

IN THE COURT OF APPEALS OF IOWA

FILED

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CLERK SUPREME COURT

AGRI FINANCIAL SERVICES, INC.,)

Plaintiff,)

C & J LEASING II LIMITED,)
PARTNERSHIP,)

Plaintiff-Appellant,)

vs.)

KEITH K. SWANSON, NANCY L.)
SWANSON, MICHAEL J. REILLY,)
JANET L. REILLY,)

Defendants-Appellees,)

DEUTZ-ALLIS CREDIT CORPORATION,)
f/k/a CHALMER CREDIT CORP. and)
DEUTZ-ALLIS CORPORATION, ALLIS)
CHALMERS FARM EQUIPMENT, INC.,)
MAHASKA INVESTMENT COMPANY, MIC)
LEASING DIVISION, FIRST)
INTERSTATE BANK OF URBANDALE,)
f/k/a PLAZA STATE BANK,)
MELVIN CLARK, and)
DANIEL J. GENESER,)

Defendants.)

8

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Appeal from the Iowa District Court for Polk County
(No. CE 26-14976), Gene Needles, Judge.

C & J Leasing appeals from a district court ruling
finding that AGRI financial services had a prior perfected
security interest in farm equipment and is entitled to
possession. **AFFIRMED.**

Ronald A. Baybayan of Des Moines for plaintiff-appellant.

Thomas H. Burke of Whitfield, Selvy, Kelly & Eddy, Des Moines, for defendants-appellees.

Heard by Oxberger, C.J., and Donielson and Hayden, J.J.

OXBERGER, C.J.

C & J Leasing appeals from a district court ruling finding that AGRI Financial Services had a prior perfected security interest in two combines and two grain head attachments and is entitled to possession thereof. C & J Leasing contends that both AGRI and Swanson and Reilly entrusted the farm equipment to the implement dealer, Geneser, so that C & J Leasing, as a subsequent good faith purchaser without notice, takes free of the prior perfected security interest and is entitled to the possession of the equipment. As this is a matter in equity, our review is de novo. We affirm.

In 1982, Geneser Equipment Store and Dan Geneser sold some equipment to the Swansons and the Reillys which was financed through a finance company. This purchase was an investment as neither the Reillys nor the Swansons are farmers. In June 1984, Geneser contacted these individuals and proposed that they refinance at a lower rate through AGRI Services, Inc. The Swansons and Reillys gave Geneser authority to refinance and provided him with all the necessary financial information. However, Geneser did not refinance the 1982 equipment. Instead, Geneser sold AGRI the M-3 and N-6 combines with cornheads. AGRI entered into a lease with Swanson and Reilly, giving them an option to buy the equipment for one dollar. This agreement created a security interest which was properly filed by AGRI on

June 11, 1984. Geneser continued to represent to Swanson and Reilly that he was "leasing out the equipment to farmers" as they had authorized. The equipment stayed with Geneser. Neither AGRI nor Swanson and Reilly ever examined the equipment.

In December of 1984 Geneser sold one of the combines to C & J Leasing and the other in October of 1985 to Melvin Clark, a farmer. Neither purchaser was aware of the previous sale of this equipment to AGRI. C & J filed a financing statement on their combine in December 1984. In 1986 Geneser took bankruptcy.

This replevin action was instituted in order to determine who had the right to the two combines and grain head attachments. The parties stipulated before trial that: 1) Dan Geneser, doing business as Geneser Farm Implement, was a merchant of new and used farm equipment; 2) C & J Leasing and Melvin Clark were buyers in the ordinary course of business; and 3) Swanson and Reilly "entrusted" the equipment to Geneser. Following the trial, AGRI assigned its interests in this lawsuit to the Swansons and Reillys.

The issues presented on appeal are: 1) whether C & J, as a buyer in the ordinary course of business, may defeat AGRI's prior perfected security interest pursuant to Iowa Code § 554.2403 because Swanson and Reilly had entrusted the equipment to Geneser; and 2) whether AGRI entrusted Geneser with the property and the subsequent sale to C & J defeated AGRI's prior perfected security interest.

I.

12

The lease agreement as to N-6 and M-3 combine and corn-heads between AGRI and Swanson and Reilly which provides for an option to purchase for nominal consideration constitutes a security agreement. See Iowa Code § 554.1201(37) (1987).

On this point we find a Montana case which interprets Iowa law and which is cited by the appellee to be relevant. In Exchange Bank of Osceola v. Jarrett, 558 P.2d 1003 (Mont. 1979), the court held that the remote buyer in the ordinary course of business did not take free of the secured party's interest because the purchaser's seller did not create the security interest. In this case, it is AGRI and not Geneser who created the security interest at issue. As Geneser is C & J's seller and not the creator of the security interest, we find section 554.9307(1) is not applicable. Thus, although C & J is a buyer in the ordinary course of business, C & J may not take free of the security interest.

Section 554.2403(1) provides in part: "A person with voidable title has power to transfer a good title to a good faith purchaser for value." Iowa Code § 554.2403(1) (1987). This rule essentially provides that sale to a good faith purchaser for value cures the defects in the seller's voidable title. It cannot however cure void title. The Fifth Circuit Court of Appeals addresses the void -

voidable distinction with respect to U.C.C. § 2-403 in American Standard Credit v. National Cement Co., 643 F.2d 248 (1981). The court held that in order for the seller to have obtained even voidable title, he must have obtained delivery of the goods through "a transaction of purchase." Id. at 268. This phrase has generally been limited to those situations in which the party who delivered the goods to the subsequent seller intended, however misguidedly, that the seller would become the owner of the goods. Id. The court further explains that a con artist who converts the goods to his own use after having obtained possession of them in some manner other than through a transaction of purchase does not have even voidable title; instead, he has void title, and cannot pass good title to a good faith purchaser for value. Id. (citing J. White and R. Summers Handbook of the Law Under the Uniform Commercial Code § 3.11, at 140-42 (2d ed. 1980)).

When the Reillys and the Swansons entrusted the equipment back to Geneser their intent was that Geneser would lease the equipment in their behalf. The record reveals that they did not intend for Geneser to become the owner of the goods. Thus, Geneser did not obtain the equipment from the Swansons and the Reillys through a transaction of purchase. Accordingly, Geneser obtained "void" title and not "voidable" title and Geneser's sale to a good faith purchaser could not cure such a defect in the title. Even if

Geneser could cure the defect in title, the entruster can only transfer the rights that the entruster has. See Iowa Code § 554.2403(2) (1987). In this case, the entrusters' interest is encumbered by AGRI's security interest. See Iowa Code § 554.9306(2) (1987) (a secured party's security interest continues in the collateral notwithstanding sale, exchange, or other disposition unless the disposition is authorized by the secured party).

II.

C & J also relies on Iowa Code section 554.2403(2) and (3) which provides:

2. Any entrusting of possession of goods to a merchant who deals in goods of that kind gives the merchant power to transfer all rights of the entruster to a buyer in ordinary course of business.

3. 'Entrusting' 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.

Section 2403(2) is said to protect a buyer in the ordinary course of business against a "true owner" in every case in which the owner has entrusted goods to a merchant who deals in goods of that kind. See Hawkland, U.C.C. Series § 2.403:07 (1984). While entrustment has been construed broadly, one limitation which commentators and cases take note of is that in

order to be eligible to "entrust" goods, one must be the owner of such goods. See Adams v. City National Bank & Trust Co. of Norman, 565 P.2d 26, 29 (Okla. 1987) (where the bank was the secured creditor and not the owner of the Ford automobile, bank could not be the entruster); Sunnyland Employee's Federal Credit Union v. Fort Wayne Mort. Co., 182 Ga. App. 5, 354 S.E.2d 645 (1987) (where a bank was the secured creditor of collateral, U.C.C. section 2-403(2), (3) was not applicable to the situation since the bank was not the owner of the collateral and could not entrust it to the dealer under circumstances giving him the power to convey good title); United Carolina Bank, 158 N. Ga. App. 107, 279 S.E.2d 272 (1981) (court held that U.C.C. section 2-403 (2),(3) applies only to owners of goods). See also Hawkland U.C.C. series section 2403 (1984).

The courts of this State have not considered the applicability of section 554.2403 to those other than owners. We find case law and commentary which has interpreted U.C.C. section 2-403 to apply only to the owner of goods to be persuasive. We further find such an interpretation to be in line with the purpose of this section which is to protect a buyer in the ordinary course of business against a "true owner" when the owner has entrusted such property to a merchant who deals in goods of that kind.

AGRI, as the secured creditor, is not the owner of the farm equipment at issue. The Reillys and Swansons are the owners. Therefore we find section 554.2403(2) and (3) inapplicable to AGRI. Therefore, we find that AGRI's security interest is not defeated. As it is the first in time, we find the trial court did not err when it held AGRI had the prior perfected security interest in the two combines and two grain head attachments and is entitled to possession thereof.

AFFIRMED.