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Chapter 6: Commercial Law

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CHAPTER 6

Commercial Law

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§6.1. General. The number of states that have adopted the Uniform Commercial Code has more than doubled since the end of the 1960 Survey year, with New Jersey numbered as the fourteenth. The Massachusetts Uniform Commercial Code was affected by only a single amendment — an increase in the fee for filing papers concerning secured transactions from $3 to $4, whenever the filing must be done in a registry of deeds because the transaction affects real property.1

Chapter 172 of the General Laws, relating to trust companies, has been completely revised.2 Although much of the prior chapter has been retained, there are many changes of detail and of substance. Other statutes of importance, in addition to a number of detailed changes in banking legislation, include further regulation of consumer credit,3 but still no general retail instalment sales act.

Decided cases were concerned with fundamental principles of commercial law. One case involved payment of a forged instrument, with the Supreme Judicial Court discussing the famous eighteenth century case of Price v. Neal — the case in which the English court made the shocking statement that the forgeries were committed by one Lee, who had since been hanged for forgery. A second commercial law case involved the elements of purchase in good faith, and — shades of Price v. Neal — one of the principals was subsequently incarcerated in Norfolk prison.4 A third case added important refinements to the doctrine of implied warranties raised in sales. A fourth case required a determination of the time that risk of loss of sold goods passes when the goods have been destroyed before effective insurance coverage has been obtained.

§6.2. Sales: Risk of loss. The risk of loss of goods that have been sold generally follows title under the Uniform Sales Act. If title is retained by the seller for security purposes only, however, the retention of such title does not prevent the risk of loss from passing to the

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2 Id., c. 493.
3 See §6.6 supra.
4 For a statement on this incarceration, see Elbar Realty, Inc. v. Shapiro, 342 Mass. 276, 173 N.E.2d 254 (1961). The case does not involve commercial law problems and is not reviewed in this chapter.
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purchaser. Under the Uniform Commercial Code, a determination of the time that the risk of loss passes to the buyer is made independently of the determination of the time that title passes. Accordingly, a determination of whether a sale is absolute or conditional is immaterial to a determination of the time that the risk of loss will fall upon the buyer, under the prior as well as under the present statutory schemes of Massachusetts.

However, while the risk of loss may pass to the buyer irrespective of whether the sale is conditional, the seller may have an insurable interest in the goods that have been sold and delivered under a conditional sale contract even though the risk has passed to the buyer. If the seller with such an insurable interest has a policy of insurance, and if the goods are lost by a casualty insured against after only a partial payment by the buyer, the buyer may have some rights under the policy that will reduce the loss he must bear.

This possibility was one of the hopes of the plaintiff-buyer in Waltham Door & Window Co. v. S. A. Woods Machine Co.¹ The plaintiff had contracted to purchase machinery from the defendant by signing a printed contract that, although in form a contract for conditional sale, had its blanks filled in with the anomalous requirement that the purchaser pay the entire balance owing (after a small amount paid at the time of signing) upon notification that the machinery was ready for delivery. This printed contract was not executed by the defendant-seller. Instead, the defendant executed a printed form that it used to acknowledge orders for absolute sales. The machinery was loaded onto the plaintiff's truck on a Friday, and arrived at the plaintiff's plant on Saturday. The plaintiff's check for the balance owing was received by the defendant on the same Saturday.

Although the machinery had been insured by the plaintiff during the transit, it was not insured after its arrival on Saturday because of weekend difficulties, and it was destroyed by fire in the early hours of Monday morning. The defendant, on the other hand, had a policy of insurance covering equipment on location under instalment sales contracts. The conditional sale agreement that the plaintiff had signed contained a clause requiring the purchaser to reimburse the vendor for the cost of insurance.

The Supreme Judicial Court decided that a finding that the sale was not intended as a conditional sale was justified under the circumstances. As an absolute sale, risk of loss as well as title passed to the plaintiff upon delivery to its truck. Furthermore, since the sale was not conditional, the terms in the printed contract form relating to insurance were not part of the actual agreement between the parties. Therefore, the plaintiff's rights under the terms in a true conditional sale contract, if any, did not have to be determined.

Had the Uniform Commercial Code been in force when this sale occurred, the result would have been the same although the judicial technique might have been slightly different. Irrespective of whether


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the sale was conditional, the risk of loss was on the buyer from the time of delivery to his truck.\(^2\) If the sale were conditional, however, the seller would have had an insurable interest in the goods so long as he had a security interest.\(^3\) In order to determine whether the sale was conditional, the Court would have been assisted by Section 2-207(3), which provides:

Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree. . . .

With the aid of these pronouncements, the Court might have felt easier about trying to piece together the actual agreement of these parties, one of whom signed a printed conditional sale agreement that obviously was not intended to provide the terms of a cash sale, and the other of whom signed an acceptance form that was not at all responsive to the terms printed in the conditional sale contract except for the description of the subject matter, terms of shipment, and terms of payment.

This case, involving as it did the completely haphazard use of printed forms to cover what seemed at the time to be a simple legal situation, emphasizes the importance of care in the drafting of any agreement of sale. Among other things, the Uniform Commercial Code, through its broad description of insurable interests, allows tremendous flexibility in matters of risk of loss and possible coverage by insurance. It might be hoped that these provisions will be reflected by the appearance of contracts that have been drafted to provide for contingencies that the parties at the time of contracting consider too remote to be worth special attention.

§6.3. Sales: Warranties. If there was any doubt left by prior Massachusetts cases about the application of implied warranties to injuries caused by defective containers in which goods are supplied, when the purchaser of the goods cannot twist the facts into a sale of the container, those doubts have been dispelled by Hadley v. Hillcrest Dairy, Inc.\(^1\) Several years ago, the case of Poulos v. Coca-Cola Bottling Co. of Boston\(^2\) had held that the warranty of merchantability applied to a bottle as well as its contents. However, Mead v. Coca-Cola Bottling Co.,\(^3\) decided a few years afterwards, held that compensation for injuries occasioned by a defective bottle was within the scope of an implied warranty of merchantability only because the Supreme Judicial Court was able to conclude that, in the absence of evidence to the con-

\(^2\) G.L., c. 106, §2-509.
\(^3\) Id. §2-501(2).

\(^2\) 322 Mass. 586, 77 N.E.2d 405 (1948).
trary, it could assume that the purchaser of a soft drink from a vending machine purchases the bottle as well as its contents. That a sale of the bottle was a prerequisite to the warranty was implicit in the decision. 

_Hadley v. Hillcrest Dairy, Inc._, was an action for damages sustained by handling a defective milk bottle. Although the Court assumed that the bottle had been lent when its contents were sold, it was held nevertheless that as the bottle had been supplied under the contract of sale, the statutory requisites for a warranty covering the merchantability and fitness of the bottle were satisfied. In reaching this result, the Court relied upon an English case interpreting the English Sale of Goods Act. Both the English act and the Uniform Sales Act contain the same expression: “There is no warranty . . . as to the quality or fitness . . . of goods supplied under a contract to sell” unless certain conditions are met. This, the English court had held, means that if the conditions are met the warranties are raised, irrespective of whether the defective goods supplied under the contract were sold.

The Uniform Commercial Code (which did not apply to the _Hadley_ case, since the transaction arose prior to October 1, 1958) does not contain the general negation of warranties of goods supplied under a contract to sell, or a sale. Instead, it says: “[A] warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant.” 

(Emphasis supplied.) Although these words would not seem to leave any room for finding a warranty of merchantability to cover the container that has been supplied under the contract but that has been lent rather than sold, the Code provides specifically that goods that are not adequately packaged are themselves not merchantable. Therefore, it would seem that the Code would not cause any difference in cases like _Hadley_, although it might be necessary to say that the milk sold in a defective bottle is not merchantable rather than that the defective bottle supplied under the contract for the sale of milk is, in itself, not merchantable.

The warranty of fitness for a particular purpose under the Uniform Commercial Code does use terms sufficiently like those in the prior statutes to make the _Hadley_ case of value as a precedent. A warranty of fitness for the particular purpose is implied if the seller has reason to know the particular purpose and that the buyer is relying upon his skill and judgment “to select or furnish suitable goods.” There is no specific limitation of the warranty to “the goods” that are sold, as seems to be the case with the warranty of merchantability. Consequently, a warranty that a milk bottle is fit for the purpose of ordinary handling might well be implied under the Uniform Commercial Code in a sale in which the buyer relies upon the seller to “furnish” the bottle, although the bottle is not sold.

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Commerical paper: Forged instruments. _Mechanics National_
Bank of Worcester v. Worcester County Trust Co.\(^1\) was a suit by a
drawee bank, that had paid a forged check, to recover the money back
from the presenting bank. The check (for $3940) had been taken by
the presenting bank for deposit to the extent of $340, and the balance
of $3600 had been paid in cash to the person representing himself to
be the depositor. Despite this payment of cash, the teller had required
no identification and, in addition, ignored other very suspicious
circumstances. The check was paid through a clearinghouse and was
charged to the purported drawer's account by the drawee bank before
the forgery was discovered.

The Supreme Judicial Court was faced with two interrelated prob-
lems: first, whether the rule of \textit{Price v. Neal}\(^2\) applied to the facts,
making payment by the drawee of a forged instrument final; and, second,
if this rule did not apply, whether the clearinghouse rules that
allow the return of certain items within a prescribed time bar, by nega-
tive implication, a return after that time. The Court decided that,
although \textit{Price v. Neal} is the law of Massachusetts, its doctrine of
finality of payment could not apply to this case because the trial court
had found that the presenting bank had itself been negligent in pur-
chasing the check. As it is well settled in this Commonwealth that such
negligence as contributes to the deception of the drawee destroys the
reason for the rule, the rule cannot operate to deprive the payor from
recovering back the money paid under mistake.

Had this transaction arisen after the effective date of the Uniform
Commercial Code, the answer to this question would have been other-
wise. The rule of \textit{Price v. Neal} is adopted by Section 3-418 of the Code
with the sweeping statement that payment is final in favor of a holder
in due course or person who has changed his position in good faith,
with exceptions only for liability for breach of warranty and limited
recoveries of bank payment. The warranties imposed by Section 3-417,
therefore, must contain the only exceptions to the finality rule in the
usual case. These warranties include a warranty that the person ob-
taining payment has no knowledge that the signature of the drawer is
unauthorized; but this warranty is limited to lack of knowledge, and
does not cover the genuineness of the instrument in the absence of such
knowledge. Recovery back simply because the instrument is a forgery,
therefore, is limited to recovery from persons who are not holders in
due course. And even the nonholder in due course who has obtained
payment is protected if he has changed his position in good faith in
reliance upon the payment. Negligence of the holder that is not so
great as to amount to notice or bad faith which would keep him from
becoming a holder in due course, therefore, is no longer a reason to
deny operation of the rule of finality of payment in Massachusetts.

It is perhaps conceivable that if the Code had governed the case the
trial judge might have found that the presenting bank was not a holder
in due course. It is doubtful, however, whether such a finding could

have been justified under the facts of the case, which showed only simple negligence or carelessness. It would seem, therefore, that had the Code governed, recovery by the drawee would have been denied without the necessity of reaching the second problem presented, namely, the effect of the rules of the clearinghouse upon the right to recover back payments when such rights would exist in the absence of clearinghouse operations.

A bank that, under clearinghouse rules, must settle for an item first and then look at the instrument to see if it is genuine, or at the drawer's account to determine whether there are sufficient funds to cover the item, must have some right to return the item after it has looked. The clearinghouse rules involved in this case did contain such a right, by providing for "return items," with a sharp limitation on the time of such return through the clearinghouse. The Court held, however, that these rules were not sufficiently clear to bar a right of return after the short time limit had expired, when the right would have existed had presentment been made over the counter instead of through the clearinghouse. In other words, even if the rule of \textit{Price v. Neal} had applied, the drawee obligated to settle under clearinghouse rules would have had a right to return the item, limited to the short time period provided. However, since the rule of finality of payment did not apply because of the negligence of the presenting bank, the clearinghouse rules did not make, by any negative implication, the item nonreturnable after the stated time limit.

The problems discussed in this portion of the opinion, although covered only partially by the statutes in force in Massachusetts before the enactment of the Uniform Commercial Code, are now included within the scope of Article 4 — Bank Deposits and Collections. This article provides for warranties by banks in the collection process comparable to those made by other holders who obtain payment. Thus the presenting bank warrants only that it has no knowledge that the signature of the drawer is a forgery, and not that the instrument is genuine. Therefore, payment to the presenting bank may not be recovered back unless the bank is not a holder in due course and has not changed its position in good faith. A mere settlement, however, as opposed to a final payment, does not prevent recovery if the bank acts quickly. Thus the rule of the clearinghouse permitting returns after the bank has had an opportunity to examine the instrument and account is carried into the Code. This rule does not, however, expressly prevent a return after final payment has been made or after the time for return has expired. If there is a right of recovery because of a breach of warranty, or because the bank is not a holder in due course, this right must survive final payment.

3 G.L., c. 106, §4-207.
4 Id. §§4-301, 4-213.
5 See also G.L., c. 167, §55. This section was repealed upon enactment of the Uniform Commercial Code.
6 See G.L., c. 106, §4-302.
Consequently, if the presenting bank in the Mechanics National Bank case had acted so negligently that its purchase was not in good faith, the rules of the Uniform Commercial Code clearly would have preserved the right of the drawee bank to recover back its payment despite the passage of the time limit for ordinary return items. The Code, therefore, would make no change in this portion of the law as decided by the Supreme Judicial Court.

§6.5. Investment securities: Purchase in good faith. In a case whose facts had all the suspense of fiction, the Supreme Judicial Court in the 1961 Survey year had the occasion to inquire into the bona fides of an unusual bank transaction. The defendant bank in Elbar Realty, Inc. v. City Bank & Trust Co. took as a pledge securing a loan a United States bearer certificate of deposit that had been stolen from the plaintiff. The borrower, who stated that he was the agent for an undisclosed principal after a highly unlikely series of events, withdrew in small bills $30,000 of the $90,000 credited to the account which he had opened for the face amount of the loan. The circumstances were even more suspicious on the following day when the borrower withdrew another $30,000 in small bills. The Court, after an excellent analysis of the elements of good faith, concluded that there had been sufficient evidence to warrant submitting the issue of good faith to the jury, but that evidence of the circumstances which arose after the loan had been made should not have been admitted without limitation to the issues on which it had relevance. Good faith vel non at the time of making the loan was not such an issue.

This case, decided under the statutory law in force before the enactment of the Uniform Commercial Code, is an especially interesting one to analyze in light of the Code. The Court, in several footnotes to the opinion, states that the present provisions of the statutes comparable to those that governed the case are G.L., c. 106, §§3-302, 3-304, and 3-307, as indeed they are. A discussion of this case in the Massachusetts Law Quarterly goes even further and assumes that not only are these the comparable provisions, but that they would control a similar case. However, Article 3 of the Commercial Code, unlike the prior Uniform Negotiable Instruments Law, does not cover investment securities. Instead, a separate set of rules is provided by Article 8 to govern these instruments that are certainly first cousins to commercial paper but which serve different purposes.

Since a United States Treasury certificate of deposit is commonly recognized as a medium for investment and is quoted as such in financial papers, there seems to be little doubt that it will be governed by Article 8 — Investment Securities. The differences between the treatment afforded by this article and that required by Article 3 are substantial in several respects. In the first place, the terminology is different. Since there is rarely any reason to treat the first holder of an investment security any differently from a remote holder (in fact, in-

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commercial Law

6.6 Instruments issued in registered form are often reissued directly to the remote purchaser after his acquisition, the concept of holder in due course has been replaced by the bona fide purchaser and, in some cases, by the purchaser for value although not bona fide.

The definition of the bona fide purchaser is at the same time both deceptively similar to and subtly different from the definition of the holder in due course. The general requirement of good faith is the same. The lack of notice requirements are substantially the same. The concept of value is quite different. Under Article 3 — Commercial Paper, value generally means the extent to which the agreed consideration has been performed. Consequently, merely crediting the account of the borrower would not make a bank a holder in due course of commercial paper. Therefore, circumstances existing at the time of withdrawals could affect a determination of whether the bank is a holder in due course to the extent of the particular withdrawal. Article 8, however, contains no specific definition of value. Consequently, the general definition in Article 1 must apply, and this definition provides: "... a person gives 'value' for rights if he acquires them (a) ... for the extension of immediately available credit whether or not drawn upon. . . ." 4

This difference in the concept of value could have a substantial effect on the ultimate outcome of cases like Elbar Realty, Inc. A separate determination of good faith must be made whenever credit granted by a bank is withdrawn, in order to determine whether the bank then becomes a holder in due course of commercial paper to the extent of the withdrawal; but no such new determination is required if the credit was originally extended on the security of an investment security rather than commercial paper. Of course, since the bank in the case had acquired only a limited interest in this investment security, it could not prevail over the adverse claimant beyond the extent of its limited interest. To the extent, therefore, that the credit had never been withdrawn, the adverse claimant should prevail. But if, as is possible, the retrial of the Elbar case should establish that the defendant was a holder in due course to the extent of the first withdrawal of funds but not to the extent of the second, the division recognized would be one not permitted to transactions arising in the future, under the Uniform Commercial Code.

§6.6. Consumer Protection. The protection of consumer interests has proceeded through three statutes: one designed to preserve the rights that an injured purchaser has against an unpaid dealer although the debt is in the hands of a finance company, and two directed toward the lessening of deception.

Many courts and legislatures have had the occasion to consider the plight of the purchaser of defective goods who is sued for their price by a finance company that is independent of the seller. Although the Massachusetts Court has held that clauses in instalment contracts that

3 G.L., c. 106, §§3-303.
4 Id. §1-201.
purport to cut off defenses of the consumer against an assignee of the contract are inoperative, it has also held that a finance company that acquires a negotiable instrument may be a holder in due course of the instrument although it was executed in connection with an instalment sale. Accordingly the buyer, who in financing his purchases executes negotiable instruments, may find that he must pay those instruments when they fall due even though the goods that he purchased are defective or worthless.

In response to a growing belief that this situation is inequitable when the purchase is for nonbusiness purposes, the General Court has now provided that promissory notes given in connection with the purchase of consumer goods must contain the printed words, "consumer note," and when they do so they shall not be negotiable instruments within the meaning of the Uniform Commercial Code. Violation carries criminal sanctions and also bars collection of finance charges.

An earlier bill to accomplish this purpose would have amended the Uniform Commercial Code to provide that any holder of an instrument given for financing consumer goods would be subject to all defenses that the obligor might have against the seller. Because of the objection of the Commissioners on Uniform State Laws to such tampering with the uniformity of the Code, however, the Code was left intact by the final bill. Amendment of the Code would have given one advantage: for all purposes other than cutting off defenses, the instrument would have been governed by the Code. As it now stands, the status of these consumer notes is left in doubt. Whether they are to be governed by the law merchant, the Uniform Commercial Code, or the law of contracts is not clear. The differences may be substantial when liability of secondary parties on the instrument becomes involved.

Competing bills would have provided for a notice requirement whereby the finance company could force the buyer to disclose his defenses within a stated time period or else be barred from raising them. This method is used in New York. It provides no protection to the consumer, however, if the defect in the goods has not become apparent by the time when he must notify the finance company.

One rather patent loophole in the legislation as enacted is its limitation to promissory notes. There is nothing to restrict the use of drafts on which a buyer may become liable as an acceptor; and since the statute is partially penal in nature, it probably could not be extended judicially to cover such instruments.

§6.7. Banks and banking: Insurance funds. On May 12, 1932, the Central Credit Union Fund, Inc., was created to provide "a measure of relief in the existing financial emergency" by assisting member credit

4 Ibid.
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unions temporarily in need of cash or holding investments that could not be readily liquidated, through loans to those members.\(^1\) The original duration of this corporation was five years, although the five were later extended to thirty. As it was about to enter its last year, this corporation was made a permanent institution.\(^2\) It is interesting to note that this temporary expedient adopted during the depths of the depression to meet the special financial needs of that period should be made permanent during this age of affluence. One chapter of our financial history has ended, and another has begun.

The Mutual Savings Central Fund, Inc., also created in 1932 for a period of five years,\(^3\) became a permanent institution some years ago. Two years after its creation, a deposit insurance fund was established under its administration.\(^4\) Since then, the Federal Government has entered the field of deposit insurance. Although the state's deposit insurance fund continues to insure amounts not covered by the Federal Deposit Insurance Corporation, the existence of the F.D.I.C. does raise new problems in the operation of the Mutual Savings Central Fund, Inc. Accordingly, the sections of the statute enabling this corporation to take possession of banks in an unsafe condition no longer apply to banks whose members are insured by the F.D.I.C.\(^5\) In addition, possible insurance of the insurer is eliminated by the new legislation, since insurance under the state fund is specifically denied to deposits in member banks that have been made, directly or indirectly, by the Federal Deposit Insurance Corporation.

§6.8. Banks and banking: Loans and reserves. Loans to veterans guaranteed by the Administrator of Veterans' Affairs under the Service-men's Readjustment Act of 1944, as amended, have been authorized in this Commonwealth since 1945.\(^1\) The original authorization was for five years after the termination of World War II. As the Congress extended its agreement to have the loans guaranteed, this Commonwealth extended the authority of its banks to make these loans. The General Court during the 1961 Survey year, however, has stopped trying to keep up with the year-by-year extensions of Congress and has removed its time limit.\(^2\) The present expiration time set by Congress is a fairly complicated formula that depends upon the length of service, the period of service, and the incurrence of disability for each prospective borrower.

The permissible classes of mortgage loans by savings banks have been extended to include mortgage loans on real estate anywhere, relative to armed services housing guaranteed by the Secretary of Defense under

\(^1\) Acts of 1932, c. 216.
\(^3\) Acts of 1932, c. 44.
\(^4\) Acts of 1934, c. 43.

\(^1\) Acts of 1945, c. 46.
Title VIII of the National Housing Act. Savings bank construction loans in residential developments have been liberalized with the maximum limit of mortgage per parcel of real estate raised from $15,000 to $20,000, and the total permissible loans of this nature raised from 2 percent of the deposits of the bank to 4 percent.

§6.9. Banks and banking: Miscellaneous. The practice by supermarkets and some other merchants of selling registered checks will no longer be permitted unless the merchant can prove his solvency. Anyone except a bank engaging in this business must file an annual statement showing net worth of at least $200,000, or else must post a bond of $25,000 to $100,000, as the Commissioner of Banks deems necessary. Annual filing fees range from $100 to $300.

The procedure for investigating charges of improper conduct of bank officers has been changed. While in the past the Commissioner of Banks was required to certify facts to a board consisting of the State Treasurer, the Attorney General, and the Commissioner of Corporations and Taxation, if the conduct of a bank officer was improper after written warning, it is now within the discretion of the Commissioner to notify the bank officials, and for them to meet and take appropriate action to protect the interest of the bank and its depositors.

Advertising anticipated rates of interest or dividends more than sixty days in advance is now prohibited unless the consent of the Commissioner of Banks is obtained. The statute states: "No bank shall advertise in any manner . . ." Whether a statement of past dividends will be held to be such an advertisement seems to be open.

Cooperative banks may now issue shares in either $100 or $200 denominations. In the past, shares were always for $200, an amount set when interest rates were 6 percent. With present lower rates of interest, it takes longer for regular investments to build up to $200. Consequently, the lower valued shares may give depositors a sense of faster accomplishment.

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3 Id., c. 804, adding par. 13 to G.L., c. 168, §35.