that reached by the *Zions* court. Absent the seller's compliance with the procedures of section 9-312(3) for establishing the priority of its purchase money security interest, the bank would have prevailed on the basis of its early filing.[236]

Zions First National Bank, then, reflects too little regard for the Code's construct of property interest and conveyancing rules and too much

---

[230] 534 P.2d 900 (Utah 1975).

[231] In *Zions*, the seller directed the buyer's employee to segregate the goods—here, cattle which were branded with a different mark—on delivery. That action of the seller, however, does not change the fact that its only interest in the cattle at that point was a security interest.

[232] Comment 3 to § 9-312 explicitly notes that the priority rules of § 9-312 were intended to preclude such "manipulation of title theory."

[233] Although the parties may postpone the time when the special property arises, they may not postpone it beyond the time of delivery. First Nat'l Bank v. Smoker, 153 Ind. App. 71, 87, 286 N.E.2d 203, 212 (1972). *See* U.C.C. § 2-501(1).

[234] *See, e.g., In re* Automated Bookbinding Serv., Inc., 336 F. Supp. 1128, 1135 (D. Md. 1972) (identification gives debtor sufficient rights in collateral for purchase money security interest to attach).

[235] U.C.C. § 2-401(1).

[236] *See* U.C.C. § 9-312(5).

regard for title analysis. In addition, the case creates a significant and unwarranted incursion into the notice protection afforded to revolving inventory lenders by section 9-312(3). There may be cases in which fairness demands relaxation of specific Code rules,[237] but such flexible application of the Code should turn on careful evaluation of policy rather than on unthinking reversion to title theory.

Zions First National Bank represents one of the clearest illustrations of the title reliance syndrome, but by no means does it stand alone.[238] In other cases, the misreliance on title has taken more subtle forms. In *Thermo-Sentinal Corp. v. Chad Metals, Inc., (In re Thermo Sentinal Corp.)*,[239] the court characterized as a title question a conveyancing dispute in which title had no bearing at all. The buyer had ordered bonded metal from the seller and had directed the seller to deliver it to a third party for fabricating. Before completion of the fabrication and before payment, the buyer filed in bankruptcy. The seller asserted a claim for the metal held by the fabricator. The court determined that the fabricator was not the seller's agent for purposes of maintaining possession to preserve an Article 2 security interest.[240] Having found that the seller had relinquished possession without filing, the court concluded that the seller had retained no security interest in the metal.[241] The court then identified the critical issue as one of title to be determined under the title passage rules of section 2-401.[242] On that assumption, the court reviewed the facts, noted that the seller had delivered the goods, held that title had passed on delivery, and ruled against the seller in favor of the buyer's trustee in bankruptcy.

Removed from the title framework, the *Thermo-Sentinal* case yields a different perspective. The proper resolution of a dispute between a seller and a bankrupt buyer's creditors must begin with a review of the seller's rights in the goods at the point at which the transaction broke down. Once goods are identified to a contract, the buyer acquires a legally-cognizable interest in them—the special property.[243] At that point, the seller still

---

[237] For some provocative suggestions on the manner of effecting such modification of Code rules, see Summers, General Equitable Principles Under Section 1-103 of the Uniform Commercial Code, 72 Nw. U.L. Rev. 906 (1978).

[238] *See, e.g.*, American Nat'l Bank v. O'Neil (*In re* Magrey), 25 U.C.C. Rep. Serv. 868 (D. Conn. 1979) (court holds that because title never passed to the debtor, the secured party took no interest. In fact, the buyer-debtor had a special property and although the seller conveyed not to the buyer-debtor but to his wife, the wife must take what the seller had: title subject to the husband's special property, in which the bank had a perfected security interest); Exchange Bank & Trust Co. v. Glenn's Marine, Inc., 265 Ark. Adv. Sh. 508, 579 S.W.2d 358 (1979) (court uses title analysis in a sale on approval case and ignores § 2-326(3), which should have governed). *But see* General Elec. Credit Corp. v. Tidwell Indus., Inc., 115 Ariz. 362, 565 P.2d 868 (1977) (court rejects the *Zions* case and distinguishes the *International Harvester* case).

[239] 426 F. Supp. 1179 (W.D. Pa. 1977).

[240] *Id.* at 1181.

[241] *Id.* at 1182.

[242] *Id.* at 1181-82.

[243] U.C.C. § 2-501(1).

enjoys certain rights in the goods, but these rights may be exercised only in certain situations. For example, the seller may withhold delivery or cancel if the buyer breaches;[244] it may stop delivery[245] or reclaim delivered goods[246] if the buyer is insolvent or tenders a bad check; or it may retain the rights appurtenant to a security interest in the goods by complying with Article 9 after delivery of them.[247] Delivery extinguishes the first-mentioned of these rights, but not the others.[248] Unless, however, the circumstances are such that the seller can avail himself of one of these Code provisions granting him rights in the goods, the buyer's special property will defeat the seller and, by operation of security of property principles, the buyer's creditors defeat the seller as well.

The ultimate result in *Thermo-Sentinal* may well be the same under both analyses. Yet the litigator who fails to appreciate the reasoning advocated by this article loses the opportunity to develop the facts to support that reasoning. The record in *Thermo-Sentinal* reveals that the seller had delivered the metal to the fabricator and that it had not filed a financing statement, but we do not know, for example, whether the seller demanded return of the goods within time to permit reclamation under either section 2-507(2) or section 2-702(2), or whether the buyer's financial state at the time of delivery satisfied the requisites of the latter section. Contrary to the implication of the *Thermo-Sentinal* opinion, most courts have held that the seller's right to reclaim does defeat the trustee in bankruptcy.[249] Thus, emphasis by counsel and the court on facts bearing on the seller's ability to defeat the buyer's special property might have led to a contrary holding in *Thermo-Sentinal*. Certainly it would have led to an analysis that was more consistent with the Code's objectives than the court's title-bound approach.

United Road Machinery Co. v. Jasper[250] provides another recent example of this misconception as to the nature of the seller's rights in goods that have been delivered. The seller, a dealer in heavy trucking equipment, entered into an oral contract for the lease of a truck scale, with an option to purchase the equipment for one dollar at the end of the lease. The arrangement strongly suggests a disguised security agreement, *i.e.*, a sale with the seller reserving a security interest and the lease serving as the security agreement.[251] The lessee, who was not a dealer in scales and who never executed the lease that was sent to it, failed to make any payments.

---

[244] U.C.C. § 2-703(a),(f).

[245] U.C.C. § 2-705.

[246] U.C.C. §§ 2-507(2), 2-702(2).

[247] *See* U.C.C. § 9-113.

[248] The right to reclaim and the rights appurtenant to an Article 9 security interest may survive delivery. *See* U.C.C. §§ 2-507(2), 2-702(2), 9-113.

[249] *See* notes 158-59 *supra*.

[250] 568 S.W.2d 242 (Ky. App. 1978).

[251] Section 1-201(37) provides that the facts of each case determine whether a lease is intended as security but stipulates that an agreement which permits the lessee to become the owner at the end of the lease for a nominal consideration does make the lease one intended for security.

It sold the scale to a third party, who in turn resold it to a fourth party who had possession of the equipment at the time of suit.

Analysis of the case begins with security of property doctrine. The buyer passed whatever interest it had to the third party, who passed it to the fourth party. The issue, then, is whether the buyer's interest was subject to any enforceable interest of the seller. The seller had reserved an oral security interest under the lease. That interest, however, would fall under the statute of frauds provision of section 9-203(1), which stipulates that a security agreement must be in writing and signed by the debtor unless the creditor is in possession.[252] The buyer, therefore, did not hold the goods subject to a security interest of the dealer, and the dealer's interest clearly could not defeat the buyer's conveyance to a third party.[253] Unmindful of this simple approach, the court attempted to trace the path of title to the scale. Using section 2-401, it concluded that the nonpaying buyer had voidable title to the goods and that, through operation of the voidable title doctrine, the third party had taken good title and conveyed it to the fourth party.[254] The court also toyed imprecisely with an argument that the third party had received good title because the seller "entrusted" the goods to the buyer.[255]

Although the result in *United Road* is consistent with that dictated by Code rules, the court reached it by reliance on two concepts—voidable title and entrustment—that were inapposite to the facts of the case. Traditionally, voidable title does not arise simply because a buyer fails to make the payments called for by the contract. Rather, it arises when the buyer fraudulently misleads the seller, usually by misrepresenting his identity[256] or by giving the seller a check drawn against insufficient funds.[257] The *United Road* holding, which was not predicated on any finding of such fraud on the buyer's part, would extend the doctrine to virtually every nonpayment case and every open account sale—significant and unwarranted expansions of the doctrine. Nor do the facts of *United Road* satisfy the requirements of the entrustment rules. Those rules stem from an estoppel notion and have traditionally applied to only two situations: cases in which the entrustee is a person who deals in goods of the kind,[258] and

[252] The rules of Article 9 for the creation and enforceability of a security interest apply once the buyer receives possession of the goods. *See* U.C.C. § 9-113.

[253] For a case which supports the reasoning advanced in the text see Tate v. Gallagher, 116 N.H. 165, 355 A.2d 417 (1976).

[254] United Road Mach. Co. v. Jasper, 568 S.W.2d at 244-45.

[255] *Id.* at 245.

[256] *See, e.g.*, Phelps v. McQuade, 220 N.Y. 232, 234-35, 115 N.E. 441, 442, 143 N.Y.S. 822, 823-24 (1913). *See generally* 3 S. Williston, *supra* note 18, § 635, at 444, and cases therein cited. U.C.C. § 2-403(1)(a) codifies this common law rule.

[257] *See, e.g.*, White v. Garden, 138 Eng. Rep. 364 (C.P. 1851). Note, however, that many jurisdictions adopted the position that a worthless check was not payment, so that no title—not even a voidable one—passed to the buyer. Thus, the original seller could assert his right to the goods even against a bona fide purchaser. Williston criticized this view as inconsistent with the courts' usual emphasis on the seller's intent to transfer ownership of the goods. 2 S. Williston, *supra* note 18, § 346a, at 344-46.

[258] Pickering v. Busk, 104 Eng. Rep. 758 (K.B. 1812). *See also* Griswold v. Sheldon, 4 N.Y.

cases in which the entrustor clothes the entrustee with indicia of title in addition to possession.[259] The buyer in *United Road* did not deal in goods of the kind sold, nor are there any facts in the court's opinion indicating that the seller clothed the buyer with more than mere possession of the goods. *United Road* would extend the entrustment concept to virtually any case in which one party leaves goods in the possession of another party—an extension that is not justified by the common law history of entrustment or by the Code.[260]

These cases[261] represent a trend to ignore the import of the Code rules. A seller may reserve a security interest in identified goods and may be entitled to specific remedies recited in the Code with respect to the goods. Absent such a security interest, or in cases where these specific remedies are inapplicable, the buyer and his transferees defeat the seller. Generally, the Code rules serve commercial policy. It is these rules, with the policy they embody—rather than old title principles which the Code rejects—that should direct a court in resolving commercial disputes.

Article 9 and Buyers

We have seen that title theory sometimes blurs analysis of reserved security interest cases. It can also blur application of the Article 9 rules which accord protection to a buyer against preexisting security interests.

There are two major good faith purchase rules in Article 9. Section 9-306(2) permits any buyer to defeat the secured creditor if the creditor authorizes the sale.[262] Section 9-307(1), a second and narrower rule, supplements the first by protecting buyers out of inventory even if the creditor forbids the sale.[263] Courts have encountered some difficulty in determining the point in the transaction at which the buyer defeats the

---

581, 590 (1851) (where mortgagee permitted merchant-mortgagor to retain possession of collateral and sell it in ordinary course of business, "no one would think for a moment" that the mortgagee could recover goods sold to the debtor's customers). *Cf.* Gallagher v. Unenrolled Motor Vessel River Queen, 475 F.2d 117 (5th Cir. 1973) (§ 2-403(2) does not apply if owners entrusted to marine operator in his capacity as one who stores boats rather than in his capacity as one who deals in boats); Antigo Co-op Credit Union v. Miller, 86 Wis. 2d 90, 271 N.W.2d 642 (1978) (§ 9-307(1) applies to sale of horse even though creditor did not know debtor was in the business of selling horses).

[259] W. Raushenbush "[T]he mere possession [of chattels], by whatever means it may have been acquired, if there be no other evidences of property, or authority to sell from the true owner, will not enable the possessor to give a good title." Corvill v. Hill, 4 Denio 323, 327 (N.Y. 1847). *See generally* R. Brown, The Law of Personal Property § 9.7, at 202-06 (3d ed. 1975) and cases cited therein.

[260] *See* note 220 *supra*. *See also* U.C.C. § 1-201(9) (defining buyer in ordinary course).

[261] In addition, see Wood Chevrolet Co. v. Bank of the Southeast, 352 So. 2d 1350 (Ala. 1977), where court uses title approach in a reserved security interest situation.

[262] "Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange, or other disposition thereof *unless the disposition was authorized by the secured party* in the security agreement or otherwise . . . ." U.C.C. § 9-306(2) (emphasis added). *See* American Nat'l Bank v. Mar-K-Z Motors & Leasing Co., 57 Ill. 2d 29, 309 N.E.2d 567 (1974); Farnum v. C.J. Merrill, Inc., 264 A.2d 150, 152 (Me. 1970).

[263] *See* U.C.C. § 9-306(2), Comment 3; Sanders v. M.D. Aircraft Sales, Inc., 575 F.2d 1086, 1089 (3d Cir. 1978) (dictum).

secured party. A majority of the cases have identified delivery as the critical point of reference. These cases justify that selection on the assumption, explicit in some cases and implicit in others, that the buyer does not defeat the secured party until title passes.

The issue arises under both section 9-306(2) and section 9-307(1). A recent case from the Fifth Circuit illustrates the title-oriented approach to the former section.[264] *Weisbart & Co. v. First National Bank*[265] involved a cattle feed lot operation. The seller agreed with the buyer to purchase livestock, fatten them and sell them to the buyer. The bank financed the seller and retained a properly perfected security interest in the cattle. The bank knew of its customer's contract with the buyer and, when rising cattle and feed prices rendered the seller's performance problematic, the bank participated in negotiations with the buyer to extend the time for delivery of the cattle. When it appeared that the seller would not be able to fulfill its contract with the buyer without incurring a loss and would not, therefore, be able to generate funds to repay the loans, the bank seized the cattle under the terms of the security agreement. The buyer sued the bank, claiming that the latter had consented to the sale and that, under section 9-306(2), the buyer took the cattle free of the bank's security interest.

The court found section 9-306(2) inapplicable. It noted that the section pertains to a "sale, exchange or other disposition." Looking to the Code's definition of sale in section 2-106(1),[266] the court determined that passage of title was the crucial element.[267] Because the cattle had not been delivered, the court concluded that title had not passed and that a "sale" had not occurred. The court was at a loss to distinguish a "sale" from an "exchange or other disposition" and, having found that the buyer could not satisfy the "sale" requirement of section 9-306(2), it held that the bank should prevail.

The case demonstrates once again the reluctance of courts to give full effect to the Code's property interest scheme. On identification of the cattle to the contract, the buyer obtained a special property in them. Identification, then, operated to "dispose" of part of the seller's property interest in the goods, and the evidence strongly suggests that the bank authorized that "disposition." In fact, the court framed the issue as one of determining whether the bank's consent to the sales contract subordinated its security interest to the buyer's rights.[268]

---

[264] The leading case under § 9-307(1) is Chrysler Corp. v. Adamatic, Inc., 59 Wis. 2d 219, 208 N.W.2d 97 (1973), which held that a person does not become a buyer until title passes. *Id.* at 238-39, 208 N.W.2d at 106. *Accord* Integrity Ins. Co. v. Marine Midland Bank-Western, 90 Misc. 2d 868, 870, 396 N.Y.S.2d 319, 321 (S. Ct. 1977) (court finds constructive delivery). For criticism of the *Adamatic* case, see Dolan, *supra* note 122, at 1154-59.

[265] 568 F.2d 391 (5th Cir. 1978).

[266] "A 'sale' consists in the passing of title from the seller to the buyer for a price (Section 2-401)." U.C.C. § 2-106(1).

[267] Weisbart & Co. v. First Nat'l Bank, 568 F.2d at 394.

[268] The court framed the issue: "[D]oes the consent of the bank to a contract between a seller and a purchaser in and of itself subordinate the bank's security interest to the contract of sale?" *Id.* at 393.

The *Weisbart* court's adherence to the notion that passage of title is indispensable to the operation of section 9-306(2) led to what may be an unfair and commercially unsound result.[269] In essence, the question in *Weisbart* is one of allocating the economic risk of a rising market in a fixed price contract. Generally, the seller must shoulder the loss when a rising market erodes the bargain of his contract. That loss, however, may be heavier than the financial strength of the seller can bear, forcing him into insolvency. In such a case, the buyer's "bargain" means little, for the seller can neither perform nor pay damages. Thus if a bank makes loans to the seller which enable him to complete the contract, the buyer should have no complaint even though goods which are the subject of his contract were used as collateral. The Code, nonetheless, interdicts such additional loans when made without the buyer's consent.

Section 9-306(2) stipulates that the secured party loses its security interest in the primary collateral in the event it authorizes a disposition, as did the bank in *Weisbart.* After such authorization, therefore, the cattle will no longer serve as collateral for the bank's loans. The disposition of the cattle, however, should generate proceeds—here, the right to the purchase price—and the bank enjoys a continuously perfected security interest in those proceeds.[270] The careful bank, then, must take steps to ensure that it ultimately receives such proceeds.[271]

The bank's attorneys will argue that section 9-306(2) reflects bad economics. They will point out that without the additional loans the seller, rendered insolvent, would not perform and the buyer would lose his bargain entirely. The Code's rejection of that plausible argument is, however, justified. The weakness of the bank's position lies in the common practice of inventory lenders to cross-collateralize their loans. A cross-collateral clause, standard in most bank security agreements, allows the bank to use the collateral as security for all loans or other indebtedness arising subsequent to the taking of the security agreement. Unrestricted use of such an arrangement in *Weisbart* would permit the seller to tap the increased value of the cattle identified to the *buyer's* contract to finance the performance of *other* contracts, thus diluting the bargain won by the buyer in a rising market.

[269] There is considerable support for the idea advanced in the text that neither delivery nor passage of title are prerequisites for operation of the buyer protection rules of § 9-306(2) and § 9-307(1). *See* Goldberg Co. v. County Green Ltd. Partnership (*In re* County Green Ltd. Partnership), 438 F. Supp. 693, 696 (W.D. Va. 1977); Rex Financial Corp. v. Mobile Amer. Corp., 119 Ariz. 176, 177-78, 580 P.2d 8, 9-10 (1978); International Harvester Credit Corp. v. Associates Fin. Serv. Co., 133 Ga. App. 488, 493-94, 211 S.E.2d 430, 433-34 (1974); 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, 270, 288 N.Y.S.2d 525, 533-34 (1968). *See also* Holstein v. Greenwich Yacht Sales, Inc., — R.I. —, 404 A.2d 842 (1979); 2 G. Gilmore, *supra* note 146, at 696; Warren, Cutting Off Claims of Ownership Under the Uniform Commercial Code, 30 U. Chi. L. Rev. 469, 473 (1963). *But see* Mechanics Nat'l Bank v. Gaucher, 79 Mass. App. Ad. Sh. 315, 386 N.E.2d 1052 (1979) (court ignores buyer's special property and holds that there was no disposition of mobile home until delivery).

[270] *See* U.C.C. § 9-306(2).

[271] *E.g.*, U.C.C. § 9-318(3).

The analysis advocated by this article imposes a limitation on the bank's use of cross-collateralization. With one important caveat discussed below, once the bank has authorized a sales contract, it may no longer look to goods which are the subject of that contract to satisfy the seller's debt. By contrast, the *Weisbart* holding permits the bank which authorized a fixed price contract to lend money against the increased value of the subject of the contract, not only to enhance performance of that contract but also to promote other contracts. Thus under *Weisbart,* the bank is able to profit from the rising value of the collateral without regard to any detriment resulting to the buyer from the seller's indiscriminate use of new loans. Application of section 9-306(2) to the *Weisbart* situation, without regard to whether title has technically passed, guards against this unfairness.

There remains for discussion one additional consequence of this reading of the relation of section 9-306(2) to the transactions in *Weisbart.* It is important to note that the analysis offered here will apply not only to authorized sales under section 9-306(2) but also to sales which are unauthorized but to which the Code affords buyer protection under section 9-307(1). The buyer in ordinary course rule—which did not apply in *Weisbart* because of the farm products exception in section 9-307(1)—would have the same effect on a bank which does not authorize the sales contract as section 9-306(2) imposes on a bank which does authorize it. At first glance, this result appears harsh, for the secured party who has not authorized the sale might reasonably rely on the debtor-seller's continued possession of collateral already identified to a contract unknown to the secured party. In fact, however, section 2-402(2) tempers that harshness. Under that section, the secured party may treat "the identification of the goods to a contract of sale as void" under the *Twyne* rule when the debtor-seller retains possession.[272] That section, of course, permits a buyer to leave goods with a merchant-seller for a commercially reasonable period of time. Had Weisbart's case come within section 9-307(1), he would have been able to argue convincingly that it was commercially reasonable to leave cattle identified to the contract with the seller when the contract called for the seller to fatten them.

The only burden this analysis imposes, then, arises in a narrowly constructed situation, the parameters of which depend on reasonable commercial practices. We must admit that the cattle feed lot industry is somewhat anomalous and that the rule suggested here will not find frequent application. It is unfortunate, nonetheless, that even though the Code anticipates the situation and provides a commercially sound pattern for its resolution, the *Weisbart* court failed to perceive it.

V. Conclusion

It would be inaccurate to leave the impression that no courts have grasped the Code's basic structure. As this article acknowledges, there are

[272] *See* U.C.C. § 2-402(2).

cases that support the method of analysis proposed here. Nevertheless, the fact remains that many, if not most, courts do not employ it. To some extent, this failure stems from continued reliance on familiar title concepts. The tone of many opinions suggests, however, that the fundamental problem is the failure of judges and practitioners to perceive the dominant themes that unify the Code. When courts do not perceive this pattern, they are wont to fall back on traditional concepts such as title and bailment.

The problem stems from the practice of approaching the Code as eight discrete statutes that deal with eight different subjects. This incremental approach obscures the basic property concepts upon which the Code rests. It matters less, of course, that courts reach commercially desirable results by academically pure routes than that they reach commercially desirable results at all. Yet review of the cases demonstrates that courts frequently reach unfair conclusions when application of Code rules would yield fair ones. The challenge, then, is one of putting the Code together.