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Entrustment under U.C.C. Section 2-403 and Its Implications for Article 9

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ENTRUSTMENT UNDER U.C.C. SECTION 2-403 AND ITS IMPLICATIONS FOR ARTICLE 9

I. INTRODUCTION

Under what circumstances does entrustment operate to sever a secured party's rights in collateral? Consider how the Uniform Commercial Code applies to the following situations. Suppose Ed takes his bicycle to Merv, a bicycle dealer, for repairs, but instead of making repairs Merv sells the bicycle to Betty. Who now owns the bicycle? Section 2-403(2) states that “[a]ny entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business.” Ed has entrusted possession of goods to Merv, a merchant dealing in goods of that kind. Assuming Betty is a buyer in the ordinary course of business (BIOC), Merv now has the power to transfer all of Ed's rights in the bicycle.

1. UNIFORM COMMERCIAL CODE OFFICIAL TEXT (9th ed. 1978) (hereinafter cited as U.C.C.; other editions are cited by date of draft).
2. U.C.C. § 2-403(3) defines entrusting. See infra text accompanying note 18.
3. Id.
4. “[A]ll things . . . movable at the time of identification to the contract . . .” U.C.C. § 2-105(1).
5. A “person who deals in goods of the kind . . .” U.C.C. § 2-104(1).
7. See U.C.C. § 1-201(9). For simplicity, “BIOC” is used in place of “buyer in ordinary course of business”.

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to Betty. Betty now owns the bicycle, and Ed cannot validly assert any ownership claim against her. Ed's only remedies would be against Merv.

Next, assume that Merv, the bicycle dealer, buys a bicycle for his inventory, borrowing money from Sam to buy it and granting Sam a perfected security interest in the bicycle. Without Sam's authorization, Merv sells the bicycle to Betty. This transaction raises the question of whether Sam can validly assert his security interest in the bicycle against Betty. Section 9-306(2) provides the answer—it states "[e]xcept where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange, or other disposition . . . ."9 Section 9-307, designated by section 9-306 comment 3 as one of the places where Article 9 "otherwise provides," allows a "buyer in ordinary course of business . . . [to take] 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."10 Assuming again that Betty is a BIOC, she takes the bicycle free of the security interest created by her seller, Merv. Sam cannot now validly assert his security interest in the bicycle against Betty.

So far the U.C.C. provides clear answers to the questions raised. Consider however, one last example where the answer is not so clear.11 Suppose in the first example that Sam owned a perfected security interest in Ed's bicycle at the time of Ed's entrustment to Merv, the dealer. Without Sam's authorization, Merv now sells the bicycle to Betty in the ordinary course of business. As explained by Professors White and Summers,13 under Article 2 the rights of the BIOC, Betty, are superior to those of the entruster,

8. See U.C.C. § 9-306(2). If Sam authorized the sale, he could not assert his security interest after disposition of the collateral.
10. U.C.C. § 9-307(1) (emphasis added). This section actually applies only to a BIOC "other than a person buying farm products from a person engaged in farming operations." Id. This farm products exception to the protection of the BIOC under U.C.C. § 9-307(1) is not within the scope of this Comment, but for a discussion of the topic see Dugan, Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code, 46 U. COLO. L. REV. 333, 337-45 (1975).
11. This example is based on the example in J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE § 25-15, at 1074-75 (2d ed. 1980).
12. Also assume that Sam filed a financing statement covering the bicycle prior to the sale to Betty. Otherwise U.C.C. § 9-307(2) could under certain circumstances sever the security interest. See infra note 113.
13. See WHITE & SUMMERS, supra note 11, at 1074-75.
The more difficult problem, however, is in deciding which part of the U.C.C. governs the rights of the secured party, Sam, versus those of the BIOC, Betty. Does the solution lie in Article 9 or section 2-403 or both? Under Article 9, the buyer does not qualify for the BIOC exception of section 9-307(1) as in the second situation above because the security interest was not created by the BIOC's seller; therefore, the security interest should continue in the collateral. Under Article 2, however, the BIOC might take free of the security interest in the entrusted goods under section 2-403(2) because Merv appears to have the power to transfer the ownership rights in the bicycle. When both Articles of the U.C.C. apply to the same factual situation, what is the outcome? The U.C.C. is far from explicit on this question, and consequently more than one school of thought has emerged to give an answer.

This Comment surveys the different theories used by courts to interpret the U.C.C. in settling disputes between Article 9 and section 2-403(2). It also looks at the strengths and weaknesses of the theories proposed and suggests a solution. For the sake of simplicity, the conflict of ownership claims of the BIOC under section 2-403(2) versus those of the secured party under Article 9 will be referred to in this Comment as the entrustment problem.

II. ENTRUSTMENT UNDER SECTION 2-403

Section 2-403(3) defines entrusting as:

includ[ing] any delivery and any acquiescence in retention of possession regardless of any condition expressed between the parties

14. This problem has been recognized for quite some time: In several instances where the articles overlap, with inconsistent rules applicable to the same case [including the overlap of U.C.C. §§ 2-403(2) and 9-307(1)], the text of the Code promulgated in 1952 failed to state clearly which rule governed, or failed to remove transactions regulated by one article from the operation of the other.

STATE OF NEW YORK LAW REVISION COMM'N, Report and Appendices Relating to the Uniform Commercial Code (Legislative Document No. 65A) at 31 (1956).

15. For earlier discussions of U.C.C. § 9-307(1), see Dugan, supra note 10; Sexton, Section 9-307(1) of the UCC: The Scope of the Protection Given a Buyer in Ordinary Course of Business, 9 B.C. INDUS. & COM. L. REV. 985 (1968).

16. Cases involving unperfected security interests are not within the scope of this Comment.

17. This section of the Comment does not purport to be a comprehensive study of entrustment. Rather, it seeks only to introduce the reader to the doctrine of entrustment. For a more in-depth discussion of entrustment, see, e.g., Leary & Sperling, The Outer Limits of Entrusting, 35 ARK. L. REV. 50 (1981).
to the delivery or acquiescence and regardless of whether the proc-
urement of the entrusting or the possessor's disposition of the 
goods have been such as to be larcenous under the criminal law. 18

The rule allowing a merchant to whom goods have been entrusted 
to give better title than he has received evolved from the 19th cen-
tury days of the Factor's Acts 19 in England and the United States. The Factor's Acts, in turn, evolved from common law principles of agency. Entrusting situations which fall within the purview of section 2-403(3) come in a myriad of forms. 20 "Any entrusting by a bailor" 21 is one such type. Courts often find entrusting when a buyer leaves purchased goods in the hands of his seller, 22 but they do not always agree that entrusting exists when a secured creditor allows the debtor to retain possession of the goods. 23 One court has held that entrustment could not occur when the secured party re-
tained a negotiable warehouse receipt covering the goods, because the receipt, in effect, gave the secured creditor possession. 24

18. U.C.C. § 2-403(3).
19. See Blackburn, Contract of Sale 307-20 (2d ed. 1887); Gilmore, The Commercial Doctrine of Good Faith Purchase, 63 Yale L.J. 1057 (1954); Hawk-
land, Curing an Improper Tender of Title to Chattels: Past, Present and Com-
mercial Code, 46 Minn. L. Rev. 697 (1962). See also U.C.C. § 2-403 comment 1.
20. For North Carolina cases dealing with U.C.C. § 2-403(2)-(3) see infra text accompanying notes 149-53.
23. Compare Rex Fin. Corp. v. Marshall, 406 F. Supp. 567 (D. Ark. 1976) (no entrusting when secured party allowed debtor, a mobile home dealer, to retain possession of homes); Adams v. City Nat'l Bank & Trust Co. of Norman, 565 P.2d 26 (Okl. 1977) (secured party did not entrust car to debtor; however, debtor entr-
tusted to his employer—see infra notes 64-74 and accompanying text for a dis-
cussion of this case); Muir v. Jefferson Credit Corp., 108 N.J. Super. 586, 262 A.2d 33 (1970) (no entrusting when assignee of security interest allowed buyer of used car to retain possession); with In re Woods, 25 Bankr. 924 (E.D. Tenn. 1982) (en-
courts suggest that the entrustment doctrine should not apply in sales of certain collateral such as used automobiles, because the BIOC should know that there is a certificate of title outstanding to provide notice of security interests.

Why does the doctrine of entrustment exist? The common law favored the original owner of chattels over any person who purchased the owner's chattels without the owner's consent. This policy often led to grossly unfair results, at least from the perspective of the innocent good faith purchaser. It also restricted the merchantability of goods in the stream of commerce. The drafters of the U.C.C. in Article 2 wished to facilitate the smooth flow of commerce, thereby advancing Gilmore's "commercial doctrine" of sales law, so they offered protection to the innocent good faith purchaser in the commercial setting by creating the entrustment provisions of section 2-403(2)-(3).

In addition to requiring an entrustment of possession of goods, section 2-403(2) also places two requirements on the good faith purchaser, both of which focus on the status of the parties involved in the transaction. First, the person selling the goods must be a "merchant dealing in goods of that kind." The U.C.C. does not define merchant dealing in goods of that kind, but its definition of

581 (1971). In Hendries, a bank issued an irrevocable letter of credit to finance the debtor's purchase of imported goods, receiving a negotiable warehouse receipt covering the goods. The debtor contracted to sell to buyers goods of the same brand as those covered by the receipt, but went bankrupt before delivering all of the goods to the buyers. The court held that no entrustment occurred between the bank and debtor because delivery of the receipt gave the bank possession.


26. Gilmore, supra note 11, at 1057. The doctrine protects the good faith purchaser "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." Id.

27. Or, more precisely, the BIOC. U.C.C. § 2-403(1) already protects the non-commercial bona fide purchaser.

28. U.C.C. § 2-104(1). This section lists two other types of merchants: a person who holds himself out as having special knowledge with respect to the goods involved or one to whom such knowledge is attributed because of his use of an intermediary possessing such knowledge.
merchant does include "a person who deals in goods of the kind." Section 2-104 comment 2 implies that these terms are synonymous. Second, section 2-403(2) requires the purchaser of the goods to be a "buyer in ordinary course of business." The BIOC is essentially a good faith purchaser buying in ordinary course from a seller of goods of that kind.

What is the consequence of a BIOC buying entrusted goods from a merchant dealing in goods of that kind? The U.C.C. gives the seller power to transfer to the buyer all rights of the entruster. This provision means that when the entruster has full title to the goods, as in the first example above, the merchant/seller (who has no title at all) can actually transfer better title than he had himself, thereby protecting the buyer from the owner's claims to the property. The original owner retains no claim against the innocent buyer and may look only to the merchant/seller for relief.

III. Article 9: The Secured Party's Rights Upon Disposition of Collateral

When a security interest arises under Article 9, the general rule is that it "continues in collateral notwithstanding sale, exchange, or other disposition thereof . . . ." This rule protects secured parties, but it has exceptions which arise when "Article [9] otherwise provides." For purposes of analyzing entrustment cases in light of Article 9, only two of the exceptions are pertinent.

29. Id. (emphasis added).
30. U.C.C. § 2-104 comment 2 explains that this definition of merchant includes "a much smaller group than everyone who is engaged in business and requires a professional status as to particular kinds of goods."
31. U.C.C. § 1-201(9). The following conditions preclude BIOC status: a buyer who has knowledge that the sale of goods violates a third party's security interest or ownership rights; a seller who is a pawnbroker; a transfer in bulk; a transfer which is security for a money debt; or a transfer in satisfaction of a money debt. Id. But note that a "merchant dealing in goods of that kind" who otherwise qualifies may enjoy BIOC status. See Bank of Utica v. Castle Ford, Inc., 36 A.D.2d 6, 317 N.Y.S.2d 542 (App. Div. 1971) (car dealer who fit BIOC definition of § 1-201(9) took car free of a security interest created by his seller).
32. U.C.C. § 2-403(2).
33. U.C.C. § 9-306(2).
34. Id.
35. See infra note 113 for a brief discussion of the limited U.C.C. § 9-307(2) consumer goods exception. For other exceptions to the general rule of U.C.C. § 9-306(2), see Dugan, 46 U. Colo. L. Rev. 333 n.2 (1975).
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A security interest does not continue in collateral if the secured party authorizes disposition of the collateral and the debtor subsequently disposes of it. Three factors support this rule. First, though Article 9 protects a secured creditor from the loss of his security interest resulting from the disposition of collateral which comes as a surprise, his authorization of the disposition precludes the possibility of unfair surprise. Second, if the secured creditor authorizes disposition, he expects buyers to buy, and cannot expect buyers to purchase goods subject to his security interest. Finally, the secured creditor may have a continued security interest in the proceeds from the disposition.

Section 9-307(1) presents a second and more narrow exception to the rule of continuous security interests. This exception gives protection to the BIOC, who "takes free of a security interest created by his seller . . . ." Section 9-307(1) severs the security interest even if it is perfected and "even though the buyer knows of its existence." The U.C.C. states that section 9-307(1), read in conjunction with the definition of BIOC in section 1-201(9), allows a buyer to take free of the interest if he "merely knows that there is a security interest which covers the goods but [the BIOC] takes subject [to the security interest] if he knows, in addition, that the sale violates some condition of the security agreement. Apparently, when the buyer knows the purchase will violate a security agreement covering the goods, he loses his status as a BIOC and will not take free of the security interest. Courts often interpret the language "by his seller" in section 9-307(1) literally, construing it to sever a security interest created by the buyer's immediate seller, but not to sever a security interest created by someone other than the BIOC's immediate seller. The purpose of the sec-

36. U.C.C. § 9-306(2).
37. See U.C.C. § 9-306(3).
40. Id.
41. Id.
42. U.C.C. § 9-307 comment 2.
tion 9-307(1) exception is to ensure the merchantability of goods by protecting buyers from “floor plan” inventory financing of dealers. Although courts know that the danger to the BIOC of a continuing security interest exists when a more remote seller creates the security interest, they apparently do not interpret the U.C.C. as drafted to provide protection to the BIOC in that situation.

IV. RECONCILING SECTION 2-403 WITH ARTICLE 9

A. The Prevailing Article 9 Secured Creditor

One school of thought dealing with the entrustment problem favors the secured creditor under section 9-307(1), rather than the BIOC under section 2-403(2). Though this view has support from both commentators and courts, its proponents do not always use the same line of reasoning to reach their common conclusion.

Nevertheless, one theory predominates among courts favoring the secured party. Courts adopting this theory interpret “power to transfer all rights of the entruster” to mean that the buyer takes whatever rights the entruster had, which at best exists as an equity interest subject to any outstanding security interests. Courts following this approach generally give only sparse analysis to support their conclusions, but the factual settings in the cases illustrate a variety of situations involving both security interests and section 2-403(2). Exchange Bank of Osceola v. Jarrett is one of the simpler situations. The debtor in Jarrett purchased a tractor-scaper through a Florida bank and gave the bank a perfected


45. See Gilmore, supra note 19.
46. See infra text accompanying note 54.
47. See WHITE & SUMMERS, supra note 11.
48. See Adams v. City Nat'l Bank & Trust Co. of Norman, 565 P.2d 26 (Okla. 1977); Commercial Credit Equip. Corp. v. Bates, 154 Ga. App. 71, 267 S.E.2d 469 (1980); American Standard Credit, Inc. v. National Cement Co., 643 F.2d 248 (5th Cir. 1981); Exchange Bank of Osceola v. Jarrett, 180 Mont. 33, 588 P.2d 1006 (1979) all of which are discussed infra. See also Carey Aviation, Inc. v. Giles World Marketing, Inc., 46 Bankr. 458 (D. Mass. 1985). Although entrusting was not at issue, the court stated that “even if general law principles or Article 2 would permit him to replevy the goods from the secured party, he could only take them subject to the prior security interest,” id. at 462, thus hinting that Article 9 would control any conflict between Article 2 and Article 9.
49. U.C.C. § 2-403(2).
security interest in the tractor. The debtor then sold it to an Iowa farm implement dealer who resold it to a Montana BIOC. Under these facts, section 9-307(1) did not save the BIOC from the security interest because a remote seller had created it, so the BIOC sought protection under section 2-403(2). The Jarrett court determined that entrustment occurred when the debtor sold the tractor-scraper to the Iowa dealer, but it also held that the BIOC lost under section 2-403. The extent of the court's section 2-403 analysis was its statement that "[the emphasized language of [section 2-403(2)]] disposes of [the BIOC's] alternative claim." The court further "recognize[d] that this [was] a harsh result," but held that any further action on the issue should be taken by the legislature. The court failed to suggest how or why the legislature should clarify the law on this issue.

American Standard Credit, Inc. v. National Cement Co. was a "complicated diversity case [in which the court] attempt[ed] to resolve the competing claims of various parties to an expensive piece of coal mining equipment . . . sold more than once by the same dealer." After sifting through agency issues the court addressed the entrustment issue. Studying the four standard fact patterns which Professors White and Summers say constitute entrustment, the court determined that "the case at bar [did] not seem to fit neatly within any one of these categories." Nevertheless, according to the court, entrustment may occur under facts

51. Id. at 38, 588 P.2d at 1009. The court relied on the "landmark" decision of National Shawmut Bank of Boston v. Jones, discussed infra at notes 103-12 and accompanying text to reach this result.

52. The language emphasized by the court was: "gives him power to transfer all rights of the entruster . . . ."

53. 180 Mont. at 38, 588 P.2d at 1009.

54. Id.

55. Id.

56. 643 F.2d 248 (5th Cir. 1981).

57. Id. at 250.

58. Professors White and Summers list four common entrustment situations in which the BIOC prevails over the entruster:

[1] Ernie Entruster turns his car over to Dave Dealer so that Dave can sell it for Ernie . . . . [2] A wholesaler gives Dealer the goods 'on consignment' or under a 'floor planning' agreement . . . . [3] George leaves goods to be repaired with Dealer who resells them to a buyer in ordinary course . . . . [4] Edgar buys goods from Dealer but leaves the goods in Dealer's hands.

WHITE & SUMMERS, supra note 11, § 3-11, at 143.
other than the four common situations, as long as there is "any delivery and any acquiescence in retention of possession." Concluding that the trial court could resolve the entrustment issue on remand,\textsuperscript{61} the court addressed the crucial issue of what rights the entruster may transfer to the BIOC. Citing \textit{Jarrett}, the court held that entrustment does not destroy a security interest unless the secured party is the entruster\textsuperscript{62} in which case the merchant dealing in goods of that kind can transfer all rights of the secured party to the BIOC. This brief statement was the extent of the court's resolution of the entrustment problem.\textsuperscript{63}

In \textit{Adams v. City National Bank},\textsuperscript{64} an Oklahoma case, a car dealer assigned a car's title to one of its salesmen. The salesman then procured a loan from the bank, and granted the bank a perfected security interest\textsuperscript{65} in the car. The car dealer subsequently sold the car to a BIOC, obtaining reassignment of the title from the salesman and delivering title to the BIOC. The bank then tried to assert its security interest against the BIOC. Finding that the salesman entrusted possession of the car to the car dealer,\textsuperscript{66} the court stated that under section 2-403(2), "[t]he transaction gave [the BIOC] the same title [held by the salesman, or entruster], which was title subject to the bank's security interest. Bank's security interest [was] still intact under section 2-403(2)."\textsuperscript{67} The BIOC's only recourse was to seek protection under the section 9-307(1) exception. It appeared that the court would favor the secured creditor because the security interest was created not by the BIOC's seller (the car dealer) but by a more remote party, the salesman.

The \textit{Adams} court, however, looked to an earlier Oklahoma case, \textit{Idabel National Bank v. Tucker},\textsuperscript{68} which held "against a se-

\begin{itemize}
\item \textsuperscript{60} \textit{Id.} (quoting U.C.C. § 2-403(3)).
\item \textsuperscript{61} \textit{Id.} at 272.
\item \textsuperscript{62} \textit{Id.} at 270.
\item \textsuperscript{63} But the court did give a good discussion of how agency and estoppel principles may operate to bar a secured party's rights against a BIOC—a topic outside the scope of this Comment which may, if applicable, nevertheless be an important consideration for the BIOC in winning a struggle against remote security interests.
\item \textsuperscript{64} 565 P.2d 26 (Okla. 1977).
\item \textsuperscript{65} "Oklahoma does not require a security interest to be recorded on the certificate of title in order for it to be perfected." \textit{Id.} at 28 n.1.
\item \textsuperscript{66} \textit{Id.} at 29.
\item \textsuperscript{67} \textit{Id.}
\item \textsuperscript{68} 544 P.2d 1287 (Okla. Ct. App. 1975). In \textit{Tucker}, the BIOC prevailed over
\end{itemize}
cured party in favor of a buyer of an automobile . . . .”

In *Tucker* the court stated:

Ordinarily, when a person goes into a merchant’s place of business to make a purchase . . . the purchaser ought to have the right to assume that the merchant has a right to sell the commodity in question and should not be required to make a record search before purchasing or to see to it that the merchant obtains a valid release of the item from a bank floor plan before delivering it to the purchaser and receiving his money or obligation.

The *Adams* court considered the issue of an agency relationship between the car dealer and its salesman, then agreed with *Tucker* and *Texas National Bank of Houston v. Aufderheide* that the BIOC should be protected. Accordingly, it decided that the car dealer and the salesman were the same entity for the purpose of deciding who created the security interest. Therefore, under section 9-307(1) the BIOC was protected from the secured party’s claim since the court deemed the car dealer, rather than its salesman, to have created the security interest. This case is somewhat peculiar in that the BIOC prevailed over the secured creditor even though the court held that Article 9 rather than section 2-403(2) governed the entrustment problem. In light of Oklahoma precedent favoring the BIOC when the actual entrustment problem arose, it seems probable that the Oklahoma Supreme Court would have favored the BIOC in this case even if the court were unable to apply the section 9-307(1) exception.

One case utilizing the theory that the BIOC takes no more than the entruster had goes beyond the sparse analysis of earlier cases, but the court’s reasoning has only limited application. See the secured party under U.C.C. § 9-307 because the BIOC’s immediate seller created the security interest.


71. “The Uniform Commercial Code has not changed the law in this state regarding clothing an agent with apparent authority to convey title, especially if the agent is one who ordinarily deals in the goods which the principal has entrusted to him.” 565 P.2d at 30-31 (quoting Medico Leasing Co. v. Smith, 457 P.2d 548, 550 (Okla. 1969)). See also *supra* note 63.


curity Pacific National Bank v. Goodman\textsuperscript{75} involved a classic entrustment situation.\textsuperscript{76} The debtor granted a perfected security interest in a boat, then delivered the boat plus a "power of attorney" to a merchant dealing in goods of that kind. The merchant then sold the boat to the BIOCs. When the merchant went into insolvency, the secured creditor repossessed the boat.\textsuperscript{77} Though the court noted that a "purpose underlying section [2-403] is to protect the merchantability of goods in the possession of a dealer,"\textsuperscript{78} it held against the BIOCs because they "had a simple and effective means of determining whether any security interest was outstanding [by checking] the public records of the [California] State Department of Harbors and Watercraft."\textsuperscript{79} This reasoning—that the buyers could and should have checked such "public records" for notice of liens—is valid only when the existence of outstanding liens is easily verified. Such a situation would arise when the collateral is a vehicle with a title governed by a certificate of title statute requiring notation of a security interest on the certificate itself for perfection.\textsuperscript{80} The court did not address the situation in which liens are not readily verifiable.

The buyers in Goodman could possibly have protected themselves by checking public records or requiring the seller to allow them to inspect the title certificate. In a sale of goods not covered by such a statute however, the best that a potential buyer could reasonably do is check for U.C.C. financing statements at the courthouse of the proper county.\textsuperscript{81} Such a search, however, would reveal only security interests created by the BIOC's immediate seller. It would be highly unlikely for security interests created by a more remote seller to surface, because the potential buyer would check only records indexed under his immediate seller's name. Therefore, a potential buyer searching records for goods not subject to a certificate of title statute could not adequately protect himself from these remotely created security interests. As stated earlier, the courts will generally interpret the "created by his

\textsuperscript{75} 24 Cal. App. 3d 131, 100 Cal. Rptr. 763 (1972).
\textsuperscript{76} J. White & R. Summers § 25-15, at 1074-75.
\textsuperscript{77} And, as an added twist to the case, the secured creditor redelivered the boat to the debtor who paid off the loan and resold the boat to another party. 24 Cal. App. 3d at 134, 100 Cal. Rptr. at 766.
\textsuperscript{78} 24 Cal. App. 3d at 138, 100 Cal. Rptr. at 768.
\textsuperscript{79} Id. at 141, 100 Cal. Rptr. at 770.
\textsuperscript{80} See U.C.C. § 9-302(3).
\textsuperscript{81} Or wherever U.C.C. § 9-401 designates as the proper place for filing.
seller" exception of section 9-307(1) to exclude protection of a BIOC in such a situation. The Goodman court could have clarified its position if it had distinguished the two types of situations and held that Article 9, rather than section 2-403(2), governs only in entrustment situations such as those involving goods covered by a certificate of title statute in which a prospective buyer can readily check the certificate for notations indicating security interests created by any seller, not just his immediate seller.

Commercial Credit Equipment Corp. v. Bates also interprets section 2-403(2) as permitting a merchant dealing in goods of that kind to transfer no better title than that of the entruster. In Bates, a tractor dealership, through its employee, sold a tractor to the debtor. The dealership assigned its security interest in the tractor to another party who perfected the interest. The debtor, who had not yet taken possession of the tractor, then leased it back to the employee. Later, the tractor dealership sold the tractor to a BIOC. The Bates decision contains not one, but three reasons that explain why the secured creditor prevails over the BIOC. First, relying on Adams v. City National Bank, the court held that the BIOC acquired the same rights as the entruster—an equity interest subject to a security interest. Second, the court characterized the entrustment provisions of section 2-403 as merely a "precisely limited exception to the common law rule that the seller can convey no greater title than he has himself." Third, and most

82. See supra note 44. But courts are usually generous in finding that entrustment exists in "titled" goods, such as automobiles, despite any non-delivery of title papers. See, e.g., Couch v. Cockroft, 490 S.W.2d 713 (Tenn. Ct. App. 1972) (entrustment of car notwithstanding non-delivery of title certificate); Medico Leasing Co. v. Smith, 457 P.2d 548 (Okla. 1969) (same). See also Godfrey v. Gilsdorf, 476 P.2d 3 (Nev. 1970), discussed infra at text accompanying notes 141-48.

83. Or in other appropriate situations under U.C.C. § 9-302(3).


85. Although both the debtor and the secured party argued that the debtor did not entrust the tractor to the dealer, but entrusted it to [the dealer's employee] in his private capacity as a pond-digger, without knowledge that it would find its way back to the dealer, and that therefore [the debtor] did not entrust "possession of [the] goods to a merchant who deals in goods of that kind" ... [the court found] it unnecessary to determine whether [the debtor] entrusted the tractor to [the employee] individually, to the dealer, or to [the employee] as an agent of the dealer.

Id. at 73, 267 S.E.2d at 471.

86. Id. at 74, 267 S.E.2d at 472 (citing Simson v. Moon, 137 Ga. App. 82, 222 S.E.2d 873 (1975)).
convincingly, the court injected section 9-306\(^8\) into the case, holding that section 2-403 "does not, expressly or even impliedly, abrogate the clear intent of [section 9-306] providing for the continuation of [the secured party's] perfected security interest."\(^8\) 8

The first of these theories has already been examined in the cases discussed above. As noted, the courts have given sparse analysis to the reasoning found in Adams, possibly because the wording of section 2-403(2) is so straightforward, allowing easy disposal of a case involving a complex U.C.C. problem. The second theory used in Bates shows the court's awareness of common law rules, which under certain circumstances may supplement the U.C.C.\(^9\) The court's assertion, however, that entrustment is merely a "precisely limited exception to the common law rule"\(^9\) may be an improper characterization of section 2-403. The entrustment provisions are more properly an abrogation of, rather than an exception to, the common law rule that one may transfer no better title than he has himself.\(^9\) This is especially true in light of the U.C.C. policy of "simplify[ing], clarify[ing] and moderniz[ing] the law governing commercial transactions."\(^9\) Section 2-403 applies Professor Gilmore's commercial theory\(^9\) to transactions of goods in a truly commercial setting,\(^4\) the goal of which is to "facilitat[e] the ready exchange of goods in the market place."\(^9\) When coupled with the mandate of liberal construction set out in section 1-102(1),\(^9\) the

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87. U.C.C. § 9-306(2) states “[e]xcept where this Article otherwise provides, a security interest continues in collateral notwithstanding . . . disposition” (unless authorized by the secured party).

88. 154 Ga. App. at 74, 267 S.E.2d at 472.

89. U.C.C. § 1-103 states “[u]nless displaced by the particular provisions of this Act, the principles of law and equity . . . shall supplement its provisions.” See also U.C.C. § 2-403 comment 1.

90. 154 Ga. App. at 74, 267 S.E.2d at 472.

91. See, e.g., Levi v. Booth, 58 Md. 305 (1882), holding that an entrusting of possession of goods to a merchant dealing in such goods did not give the merchant power to transfer ownership. The court stated: "If it were otherwise people would not be secure in sending their watches or articles of jewelry to a jeweler's establishment to be repaired or cloth to a clothing establishment to be made into garments." Id. at 315.

92. U.C.C. § 1-102(2)(a).

93. See Gilmore, supra note 19, at 1062 n.14.


96. U.C.C. § 1-102(1) states “[t]his Act shall be liberally construed and ap-
entrustment provisions are not merely a "precisely limited exception" but rather a catalyst allowing goods to flow freely into the stream of commerce. The Bates "limited exception" strict construction approach therefore contradicts the liberal U.C.C. policy.

However, there remains the third and strongest of the Bates' arguments in favor of the secured creditor, the section 9-306 theory. Despite the underlying U.C.C. policy favoring merchantability of goods, section 9-306(2) provides that a security interest continues in collateral following disposition "[e]xcept where this Article otherwise provides." Nowhere does Article 9 explicitly provide that entrustment under section 2-403(2) extinguishes a security interest in collateral. Therefore, unless some provision within Article 9 implicitly "otherwise provides," entrustment should not destroy a perfected Article 9 security interest. The section 9-306(2) argument proposed in Bates is perhaps the strongest in favor of the secured creditor. Likewise, it is the most difficult to refute because of the straightforward language of section 9-306(2). This Comment's later discussion of cases in which entrustment severs the security interest will reveal the strength of this argument. None of these cases directly confront the first clause of section 9-306(2). Apparently, the BIOC can prevail under section 9-306(2) only if the court interprets a secured party's acquiescence in delivery to and possession by a merchant dealing in goods of that kind to constitute authorization of the sale, thereby avoiding application of the section 9-306(2) theory.

National Shawmut Bank of Boston v. Jones is one of the earliest and most frequently cited cases in this area, although the case uses a somewhat weaker argument found in Article 2 to rule

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97. Unless the disposition was authorized.
98. Or in identifiable proceeds.
99. Professor Dugan explains that some provisions lying outside Article 9 (e.g., U.C.C. §§ 1-103, 7-205) apply to extinguish the security interest through express cross-reference or through interarticle priority references. Dugan, supra note 10, at 333 n.2.
100. With respect to application of the interarticle priority reference of U.C.C. § 2-403(4) to sever the secured party's interest, see In re Woods, 25 Bankr. 924 (E.D. Tenn. 1982), discussed infra at notes 137-40 and accompanying text. See also supra note 99.
101. Or outside Article 9 if incorporated by cross-reference or by an interarticle priority reference.
102. See infra text accompanying notes 137-40.
in favor of the secured party. The case involved a car dealer who sold an automobile to the debtor on a retail installment contract, with the car dealer assigning the security interest to a bank which perfected by filing pursuant to section 9-401. The debtor then "traded or sold" the car to a used-car dealer, who subsequently sold it to a BIOC. The court's discussion referred to subsection 1 of section 2-403, but not to subsections 2 or 3. It is unclear from the opinion why the court failed to address the issue of entrustment since the facts strongly suggest that the debtor entrusted the car to the used-car dealer, a merchant dealing in goods of that kind. In any event, the brief analysis of Shawmut gave three arguments in favor of the secured party. First, the court propounded the section 9-306(2) theory stated above—that the secured creditor's rights are preserved against the BIOC because section 2-403(2) is not one in which Article 9 provides that a security interest fails to continue in collateral.

The court grounded its second theory in the words of section 2-402(3)(a), which states that "[n]othing in [Article 2] shall be deemed to impair the rights of creditors of the seller under the provisions of . . . (Article 9)." The BIOC in Shawmut was not protected under section 9-307(1) because the security interest was not created by his seller. Had the court gone one step further and labelled the transaction between the debtor and used-car dealer an entrustment, the BIOC would have remained unprotected against the secured creditor because of the court's reliance on section 2-402(3)(a). But should the secured creditor prevail over the section 2-403 BIOC under section 2-402(3)(a)? A second look at section 2-402(3) reveals that the provision speaks only of not impairing "rights of creditors of the seller." The problem in Shawmut comes in the definition of seller in section 2-402(3). The court ap-

104. Id. at 387, 236 A.2d at 485.
105. U.C.C. § 2-403(1) states:
A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer a good title to a good faith purchaser for value . . . .

For a discussion of § 2-403(1), see Warren, supra note 94.
106. 108 N.H. at 389, 236 A.2d at 486.
107. In the alternative, the court could have determined that the bank (as secured party) entrusted the car to the debtor by virtue of the bank's acquiescence in the debtor's retention of possession of the car. See supra the discussion accompanying notes 22-25.
parently interpreted seller to mean the party granting the security interest—the debtor. Therefore the bank, as a creditor of the seller, prevailed against the BIOC. However, if “seller” means the BIOC’s seller, or the used-car dealer, then it is not clear whether section 2-402(3) applies to a remote seller’s creditors such as the bank in Shawmut. The U.C.C. definitions of creditor and seller do not offer any guidance as to whether the remote secured creditor’s rights may be severed. Comment 1 to section 2-103 mentions “any legal successor in interest” of the seller, stating that this phrase (which is found in the prior Uniform Sales Act) has been omitted from the U.C.C., and that “[i]n every ordinary case, however, such successors are as of course included” in the definition. The next question is whether “creditors of the seller” is such an “ordinary case” under the comment. In other words, is “seller” in section 2-402(3) considered the BIOC’s immediate seller (the used-car dealer in Shawmut), the initial seller (the car dealer), or the whole chain of sellers (including the debtor) in an entrustment situation? The Shawmut court should have supported the section 2-402(3)(a) pro-secured party theory by stating that creditors of the “seller” in section 2-402(3)(a) include the entire chain of sellers, from the car dealer to the BIOC.

The third argument of Shawmut is based on section 2-403(4), which provides that the “rights of . . . lien creditors are governed by” Articles 9, 6, and 7. According to the court, this section implies that Article 9 rather than Article 2 governs the rights of secured creditors in an entrusting situation. A later case, In re Woods, construing this same section, disagreed with this analysis and found in favor of the BIOC. This pro-secured party argument is appealing at first glance, but it has limited persuasive effect because of the way the Shawmut court used the term “lien creditor.” The U.C.C. defines “lien creditor” as “a creditor who has acquired a lien on the property involved by attachment, levy or the like . . . .” The Shawmut court determined that section 2-403(4) implied that the rights of any secured creditor (rather than just the “lien creditor” as defined in section 9-301) are governed by Ar-

108. U.C.C. § 1-201(12).
110. U.C.C. § 2-103 comment 1.
111. 25 Bankr. 924 (E.D. Tenn. 1982), discussed infra at notes 137-40 and accompanying text.
112. U.C.C. § 9-301(3).
article 9 in a case involving the entrustment problem. Though the Shawmut interpretation of section 2-403(4) might be incorrect, it is not unique. White-Sellie's Jewelry Co. v. Goodyear Co., 113 although not decided as an entrustment case, also alludes to section 2-403(4), stating that it "directs attention to [Article] 9 of the Code for provisions regarding secured transactions . . . ." 114 Although it is not clear which of the section 2-403 subsections were at issue, the Goodyear court further stated that section 2-403 "concerns only a naked sale of goods and does not speak to a situation involving goods in which is reserved a security interest." 115 Assuming the court intended this statement to apply to section 2-403(2)-(3), it is likely that an entrustment in Goodyear would not have severed a perfected Article 9 security interest. The section 9-306(2) argument of Shawmut supports this observation because the Goodyear opinion referred to section 9-306(2) dealing with continuation of a security interest. 116

Matteson v. Harper, 117 which followed the Shawmut arguments of sections 2-402(3)(a) (providing that nothing in Article 2 impairs the rights of the seller's creditors) and 9-306(2) (providing for the continuance of perfected security interests except when Article 9 otherwise provides) found an additional reason for favoring the secured creditor over a BIOC—the comment to section 9-101. In Matteson, the seller sold a bulldozer to a group of buyers, and

113. 477 S.W.2d 658 (Tex. Civ. App. 1972). In Goodyear, the sale of two television sets from a creditor to the debtor gave the creditor a perfected security interest: a PMSI in consumer goods. (See § 9-302(1)(d), which allows such perfection without filing a financing statement.) The debtor quickly resold the sets to X company, a pawnbroker/retailer, who later resold them. The creditor sued X for conversion. X, as a pawnbroker, did not qualify as a BIOC under § 1-201(9) and therefore was not protected under § 9-307(1). X also failed to qualify for protection under § 9-307(2), because X did not purchase the sets for personal, family or household purposes. See § 9-307(2), which states:

In the case of consumer goods, a buyer takes free of a security interest even though perfected if he buys without knowledge of the security interest, for value and for his own personal, family or household purposes unless prior to the purchase the secured party has filed a financing statement covering such goods.

Under limited circumstances this provision is another method for severing security interests in entrusted goods.

114. 477 S.W.2d at 661.

115. Id.

116. Id.

took a security interest in the bulldozer. The buyers defaulted and delivered the bulldozer to an auctioneer. Meanwhile, the seller, learning of the default, wrote to the auctioneer requesting him to take a minimum bid of $22,400. However, the auctioneer sold the bulldozer to a BIOC for $20,500 cash, keeping the proceeds and eventually going into bankruptcy.

In Matteson, section 9-307(1) did not protect the BIOC because the BIOC's seller did not create the security interest. The BIOC argued that he should prevail against the secured creditor under section 2-403(2), contending that the secured creditor should be required to police the collateral, posting notice of the security interest at every sale. The court answered this contention with the comment to section 9-101: "The aim of [Article 9] is to provide a simple and unified structure within which the immense variety of present-day secured financing transactions can go forward with less cost and with greater certainty."118 Requiring the secured creditor to police the collateral "would undermine the simplicity, uniformity and reliability of the filing system."119 Deciding that "[t]he entire issue of entrustment [was] irrelevant,"120 the court held in favor of the secured creditor, stating that he should be able to rely on the U.C.C. filing system.121

Although several theories are available to explain why entrustment does not extinguish a perfected security interest, some cases reach this result without stating any supporting theories. In In re Tom Woods Used Cars, Inc.,122 section 9-307 did not apply because the car dealers who took back security interests from the debtor, another car dealer, failed to execute written security agreements under section 9-203(1).123 The court explained however, that § 9-307 "limits the effect of § 2-403 as to entrusters who have Article 9 security interests in the entrusted goods."124 Woods is thus another situation in which the secured party would apparently pre-

118. U.C.C. § 9-101 comment.
119. 297 Or. at 119, 682 P.2d at 769.
120. Id.
121. Id. at 119, 682 P.2d at 770.
122. 21 Bankr. 560 (E.D. Tenn. 1982).
123. U.C.C. § 9-203(1) states that "a security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless . . . the collateral is in the possession of the secured party pursuant to agreement, or the debtor has signed a security agreement . . . ."
124. 21 Bankr. at 563.
vail over the BIOC if the entrustment problem were at issue.\textsuperscript{125} Since the court did not have to reach this question, it is reasonable that it did not give any reasons for preferring the secured party.

Several New York lower courts favoring the secured creditor failed to reach questions that they should have addressed on the issue of entrustment. In \textit{Lindsley v. Financial Collection Agencies, Inc.},\textsuperscript{126} the facts begged for a finding of entrustment. The debtor granted a security interest in a car, and then transferred\textsuperscript{127} the car to A, who traded it to a car dealer, who in turn sold it to a BIOC. The court stated that "[a]ny attempt to apply UCC section 2-403 to the facts here [was] inappropriate,"\textsuperscript{128} but it neglected to explain why. Because the security interest in \textit{Lindsley} was not created by the BIOC's seller, the BIOC did not fall under the section 9-307(1) exception and the secured creditor prevailed. The court should either have explained why section 2-403 did not apply (by determining that there was no entrustment under these facts) or have explained, even if section 2-403 did apply, why the security interest in the collateral would still continue while in the hands of the BIOC.

The situation in \textit{Marine Midland Bank v. Smith Boys, Inc.},\textsuperscript{129} was similar to that in \textit{Lindsley}. The debtor granted a perfected security interest in a boat to boat dealer A, who then assigned the security interest. The debtor then traded the boat back to A, who then sold it to a BIOC. The BIOC traded it to boat dealer B, who finally sold it to another buyer. Again, these facts did not warrant section 9-307(1) protection for the BIOC, but they did suggest a possible entrusting under section 2-403.\textsuperscript{130} \textit{Marine Midland} briefly referred to subsection 1 of section 2-403 only, in deciding in favor of the secured party. Though this court, like its predecessor in \textit{Lindsley}, did not address the issue of entrusting, it strongly hinted at why entrustment would not affect a perfected security interest. The court explained that the U.C.C. drafters intended to limit narrowly the exception to the general rule of section 9-306(2) that a

\textsuperscript{125} But see \textit{In re Woods}, 25 Bankr. 924 (E.D. Tenn. 1982) discussed \textit{infra} at notes 137-40 and accompanying text in which the same bankruptcy court allowed entrustment to sever a security interest.

\textsuperscript{126} 97 Misc. 2d 263, 410 N.Y.S.2d 1002 (N.Y. Sup. Ct. 1978).

\textsuperscript{127} \textit{Id.} at 264, 410 N.Y.S.2d at 1003.

\textsuperscript{128} \textit{Id.} at 265, 410 N.Y.S.2d at 1004.

\textsuperscript{129} 129 Misc. 2d 37, 492 N.Y.S.2d 355 (N.Y. Sup. Ct. 1985).

\textsuperscript{130} See \textit{In re Woods}, 25 Bankr. 924 (E.D. Tenn. 1982), discussed \textit{infra} at notes 137-40 and accompanying text.
security interest continues notwithstanding disposition. Reviewing *Ocean County National Bank v. Palmer,*¹³¹ the court noted that section 9-307(1) apparently did not include the language "created by his seller" in the 1952 draft of the U.C.C., but all later versions have.¹³² This suggested that the U.C.C. drafters intended to limit severely exceptions to section 9-306(2), which is another good theory for resolving the entrustment problem. The court added, however, that until New York passes a certificate of title act for boats, "purchasers in this situation will have to take care to trace the chain of title and insure the absence of any security interest by checking filings on each and every person in the chain."¹³³ This conclusion contradicts the U.C.C. policy of "facilitating the ready exchange of goods in the market place,"¹³⁴ and once again brings into conflict the policies of protecting secured parties and facilitating the smooth flow of commerce.

B. The Prevailing Section 2-403 Buyer in the Ordinary Course of Business

The opposing view, favoring the section 2-403 BIOC over the Article 9 secured creditor in the entrustment problem, finds almost equal support among commentators¹³⁵ and courts. Again, a variety of theories leads to a common conclusion.

First, many courts have held that the BIOC should prevail when the secured creditor is deemed the entruster (as, for example, when a secured creditor knows of and acquiesces in the transfer of...
possession of goods from a debtor to a merchant). 136 This conclusion is correct under section 2-403 because the entrustee/merchant has the power to transfer the security interest ("all of the rights of the entruster") of the secured creditor. According to In re Woods, 137 it is also correct because the secured creditor's acquiescence in delivery to and possession by a merchant dealing in goods of that kind constitutes authorization of the sale under section 9-306(2). In Woods, the debtor bought a car and granted a perfected security interest to the car dealer, who assigned the interest to another party. The debtor eventually returned the car to the dealer, who then resold it to a BIOC. Arguably, the entrusting was by the debtor to the dealer, but the court determined that the assignee of the security interest was the entruster by virtue of his knowledge of and acquiescence in the dealer's possession of the car, which was tantamount to authorization of the disposition. Woods could have referred to section 9-306 comment 3 to support this argument. Comment 3 states: "The transferee will take free whenever the disposition was authorized; the authorization may be contained in the security agreement or otherwise given." 138 Entrustment by the secured party would be considered authorization "otherwise given" under this analysis.

Woods is an excellent example to support the view that entrustment severs security interests, because the opinion contains two other theories aligned with this view. One is the flip side of the section 2-403(4) argument proposed in National Shawmut Bank of Boston v. Jones and followed by White-Sellie's Jewelry Co. v. Goodyear Co. 139 While Shawmut and Goodyear interpreted "lien creditor" to encompass "all secured creditors," the Woods court correctly pointed to the section 9-301(3) definition of "lien creditor," showing that it covers only situations involving involuntary liens rather than the consensual Article 9 liens. Therefore, under this analysis entrustment severs the rights of secured creditors who do not fit the lien creditor definition.


137. 25 Bankr. 924 (E.D. Tenn. 1982).


139. See supra text accompanying notes 111-16.
An interarticle priority reference—section 2-403 comment 2— is the basis for the third Woods theory. The court read the language of the comment to mean that section 2-403(2) will sever a security interest created by the BIOC's seller in every entrustment situation except those involving farm products sold by a person engaged in farming operations. The Woods rationale is that section 2-403(2) is one of those situations under section 9-306(2) where, through the interarticle priority scheme, Article 9 "provides otherwise." Given the comment's statement, however, that the farm products provision of section 9-307(1) limits section 2-403(2), a question of statutory analysis arises. Does comment 2 mean that the farm products provision is the only rule that limits section 2-403(2), or is it one of several rules limiting section 2-403(2) and thus happens to be the only rule to which comment 2 refers? The answer will depend on making a choice between two U.C.C. policies—promoting merchantability of goods versus protecting perfected secured parties.

One of the more complicated theories favoring the BIOC arises from Godfrey v. Gilsdorf, where the court did not have to resolve the entrustment problem but nevertheless suggested a theory for its resolution. Gilsdorf involved a classic entrustment situation in which the debtor granted a perfected security interest in his car, then delivered it to a car dealer for resale. The dealer sold the car to a BIOC and went out of business without having paid the debtor. The entrustment problem was not at issue in Gilsdorf because the debtor paid the secured party before the case went to trial. However, the court found entrustment between the debtor and the car dealer, then went one step further to propose a theory for resolving the entrustment problem. According to the court, section 2-403(2) standing alone allows the BIOC to take only the rights of the entruster, which are at best an equity interest of the debtor subject to a perfected security interest, but "sections of the U.C.C. found elsewhere, particularly [section 2-103(1)(d)] defining 'seller,' and [section 9-307] of article 9, may be construed to mean that [the BIOC] took the car free of the perfected security

140. U.C.C. § 2-403 comment 2 states: "As to entrusting by a secured party, subsection (2) is limited by the more specific provisions of Section 9-307(1), which deny protection to a person buying farm products from a person engaged in farming operations."


142. See supra text accompanying notes 48-85.
interest”143 of the secured party.

How does this argument work? Gilsdorf gives no explanation, but the reasoning is probably as follows: Under section 9-307(1) the BIOC will take free only of security interests created by his seller. Section 2-103(1)(d) defines a seller as “a person who sells or contracts to sell goods.” If the debtor in Gilsdorf had delivered the car to the car dealer under a consignment or other contract requiring him to sell it, then the debtor could be considered the “seller,” and the dealer would just be a conduit through which the transaction passed. Therefore, the BIOC could take the car under section 9-307(1) free of the security interest created by “his seller,” the debtor.

This theory looks promising for the BIOC in certain situations such as consignment-type arrangements, but it has its drawbacks. First, what is the definition of “seller” as used in Article 9? “In this Article” prefaces the section 2-103(1) definition, prompting the question of whether the definition also applies to Article 9. Article 9 does not define seller, but the “definitions” section of Article 9, section 9-105, states that some definitions in other U.C.C. articles apply to Article 9.144 “Seller” is not among the definitions listed in section 9-105(3), but “sale” as defined in section 2-106 is applicable:146 “A ‘sale’ consists in the passing of title from the seller to the buyer for a price (Section 2-401).”146 Finally, the “definitional cross-references” of section 2-401 point to section 2-103 for the definition of seller. Thus, passage through a maze of U.C.C. provisions reveals a possible escape hatch under section 9-307(1) favoring the BIOC against a secured creditor’s claim created by a remote seller.

Unfortunately for the BIOC, the Gilsdorf theory also raises a new line of questions. For instance, if the seller is the non-merchant debtor who created the security interest, rather than the car dealer/entrustee, does the buyer lose his BIOC status because he is now deemed to have bought the goods from one who is not a merchant dealing in goods of that kind? In other words, can the buyer have the best of both worlds by claiming protection under section 9-307(1) from a security interest granted by the remote debtor because the debtor is deemed to be the seller, and yet still

143. 476 P.2d at 6.
144. See U.C.C. § 9-105(3).
145. Id.
146. U.C.C. § 2-106(1).
qualify as a BIOC by virtue of having purchased from the merchant dealing in goods of that kind? It seems to strain the BIOC exception of section 9-307(1) for the good faith buyer to prevail by holding that both the non-merchant debtor and the merchant/entrustee are the “seller” under different clauses of that section, without any clear indication from the U.C.C. that this is the proper resolution of this situation. This observation is especially true in light of the fact that the U.C.C. drafters intended to narrowly limit this exception to section 9-306(2), as evidenced by the omission of the “created by his seller” clause from the original draft only.\textsuperscript{147} The Gilsdorf court would never have had to initiate such a complicated theory had the U.C.C. clearly explained how to resolve the entrustment problem.\textsuperscript{148} 

\textsuperscript{147.} See supra text accompanying notes 129-32. 
\textsuperscript{148.} Other cases have resolved the entrustment problem in favor of the BIOC without giving reasons or by relying on those already discussed. See Executive Financial Servs., Inc. v. Pagel, 238 Kan. 809, 715 P.2d 381 (1986), where a tractor dealership, a corporation managed by individuals A and B, sold tractors to the secured party, who, without ever taking possession, “leased” the tractors back to A and B, doing business as a partnership, with the “lease” guaranteed by the tractor dealership. The dealership sold the tractors to three BIOCs; the partnership of A and B then defaulted. One BIOC, himself a tractor dealer, resold one of the tractors to the defendant. The court held: (1) the “sale-leaseback” was actually an Article 9 security interest, (2) A and B as a partnership rather than the corporate seller created the security interest, therefore U.C.C. § 9-307(1) did not protect the BIOCs, (3) the BIOCs prevailed over the secured party, following the holding in In re Woods, (see supra note 137). See also In re Mercury Machine Tool & Supply Corp., 12 Bankr. 944 (M.D. Fla. 1981) where the debtor, with a lease and option to purchase, consigned a lathe to an equipment dealer who later went into bankruptcy. The court held: (1) the secured party prevailed over the trustee in bankruptcy who did not have the rights of a BIOC, (2) a BIOC “would unquestionably take free of [the] security interest.” Id. at 945. However, this court did not explain why a BIOC would “unquestionably take free.” See also Tulsa Auto Dealers Auction v. North Side State Bank, 431 P.2d 408 (Okla. 1966) where out-of-state car dealer A sold a car through the plaintiff (an auction company) to car dealer B, who granted a security interest in the car, then sold it through the plaintiff to car dealer C. C then sold or delivered the car back to B, who then sold or delivered it to another secured party. The court held that the sale from C back to B was in the ordinary course of business, thus B took the car free of the plaintiff’s security interest. See also Riverside Nat'l Bank v. Law, 564 P.2d 240 (Okla. 1977) where a secured creditor loaned funds upon debtors' false representations of owning automobiles, and upon learning of the fraud obtained a temporary restraining order to prevent disposition of the cars pending a suit filed seeking imposition of a constructive trust. The debtors then sold to a BIOC. The court, quoting § 2-403(2)-(3), ruled that the BIOC took the cars free of the security interest.
C. The North Carolina View

North Carolina courts have not yet dealt with a contest between a secured creditor and the BIOC in a section 2-403 entrustment case. The seminal North Carolina entrustment case is Toyomenka, Inc. v. Mount Hope Finishing Co. Toyomenka involved the entrustment of textile goods under section 2-403(3) between an importer and a customs broker who was hired by the importer "to enter and clear the goods through customs in the name of [the importer] and to hold for shipping instructions." Section 2-403(2) did not protect the BIOC in this instance from the security interest however, since the broker was not a merchant dealing in goods of that kind.

Two other North Carolina cases have dealt with entrusting situations involving security interests, but the security interests in those cases were not remote; instead, the immediate sellers of the BIOC had created them. In North Carolina National Bank v. Robinson, the debtor (a car dealer) executed an inventory financing security agreement covering an automobile. He then sold the car to a BIOC, and subsequently went into bankruptcy. The BIOC prevailed against the secured creditor under section 2-403(2) because the secured creditor was also the entruster and under section 9-307(1) because the security interest was created by BIOC’s immediate seller.

Similarly, in American Clipper Corp. v. Howerton, the BIOC prevailed again under both sections 2-403(2) and 9-307(1). In American Clipper, a manufacturer delivered a recreational vehicle to a dealership. The dealership sold the vehicle to a BIOC, taking and then assigning a security interest in it. When the dealership failed to pay the manufacturer, the manufacturer sought to enforce a security interest in the vehicle against the BIOC. The BIOC prevailed in American Clipper because the court found entrustment between the manufacturer and the dealership.

Although neither American Clipper nor Robinson actually addressed the entrustment problem, the Robinson court suggested that entrustment could sever a perfected security interest: "the UCC as adopted in this State protects purchasers in the ordinary course of business from the claims of predecessors in interest who

149. 432 F.2d 722 (4th Cir. 1970).
150. Id. at 725.
place items into the stream of commerce without warning that they subsequently will claim ownership." If the word "predecessors" encompasses security interests created by remote sellers, then the BIOC should prevail in North Carolina, although there is not yet any concrete evidence of what supporting theory a North Carolina court would employ.

V. Conclusion

In entrusting cases not involving security interests, section 2-403 governs, while in secured transactions not involving entrusting, Article 9 generally governs. In entrusting cases involving the section 2-403(2) BIOC and the remote, perfected Article 9 secured creditor, however, the courts are split as to whose ownership rights are superior. Those courts favoring the secured party usually employ one or more of the following arguments:

1. Under section 2-403(2) the BIOC takes "all rights of the entruster," which is at best only the debtor's equity, subject to any outstanding security interests.

2. The entrusting provisions of section 2-403 are a "precisely limited exception to the common law rule that the seller can convey no greater title than he has," which do not affect security interests.

3. Section 9-306(2) mandates that a security interest continues in collateral except where Article 9 otherwise provides, and section 2-403(2) is not a place where Article 9 otherwise provides; therefore the security interest is unaffected.

4. Section 2-402(3)(a) provides that nothing in Article 2 impairs the rights of the seller's creditors.

5. The language of section 2-403(4) stating that the rights of "lien creditors" are governed by Article 9 implies that the rights of secured creditors are also governed by Article 9, rather than Article 2, in an entrusting situation.

6. Since the original draft of the U.C.C. omitted the "created by his seller" language now found in section 9-307(1), the drafters intended to severely limit the exceptions to the general rule of continuity of security interests.

7. The comment to section 9-101 states that the purpose of the U.C.C. generally, and the secured transaction provisions specifi-

153. 78 N.C. App. at 7, 336 S.E.2d at 670.
cally, is to provide a simple and unified structure conducive to efficient financing transactions.

8. The U.C.C. policy of protecting perfected secured parties is paramount to that of promoting merchantability of goods.

Conversely, those courts favoring the BIOC usually rely on the following theories:

1. The U.C.C. policy of promoting merchantability of goods is paramount to that of protecting perfected security interests.

2. Entrustment constitutes authorization under section 9-306(2); therefore disposition of the collateral extinguishes the security interest.

3. Section 2-403(4) states that the rights of lien creditors only are governed by Article 9, so that a secured creditor's rights in an entrustment case are inferior to those of the BIOC.

4. Comment 2 to section 2-403 allows entrustment to sever a secured creditor's interest in all situations except those involving the sale of farm products by one engaged in farming operations.

5. Under the section 2-103(1)(d) definition of "seller," the seller in the BIOC exception of section 9-307(1) can include a remote seller who contracts to sell to the BIOC's seller, thus severing a remote security interest.

Reconsidering the earlier examples, the outcome of the contest between Sam, the secured creditor, and Betty, the BIOC, over ownership of the bicycle will depend on which theory the court follows and any additional facts, such as whether Sam knew and agreed to entrustment by the debtor. Roughly a dozen theories apply to the question of whether entrustment severs Sam's security interest, with a majority of the existing cases favoring the secured creditor.

Probably the most effective solution to this entrustment problem is a clarification of the U.C.C. Section 2-403 should be modified to show that entrustment always, never or sometimes severs a security interest. Allowing entrustment always or never to extinguish the security interest would promote one U.C.C. policy to the exclusion of another. Perhaps there is a solution which promotes both U.C.C. policies of protecting perfected security interests and encouraging the merchantability of goods: allow entrustment to sever security interests in some situations but not in others. A final use of the earlier examples will demonstrate the answer.

Assume that Betty, the BIOC, wants to buy a bicycle from Merv, the bicycle dealer. If the law states that entrustment can never sever a perfected security interest, then the burden is on
Betty as the buyer to verify that the bicycle is free from perfected security interests, regardless of their remoteness. In the case of a relatively low-priced bicycle, this burden is high relative to the value of the goods. But if Sam’s perfected security interest in the bicycle were to vanish, his loss would be relatively low. Suppose, instead of a bicycle, Betty wanted to buy a high-priced good, such as an automobile, boat, or airplane, and Merv was an appropriate merchant dealing in goods of that kind. This results in a much lower burden on Betty relative to the goods’ value. Consequently, Sam has much more to lose, assuming the value of his security interest is substantial in relation to the collateral’s value.

In balancing the BIOC’s relative burden of verifying “clean” title against the value of the secured creditor’s interest, it is feasible that in an entrustment a perfected security interest should continue in collateral as long as the value of the security interest outweighs the BIOC’s burden. When the BIOC’s burden outweighs the value of the security interest, entrustment should sever the interest. Theoretically, market forces would determine a cut-off point at which the value of a security interest in collateral equals the BIOC’s burden of checking title. Practically, however, an artificial method must be used to separate entrustment situations in which a security interest continues from those in which it does not. This notifies parties of their rights in goods well before they enter a transaction.

At least three solutions could accomplish this objective. One solution is to fix a cut-off dollar amount, as in the U.C.C. Statute of Frauds. A second solution is to designate specific goods in which a perfected security interest would continue, such as “automobiles,” “boats,” and the like. Because most of the existing cases involve goods subject to certificate of title legislation, the most appropriate solution is to permit perfected security interests to continue in a section 2-403 entrustment situation only if certificate of title legislation covers the collateral. The following provision added to section 2-403(2) would codify this rule: “Nothing in this section shall be deemed to impair the rights of a secured party under provisions of Article 9 where the goods are subject to a certificate of title statute of this state.” The resulting modification of section 2-403(2) would balance the competing U.C.C. policies of

155. U.C.C. § 2-201(1).
156. However, problems may still arise in interstate transactions absent a uniform certificate of title act.
protecting perfected security interests and promoting the merchantability of goods.

Modifying section 2-403(2) to allow entrustment to sever security interests unless the collateral is covered by certificate of title legislation is a compromise which functions to protect perfected interests while promoting merchantability of goods. If a certificate of title covers the goods, the BIOC must check for outstanding security interests to protect himself. If certificate of title does not apply, section 2-403 will protect him. Conversely, the secured creditor has a protected interest as long as a certificate of title covers the collateral; without this title certificate, he must police his debtor to protect himself. Rather than promoting one U.C.C. policy to the exclusion of the other by an all-or-nothing entrustment rule, this give-and-take solution promotes both policies equally in a battle of conflicting U.C.C. provisions.

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