

Permanent Editorial Board for the Uniform Commercial Code

PEB Commentary No. []

Buyer in Ordinary Course of Business

Draft for Public Comment

December 5, 2022

Comments on this draft must be submitted by no later than February 3, 2023.

Comments may be submitted by email to UCCComments@ali.org

**This draft has been approved for publication by the PEB
subject to revisions based on comments received.
The PEB reserves the right to withdraw this proposed PEB Commentary.**

PREFACE TO PEB COMMENTARY

The Permanent Editorial Board for the Uniform Commercial Code (PEB) acts under the authority of the American Law Institute and the Uniform Law Commission (also known as the National Conference of Commissioners on Uniform State Laws). The PEB has resolved to issue supplemental commentary on the Uniform Commercial Code (UCC) from time to time. The supplemental commentary of the PEB generally will be known as a *PEB Commentary*, to distinguish it from the Official Comments to the UCC. A *PEB Commentary* may be denominated a commentary, a report, or otherwise as determined by the PEB.

The Resolution states that:

The underlying purposes and policies of the *PEB Commentary* are those specified in Section 1-103(a). A *PEB Commentary* should come within one or more of the following specific purposes, which should be made apparent at the beginning of the Commentary: (1) to resolve an ambiguity in the UCC by restating more clearly what the PEB considers to be the legal rule; (2) to state a preferred resolution of an issue on which judicial opinion or scholarly writing diverges; (3) to elaborate on the application of the UCC where the statute and/or the Official Comment leaves doubt as to the inclusion or exclusion of, or application to, particular circumstances or transactions; (4) consistent with Section 1-103(a)(2), to apply the principles of the UCC to new or changed circumstances; (5) to clarify or elaborate upon the operation of the UCC as it relates to other statutes (such as the Bankruptcy Code and federal and state consumer protection statutes) and general principles of law and equity pursuant to Section 1-103(b); or (6) to otherwise improve the operation of the UCC.

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Buyer in Ordinary Course of Business

Issue: A buyer in ordinary course of business of goods takes the goods free of (i) the rights of a person who entrusted the goods to the buyer's seller¹ and (ii) a security interest in the goods created by the buyer's seller.² Under § 1-201(b)(9), a buyer can be a "buyer in ordinary course of business" only if the buyer "takes possession of the goods or has a right to recover the goods from the seller under Article 2."³ For purposes of this definition, does a buyer take "possession"⁴ of the acquired goods that remain with the seller pursuant to an agreement that the seller holds the goods for the buyer's disposition?⁵

¹ UCC § 2-403(2) ("Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business."). For these purposes, "[e]ntrusting" includes any delivery and any acquiescence in retention of possession regardless of any condition expressed between the parties to the delivery or acquiescence and regardless of whether the procurement of the entrusting or the possessor's disposition of the goods have been such as to be larcenous under the criminal law." UCC § 2-403(3). For ease of reading, this Commentary will address the rights of a buyer against a secured party holding a security interest created by the seller. The analysis in this Commentary also applies to the rights of a buyer against a person who entrusts goods to the seller.

² UCC § 9-320(a) ("... a buyer in ordinary course of business ... takes free of a security interest created by the buyer's seller ...").

³ This Commentary does not discuss the application of the second alternative, where the buyer "has a right to recover the goods from the seller under Article 2." See UCC §§ 2-502 & 2-716.

⁴ The body of this Commentary does not discuss several similar circumstances. It does not discuss the situation in which the buyer has completed its purchase of goods from the seller and leaves them in the seller's possession for appropriate business reasons and the seller *later* attempts to create a security interest in those goods. An Article 9 secured party of a seller is not a "buyer" of goods (UCC § 2-103(1)(a)) and thus cannot be a buyer in ordinary course of business. The seller normally can create a security interest only in whatever interest the seller has in the goods left in its possession. See UCC § 9-203(b)(2) and Cmt. 6. The seller in this circumstance generally has no rights with respect to goods that have been sold (other than any limited possessory right) and so cannot create a security interest in the buyer's interest. Nor does this Commentary address (i) the rights of a financing buyer, see T. Jackson & A. Kronman, *A Plea for the Financing Buyer*, 85 *Yale L.J.* 1 (1975), (ii) the possible status of a buyer as a purchase-money secured party, or (iii) the effect of an intercreditor agreement between a secured party of the seller and the buyer. In addition, a secured party might authorize the sale of the goods to the buyer free of the secured party's security interest (as provided in § 9-315(a)). If a buyer buys goods free of a security interest because of an agreement with the secured party or pursuant to the secured party's authorization, the "possession" issue discussed in this Commentary would not be relevant (unless so agreed in the agreement or that authorization). This Commentary also does not discuss whether a buyer might have possession through a field warehouse or other effective segregation of the goods. A bailee holding the goods for the buyer might also provide the buyer with possession.

⁵ Under UCC § 9-320(a), a buyer does not take free of a security interest granted by a person who was not the buyer's seller (such as a previous owner of the goods) and this Commentary does not address that circumstance. See also UCC § 9-320(d) (buyer in ordinary course of business buying oil, gas, or other minerals at the wellhead or minehead or upon extraction takes free of interest arising out of an encumbrance). A buyer of goods acquires all title which the seller had or had power to transfer. UCC § 2-403(1). This is sometimes referred to as the "shelter principle." See, e.g., UCC § 9-207, Cmt. 6. Thus a buyer of goods (whether or not the buyer is a buyer in ordinary course of business) from a person that itself, as a buyer in ordinary course of business of those goods (or otherwise took free of a security interest in the goods), took free of the rights of a secured party holding a security interest (as provided in §§ 2-403(2) and 9-320(a)) also takes free of those interests. A buyer of goods from a person that did *not* acquire the goods as a

Several provisions of the Uniform Commercial Code use the term “possession,” but the Uniform Commercial Code does not define that term. Some courts have held that a buyer may satisfy the “takes possession” element of buyer-in-ordinary-course-of-business status if the seller identifies the goods to the contract of sale and agrees to hold them for the buyer’s disposition without the buyer taking direct possession⁶ of the goods.⁷ As this Commentary explains, that interpretation is not correct.⁸ When a seller identifies goods to a contract of sale and agrees to hold them for the buyer’s disposition and, accordingly, the buyer does not have direct possession of those goods, the buyer does not satisfy the “takes possession” element of buyer-in-ordinary-course-of-business status.⁹

Analysis: Articles 2 and 9 balance the interests of, on one side, a buyer of goods with, on the other side, the interests of a secured party of the seller with an existing security interest in the goods. In implementing this balance, Articles 2 and 9, for the reasons explained below, require that, in order for the buyer to take the goods free of the rights of a secured party holding a security interest in the goods created by the seller, the buyer must, *inter alia*, either have “possession” of the goods or have a right to recover the goods from the seller under Article 2. This rule implements several policy goals:

- Allowing a buyer without direct possession of the goods to take free of a security interest previously granted by the seller in the seller’s goods could result in the seller’s secured party not having notice that goods are owned by the buyer that visually appear to continue to be

buyer in ordinary course of business generally takes the goods subject to a perfected security interest in the goods not created by the seller. *See also* UCC §§ 9-201, 9-315(a)(1), 9-317(b), & 9-320(b). In some circumstances, the seller may enjoy rights with respect to the sold goods that are effective against the buyer. *See, e.g.*, UCC § 2-703. The seller may create a security interest in those rights. Also, in some circumstances, the buyer’s rights might become subject to the rights of creditors of the seller under other law, as noted in UCC § 2-402(2).

⁶ The term “direct possession” is used in this Commentary to refer to physical possession of the goods by a person (which can be through an agent or bailee of the person). For purposes of the definition of “buyer in ordinary course of business”, the criterion that the buyer have possession is not satisfied if the seller is acting as the agent or bailee of the buyer.

⁷ *See, e.g., In re Western Iowa Limestone, Inc.*, 538 F.3d 858 (8th Cir. 2008); other courts have reached a similar conclusion as to the law but have concluded that on the facts the buyer did not obtain “possession.” *See, e.g., In re Sunbelt Grain WKS, LLC*, 427 B.R. 896 (D. Kan. 2010).

⁸ Unlike the situation where there is a security interest in goods and a secured party can file a financing statement to perfect its security interest (in place of or in addition to perfecting the security interest by having possession of the goods), the definition of “buyer in ordinary course of business” does not provide that the filing of a financing statement by a buyer can substitute for the requirement that the buyer take possession of the goods or have the right to recover them from the seller under Article 2.

⁹ As noted above, a buyer can satisfy this aspect of buyer-in-ordinary-course-of-business status either by taking possession of the goods or by having a right to recover the goods from the seller under Article 2. Thus, even though a buyer in the circumstances described in this Commentary has not taken direct possession of the goods (and, thus, does not satisfy the first alternative), if the buyer has the right under Article 2 to recover the goods from the seller, the buyer will satisfy the second alternative for this aspect of buyer-in-ordinary-course-of-business status and, thus, may qualify as a buyer in ordinary course of business.

owned by the seller (the secured party's debtor) because the seller (not the buyer) has direct possession of the goods.

- As noted, a buyer can be a buyer in ordinary course of business without “possession” of the goods only if the buyer has a right to “recover” the goods “from the seller” under Article 2.¹⁰ The phrase “right to recover the goods *from* the seller” (emphasis added) by its terms means that upon exercise of that right, the seller would not have direct possession of the goods. It would be “strikingly anomalous” (in the words of the PEB Report cited below) if, in circumstances in which the buyer did *not* have direct possession of the goods nor have the right to recover the goods from the seller, the buyer nonetheless had a right to the goods against a secured party of the seller. That result would give the buyer greater rights against the seller's secured party than the buyer would have against the seller itself. Requiring that the buyer have direct possession of the goods would give that phrase a meaning comparable to the meaning in the same definition of the right under Article 2 to recover the goods from the seller.¹¹
- It would also be anomalous that a buyer must “receive[] delivery”¹² of goods (among other requirements) to take free of an *unperfected* security interest but would not need direct possession of the goods to take free of a *perfected* security interest.
- Further, Article 1's reference to “possession” in the definition of “buyer in ordinary course of business” as requiring direct possession would recognize a buyer rights against a seller's secured party that correspond to the buyer's reasonable expectation interest in its right under Article 2 to recover the goods from the seller itself (when the buyer does not already have direct possession). If the buyer does not have a right to recover the goods from the seller under Article 2, then, if the seller does not deliver the goods to the buyer, the buyer's only reasonable expectation is of a damages remedy and not an expectation of being able to enforce the seller's obligation to deliver the goods. Thus preserving the rights of the secured party when the buyer does not have direct possession would not interfere with the buyer's expectations as to recovery of the goods from the buyer's seller.¹³

Conclusion: Accordingly, when a seller identifies goods to a contract of sale and agrees to hold them for the buyer's disposition, but the buyer has not taken actual possession, the buyer does not satisfy the “takes possession” element of buyer-in-ordinary-course-of-business status. Comment 9 to UCC § 1-201 is hereby amended to add at the end of that Comment the following sentences:

¹⁰ As noted above, a buyer has a right to possession of goods against the seller that the buyer has bought only in very limited circumstances.

¹¹ See PEB Study Group Uniform Commercial Code Article 9, Report December 1, 1992, pages 190 – 192.

¹² A buyer “receives” delivery of goods when the buyer “tak[es] physical possession” of the goods. UCC § 2-103(1)(c).

¹³ See, Frisch, Buyer's Status Under the UCC: A Suggested Temporal Definition, 72 *Iowa Law Rev.* 531 (1987) (cited in the PEB Report as being in “accord” with the proposed rule in Article 9; in the absence of “physical” possession, a person would not be a “buyer” for purposes of the meaning of “buyer in ordinary course” of goods unless the person had a right to possession of the goods under Article 2).

“A buyer that does not have the right to recover the goods under Article 2 (sections 2-502 and 2-716) does not qualify as a buyer in ordinary course of business unless the buyer has possession of the goods. A buyer does not have possession of goods for this purpose if the goods remain in the possession of the seller pursuant to an agreement that the seller holds the goods for the buyer’s disposition.”