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Uniform Commercial Code and the Concept of Possession in the Marketing and Financing of Goods

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The Uniform Commercial Code and the Concept of Possession in the Marketing and Financing of Goods

John F. Dolan*

The "buyer in ordinary course" rule of section 9-307(1) of the Uniform Commercial Code shelters good faith purchasers of certain goods from the rival claims of sellers' secured creditors. Professor Dolan argues that the Code's refusal to let title determine disputes over goods in other contexts extends to clashes between creditors and buyers under section 9-307(1). He finds the key to the Code's scheme for settling these clashes in the "special property interest" a buyer acquires at the moment goods are identified to a contract of sale. The scheme, he believes, is one of general respect for reasonable expectations based on possession, the special property interest taking up where those expectations cease. Professor Dolan expounds his interpretation of the Code in reference to a rival interpretation recently adopted by the New York Court of Appeals in Tanbro Fabrics Corp. v. Deering Milliken, Inc.

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"Then the bird does not belong to any of you?" Spade asked, "but to a General Kemidov?"

"Belong?" the fat man said jovially, "Well, sir, you might say it belonged to the King of Spain, but I don't see how you can honestly grant anybody else clear title to it—except by right of possession." He clucked. "An article of that value that has passed from hand to hand by such means is clearly the property of whoever can get hold of it."¹

I. Introduction

The function of property law is the substitution of rational rules for force in the allocation of property. Title and seisin² figured boldly in the first conceptual scheme to which the common law committed that function.³ Both notions drew their importance from the principle

1. D. HAMMETT, *THE MALTESE FALCON*, in *THE NOVELS OF DASHIELL HAMMETT* 397 (1965).

2. For a discussion of the concept of seisin as applied to personal property, see Maitland, *The Seisin of Chattels*, 1 *LAW Q. REV.* 324 (1885).

3. The term "possession" itself takes on broad metaphysical significance in common law,

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of "security of property": a grantee acquires whatever his grantor possesses, and no more—caveat emptor. So enshrined did security of property, title, and seisin become that courts elaborated rules to serve them without regard for the commercial realities that shaped reasonable but contrary expectations. It took a centuries-long struggle to temper the harsh results of the entrenched notions. Resolution came in the form of an exception to security of property principles, the good faith purchase doctrine, under which a purchaser for value who takes in good faith and without notice of a prior claim defeats the prior claimant. Possession,⁴ the touchstone of seisin, thus appeared in a new light, since deference to expectations based on possession was also the core of the good faith purchase exception.

The common law and, more recently, the Uniform Commercial Code⁵ (the Code) continue to refine the synthesis based on security of property⁶ with exceptions for good faith purchase.⁷ The Code takes a considerable step toward dismantling the original metaphysical framework of untempered security of property principles by cutting back the role of title in rules governing the rights of buyers and sellers. The Code recognizes from the moment at which goods are "identified to" a contract of sale a buyer's "special property interest,"⁸ which may antedate passage of title and the seller's delivery of the goods. The scope and nature of the special property interest pose a difficulty, however, because apart from a definitional section the Code refers to this interest elliptically. Encountering that difficulty, courts have sometimes succumbed to the allure of familiar title rules that are not explicitly abro-

for example, in the law of trespass and larceny. See O. HOLMES, *THE COMMON LAW* 206-46 (1881); 2 H. BRACON, *ON THE LAWS AND CUSTOMS OF ENGLAND* 121 (S.E. Thorne ed. 1968).

4. In law, the term "possession" carries a measure of historic freight. Defining "legal possession" has consumed a good deal of legal talent and energy. See Bingham, *The Nature and Importance of Legal Possession* (pts. 1-2), 13 MICH. L. REV. 535, 623 (1915). This Article uses the term "possession," not in the sense of "legal possession," but in the everyday sense elaborated by "the fat man" in the epigraph of this Article. Cf. U.C.C. § 2-103(1)(c) (defining "receipt" of goods as "taking physical possession of them").

5. All section and comment citations, unless otherwise noted, are to the 1972 version of the Code. Although New York has adopted the 1972 Amendments to Article 9, the 1962 version of the Code governed the *Tanbro* case, discussed in text accompanying notes 12-13 *infra*. With one exception the 1972 amendments do not bear on this discussion. See text accompanying note 226 *infra*.

6. See U.C.C. §§ 2-401(1), 3-201(1), 7-504(1), 8-301(1), 9-201.

7. Good faith purchase doctrine in its generic sense includes a wide range of rules that allow a purchaser to take more than his grantor had. These rules countervail security of property dogma which holds that the grantee can take no greater property interest than the grantor has. See generally Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 YALE L.J. 1057 (1954); Warren, *Cutting Off Claims of Ownership Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 469 (1963).

8. U.C.C. § 2-501(1).

gated by the Code. This Article argues that nothing should turn on title; that we can easily identify the Code provisions that delineate the special property interest; and that these provisions settle claims to disputed goods in a manner consistent with reasonable expectations based on possession, to which the Code routinely defers unless a more compelling public policy calls for a different outcome.

The focus of the discussion will be the New York Court of Appeals' recent expansive reading of section 9-307(1) of the Code. That section states one of several Code rules derived from the good faith purchase doctrine: "A buyer in ordinary course of business . . . takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence." The New York court properly attended to commercial practice in the industry in question and correctly held that one may benefit from the Code's buyer in ordinary course rules even though he does not take possession of goods. But the court incurred the dudgeon of at least some commercial lawyers⁹ by holding that it is "ordinary" for a purchaser to obtain superior rights in goods that are in the possession not of the seller but of the seller's creditor. To the extent that the rule springs from pro-buyer sentiment, it misses the mark. Buyers will generally suffer from the higher cost of credit to which the rule promises to lead by fostering secret sales. To the extent that the rule reflects title considerations, it resurrects a brand of thinking legislatures and commercial lawyers rejected long ago.¹⁰ If the rule withstands scintiny, possession will assuredly become something less than the nine points of the law commercial parties think it to be. Most importantly, by denying the controlling significance of reasonable expectations based on possession and creating instead a broad new exception to security of property principles, the New York rule upsets the scheme of the Code.

Part II sets forth the facts of *Tanbro Fabrics Corp. v. Deering Milli-*

9. See, e.g., Kreindler, *The Uniform Commercial Code and Priority Rights Between the Seller in Possession and a Good Faith Third-Party Purchaser*, 82 COM. L.J. 86 (1977); Kripke, *Should Section 9-307(1) of the Uniform Commercial Code Apply Against a Secured Party in Possession?*, 33 BUS. LAW. 153 (1977); UNIFORM COM. CODE L. LETTER, November 1976, at 1. Not all reaction was negative, however. 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); Gottlieb, *Section 9-307(1) and Tanbro Fabrics: A Further Response*, 33 BUS. LAW. 2611 (1978); Burke, *Secured Transactions, 1977 Uniform Commercial Code Annual Survey*, 32 BUS. LAW. 1133, 1149-50 (1977); Coogan, *Article 9—An Agenda for the Next Decade*, 87 YALE L.J. 1012 (1978). Professor Coogan challenges many of the assumptions underlying the possession rules discussed in this Article, but largely in a different context, viz. bankruptcy and "paperless" instruments. To some extent, however, his article and this one reflect different views on the efficacy of possession as a touchstone in secured transactions.

10. See U.C.C. § 2-401, Comment 1; *id.* § 1-201(37).

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ken, Inc.,¹¹ which occasioned the New York court's pronouncement, and then proposes an alternative resolution of the claims in *Tanbro* that would properly acknowledge the role of special property interests under the Code. To support the alternative and show the manner in which the New York rule damages the Code's possession-oriented scheme, Parts III, IV, and V discuss a range of financing devices and standard credit transactions in which possession-based expectations have a governing role. With the Code's scheme fully developed, Part VI discounts the affirmative arguments of the *Tanbro* opinion for the New York rule.

II. The New York Rule

A. *The Tanbro Facts*

In 1968, Deering Milliken Company (Deering) manufactured 510,000 yards of fabric for Mill Fabrics (Mill), which "converted" the unfinished textile into dyed and patterned goods.¹² In a fashion common among industries in which suppliers like Deering are strong and buyers like Mill are weak, textile converters customarily purchase unprocessed material without knowing what their sales will be, and before they are able to pay for the unprocessed materials. In the event a converter cannot generate sufficient sales volume to use all the fabric it has ordered, the converter customarily resells the fabric to a second converter. Thus, it is ordinary in the industry for converters to be both primary buyers (from the manufacturer) and sub-buyers (from converters reselling excess, unprocessed goods).

For three reasons Deering customarily retained possession of the fabric until a converter had an order to fill. First, the parties knew that some of the goods might be resold to another converter; they wanted to avoid double shipping and handling costs. Second, converter warehouse space was limited. Third, having retained under the contract of sale a security interest in the fabric, Deering wanted to perfect that security interest by possession, the "bill and hold" practice common to Deering's marketing program. Significantly, the clause creating Deering's security interest provided that the interest secured not only the price of the fabric purchased but all other amounts due Deering from

11. 39 N.Y.2d 632, 350 N.E.2d 590, 385 N.Y.S.2d 260 (1976).

12. This statement of the *Tanbro* facts draws on four opinions by the New York Courts. *Tanbro Fabrics Corp. v. Deering Milliken, Inc.*, 35 App. Div. 2d 469, 318 N.Y.S.2d 764, *aff'd mem.*, 29 N.Y.2d 690, 274 N.E.2d 751, 325 N.Y.S.2d 419 (1971); *Tanbro Fabrics Corp. v. Deering Milliken, Inc.*, 48 App. Div. 2d 784, 369 N.Y.S.2d 146 (1975), *aff'd*, 39 N.Y.2d 632, 350 N.E.2d 590, 385 N.Y.S.2d 260 (1976).

Mill as well. Although Mill paid Deering for this fabric it was in debt to Deering already and incurred further obligations throughout the course of the transaction.¹³

After contracting to buy the fabric, Mill took delivery of some 250,000 yards. Sometime between the 1968 purchase and the spring of 1969, Deering ended further production of the fabric. When it received an inquiry from Tanbro Fabrics Corporation (Tanbro), it referred Tanbro to Mill. Thus, unwittingly, Deering salespeople invited Tanbro to make the very purchase that triggered the dispute.

In May 1969 Mill, acting through a broker, entered into a contract of sale with Tanbro for the 260,000 yards of fabric Deering still held. Tanbro, itself a frequent customer of Deering, was familiar with Deering's bill and hold practices, and knew Deering held these goods for Mill; nonetheless, Tanbro paid Mill for them. In October and November of the same year Tanbro wanted to take delivery of 57,000 yards of the fabric. Contrary to its custom in such secondary purchase situations, Tanbro did not contact Deering but asked Mill to arrange a drop shipment to a converting facility operated by a Tanbro affiliate. Only in January 1970, after Mill's financial demise became apparent, did Tanbro contact Deering to demand delivery of the 203,000 yards of fabric still at Deering's plant. From May 1969 until January 1970 Deering held goods it thought belonged to Mill, while in fact Mill had agreed to sell them to Tanbro. When Tanbro demanded delivery of the 203,000 yards, Deering, aware of Mill's insolvency, claimed the goods. Tanbro sued for conversion, and won both at trial and on appeal.

B. Interests of the Buyer and the Secured Party

The rights of Deering and Tanbro to the fabric turn on a number of Code concepts that balance the interests of secured parties on the one hand and buyers on the other. Deering perfected by possession¹⁴ a security interest Mill created under the purchase agreement. But Tan-

13. In the first set of reported opinions, the appellate division and court of appeals suggest that Mill paid for the fabric, that Mill then resold to Tanbro, and that only then did Deering make credit advances to Mill. 35 App. Div. 2d 469, 470, 318 N.Y.S.2d 764, 766, 767, *aff'd mem.*, 29 N.Y.2d 690, 274 N.E.2d 751, 325 N.Y.S.2d 419 (1971). That chronology would dictate a result in favor of Tanbro without resort to U.C.C. § 9-307(1). See U.C.C. § 9-203(2); note 22 *infra*. The opinions dealt with a pretrial motion to compel arbitration. The motion ultimately failed. In the later set of opinions, both the appellate division and the court of appeals refer to evidence, varying the pleaded facts, to the effect that throughout the course of the dealings Mill was indebted to Deering. 48 App. Div. 2d at 786, 369 N.Y.S.2d at 148; 39 N.Y.2d at 635, 350 N.E.2d at 591, 385 N.Y.S.2d at 261.

14. U.C.C. § 9-305 permits perfection in this manner.

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bro as a purchaser enjoyed rights in the goods, notwithstanding Deering's perfected security interest. Section 2-501(1) provides that a purchaser acquires an interest when goods are identified to the contract as this fabric was.¹⁵ Nothing in the Code prevents a debtor in Mill's position from selling his interest to a third party like Tanbro.¹⁶ The drafters did not give a name to the interest the debtor may sell.¹⁷ They did, however, provide a label for the interest the buyer obtains; it is a "special property . . . interest."¹⁸ It is not a security interest.¹⁹ Its incidents under other sections of Articles 2 and 9 determine the buyer's rights against the seller's creditors under the rules of good faith purchase.²⁰ Various Code provisions declare that title is of no consequence,²¹ and both the Code and common law give the good faith purchaser no other interest in the goods.²²

15. "In the absence of explicit agreement identification occurs . . . when the contract is made if it is for the sale of goods already existing and identified." *Id.* § 2-501(1)(a). The Code uses the word "identify" in this definition in the first instance as a term of art and in the second in its usual sense.

16. *Id.* § 9-311.

17. The comments refer to it as "legal title or an equity." *Id.* Comment 1.

18. *Id.* § 2-501(1). See also *id.* § 2-401(1).

19. *Id.* § 1-201(37). See also *id.* § 9-113, Comment 4.

20. *Id.* § 2-401, Comment 3.

21. *Id.* § 2-401. See also *id.* § 9-202, Comment; § 2-505, Comment 1.

22. The following table illustrates the general Code scheme for allocating interests and priorities between the seller's creditor and the buyer. The table also designates the event on which the rights arise.

I Creditor	II Critical Event	III Buyers who win	IV Buyers who lose
A. Unsecured	Identification of goods to the sale [§ 2-501(1)]	All, except certain "fraudulent" buyers [§ 2-402(2)]	None, except certain "fraudulent" buyers [§ 2-402(2)]
B. Secured but unperfected	Attachment of the security interest [§ 9-203(2)] and identification of the goods to the sale [§ 2-501(1)] and (sometimes) delivery to the buyer [§ 9-301(1)(c)]	(a) All buyers if the sale is authorized [§ 9-306(2)]; (b) Buyers in ordinary course [§ 9-307(1)]; (c) Buyers not in ordinary course who take delivery without knowledge of the security interest [§ 9-301(1)(e)]	All buyers not listed in B(III) [§ 9-201, -306(2)]
C. Secured and perfected	Same as B(II) above and perfection of the security interests [9-303(1)]	(a) All buyers if the sale is authorized [§ 9-306(2)]; (b) Buyers in ordinary course, except those who buy farm products from farmers [§ 9-307(1)]	All buyers not listed in C(III) [§§ 9-201, -306(2)]

See note 107 *infra*; U.C.C. §§ 7-205, -504(2). The rights of lien creditors appear to depend on non-Code notions. See *In re Kravitz*, 278 F.2d 820, 822 (3d Cir. 1960). Generally, the non-Code rules follow strict security of property doctrine. See *In re Federals, Inc.*, 553 F.2d 509, 515 (6th Cir. 1977); *In re Mel Golde Shoes, Inc.*, 403 F.2d 658, 660 (6th Cir. 1968). For a criticism of this non-Code approach, see 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, 937 (1978).

C. *The Special Property Interest*

The special property interest rule is a contemporary version of the ancient security of property principle. That conveyancing precept, sometimes called an "umbrella" or "shelter" principle, is common to other Code articles.²³ In the past, case law and statutes used a wide range of terms in formulating it;²⁴ Article 2, recognizing the confusion to which earlier terminology led, employs the phrase "special property interest" for this "qualified interest"²⁵ in goods. Section 2-501, which creates the special property interest, states only that unless otherwise agreed a buyer acquires it at the moment goods are identified to a contract of sale. We must consult other Code sections²⁶—notably the buyer remedy provisions of Article 2 and the buyer protection provisions of Articles 2 and 9—to learn what rights the interest embraces. The buyer remedy and protection provisions are linked to the special property interest by their frequent references to the event of identification²⁷ in determining the priority of claims to disputed goods by seller/creditor, buyer/debtor and takers under the debtor. The sections do not use the phrase "special property interest" itself. The absence of explicit cross references has misled some courts.

Under the Code, a negative implication of the security of property principle also survives. Normally, a transferee gets whatever rights the transferor enjoys, and, by negative implication, no more than that. The Code departs from this view, however, as the common law eventually did, conferring additional rights on the good faith purchaser. When these rights accrue is the first question courts confronted in dealing with the special property interest.

A leading case is *Chrysler Corp. v. Adamatic, Inc.*,²⁸ in which the Wisconsin Supreme Court denied replevin to a buyer of undelivered goods, some of which were arguably identified to the contract. Resorting to the definition of "sale" in section 2-106 as the "passing of title from the seller to the buyer for a price," the court reasoned that a party does not become a "buyer"²⁹ for buyer in ordinary course purposes until title passes to him.³⁰ Since passage of title generally abides deliv-

23. See note 6 *supra*.

24. See Maitland, *The Mystery of Seisin*, 2 LAW Q. REV. 481, 484, 490 (1886).

25. O. HOLMES, *supra* note 3, at 244.

26. See U.C.C. § 2-401, Comment 3.

27. See, e.g., *id.* §§ 2-402, -502, -716.

28. 59 Wis. 2d 219, 208 N.W.2d 97 (1973).

29. The *Chrysler* court does not dwell on the question, but one cannot help wondering what to call, before title passes, the party who becomes the buyer after title passes. The *Chrysler* court called it "Chrysler." There is an irresistible temptation to call that party the "buyer."

30. 59 Wis. 2d at 241, 208 N.W.2d at 106. Cf. *Weisbart & Co. v. First Nat'l Bank*, 568 F.2d

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ery of the goods,³¹ that holding and others like it postpone the time at which a purchaser benefits from the good faith purchase doctrine from the moment of identification to that of delivery. The Wisconsin court's reliance on the Article 2 definition of "sale," however, did not take into account the statute's definition of "buyer" as one "who buys or contracts to buy goods"³²—a definition that does not mention either title or delivery. Nor did the court take into account that section 2-716, the buyer remedy section that permits replevin under some circumstances, specifically refers to goods "identified to the contract."³³ If a buyer has no replevin rights until title passes, as *Chrysler* held, there is no need for the replevin section to mention identification, since identification must occur *before* title passes.³⁴

The *Chrysler* court, however, offered substantive grounds for its decision. Noting disagreement among commentators,³⁵ it recognized that the Code stresses, on the one hand, the notice function of a filing and, on the other, actual possession of goods. A holding in favor of the buyer would subject inventory in the seller's possession to a claim of the buyer, arguably to the confusion of the seller's creditor who might reasonably rely on the seller's possession.³⁶ This concern, urged in an amicus brief filed by a commercial finance and factoring industry trade association,³⁷ reflects a proper regard for the role of possession in the common law. It is a concern, nonetheless, that courts must abandon in the face of evidence that the legislature has deviated from the common law's course.

Evidence to that effect abounds. First, as Professors Warren and Gilmore point out,³⁸ the Code patterns section 9-307(1), one of the

391, 394-95 (5th Cir. 1978) (relying on the definition of "sale" in denying relief to a buyer who argued authorized sale under § 9-306(2)(b)); *Integrity Ins. Co. v. Marine Midland Bank-Western*, 90 Misc. 2d 868, 870-71, 396 N.Y.S.2d 319, 321 (Sup. Ct. 1977) (positing the same rule but finding constructive delivery and holding, therefore, that U.C.C. § 9-307(1) applies in favor of the buyer). For contrary authority, see note 42 *infra*.

31. U.C.C. § 2-401(2).

32. *Id.* § 2-103(1)(a) (emphasis supplied).

33. *Id.* § 2-716(3).

34. *Id.* § 2-401(1). "Title to goods cannot pass . . . prior to their identification . . ." *Id.*

35. 59 Wis. 2d at 239, 208 N.W.2d at 106-07. The court was apparently moved by the fact that one author has criticized Article 2 because it did not extend buyer in ordinary course protection to a buyer who has not taken delivery. Smith, *Title and the Right to Possession Under the Uniform Commercial Code*, 10 BOSTON C. INDUS. & COM. L. REV. 39, 60-61 (1968). Other authority takes the position advocated in this Article, that buyer in ordinary course protection may extend to one who does not take possession. See note 42 *infra*.

36. 59 Wis. 2d at 240-41, 208 N.W.2d at 107.

37. *Id.* at 240, 208 N.W.2d at 107.

38. 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 26.6, at 696 (1965); Warren, *Cutting Off Claims of Ownership Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 469, 473 (1963). But see Jackson & Peters, *supra* note 22, at 955.

chief buyer in ordinary course rules, after section 9-2(a) of the Uniform Trust Receipts Act, which protected buyers "to whom goods are sold and *delivered* . . ."39 Yet section 9-307(1) does not mention delivery. These authorities conclude that the omission of the delivery feature of the rule was intentional.⁴⁰ Second, section 2-402(1) recognizes that certain rights of *buyers*, superior to those of some creditors of the seller, arise at the moment of identification.⁴¹ Third, section 2-402(2) limits the buyer's rights against any creditor if under local law the seller's retention of the goods is fraudulent; the subsection further provides that a merchant seller's retention of goods "in good faith and current course of trade for a commercially reasonable time . . . is not fraudulent." Thus, the Code implies not only that a buyer becomes a buyer at the time of identification, rather than the time of delivery, but also that creditors must assume that merchant sellers—the sellers to whom section 9-307(1), the Article 9 buyer in ordinary course rule, applies—may retain possession of sold goods for a commercially reasonable period of time. Some courts, accepting this analysis, have held that a buyer need not take possession to be a buyer in ordinary course.⁴²

Nothing in this discussion suggests that the special property interest carries paramount rights with it.⁴³ Section 2-501 says only that the buyer obtains an interest at the time of identification. The scope and relative priority of that interest depend on other Code sections.⁴⁴ Most importantly, they depend on the three rules that appear in part 4 of Article 2, the rules on title,⁴⁵ creditors,⁴⁶ and good faith purchasers.⁴⁷

39. UNIFORM TRUST RECEIPTS ACT § 1 (emphasis added).

40. For a more complete discussion of this reasoning in a work that serves as persuasive "legislative history" for the Code, see REPORT OF THE [N.Y.] COMM'N FOR 1955 STUDY OF THE UNIFORM COMMERCIAL CODE 232, 239-42.

41. This rule assigns added significance in light of the policy of U.C.C. § 2-501 that identification occur early in the performance of the contract. See *id.* § 2-501, Comments 2, 4, & 6.

42. The courts, however, couch their rules in title language. See *Rex Fin. Corp. v. Mobile America Corp.*, 580 P.2d 8, 10 (Ariz. App. 1978); *International Harvester Credit Corp. v. Associates Fin. Serv. Co.*, 133 Ga. App. 488, 492-94, 211 S.E.2d 430, 433-34 (1974); *Chrysler Credit Corp. v. Sharp*, 56 Misc. 2d 261, 270, 288 N.Y.S.2d 525, 534 (1968).

43. Thus, for example, a holding in the *Chrysler* case that the buyer became a buyer at the time the goods were identified does not automatically mean that the buyer could replevy the goods. Sections 2-502(1) and 2-716(1) define such rights. Similarly, if the plaintiff in *Chrysler* had been the buyer's creditor, instead of the buyer, the creditor's rights find their limit in the rights of the buyer, unless the creditor qualifies for good faith purchase treatment. Cf. note 159 *infra* (discussing rights of buyer's creditor against reclaiming seller).

44. See, e.g., U.C.C. §§ 2-402(1), -403, -711, -722, 7-205, 9-306(2), -307(1).

45. *Id.* § 2-401 sets forth the general title rules.

46. *Id.* § 2-402 sets forth the general rules for allocating rights in goods between seller's creditors and buyers.

47. *Id.* § 2-403 includes the special rules of actual authority, apparent authority, voidable title, and good faith purchase.

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This analysis concludes that the Code makes identification the key event.⁴⁸

The dispute over the choice between identification and passage of title as a reference point often centers on pro-buyer or pro-secured party arguments. In *Chrysler*, the National Commercial Finance Conference, Inc. argued that the identification rule is contrary to the ostensible ownership of the seller and would be unfair to the credit industry.⁴⁹ Commentators, on the other hand, have argued that the Code leaves prepaying buyers vulnerable.⁵⁰ There is of course no way to satisfy both sides of the argument. The Code must strike a balance somehow, and any solution will offend some lenders and some buyers.

The moment of identification certainly is a happier choice as the reference point than title passage or delivery, which generally occur simultaneously late in the transaction. By opting for identification, the Code appears to promote the interests of buyers. In fact, it promotes the interests of a commercial society. It fosters sales. It encourages buyers to buy and pay early. The argument that the rule discourages lending misses the point. For lenders as a class, the selection of an early reference point rather than a later one makes no difference. The rules of Article 9⁵¹ to an extent may operate in conjunction with the identification rule to defeat the security interest of the *seller's* secured party, but to the same extent section 9-203⁵² provides that a buyer's

48. One must be mindful that some decisions reflect an unwillingness to extend the scheme of Article 2 to buyer/secured party disputes arising under Article 9. See, e.g., *Sherrock v. Commercial Credit Corp.*, 290 A.2d 648, 650 (Del. 1972), which holds that the merchant good faith rule of Article 2 does not apply to buyers seeking the protection of the Article 9 buyer protection rule, § 9-307(1). This Article does not deal with that controversy but does assume that fashioning a different scheme when good faith purchase rules involve the rights of secured parties would serve no purpose or policy. This position is consistent with the plan of Article 2. Section 2-402(3) states that the rules of Article 2 do not impair the rights of a secured party. Cf. U.C.C. § 2-403, Comment 2 (second paragraph, fourth sentence) (the Article 2 entrustment rule is subject to the farm products exception of § 9-307(1)). This Article does not interpret Article 2 as *impairing* the rights of a secured creditor. While it does use the article in determining the time at which the buyer defeats the secured party, it also uses the article in determining the time at which the secured party defeats the buyer. It is Article 9, through §§ 9-306(2) and 9-307(1), that impairs the rights of the secured party. The role of Article 2 in providing the reference point is neutral. Attempts to apply Article 9 exclusively to disputes between buyers, sellers, and secured parties have led to questionable reasoning and results. See notes 142-46 *infra* & accompanying text.

49. 59 Wis. 2d at 240, 208 N.W.2d at 107. For the view that modern inventory lenders tend not to rely on debtor possession in extending credit, see Gordon, *The Prepaying Buyer: Second Class Citizenship Under Uniform Commercial Code Article 2*, 63 Nw. U.L. Rev. 565, 577-78 (1968).

50. See Gordon, *supra* note 49; Smith, *supra* note 35. But see Spiedel, *Advance Payments in Contracts for Sale of Manufactured Goods: A Look at the Uniform Commercial Code*, 52 CALIF. L. REV. 281 (1964) (suggesting a way for the well-advised prepaying buyer to protect himself under the provisions of Article 9).

51. See U.C.C. §§ 9-306(2), -307(1).

52. Under the 1962 Code, § 9-204(1) was the applicable provision.

secured party cannot obtain a security interest in goods until the buyer has an interest in them. By deeming that interest to arise early, the Code hastens the time when the buyer's secured party can look to new property of the buyer.

Commercial law should defer to the expectations possession arouses, absent compelling reasons to the contrary. The identification rule makes the buyer's interest arise while the goods remain in the seller's possession. Thus the seller's creditor might rely on that possession to his detriment. This consequence appears to be a heavy burden on the seller's creditor and, more importantly for the purposes of this Article, runs counter to the force of traditional possession rules. The role of the identification rule, however, is the limited one of fixing a point of reference. The conveyancing rules of Articles 2 and 9, not the identification rule, allocate economic risk. Section 2-402(2),⁵³ moreover, permits other state law to impose a time limit on the operation of the identification rule.⁵⁴ In some jurisdictions⁵⁵ a buyer who leaves identified goods with a seller for more than a commercially reasonable time cannot defeat any of the seller's creditors. While other states may not have this common law rule for section 2-402(2) to defer to, nothing prevents the courts of those states from fashioning one. Indeed, some might construe section 2-402(2) as an invitation to do so.⁵⁶

The system of rights built on the identification rule, moreover, parallels that of Article 9 inventory rules.⁵⁷ The holder of a security

53. The rule of § 2-402(2) codifies the ostensible ownership doctrine that renders fraudulent a trader's conveyance without surrender of possession. See *Ryall v. Rowles*, 27 Eng. Rep. 1074 (Ch. 1749).

54. U.C.C. § 2-402(2) provides:

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

55. See, e.g., *Edwards v. Harber*, 100 Eng. Rep. 315, 321 (K.B. 1788). See generally 1 G. GLENN, *FRAUDULENT CONVEYANCES AND PREFERENCES* § 354 (rev. ed. 1940).

56. There remains one ghost to be laid to rest. Nothing in the argument advanced in this note supports the claim of a creditor of an insolvent buyer who has not paid for identified, undelivered goods. Under § 2-702(3) such a good faith creditor should defeat the seller's right of reclamation under the voidable title rule of § 2-403(1). That rule applies, however, only if the goods are delivered. Voidable title is a rule of *title*, and title does not generally pass until delivery. In any event, to the extent that goods have not been delivered, the seller need not resort to his right to reclaim under § 2-702 but can resort to his seller's lien as provided in § 2-507(2), a lien which the Code does not make subject to the claims of good faith purchasers who have not taken delivery. See also § 2-703(a) & (f). In *Stowers v. Mahon (In re Samuels & Co.)*, 526 F.2d 1238 (5th Cir.), cert. denied, 429 U.S. 834 (1976), the court held that § 2-403(1) subjects the seller's lien to the rights of third parties. That holding is correct if under state law the buyer had voidable title. Voidable title doctrine should apply, however, only if the buyer has received delivery, as in *Stowers*. See text accompanying notes 139-46 *infra*.

57. See U.C.C. §§ 9-306(2), -307(1); text accompanying notes 68-70 *infra*.

interest in inventory cannot long rely on a debtor's possession because the debtor may soon sell the collateral or have sold it already. Reliance on a debtor's possession of inventory is always precarious. An inventory check on Monday will not protect against sales on Tuesday; neither can it undo previous sales made within a commercially reasonable time. As sections 9-306(2) and 9-307(1) teach, inventory lenders need to know something about the borrower's inventory and marketing practices. The role of identification accentuates that need.⁵⁸

Another limitation on the effect of the identification rule on expectations arising out of possession lies in the fact that the rule relates only to sales from inventory. Buyers may use identification against *sellers* of noninventory items including equipment, consumer goods, or farm products; but unless the *secured party* authorized a sale, buyers of those goods cannot defeat him. Only buyers from a person in the business of selling goods of that kind benefit from section 9-307(1).⁵⁹

These conclusions notwithstanding, *Chrysler* typifies the approach of many courts that remain unpersuaded and seem to prefer the title route⁶⁰ or the delivery route⁶¹ for determining the time when the buyer's rights arise.⁶² The *Tanbro* case illustrates the operation of these special property rules and one court's reluctance to accept them.

D. Application of Special Property Interest Rules to Tanbro

Under the foregoing analysis of the special property interest, Tanbro acquired a special property interest in the goods in which Deering enjoyed a prior perfected security interest. Under classic security of

58. Thus in the *Chrysler* case it was incumbent upon the creditor of the seller to know that several items, which comprised a significant portion of the seller's inventory, were already paid for. Those familiar with inventory financing must admit that careful inventory creditors insist on this kind of sales information.

59. See U.C.C. §§ 1-201(9), 9-307(1).

60. See, e.g., *Weisbart & Co. v. First Nat'l Bank*, 568 F.2d 391, 394 (5th Cir. 1978); *Wood Chevrolet Co. v. Bank of the Southeast*, 352 So. 2d 1350, 1352 (Ala. 1977); *CIT Financial Services Corp. v. First Nat'l Bank*, 344 So. 2d 125, 126 (Miss. 1977); *Integrity Ins. Co. v. Marine Midland Bank-Western*, 90 Misc. 2d 868, 396 N.Y.S.2d 319 (Sup. Ct. 1977); *Zions First Nat'l Bank v. First Security Bank*, 534 P.2d 900 (Utah 1975); *National Exch. Bank v. Mann*, 81 Wis. 2d 352, 362, 260 N.W.2d 716, 720 (1978). *Contra*, *Rex Fin. Corp. v. Mobile Am. Corp.*, 580 P.2d 8, 10 (Ariz. App. 1978). *Cf.* *Richards & Assoc., Inc. v. Tennessee Forging Steel Corp.* (*In re Tennessee Steel Corp.*), 24 U.C.C. REP. SERV. 326, 329-30 (E.D. Tenn. 1978) (using both identification and title to rule for the buyer). For a different view from that advanced in the text, see Anzivino, *When Does a Debtor Have Rights in the Collateral Under Article 9 of the Uniform Commercial Code?*, 61 MARQ. L. REV. 23 (1977).

61. See, e.g., *United States v. Wyoming Nat'l Bank*, 505 F.2d 1064, 1067 (10th Cir. 1974); *General Elec. Credit Corp. v. Tidewell Indus. Inc.*, 115 Ariz. 362, 565 P.2d 868, 870 (1977); *First Nat'l Bank v. Smoker*, 153 Ind. App. 71, 80-81, 286 N.E.2d 203, 209 (1972).

62. *But see, e.g.*, *Goldberg Co. v. County Green Ltd. Partnership* (*In re County Green Ltd. Partnership*), 438 F. Supp. 693, 696 (W.D. Va. 1977).

property principles Deering would prevail. Mill, which had encumbered its property, could give Tanbro only the interest Mill retained,⁶³ an interest subject to Deering's security interest. The Code, however, subjects the general security of property notion to a number of exceptions in favor of those who purchase goods,⁶⁴ instruments,⁶⁵ documents,⁶⁶ and chattel paper.⁶⁷ Of these, two bear on the *Tanbro* controversy.

The first creates an exception to the rule that a security interest follows goods into the hands of the purchaser, in the event that "the disposition was authorized by the secured party in the security agreement or otherwise."⁶⁸ In particular, if the secured party authorizes the debtor to *sell* the goods, the secured party loses his security interest.⁶⁹ It is of no moment that the secured party intends to retain his security interest.

The Deering fabric was inventory, for both Deering and Tanbro, and since the purpose of inventory is sale in most situations, section 9-306(2) serves to protect the interest of the purchaser against that of the secured party.⁷⁰

By delivering the first shipment of 57,000 yards of fabric to Tanbro's affiliate, Deering authorized the disposition to Tanbro.⁷¹ It

63. *Non dat qui non habet*. Mill could not give what it did not have. Latinists may (and may not) prefer *nemo plus juris in alium transferre potest quam ipse habet*, Wheelwright v. Depeyster, 1 John. 471, 479 (N.Y. 1806).

64. U.C.C. §§ 9-301(1)(c), -306(2), -307.

65. *Id.* §§ 9-301(1)(c), -306(2), -308, -309.

66. *Id.* §§ 9-301(1)(c), -306(2), -309.

67. *Id.* §§ 9-301(1)(c), -306(2), -308.

68. *Id.* § 9-306(2) (emphasis added). The 1972 version of this subsection differs slightly from the 1962 version. The difference does not affect the argument advanced here.

69. *See, e.g.*, Farmers Nat'l Bank v. Ceres Land Co., 32 Colo. App. 290, 293, 512 P.2d 1174, 1176 (1973); Draper v. Minneapolis-Moline, Inc., 100 Ill. App. 2d 324, 329, 241 N.E.2d 342, 345 (1968). *Contra*, United States v. Sommerville, 324 F.2d 712, 717 (3d Cir. 1963), *cert. denied*, 376 U.S. 909 (1964); Vermilion County Prod. Credit Ass'n v. Izzard, 111 Ill. App. 2d 190, 194, 249 N.E.2d 352, 354 (1969). *See generally* 2 G. GILMORE, *supra* note 38, § 26.11 (1965). *See also* U.C.C. § 9-306(2), Comment 3 (1962 version).

70. If the lender does not authorize a sale, § 9-307(1) fulfills the reasonable expectations of a good faith buyer. A buyer in ordinary course takes free even of a known security interest, unless he knows that the sale violates the security agreement. U.C.C. § 9-307, Comment 2. The provision specifically excepts from its operation farmers' sales of farm products. *Id.* Farm products are not "inventory" under the Code. *Id.* § 9-103(3). Farm security agreements traditionally do not authorize farmer debtors to sell crops and livestock that secure agricultural loans.

71. By delivery, Deering also lost the benefit of perfected status. Without any filed financing statement, delivery of this collateral to the debtor or a third party renders the secured party unperfected unless the delivery is protected under the twenty-one day rule of § 9-304(5). A buyer who takes delivery of the collateral without notice of an unperfected security interest defeats the secured party under § 9-301(1)(c). A buyer, not a buyer in ordinary course, who knows of the security interest, as Tanbro did, would lose to an unperfected secured party such as Deering. *See* text accompanying notes 14-22 *supra*.

might have been argued that Deering authorized the sale not only of the 57,000 yards it delivered but also of the 203,000 it continued to hold, on the grounds that Deering was aware of the industry practice of resale among converters, that Deering shipped the first 57,000 yards to Tanbro's affiliate on Mill's instructions, and that Deering salespeople had first informed Tanbro that Mill had fabric to sell. The success of the argument would turn on the facts and the characterization of Deering's concern for the fabric as arising only when Mill's insolvency became evident. If Deering had authorized the sale and attempted to revoke that authorization after Mill had entered into the contract with Tanbro, *i.e.*, after Tanbro had obtained a special property interest in the goods, its revocation would come too late;⁷² section 9-306(2) would yield a result in favor of Tanbro.

The opinions, however, do not discuss this argument. The trial court directed a verdict on the issue of liability at the close of the evidence. The New York Court of Appeals recognized that Tanbro could succeed under section 9-306(2) if "the sale was not unauthorized,"⁷³ but chose instead to bottom its decision on section 9-307(1) when it characterized the issue as "whether Tanbro's purchase of goods was in the ordinary course of Mill's business"⁷⁴

III. Financing Devices Affected by the New York Rule

Tanbro unsettles commercial lawyers, not because it favors buyers over lenders, but because it ignores the reasonable expectations of lenders and promotes careless or even deceptive conduct on the part of buyers. The case will not inevitably undermine the structure of commercial finance or increase transaction costs dramatically. It will, however, disturb modern commercial practices and needlessly reward unsuspecting parties, without any concomitant benefit. Widespread commercial practices presuppose that possession of goods signifies power to sell the goods and that lack of possession signifies want of that

72. The facts may justify this scenario. It appears that Deering was not concerned with Mill's creditworthiness during 1969. Deering made credit advances to Mill totalling \$300,000 after May 1969. In October and November of the same year Deering delivered 57,000 yards of fabric to Tanbro's affiliate at a time when Mill owed Deering more than \$115,000. Mill sold the fabric at \$.26/yard. In fact, when Tanbro sought delivery of the 203,000 yards of fabric, Deering asked for a cash deposit of only \$50,000. Thus, unless Deering held other collateral that the opinions do not mention, it held fabric valued at far less than Mill's debt in November 1969 when Deering shipped the 57,000 yards.

73. *Tanbro Fabrics Corp. v. Deering Milliken, Inc.*, 39 N.Y.2d 632, 636, 350 N.E.2d 590, 592, 385 N.Y.S.2d 260, 262 (1976).

74. *Id.* at 634, 350 N.E.2d at 591, 385 N.Y.S.2d at 261.

power. This presupposition is manifest in both the marketing and financing of goods.

This Part and Part IV will examine a long list of credit transactions encompassed by the Code's possession-oriented scheme for protecting creditors, debtors, and debtors' takers. The purpose of the section divisions is to stress that the New York rule adversely affects some of these financing arrangements, despite what would otherwise seem to be the Code's intent, while others survive unharmed. This Part explains how the New York rule undermines credit arrangements based on the use of the pledge, field warehousing, and repossession; the next Part describes thirteen devices preserved or originated by the Code, to which the New York rule does not apply. Both sections, however, serve to illustrate the breadth of the Code's respect for expectations based on possession and the great extent to which the New York rule could disturb the Code's underlying plan. Part V is devoted to the "thief rule," an exception to possession-oriented rules that is preserved by the Code for reasons of paramount social policy. Taken together, these Parts permit a recasting of the issue the New York rule raises: it is not simply whether a buyer in ordinary course should defeat a creditor in possession, but whether, given the role possession plays in commercial law and the Code's evident acceptance and refinement of that role, courts can justifiably create a new exception to security of property principles that defies this history and disappoints possession-based expectations.

A. Pledge

The pledge, an ancient personal property security device,⁷⁵ is an arrangement whereby the creditor deprives his debtor of possession of the collateral.⁷⁶ It is the general rule that a pledge fails absent delivery to the creditor⁷⁷ or his agent,⁷⁸ and expires when the creditor surrenders the collateral to the debtor.⁷⁹ The Code recognizes these rules in

75. See Code of Hammurabi 118.

76. The deprivation is fundamental to the pledge. R. BROWN, *THE LAW OF PERSONAL PROPERTY* § 15.1 (3d ed. 1975). There have long been two types of chattel security devices, one requiring possession, the other nonpossessory. Some authorities have used "pledge" as a broad term encompassing both possessory and nonpossessory chattel security arrangements. The common-law pledge, however, is a possessory security interest. See Gilmore & Axelrod, *Chattel Security: I*, 57 *YALE L.J.* 517, 521-23 (1948); Wigmore, *The Pledge-Idea: A Study in Comparative Legal Ideas III*, 11 *HARV. L. REV.* 18 (1897). See also 2 S. WILLISTON, *THE LAW GOVERNING SALES OF GOODS* § 338a (rev. ed. 1948); 3 *id.* § 515.

77. *Wilson v. Little*, 2 *N.Y.* 443, 446-47 (1849).

78. *Accord*, R. HENSON, *HANDBOOK ON SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE* 60 (1973); cf. U.C.C. § 9-305, Comment 2 (possession may be by an agent for the secured party, but the debtor or a person controlled by him cannot qualify as the agent).

79. *Casey v. Cavaroc*, 96 *U.S.* 467, 477, 478, 480 (1877); *Bodenhammer v. Newsom*, 50 *N.C.*

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sections 9-203 and 9-305, which permit creation and perfection of a security interest by possession. Significantly, these provisions do not extend to the types of collateral, accounts and general intangibles, possession of which cannot be transferred.⁸⁰ Pledge rules rest not on inapplicable physical considerations but on the realities of commercial expectations. It was reasonable for a medieval creditor to assume that his merchant debtor could not sell wares held by the creditor and equally reasonable for the medieval buyer to resist sales efforts by a peddler with an empty cart. Modern creditors have found safety in possession of collateral and modern buyers are reluctant to pay cash for goods they cannot see. By protecting the creditor in possession, the common law and the Code defer to these realities.

Possession by the creditor or his agent and lack of possession by the debtor serve the twofold purpose of any security device: they protect the creditor against use or sale of the collateral by the debtor and warn purchasers against giving value for goods subject to a security interest.

The common-law pledge permitted a number of exceptions to the general rule that the creditor must deprive the debtor of possession. As a general rule, the release of collateral to the debtor for services that benefited the creditor did not terminate the pledge.⁸¹ Common-law courts, however, recognized the commercial peril of permitting the lender to surrender the collateral and mislead third parties who might rely on the debtor's possession. It was the rule, therefore, that these third parties would defeat the pledge.⁸² Article 9 greatly limits the circumstances in which a pledgee may surrender possession to the debtor and still retain a security interest.⁸³ In various circumstances, the purchaser's ignorance or incomplete knowledge of the security interest defeats or subordinates that interest.⁸⁴

The implications of *Tanbro* for the pledge are obvious. If the trier of fact finds it "ordinary" in a given industry for parties to effect purchases and sales without the buyer's taking delivery, the pledge becomes no better than a security interest perfected by filing. Neither perfection by possession nor perfection by filing protect the creditor

(5 Jones) 107, 109 (1857). Courts, however, distinguished between mortgages of personalty and pledges of personalty, using a title theory to permit redelivery to the debtor in mortgage situations without loss of the mortgage lien. *See, e.g.,* *Casey v. Cavaroc*, 96 U.S. 467 (1877).

80. U.C.C. § 9-305 & Comment 1.

81. *Casey v. Cavaroc*, 96 U.S. 467, 480 (1877); RESTATEMENT OF SECURITY § 11(2) (1941).

82. *Bodenhammer v. Newson*, 50 N.C. (5 Jones) 107, 109 (1857); RESTATEMENT OF SECURITY § 11(2), Comment c, at 40.

83. U.C.C. § 9-304(4) & (5).

84. *See id.* §§ 9-307, -308, -309.

from sales by the debtor—a conclusion contrary to the reasonable expectations of the parties.

B. Field Warehousing

Modern creditors frequently employ a variant of the pledge that involves warehouse receipts. Under the Code, creditors may take a security interest in inventory and perfect by filing a financing statement.⁸⁵ The perfected security interest falls, however, before the interest of a buyer in ordinary course,⁸⁶ since such a buyer reasonably expects to take free and clear. Sections 9-306(2) and 9-307(1) provide that most buyers will prevail in these circumstances.⁸⁷ Inventory lenders, aware of the open market effects of these sections but unwilling to use the bulky pledge procedure, have utilized field warehousing to avoid those effects. The field warehouseman operates a manned physical enclosure located at the debtor's place of business and acts as the creditor's agent. The warehouseman takes possession of the debtor's inventory and issues warehouse receipts in nonnegotiable form directly to the creditor. The debtor grants the creditor a security interest, and the creditor perfects by one of the three methods permitted in section 9-304(3). The field warehouse agent on the debtor's premises may release collateral to the debtor only upon the creditor's instructions.⁸⁸

The purpose of the field warehouse is thus not to secure the creditor. Article 9 permits creditors to acquire a security interest and perfect it with a simple security agreement and financing statement, without the cost and inconvenience of the physical enclosure, nonnegotiable receipts, and delivery orders.⁸⁹ Creditors incur the expense of field warehousing not for the purpose of creating or perfecting a security interest but in order to deprive the debtor of possession. They choose to deprive him of possession, moreover, not because they fear he will use the inventory but because they fear he will sell it and that buyers in ordinary course will use section 9-307(1) to defeat the secured party. The field warehouse is a collateral policing device that permits

85. *Id.* §§ 9-203, -302.

86. *Id.* § 1-201(9) defines a "buyer in ordinary course" as "a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind"

87. Under § 9-306(2) any buyer, except certain fraudulent buyers, will prevail over the secured party who authorizes the sale. *See* U.C.C. § 2-402(2). *See also* note 22 *supra*.

88. To release collateral without authorization will generally render the field warehouse liable. *See* U.C.C. § 7-403.

89. *Id.* §§ 9-203, -204. Professor Henson notes that "an aura of esoterica" still surrounds field warehousing. R. HENSON, *supra* note 78, at 62 n.21.

the creditor to control the amount of collateral available to satisfy his security interest.

The New York rule announced in *Tanbro* has the effect of providing every buyer with a key to the field warehouse lock. By proving buyer in ordinary course status, a buyer under the *Tanbro* rule can defeat the secured party who deprived his debtor of possession precisely in order to avoid the buyer in ordinary course difficulty.

C. Repossession

In many, if not most, instances the classic pledge and the field warehouse will not fit the needs of the borrower and his secured party. Usually creditors cannot maintain possession of equipment that the borrower uses or inventory that he sells. Field warehousing entails start-up and handling costs that the debtor may not be willing to bear.

Most inventory security interests are nonpossessory: the debtor holds the collateral, and the secured party either resorts to such policing efforts as periodic inspection or certified credit, or relies on the integrity of his borrower. In the event of default, most security agreements and the Code itself provide that the secured party may take possession of the collateral⁹⁰ and sell it free of the debtor's interest.⁹¹ In some instances the Code permits strict foreclosure, *i.e.*, simple retention of the collateral in satisfaction of the debt.⁹²

This process of repossession serves two purposes. First, it is a prerequisite to depriving the debtor of his title, either by sale or by strict foreclosure. Second, it prevents the debtor from alienating the collateral. *Tanbro* undermines both functions. If a debtor without possession may sell to a buyer in ordinary course who can defeat the secured party, creditor repossession affords no protection. One effect of *Tanbro* may be to promote quick sale by the secured party in order to beat buyers in ordinary course. These sales might be commercially reasonable,⁹³ given the danger of debtor sales to a buyer in ordinary course, but low selling prices could result in loss to the secured party and the debtor.⁹⁴

90. U.C.C. § 9-503.

91. *Id.* § 9-504.

92. *Id.* § 9-505(2).

93. Failure of the secured party to sell the collateral in a commercially reasonable manner will jeopardize his claim for a deficiency and may expose him to liability to the debtor. *See, e.g.*, *Atlas Thrift Co. v. Horan*, 27 Cal. App. 3d 999, 1008, 104 Cal. Rptr. 315, 321 (1972); *Camden Nat'l Bank v. St. Clair*, 309 A.2d 329, 332 (Me. 1973).

94. This danger may apply only to inventory loans. There is authority holding that a buyer of used equipment in an incidental sale cannot rise to the level of a buyer in ordinary course. *Hempstead Bank v. Andy's Car Rental Sys.*, 35 App. Div. 2d 35, 38, 312 N.Y.S.2d 317, 320 (1970).

IV. Transactions Not Affected by the New York Rule

Tanbro rejects the idea that a seller must be in possession for his taker to attain buyer in ordinary course status. Evaluation of that judgment requires analysis not only of the three commercial practices already discussed, pledges, field warehousing, and repossession, but also of other rules that have evolved in the long effort to temper the baleful effects of the security of property principle. The following analysis will suggest that the implications of possession are at the bottom of this long effort and that *Tanbro* is a significant and ill-advised departure from a reasonable limit on good faith purchase rules.

A. Negotiable Documents of Title

As in field warehousing, the rules of commodity paper generally proceed on the assumption that possession by a bailee provides protection to the person entitled to the goods under the terms of the document. In agricultural commodity transactions, grain elevators and gin companies frequently issue negotiable warehouse receipts to true owners who use the negotiable documents⁹⁵ in the financing and marketing of their goods. With sections 7-501 to 7-509, the Code systematically protects the interests of a "holder to whom these negotiable documents of title are duly negotiated" (a "qualified holder").⁹⁶ Such holders take title to the goods free of most claims.⁹⁷ In fact, the Code provides for only two instances where the qualified holder loses.

Under section 7-205 a qualified holder loses to a buyer in ordinary course who takes delivery of fungible goods from a warehouse in the business of selling those goods.⁹⁸ Section 7-205 is thus a good faith purchase section that favors buyers over secured parties. The second exception is a security of property rule. Section 7-503 prevents a thief or other unauthorized party from bailing goods and passing good title to a qualified holder. It affirms the paramount rights of persons whose interests arise prior to the bailment and who are in no way estopped⁹⁹

Hempstead rejects the argument that a car rental company that customarily sells its vehicles after having leased them is "in the business of selling goods of that kind," within the meaning of § 1-209(9). Accordingly, buyers of vehicles from the car rental company would not be buyers in ordinary course. Most sales by a business of its equipment would not constitute sales by a person in the business of selling goods of that kind.

95. U.C.C. § 1-201(15).

96. *Id.* § 7-501(4) sets forth the requirements for negotiation.

97. *Id.* § 7-502.

98. *Cf. In re Fairfield Elevator Co.*, 14 U.C.C. Rep. 96, 106 (S.D. Iowa 1973) (the court uses the doctrine of voidable title to achieve this result).

99. U.C.C. § 7-503(1)(a) & (b). *See United States v. Hext*, 444 F.2d 804, 814 n.34 (5th Cir. 1971).

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from asserting their paramount position.

Arguably, under *Tanbro* a true owner who has bailed his goods and granted a security interest in them by conveying a negotiable document of title to his bank can sell those goods to a buyer in ordinary course, and the buyer, who does not take possession, prevails. That implication, however, flies in the face of the language of section 9-309, which provides that “[n]othing in this Article limits the rights of . . . a holder to whom a negotiable document of title has been duly negotiated”¹⁰⁰ While the main thrust of the section relates to persons with nonpossessory security interests in such documents,¹⁰¹ its plain language forbids courts from applying section 9-307(1) against secured parties who are also qualified holders.¹⁰² *Tanbro*, then, should not affect the rights of qualified holders.

B. Documentary Drafts

In the simplest form of documentary draft transaction,¹⁰³ a seller ships goods by a carrier from whom he obtains a negotiable bill of lading. The seller forwards the bill, along with a draft, through the banking chain. The collecting bank presents the draft to the buyer. When the buyer honors the draft, the bank surrenders the bill of lading, and the buyer can obtain the goods from the carrier when the shipment arrives.

The documentary draft benefits both buyer and seller. The seller knows that without the bill the buyer will not obtain the goods because the carrier will not deliver them except to the holder of the bill.¹⁰⁴ The seller also takes comfort from the fact that the bank will not deliver the bill to the buyer unless the buyer honors the seller’s draft.¹⁰⁵ The buyer, in turn, willingly honors the draft because he knows that possession of the negotiable bill is tantamount to possession of the goods.

100. U.C.C. § 9-309 (emphasis added).

101. *See id.* Comment 2 (second sentence).

102. Professor Skilton makes this point in Skilton, *Buyer in Ordinary Course of Business Under Article 9 of the Uniform Commercial Code (and Related Matters)*, 1974 WIS. L. REV. 1, 48-49.

103. For an explanation in more detail of this transaction and its variables, see Farnsworth, *Documentary Drafts Under the Uniform Commercial Code*, 22 BUS. LAW. 479 (1967).

104. In the event the carrier surrenders the goods to someone other than the qualified holder, the carrier will be liable. U.C.C. § 7-403. *Cf.* *Turner v. Scobey Moving & Storage Co.*, 515 S.W.2d 253, 256 (Tex. 1974) (warehouse liable for misdelivery of goods covered by a nonnegotiable receipt).

105. A bank that delivers the bill of lading before the buyer honors the draft exposes itself to liability for any losses the buyer sustains. *See* U.C.C. §§ 4-202(1), -204(2) & Comment 3, -211(1); *cf.* *Pere Marquette Ry. v. J.F. French & Co.*, 254 U.S. 538 (1921) (pre-Code dictum to the same effect).

Tanbro does not affect the assumptions of the buyer in documentary draft transactions. First, many buyers who receive a documentary draft will qualify as holders to whom a negotiable document of title has been duly negotiated.¹⁰⁶ They will benefit from section 9-309, as explained in Part V(A). In addition, because *Tanbro* rests on section 9-307(1), it applies only to buyers in ordinary course asserting claims in conflict with *secured parties*, not in conflict with other buyers. Consequently, if a seller, after delivering goods to the carrier and sending the bill of lading through the banking chain, attempts to sell to a second buyer, the second buyer will lose to the first.

C. Article 2 Security Interests

Under section 2-505, which codifies part of the common law lien for unpaid sellers, a seller reserves a security interest in goods that he ships under a bill of lading reflecting his interest in the goods.¹⁰⁷ His security interest terminates upon surrender to the buyer of the document of title if it is negotiable,¹⁰⁸ or delivery of the goods if it is non-negotiable.¹⁰⁹ Until surrender or delivery, however, the buyer cannot defeat the security interest by selling to a third party. Even though,

106. U.C.C. § 7-501 provides:

(1) A negotiable document of title running to the order of a named person is negotiated by his indorsement and delivery. After his indorsement in blank or to bearer any person can negotiate it by delivery alone.

(2) (a) A negotiable document of title is also negotiated by delivery alone when by its original terms it runs to bearer.

(b) When a document running to the order of a named person is delivered to him the effect is the same as if the document had been negotiated.

(3) Negotiation of a negotiable document of title after it has been indorsed to a specified person requires indorsement by the special indorsee as well as delivery.

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

(5) Indorsement of a non-negotiable document neither makes it negotiable nor adds to the transferee's rights.

(6) The naming in a negotiable bill of a person to be notified of the arrival of the goods does not limit the negotiability of the bill nor constitute notice to a purchaser thereof of any interest of such person in the goods.

107. The purpose of § 2-505 is to overcome the common-law notion that the seller either loses all interest in the goods when he delivers them to the carrier or retains title. See U.C.C. § 2-505, Comment 1. The section is consistent with this Article's view that title is irrelevant in sales and secured transactions. See text accompanying notes 239-43 *infra*. When the goods are identified to the contract, the buyer obtains a special property interest. When the seller ships them under reservation, he obtains a security interest. Title has no bearing on the rights of the buyer and the seller as against each other.

108. See U.C.C. §§ 7-502, -503, -504.

109. See *id.* § 2-505(1)(b) & Comment 3.

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under *Tanbro*, the buyer's taker may be a buyer in ordinary course, he will not defeat an Article 2 security interest (since any Article 2 security interest will have been created by operation of law rather than by his seller). Section 9-307(1) permits the buyer in ordinary course to prevail only over security interests created by "his seller."¹¹⁰ There has been strong sentiment among some commercial lawyers to excise this feature from section 9-307(1), making it apply against all security interests.¹¹¹ The amendment might add Article 2 possessory security interests to the list of *Tanbro*'s casualties. Absent that amendment, however, *Tanbro* does not upset the Code's construct for Article 2 security interests,¹¹² notwithstanding the fact that *Tanbro* permits a buyer to claim ordinary course status when his seller is not in possession.

Article 2 also creates a security interest in favor of buyers who rightfully reject or revoke acceptance of goods.¹¹³ That Article 2 security interest, which extends only to goods in the disappointed buyer's possession or control, should withstand attack by buyers in ordinary course from the breaching seller. Such buyers may not avail themselves of the protection of section 9-307(1) against this nonconsensual security interest arising by operation of law.

D. Possessory Liens

Courts and legislatures have long recognized the significance of possession for artisans or mechanics who enhance the value of goods. Both the common law¹¹⁴ and statutes¹¹⁵ protect the lien on personal property of certain creditors who maintain possession of that property. In the event those creditors surrender possession of the goods, however, they generally lose the lien.¹¹⁶ The Code recognizes this kind of lien and the significance of corresponding possession. It sanctions the pri-

110. Emphasis supplied. See, e.g., *National Shawmut Bank v. Jones*, 108 N.H. 386, 236 A.2d 484 (1967).

111. See Knapp, *Protecting the Buyer of Previously Encumbered Goods: Another Plea for Revision of UCC Section 9-307(1)*, 15 ARIZ. L. REV. 861 (1973). The text assumes that Article 9 governs Article 2 security interests except as specifically exempted from Article 9 by § 9-113. Accord, J. WHITE & R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE* 781 (1972). Contra, Kreindler, *supra* note 9, at 87.

112. U.C.C. § 2-505, Comment 4 supports the conclusion of the text. By stating that a sub-buyer in ordinary course will defeat the seller who does not reserve a security interest, the Comment implies that such a sub-buyer will not defeat a seller who does reserve one.

113. *Id.* § 2-711(3).

114. The classic instance of a common-law possessory lien is that of the unpaid seller in possession. See, e.g., *McEwan v. Smith*, 9 Eng. Rep. 1109, 1117 (H.L. 1849). See generally 3 S. WILLISTON, *supra* note 76, § 507a.

115. See, e.g., UNIFORM SALES ACT § 54. Significantly, those statutes not requiring possession employ a notice-filing scheme. See, e.g., MICH. COMP. LAWS § 570.1 (1970).

116. See, e.g., U.C.C. § 7-209(4).

ority of the lien over earlier perfected security interests.¹¹⁷ While *Tanbro* suggests that a buyer of goods subject to such a possessory lien may satisfy buyer in ordinary course requisites, nothing in section 9-307(1) suggests that such a buyer defeats the possessory lien, which is not a security interest.¹¹⁸

E. Entrustment

Commercial lawyers have also recognized the unfairness of permitting a true owner to clothe another with the appearance of ownership and then deny the implications of that appearance. Manifest in a number of separate rules, this recognition has roots in estoppel and agency doctrines and results directly from the notion that possession connotes ownership.¹¹⁹

The development of this rule has been somewhat tortuous. Originally, the true owner lost to a buyer only if the owner permitted the trustee to mislead the buyer. Possession alone was insufficient, but possession with a bill of sale¹²⁰ or with the trustee's name emblazoned on the goods¹²¹ sufficed. Gradually, commercial lawyers came to accept the view of Lord Ellenborough in *Pickering v. Busk*,¹²² that an entrustor who delivers goods to a merchant dealer in those goods will not be heard to say he delivered them without authority to sell.¹²³ Section 2-403(2) codifies this rule.

It is customary to justify the rule in terms of fault. Both true owner and buyer are innocent of wrongdoing, the merchant being the culprit. Yet either the true owner or the buyer must suffer loss of the goods, with the merchant's fisc as his only resort.¹²⁴ Courts rise to the occasion with relish and announce that the true owner, having put his trust in the wrongdoer, should bear the loss.¹²⁵

117. *Id.* § 9-310. The priority, however, will not arise if the rule of law or statute creating the lien provides otherwise. *Id.*

118. *See id.* § 9-310 & Comment; *cf. id.* § 7-209 (treating a warehouse lien and a warehouse security interest differently).

119. *See, e.g.,* Gilmore, *supra* note 7, at 1057-60; RESTATEMENT (SECOND) OF AGENCY § 8, Comment a (1957).

120. *Nixon v. Brown*, 57 N.H. 34, 37 (1876).

121. *O'Connor's Adm'x v. Clark*, 170 Pa. 318, 321, 32 A. 1029, 1030 (1895). *See generally* 2 S. WILLISTON, *supra* note 76, § 316.

122. 104 Eng. Rep. 758 (K.B. 1812).

123. *Id.* at 760-61.

124. In the event the true owner suffers the loss of the goods, he has a cause of action against the merchant sounding in tort, conversion. *See* W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 15, at 87-89 (4th ed. 1971). In the event the buyer suffers the loss, he has a cause of action against the merchant for breach of warranty of title. *See* U.C.C. § 2-312(1).

125. *See O'Connor's Adm'x v. Clark*, 170 Pa. at 321, 32 A. at 1030 (1895); *cf. Miller v. Race*, 97 Eng. Rep. 398, 400 (K.B. 1758) (involving commercial paper where the successful plaintiff's

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Some have objected to this analysis on the grounds that both buyer and true owner trusted the merchant and that the rule is essentially one of allocating loss in a fashion that facilitates commerce.¹²⁶ Yet the traditional explanation merits more credit than its critics are willing to give it. The rule is eminently sensible. It allocates loss in a manner that forces true owners to select merchants carefully and frees buyers from title inquiry. The rule thus acknowledges the fact that it is easier and less costly for an entrustor to select and control his merchant than it is for a buyer to do so. Most often, buyers deal with more merchants, true owners with fewer; and buyers generally deal with their merchant sellers on an infrequent or casual basis, the true owner enjoying a more permanent relationship with his merchants. The rule serves the realities of the usual setting and comports with what reasonable parties expect. The courts have correctly concluded that a true owner who selects a dishonest merchant bears more blame than a buyer who selects one.

More important for the purposes of this discussion is the role that reasonable expectations play in fashioning or justifying commercial precepts. Absent other compelling considerations,¹²⁷ these expectations should determine the rules of commercial law, and the entrustment rule respects expectations based on possession.¹²⁸

F. Factors

It was a principle of early commercial law that a factor could convey title to a good faith purchaser even though the factor acted beyond the scope of his actual authority.¹²⁹ Brokers, however, could not pass better title than they themselves enjoyed or had power to convey.¹³⁰ The reason for the disparate treatment stemmed in part from possession: the factor had it, the broker did not.¹³¹ More importantly, buyers

attorney argued that the true owner, who was robbed of his bank note, "was guilty of some laches in not preventing it.")

126. See L. VOLD, HANDBOOK OF THE LAW OF SALES 177-78 (2d ed. 1959).

127. Such compelling considerations are infrequent. Illegality, which sometimes comes as a surprise to the parties but nonetheless renders their contract disabled, is one example. Thus it is no criticism of the general commercial principle that an unlawful pact is void to say that the parties reasonably expected it to be enforceable. See text accompanying notes 200-11 *infra*.

128. Professor Gilmore observes that the good faith purchaser "is protected not because of his praiseworthy character, but to the end that commercial transactions may be engaged in without elaborate investigation of property rights and in reliance on the possession of property by one who offers it for sale or to secure a loan." Gilmore, *supra* note 7, at 1057.

129. See *James v. Meriwether Graham Oliver Co.*, 152 Tenn. 528, 279 S.W. 390 (1925).

130. The text assumes a distinction between brokers and factors that commercial practice and courts did not always observe. Compare *Pickering v. Busk*, 104 Eng. Rep. 758, 760 (K.B. 1812), with F. TIFFANY, HANDBOOK OF THE LAW OF PRINCIPAL AGENCY § 24, at 64 (2d ed. 1924).

131. The agent who held the goods or a warehouse receipt covering them, however, could

reasonably expected that factors had authority to sell but could not reasonably believe the same of brokers. By framing its rule in terms of "entrustment,"¹³² the Article 2 buyer in ordinary course rule, section 2-403(2), embodies this presumption. *Tanbro* therefore does nothing to alter this aspect of the good faith purchase doctrine, which the provision of section 2-403(2) expressly controls.

G. *Voidable Title*

Another, less precise manifestation of commercial law deference to apparent ownership is the doctrine of voidable title codified in section 2-403(1). At common law certain fraudulent conduct on the part of a buyer from the true owner gave the true owner of goods the right to void the transaction and recover delivered goods.¹³³ Prior to recovery the fraudulent party enjoys possession, and the situation is likely to mislead the good faith buyer. The voidable title doctrine stipulates that in the event the common law vests the malefactor with voidable title, he can transfer good title to a good faith purchaser for value. While courts often justify the voidable title doctrine by reference to the culpability rationale used in the entrustment cases,¹³⁴ the rule's appeal¹³⁵ stems from its recognition that possession induces reliance and that true owners are usually in a better position to investigate the credit and integrity of their buyers than buyers are to investigate the title apparently held by their sellers.¹³⁶ The doctrine of voidable title

convey good title. *See* *Commercial Nat'l Bank v. Canal-Louisiana Bank & Trust Co.*, 239 U.S. 520, 525 (1916).

132. "Entrusting" includes any delivery and any acquiescence in retention of possession" U.C.C. § 2-403(3).

133. *See* *California Conserving Co. v. D'Avanzo*, 62 F.2d 528, 530 (2d Cir. 1933); *Stanton Motor Corp. v. Rosetti*, 11 App. Div. 2d 296, 298, 203 N.Y.S.2d 273, 276 (1960). The Code abolishes that right to recover in credit sales except in cases where the buyer receives goods while insolvent. U.C.C. § 2-702(2). Nonetheless, the doctrine of voidable title survives largely intact. *Id.* § 2-403(1). In cash, as opposed to credit sales, moreover, the Code gives the seller the right to recover goods when the buyer's cash equivalent turns out to be a rubber check. *Id.* § 2-507. *See* *Lawrence v. Graham*, 29 Md. App. 422, 427, 349 A.2d 271, 274 (1975); *cf.* *Twyne's Case*, 76 Eng. Rep. 809, 820 (S.C. 1601) (interpreting statute to protect certain purchasers and certain creditors against fraudulent conveyances).

134. *See* *White v. Garden*, 138 Eng. Rep. 364, 367 (C.P. 1851): "One of two innocent parties must suffer: and surely it is more just that the burthen should fall on the defendants, who were guilty of negligence in parting with their goods upon the faith of a piece of paper which a little inquiry would have shewn to be worthless, rather than upon the plaintiff, who trusted to the possession of the goods themselves."

135. Arguably the rule, because of its imprecision, has no appeal. *See* Warren, *Cutting Off Claims of Ownership Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 469, 475 (1963). Yet that imprecision stems not from the policy of protecting buyers against true owners but from the difficulty of determining when the common law clothes the malefactor with voidable title.

136. This assumption, though difficult to substantiate by data, underscores much of commercial law. It stems in part from the assumption that most buyers are small and most sellers big. *See* Kripke, *The Principles Underlying the Drafting of the Uniform Commercial Code*, 1962 U. ILL.

manifests again the law's concern that possession not mislead.¹³⁷ Section 2-403(1) insulates this aspect of the Code scheme from *Tanbro*.

H. Seller's Lien

Analogous to the Article 2 security interest and the artisan's possessory lien is the seller's lien¹³⁸ provision of section 2-507(2). That subsection protects the cash seller against the buyer, stipulating that the buyer has no right to possession of the goods unless he pays for them. Courts have construed section 2-507(2), along with section 2-511, as permitting the seller to recover possession when he has delivered goods against a check that is later dishonored.¹³⁹ Significantly, section 2-507(2) does not contain any provision extending or denying extension of the seller's right as against subsequent purchasers.¹⁴⁰

L.F. 321, 323-26. Significantly, although *White v. Garden*, 138 Eng. Rep. 364, 368 (C.P. 1851), contains language supporting the culpability rationale, it also contains reasoning that is economic in slant. The true owners argued that they should be able to recover the goods they had sold to the fraudulent party. Chief Justice Jervis considered that argument "most inconvenient." Similarly, the most liberal entrustment case, *Pickering v. Busk*, 104 Eng. Rep. 758, 760 (K.B. 1812), uses economic as opposed to moral suasion. "Strangers can only look to the acts of the parties, and to the external indicia of property, and not to the private communications which may pass between a principal and his broker . . ." *Id.* at 760. For a more recent entrustment case with a similar mixture of culpability reasoning and economic rationale, see *Fuqua Homes, Inc. v. Evans-ton Bldg. & Loan Co.*, 52 Ohio App. 2d 399, 402, 370 N.E.2d 780, 783 (1977).

137. Significantly, the common law did not consider the malefactor to have possession in the legal sense. Professor Maitland observes that his butler did not "possess" the family plate; but if the butler fraudulently sold to a silversmith, the silversmith did have "possession." Maitland, *supra* note 24, at 488. Evidently law professors were rather better off in those days. This Article does not make Professor Maitland's distinction between "legal possession" and possession in the usual sense. See note 4 *supra*.

138. So long as the seller retains possession of the goods, it does little harm to refer to his rights in the goods as a "lien." That terminology proves troublesome, however, in the bankruptcy context when the seller has parted with possession. Professor Kennedy implies that the term "interest" serves commercial lawyers better. Kennedy, *The Interest of a Reclaiming Seller Under Article 2 of the Code*, 30 BUS. LAW. 1833 (1975). See also *In re Federal's, Inc.*, 553 F.2d 509 (6th Cir. 1977); *Alfred M. Lewis, Inc. v. Holzman (In re Telemart Enterprises, Inc.)*, 524 F.2d 761 (9th Cir. 1975); Countryman, *Buyers and Sellers of Goods in Bankruptcy*, 1 N.M.L. REV. 435 (1971).

139. *In re Helms Veneer Corp.*, 287 F. Supp. 840, 845 (W.D. Va. 1968); *In re Mort Co.*, 208 F. Supp. 309, 310 (E.D. Pa. 1962); *Guy Martin Buick, Inc. v. Colorado Springs Nat'l Bank*, 32 Colo. App. 235, 239, 511 P.2d 912, 913 (1973); *Lawrence v. Graham*, 29 Md. App. 422, 426, 349 A.2d 271, 273 (1975).

140. Section 2-702, however, which gives the seller certain reclamation rights after delivery in a credit sale situation, does contain such a provision. U.C.C. § 2-702(3). The credit sale section also contains a ten day limit on the time within which the seller must demand recovery of possession. *Id.* § 2-702(2). Most courts, with the encouragement of Comment 3, have read the ten day rule into § 2-507. See, e.g., *In re Fairfield Elevator Co.*, 14 U.C.C. Rep. 96, 107 (S.D. Iowa 1973); *Ranchers & Farmers Livestock Auction Co. v. First State Bank*, 531 S.W.2d 167, 169 (Tex. Civ. App.—Amarillo 1975, writ ref'd n.r.e.). Some courts, moreover, and a strong suggestion in the comments, would incorporate all of the limitations of § 2-702(3) into § 2-507(2). See U.C.C. § 2-507, Comment 3 (third sentence); *Stowers v. Mahon (In re Samuels & Co.)*, 526 F.2d 1238, 1244 (5th Cir.), cert. denied, 429 U.S. 834 (1976). Significantly, all of the cases cited in this footnote involve delivery from seller to buyer and therefore are consistent with the result that the thesis advanced in this Article would yield. They are inconsistent only to the extent that any court

If *S* enters into a contract of sale with *B*, and *B* refuses payment, section 2-507(2) permits *S* to withhold the goods from *B*. Similarly, if *S* delivers against *B*'s check which later turns out to be worthless, section 2-507(2) permits *S* to recover possession from *B*, even though *S* has delivered. Assume, however, that before *S* recovers the goods, *B* enters into a contract of sale with a third party or that *B* has granted a security interest in after-acquired property to a bank. Because section 2-507(2) does not speak to these possibilities, their resolution must rest on the basic pattern of Code conveyancing rules. That pattern begins with security of property: *B* cannot give to his takers what he does not have. Even if *S* has delivered, *B* does not hold the goods free of *S*'s right to recover them, and under strict security of property principles *B*'s buyer and the bank take subject to that right.

Security of property, however, is only the starting point. *B*'s buyer and the bank may attempt to rely on the good faith purchase rules¹⁴¹ of sections 2-403(2) and 2-403(1). Under the former, if *B* is a merchant dealer in goods of the kind *S* sold and *B*'s buyer is a buyer in ordinary course, *B*'s buyer defeats *S* who entrusted to *B*. Under the latter, if the law of the jurisdiction confers voidable title on *B* under traditional voidable title theory,¹⁴² either *B*'s buyer¹⁴³ or the bank¹⁴⁴ prevails as a good faith purchaser.¹⁴⁵

would extend them to sub-purchasers in good faith when the seller, as in *Tanbro*, never delivered the goods.

141. U.C.C. Section 2-507(2), Comment 3 supports this view. Section 2-507(2) speaks of the buyer's rights "as against the seller." Comment 3 notes that these terms are used "as words of limitation to conform with the policy set forth in the bona fide purchase sections" of Article 2. *Cf. Id.* § 2-505, Comment 4 (second sentence) (explicitly approving the use of good faith purchase rules to defeat an Article 2 security interest).

142. *Parker v. Patrick*, 101 Eng. Rep. 99 (K.B. 1793).

143. *See Gardiner Mfg. Co. v. United States*, 479 F.2d 39, 41 (9th Cir. 1973); *In re Fairfield Elevator Co.*, 14 U.C.C. Rep. 96, 106 (S.D. Iowa 1973); *cf. Ranchers & Farmers Livestock Auction Co. v. Honey*, 552 P.2d 313, 317 (Colo. Ct. App. 1976) (sub-purchaser did not defeat right of reclamation because he knew of the right and, therefore, did not satisfy the good faith purchase standard); *accord, In re American Food Purveyors, Inc.*, 17 U.C.C. Rep. 436, 442 (N.D. Ga. 1974) (credit-sale case). *See also Dugan, Cash-Sale Sellers Under Articles 2 and 9 of the Uniform Commercial Code*, 8 *COM. L.J.* 330, 352-63 (1975).

144. A lender who takes a security interest is a "purchaser." *See* U.C.C. § 1-201(32), (33); *Evans Products Co. v. Jorgensen*, 245 Or. 362, 421 P.2d 979 (1966).

145. *Accord, Stowers v. Mahon (In re Samuels & Co.)*, 526 F.2d 1238, 1242 (5th Cir.), *cert. denied*, 429 U.S. 834 (1976); *United States v. Wyoming Nat'l Bank*, 505 F.2d 1064, 1067 (10th Cir. 1974); *cf. Guy Martin Buick, Inc. v. Colorado Springs Nat'l Bank*, 32 Colo. App. 235, 240, 511 P.2d 912, 914 (1973) (§ 9-301 lists those parties who defeat an unperfected security interest and does not include the seller with a right to reclaim; therefore, the unperfected secured party prevails). That holding leads to unacceptable results. For example, if a thief steals goods and grants a security interest in them, no one would suggest that the secured party defeats the true owner, even though the true owner is not listed in § 9-301 as defeating the secured party. It is more appropriate to read § 9-301 as applying only to rights of parties arising *after* the secured party takes his unperfected security interest. *See also* note 22 *supra*.

Tanbro suggests that even if *S* did not deliver the goods to *B*, *B*'s buyer may rise to the status of a buyer in ordinary course. Even with that status, however, he will not defeat *S* because none of the buyer in ordinary course provisions help him. He does not benefit from section 2-403(2) because there is no entrustment. He does not qualify under section 7-205, because he did not take delivery. Section 9-307(1) does not benefit him because it protects only against a security interest created by *B*.¹⁴⁶ These conclusions find further support in section 2-703, which gives sellers the right to "cancel" the contract and withhold delivery in the event of the buyer's breach. Nothing in that section suggests that these rights are subject to the interests of third parties. If delivery has not occurred, there is no need to give third parties rights.

Analysis of the seller's very limited right to recover goods after delivery in credit-sale situations yields similar conclusions. In credit sales, the operative provision, section 2-702, explicitly refers to the good faith purchase rules of section 2-403.¹⁴⁷ The credit seller's right to reclaim, furthermore, fits the security interest mold no better than the cash seller's right to reclaim after delivery.¹⁴⁸ Being nonpossessory, the interest, if a security interest, would be unperfected and thus lose to most good faith purchasers under either section 2-403 or section 9-301(1)(c).

This view of the seller's lien illustrates traditional application of possession rules. If the cash seller surrenders possession in return for a cash equivalent that turns out to be worthless, he loses to good faith purchasers under section 2-403. Those sub-purchasers may have relied on the first buyer's possession. If a cash seller retains possession, however, and does not deliver the goods, he defeats good faith purchasers. Purchasers could not have relied on the first buyer's possession.

Those who consider the seller's right to the goods under section 2-507(2) a security interest implicitly reject this analysis, but they do not argue for a resulting situation to which *Tanbro* applies. If the seller's

146. The right to reclaim may not be a security interest at all. *But see* Kennedy, *supra* note 138. The notion of characterizing the seller's rights under § 2-507(2) as a security interest places limits on those rights. Section 9-113, Comment 3 takes the position that any Article 2 security interest is subject to the attachment, perfection, and priority rules of Article 9 once the goods are delivered to the buyer. The leading case, *In re Kravitz*, 278 F.2d 820 (3d Cir. 1960), tacitly rejects that view in favor of a seller's right to reclaim in a credit sale situation. *See also In re Federal's, Inc.*, 553 F.2d 509, 511 (6th Cir. 1977); *cf. In re Mel Golde Shoes, Inc.*, 403 F.2d 658, 660 (6th Cir. 1968) (explicitly rejecting the argument that the seller's right to reclaim under § 2-702 is a security interest). *Contra*, *Stowers v. Mahon (In re Samuels & Co.)*, 526 F.2d at 1246 (5th Cir.), *cert. denied*, 429 U.S. 834 (1976); *Peerless Equip. Co. v. Azle State Bank*, 559 S.W.2d 114, 115 (Tex. Civ. App.—Fort Worth 1977 no writ); *Jackson & Peters, supra* note 22, at 926-28.

147. U.C.C. § 2-702(3).

148. *See* note 150 *infra*.

right is a security interest, prior to delivery it is perfected by possession and buyers in ordinary course will not prevail over that interest under *Tanbro*. Such a security interest is not created by "his seller" as section 9-307(1) requires. The buyer who takes delivery, however, would defeat the unperfected seller. Section 9-301(1)(c) governs. In short, *Tanbro* should not disturb the seller's rights under section 2-507(2).

In a recent article Professors Jackson and Peters¹⁴⁹ take the position that the seller's right to reclaim goods, whether it arises under section 2-507(2) (the bad check situation) or section 2-702(2) (the insolvent buyer situation), is an Article 2 security interest.¹⁵⁰ Significantly, they would accord perfected status to the right of reclamation even though the seller has delivered the goods to the buyer.¹⁵¹ That view differs from the position of this Article in two important respects. First, it deemphasizes the role of possession. Authorities generally agree that the seller's interest recognized by sections 2-505 and 2-711(3) is an Article 2 security interest and is exclusively possessory.¹⁵² Even though the seller has delivered the goods to a third party, *e.g.*, a common carrier, he controls the conduct of that party by virtue of his power to stop goods in transit¹⁵³ and prevent delivery to the buyer unless the buyer pays.¹⁵⁴ The possessory nature of this security interest justifies the general rule of Article 9 that the integrity of Article 2 security interests does not depend upon the existence of a security agreement or the filing of a financing statement.¹⁵⁵ Characterizing the seller's right to reclaim as a security interest, however, leads to the conclusion, accepted by

149. Professor Peters, since the publication of the article, accepted an appointment to the Supreme Court of Connecticut.

150. Jackson & Peters, *supra* note 22, at 926. Section 1-201(37) defines a security interest to include "an interest in personal property or fixtures which secures payment or performance of an obligation." Clearly there is some conceptual difficulty with the conclusion that a right to reclaim goods, which arises upon events unknown to the seller at the time of delivery, is an interest to secure payment or performance. The interest of a seller which permits him to reclaim delivered goods more closely resembles a right to cancel—a right to avoid performance, not secure it. See Braucher, *Reclamation of Goods from a Fraudulent Buyer*, 65 MICH. L. REV. 1281, 1290 (1967). Professor Kennedy is willing to include the seller's right to reclaim within the security interest definition but nonetheless rejects the notion that the right should be subject to Article 9 priority rules. He confines Article 9 rules to consensual security interests. See Kennedy, *supra* note 138. See also Henson, *Reclamation Rights of Sellers Under Section 2-702*, 21 N.Y.L.F. 41, 49 (1975).

151. Jackson & Peters, *supra* note 22, at 926.

152. See Kennedy, *supra* note 138.

153. U.C.C. § 2-705.

154. See text accompanying notes 104-05 *supra*. Note also that the § 2-711(3) security interest arises only if the aggrieved buyer is in possession or control of the goods.

155. U.C.C. § 9-113. Section 9-113 treats the Article 2 security interest in a fashion closely analogous to Article 9 treatment of pledges by modifying the general requirement for a security agreement and eliminating the general requirement of a filed financing statement. See *id.* §§ 9-203(1)(a), -305. This parallel may serve as further support for the view that § 9-113 expects Article 2 security interests to be possessory as pledges are.

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Professors Jackson and Peters, that a seller has a valid security interest without possession and without a filing, *i.e.*, a valid, secret lien.¹⁵⁶

Second, holding that the seller's right to reclaim is a security interest forces resolution of disputes among purchasers into the priority rules of Article 9,¹⁵⁷ and conflicts with the general thesis of this Article that Article 2 conveyancing rules, beginning with the security of property principle and including specific good faith purchase rules, should govern these disputes. The language of Article 9 does not always mesh well with a seller's nonconsensual right to reclaim; Professors Jackson and Peters resolve these problems through complex, resourceful, and lengthy analysis accompanied by a modicum of violence to Code language.¹⁵⁸ The simpler approach suggested here may well be preferable. The two theories, moreover, have different results in some instances.¹⁵⁹

156. Jackson & Peters, *supra* note 22, at 939. If the right to reclaim is a security interest, it must be perfected. Any other conclusion would yield unacceptable results, such as a rule that the seller's right to reclaim is subordinate to the rights of the trustee in bankruptcy—a rule which most courts and commercial lawyers agree is contrary to the intention of Article 2. *Id.* But see Dugan, *supra* note 143, at 364-71. This view, that the seller's interest is perfected notwithstanding the seller's delivery, depends upon the language of § 9-113, which excuses Article 2 security interests from the security agreement and filing requirements of Article 9 "so long as the debtor does not have or does not lawfully obtain possession of the goods." Clearly, a buyer who snatches the goods and then locks himself in his house and refuses to pay has not lawfully obtained possession, and pre-Code authority suggests that it is against just such conduct that § 9-113 guards. See Burns Bros. v. Bigelow, 122 N.Y.S. 253, 255 (Sup. Ct., App. T. 1910); 1 REPORT OF THE [N.Y.] L. REV'N COMM'N FOR 1955, STUDY OF THE UNIFORM COMMERCIAL CODE 482. The Jackson-Peters position, arguably borne out by the language of § 9-113, extends Article 2 perfected security interest status to nearly all situations governed by §§ 2-507(2) and 2-703(2), needlessly expanding the possibility of a secret lien. Rejection of security interest status for the seller's right to reclaim obviates that expansion. As this Article demonstrates, the right to reclaim viewed solely as a right, rather than a security interest, will defeat the trustee in bankruptcy. See note 22 *supra*. This Article's approach, moreover, relieves the pressure to expand the scope of the "not lawfully obtain possession" language of § 9-113 beyond the snatch-and-lock situation and thus limits the scope of the secret lien. Secret liens are not always commercially baleful. See note 159 *infra*. Here, however, reliance creditors might be trapped by the seller's secret right to recover.

157. U.C.C. § 9-113 does not relieve Article 2 security interests from the priority regulations of Article 9.

158. For example, the priority rule of § 9-301(1)(c), which designates those persons who defeat unperfected security interests, speaks of a "transferee" or a "buyer," neither of which categories fits the reclaiming seller.

159. There are two important instances. First, the analysis of Professors Jackson and Peters favors the seller's right of reclamation over the *unperfected* secured party. See Jackson & Peters, *supra* note 22, at 972. The theory of this Article could yield a contrary result. Under security of property rules, a buyer cannot grant more to his unperfected secured lender than the buyer himself enjoys. The buyer holds goods subject to the seller's right to reclaim; and it is, therefore, in goods subject to that right that the secured party obtains a security interest. Yet security of property is only the starting point; the inquiry follows with a search for good faith purchase rules that modify the general principle. The secured party, whether perfected or unperfected, is a purchaser; § 1-201(31), -201(32), and § 2-403(1) protect the good faith purchaser in the event the buyer has voidable title, as this buyer would under most voidable title cases and in the event the secured party has taken delivery at some point. See text accompanying note 133 *supra*. Professors Jackson and Peters rightly note that this Article's view may protect a secret lien—that of a

I. *Fraudulent Retention*

It would be a mistake, however, to read the entrustment and voidable title rules as part of a common-law tradition favoring protection of buyers against secured parties at all costs. As the fraudulent retention rule of section 2-402 demonstrates, the rules are part of a fabric designed to satisfy the reasonable expectations of all parties.

Under the fraudulent retention rule, a buyer who leaves his seller in possession exposes himself to the claim by the seller's creditors that the seller's possession misled them. Possession of the goods by the seller leads creditors to believe the seller is worthy of credit. Some common-law courts responded to this reasonable reliance by characterizing the retention of sold goods as fraudulent¹⁶⁰ and by ruling against the buyer.¹⁶¹ In section 2-402(2), the Code recognizes the rule of those cases.¹⁶²

J. *Bulk Sales*

Bulk sales statutes express a similar desire to protect creditors against being misled. Adopted by many states,¹⁶³ these statutes required that creditors of a business be notified of an impending bulk sale of inventory.¹⁶⁴ Failure to give notice renders the sale ineffective against the creditors.¹⁶⁵ Article 6 of the Code makes these rules uniform and is another instance of the recognition that possession of goods may induce reliance by creditors as well as buyers.

secured party who fails to perfect or who loses his perfection. The protection applies, however, only in favor of a *good faith* secured party, and it applies against a seller who is not a reliance creditor. The seller's right to reclaim arises not in situations where the seller is relying on the buyer's possession or on the lack of filings. The right arises when the seller relies either on a check which proves worthless or on the solvency of a buyer who is insolvent. The secret nature of the unperfected secured party's interest, then, does not offend the sensibilities which secret liens normally offend—reasonable reliance on appearances. Second, the Jackson-Peters article also seems to favor the seller's right to reclaim over perfected secured parties. Jackson & Peters, *supra* note 22, at 969. That result also conflicts with the result the thesis of this Article would yield. See text accompanying notes 138-45 *supra*. Cf. *In re American Food Purveyors, Inc.*, 17 U.C.C. Rep. 436, 441 (N.D. Ga. 1974) (holding that a secured party never defeats the right to reclaim under § 2-702).

160. See, e.g., *Sturtevant v. Ballard*, 6 Am. Dec. 281, 285 (N.Y. 1812).

161. Not all jurisdictions accepted the common-law rule, however. Many of them enacted statutes that modified it. See generally 2 S. WILLISTON, *supra* note 76, § 353; 1 G. GLENN, *supra* note 55, § 354.

162. The Code softens the impact of the rule somewhat by excepting from its operation the "possession in good faith and current course of trade by a merchant-seller for a commercially reasonable time after a sale or identification . . ." U.C.C. § 2-402(2).

163. W. HAWKLAND, SALES AND BULK SALES 163 (1958).

164. See, e.g., N.Y. PERS. PROP. LAW § 44 (repealed 1964).

165. *Lowendahl v. Van Bokkelen, Inc.*, 139 Misc. 857, 858, 248 N.Y.S. 553, 554, *aff'd*, 234 App. Div. 749, 254 N.Y.S. 917 (1931), *aff'd*, 260 N.Y. 557 (1932).

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In both bulk sale and fraudulent retention situations courts and legislatures place the burden on the buyer, not the creditor. This allocation is justified by the same kind of analysis that justifies the opposite result in the entrustment and voidable title cases. Since *buyers* with relatively modest expense and diligence can prevent creditor reliance in the fraudulent retention and bulk sale situations, buyers bear the cost. Since *creditors* can prevent buyer reliance in the voidable title and entrustment situations more easily than buyers can inquire into title, creditors bear the losses in those cases. Arguably, the rules in these buyer versus creditor disputes turn not on pro-buyer or pro-creditor bias of the Code but on the principle of keeping costs low.

K. Consignments

The law of consignment provides additional support for these conclusions. Consignment, a special kind of entrustment, leaves title to goods in the true owner while permitting the merchant to take possession. This private allocation of the incidents of title between two parties bodes ill for both purchasers and creditors of the merchant. First, if the true owner can deny the merchant's authority to sell, buyers will be misled by the merchant's possession. Second, if the true owner can deny the merchant's title, creditors will be similarly misled. While there is no evidence that true owners have had the temerity to argue for, or that any courts would accept, the first of these commercial outrages,¹⁶⁶ there is authority for the second.¹⁶⁷ Some courts accepted the metaphysical distinction between one who sells goods and retains a security interest—the pre-Code conditional seller and chattel mortgagee—and the consignor, who does not sell but retains title and merely surrenders possession. Other courts avoided the unfortunate effect of the arrangement by looking through it to find a disguised conditional sale, a chattel mortgage, or a modification of the consignment prerequisite.¹⁶⁸ The latter trend in the case law rendered consignments sufficiently problematical that true owners frequently refused to accept the risk of failure to comply with the filing requirements of the conditional sales statutes¹⁶⁹ and chattel mortgage statutes,¹⁷⁰ which entailed loss of title to the merchant's creditor. Adoption of the Code ended this experiment in misleading creditors. Section 2-326 expressly provides

166. The Code interdicts any such position today by virtue of § 2-403(2).

167. *See, e.g.,* Ludvigh v. American Woolen Co., 231 U.S. 522, 528 (1913). *See generally* Hawkland, *Consignment Selling under the Uniform Commercial Code*, 67 *COM. L.J.* 146 (1962).

168. *See* cases cited in Hawkland, *supra* note 167, at 147 n.6, 7, & 8.

169. *See, e.g.,* UNIFORM CONDITIONAL SALES ACT § 5.

170. *See, e.g.,* CAL. CIV. CODE § 2957 (West 1935) (repealed 1965).

that such consignments are good against the merchant's creditor only if facts demonstrate that no reasonable creditor will be misled.¹⁷¹

L. *Secret Liens*

Few commercial practices have earned the universal opprobrium courts and legislatures have heaped on the secret lien. Secret liens, *i.e.*, interests reflected by neither possession nor notice, amounted to fraud at common law and were unenforceable.¹⁷² It is far less costly for a creditor out of possession to make his lien public than it is for third parties to ferret out surreptitious conveyances. Legislatures strictly required notice filing in the plethora of pre-Code statutes that authorized nonpossessory security interests.¹⁷³ The Code follows suit.¹⁷⁴ Oppo-

171. U.C.C. § 2-326(3) subjects consigned goods to the claims of the merchant's creditors unless the consignor:

- (a) complies with an applicable law providing for a consignor's interest or the like to be evidenced by a sign, or
- (b) establishes that the person conducting the business is generally known by his creditors to be substantially engaged in selling the goods of others, or
- (c) complies with the filing provisions of the Article on Secured Transactions (Article 9).

Consumer transactions expose the weakness of this rule. In *Founders Inv. Corp. v. Fegett*, — S.W.2d — (Ky. 1978), for example, a consumer who suffered from dyslexia and whose wife was ill felt he could not afford the payments on his inobile home. He returned the home to the retailer, and asked the retailer to solicit orders. The retailer's bank argued that the arrangement was a consignment and that the bank could make a claim on the mobile home, since the consumer had not complied with § 2-326. The court rejected the bank's argument with the rejoinder that it would be "unfair" to apply the consignment rule to this consignor. — S.W.2d at —. There is no explicit Code support for the court's position. The consignment section, however, is a good faith purchase rule. The doctrine of good faith purchase is commercial in nature. See generally Gilmore, *supra* note 7; Llewellyn, *Across Sales on Horseback*, 52 HARV. L. REV. 725 (1939); Llewellyn, *The First Struggle to Unhorse Sales*, 52 HARV. L. REV. 873 (1939). When consumers own valuable nontitled assets like inobile homes, their entry into commerce becomes significant. The *Fegett* court refused to apply a commercial doctrine in favor of a bank and against a good faith consumer who could not read or write. Striking the balance in similar cases will not be easy, but the *Fegett* court might have made more of the fact that the good faith purchase doctrine does not mesh well with the reasonable expectations of consumers. Cf. 1 REPORT OF THE [N.Y.] LAW REV'N COMM'N FOR 1954, HEARINGS ON THE UNIFORM COMMERCIAL CODE 108 (Professor Llewellyn on certain merchant rules: "[A]ll of these rest on the vital need for distinguishing merchants from housewives . . .").

172. See, *e.g.*, *Griswold v. Sheldon*, 4 N.Y. 581, 589 (1851); cf. *Paget v. Perchard*, 170 Eng. Rep. 329, 330 (K.B. 1794) (a lien creditor case).

173. See, *e.g.*, UNIFORM CONDITIONAL SALES ACT § 5; UNIFORM TRUST RECEIPTS ACT § 7; California Chattel Mortgage Statute, CAL. CIV. CODE § 2957 (West 1935) (repealed 1965).

174. See U.C.C. § 9-302. The broadest exception to the Code's general possession-or-filing requirement applies to consumer goods. See *id.* § 9-302(1)(d). That exception stems from the notion that these rules of purchase apply in the commercial context but not elsewhere. Professor Gilmore is adamant on that point and takes pains to distinguish noncommercial cases. See generally Gilmore, *supra* note 7. The exception for purchase money security interests in consumer goods does not imply that any transaction involving consumers is noncommercial. On the contrary, sales out of inventory are commercial and the purchase rules apply to them. Yet the sales of consumer goods to which § 9-302(1)(d) is applicable, are inherently noncommercial. See U.C.C. § 9-307(2).

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nents of the secret lien found a willing champion in Justice Brandeis, who attempted to lay this ghostly interest to rest once and for all in *Benedict v. Ratner*.¹⁷⁵

Benedict held that even though possession of accounts cannot be transferred physically—there being nothing to transfer—and even though the transferor cannot maintain possession, permitting a debtor to use proceeds from the sale of collateral is so antithetical to the concept of conveyance that the practice amounted to fraud. The *Benedict* rule quickly found application in revolving inventory financing¹⁷⁶ and was one of the impediments to the floating lien. The Code properly rejects it.¹⁷⁷

Benedict concluded that a creditor, who left his debtor in possession and who took insufficient steps to ensure that the debtor paid proceeds of sales to the creditor, should not stand higher than innocent third parties.¹⁷⁸ It was not a question of ostensible ownership, the court held, but of permitting the lien to shift from one batch of accounts to a later batch of accounts. In *Benedict* the Court seemed moved by a subjective evaluation of the good faith or moral conduct of the creditor and third parties. The Court failed, however, to reckon the cost of the alternative it commanded; by requiring the creditor to police the collateral, it seriously hampered working capital loans.¹⁷⁹ The result for creditors, debtors, and ultimately buyers was waste.¹⁸⁰ By comparison, the cost to third parties of checking for filings is low.¹⁸¹ Admittedly, third parties who find filings have no way of policing the debtor's conduct, but they can evaluate the risk. Post-Code experience and the general success of floating inventory and accounts receivable loans suggest that third parties will take the risk without significant consequences.

175. 268 U.S. 353, 364 (1925).

176. *See, e.g.*, *Brown v. Leo*, 12 F.2d 350, 351 (2d Cir. 1926). In fact Justice Brandeis made it clear that the *Benedict* rule should apply "whatever the nature of the property transferred." *Benedict v. Ratner*, 268 U.S. 353, 364 (1925).

177. *See* U.C.C. § 9-205, Comments 1 & 2.

178. In *Benedict*, the innocent third party was the apollyon of commercial law, the trustee in bankruptcy.

179. "To require a dealer to apply all of the proceeds of sales to liquidate the loan may be the same as asking him to retire from business." Skilton, *The Factor's Lien on Merchandise* (pt. 1), 1955 Wis. L. Rev. 356, 362.

180. *Id.*; Gilmore & Axelrod, *supra* note 76.

181. In New York at the time of the *Benedict* case, no filing was necessary to perfect the assignment of accounts. The case does not turn on that point, however, and would have applied regardless of filing. *See Benedict v. Ratner*, 268 U.S. 353, 363-64 (1925). *See also* *Brown v. Leo*, 12 F.2d 350, 351 (2d Cir. 1926).

The lesson of *Benedict* is analogous to much of the experience of good faith purchase doctrine. Commercial lawyers must overcome the initially tempting route of resolving these conflicts by resort to notions of innocence versus culpability. From a *subjective* standpoint, an innocent buyer in bulk who takes subject to a filed security interest¹⁸² is no more or less culpable than the innocent buyer in bulk who takes free of an unperfected security interest. Nor is the creditor who files purer from a subjective standpoint than the mistaken creditor who does not file. Commercial law, however, can seldom afford the luxury of subjective inquiry. It must resort to objective standards of conduct, standards determined by conduct that is reasonable in the marketplace and the banking house.

M. Purchase Money Priority

The purchase money priority rule of section 9-312 governs priority disputes between a purchase money lender and a revolving lender. Assume that on January 1 Mill had borrowed working capital from a bank and granted the bank a security interest in all its after-acquired inventory and equipment. Assume as well that on May 1 Deering entered into a contract with Mill to sell fabric and retained a security interest for the purchase price, perfected by possession. There are priority problems concerning the fabric and the proceeds when Mill sells the fabric.

Generally, when two secured parties claim an interest in the same collateral, the party who files or perfects first prevails.¹⁸³ In this hypothetical the bank filed first and would prevail under that general rule.¹⁸⁴ Since Deering's interest is a purchase money security interest,¹⁸⁵ however, the general rule gives way to the special priority rules of section 9-312(3) and (4). The first relates to inventory, the second to equipment. Inventory consists of goods "held by a person who holds

182. U.C.C. § 9-301(1)(c).

183. *Id.* § 9-312(5)(a). This rule is a curious mix of security of property principles and good faith purchase doctrine. Under the rule, *A* may prevail over *B*, even though *B* perfects first. *A* may file first and become perfected after *B*. *Id.* §§ 9-203(2), -303(1). Cautious lenders often pursue just such a practice. Yet if *A* prevails, even though his perfected security interest arises after *B*'s, then the rule clearly departs from security of property principles in favor of a notice scheme. On the other hand, if *A* and *B* both perfect without filing, the first to perfect prevails—a result more consistent with security of property.

184. The hypothetical reflects careful lending practice. A lender traditionally will file first and check to see that its filing enjoys priority before it disburses loan proceeds. The priority rule of § 9-312(5)(a) follows that tradition by granting the lender priority as of the date of filing, even though his security interest attaches later when he disburses the loan. See *id.* § 9-203(2).

185. See *id.* § 9-107(a).

them for sale.”¹⁸⁶ Equipment consists of goods “used or bought for use primarily in business” and includes goods that do not fall into the categories of inventory, farm products, or consumer goods.¹⁸⁷ Two questions arise concerning the Tanbro fabric. The first is whether the fabric is Mill’s inventory or equipment. Clearly it is neither farm products nor consumer goods.¹⁸⁸ Traditional notions of inventory and equipment favor the inventory characterization. Mill does not “hold” the fabric unless for purposes of the definition courts would construe Deering’s physical possession as Mill’s control. That view should not shock anyone and would better serve reasonable expectations than the view that the fabric is equipment. The second question is whether, if the fabric *is* inventory, the purchase money seller¹⁸⁹ must notify Mill’s bank. Neither the letter nor the spirit of section 9-312(3) requires notice. The subsection specifies that the purchase money lender must give notice before he files a financing statement¹⁹⁰ and not more than five years before the debtor receives possession.¹⁹¹ In this hypothetical situation, however, Deering never files a financing statement but perfects by possession instead. Mill, moreover, never takes possession, unless the conclusion that Mill “holds” the fabric dictates the conclusion that Mill “possesses” it.

There is a certain appeal to this conclusion, yet such literal treatment conflicts with basic Code policy and the common-law tradition of disregarding “a statutory limitation where the reason of the limitation did not apply.”¹⁹² The reason for the notice requirement in section 9-312(3) is to warn the revolving inventory lender (the bank in this example) that dilution of its collateral is imminent.¹⁹³ Warning serves two purposes. First, it prevents such a lender from being misled. Absent notice, high inventory levels might lull the lender into a false sense of security, and the lender would then fail to realize that another secured party may claim priority. The comment indicates that the drafters fashioned the notice provision in order to avoid that false sense of security. The notice serves a second purpose. Some lenders are understandably wary of sharing collateral with anyone and insist that theirs be the only security interest. In the event of default the lender may

186. *Id.* § 9-109(4) (emphasis added).

187. *Id.* § 9-109(2). *See also id.* § 9-109, Comment 5 (third sentence).

188. *See id.* § 9-109(1) & (3).

189. Although the hypothetical involves a purchase money seller, the analysis would be no different if the purchase money party were a lender. *See id.* § 9-107.

190. *Id.* § 9-312(3)(b).

191. *Id.* § 9-312(3)(c).

192. *Id.* § 1-102, Comment 1.

193. *See generally* 2 G. GILMORE, *supra* note 38, § 29.3.

want to sell the collateral in bulk. He certainly does not want to contend with another secured party over terms of the sale or the extent to which collateral falls under one security agreement or the other—an issue that may require dating the collateral, a process that may prove impossible if the debtor has collateral at various states of manufacture with some components subject to one security agreement and some components subject to another. Inventory lenders have come to rely on the notice feature of section 9-312(3).¹⁹⁴

Failure to give notice in this hypothetical, however, does not frustrate either of these purposes. Since Deering retains possession of the fabric, the bank will not face either problem. It is possible that the bank may rely not on physical inspection of Mill's inventory but on financial reports; these reports should disclose, however, that the debtor is not in possession.¹⁹⁵

These conclusions find further support in the proceeds rules of the purchase money priority provisions. In fashioning the 1972 Amendments to Article 9, the drafters resolved the dispute over proceeds in favor of the working capital lender as to inventory, and in favor of the purchase money lender as to equipment.¹⁹⁶ Section 9-312(3) grants a thin sliver of priority in proceeds to the purchase money seller of inventory.¹⁹⁷ Section 9-312(4) provides a broad priority in proceeds, however, for the purchase money seller of equipment. The drafters justify this disparate treatment with the theory that inventory nearly always generates proceeds, including accounts that are sometimes the subject of financing arrangements, while equipment rarely does so.¹⁹⁸ Clearly the fabric in this hypothetical problem fits the inventory mold, and that characterization will better serve the drafters' assumptions.

194. U.C.C. § 9-312, Comment 3 (fourth paragraph).

195. Lenders should request such information in advance of the audit. It appears that the accounting profession still determines interests in inventory under a title approach. See 4 AICPA, PROFESSIONAL STANDARDS (CCH), § 9005.10; R. KENNEDY & S. McMULLEN, FINANCIAL STATEMENTS 73 (6th ed. 1973); R. WISON, W. KELL, & N. BEDFORD, ACCOUNTANTS' HANDBOOK § 12, at 30 (5th ed. 1970).

196. See REVIEW COMMITTEE FOR ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE, PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, FINAL REPORT 113-14 (1971); R. HENSON, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE 136-38 (1973).

197. The priority extends only to identifiable cash proceeds received before the "debtor" delivers the inventory to the "buyer." U.C.C. § 9-306(1). In traditional sales, few cash proceeds, other than a buyer's down payment, will arise before such delivery. The less traditional prepaying buyer, however, may generate substantial proceeds before the debtor delivers the goods to him. To the extent that the purchase money party can identify those proceeds, he has broadened the priority.

198. REVIEW COMMITTEE FOR ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE, *supra* note 196, at 114.

In short, to the extent that *Tanbro* posits an early time in the course of the sales contract for granting a buyer rights in the goods, it does not upset the plan of the purchase money priority rule. Even though a purchase money seller “holds” the goods in order to perfect its security interest, courts should consider the goods inventory; and that holding should not require the purchase money seller to notify the working capital lender in order to protect the seller’s priority position.

V. The Thief Rule

It would surprise lawyers to encounter a rule of law without exceptions. The rule this Article proposes—that possession and nonpossession govern respectively the application and reach of good faith purchase doctrine—admits of exceptions. They reveal a simple and sensible approach: courts and legislatures set possession rules aside when, but only when, the policy the rules serve conflicts with a paramount policy.

We have already discussed the special property interest rule of section 2-501 and the modest and short-term deviation it makes from a strict rule honoring creditor reliance on debtor possession of inventory.¹⁹⁹ A more significant and far reaching exception is the “thief rule.”²⁰⁰

Security of property principles do not permit a thief to pass good title. Yet a thief in possession can mislead innocent purchasers, even purchasers who qualify as good faith purchasers for value. Courts and legislatures have generally insisted, without regard for the good faith purchase doctrine, that a thief cannot convey what he does not have.²⁰¹

There are a number of instances, however, in which the thief rule itself admits of exception. For example, a person taking certain highly negotiable types of property from a person who stole the property defeats the true owner’s title. Negotiable instruments,²⁰² documents of title,²⁰³ securities²⁰⁴ (in bearer form) and money²⁰⁵ fall into the class of

199. See text accompanying notes 23-63 *supra*.

200. The designation of exceptions depends on the starting point adopted. If, as one might suspect, possession is the oldest of property rules, any rule that departs from the possession rule is an exception. If, on the other hand, title is the first rule of property, as the common-law courts suggested, the possession rules discussed in this Article are exceptions, and the thief rule is not an exception but an example of the general precept. This Article’s characterization of the thief rule as an exception assumes that the possession rule is older. *Accord*, 2 F. POLLOCK & F. MAITLAND, THE HISTORY OF ENGLISH LAW BEFORE THE TIME OF EDWARD I 79 (1895); Maitland, *supra* note 24, at 488.

201. *E.g.*, *Wheelwright v. Depeyster*, 1 Johns. 471, 479 (N.Y. 1806).

202. See U.C.C. §§ 3-202(1), -305(1).

203. See *id.* §§ 7-501, -502.

204. See *id.* §§ 8-301(2), -302.

property to which a thief *can* give good title. There is authority for a similar result with respect to items requiring indorsement, if the true owner's negligence contributes to the thief's forgery.²⁰⁶

Negligence by the owners of *goods* does not give rise to such broad preclusion rules, however. The law of goods interposes the more limited doctrines of estoppel and agency—the rules of entrustment and voidable title defeat the negligent owner of goods.²⁰⁷ Although the common law sometimes permitted a fraud to convey good title,²⁰⁸ it did not always require that result if the malefactor's conduct amounted to larceny.²⁰⁹ While it overlooks some of the distinctions between fraud and "larceny by trick,"²¹⁰ the Code adheres to the general notion that a thief cannot convey good title.²¹¹

As this Article has indicated, the cases ground these distinctions in the proposition that a thief cannot convey what he does not have. Yet that proposition is true of all good faith purchase situations, and it cannot justify the distinctions. Rather, courts conclude that to permit a thief to convey good title would make it easier for thieves to dispose of goods and thereby promote theft—hence, the thief exception. The thief rule thus departs from possession doctrine to serve what courts view to be a paramount policy.

VI. The Doubtful Case for the New York Rule

The issue before the courts in *Tanbro* was whether, given the role possession plays in commercial law and the expectations that arise from possession in practice, a new exception to security of property principles is justified. The courts, however, believed they had only to apply an isolated bit of straightforward statutory language—a belief that is not often safe in construing a code—and accordingly built their holdings on shallow foundations. We shall now consider those foundations and others suggested by commentators.

A. *Buyers in Ordinary Course*

The New York court held that a buyer who does not take delivery

205. See, e.g., *Miller v. Race*, 97 Eng. Rep. 398, 401 (K.B. 1758).

206. See U.C.C. §§ 3-405, -406, 4-406, 8-311.

207. See text accompanying notes 119-137 *supra*; cf. *Porter v. Wertz*, 23 U.C.C. Rep. 614 (N.Y. Sup. Ct. 1978) (using estoppel against true owner who entrusted the goods to a thief).

208. See, e.g., *White v. Garden*, 138 Eng. Rep. 364, 367 (C.P. 1851).

209. See, e.g., *Parker v. Patrick*, 101 Eng. Rep. 99 (K.B. 1973) (dictum).

210. See U.C.C. § 2-403, Comment 2 (second paragraph).

211. *Id.* § 7-503, Comment 1 advises: "A thief of the goods cannot indeed by shipping or storing them to his own order acquire power to transfer them to a good faith purchaser."

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may nonetheless be a buyer in ordinary course.²¹² *Chrysler*²¹³ and one other decision²¹⁴ suggest a contrary view. Those cases, however, overlook the Code plan for determining a buyer's rights. The Code accords rights in the goods to the buyer at the time the goods are identified to the contract.²¹⁵ The moment of identification is also the time at which the rights in the goods of a buyer in ordinary course arise. That it may be in ordinary course for a buyer to buy without taking delivery though the seller is not in possession is a novel idea, but not one forbidden by the Code. The language "in ordinary course" indicates legislative deference to commercial practice and is consistent with the Code policy of accommodating the "continued expansion of commercial practices through custom, usage and agreement of the parties."²¹⁶

Practices of commerce determine what ordinary course is. The New York courts made a factual finding that it was ordinary, though infrequent, for textile converters like Mill to resell fabric to other converters while the fabric remained with the manufacturer, the only party with sufficient warehouse space to store it. Commercial practice will determine the reach of the New York rule. To the extent that it is out of the ordinary for buyers to buy goods that are not in the seller's possession and of which the buyer does not take delivery, the *Tanbro* holding does not apply.²¹⁷ The holding that *Tanbro* was a buyer in ordinary course should not be viewed as conflicting with Code language or policy.

B. Possession and Section 9-307(1)

The language of section 9-307(1), moreover, supports the position that the seller need not be in possession of the goods for the buyer in ordinary course to defeat the seller's secured creditor. Buyers in ordi-

212. This Article does not consider whether *Tanbro* acted in good faith, so as to satisfy the "buyer in ordinary course" definition. See *id.* § 1-201(9).

213. See text accompanying notes 28-62 *supra*. *Chrysler* held that a party does not become a buyer until title passes. The court would not require delivery unless necessary to pass title.

214. *Cf. Farnum v. C.J. Merrill, Inc.*, 264 A.2d 150, 152 (Me. 1970) (a § 9-306(2) case).

215. See text accompanying notes 14-62 *supra*.

216. U.C.C. § 1-102(2)(b).

217. Nothing in § 2-501 suggests that goods cannot be identified unless they are in the seller's possession. That construction would hamper the practice of drop shipping common to marketing arrangements in many industries. Fairness to buyers requires a rule permitting the earliest time for identification, and the rules of § 2-501 effect that result. See *id.* § 2-501, Comments 2-6. Of course a rule that goods not in the seller's possession cannot be identified would destroy *Tanbro's* argument. Under this rule *Tanbro* would have no rights in the fabric, which was never in the seller's possession. The rule, however, finds no justification in the letter or policy of § 2-501. See *Morey Mach. Co. v. Great W. Indus. Mach. Co.*, 507 F.2d 987 (5th Cir. 1975).

nary course find most of their special privileges in three Code sections. The Article 2 entrustment provision expressly requires the seller to be in *possession* of the goods.²¹⁸ An Article 7 provision applies only if the goods are "sold and *delivered*"²¹⁹ by the warehouse. By including neither an entrustment nor a delivery requirement in section 9-307(1), Code drafters obviously intended that neither be a prerequisite for operation of the provision.²²⁰ Finally, the statute on which the buyer in ordinary course rule of section 9-307(1) is patterned²²¹ contained a delivery requirement. As this Article noted earlier, the omission of that requirement would appear to be intentional.²²² These distinctions, moreover, did not escape the notice of the New York Law Revision Commission when it studied the Code prior to adoption by the New York legislature.²²³ The Commission's conclusion that section 9-307(1) entails no delivery requirement stands as persuasive legislative history.

Other Article 9 sections, by specifically requiring delivery, highlight the absence of the delivery requirement in section 9-307(1). Protection of bulk buyers against unperfected security interests applies only if the buyers take delivery.²²⁴ Protection of purchasers of chattel paper, instruments, and documents of title against prior secured parties also depends upon possession by the purchaser.²²⁵ Only sections 9-306(2) and 9-307(1) provide protection to buyers who do not take delivery.

The conclusion, however, that Code drafters intentionally omitted the possession and delivery requirements in inventory sales does not support the *Tanbro* result. It does support, and makes sense in terms of, the view that a buyer's rights accrue at the moment of identification. Sections 9-306(2) and 9-307(1) complement each other. Essentially, they are inventory rules that favor buyers of inventory over sellers' secured lenders. In most cases, the secured party will authorize sales out

218. Section 2-403(2) applies only if the true owner entrusts the goods to a merchant who deals in goods of that kind. "Entrusting" includes delivery to the merchant or acquiescence in his retention of possession. *Id.* § 2-403(3).

219. *Id.* § 7-205 (emphasis added). The rule of Article 7, moreover, applies only to fungibles. *Id.*

220. The predecessor provisions of § 9-307(1) assumed that the seller was in possession. *See* UNIFORM CONDITIONAL SALES ACT § 9; UNIFORM TRUST RECEIPTS ACT §§ 1 & 9-2(a).

221. UNIFORM TRUST RECEIPTS ACT § 1.

222. *Id.* *See also* note 40 *supra* & accompanying text.

223. The Commission's report not only notes the omission but comments on it extensively and with some disapproval. *See* 1 REPORT OF THE [N.Y.] LAW REV'N COMM'N FOR 1955, STUDY OF THE UNIFORM COMMERCIAL CODE 239-42.

224. U.C.C. § 9-301(1)(c).

225. *See id.* §§ 9-308, -309. *Cf. id.* §§ 1-201(20), 3-302, 7-501, 8-301 (indicating that possession is a prerequisite for the application of § 9-309).

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of inventory. Under section 9-306(2) that authorization operates to give the buyer the goods free of the security interest.²²⁶ In the unlikely, but possible, event that the secured party does not authorize sales, section 9-307(1) fulfills the reasonable expectation of buyers out of inventory by providing that buyers in ordinary course take free of the security interest no matter what the secured lender says about sales.²²⁷

By eliminating the delivery requirement from sections 9-306(2) and 9-307(1), however, the Code drafters apparently permit sale free of a security interest when the secured party, not the seller, is in possession—the *Tanbro* result. Yet “the proper construction of the Act requires that its interpretation and application be limited to its reason.”²²⁸ The ostensible purpose of not requiring delivery in sections 9-306(2) and 9-307(1) is to prevent the secured party from defeating a buyer when goods free of a possessory security interest have been identified. The view adopted by the New York court, that the secured party loses *even when he is in possession*, carries the nondelivery feature of section 9-307(1) further than its purpose requires, and is inconsistent with the commercial law tradition of according significance to possession.²²⁹

226. In *Tanbro*, the court of appeals makes passing reference to the fact that Deering enjoyed a security interest in any proceeds arising upon the sale of the fabric by Mill and suggests that this fact provides an alternative basis for the court’s ruling. That reasoning stems from Comment 3 to § 9-306 (1962 version) which says that by taking a security interest in proceeds the secured party may have impliedly authorized the sale. If authorized, of course, the sale is free of the security interest. *Id.* § 9-306(2). The notion that taking a security interest in proceeds impliedly authorizes the sale has a colorful history. When the New York legislature first considered the Code, a rule to that effect was part of § 9-307(3). See U.C.C. § 9-307(3) (1950 version). The 1957 version of § 9-306(2) deleted any reference to the idea. See U.C.C. § 9-306(2) (1957 version). The comments, however, retained it. *Id.*, Comment 3. In the 1972 amendments adopted in New York after *Tanbro*, the Permanent Editorial Board excised the language from the comments and added that such right to proceeds “does not in itself constitute an authorization of sale.” *Id.* § 9-306, Comment 3 (second paragraph). It would be a misreading of the New York court’s opinion to say that the case turns on this alternative theory. A fair reading of the opinion clearly indicates that the court decided the case on the basis of § 9-307(1), not § 9-306(2). Thus the 1972 amendments now adopted in New York do not, by altering the comment to § 9-306(2), affect the New York rule.

227. The absence of the delivery requirement from §§ 9-306 and 9-307 is consistent with the view that the rights of the buyer arise upon identification. Thus a secured party cannot claim that he defeats a buyer of identified goods when the buyer has not taken delivery. The drafters saw delivery as essential only in situations that do not involve goods, when the concept of identification has no application, and in the rule of § 9-301(1)(c) which protects buyers not in ordinary course. It is beyond the scope of the text to discuss whether these sensible rules should apply to those who buy farm goods from farmers. See generally Dolan, *Section 9-307(1): The UCC’s Obstacle to Agricultural Commerce in the Open Market*, 72 *Nw. U.L. Rev.* 706 (1977).

228. U.C.C. § 1-102, Comment 1.

229. The New York rule, moreover, does not take into account the significance of the time involved in the *Tanbro* case, where Deering held the fabric for some eight months. 48 *App. Div. 2d* at 786, 369 *N.Y.S.2d* at 148-49 (1975) (dissenting opinion), *aff’d*, 39 *N.Y.2d* 632, 350 *N.E.2d*

C. Commercial Fairness

Tanbro ostensibly rests in part on solicitude for buyers' interests. Those who defend it assume that section 9-307(1) is a buyer protection rule and that the rule's expansion is good because it theoretically relieves an imbalance between buyers and lenders.²³⁰ As a pro-buyer measure, however, the New York rule is patently wasteful. Under it, secured parties may no longer rely with confidence on pledges, field warehousing arrangements or the option of repossession, for a trier of fact²³¹ may conclude that it is "ordinary" for buyers in the industry to buy even when a seller does not have possession. Lenders in New York may now be compelled to compute the cost of that uncertainty into the price of their credit; their borrowers will pay that cost and pass it on to customers.

Comparison of the New York rule's cost to creditors with its benefits to buyers tells against the rule. Although buyers gain protection against the seller's creditors with Article 9 security interests, they remain vulnerable to creditors with Article 2 security interests, artisans with liens, qualified holders, and sellers in possession. If a buyer pays for goods before delivery, he does so at the risk that the seller may fail to deliver or that a third party other than the seller's creditor may have superior rights. Cautious buyers will continue the tradition of paying after delivery or against documents.²³² In short, the rule does not benefit buyers greatly.

The detriment to creditors, however, is significant. No creditor can know whether the goods he holds have been sold or remain security for his loan. A secret sale will be possible, in conflict with the spirit

590, 385 N.Y.S.2d 260 (1976). If there is some way to extend the special property rule to the *Tanbro* situation, it should not be extended without the commercially reasonable time limitation of § 2-402(2). See text accompanying notes 41, 55, & 56 *supra*.

230. See Birnbaum, *supra* note 9; Burke, *Secured Transactions, Uniform Commercial Code Annual Survey*, 32 BUS. LAW. 1133, 1150 (1977).

231. It would seem that the question of ordinary course is a factual issue. In *Tanbro*, however, the trial court directed a verdict on the liability issue and both appellate courts affirmed that holding. *Tanbro Fabrics Corp. v. Deering Milliken, Inc.*, 48 App. Div. 2d 784, 785, 369 N.Y.S.2d 146, 147 (1975), *aff'd*, 39 N.Y.2d 632, 350 N.E.2d 590, 385 N.Y.S.2d 260 (1976). This result is particularly surprising in light of the fact that the trial record apparently reflected conflicting testimony on the ordinary course issue. *Id.* at 787, 369 N.Y.S.2d at 149 (1975) (dissenting opinion). See also *Hempstead Bank v. Andy's Car Rental Sys.*, 35 App. Div. 2d 35, 39, 312 N.Y.S.2d 317, 321 (1970), which also treats the ordinary course question as a matter of law. Professor Skilton views the question as one of fact. Skilton, *supra* note 102, at 31-32.

232. To some degree *Tanbro* aids the prepaying buyer. Yet that benefit is too small to offset the cost of the New York rule. This Article's view of the identification rule favors prepaying buyers and without the difficulties of the New York rule. If a prepaying buyer may become a buyer in ordinary course at the moment of identification, many prepaying buyers will defeat the seller's creditor if the creditor is not in possession.

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of section 2-402(2), which forbids secret sales in another context.²³³ As this Article noted earlier,²³⁴ this section recognizes a line of pre-Code cases that treated as fraudulent the practice of leaving a seller in possession of goods after their sale: the section's purpose is to prevent seller and buyer from misleading seller's creditor who may reasonably rely on seller's merchandise as collateral.²³⁵

A creditor relying on a pledge, field warehouse, or the option of repossession can do almost nothing to prevent application of the New York rule. He must either bear the economic loss or pass it on to his debtors in the form of a higher cost of credit. The repossessing creditor may conceivably protect himself by selling the collateral promptly, before the debtor can find a buyer in ordinary course. But the pressure to sell quickly may result in reduced sales prices, which will not benefit creditors or debtors.

The cost of a contrary rule would be small. If possession remained a signal of ownership, except when possession was in a thief, buyers could usually rely on that signal. Nonpossession would warn against purchase: the careful buyer, unlike *Tanbro*, would not pay for goods he could not see. Thus, the possession rule would reward the buyer who did not pay for goods until they were delivered, or at least until the seller had possession. It is easy and inexpensive for buyers to comply with the possession rule;²³⁶ buyers need only observe practices they should observe to protect themselves in any event.

The defenders of the New York rule substitute pro-buyer senti-

233. This section permits a creditor of the seller to treat a sale as void if the buyer leaves the seller in possession in a manner that local law considers a fraud against the creditor. See *Warner v. Norton*, 61 U.S. (20 How.) 448, 460 (1857); *Hamilton v. Russell*, 5 U.S. (1 Cranch) 309, 318 (1803).

234. See text accompanying notes 160-62 *supra*.

235. The letter of § 2-402(2) does not, however, reach the conduct of *Mill* and *Tanbro*. *Tanbro* did not leave *Mill* in possession—the conduct that triggers application of the section. *Tanbro* did leave *Deering* in possession, and conduct of this sort, protected by the New York rule, misleads to a greater degree than the conduct deemed fraudulent by the pre-Code line of cases to which § 2-402(2) defers.

Buyers who enter into a contract, as *Mill* did, to buy goods in the possession of a third party bailee, may insist on attornment by the bailee before paying for the goods. That procedure is inexpensive and relatively quick. The buyer issues a delivery order and asks the bailee to “accept” it. The arrangement is not common to American commercial experience, but neither is the practice of *paying* for goods that are not in the seller's possession or are not represented by documents. In any event, a rule requiring attornment will yield less waste than the *Tanbro* rule. For an instance of the practice suggested here, see *Midland Bean Co. v. Farmers State Bank*, 552 P.2d 317 (Colo. App. 1976). See generally *Murray, The Delivery Order in American and English Commercial Law*, 82 *Com. L.J.* 205 (1977).

236. Buyers distant from the seller's premises may insist on a bill of lading before they pay for goods—an inexpensive and well-established procedure. See text accompanying notes 103-05 *supra*.

ment and the culpability standard for efficiency and common sense.²³⁷ Their approaches do not provide realistic guidance in creditor-buyer disputes.²³⁸ They ignore the most compelling argument for treating possessory and nonpossessory interests differently in the law: parties deal with them differently in fact. Commercial fairness therefore fails to justify the New York rule.

D. Title

During the drafting of the Code, commercial lawyers struggled over the role title should play in commercial law. Respected authority cautioned against scuttling a concept so central to the law of sales.²³⁹ Other counsel²⁴⁰ prevailed, however, and the sales article reduced title to the narrowest role. The preamble to section 2-401 makes it clear that title does not govern the rights of the buyer under Article 2 and that the role of title largely relates to noncommercial questions:²⁴¹ "[T]he rights and remedies of the parties to the contract of sale, as defined in [Article 2] . . . rest on the contract and its performance or breach and not on stereotyped presumptions as to the location of title."²⁴² From time to time the interests of buyers and secured parties intersect. Section 9-307(1) is one such instance, and it would be a distinct disservice to the cause of uniformity and to the entire Code effort if courts were to give buyers rights under Article 9 that Article 2 does not accord them. *Tanbro* and other recent cases have committed that

237. For criticism of the culpability standard, see text accompanying notes 119-27 *supra*.

238. For similar criticism of the pro-lender rule excepting farm sales from § 9-307(1), see Dolan, *supra* note 227.

239. See Williston, *The Law of Sales in the Proposed Uniform Commercial Code*, 63 HARV. L. REV. 561, 566-72 (1950).

240. See generally Llewellyn, *Through Title to Contract and a Bit Beyond*, 15 N.Y.U.L. REV. 159 (1938).

241. U.C.C. § 2-401 provides in pertinent part: "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 provision refers to such title."

242. *Id.* § 2-505, Comment 1. Some authorities see the comment as overbroad. See, e.g., the evaluation by Professor Honnold in 1 REPORT OF THE [N.Y.] LAW REV'N COMM'N, *supra* note 223, at 445. See also W. HAWKLAND, SALES AND BULK SALES 90-91 (1958); R. NORDSTROM, HANDBOOK OF THE LAW OF SALES 375-76 (1970). It is clear, however, that these authorities relegate title to the very narrowest role. Professor Honnold says that "remitting problems to a 'title' concept is inconsistent with the aims of the Code to provide specific rules for different sales problems." N. Y. LAW REV'N COMM'N REPORT, *supra* note 223, at 451. It is clear, moreover, that Professor Llewellyn, chief draftsman of Article 2, saw the role of title confined not to seller-buyer disputes but to questions such as taxation and larceny: "The fact is that to make the respective rights of seller and buyer turn on where title passes according to an intention which buyer and seller do not have, has made trouble which a century and a half of case law has not cleared up. Meanwhile such questions as those of taxation and the like are handled with new clarity and certainty by Sec. 2-401 ff." 1-REPORT OF THE [N. Y.] LAW REV'N COMM'N FOR 1954, *supra* note 171, at 123 (emphasis in original).

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error.²⁴³

VII. Conclusion

From folklore to commercial law the concept of possession has proved an efficient guide for determining rights to goods. In the long struggle between secured lenders and buyers, possession has been the touchstone for the doctrine of good faith purchase in its various manifestations. When possession induces reliance on the part of buyers, the entrustment and voidable title rules defer to that reliance. When possession may mislead the creditor, the fraudulent retention rule defers to the creditor. In general, possession rules serve reasonable expectations and efficiency. Both the common law and the Code disappoint the reasonable expectations possession fosters when that possession results from theft. In that situation the law defers to security of property principles and rejects the claims of good faith purchasers. In addition, the effect of identification rules may disappoint, though briefly, some cred-

243. *Tanbro* reflects a mode of thought rooted in outdated title rules. The court of appeals opinion notes and never rejects plaintiff's argument that "if it had title by purchase its goods were excluded from the security arrangement which was literally restricted to the 'property of the buyer', that is, Mill Fabrics." 39 N.Y.2d at 636, 350 N.E.2d at 592, 385 N.Y.S.2d at 261-62. In fact, the court compounds the error of *Tanbro*'s attorneys by posing the issue in terms of title. "In any event, unless prevented by other provisions of the code . . . *Tanbro* took title subject to Deering's security interest." *Id.* at 636, 350 N.E.2d at 592, 385 N.Y.S.2d at 262.

Assuming that the parties had identified the subject matter of the sale, *Tanbro* did take title. See U.C.C. § 2-401(3)(b). But title should have had nothing to do with the court's inquiry. The error of couching the facts in terms of title lies in the implicit assumption that if *Tanbro* had title, Mill did not. From that intermediate premise the trial court leapt to the incorrect conclusion that Deering could have no security interest in property that did not belong to its debtor. See *Tanbro Fabrics Corp. v. Deering Milliken, Inc.*, 48 App. Div. 2d 784, 787, 369 N.Y.S.2d 146, 149 (1975) (dissenting opinion), *aff'd*, 36 N.Y.2d 632, 350 N.E.2d 590, 385 N.Y.S.2d 260 (1976). The idea that *Tanbro* had title to the fabric argues for the conclusion that it was *Tanbro*'s fabric for all purposes. One commentator argues that if a buyer obtains title he takes free of an original seller's Article 2 security interest. Kreindler, *supra* note 9, at 87-88. The argument rests on common-law notions of title. It is difficult to find anything in the Code that suggests the result. Kreindler himself admits that "the Code does not expressly so state." *Id.* at 87. As this Article argues, buyers should take subject to Article 2 possessory security interests as well as Article 9 security interests, unless they benefit from good faith purchase rules. The Code's use of the term "security interest" in Article 2 supports this view. See U.C.C. § 2-401; Kreindler, *supra* note 9, at 86-87 and authority cited therein.

The New York courts consistently referred to the fact that *Tanbro* "purchased" the fabric and that Mill "sold" it to *Tanbro*. See, e.g., 48 App. Div. 2d at —, 369 N.Y.S.2d at 147, 39 N.Y.2d at 634-35, 350 N.E.2d at 590-91, 385 N.Y.S.2d at 260-61. Words such as "purchase," "buy," and "sell" carry much pre-Code cargo, and most of it is title oriented. For precision, courts and lawyers should not use these terms in evaluating the rights of buyers and sellers. Instead, they must recognize that buyers' and sellers' rights emanate from contracts of sale and Article 2, not from metaphysical presumptions conjured up by freighted language. The contract in *Tanbro* gave the buyer a special property interest in the goods. Whether that property interest deserved to prevail requires analysis of the reason and purpose of § 9-307(1). To approach the analysis with title and its pre-Code connotations in mind prejudices the inquiry.

itors who rely on their debtor's possession. These exceptions, however, serve a paramount policy.

Ignoring the general scheme and the rules of Article 2 that reflect it, a New York court has found in section 9-307(1) a broad exception to the scope of possession's role. The thief exception defers to the policy against theft and against making the rewards for theft easy. The Code's novel identification rule fosters commercial celerity and operates within short time constraints. The New York rule, however, serves no policy and operates without commercially reasonable restraints. Relying on the strict language of section 9-307(1) and the emotive concepts of title and buyer protection, the *Tanbro* court has abandoned the efficiency analysis on which the possession rules are bottomed. The result is a commercial anomaly, a rule that serves no purpose and casts a pall of uncertainty over the commercially useful devices of pledge, field warehouse, and repossession.