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Uniform Commercial Code -- Sections 1-201 (19), 2-103(1)(b), 9-307(1) -- Good Faith Requirement for Buyer in Ordinary Course -- Sherrock Brother v. Commercial Credit Corporation

Leonard S. Volin

CONCLUSION

In *Lucas v. Wisconsin Electric Power Company*, the facts that the state of Wisconsin gave the Electric Company a great deal of assistance and support; that its motive in doing so was to enable the Company to perform what may be classified as a public function; that the Company did in fact perform a function vital to the community; that the state exercised great control over the Company's activities; and that the state specifically permitted the Company to terminate electric service for nonpayment of a disputed bill, when taken together, show "significant involvement" of the state in the affairs of the Company, make the state a "joint participant" in the Company's termination of the plaintiff's electric service, and thereby turn the Company's "private" action in discontinuing service into state action. In many states other than Wisconsin, these same factors can be found in the relationship between the state and its utilities. Accordingly, it is submitted that whenever a problem arises in any of these jurisdictions concerning termination of a vital service by a utility, the utility's action should be considered state action for Fourteenth Amendment purposes. Furthermore, since a service such as electricity is a vital service in all parts of the country, in all states due process should require that a prior impartial hearing be given before service is actually discontinued.

WILLIAM J. TUCKER

Uniform Commercial Code—Sections 1-201(19), 2-103(1)(b), 9-307(1)—Good Faith Requirement for Buyer in Ordinary Course—*Sherrock Brothers v. Commercial Credit Corporation.*[1]—Plaintiff Sherrock Brothers, an automobile dealer, purchased two new automobiles from Dover Motors, another dealer, which had a floor plan financing agreement for its vehicles with defendant, Commercial Credit Corporation. Pursuant to the sales agreement, plaintiff made payment to Dover but allowed Dover to retain possession of the two automobiles for several days in order that Dover might use these vehicles for display purposes. Dover agreed that it would then deliver the vehicles to Sherrock Brothers. Before Dover delivered the cars, however, Commercial discovered that Dover had been selling cars "out of trust."[2] Therefore, citing a provision in its security agreement with Dover

its members, has no interest in the outcome of the dispute, and hence could be relied on to conduct a fair hearing and render an impartial decision.

The question of precisely what elements of a fair hearing are necessary in order to satisfy due process requirements is open to some dispute. However, a consideration of these elements is beyond the scope of the present article.

[1] 290 A.2d 648 (Del. 1972).

[2] The term "out of trust" refers to the practice whereby a debtor under a secured transaction sells the goods subject to the security agreement to a third party and does not satisfy his financial obligation to his creditor. Sherrock Brothers v. Commercial Credit Corp., 277 A.2d 708, 709 (Del. Super. Ct. 1971).

which prohibited the car dealer from selling any cars without its permission, the defendant repossessed Dover's entire stock of automobile inventory, including the two cars that Sherrock Brothers had purchased. Consequently plaintiff instituted an action for the wrongful possession of the two automobiles by Commercial, the secured party.

At trial, the Delaware Superior Court held that Sherrock Brothers was not entitled to the two vehicles since it did not fall under the protective aegis of Section 9-307(1) of the Uniform Commercial Code.[3] Under this section, if a party is able to establish himself as a "buyer in ordinary course of business," he is entitled to take the goods free of any security interest created in them by his seller, and the secured party must look to his debtor for his remedy. In order to qualify as a "buyer in ordinary course,"[4] the purchaser must act in "good faith." The trial court reasoned that because the plaintiff was a merchant-buyer, it must satisfy not only the "good faith" requirement of Article 1 but also the more stringent Article 2 "good faith" requirement of

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[3] Id. at 713. U.C.C. § 9-307(1) provides:

> A buyer in ordinary course of business (subsection (9) of section 1-201) other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence.

All cites to the Uniform Commercial Code will be to the 1962 Official Text, hereinafter cited as U.C.C., unless otherwise indicated. (Delaware has not yet officially adopted the 1972 Official Text.) For the purposes of this note, Delaware's adoption of the Code accurately follows the official text. The term "buyer in ordinary course of business" is defined in U.C.C. § 1-201(9) as follows:

> "Buyer in ordinary course of business" means 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 . . . .

These two sections taken together are interpreted in the Official Comments to § 9-307 as follows:

> The buyer takes free (of a security interest) if he merely knows that there is a security interest which covers the goods, but takes subject if he knows, in addition, that the sale is in violation of some term in the security agreement . . . .

U.C.C. § 9-307, Comment 2.

Section 9-307 is intended to facilitate the free movement of goods by establishing a rule of priority between a secured party and a "buyer in ordinary course of business" when a conflict arises after an unauthorized sale of secured collateral by a debtor. Note, 9 B.C. Ind. & Com. L. Rev. 985, 990-91 (1968). It is also "designed to prevent the inventory lender from . . . claiming on the one hand, that his security interest has priority over the good faith buyer, and, on the other hand, allowing the financier to clothe the dealer with apparent authority to sell without obvious restraint." Murray, Security Interests in Inventory Priorities and Problems, 25 U. Miami L. Rev. 634, 651 (1971).

Typically, in floor plan financing situations, the secured party expects his debtor to sell the goods before the debt is paid since this method is the only way that the debtor can raise the cash necessary to pay the debt. Thus, a buyer in ordinary course can purchase goods which are the collateral to a security agreement and still maintain a position of priority vis-à-vis the secured party.

[4] U.C.C. § 1-201(9), quoted in pertinent part in note 3 supra.

observance of "reasonable commercial standards"[5] in order to qualify as a "buyer in the ordinary course of business."[6] In short, the plaintiff's status as a merchant was grounds for applying the latter standard. The trial court found that Sherrock Brothers had not observed "reasonable commercial standards," and that therefore it had not satisfied the Article 2 test of "good faith."[7] Accordingly, the court held, Sherrock Brothers did not qualify as a buyer in the ordinary course and therefore could not be protected by section 9-307(1).

On appeal, the Delaware Supreme Court considered the issue of whether Sherrock Brothers, a merchant-buyer, had to fulfill the "good faith" requirements of both Articles 1 and 2 in order to become a buyer in ordinary course and thus qualify for protection under section 9-307(1). The court, noting that the litigation was between a buyer and a secured creditor rather than a buyer and a seller, HELD: in order to qualify for the protection offered by section 9-307(1) to a "buyer in ordinary course of business," a merchant who purchases from a debtor who is a party to a secured transaction must satisfy only the section 1-201(19) requirement of "honesty in fact."[8] The court reasoned that the more rigorous Article 2 definition of "good faith" is limited to the sales transactions that are the subject of that Article, and that the relationship between the plaintiff and the defendant depended not upon a sale between them but rather upon what was in essence an Article 9 secured transaction; hence plaintiff's "good faith" must be tested only by the Article 1 definition of "good faith," which is generally applicable to *all* sections of the Code.

This decision represents an attempt by the highest court of Delaware to correct the apparent lack of guidelines in the Code regarding the "good faith" requirements that a merchant seeking classification as a buyer in ordinary course must satisfy in a controversy involving both a sale and a secured transaction.[9] This note will examine the *Sherrock* holding and rationale. It will then consider the pre-Code development of two definitions of "good faith" in commercial transactions—subjective and objective—and the incorporation of these definitions into the Code. The history of Section 1-102 of the Code will then be considered in order to determine the degree of "flexibility"

[5] The Article 1 definition of "good faith" provides: "Good faith means honesty in fact in the conduct or transaction concerned." U.C.C. § 1-201(19). The Article 2 definition provides: "(1) In this Article unless the context otherwise requires . . . (b) 'Good faith' in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." U.C.C. § 2-103(1)(b).

[6] 277 A.2d at 710-11. It is settled that a merchant-buyer may qualify as a "buyer in the ordinary course of business." See Bank of Utica v. Castle Ford, Inc., 36 App. Div. 2d 6, 9, 317 N.Y.S.2d 542, 545 (1971); Associates Discount Corp. v. Rattan Chevrolet, Inc., 462 S.W.2d 546, 549 (Tex. 1970).

[7] 277 A.2d at 713.

[8] 290 A.2d at 650-51.

[9] Eisenberg, Good Faith Under the Uniform Commercial Code—A New Look at an Old Problem, 54 Marq. L. Rev. 1, 3-4 (1971).

afforded to expressly limited definitions in the Code. It will be submitted that, while the *Sherrock* holding is a proper interpretation of the Uniform Commercial Code, that case should not be followed in all cases involving secured transactions. Rather, it will be submitted, section 1-102 permits a limited degree of flexibility in applying the Article 2 requirement: Specifically, it allows a court to impose that stricter standard of "good faith" on merchants in a secured transaction case if that secured transaction arose out of a sale transaction to which both litigants were parties.

The Sherrock *Rationale*

In arriving at its holding in *Sherrock*, the Delaware Supreme Court relied upon the fact that since Sherrock Brothers and Commercial had not been parties to a sale between themselves, the controversy between the litigants arose solely out of a secured transaction; hence it should be governed by Article 9, not Article 2. Therefore, in deciding whether Sherrock Brothers had acted in "good faith" and thereby qualified as a "buyer in ordinary course of business," the court reasoned that Sherrock Brothers should be held only to the Article 1 standard of "honesty in fact." The Article 2 definition is applicable only in controversies arising out of a sale between the litigants. The court noted several reasons for this conclusion:[10] first, Article 9 of the Code contains a provision which explicitly refers to Article 1 for definitions[11] but contains no similar reference to Article 2 for any definitions; second, section 9-307(1) expressly refers to section 1-201(9) for the definition of buyer in the ordinary course;[12] third, the Definitional Cross References to section 9-307 refer to specific sections of Article 1 for definitions, but there is no similar reference to Article 2;[13] and finally, the definitions contained in Article 2 are expressly limited to that Article.[14] Applying the Article 1 standard of "honesty in fact," the court found that Sherrock Brothers had met that test and was therefore entitled to protection under section 9-307(1); even though the lower court had found that Sherrock Brothers had been commercially imprudent, such a finding did not affect its qualification under Article 1.[15]

The appellate court in *Sherrock*, then, relied upon the nature of the transaction between the litigants. The major significance of the decision is the holding that when there is a controversy between merchants over priority rights in goods which were not subject to a sale between the litigants—even though a sale between a litigant and

10 290 A.2d at 651.

11 U.C.C. § 9-105(4) provides: "In addition Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article."

12 The text of § 9-307(1) is set out in note 3 supra.

13 U.C.C. § 9-307, Definitional Cross References.

14 U.C.C. § 2-103(1).

15 290 A.2d at 650.

a third party is involved in the facts which give rise to the litigation—then Article 2 definitions should not be applied in the determination of the parties' rights. Also significant was the court's refusal to accept the lower court's test, which focused not upon the nature of the transaction but upon the status of the parties as merchants and found in that status justification for imposing the Article 2 requirement. It may be noted at this point that the same focus is evident in the appellate dissent, which, as will be discussed below, argued that on policy grounds merchants should be held to the Article 2 standard even in a secured transaction.

It will be submitted that the court's holding was legally sound, but that its rationale would have been more effective had it utilized the history of the term "good faith" as it was developed in pre-Code case law and a statutory interpretation of the use of the term "good faith" in the Code.[16] Both factors, it is argued below, significantly strengthen the court's decision to look to the nature of the transaction between the parties. They reveal no grounds for extending the Article 2 requirement to all merchants, strong as the policy reasons for such an extension may be.

It will also be submitted, however, that *Sherrock* should not be followed indiscriminately. Although it may be true that the Article 2 test cannot be used if there was no sale between the parties to the litigation, it does not follow that it may not be used in *any* case where the cause of action is a secured transaction. Rather, there are grounds for arguing that section 1-102 permits such use if the secured transaction in question was part of a sales transaction between the parties.

Definitions of "Good Faith"

"Good faith" has historically been defined either subjectively or objectively. The subjective definition of "good faith" as "honesty in fact"—which is sometimes referred to as "the rule of the pure heart

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16 It is also submitted that the court's use of precedent was weak. For example, the court cited Associates Discount Corp. v. Rattan Chevrolet, Inc., 462 S.W.2d 546 (Tex. 1970), as authority for the *Sherrock* decision. *Associates* involved a similar situation of a dealer selling automobiles to another dealer "out of trust" in violation of a security agreement. However, the Texas court concluded solely that a merchant-dealer can enjoy the status of a "buyer in ordinary course of business." That court did not reach the central question of the *Sherrock* case which concerned the good faith requirements that a merchant-buyer must satisfy when involved in a dispute with a secured party over goods sold to the buyer by the secured party's debtor.

The *Sherrock* court also dismissed without comment the contrary decision reached in 1971 by the New York Appellate Division in Bank of Utica v. Castle Ford, Inc., 36 App. Div. 2d 6, 317 N.Y.S. 2d 542 (1971), which involved a fact situation similar to that in *Sherrock*. The New York court held that a merchant-buyer must satisfy both "good faith" tests in order to qualify for the protection afforded by § 9-307(1). However, the *Castle Ford* court did not base its decision upon any case law or analysis of the statutory history of the Code; rather, it merely assumed that both standards of "good faith" should be applied regardless of the type of transaction in dispute.

and the empty head"[17]—dates back in the law of negotiable instruments to the 1836 case of *Goodman v. Harvey*.[18] The primary concern under the subjective theory of "good faith" is whether "the particular purchaser believed he was in good faith, not whether anyone else would have held the same belief."[19] The test to determine whether one is acting in "good faith" under this standard is what the particular person did or thought in the given situation and whether or not he was honest in what he did. Under this theory, a purchaser of goods must have *actual knowledge* of some other person's interest in the goods in order to be found lacking in "good faith": "Mere suspicion is not enough. Gross negligence is insufficient. Mere failure to inquire is not enough to impeach his title, although he must not shut his eyes to the means of knowledge which he knows are at hand."[20]

The only instances in which the subjective test of "honesty in fact" rules that conduct has not been in "good faith" are when the "purchaser . . . feigns ignorance of third party rights . . . , pretends belief in their absence or willfully refrains from investigating"[21] facts which would inform him of third party rights.[22] Actual knowledge of third party rights, or a deliberate attempt not to ascertain this knowledge, is required for one not to be "honest in fact." Therefore, if the "purchaser . . . negligently fails to ascertain the existence of third party rights,"[23] he has not violated the subjective "good faith" requirement.[24] Thus, what is most important under the subjective theory of "good faith" is the state of mind of the purchaser and his degree of innocence and/or ignorance.

The objective theory of "good faith" originated in 1824 in the case of *Gill v. Cubitt*.[25] According to this test, the trier of fact must determine what an ordinarily prudent man would have done or thought under the same circumstances. One's actual state of mind is no longer the critical factor; one's innocence, suspicion or actual notice is no

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17 Braucher, The Legislative History of the Uniform Commercial Code, 58 Colum. L. Rev. 798, 812 (1958).

18 111 Eng. Rep. 1011 (1836). This case held that in an action by the indorsee of a bill who has given value, whose title is disputed on the ground that his indorser obtained the discount of the bill in fraud of the rightful owner, the question for the jury is whether the indorsee acted in good faith in taking the bill; and that one is acting in good faith even if he takes the bill under circumstances which might reasonably have awakened one's suspicion.

19 Note, 51 Va. L. Rev. 1342, 1357 (1965).

20 Littlefield, Good Faith Purchase of Consumer Paper: The Failure of the Subjective Test, 39 S. Cal. L. Rev. 48, 53 (1966).

21 Summers, "Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code, 54 Va. L. Rev. 195, 210 (1968).

22 Id. at 210-11.

23 Id. at 210.

24 Id.

25 107 Eng. Rep. 806 (1824). This case held that in an action on a bill of exchange by the broker against the acceptor, the jury was properly directed to find a verdict for the defendant if they found that the plaintiff had taken the bill under circumstances which ought to have excited the suspicion of a prudent and careful man.

longer relevant. Instead, the inquiry goes to the prevailing community standards as to what is decent, fair or reasonable.[26] The conduct in question is judged according to the prevailing customs, usages and practices of the particular business involved. Consequently, the party seeking to prove his own "good faith" under the objective test must not only demonstrate a lack of actual knowledge but must also show that he made the efforts which an ordinarily prudent businessman would have made in order to determine if any third party rights did exist. Even a negligent failure to ascertain third party rights could be a violation of the objective standard if the prevailing customs and practices in the trade would require a prudent businessman to ascertain these rights under the circumstances.[27]

The objective standard of "good faith" thus imposes a more stringent requirement on one who claims to be a "buyer in ordinary course of business" than does the subjective standard, since a good faith purchase is requisite to classification as a buyer in ordinary course. The subjective standard requires only that the buyer be unaware of any conflicting claims in the goods involved in the transaction. The objective test, on the other hand, demands not only that the actual purchaser be unaware of any third party rights to the goods, but also that an ordinarily prudent businessman would have remained similarly unaware of these third party rights.

"Good Faith" in the Uniform Commercial Code

The draftsmen of the Uniform Commercial Code recognized these two different "good faith" tests and incorporated both into the Code. In the 1950 proposed draft of the Code, there was one general "good faith" definition, which was contained in Section 1-201:

> "Good faith" means honesty in fact in the conduct or transaction concerned. Good faith includes observance by a person of the reasonable commercial standards of any business or trade in which he is engaged.[28]

This Article 1 definition thus included the terminologies of both the subjective and objective theories of good faith. In effect, this definition would have required a merchant to behave in a commercially reasonable manner in any transaction governed by the Code.

In the 1952 final official draft of the Code, the objective standard was deleted from the Article 1 definition of "good faith"[29] and was

[26] Farnsworth, Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code, 30 U. Chi. L. Rev. 666, 668 (1963).

[27] Summers, supra note 21, at 210-11.

[28] U.C.C. § 1-201(18) (1950 Proposed Draft).

[29] Walter D. Malcolm, one of the drafters of the Code, has noted that the Committee on the Proposed Commercial Code of the Section on Corporation Banking and Business Law of the American Bar Association recommended that the 1950 definition of good faith in Article 1 be changed so that "reasonable commercial standards" be deleted from the definition. The committee gave three reasons for its recommendation:

inserted in certain provisions in Article 2 and Article 7.[80] On the basis of this change, it may be concluded that the draftsmen intended that the subjective definition of good faith was to apply generally—to *all* transactions covered by the Code—while the objective definition was to be used only when a particular provision of the Code called for its application. One such provision in the 1952 draft was section 2-103(1)(b), which stated that a merchant involved in a sales transaction covered by Article 2 must observe "reasonable commercial standards" as well as be "honest in fact." This section has not been changed in subsequent drafts and is identical to the present section 2-103(1)(b).

Another change made in the 1950 proposed draft of the Code appears to offer further support for the theory that the subjective definition of "good faith" is to be applied throughout the Code while the objective definition is to be used only when a specific provision, such as Section 2-103(1)(b), expressly calls for its application. In the 1950 draft, section 1-102(3) read as follows:

> A provision of this Act which is *stated to be* applicable "between merchants" or otherwise to be *of limited application* need not be so limited when the circumstances and underlying reasons justify extending its application.[81]

If this section had been retained in the Code, it could be argued that the Article 2 definition of "good faith" could be applied to a merchant regardless of the type of transaction in dispute; in other words, the section could be interpreted to support a status test. This argument is based upon the theory that the language in the 1950 proposed version of section 1-102(3) could be interpreted as allowing the Article 2 definition of "good faith," despite the explicit statement limiting its use to that Article, to be applied in appropriate situations to a merchant even when the transaction in dispute is not covered by Article 2. However, this section was deleted from the Code, and the present Section 1-102 was adopted in its place.

The present version of section 1-102 provides in part:

> (1) To the average person and the average lawyer, "good faith" signifies primarily "honesty";
> (2) The phrase "observance of reasonable commercial standards" carries with it the implication of usages, customs and practices. It would be very difficult to determine what usages, customs or practices are included in the standard; and
> (3) There is the serious possibility that customs and practices could be frozen into particular molds, thereby destroying the flexibility absolutely essential to the gradual evolution of commercial practices.

Malcolm, The Proposed Commercial Code, 6 Bus. Law. 113, 128 (1951).

80 U.C.C. §§ 2-103(1)(b), 7-404. The text of § 2-103(1)(b) is set out in note 5 supra. U.C.C. § 7-404 exempts from liability a "bailee who in good faith including observance of reasonable commercial standards has received goods and delivered or otherwise disposed of them according to the terms of the documents of title" or pursuant to Article 7.

81 U.C.C. § 1-102(3) (1950 Proposed Draft) (emphasis added).

(1) This Act shall be liberally construed and applied to promote its underlying purposes and policies.
(2) Underlying purposes and policies of this Act are
(a) to simplify, clarify and modernize the law governing commercial transactions;
(b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties;
(c) to make uniform the law among the various jurisdictions.[82]

Although this section allows for the liberal construction of the Code, it does not appear to have the same effect as the 1950 proposed version with regard to encouraging the extension to other Articles or sections of the Code provisions which ostensibly are applicable only to a specified section or Article. However, it does permit a limited degree of flexibility, one which may be exercised in conjunction with a nature-of-the-transaction test such as the *Sherrock* court used.

For example, it is submitted that the present section 1-102 *would* permit the Article 2 definition of "good faith" to be utilized in an Article 9 secured transaction situation wherein a merchant-seller delivers to a merchant-buyer a quantity of goods and the seller retains a security interest in the goods to insure payment at a later date.[83] Since this situation has a sales aspect to it and both merchants are parties to the sale, Article 2 applies and both parties should be held to the "reasonable commercial standards" definition of "good faith" when dealing with each other. If the seller-secured party should institute an action either for the price under the sales agreement[84] or for the goods under the security agreement,[85] it arguably should make

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[82] U.C.C. § 1-102.

[83] A "good faith" issue can arise in several instances in this two-party situation whereby the seller also retains a security interest in the goods involved in the sale. For example, "good faith" could become an issue in an instance where the agent of the seller-secured party, aware that his debtor had defaulted on currently due loan payments, gives assurances to the debtor that additional capital financing will be forthcoming, tells the debtor to use his available funds to pay his general obligations (and, thus, not pay the loan payments then due) and then the seller-secured party, without notice, exercises his security rights to seize the delinquent debtor's entire stock in trade. The Third Circuit was faced with this fact situation in Skeels v. Universal C.I.T. Credit Corp., 335 F.2d 846 (3d Cir. 1964). The court held the secured party to a "good faith" standard, citing the requirement of section 1-203 that "[e]very contract within this Act imposes an obligation of good faith in its performance or enforcement." Id. at 851. The court, however, did not reach the issue of which "good faith" standard was to apply, finding implicitly that the defendant's actions were so blatantly in bad faith as to have violated both standards.

[84] U.C.C. § 2-709 allows a seller to recover the price of goods accepted by the buyer when the buyer fails to pay the price as it becomes due.

[85] U.C.C. § 9-503 gives a secured party the right to take possession of the secured goods upon the default of his debtor. Although this "self-help" provision of the Code does not require the secured party to go to court for a judgment against the debtor, the constitutionality of this procedure is now in doubt. See Adams v. Egley, 388 F. Supp.

no difference whether the seller-secured party's cause of action is based upon the sales contract or the security agreement, since both causes of action evolved out of the same transaction and are therefore intertwined with each other. Therefore, both transactions should be governed by the same legal principles and definitions.

On the basis of this reasoning, it is submitted that even if the secured party should bring suit against his debtor on the security agreement alone, the Article 2 "reasonable commercial standards" definition test, as well as its requirement of "honesty in fact," should be applied to both parties. Since the essence of the transaction between the parties was a *sale*, both should be held accountable to the more rigorous standard throughout the rest of their transaction. This two-party sale-secured transaction is one instance wherein it appears that the present Section 1-102 of the Code would permit an Article 2 definition to be applied in a dispute based in part on the secured party's security interest in the goods which he had sold to his debtor.

It is submitted, however, that the deletion of the former version of section 1-102 precludes the extension of the Article 2 definition of "good faith" to a situation like that in *Sherrock*, where the interest of the seller-secured party conflicts with the interest of a merchant who purchased goods from the secured party's debtor. In this three-party situation, the conflict is between two parties who are not in a seller-buyer relationship. The dispute involves only the determination of priority rights to goods subject to a security agreement. On the other hand, the former version of section 1-102(3) could have been interpreted to permit an Article 2 definition to be applied to such a three-party conflict. As has been suggested, that version seemed to sanction the application of a definition which was expressly limited to merchants involved in sales transactions to different types of transactions covered by other articles and provisions in the Code when "circumstances justify extending its application."[36] It appears that the deleted section would have permitted the utilization of the objective theory of "good faith" whenever a merchant was involved in any type of transaction that was governed by the Code: in short, it could have justified broad application of a status test such as that exercised by the lower court in *Sherrock.*

The deletion of former Section 1-102(3) from the Code thus further underscores the unadvisability of applying the Article 2 definition of "good faith" to a dispute between merchants who were not parties to a sales transaction between themselves. If that section had been retained, it could be maintained that regardless of the type of transaction involved, a merchant's "good faith" must be judged according to the objective theory. With the deletion of that section,

614 (S.D. Cal. 1972). Hence, secured parties may be required to litigate the issues of good faith in the sales agreement and the security agreement.

[36] U.C.C. § 1-102(3) (1950 Proposed Draft). This section is set out in the text at note 31 supra.

however, it appears that the determination of which definition of "good faith" to apply should be based upon the nature of the transaction between the parties involved in the dispute. The present language of the Code should not be interpreted as permitting the Article 2 "good faith" definition to be applied in a controversy between parties who were not involved in a sales transaction between themselves.

The Sherrock *Holding*

On the basis of this analysis of the term "good faith" and its history under the Code, it appears that the Delaware Supreme Court reached a correct decision in the *Sherrock* case. The court held that Sherrock Brothers was to be judged solely according to the subjective, or Article 1, test of "good faith" in determining whether it was a "buyer in ordinary course of business." Since the trial court had found that Sherrock Brothers was "honest in fact,"[37] it qualified as a "buyer in ordinary course of business" and was entitled to the protection offered by section 9-307(1). There was no need to apply the objective, or Article 2, definition of "good faith" since the two parties, Sherrock Brothers and Commercial Credit, were not parties to a sales transaction between themselves, and the conflict arose solely because Commercial retained a security interest in the vehicles.

The dissent in *Sherrock* rejected the majority's analysis of the problem in terms of the transaction and relationship between the litigants and instead adopted a more policy-oriented approach based on the fact that Sherrock Brothers, the party whose "good faith" was in question, was a merchant.[38] The dissent argued that for a merchant to be accorded the status of a "buyer in ordinary course of business," the merchant must observe "reasonable commercial standards" as well as be "honest in fact" in any transaction in which he is involved.[39] Thus, according to the dissent, because Sherrock Brothers was a merchant, the Article 2 objective definition of "good faith" should have been applied to the dispute. However, although this argument may be commercially reasonable and advisable, it is not supported by the explicit language of the Code.[40] The definition of "buyer in ordinary course" contains no reference to the objective standard of "good faith,"[41] and there is no statement in Article 2 that the definitions contained therein apply to other Articles of the Code. Furthermore, the preceding historical treatment of the subjective and objective definitions of "good faith" and their adoption as separate definitions by the drafters of the Code rebuts the policy justification for the dissenting opinion. Therefore, the objective definition of "good

37 277 A.2d at 708-09.

38 290 A.2d at 651-52 (dissenting opinion).

39 Id.

40 For a full development of this point, see text accompanying notes 10-15 supra.

41 The term "buyer in ordinary course of business" is defined in § 1-201(9), which is quoted in pertinent part in note 3 supra.

faith" should not be applied to a merchant merely because he is a merchant but should be applied only to a merchant who is involved in a sales transaction, and therefore subject to the provisions of Article 2.

Although the majority in *Sherrock* apparently reached a correct conclusion, it is submitted that the *Sherrock* holding should be strictly construed. It should not be interpreted as precluding absolutely the application of the Article 2 definition of "good faith" to any case involving a secured transaction since it is arguable that in a two-party sale-secured transaction between merchants, the parties should still be governed by any definition which applies to merchants involved in a sales transaction even though there is also a secured transaction involved. On the basis of this theory, it appears that the *Sherrock* decision should control only where there is a similar three-party situation giving rise to a controversy between a merchant-buyer and a secured party over priority rights to goods which were sold "out of trust" to the merchant-buyer.

Conclusion

"Good faith" is a highly amorphous term. One commentator has suggested that the term should not be given a meaning of its own but should rather be defined negatively in terms of what it is not.

> ["Good faith"] is a phrase without general meaning (or meanings) of its own and serves to exclude a wide range of heterogeneous forms of bad faith. In a particular context the phrase takes on specific meaning, but usually this is only by way of contrast with the specific form of bad faith actually or hypothetically ruled out.[42]

The Code draftsmen have, however, attempted to give specific meaning to the term by defining "good faith" to mean "honesty in fact"[43] and also, in certain situations, the "observance of reasonable commercial standards."[44] The draftsmen neglected, however, to provide standards to assist in the proper application of these two "good faith" definitions. The 1950 proposed draft demonstrates an intent by the draftsmen to have the objective standard of "good faith" applied to a merchant whenever he is involved in a commercial transaction, whether it be a sale or any other transaction. However, the 1952 final official draft evidences a contrary intent whereby the objective definition is to be utilized only when a specific section of the Code calls for its application. The present Code, which follows the 1952 draft, therefore requires that the objective standard be applied

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[42] Summers, supra note 21, at 200-01.

[43] U.C.C. § 1-201(19).

[44] U.C.C. § 2-103(1)(b).

only when a party is involved in a sales transaction and does not call for the application of the objective standard in a dispute between two merchants not parties to a sales transaction between themselves.

LEONARD S. VOLIN

Labor Law—Authority of National Labor Relations Board—Consolidation of Existing Bargaining Units through Unit Clarification Proceedings—*United Glass & Ceramic Workers v. NLRB.*[1]—The United Glass and Ceramic Workers and various locals thereof (Union) brought suit in the United States Court of Appeals for the Third Circuit to challenge a decision by the National Labor Relations Board[2] which dismissed an unfair labor practice complaint filed against Libbey-Owens-Ford Co. The Company maintained ten plants at various locations throughout the country, eight of which composed a single multiplant unit; in this unit the Union was certified as the exclusive bargaining representative. Each of the two remaining units was organized as a separate bargaining unit by the Union, and the Union enjoyed voluntary recognition in the two single-plant units.[3] In 1968, after the Company had refused during collective bargaining with the multiplant unit to consent to Union requests for consolidation of all three units, the Union petitioned the Board for a unit clarification to merge the three units into a single multiplant unit. The full Board decided, with Members Fanning and Jenkins dissenting, that the unit clarification proceeding may be used to consolidate existing bargaining units, and ordered a self-determination election in each single-plant unit to ascertain the wishes of the employees.[4] In the elections, a majority in each plant preferred consolidation with the multiplant unit, and the NLRB, subsequent to the elections, ordered the consolidation of the three units.[5] The Company acceded to the merger of one of the single-plant units with the multiplant unit, but, for a number of reasons,[6]

1 463 F.2d 31, 80 L.R.R.M. 2882 (3d Cir. 1972).

2 Libbey-Owens-Ford Co., 189 N.L.R.B. No. 139, 76 L.R.R.M. 1806 (1971).

3 Libbey-Owens-Ford Glass Co. v. McCulloch, 67 L.R.R.M 2712, 2714 (D.D.C. 1968). In this case the district court enjoined the Board from conducting the self-determination election hereinafter discussed. On appeal the injunction was dissolved. The dissolution was based upon a lack of jurisdiction in the district court to enter the injunction. McCulloch v. Libbey-Owens-Ford Glass Co., 403 F.2d 916, 68 L.R.R.M. 2447 (D.C. Cir. 1968), cert. denied, 393 U.S. 1016 (1969).

4 Libbey-Owens-Ford Glass Co., 169 N.L.R.B. 126, 67 L.R.R.M. 1096 (1968). The use of the unit clarification for this purpose was a marked departure from traditional Board usages. See text at notes 13-22 infra.

The official report of the Board indicates a majority consisting of Chairman McCulloch and Members Fanning and Zagoria, with Members Fanning and Jenkins concurring in part and dissenting in part. It seems apparent that Member Brown, not Member Fanning, was a member of the majority, and that there was a misprint in the official report.

5 Libbey-Owens-Ford Glass Co., 173 N.L.R.B. 1231, 69 L.R.R.M. 1558 (1968).

6 Brief for Intervenor at 31-33, United Glass & Ceramic Workers v. NLRB, 463