Chapter 6: Commercial Law

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CHAPTER 6

Commercial Law

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§6.1. General. Views may diverge as to what judicial and legislative developments in the Commonwealth since the 1961 ANNUAL SURVEY properly fall within the purview of "Commercial Law." Of those selected for this chapter and discussed below, it is at once apparent that the greatest flurry of activity dealt directly or indirectly with banks and related institutions. The trend in the General Court generally was to expand the powers of banks, trust companies and credit unions in the kinds and amounts of credit they could extend and the investments they could make.¹ Decisions of the Supreme Judicial Court and the federal courts sitting in Massachusetts, three also involving banks, three involving warranties in the sale of goods and others involving secured transactions, debts dischargeable in bankruptcy and commercial paper, ranged from doubtful to superb. In only a few instances were the developments of significant interest to other than those who may have been immediately involved. These instances are accorded the most attention in the discussion that follows.

§6.2. Banks and banking: Liability of collecting bank to drawer of check with forged indorsement. Whether a collecting bank is liable to the drawer of a check which did not reach the payee and upon which the payee's indorsement was forged was unsettled in Massachusetts law, and remained so with the enactment of the Uniform Commercial Code, until Stone & Webster Engineering Corp. v. First National Bank & Trust Co. of Greenfield ¹ was decided in 1962. An employee of the drawer plaintiff, instead of sending the checks to the payee in payment of obligations of the drawer, forged the indorsement of the payee and "cashed" them with the defendant bank. In a well-reasoned opinion, the Supreme Judicial Court affirmed the order sustaining the defendant's demurrer to the plaintiff's complaint which contained counts for money had and received and for conversion. The Court gave a number of reasons for its holding, the most salient

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of which were the fact that the plaintiff was not a holder to whom
the checks were valuable property and to whom the drawee could
make payment under Sections 1-201(20), 3-419 and 3-504 of the Uni-
form Commercial Code; the defendant had paid out its own funds
and not the plaintiff's; if a conversion action lies, it is by the payee;
the plaintiff had a right to have its account recredited by the drawee
bank unless that bank had a defense and, if such a defense existed,
that bank may have no right to recover over against the collecting
bank. Thus, while seemingly preventing circuity of action, the rights
of one party against another are not absolute or even upon the same
bases. Several times the Court suggested that expediency would have
been served had the drawee bank been made a party in order to settle
the matter in a single suit among all parties. 2

Section 3-419(1)(c) of the Uniform Commercial Code provides that
an instrument is converted when it is “paid on a forged indorsement.”
The provision is ambiguous in determining to whom the liability in
conversion runs. The Court is correct in holding that a drawer is not
such a person since, while the check, for lack of delivery to the payee,
remains the property of the drawer, there is no promissory obligation
on the check running to the drawer. Technically, only the piece of
paper is converted. The Court suggests, however, that if a payee has
an action against a collecting bank, it is not by virtue of Section 3-419.
In effect, the Court is construing the word “paid” in its technical
sense, meaning final payment by the payor-drawee bank. 3 The word
could as well be construed to have its ordinary meaning of payment
by any person, including “cashing” the check by a collecting bank.
Subsections (2) and (3), limiting the liability “in conversion or other-
wise” of collecting banks to proceeds they still have, make this con-
struction logical. They also would preclude recovery in this case by
even a payee to whom the check was delivered.

A check with a forged payee's indorsement is not “properly
payable” from the drawer-depositor's account, and the drawee-payor bank's lia-
ability is thus implicit in Section 4-401. The depositor is given three
years from the time the item is made available to him with his bank
statement to discover and report the forgery. 4 However, the duty to
use reasonable care and promptness in discovering and notifying the
bank of forgery of his own signature or of a material alteration 5 does
not include forged indorsements. A payor bank may not recover from
a collecting bank the amount of the item if it fails to assert a defense
against its customer based upon breach of this duty. 6 It is this syllo-
gism which militates against the drawer's recovery directly from the

2 See U.C.C. §§3-803, G.L., c. 106, §§3-803, which allows “vouching in” of third
parties who may be liable over. Further citations to the Uniform Commercial Code
in this chapter are only to the U.C.C. citation. The section number thus cited is the
same as that appearing in G.L., c. 106.
3 See U.C.C. §4-213(1), which provides for when final payment occurs.
4 U.C.C. §4-406(4).
5 Id. §4-406(1).
6 Id. §4-406(3).
The payor bank does not have an absolute right of recovery. This is the only case in which the Code would deny recovery by the payor bank, but does not preclude applying the reasoning to deny recovery by the drawer from the collecting bank in the case of a forged indorsement. In these cases, consistency and certainty are virtues. However, it is important to note that the Code itself does not preclude recovery by a payor bank from a presenting or transferring bank upon a breach of warranty for its failure to assert any other defense, such as negligence contributing to an alteration or a forgery, against its customer. In this context, the rule of Section 4-406(5) should not be extended.7

§6.3. Creditors' rights: Debts dischargeable in bankruptcy: Assignee and trustee for benefit of creditors. Carmel Credit Union v. Lesser1 is more procedural than substantive in holding that mere admission by a plaintiff creditor that bankruptcy proceedings have been commenced, without pleading an exception to discharge under Section 17 of the Bankruptcy Act, does not render the complaint demurrable. Discharge, as with the statute of limitations, is a matter of affirmative defense which, if raised, would only then require pleading and proof of an exception. The plaintiff alleged that the defendants in two companion actions had failed to list all of their debts in obtaining a loan from the plaintiff. Before the amendment to Section 14 of the Bankruptcy Act,2 obtaining money by false representations was ground for denial of discharge. This is no longer true of a non-business bankrupt, but the money so obtained remains a non-dischargeable debt under Section 17. The amendment was designed to give some relief to individual debtors duped by shrewd lenders and creditors into neglecting to list all creditors in applications for credit. The result of the amendment is to make the practice fashionable, since those who do not follow it will find their claims discharged while the more astute have protected themselves in this way.

A depositary bank has a right to set off funds of the depositor against his obligations to the bank. This has not been true of unmatured obligations except when insolvency proceedings by or against the debtor are commenced.3 The Supreme Judicial Court in Friedman v. First National Bank of Boston4 put an assignment for the benefit of creditors on the same footing, holding that a bank could with impunity dishonor two checks of the depositor payable to the assignee under an assignment made six days prior and which were presented one day prior to the maturity date of the assignor's note

7 Id. §3-406. "Although the principle of subsection (5) might well be applied to other types of claims of customers against banks and defenses to these claims, the rule of the subsection is limited to defenses of a payor bank under this section. No present need is known to give the rule wider effect." U.C.C. §4-406, 1958 Official Comment.

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held by the bank. The bank knew of the assignment, its debt had not been listed by the assignor and its ability to collect had been jeopardized; hence the assignment of all assets to the assignee "gave the bank a right of set off."

An assignment or trust for the benefit of creditors is a non-bankruptcy device for liquidation of assets. Increasingly, the assignee is being placed in the same relationship vis-à-vis the debtor and his creditors as is the trustee in bankruptcy. Unless bankruptcy is to become the only available means of liquidation, this must be so. Had the bank precipitated bankruptcy in this case, its right of set-off would have been secure. Whether this is sound, since it results in a lawful preference, is a matter of policy which the Supreme Judicial Court properly did not reach. Implicit in the decision is that a creditor assenting to the assignment would not have the right of set-off. However, there is no reason to limit the right to banks as creditors: any creditor with mutual debts and credits should be allowed to set off the amount he owes.

On the other hand, in the absence of statute, there are certain powers of the trustee in bankruptcy denied to an assignee. One of these is avoiding certain liens acquired within four months of the assignment. But neither trustee nor assignee succeeds to the rights of creditors with valid, enforceable liens. The Court in the Friedman case so held in denying the assignee's claim for funds held by the bank which creditors had previously reached by trustee process.

The duties of trustees for the benefit of creditors were augmented by statute where the assets or liabilities of the assignor exceed $5000. In addition to the obligations to give notice to creditors and to file publicly a copy of the assignment, in these cases the trustee must now, fifteen days before distribution of assets, furnish a statement of total assets of the trust with the assignee's affidavit that they comprise all of his property and estate, liabilities of the trust and all costs, fees and expenses. The effect of this amendment is indirect: failure to comply will subject the assignment to attack in insolvency proceedings as invalid and the trustee to possible personal accountability for the property or its proceeds under Section 40 of Chapter 203.

§6.4. Retail instalment contracts: Charge for deferred payments under motor vehicle contracts and rebates for prepayment of service contracts. Two statutes were enacted during the 1962 SURVEY year further regulating instalment contracts for goods and services. One made a distinction between a renewal of the unpaid time balance and deferment of instalment payments under retail instalment contracts for the sale of motor vehicles. Former Section 17 of Chapter 255B had tended to treat them in the same manner. Actually, their effect

§6.4. 1 Acts of 1962, c. 293.

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is the same in most cases: extension of the time of payment under the initial contract. However, a renewal has to do with the entire unpaid balance, while deferment may apply to one or more instalments without affecting the outside time for complete payment under the original contract. The means of recomputation of the finance charge upon the entire balance after credit for prepayment could not logically apply to deferments. Thus sellers or their assignees were discouraged from providing temporary relief from instalment obligations.

The recomputation rule of Section 17 remains the same for renewals. However, holders may now collect a deferment charge of not more than one percent per month on each amount deferred from the date it was originally payable until it is payable under the deferment agreement. A minimum of one dollar may be charged in any case. In the case of neither renewal nor deferment is it clear what sort of writing, if any, is required. Ostensibly, renewal involves a completely new instalment contract, and compliance with the formalities of Sections 9-13 of Chapter 255B so far as possible is at least implicitly contemplated. To defer payments, something more than tacit assent to a late payment would seem to be required. The deferment charge is not a delinquency charge, but an additional charge for overtly extending the credit period. The limitation on the period for which the additional charge may be made uses the term “agreement,” something short of a new instalment contract but more than a waiver of delinquent payments. The agreement wisely should be reduced to writing with the essential terms of the deferment.

Since 1955 purchasers of consumer goods on instalment credit have been assured of the right to prepay the indebtedness in advance and to receive a credit for or rebate of finance charges computed by the sum of digits or “Rule of 78” method. The statute did not cover contracts solely for service and may not have covered services rendered in connection with the instalment sale of consumer goods. Section 12D has now been added to Chapter 255, and allows prepayment and credit for finance charges computed in the same manner “in any transaction for services rendered or to be rendered to a retail consumer for personal, family or household purposes.” It seems clear that this provision applies (1) to services in connection with an instalment sale of goods and (2) to services alone provided on instalment credit. There are two limitations: the debtor must be a retail consumer, and the services must be for personal, family or household purposes. These would exclude services rendered to the business debtor. However, the types of services which meet the limitations are many. They range from the overhaul and repair of watches, washing machines and furnaces to the application of siding to or installation of a dormer upon a private dwelling. It is, perhaps, unfortunate that “services” alone or in conjunction with a security interest in consumer goods are not

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2 G.L., c. 255B, §11.
3 Id. §12B.
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included in the statutes regulating the contents of the agreement, restricting the kinds and amounts of collateral, and requiring that notes be labeled “Consumer Note” preventing acquisition by holders in due course. The possible abuses in instalment service contracts are as great as in instalment transactions with goods.

§6.5. Sales: Breach of contract and breach of warranty. Three cases, all decided by federal courts, involved breach of sales contracts and breach of warranty. The decision in each case turned upon proof offered by the plaintiff buyer. Ordinarily, that fact would mitigate against any broader significance, but it is precisely that fact that warrants their inclusion and comparison here. In Skopes Rubber Corp. v. United States Rubber Co. both sides had carefully and thoroughly presented evidence going to the establishment of the contract for sale of a vinyl-coated rubber product for use in skin-diving suits, of a warranty by sample as part of the contract and of a breach of both. The Court of Appeals reversed a lower court decision directing a verdict for the defendant seller, holding that the evidence was sufficient for a jury determination of the issues. By contrast, Judge Caffery gave judgment for the seller in both D’Orsay Equipment Co. v. United States Rubber Co. and Belanger Sons, Inc. v. Fry Roofing Co. when the buyer in each case failed to produce evidence sufficient to support its claims. The Uniform Sales Act and not the Uniform Commercial Code governed all three cases. The moral for counsel is that the courts are reading the statutes carefully and are requiring careful adherence in the proof required to meet them. The moral goes one step further: counsel must advise the client wisely in procedure to be followed long before the dispute reaches the courts in which that prior conduct will determine the eventual outcome.

In the Skopes case, the buyer, whether on advice or not, gave immediate notice to the seller when the material eventually received failed to meet the elaborate tests of the original sample. In D’Orsay, the buyer notified the seller of alleged defects five months after it received the first complaint from a customer, while the statute required notice within a reasonable time and the parties’ contract required thirty days’ notice. Inadequate evidence of causal connection between the damage suffered and the ill-proved defects in a waterproofing substance helped defeat the buyer in Belanger Sons, Inc.; in Skopes, the testimony was long and detailed on this issue. The plain-

5 G.L., c. 255, §12.
6 Id. §13B.
7 Id. §12C.
8 See Model Retail Installment Sales Act, 3 B.C. Ind. & Comm. L. Rev. 437 (1962).

§6.5. 1 299 F.2d 584 (1st Cir. 1962).
4 299 F.2d 584, 590 (1st Cir. 1962).
7 299 F.2d 584, 592-593 (1st Cir. 1962).
tiff in the *Skopes* case produced both documentary and oral evidence of the lengthy negotiations, conferences and agreements of the parties toward establishing both the contract and the warranty; the plaintiff in the *D'Orsay* case chose to ignore a prior contract, the terms of which, including delivery and price, were adhered to in the contract in dispute, because other terms disclaimed warranties and limited remedies.\(^8\)

The comparison could be extended. Article 2 of the Uniform Commercial Code reflects draftsmanship sensitive to commercial needs and understanding. The requirements for complying with its terms before and at the time, during performance, and after breach of a contract for sale are no more than buyers and sellers should expect. The court in the *Skopes* case was able to find evidence of a warranty by sample sufficient to send to a jury,\(^9\) distinguishing a prior case in which it was said that the buyer's hope had exceeded the result but no express warranty that the hope would be fulfilled had been made.\(^10\) This is, perhaps, a fine distinction, but illustrative of distinctions that must be made in fact. Under the Uniform Commercial Code, a buyer must establish that there was an *affirmation or promise*, as opposed to a hope, which became a *basis of the bargain* in order to establish an express warranty.\(^11\)

§6.6. Secured transactions: Assignment of contract rights and accounts. After reading the lengthy and complex opinion in *Aetna Casualty & Surety Co. v. Harvard Trust Co.*,\(^1\) decided on the basis of pre-Code law, the commercial lawyer must breathe a sigh of relief for the comparatively simple provisions of Article 9 of the Uniform Commercial Code. The events all began in 1954 when a bank *orally* agreed to extend a $200,000 line of credit to a contractor, each advance of which was to be secured by assignments of "all the proceeds" from specific accounts receivable for work performed under the contracts financed. Until February 3, 1958, the bank made substantial loans to the contractor, allowed him to deposit the money in his usual checking account and to use it freely, and accepted checks drawn upon the account in payment of the loans. During this time, five of the contracts were with the United States and one was with the city of Cambridge. The contractor applied for and obtained performance bonds on the federal contracts as required by the Assignment of Claims Act. Each application assigned to the surety the contractor's contract rights against the Government, and each assignment was to secure payment to the surety upon the contractor's default under the other contracts and bonds. Neither bank nor surety gave notice of the assignments to the Government or to each other, although the surety knew that the bank was financing the contractor.

As each advance was made by the bank, the contractor signed a col-

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\(^9\) 299 F.2d 584, 591 (1st Cir. 1962).
\(^10\) Egyptian Chemical Co. v. General Products Co., 229 F.2d 263 (1st Cir. 1956).
\(^11\) See U.C.C. §2-813.

lateral note and assigned book accounts evidenced by invoices. The contractor's books were marked to reflect the assignment to the bank. Money advanced by the bank was not used exclusively for the contracts involved.

Between November 30, 1956, when all prior indebtedness had been paid, and February 3, 1958, the bank advanced $981,000 and received in payments a total of $433,269. On February 3, the bank learned of the assignment to the surety, of the contractor's default under the Government contracts and, so it contended, of the requirement of notice under the Assignment of Claims Act. The contractor and bank executed proper assignments under the act on February 10, and the bank received from the contractor two additional payments on February 3 and 11. The surety took all further payments by agreement with the bank and then sought to recover all payments received by the bank prior to that time.

The Supreme Judicial Court held, upon facts found by a master, that the surety could recover only the payments made after February 3 before which the bank had no notice of the assignment to the surety which, by the contractor's default, had become unconditional. Reaching this result required consideration of many pre-Code cases and some often nebulous distinctions. The Court rejected as reasons the failure of the surety to notify the bank and the fact that the bank's advances reduced the surety's risks. The significant fact was the actual receipt of payment by the bank before notice. Until the default of the contractor, the surety's rights were "inchoate" and merely equitable, whether acquired by assignment or by subrogation.

The Uniform Commercial Code would make the result somewhat easier and somewhat different. In the first place, the oral agreement between the bank and the contractor could have no efficacy under Section 9-203(1), which requires a written security agreement. No doubt the subsequent collateral notes, if they created or provided for the security interest in the contract rights or accounts, or the formal assignments themselves, or both together, would constitute security agreements. By contrast, the written applications for bonds which assigned the contract rights to the surety, even though the obligation secured was conditional upon the contractor's default, were security agreements adequate under the Code. At the time of the suit, neither party had perfected his security interest which, in the case of accounts and contract rights, can only be accomplished by filing financing statements in the proper office or offices.² Thus the rule of priority as to the accounts or contract rights themselves is found in Section 9-312(5)(c):

² U.C.C. §9-302.
the assignment to the bank at least giving it knowledge of the claim. It is difficult to believe that the bank, financing contractors with the Government in such large sums, was ignorant of the requirements of the act.

It must be assumed that the application for and issuance of the bond preceded both the consummation of the contract and the formal assignments to the bank in exchange for advances that occurred only after the contract existed. If this is so, the surety's security interest attached to the contract rights immediately upon execution of the contracts and to the accounts upon performance by the contractor, while the bank's could not attach until the assignments (security agreements) were executed. However, when the contractor received the proceeds and they were commingled freely, the security interest of either party, extending to only identifiable proceeds and to those only ten days after receipt, was lost. At best, the payments to the bank before February were mere preferences not unlike, as against the surety, payments to any other creditor.

After February 3, when the bank learned of the surety's claim, if the proceeds under the contracts had not been received and remained identifiable, the surety would be entitled to them as the holder of the first attaching security interest in the accounts or contract rights. If, on the other hand, the payments to the bank on February 6 and 11 were from the contractor's commingled cash in his account, they would be no different from the prior payments. Notice of the surety's claim has no bearing on priorities. Instead of notice, the surety should have acquired a lien upon the contractor's bank account and, to be secure as to future proceeds, filed a financing statement covering both the contract rights and proceeds. Even at that late date, the surety would prevail as the first to perfect. It is safe to say that neither sureties nor banks will be so naive in future transactions with contractors.

§6.7. Secured transactions: Knowledge of contents of financing statements. A conditional seller of machinery filed financing statements with the Secretary of the Commonwealth and the Register of Deeds for Bristol County, but none with the city clerk of Attleboro, where the buyer-debtor had its only place of business. The trustee in bankruptcy of the debtor sold the machinery, and the referee denied the petition of the conditional seller to establish a lien on the proceeds. In affirming, the federal district court held in In the Matter of Babcock Box Co. that the security interest was unperfected as required by Section 9-401 of the Uniform Commercial Code and hence was subordinate to the rights of a trustee in bankruptcy as a lien creditor under Section 9-301(1) and (9). The court held that even though the conditional seller had filed in good faith and the trustee in bankruptcy knew of the contents of the financing statement, he was still

8 Id. §§9-204(2)(c).
4 Id. §§9-203(1)(b), 9-204(1).
5 Id. §§9-306(2)(3).
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a lien creditor without knowledge since *all* creditors did not have knowledge as provided in Sections 9-401(2) and 9-301(3). The court also held that the result would be the same under Section 70c of the Bankruptcy Act, which gives the trustee the status of the ideal lien creditor, meaning one without knowledge.

The construction of the Uniform Commercial Code sections cited is probably correct, although not inevitable. Nothing directly connects the definition of lien creditor in subsection (3) of Section 9-301 and the effectiveness of filed financing statements the contents of which are known to the contesting third party provided in subsection (2) of Section 9-401. The former deals with knowledge of the security interest, while the latter deals with knowledge of the contents of a financing statement. More important, however, is the court's indication that the status of the trustee under Section 70c is independent of the status given him by Article 9, but that the two shall be found consistent wherever possible. Thus, assuming *all* creditors in bankruptcy knew of the security interest and their knowledge is imputed to the trustee by the Code provision, there is no basis for concluding that he will be held to have that knowledge as a lien creditor under Section 70c.