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One commentator, however, has questioned whether proposed section 1301(b)(4) eliminates more diversity than it should. For example, in a situation where the beneficiaries are all nonresidents and are prosecuting the action, but the decedent was a resident, the proposed statute would deny the nonresidents federal jurisdiction.⁴³

Diversity jurisdiction is meant to protect the out-of-state citizen from local bias.⁴⁴ However, this bias is still present when an action is prosecuted by a resident personal representative. The parties that will benefit from a recovery cannot be hidden from the court and jury. Furthermore, the representative's duties and responsibilities are only meant to insure that the administration of an estate is competently and diligently completed. Such duties by themselves do not give the administrator any real economic interest other than that which arises from his legal relationship with the estate. This legal relationship has led to the rule that only the personal representative has capacity to sue or be sued. This determination, however, should not be controlling as to the real party in interest.

Since the duties of the administrator do not make him a real party, only those persons who have a direct, personal interest in the outcome should be considered the parties with the real interest. As was held in *Miller*, the citizenship of the beneficiaries, rather than that of the administrator or of the decedent, should control diversity. Such a determination insures that federal jurisdiction will be invoked only when necessary to protect the party whose personal interest in the suit might be prejudiced by the presence of local bias.

L. JAMES BLACKWOOD

Uniform Commercial Code—The Standard of Good Faith for Merchant Buyers Under Section 9-307(1)

A new aspect to the continuing controversy over applying sections of article 2 (Sales) of the Uniform Commercial Code to article 9 (Secured Transactions) has recently been examined by the Delaware Supreme Court in the case of *Sherrock v. Commercial Credit Corp.*¹ The

⁴³Kennedy, *supra* note 29, at 720.

⁴⁴This has been the historical view for why diversity jurisdiction originated. *E.g.*, *Bank of the United States v. Deveaux*, 9 U.S. (5 Cranch) 61, 67 (1809). *See generally* Frank, *Historical Bases of the Federal Judicial System*, 13 LAW & CONTEMP. PROB. 3 (1948). *But see* Friendly, *The Historic Basis of Diversity Jurisdiction*, 41 HARV. L. REV. 483 (1928).

issue faced by the court was whether or not to apply the article 2 definition of good faith for a merchant buyer to an article 9 transaction. The court decided that there was no basis for a "crossover" between the articles. This note will examine the effects of applying the general definition of good faith found in article 1 to merchant buyers involved in article 9 transactions and will look at the significance of the above decision on the continuing controversy over applying article 2 sections to article 9 transactions.²

The *Sherrock* case involved an action for wrongful seizure of two automobiles by a secured creditor. Plaintiffs, Robert and Edward Sherrock, were partners in an automobile dealership. They purchased two cars from a second dealer, Dover Motors, who sold the cars in violation of a security agreement it had with defendant, Commercial Credit Corporation. Commercial Credit discovered that Dover Motors was selling numerous cars "out of trust"³ and repossessed all of Dover's inventory, including the two cars sold to the Sherrock brothers. Thereafter the Sherrocks brought an action for wrongful seizure of the two cars by Commercial Credit. The lower court found that the transaction was governed by section 9-307(1) of the Uniform Commercial Code,⁴ which protects a "buyer in the ordinary course of business" by allowing the buyer 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.⁵ A "buyer in the ordinary course of business" is defined as a person who "in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind"⁶

In interpreting this definition, the lower court found that the Sherrocks had paid value for the automobiles and were without actual knowledge that the sale to them was in violation of any security agreement. The only question left was whether they exercised good faith in

²For a discussion on the controversy dealing with the application of article 2 sections to article 9 transactions see Comment, *Unconscionable Security Agreements: Application of Section 2-320 to Article 9*, 11 B.C. IND. & COM. L. REV. 128 (1969).

³Selling an item "out of trust" means that a seller who is under a security agreement has failed to pay the inventory financier with the proceeds of the sale to the buyer.

⁴*Sherrock v. Commercial Credit Corp.*, 277 A.2d 708 (Del. Super. Ct. 1971) (opinion giving judgment for defendant).

⁵UNIFORM COMMERCIAL CODE § 9-307(1), DEL. CODE ANN. tit. 5A, § 9-307(1) (Spec. UCC Pamphlet 1970) [hereinafter cited as UCC].

⁶UCC § 1-201(9).

the transaction. Since the Sherrocks were merchant buyers, the lower court applied the sales definition of good faith, which not only includes the requirement of "honesty in fact in the conduct or transaction concerned"⁷ found in article 1, but also includes "the observance of reasonable commercial standards of fair dealing in the trade."⁸ The lower court reasoned that "[i]f the standard of good faith is to have meaning in Article 9 with regard to merchants, it should not vary with that applied to merchants under Article 2."⁹ Expert testimony at the trial indicated that payment by a dealer for new cars before actual receipt of the cars was both an unusual and unreasonable procedure in the automobile industry even where the dealers had dealt with each other before, but that the practice in the instant case was even more unusual and unreasonable because the dealers involved had not dealt with each other in the past.¹⁰ Also, the fact that the Sherrocks paid for the cars without a firm delivery date was said to be unreasonable conduct in the industry.¹¹ In light of the Sherrocks' commercially unreasonable conduct, the trial court found for Commercial Credit.¹²

The Supreme Court of Delaware reversed,¹³ rejecting the "reasonable commercial standard of fair dealing" test of good faith under article 2 in favor of the "honesty in fact" test found in article 1. The court reasoned that there was no justification for a "crossover" between article 2 and article 9 because there was no reference in section 9-307(1) to article 2 for the definition of good faith.¹⁴ In fact, the definitional section of article 9 refers expressly to article 1 for general definitions applicable throughout the article.¹⁵ The court also noted that there was a direct reference by section 9-307(1) to article 1 for the definition of "buyer in the ordinary course of business." In addition, the "Definitional Cross References" in the Delaware Study Comment referred to article 1 for definitions not found in section 9-307(1) and contained no similar reference to article 2.¹⁶

⁷UCC § 1-201(19).

⁸UCC § 2-103(1)(b).

⁹*Sherrock v. Commercial Credit Corp.*, 269 A.2d 407, 409 (Del. Super. Ct. 1970) (opinion denying plaintiff's motion for summary judgment).

¹⁰277 A.2d at 712.

¹¹*Id.* at 712-13.

¹²*Id.* at 713.

¹³290 A.2d 648 (Del. 1972).

¹⁴*Id.* at 651.

¹⁵UCC § 9-105(4).

¹⁶UCC § 9-307(1), DEL. CODE ANN. tit. 5A, § 9-307(1) (Spec. UCC Pamphlet 1970), Delaware Study Comment.

The court noted that there was an express limitation in article 2 of the definitions found therein including the sales definition of good faith.¹⁷ Since section 2-102 delineates the scope of the sales article, it is assumed that this is the express limitation to which the court was referring. Section 2-102 makes the sales article applicable to "transactions in goods" and excludes any transactions which "although in the form of an unconditional contract to sell or present sale is intended to operate only as a security transaction" The court also referred to the official Code comment explaining the definition of good faith in article 1, which indicated that the sales definition of good faith applies only to article 2.¹⁸ The comment provides that whenever "good faith" is used in the Code, it means at least "honesty in fact," but in certain articles, such as the article on sales, additional standards are required.¹⁹

The dissent in the *Sherrock* case avoided the issue of whether the sales definition of good faith should be applied to an article 9 transaction by arguing that the Sherrocks did not come within the definition of "buyer in the ordinary course of business" because they were merchant buyers. According to the dissent, a buyer in the ordinary course of business under section 9-307(1) "must be a purchaser not familiar with usages of automobile dealers dealing with each other."²⁰ The Sherrocks, as merchant buyers, could not qualify under section 9-307(1); thus, their conduct should be governed by the standards for merchant buyers set out in section 2-103(1)(b).²¹ Analyzing the case as one between two innocent parties, the dissent found Commercial to be the more innocent party due to the unreasonable conduct of Sherrocks. Consequently, the Sherrocks should bear the loss.²²

The *Sherrock* court cited a 1970 Texas case, *Associates Discount Corp. v. Rattan Chevrolet, Inc.*,²³ as authority for its decision.²⁴ This case had a fact pattern similar to the *Sherrock* case in that an automobile dealer purchased some cars from a second dealer who was under a security agreement with a finance corporation and was selling the cars "out of trust." The Texas Supreme Court held that an automobile dealer who was a merchant buyer may be a "buyer in the ordinary

¹⁷290 A.2d at 651.

¹⁸290 A.2d at 651 n.2, citing UCC § 1-201(19), Comment 19.

¹⁹UCC § 1-201(19), Comment 19.

²⁰290 A.2d at 652.

²¹*Id.*

²²*Id.* at 651-52.

²³462 S.W.2d 546 (Tex. 1970).

²⁴290 A.2d at 651.

course of business" under section 9-307(1). However, the court failed to answer the question of how a merchant buyer becomes a buyer in the ordinary course and, therefore, did not even reach the issue of what standard of good faith should be applied.²⁵

In two other cases, *Hemstead Bank v. Andy's Car Rental System, Inc.*,²⁶ and *Bank of Utica v. Castle Ford, Inc.*,²⁷ it was held that a merchant buyer could qualify as a buyer in the ordinary course under section 9-307(1) and that the sales definition of good faith was applicable. In *Hemstead*, an automobile leasing and rental company sold thirteen cars to the defendant, an automobile wholesaler, in violation of a security financing arrangement it had with the plaintiff bank. In discussing the standard of good faith for a buyer in the ordinary course under section 9-307(1), the court stated that the sales definition of good faith was controlling.²⁸ In *Bank of Utica*, a defendant automobile dealer purchased a car from a second dealer who sold the car in violation of a security financing agreement it had with the plaintiff bank. Again, in arriving at the decision, the court applied the standard of good faith found in section 2-103(1)(b) of the sales article.²⁹ In neither of the above cases, however, did the court examine whether or not the Code could be interpreted to allow "cross-over" between article 2 and article 9; instead, each applied the sales definition of good faith as a matter of course.

In determining whether the article 2 definition of good faith should be applied to article 9, the court in *Sherrock* used an approach which emphasizes strict interpretation of the Code. Since the court did not find any express references in the definitional cross references or the comments to section 9-307(1) and because the language in section 2-102 seems to limit sales definitions to article 2, the court could not find any justification for "crossover." To fully understand the significance of the court's approach, it may be helpful to examine the method of interpretation which should be applied to the Code. The Code is said to be a "true" code and therefore differs significantly from an ordinary statute

²⁵Note, *Automobiles—Certificates of Title—Status of Vendee Who Purchases Used Car Without a Certificate of Title*, 2 TEX. TECH L. REV. 288, 289 & n.8 (1970). See generally Note, *The Uniform Commercial Code and Texas Certificate of Title Act Are in Pari Materia*, 25 SW. L.J. 499 (1971).

²⁶35 App. Div. 2d 35, 312 N.Y.S.2d 317 (1970).

²⁷36 App. Div. 2d 6, 317 N.Y.S.2d 542 (1971). This case was cited by the court in the *Sherrock* decision. 290 A.2d at 651.

²⁸35 App. Div. 2d at ____, 312 N.Y.S.2d at 320.

²⁹36 App. Div. 2d at ____, 317 N.Y.S.2d at 545.

in terms of method of interpretation.³⁰ Professor Hawkland, a widely respected scholar in the area of commercial law, has stated:

A "code" is a pre-emptive, systematic, and comprehensive enactment of a whole field of law. It is pre-emptive in that it displaces all other law in its subject area save only that which the code excepts. It is systematic in that all of its parts, arranged in an orderly fashion and stated with a consistent terminology, form an interlocking, integrated body, revealing its own plan and containing its own methodology. It is comprehensive in that it is sufficiently inclusive and independent to enable it to be administered in accordance with its own basic policies.

A mere statute, on the other hand, is neither pre-emptive, systematic, nor comprehensive, and therefore, its methodology is different from that of a code.³¹

If a case does not fall within precise statutory language, the court may forget a statute and reach its decision by principles of common law. Under a code, however, if a gap appears, it is the court's duty to find by extrapolation and analogy a solution consistent with the policies of the code.³²

The Code follows Professor Hawkland's definition in that it is logically divided into interlocking articles, each dealing with one major subdivision of the entire subject. These articles are co-ordinated with one another by the use of cross references and definitional cross references which are contained in the comments to the sections.³³ The official comments to each section are persuasive authority as to the meaning of the Code, but they are not part of the Code in the sense that they do not become substantive law upon adoption of the Code by the state.³⁴ Therefore, if a conflict arises between the provisions of the Code and the comments, the provisions control.³⁵ The fact that there is no direct reference from one article or section to another as in the *Sherrock* case, does not mean the articles are completely independent of each other. They are only relatively independent of each other because if they were absolutely independent, "the code would cease to be a code and would be a digest in the Anglo-American common law sense."³⁶

³⁰Hawkland, *Uniform Commercial "Code" Methodology*, 1962 U. ILL. L.F. 291 (1962).

³¹*Id.* at 292.

³²Gilmore, *Legal Realism: Its Cause and Cure*, 70 YALE L.J. 1037, 1043 (1961).

³³Hawkland, *supra* note 30, at 301.

³⁴1 ANDERSON ON THE UNIFORM COMMERCIAL CODE § 1-102:11 (2d ed. 1970).

³⁵*Id.*

³⁶Franklin, *On the Legal Method of the Uniform Commercial Code*, 16 LAW & CONTEMP. PROB. 330, 337 (1951).

The important factor in dealing with problems which arise under the Code is that the Code does provide its own method of interpretation. This methodology provides that when a problem arises, the courts should look to the applicable codified principle and its underlying purposes and policies to reach a solution.³⁷ If the Code falls short of deciding a controversy, the Code may "itself be developed or 'applied to promote its underlying reasons, purposes, and policies.'" ³⁸ As noted by Professor Hawkland, the methodology used to solve unforeseen problems which arise under the Code is primarily by analogy.³⁹ This approach has been used by some courts to apply certain provisions of article 2 to other types of transactions,⁴⁰ including secured transactions.⁴¹ In particular, section 2-302, which deals with unconscionable contracts, has been applied to secured transaction agreements⁴² regardless of the fact that a strict interpretation of the language of article 2 would limit the unconscionable contract doctrine to article 2. The approach used in these cases, however, was in accordance with Code methodology as the problem was solved by extrapolating and analogizing to find a solution consistent with the underlying policies and purposes of the Code. The policy for allowing a court to refuse to enforce an unconscionable contract was just as applicable to security contracts as to sales contracts, and thus, these courts refused to strictly construe section 2-102 which limits the scope of article 2.⁴³

The issue raised in the *Sherrock* case cannot be solved by a strict, "statutory-type" construction of the Code. Code methodology requires that the court look to the underlying policies and purposes of the codified principle and, if necessary, to find by extrapolation and analogy a solution consistent with these policies. One of the basic objectives of the Code is to promote and facilitate the free flow of commerce in goods.⁴⁴ This policy is preserved in section 9-307(1) by protecting a security

³⁷King, *The New Conceptualism of the Uniform Commercial Code*, 10 ST. LOUIS U.L.J. 30, 36 (1965).

³⁸Franklin, *supra* note 36, at 333.

³⁹Hawkland, *supra* note 30, at 314.

⁴⁰*E.g.*, *Hertz Commercial Leasing Corp. v. Transportation Credit Clearing House*, 59 Misc.2d 226, 298 N.Y.S.2d 392 (N.Y. City Ct. 1969).

⁴¹*See Unico v. Owen*, 50 N.J. 101, 232 A.2d 405 (1967); *Urdang v. Muse*, 114 N.J. Super. 372, 276 A.2d 397 (1971); *Dean v. Universal C.I.T. Credit Corp.*, 114 N.J. Super. 132, 275 A.2d 154 (1971). *Contra*, *Hernandez v. S.I.C. Fin. Co.*, 79 N.M. 673, 448 P.2d 474 (1968).

⁴²Cases cited note 41 *supra*; Comment, 11 B.C. IND. & COM. L. REV., *supra* note 2, at 136.

⁴³*See* cases cited note 41 *supra*.

⁴⁴Note, *Section 9-307(1) of the U.C.C.: The Scope of the Protection Given a Buyer in Ordinary Course of Business*. 9 B.C. IND. & COM. L. REV. 985, 990 (1968).

interest created under article 9 "as long as it does not interfere with the normal flow of commerce."⁴⁵ Similarly, this policy objective is preserved in the article 2 sections which deal with the entrustment of goods. The entrusting provisions provide that "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."⁴⁶ Under the Code it is immaterial why possession was left with the merchant seller as long as there is a delivery and an acquiescence in his retention of possession.⁴⁷ Since the entrusting provisions of article 2 and section 9-307(1) are designed to operate concurrently as a "single principle protecting persons who buy in ordinary course out of inventory,"⁴⁸ the consistency of the two sections is destroyed when the *Sherrock* decision is applied. Both sections refer to article 1 for the definition of "buyer in the ordinary course of business"; however, in a *Sherrock* situation a merchant buyer is only held to the standard of "honesty in fact," whereas a merchant buyer under the entrusting provisions is held to the additional article 2 standard of "reasonable commercial standard of fair dealing." The result is that a person who entrusts goods to a dealer is better protected than a secured creditor who has a written security agreement with the same dealer. Because the policy underlying both sections is the same, the fact that the drafters of the Code imposed a commercial reasonableness standard on a merchant buyer dealing with a seller who is under an entrustment arrangement would indicate that the same policy should apply to a seller who is under a security agreement. Surely the drafters of the Code did not intend that the mere entrusting of goods would be provided more protection than a written security agreement. By strictly construing the language of the Code without examining the underlying policies of the section, the court in *Sherrock* fails to follow the Code method of interpretation which requires that the Code "be liberally construed and applied to promote its underlying purposes and policies."⁴⁹

The *Sherrock* court failed to examine the effect its decision will have on a secured creditor's reliance on section 9-306(2), which provides that a security interest continues in collateral notwithstanding an unau-

⁴⁵Lee, *Perfection & Priorities Under the Uniform Commercial Code*, 17 Wyo. L.J. 1, 34 (1962).

⁴⁶UCC § 2-403(2).

⁴⁷UCC § 2-403(3).

⁴⁸UCC § 2-403, Comment 2.

⁴⁹UCC § 1-102(1).

thorized sale by the debtor and continues in any identifiable proceeds including collections received by the debtor. Naturally, a secured creditor would rely on this section since it provides him with the only means of recovering some of his losses if the unauthorized sale is made to a "buyer in the ordinary course of business." If a merchant buyer's conduct is such that the secured creditor is deceived into thinking there has been no merchandise sold "out of trust," by the time the creditor discovers the unauthorized sales, the debtor will have disposed of the proceeds. The court lightly touched on the area, stating that "[t]here was no evidence that Commercial relied to its detriment upon the retention of possession by Dover of the automobiles purchased by the Sherrocks."⁵⁰ However, as pointed out by the chief justice in his dissenting opinion, "Commercial Credit was in fact misled by this action It was entitled to rely on the presence of those cars in the showroom and to assume that they were still subject to their floor plan lending. This being so it made no effort to reach the proceeds received by Dover Motors from Sherrock."⁵¹ Thus, by allowing a merchant buyer to act in a commercially unreasonable manner and thereby mislead a secured creditor, the *Sherrock* decision may be "devastating because although the floor plan lender may be willing and able to absorb the loss when a 'retail' buyer in the ordinary course of business buys one car and cuts off the security interest, the loss ceases to be bearable when the buyer buys a number of cars on the 'wholesale' level."⁵²

With the article 1 definition of good faith applied to merchant buyers, the *Sherrock* decision significantly reduces the obligation under which these merchants must conduct themselves in transactions which involve a secured transaction. The "honesty in fact" definition of good faith has historically been construed as applying only to the actor's subjective state of mind.⁵³ This standard has been criticized due to the inherent difficulties in determining that a person subjectively believes his conduct is in bad faith since it is a person's natural tendency to rationalize his conduct in a light most favorable to himself.⁵⁴ Professor Farn-

⁵⁰290 A.2d at 649.

⁵¹*Id.* at 652.

⁵²Murray, *Security Interests in Inventory Priorities and Problems*, 25 U. MIAMI L. REV. 634, 654 (1971). Although Murray discusses the lower court's decision in the *Sherrock* case (269 A.2d 407), he indicates that any time a merchant buyer qualifies as a buyer in due course, the result may be "devastating" on a secured creditor.

⁵³See Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666, 671 (1963).

⁵⁴Aronstein, *Good Faith Performance of Security Agreement: The Liability of Corporate*

sworth, a well known authority in the area of commercial law, suggests that "good faith performance [as opposed to good faith purchase] properly requires some objective standard tied to commercial reasonableness."⁵⁵ The sales definition of good faith has such an objective standard the merchant must observe "reasonable commercial standards of fair dealing in the trade." By rejecting this objective standard of good faith, the *Sherrock* decision significantly reduces the merchant buyer's duty where he is involved in transactions in which the inventory is under a security agreement.

Since one of the main objectives of the Code is uniformity throughout the various jurisdictions,⁵⁶ the weight given the *Sherrock* decision in other jurisdictions may result in a harnessing effect on other "crossover" movements since these movements are based on a liberal construction of the Code to promote its underlying policies and purposes.⁵⁷ Although the doctrine of *stare decisis* is deeply engrained in American jurisprudence, under Code methodology its application should be less vigorous here, and the courts should more readily return to the statutory text for their answers.⁵⁸ As stated by Professor Hawkland, "[c]ases construing the Code should be given high credit, but it should not be forgotten that the Code itself is its own best evidence of what it means. If cases construing it are determined to be 'wrong,' courts should be free to say so and to effectuate prompt rectification by going to the Code itself . . ."⁵⁹ Professor Hawkland goes on to point out, however, that if a decision is "right," as distinguished from the "best," it should be followed.⁶⁰

Managers, 120 U. PA. L. REV. 1, 31-33 (1971); see Farnsworth, *supra* note 53. See also Eisenberg, *Good Faith Under the Uniform Commercial Code—A New Look at an Old Problem*, 54 MARQ. L. REV. 1 (1971).

⁵⁵Farnsworth, *supra* note 53, at 671. According to Farnsworth, there are two senses in which the Code speaks of good faith—good faith purchase which deals only with the actor's state of mind and good faith performance which goes into the fairness or reasonableness of the actor's performance. The issue of good faith raised in the *Sherrock* case deals with its use in the latter sense.

⁵⁶UCC § 1-102(2)(c).

⁵⁷See Comment, 11 B.C. IND. & COM. L. REV., *supra* note 2. In justifying "crossover" from article 2 to article 9 for the unconscionable contracts section (§ 2-302) which allows a court to deny enforcement of a contract if found to be unconscionable at the time it was made, the argument advocating liberal interpretation of the limiting section of article 2 (§ 2-102) is heavily relied upon. Since the language of § 2-102 expressly applies to "transactions in goods" and the word "transactions" is not defined in the code, it should be interpreted by the court as sufficiently broad enough to extend coverage of article 2 beyond the mere sale of goods or contract for the sale of goods to other types of transactions including secured transactions. *Id.* at 131.

⁵⁸Hawkland, *supra* note 30, at 319.

⁵⁹*Id.*

⁶⁰*Id.*

If the *Sherrock* decision is determined to be "right," another possible solution to the problem is to revise the good faith definition in article 1 to include an objective standard of commercial reasonableness for merchants. A standard could be drafted to include the "observance by a person of the reasonable commercial standards of any business or trade in which he is engaged."⁶¹ Such a standard was included in the 1949 draft of the Code, but was deleted because the language was said to be ambiguous and might be read to freeze commercial practices.⁶² This rationale has long since become obsolete, and today's sophisticated and highly technical commercial world requires that an objective standard of good faith be applied to merchant buyers in all transactions, especially those involving secured creditors.

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⁶¹Braucher, *The Legislative History of the Uniform Commercial Code*, 58 COLUM. L. REV. 798, 812 (1958).

⁶²*Id.*