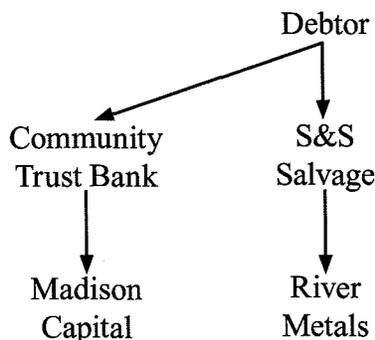


CAVEAT EMPTOR: BUYING IN ORDINARY COURSE OF BUSINESS DOES NOT NECESSARILY MEAN YOU GET UNENCUMBERED GOODS

Buyers who purchase goods from a seller that deals in goods of that kind – at least those who pay the purchase price in full and receive delivery – expect to get good title to the goods they have purchased. A recent federal court decision shows that this expectation is not always justified and the old maxim still applies: let the buyer beware. *See Madison Capital Co., LLC v. S & S Salvage, LLC*, 2011 WL 195634 (W.D. Ky. 2011)

The facts. In 2005, Community Trust Bank made a \$1.5 million loan to the debtor, a mining company, secured by equipment. Community Trust perfected its security interest. A few months later, and without Community Trust's permission, the debtor sold 85 mining shields – mechanized roof supports used in an underground mining system – as scrap metal to S & S Salvage, which in turn sold the mining shields to River Metals Recycling. After Madison Capital acquired Community Trust's position as secured creditor, a dispute arose between Madison Trust and River Metals as to who had the superior interest to the mining shields.



The court's analysis. There was some dispute as to whether S & S Salvage had purchased the mining shields from the debtor or merely acted as the debtor's agent in conducting the sale to River Metals. However, the court

ruled that the nature of the debtor's transaction with S & S Salvage was immaterial.

If the debtor had actually sold the mining shields to S & S Salvage, then the sale was not in the ordinary course of business because the debtor was in the business of mining, not the business of selling mining shields. As a result, Community Trust's security interest survived the sale. *See* UCC § 9-315(a)(1). Moreover, although the court did not say so, that security interest remained perfected (assuming S & S was located in the same jurisdiction as the debtor). *See* UCC § 9-507(a). *Cf.* UCC § 9-316(a)(3). Then, when River Metals purchased the mining shields from S & S Salvage, River Metals did not take free of Community Trust's security interest because the security interest was not created by its seller (S & S Salvage); it was created by the debtor further up the chain of title. *See* UCC § 9-320(a).

Actually, what the court said was that River Metals "would not qualify as a buyer in ordinary course of business because it would have bought from a seller who did not create the security interest." This is not precisely true. River Metals would have met the definition of a buyer in ordinary course of business, *see* UCC § 1-201(b)(9), but for the reason expressed by the court would not have been entitled to take free of Community Trust's security interest, *see* UCC § 9-320(a). So, the court's slight misstatement was of no consequence.

The court's analysis of the alternative possibility – S & S Salvage acting as the debtor's agent – is more interesting. River Metals argued that because S & S Salvage was in the business of selling scrap metal, River Metals was a buyer in ordinary course of business and should be entitled to the protections of UCC § 9-320(a). In other words, the BIOCOP protections should be examined from the perspective of the buyer. The court disagreed. Noting that the ordinary course of business exception is designed to protect buyers in a very limited set of circumstances – where a lender takes a security interest in inventory and leaves the goods in the hands of a debtor who is engaged in the business of selling goods of that kind – the court ruled that the protections for buyers should be viewed from the secured party's perspective. In essence, a lender gives its debtor apparent authority to sell inventory free and clear, but a lender gives no such apparent authority to sell non-inventory goods free of the security interest. The court noted that this may seem harsh to the buyer, but the buyer has a claim for breach of the warranty of title against the seller. *See* UCC § 2-312.

Concluding thoughts. The court's decision is unquestionably correct, and serves as a cautionary tale for buyers in ordinary course of business. The decision should not be taken as a complete victory for secured parties, though. Creditors with a security interest in a seller's assets may be protected. But creditors with a security interest in the buyer's assets must take heed. If the buyer's interest is subordinate to an existing security interest, so too will be

the interest of the buyer's secured party. *See* UCC § 9-625. So, make sure the debtor conducts its business in a way that will enable it to acquire goods free and clear.

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