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Chapter 5: Commercial Law

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§5.1. **Minor errors in financing statements.** During the 1971 Survey year the Supreme Judicial Court was presented with its first case involving UCC Section 9-402(5):1 “A financing statement substantially complying with the requirements of this section is effective though it contains minor errors which are not seriously misleading.” In *Still Associates, Inc. v. Murphy,*2 the Court correctly decided that the minor error in the financing statement had not misled or prejudiced those who had relied on the financing statement. A thorough discussion of the *Still* decision and UCC §9-402(5) is included in the student comment, §5.9 infra.

§5.2. **Sale: Acceptance of goods; Rejection of goods; Revocation of acceptance; Warranty.** In *Axion Corp. v. G.D.C. Leasing Corp.,*1 there were three sales transactions between the parties, each relating to an expensive valve-testing machine of sophisticated design. The three machines were delivered, and two of them were paid for, but the defendant buyer refused payment for the third valve-tester. In consolidated actions, the seller sued to compel payment for the third machine, and the buyer alleged damages for the seller’s breach of express and implied warranties as to each of the three machines. The trial court entered directed verdicts for the seller.

On appeal, the threshold question for the Supreme Judicial Court was whether the third machine had been accepted or rejected under the code. The seller contended that the second and third machines, which were ordered, delivered, and tested together, constituted one “commercial unit,”2 so that acceptance of the second machine constituted acceptance of the commercial unit under UCC §2-606(2): “Acceptance of a part of any commercial unit is acceptance of that entire unit.” Section 2-606(2), however, applies only where both the

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goods and the tender of delivery conform to the contract. If there is nonconformance, Section 2-601(c) permits the buyer to "accept any commercial unit or units and reject the rest," and the definition of commercial unit includes a single machine. If the buyer had won on its breach of warranty claim as to the third machine, it would have shown a nonconformance which could have entitled it to reject that machine.

Although the Court found that there had been no breach of warranty, it nonetheless rejected the seller's contention that the second and third valve-testers had comprised a commercial unit. Without reference to the definition of commercial unit as including a single machine, the Court looked to the nature of the goods. Observing, for example, that the seller had taken back the third machine separately for further work, the Court concluded:

There is no evidence that there was a commercial usage to treat two machines as a single whole or that division of a pair of machines materially impaired their character or value, or that acceptance of one produced a materially adverse effect on the other.

Thus the test employed in this case appears to be one of good faith and commercial reasonableness, so that undue significance is not attached to the grouping of goods when ordered and delivered.

Having failed to show acceptance of the third machine under Section 2-606(2), the seller prevailed on his alternative theory: the buyer's failure to make an effective rejection. Under UCC §2-606(1)(b), the goods are considered accepted if the buyer fails to make an effective rejection; and under UCC §2-602(1), a rejection of goods, in order to be effective, must occur within a reasonable time after delivery or tender and must include a seasonable notice to the seller. Since in this case the buyer gave notice of rejection to the seller more than one year after receipt of the machine, the Supreme Judicial Court held, as a matter of law, that the notification was not seasonable and the rejection was not within a reasonable time.

Once goods have been accepted, a buyer becomes obligated to pay for them at the contract price. Yet under appropriate circumstances he may revoke his acceptance and have the same rights as if he had effectively rejected the goods. Under UCC §2-608, the basic require-

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3 Ibid.
5 See UCC §2-601, Comment 1.
7 UCC §2-607(1).
8 UCC §2-608 provides in part:
   "(1) The buyer may revoke his acceptance of a lot or commercial unit whose non-conformity substantially impairs its value to him if he has accepted it
   "(a) on the reasonable assumption that its non-conformity would be cured and it has not been seasonably cured; or
   "(b) without discovery of such non-conformity if his acceptance was reasonably in-
ments for revocation of acceptance are that the goods be nonconform­ing and that the nonconformity substantially impair their value to the buyer. In *Axion* the Court found the evidence insufficient to show substantial impairment of value. As a consequence, the seller could recover the contract price under Section 2-709(1)(a), subject to any offsetting claim for damages by the buyer under Section 2-714.

Having failed to show effective rejection or revocation of acceptance, the buyer was left with nothing but its claim for damages for breach of warranties. Since the machines were semi-experimental in nature, and since no affirmation of fact or promise as to particular performance standards had been shown, the Court rejected the claim of an express warranty. As to an implied warranty of merchantability, the Court noted that the machines clearly were capable of setting valves, even if they did not set the valves within a tolerance of plus or minus 5 percent. "'The requirement when it exists that goods shall be mer­chantable does not require that the goods shall be of first quality. . . .'" A claim as to an implied warranty of fitness for a particu­lar purpose was also rejected. The Court concluded that the buyer had been actively involved in the design of the valve-tester and had not relied on the seller's skill or judgment in the production of machines that would operate within a particular tolerance.

Under the Uniform Commercial Code, a buyer faced with a tender of goods can accept them, reject them, or accept and later revoke his acceptance. *Axion* illustrates some of the significant practical differences between the remedies of rejection and revocation of acceptance. The most significant is that the course chosen by the buyer will determine who has the burden of proof. When the buyer rejects, the seller must prove that the goods and tender were conforming; but when the buyer revokes his acceptance, it is he who must prove that a breach or defect existed at the time of delivery. Another significant difference between the remedies concerns the degree of nonconformity which a buyer must prove. Any breach in either the tender of delivery or the goods themselves is sufficient to make a rejection effective, but for the buyer to revoke his acceptance, the defect must substantially impair the value of the goods to him. Finally, as *Axion* makes clear, a buyer cannot force goods back upon the seller, either by rejection or by revocation of acceptance, once a "reasonable time" has elapsed. The

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9 UCC §2-313.
10 UCC §2-314.
12 UCC §2-315.
13 For a general discussion, see Note, Rejection or Revocation under the Uniform Com­mercial Code, 31 Ohio St. L.J. 151 (1970).
14 "Thus the principal effects of acceptance are to shift the burden of proof and to subject the buyer's rights to the limitations stated in [UCC] §2-608." 1971 Mass. Adv. Sh. 817, 821-822, 269 N.E.2d 664, 668. See UCC §2-607(4).
issue of what is a reasonable time is to be determined by all the facts of the case, and a court will look particularly at contract terms relating to inspection of the goods by the buyer after delivery.

§5.3. Guaranty: Snelling v. State Street Bank and Trust Co.¹ This case arose in an equity petition in the Suffolk County Probate Court. One of three coguarantors of a loan sought a declaratory judgment and other relief as against the other two coguarantors and the creditor, the Small Business Administration (SBA). SBA had made a loan to the principal debtor, Plymouth Bay Packing Company (Plymouth), secured by a mortgage of Plymouth's properties and a security interest in its inventory. Plaintiff was the personal representative of her deceased husband. Plaintiff's intestate and two of the defendants gave a joint and several guaranty of the loan to SBA on a form customarily required by that agency. Mr. Snelling gave security to SBA for his guaranty, but the guaranty obligations of the other two coguarantors were unsecured. When Plymouth subsequently went into bankruptcy and its secured assets were sold for less than enough to cover the loan, the resulting deficiency gave rise to two separate sets of controversies: one between SBA and the guarantors and the other among the three coguarantors themselves.

As between SBA and the guarantors, the probate court erroneously entered a decree requiring each guarantor to pay one-third of the loan deficiency. On the appeal of SBA, the Supreme Judicial Court correctly held that SBA was entitled to full recovery from any of the guarantors.² Of course, there could be only one satisfaction, but if one guarantor paid more than his share, he was relegated to his right of contribution against his coguarantors. SBA was entitled to be paid in full from any guarantor, and contribution rights were no concern of SBA. The Court found it unnecessary to cite authorities, but relied exclusively on the fact that the guaranty was both "joint and several" and "unconditional."

The guarantors raised defenses based on certain actions of SBA, including an agreement to release certain collateral, authorization for payment of interest on "standby" debt, and a delay in the liquidation of collateral after the bankruptcy of the principal debtor. It is true that without waiver or consent by a guarantor, certain acts or omissions of a creditor can discharge or modify the obligation of the guarantor. Where, for example, the creditor and principal debtor substitute an entirely new obligation, or materially change the old one, the guarantor is discharged.³ However, in this transaction SBA had followed the prudent practice of incorporating into the guaranty some comprehensive waivers of possible defenses relating to changes in the incidents of the debt. The language of the guaranty gave the SBA full power, "in its uncontrolled discretion and without notice to the undersigned . . . to deal in any manner with the Liabilities and the

² Id. at 1557, 265 N.E.2d at 356.
³ See generally Restatement of Security §§122-150.

http://lawdigitalcommons.bc.edu/asml/vol1971/iss1/8
Although the Court did not specifically refer to this clause, it may be assumed that an act pursuant to this type of prior consent must plausibly be an act constituting "discretion" and not be baldly capricious or patently mischievous. Representatives of SBA testified that their conduct was a matter of their "wisdom and judgment" and was "mutually prudent," and this was apparently taken by the Court as indicating good faith.

The second and more complicated set of controversies in Snelling involved relationships among the guarantors themselves, particularly with respect to exoneration and contribution. Exoneration among coguarantors is the right of one coguarantor to have each of his co-guarantors make a contemporaneous payment to the creditor of his appropriate share of the guaranteed obligation. Contribution among coguarantors is the obligation of one coguarantor to reimburse another coguarantor who has paid to the creditor more than his appropriate share. The rights to exoneration and contribution are conferred by law rather than contract unless by contract the relationship among guarantors is changed, as where one guarantor agrees to become a subguarantor and the other the principal guarantor. In that case, the subguarantor is entitled to exoneration and reimbursement from the principal guarantor.

Snelling is authority for the principle that where there are several guarantors, as among themselves, each normally has an equal obligation. That is to say, where there are three coguarantors and one has paid the entire debt, each of the others must reimburse the paying guarantor one-third of the debt if no contrary arrangement is shown. In Snelling, however, the defendant guarantors contended that they were subsureties and essentially accommodation parties to the plaintiff guarantor. There was testimony that Mr. Snelling had told the guarantors, in effect, that they would not be called upon to pay anything on the loan. The general rule is that two or more sureties bound to answer for the same debt are considered cosureties unless the equities of the situation impose the principal liability on one of them, or unless they agree among themselves that one of them will assume the whole

5 Restatement of Security §§112, 156.
7 The Restatement of Security §154 gives rules governing certain variations in the computation of contribution. Although not involved in this case, these rules illustrate the equitable goals of the contribution concept. For instance, if one coguarantor is insolvent, the paying guarantor can, by recourse to equity, require the solvent coguarantors to contribute a larger share. Thus if there are three coguarantors, one of which is insolvent, and the paying guarantor pays $9000, the other solvent guarantor must contribute $4500. Also, where the risks assumed are unequal, the proportionate share is determined by the amount of risk assumed by each. Thus, if two persons are guarantors upon a debt and one limits his liability to $10,000 and the other to $5000, the former should bear two-thirds of the ultimate liability. If the debt is $7500 and is paid by the guarantor with the greater risk, he can recover $2500 from the other guarantor.
duty of performance.\textsuperscript{8} Where there is this relationship of principal surety and subsurety, the latter is in the same relation with the principal surety, as to rights of exoneration and contribution, as a surety is to a principal debtor. The Supreme Judicial Court found against the defendant guarantors in \textit{Snelling}, concluding that certain reported conversations “do not constitute an agreement that Snelling [the plaintiff’s intestate] was to be principal guarantor and surety, and that, as between him and them, the coguarantors were to be merely subsureties.”\textsuperscript{9}

Having determined that the defendant guarantors were cosureties with Mr. Snelling, the Court was faced with the plaintiff’s claim for exoneration. The defendant guarantors argued that “as a condition precedent to exoneration, Snelling’s estate must establish that it will be subjected to special hardship and risks if forced to pay the debt to SBA before seeking contribution from the coguarantors.”\textsuperscript{10} The Court rejected the argument, observing that nothing in the case relied on by the defendants required “proof of special hardship or risks as a basis for exoneration.”\textsuperscript{11} Yet the Court’s decree ordered contribution, not exoneration. This course may have been chosen because of a feeling that an order for exoneration would unfairly delay realization on the loan deficiency by SBA.

It is unfortunate that the Court made no reference in \textit{Snelling} to the Uniform Commercial Code, for certain provisions of the code could properly have been utilized either by direct application or by analogy. To interpret the separate instruments signed by the three guarantors, the Court could have looked to Section 3-416, which states the commercial understanding given to different words of guaranty. As support for the finding that the three parties were in fact coguarantors, Section 3-416(3) could have been used: “Words of guaranty which do not otherwise specify guarantee payments”; i.e., full payment by each guarantor. As additional support the Court could have cited the code by analogy. Section 3-414(2) regulates the liability of indorsers, all of whom have signed the same instrument. Such indorsers are liable to one another in the order in which their names appear, unless they otherwise agree. In other words, if the instrument indicated that the indorsers were to be jointly and severally liable, they would in fact be coguarantors. By analogy, since each of the instruments signed by the three parties in \textit{Snelling} contained a provision for joint and several liability, the parties could have been held as coguarantors by the terms of their own agreement. Since, under the code, the three parties would be coguarantors if they had all signed the same instrument, a different finding should not result in the \textit{Snelling} situation merely because the parties had signed separate agreements.

The Court could also have referred to the UCC when discussing

\textsuperscript{8} Restatement of Security §146.
\textsuperscript{10} Id. at 1551, 265 N.E.2d at 353.
\textsuperscript{11} Ibid. The defendants had relied on Nissenberg v. Felleman, n.6 supra.
the oral evidence introduced to support defendants' contention of subsuretyship. Under Section 3-415(3), parol evidence is admissible to prove that a party has signed for accommodation (except as against a holder in due course). In the event that such evidence does affirmatively prove the party to be an accommodation indorser, under Section 3-415(5) such accommodation party, if compelled to pay, is subrogated to the rights of the holder paid and can have his recourse on the instrument. The comment to Section 3-415(5) notes that this provision is intended to change the result of the 1906 Massachusetts case of Quimby v. Varnum, which held that an accommodation indorser who paid the instrument could not maintain an action on it against the accommodated party. Instead, Section 3-415(5) affirms the traditional common law principles of suretyship.

The Court's consideration of certain acts of SBA provided another opportunity for the application of code principles by analogy. The requirement of good faith under UCC §1-203 permeates the entire code and governs all commercial transactions. However, the Court in Snelling failed to mention the code standard of good faith when discussing the "wisdom and judgment" employed by SBA in its dealings with Mr. Snelling, his estate, and Plymouth.

Whether the UCC applies to a particular commercial transaction depends on the various specific exclusions of the code and also on a determination of what principles of law and equity supplement, and are not displaced by the code. A good illustration of the application of code principles by analogy can be found in United States v. First National Bank of Boston. Defendant bank had received payment from the United States on stolen domestic postal money orders which, although they appeared to be proper, did bear forged initials of the issuing employee and unauthorized impressions of an issuing office stamp. In an action by the government against the bank to recover the amount paid, it was held that the defendant bank was under no duty of restitution where it had given value and had received payment without reason to know of either the forgery or the lack of authorization.

Speaking for the Federal District Court for the District of Massachusetts, Chief Judge Wyzanski first noted that since federal statutory law offered no real guidelines as to the issues, the case must be determined by judicially fashioned federal common law. He reasoned that since a postal money order has characteristics making it sufficiently like a negotiable instrument, UCC §3-418 should be applied by analogy. Section 3-418 provides in part that "acceptance of any [negotiable] in-

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12 190 Mass. 211, 76 N.E. 671 (1906).
13 UCC §1-103 provides: "Unless displaced by the particular provision of this act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions."
instrument is final in favor of a holder in due course, or a person who has in good faith changed his position in reliance on the payment." Judge Wyzanski found that the policy underlying this section operated in favor of the defendant: if a bona fide purchaser of a postal money order does not get protection comparable to that of a holder in due course under the UCC, the effect would be to lessen the market for domestic postal money orders.

§5.4. Rights and obligations of a depositary bank. Article 4 of the Uniform Commercial Code (Bank Deposits and Collections) provides a convenient classification of banks in the check collection process according to functions performed by each. Thus, depositary bank means the first bank to which an item (check) is delivered for collection. Payor bank means a bank by which an item is payable as drawn or accepted (also called the drawee bank). A collecting bank means any bank handling the item for collection except the payor bank. An intermediary bank is one in the collection process which is neither the depositary bank nor the payor bank. There are also categories of presenting bank and remitting bank whose functions are, respectively, to present an item to a payor bank and to remit funds for an item. A bank may perform more than one function with respect to the same item. Thus, if an item is deposited with the same bank upon which it is drawn, the bank will be both the depositary bank and the payor bank.

In Town Bank and Trust Co. v. Eaton, the plaintiff (Town Bank) was the depositary bank, and one of the defendants (First National Bank) was the payor bank. The case involved a fund resulting from checks issued by two life insurance companies and made payable to the same beneficiary. The beneficiary payee never received the checks, however, because her son-in-law forged her signature on the indorsement and deposited the checks in an account he shared with his wife at Town Bank. He previously had placed in the same account other funds belonging to his mother-in-law and wrongfully converted by him. When the forgery of the insurance checks was discovered, the conservator of the beneficiary payee claimed all funds remaining in the account. By that time Town Bank had collected the checks from First National Bank, which in turn had charged the amount of the checks against the respective accounts of its customers, the two insurance companies. Town Bank brought a bill in equity, interpleading the beneficiary payee, First National Bank, and the two insurance companies, and seeking to compel them to litigate among themselves the claims which each had to those funds held in the account at Town Bank. In the bill, Town Bank characterized itself as a "stakeholder" and alleged that it made no claim of interest in the funds.

The case was referred to a master, whose findings illustrate the chain of responsibility which typically develops in check forgery cases. First of all, because the beneficiary payee had never received the insurance

§5.4. 1 UCC§4-105.
checks, the obligations of the two insurers to her had not yet been discharged. The companies were required, therefore, to make payment to her. For its part, First National Bank could not properly charge its customers, the insurance companies, on items where the payee’s signature had been forged. This rule as to the payor bank under the UCC has limited exceptions, principally where a claiming party was itself substantially negligent, but these exceptions and the statute of limitations prescribed in the code were not applicable in the present case. First National Bank was therefore liable to its customers to reinstate amounts improperly charged. At the end of the chain was Town Bank. As collecting bank it warranted to First National Bank, as payor bank, that it had good title to the items. Since this warranty was breached because of the forgery, Town Bank was liable to First National Bank for the amount of the two items.

None of the above findings by the master was contested on appeal to the Supreme Judicial Court. However, the master also had found that the balance of the account on deposit with Town Bank, then $3,757.45, was owed by Town Bank to the checks’ payee on the ground that the money represented the balance of those other funds wrongfully converted by the son-in-law even before the present action arose. Town Bank argued that the $3,757.45 in fact represented the balance of the checks issued by the insurance companies, and that it should not have to pay the money twice. Town Bank contended that under UCC §4-208 it was entitled to set off the $3,757.45 as against its debt to First National Bank. The Supreme Judicial Court correctly held that under UCC §4-208 security interests attach only against a customer to whom the bank has extended credit, not against the drawee bank. And in any event, no such security interest could displace the warranties made by Town Bank under UCC §4-207. Town Bank also contended that the master’s report, if upheld, would unjustly enrich the checks’ payee at its expense. As support, Town Bank cited its ledger sheets, which had been introduced at the hearing below. However, no mention was made

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4 UCC §3-405 (“Impostors; Signature in Name of Payee”) and §3-406 (“Negligence Contributing to Alteration or Unauthorized Signature”). As to §3-405, see generally First Pennsylvania Banking and Trust Co. v. Montgomery County Bank and Trust Co., 29 Pa. D. & C.2d 596 (C. P. Montgomery Co. 1962).
5 UCC§4-406(4).
6 UCC§4-207.
7 UCC§4-208(1) provides:
“(1) A bank has a security interest in an item and any accompanying documents or the proceeds of either
“(a) in case of an item deposited in an account to the extent to which credit given for the item has been withdrawn or applied;
“(b) in case of an item for which it has given credit available for withdrawal as of right, to the extent of the credit given whether or not the credit is drawn upon and whether or not there is a right of charge-back; or
“(c) if it makes an advance on or against the item.”
8 Brief for Plaintiff at 7.
of the ledger sheets in the opinion of the Supreme Judicial Court, and we do not even know if they were examined by the Court, which simply stated: "Where, as here, the evidence is not reported, the facts found by the master are conclusive unless they are mutually inconsistent or plainly wrong." As a result, it is not clear what the $3,757.45 represented. The Court, however, rendered that issue immaterial by ruling that Town Bank, as a stakeholder, had disclaimed any right to the funds and, consequently, had no standing "to object to findings as to the respective rights of the defendants or to its liability to pay the funds in its hands to the prevailing party." Town Bank should have framed its bill in equity in such a way that its own claim of setoff would have been litigated along with all other claims to the funds it held.

§5.5. Payment: Check as payment; Presentment; Certification. Gal­ linaro v. Fitzpatrick1 was an action by the purchaser of real estate for specific performance of a purchase and sale agreement. In accordance with the agreement, the purchaser had given the vendors a check for $30,000 as a deposit, with instructions that they should "wait a day or so" before cashing it. Two days later, on a Wednesday, one of the vendors sought to have the check certified at the bank where the purchaser was a depositor. The bank refused. He made the same request on Friday, and the bank again refused. This time an officer of the bank attached to the check a slip bearing the words, "uncollected funds." The principal issue in the case was whether the vendors were then justified in refusing to perform the purchase and sale agreement.

Plaintiff's bill for specific performance was dismissed in superior court. On appeal, his principal argument was that the vendors were obligated to present the check properly in order to revive his own obligation to have sufficient funds on deposit to cover the check. The Supreme Judicial Court agreed with this proposition, but held that the defendant vendors had properly presented the check on two separate occasions. The Court noted that certification of a check constitutes acceptance under UCC §3-411(1), and that under Section 3-504(1) "Presentment is a demand for acceptance or payment made upon the maker, acceptor, drawee or other payor by or on behalf of the holder." Thus, the Court reasoned, since presentment is a demand for acceptance, and since certification of a check is acceptance, demand for certification must be proper presentment.

The Court did not say why presentment was necessary. It could have referred to Section 3-802(2). Where the check was accepted by the prospective seller as a deposit against the purchase price, the obligation of the prospective buyer with respect to the deposit could be said to have been "suspended" until the check was presented. As the check was presented and dishonored, the prospective vendor could again look to the prospective buyer for the necessary deposit against the purchase price. It does not appear that any other deposit was tendered; therefore an essential element of the purchase and sale agreement was missing, and

10 Id. at 1494-1495, 264 N.E.2d at 688-689.
specific performance in favor of the prospective buyer was rightfully denied.

As to the manner of presentment, it is true that under Section 3-505 "the party to whom presentment is made may without dishonor require" certain conditions, including exhibition of the instrument and "reasonable identification of the person making presentment and evidence of his authority to make it if made for another." However, the drawee bank is not shown to have required presentment in any manner other than that actually employed. It is also true that a bank may have no obligation to certify a check under Section 3-411(2), but in this case the bank refused certification because there were not collected funds, and it did not assert an unconditional right not to certify. Moreover, an item payable on demand should be presented for payment and not for acceptance. However, if the holder presents an item for acceptance (certification in the case of a check), the drawer has no reason to complain, for if the item had been certified the drawer would have been discharged. The result in this case appears to be consistent with the Uniform Commercial Code.


2 See UCC §§3-501, Comment 3.
3 See UCC §§3-411(1).

Although the result of the case appears to be correct, the Court's reasoning seems incomplete. UCC §§3-504 was relied on by the Court, but that provision must be read with Sections 3-501 and 3-511, which were not mentioned. Section 3-504(1) itself speaks of presentment as a demand for acceptance or payment; and under Section 3-501(1)(c), in order to charge the drawer of a check (in this case the prospective purchaser), presentment for payment is necessary. If certification is acceptance under Section 3-411(1), then a demand for certification is a demand for acceptance, not payment, and the presentment would be improper. Failure to present properly does not discharge the drawer, however; his obligations are revived when proper presentment is made.

Where, as in Gallinaro, the bank which refused to certify is the drawee bank, an argument can be made that presentment for acceptance amounts to presentment for payment. Section 3-410(1) defines acceptance as "the drawee's signed engagement to honor the draft as presented," and Section 1-201(21) provides that "[t]o 'honor' is to pay ...." Therefore, presentment to the drawee for certification, which is equivalent to a presentment for acceptance, may be considered a presentment to have the check honored/paid.

It should be noted that even if the presentment in Gallinaro had been held improper by the court, the outcome of the case need not have been different. Under UCC §§3-511(3)(b), applicable to this case, the need for proper presentment is excused where payment or acceptance is refused and the refusal is not based on the lack of a proper presentment. When presentment is thus excused and the instrument is not duly accepted or paid, then under UCC §§3-507(1)(b) the instrument is dishonored. Whether the rationale of the foregoing steps could be telescoped into the first presentment made in Gallinaro is not clear. What is clear, however, is that the bank's first refusal because of uncollected funds was enough to excuse presentment under Section 3-511(3)(b) and render the second refusal a dishonor. The vendors were thereafter discharged on their obligation to perform according to the purchase and sale agreement.

The failure of the Supreme Judicial Court to apply all of the relevant code sections and discuss their interaction makes it difficult to forecast how presentment issues will be handled in future cases. Those who use the Uniform Commercial Code should be careful in tracing the sections which apply to a particular presentment problem.

§5.6. 1 433 F.2d 1281 (lst Cir. 1971).
a remedy to trustees in bankruptcy of insolvent debtors against any creditor who has received a voidable preference. A voidable preference is created by (i) a transfer, (ii) of any of the property of a debtor, (iii) to or for the benefit of a creditor, (iv) for or on account of an antecedent debt, (v) made or suffered by such debtor while insolvent, (vi) within four months before the filing by or against him of the petition initiating a proceeding under the Bankruptcy Act, (vii) where the effect of the transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class. A preference may be avoided by the trustee if the creditor receiving the transfer had, at the time when the transfer was made, "reasonable cause to believe that the debtor [was] insolvent." Where the preference is voidable, the trustee may recover the property or its value where it has been converted. In the case of conversion, the trustee may recover the value of the property from the preferred creditor who disposed of the property or from that creditor's transferee if the latter is not a bona fide purchaser or lienor for "a present fair and equivalent value."

The trustee may enforce his claim for voidable preference in a plenary action in an appropriate federal or state court. The federal courts have jurisdiction without necessity for diversity of citizenship. If the creditor has filed a proof of claim in the bankruptcy proceeding, a summary proceeding in the referee's court is available to the trustee. In either type of proceeding, the trustee has the burden of proof on all the elements enumerated in Section 60(a), as well as the additional burden imposed on the trustee in Section 60(b) to prove that the creditor had reasonable cause to believe that the debtor was insolvent at the time of transfer. Receiving a preference is not an unlawful act and, of course, many transfers are not challenged by reason of the simple fact that no bankruptcy petition has been filed within four months thereof.

Section 67 of the Bankruptcy Act, relating to liens and fraudulent transfers, is a cognate section to be considered with Section 60 in various circumstances. Section 67(d)(2) incorporates into federal bankruptcy law the substance of Sections 4 to 7 of the Uniform Fraudulent Conveyance Act. A transfer within the terms of Section 67(d)(2) of the Bankruptcy Act can be avoided by a trustee if the transfer was made within one year of the bankruptcy petition. Thus, although a transfer might not be challenged under Section 60 because four months have elapsed, it might be challenged by a trustee if the necessary elements of a fraudulent transfer are present. Section 67(d)(3) is of consequence in some circumstances. Under that section a transfer, even for present consideration, may be challenged within four months if made in contemplation of a bankruptcy petition or of liquidation, if the new consideration is intended to be used to prefer particular creditors and if the transferee "knew or believed that the debtor intended to make such use of such consideration." This section is apparently designed to discourage pref-

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3 Id., §60(a).
4 For a discussion of the referee's summary jurisdiction, see Katchen v. Landy, 336 F.2d 585 (10th Cir. 1964), aff'd, 382 U.S. 323 (1966).
5 G.L., c. 190A.
erential payments to troublesome creditors in order to postpone the filing of a bankruptcy petition against an insolvent debtor. For example, a large creditor who has received a preference may be tempted to provide funds to make relatively small payments to troublesome creditors in the hope that bankruptcy might be postponed until his own position is protected by the lapse of four months from the transfer to him.

Of course, preferential transfers can be of money or any other kind of property and can be received either as payment or as security for an antecedent debt. Although the receipt of a preferential transfer can hardly be detrimental, and might benefit a creditor, it might be prudent, if circumstances permit, for a creditor who has received property other than money to wait the four months before disposing of the property. The reason for the delay is that he can more easily give up the property if the transfer is challenged by a subsequent trustee than risk a determination of value on disposition. The creditor's obligation is measured by value and not by what he may have received in the disposition of the property. A jury verdict on value might come as an unpleasant surprise.

The *Braunstein* case provides an illustration of some of the points mentioned above and serves as an important guide to future litigants in bankruptcy preference claims. The case arose in a plenary action brought by a trustee in bankruptcy against a bank which had received a security interest in substantially all of the assets of its customer as security for an antecedent debt. After a jury trial there was judgment for the trustee, which was affirmed by the First Circuit Court of Appeals.

One of the central issues was whether the bankrupt was insolvent at the time of the transfer. It is perhaps curious that the defendant bank conceded that there was evidence from which the jury could conclude that the bank had reason to believe the debtor was insolvent at the time of the transfer, but the bank argued that there was no evidence on which the jury could find that the debtor was in fact then insolvent. The bank's seemingly curious position reflects the fact that the trustee has the burden of proving both "reason to believe" and the fact of insolvency. A creditor might believe that his debtor is insolvent, but the fact of insolvency must still be proved. The controverted evidence on insolvency involved the weight to be given to schedules filed in the bankruptcy proceeding after the transfer, and the weight to be given an accountant's report made some time prior to the transfer.

Under Section 7(a)(8) of the Bankruptcy Act, a bankrupt must prepare, make oath to, and file in court a list of his creditors and "a schedule of his property, showing the amount and kind of property, the location thereof and its money value, in detail." Such a schedule and such a list would ordinarily show an excess of liabilities over assets, i.e., an insolvency in a bankruptcy sense. The First Circuit Court of Appeals has said that if there is evidence that the bankrupt's financial condition changed but little between the transfer date and the date of the petition in bankruptcy, "the schedule could be retrojected." And in *Braunstein*

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the court of appeals stated that the schedule "may not have been dispositive but they were certainly probative evidence [for the jury to consider in determining which debts were in existence on the transfer date]." Apparently, the debts listed in the schedule must be shown to be valid debts once the defendant raises the question by timely objection. Because the schedules may be particularly useful to the trustee in an action on a preference claim, the defendant must try to influence and restrict the use of the schedules at trial.

An uncertified auditor's report of assets and liabilities of the debtor about five months before the transfer was admitted in *Braunstein* on the question of insolvency. The books and accounts of the debtor were not available at the trial, even after "diligent search," and the auditor's report was admitted "as the best available evidence." The trial judge charged that it was for the jury to decide whether the figures in the report were accurate and whether those accurately reflected the status of the business. Evidence was also introduced to show the progress or lack of progress of the business in the time between audit and transfer.

The court of appeals did not refer to the Uniform Commercial Code in the present case, but of course the code has great relevance to bankruptcy preference problems. A security interest must be perfected to be good against a trustee in bankruptcy. Whether a security interest is perfected depends on local law, which commonly means the UCC, although with certain kinds of collateral other statutes, state or federal, may control. Section 60 of the Bankruptcy Act has much to say as to time of perfecting. The subject is too large to discuss here, but a few general statements may be useful. Perfection is ordinarily accomplished either through possession or by filing and recording. Sometimes there is a choice, but with receivables and certain other kinds of collateral there must be a filing, and with instruments and securities there must be possession. Timing is important. A creditor must take his security before or at the same time as making his advance. If the advance is made first, the subsequent security is for an antecedent debt. One practical allowance is made in Section 60(a)(7) of the Bankruptcy Act. If a security agreement and filing instrument are received at the same time the advance is made, Section 60(a)(7) allows a specified time within which to file. This avoids the inconvenience or impossibility of closing every secured transaction at the filing office.

Each element in the capital Bankruptcy Act's definition of a voidable preference raises its own problems. For example, what is a transfer? If a loan is made against all present and future receivables of a debtor and new receivables are created from day to day, is each receivable transferred when created, or are the new receivables simply incorporated within the earlier blanket security agreement? It is not uncommon for a retail merchant to consent to a lien in his inventory pursuant to UCC §9-204, in order to secure a loan made to him. A problem may arise,

7 443 F.2d 1281, 1284 (1st Cir. 1971).
8 Ibid.
however, if this merchant later becomes insolvent. Although the security agreement may have been entered into well in advance of the four months preceding bankruptcy, it is quite possible that the debtor's inventory will have “turned over” completely within the four-month period. An argument can be made that the entire “floating lien” is voidable under Section 60 of the Bankruptcy Act, as it may be viewed as a transfer of collateral for antecedent debt.\(^9\)

\section*{§5.7. Subrogation: Canter v. Schlager.} \(^1\) This was an action for money owed under a written construction contract. Plaintiff was the trustee in bankruptcy of a general contractor, and defendant was the owner of the premises on which a building had been constructed by the contractor. While construction was still in progress, an involuntary petition in bankruptcy was filed against the contractor, but work on the building was completed under the supervision of a receiver. There was the usual surety company payment and performance bond, under which the surety undertook to complete the project and to pay subcontractors. The surety paid more than $60,000 to subcontractors who had furnished labor and materials for the building, and the owner paid the surety $36,630.11, which was all that remained due under the construction contract. Since the issue in Canter was the propriety of making this payment to the surety rather than to the trustee in bankruptcy, the surety was the actual party in interest in this litigation.

\(^9\) A thorough discussion of the complex issue of whether a floating lien constitutes a voidable preference is beyond the scope of this chapter. Briefly, the trustee in bankruptcy will generally argue as follows: In the “floating lien” situation, where all the necessary steps such as filing are taken before the security interest attaches, the lien is perfected under UCC §9-305(1) at the time when it attaches. However, under UCC §9-204(1), a security interest cannot attach until the debtor has rights in the collateral. Therefore, if accounts receivable or items of inventory come into the debtor’s possession within four months of the petition in bankruptcy, the “floating lien” is not perfected until within the four-month period and is consequently a voidable transfer within the definition of Section 60(a)(2) of the Federal Bankruptcy Act.

Several cases, however, have rejected this reasoning. In Rosenberg v. Rudnick, 262 F. Supp. 635 (D. Mass. 1967), involving inventory acquired under a security agreement covering present and future inventory, the federal district court found against the trustee. According to the court, the test of when a transfer takes place is not governed by the time when state law (the UCC) may determine that a security interest has been perfected. Rather, the test is governed by state law as to the time when the security interest becomes one which cannot be defeated by a subsequent lien obtainable in proceedings on a simple contract action. On the basis of this reasoning, a security interest in inventory will not constitute a voidable preference if perfected outside the four-month period. Rather, the requirements for transfer under Section 60(a)(2) will be deemed to have been met on the date of the execution of the security agreement.

For cases citing Rosenberg with approval, see Grain Merchants of Indiana v. Union Bank and Savings Co., 408 F.2d 209, 213, 216 (7th Cir. 1969); In re Grain Merchants of Indiana, Inc., 286 F. Supp. 597, 605 (N.D. Ind. 1968); In re Portland Newspaper Publishing Co., 271 F. Supp. 395, 399-400 (D. Ore. 1967). For a recent article criticizing the result and the reasoning of cases such as Rosenberg, see Countryman, Code Security Interests in Bankruptcy, 75 Com. L.J. 270-280 (Sept. 1970).
The right to payment under a contract, even where the right is not yet earned, is a "contract right" under UCC §9-106. An assignee of a contract right, as secured party, must file a financing statement to perfect his security interest against a trustee in bankruptcy, unless the assignee falls within the exceptions noted in Sections 9-104(f) and 9-302(1)(e). In its application for payment and performance bonds, the contractor in Canter assigned to the surety its right to payment under the contract. However, no financing statement was ever filed with respect to the assignment. The principal argument of the surety was that it was not a secured party under the Uniform Commercial Code and was not required, therefore, to file. The surety claimed by reason of subrogation, an equitable doctrine not affected by the code. A surety had previously prevailed, on this ground, against a Massachusetts assignee bank which claimed a security interest in a contract right. In the present case, the Supreme Judicial Court reached the same result in favor of the surety as against a trustee in bankruptcy of the contractor.

Subrogation is a broad principle of equity jurisdiction and is aptly illustrated in French Lumber Co. v. Commercial Realty and Finance Co. That case involved three successive security interests in a Cadillac automobile, each securing obligations to the respective secured parties (Ware, Commercial, and Associates). Associates, third in line, paid the debtor's obligation to Ware, which was first in line, and received an acknowledgment of payment in full from Ware. Ware might have assigned its first security interest to Associates under UCC §9-302(2), but for some reason did not do so. Nevertheless, the Supreme Judicial Court held that Associates was subrogated to the rights of Ware by reason of the payment of the debt and, therefore, came ahead of Commercial with respect to proceeds from the sale of the Cadillac. The Court in French looked to precode decisions which reached the same result through the principle of subrogation.

The decisions on subrogation discussed above are not superseded by the Uniform Commercial Code. Section 1-103 of the Code pro-

2 UCC §9-106, Comment 1, explains: "It has been found advisable to distinguish rights earned from rights not yet earned for several reasons. The recognition of the 'contract right' as collateral in a security transaction makes clear that this Article rejects any lingering common law notion that only rights already earned can be assigned."

3 UCC §9-104(f) provides that Article 9 of the code does not apply "to a sale of accounts, contract rights or chattel paper as part of a sale of the business out of which they arose, or an assignment of accounts, contract rights or chattel paper which is for the purpose of collection only, or a transfer of a contract right to an assignee who is also to do the performance under the contract."


vides in part, "Unless displaced by the particular provisions of this chapter, the principles of law and equity . . . shall supplement its provisions." No provision of the Code purports to affect the fundamental equitable doctrine of subrogation.\(^6\)

The Court in *Canter v. Schlager* repeated the rationale of *French* and also quoted\(^7\) from a 1965 Pennsylvania decision:

Of basic importance is the general rule of Section 9-102(2) that Article 9 "applies to security interests *created by contract*" (Emphasis supplied.) Rights of subrogation, although growing out of a contractual setting and oftimes articulated by the contract, do not depend for their existence on a grant in the contract, but are created by law to avoid injustice. Therefore, subrogation rights are not "security interests" within the meaning of Article 9.\(^8\)

Thus it must be deemed established in Massachusetts that claims to funds or property by right of subrogation are not security interests within the meaning of Article 9. One must look to equity jurisprudence to determine what are subrogation rights, and these rights will be enforced without regard to perfection under the code.

The *Canter* decision bolsters recent Massachusetts authority allowing a surety in the construction contract situation to obtain priority under a subrogation theory.\(^9\)

Subrogation is referred to in UCC §9-504(5), which provides:

A person who is liable to a secured party under a guaranty, indorsement, repurchase agreement or the like and who receives a transfer of the collateral from the secured party or is subrogated to his rights has thereafter the rights and duties of the secured party. Such a transfer of collateral is not a sale or disposition of the collateral under this Article.

It would seem to follow from this language that a person realizing on collateral by right of subrogation must, as regards the debtor, proceed according to the security agreement of the secured party in whose right he acts. This would appear to mean that he must follow the terms of the security agreement as to notice, and the terms of other requirements as to the realization on collateral. It would also appear to mean that the rights of a guarantor in the collateral, as against a trustee in bankruptcy of the principal debtor, depend on whether the creditor has perfected his security interest. The Supreme Judicial Court refused to establish a general requirement that sureties engaged in construction projects perfect security interests in their assignments by filing. Instead, the Court noted that the draftsmen of the Uniform Commercial Code had considered the problems of such sureties and had decided,

\(^6\) Id. at 719, 195 N.E.2d at 510.


\(^9\) See cases cited in n.4 *supra*.
presumably, not to include a requirement that rights of subrogation be filed. The result in the present case is in keeping with the common law priority long given to those who claim by right of subrogation. Creditors must be aware of the widespread use of sureties in connection with building projects, and they must look to subordination agreements for any protection they feel is necessary against the surety's priority.

§5.8. Legislation: Privity of contract. Chapter 106, Section 2-318, of the General Laws has been amended by the Massachusetts legislature so as to eliminate, for most purposes, the defense of lack of privity in actions for breach of warranty. This important statutory change has been a long time in coming, and practitioners should be aware of its possible consequences. A thorough discussion of the amendment and its potential effects may be found in §§13.3 and 13.18 infra.

STUDENT COMMENT

§5.9. Sufficiency of financing statements: Description of collateral: Still Associates, Inc. v. Murphy. On October 31, 1967, Charles J. Lavoie and his wife executed a promissory note, a chattel mortgage, a financing statement, and a security agreement in favor of plaintiff. The financing statement described, among other items of collateral, "one (1) 1967 Dodge, 6 cyl. D-100 pickup, serial #1161-702080." Plaintiff's agent, however, had made a one-digit error in preparing the documents for Lavoie's signature: the true serial number was 1161-702088. On September 30, 1968, Lavoie sold the truck to the defendant with the serial number correctly identified on the bill of sale. At that time Lavoie was in default on his payments to plaintiff. Defendant had no knowledge of plaintiff's lien and purchased the truck in good faith, but without any search for recorded security interests. He took possession of the truck and refused a subsequent demand by the plaintiff that it be returned to Lavoie.

Plaintiff then brought an action in the Boston Municipal Court for conversion by defendant of the 1967 Dodge truck. Defendant answered by way of general denial, and the trial judge found in his favor. The appellate division of the Boston Municipal Court affirmed, whereupon plaintiff appealed to the Supreme Judicial Court, assigning as error the invalidation of his financing statement because of a one-digit error in the serial number. The Supreme Judicial Court reversed and held that "one (1) Dodge, 6 cyl. D-100 pickup" was sufficient description even without the serial number, and that the one-digit error was not so misleading as to invalidate the financing statement without proof of actual prejudice. The court relied on the notice-filing theory of UCC.


§9-402 and overruled Wise v. Kennedy, the case on which the appellate division had based its decision.

This comment will be concerned with the sufficiency of financing statements under the Uniform Commercial Code, with particular attention to problems in description of collateral and to the notice-filing theory of the code, which is the essence of the decision in Still Associates. The general standards which have emerged in the decisions of other jurisdictions will also be reviewed. It will be argued that Wise v. Kennedy should have been distinguished on its facts rather than overruled, and that its reasoning may still retain some validity.

To perfect a security interest in personal property, fixtures, accounts, or contract rights within the scope of Article 9 of the UCC, the parties must execute a security agreement and file a financing statement pursuant to UCC §§9-203 and 9-402, respectively. A security agreement is proper only if it is signed by the debtor and contains a description of collateral, or in certain cases a description of the land from which collateral will originate. These formal requirements are in the nature of a statute of frauds for secured transactions. Their purpose is evidentiary: to reduce "the possibility of future dispute as to the terms of a security agreement and as to what property stands as collateral for the obligation secured." The financing statement, on the other hand, must contain the signatures of both the debtor and the secured party, together

2 The UCC was enacted as Chapter 106 of the Massachusetts General Laws. Because corresponding section numbers are identical, all references, unless otherwise indicated, are to the 1962 Official Text of the Uniform Commercial Code.


4 The scope of Article 9 is set forth in UCC §9-102, which provides:

"(1) Except as otherwise provided in Section 9-103 on multiple state transactions and in section 9-104 on excluded transactions, this Article applies so far as concerns any personal property and fixtures within the jurisdiction of this state "

"(a) to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper, accounts or contract rights; and also

"(b) to any sale of accounts, contract rights or chattel paper.

"(2) This Article applies to security interests created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor’s lien, equipment trust, conditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security. This Article does not apply to statutory liens except as provided in section 9-310.

"(3) The application of this Article to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this Article does not apply."

5 UCC §9-203 provides:

"(1) Subject to the provisions of section 4-208 on the security interest of a collecting bank and section 9-113 on a security interest arising under the Article on Sales, a security interest is not enforceable against the debtor or third parties unless

"(a) the collateral is in the possession of the secured party; or

"(b) the debtor has signed a security agreement which contains a description of the collateral and in addition when the security interest covers crops or oil, gas or minerals to be extracted or timber to be cut, a description of the land concerned. In describing collateral, the world ‘proceeds’ is sufficient without further description to cover proceeds of any character."

6 UCC §9-203, Comment 3. Comment 5 to the same section further explains: "The for-
with their addresses and a statement "indicating the types or describing the items of collateral." In Massachusetts the statement must then be filed with the secretary of state and the clerk of the town where the debtor’s residence or place of business is located. Certain information from the filed statement is thereafter available "upon the request of any person."

This is the essence of notice-filing. Its purpose is to alert interested parties to the fact that certain types of property may be subject to security interests. Further inquiry directed to the signed parties themselves is usually required if an interested party is to learn the precise nature of the interests and the identity of the property involved. Unlike the security agreement, the financing statement need not indicate the kind of security interest, and a specific description of the collateral is optional. Yet the description of collateral must meet the standard of UCC §9-110: "For the purposes of this article, any description of personal requisites stated in this Section are not only conditions to the enforceability of a security interest against third parties. They are in the nature of a Statute of Frauds. Unless the secured party is in possession of the collateral, his security interest, absent a writing which satisfies subsection (1)(b), is not enforceable even against the debtor and cannot be made so on any theory of equitable mortgage or the like. . . . More harm than good would result from allowing creditors to establish a secured status by parol evidence after they have neglected the simple formality of obtaining a signed writing."

7 UCC §9-402(1) provides: "A financing statement is sufficient if it is signed by the debtor and the secured party, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral. A financing statement may be filed before a security agreement is made or a security interest otherwise attaches. When the financing statement covers crops growing or to be grown or goods which are or are to become fixtures, the statement must also contain a general description of the real estate concerned and the name of the record owner thereof. A copy of the security agreement is sufficient as a financing statement if it contains the above information and is signed by both parties."

8 G.L., c. 106, §9-403(1) provides: "Presentation for filing of a financing statement and tender of the filing fee or acceptance of the statement by the filing officer or register of deeds constitutes filing under this Article. As used in this Part, ‘filing officer’ means a filing officer other than a register of deeds." Massachusetts has localized the code provisions which govern filing. See G.L., c. 106, §9-401(1).

9 G.L., c. 106, §9-407(2) provides: "Upon request of any person, the filing officer, except the registers of deeds and assistant recorders of the land court, shall issue his certificate showing whether there is on file on the date and hour stated therein, any presently effective financing statement naming a particular debtor and any statement of assignment thereof and if there is, giving the date and hour of filing of each such statement and the names and addresses of each secured party named therein. The fee for such a certificate shall be three dollars. Upon request the filing officer shall furnish a copy of any filed financing statement, continuation statement, termination statement, statement of assignment or statement of release . . . ."

10 UCC §9-402, Comment 2 explains: "This Section adopts the system of 'notice filing' which has proved successful under the Uniform Trust Receipts Act. What is required to be filed is not, as under chattel mortgage and conditional sales acts, the security agreement itself, but only a simple notice which may be filed before the security interest attaches or thereafter. The notice itself indicates merely that the secured party who has filed may have a security interest in the collateral described. Further inquiry from the parties concerned will be necessary to disclose the complete state of affairs."
sonal property or real estate is sufficient whether or not it is specific if it reasonably identifies what is described." This section would appear to establish a single standard of sufficiency of description for the documents involved in a secured transaction, but in reality it does not. The descriptions of collateral in the security agreement and the financing statement serve distinctly different purposes: the former description serves as proof of the existence and scope of a security interest, while the latter is intended simply to alert interested persons to make further inquiry. As a result, separate standards have evolved for determining the sufficiency of a description of collateral.

The difference in standards is illustrated by In re Taylored Products, Inc., wherein the debtor had executed a financing statement and security agreement prior to bankruptcy. Both documents described collateral as "accounts and notes receivable and inventories of raw materials, work in process and finished goods wherever located." Neither document specifically referred to after-acquired property. Petitioner, the secured creditor, requested authority to foreclose against certain after-acquired property in debtor's inventory. The property, however, had been included in the estate in bankruptcy, and the trustee objected to the foreclosure on the ground that after-acquired property had not been specifically mentioned in either financing document. The referee concluded that while an after-acquired property clause is not necessary in a financing statement, it must be included in the security agreement if an enforceable interest is to attach in property thereafter acquired. He reasoned that the UCC required the entire transaction to be embodied in the security agreement, but not in the financing statement. In further support of his position, the referee could have pointed to the difference under the code between a security agreement, which must describe the collateral, and a financing statement, which is sufficient even if it merely indicates the type of collateral. It is possible, for example, to indicate the type of collateral without distinguishing it from other property of the same type.

The Review Committee Proposals for changes in Article 9 recognized the different standards which have developed for security agreements and financing statements, and the committee recommended, therefore, that UCC §9-110 be amended to read: "Except as provided in Section 9-402 on formal requirements of a financing statement, any

11 "The collateral description in the financing statement, under section 9-402, need be only of the 'types' of property secured. The distinction between this and the security agreement 'description of the collateral' is not completely clear. Nor is there much help in the Comment to section 9-203, to the effect that the security agreement contain 'a description of the collateral or kinds of collateral.' " Kripke and Felsenfeld, Secured Transactions, A Practical Approach to Article 9 of the Uniform Commercial Code, 17 Rutgers L. Rev. 168, 172 (1962).
13 The referee based his opinion in part upon the fact that UCC §§9-204(3) and (4) refer specifically to after-acquired property clauses.
14 For the complete text of the committee proposals, see Permanent Editorial Board for the UCC, Review Committee for Article 9 of the UCC, Preliminary Draft 1 (Dec. 1968).
description of personal property or real estate is sufficient . . . if it reasonably identifies what is described.’” 15 (Committee's emphasis.) This addition would have given fair notice of the double standard which has emerged in judicial decisions under Article 9, but the proposal was not adopted in the committee's final report. 16

In Still Associates the Supreme Judicial Court confirmed that the purpose of the financing statement is to give notice that certain collateral may already be subject to a security interest. The Court relied on National Cash Register Co. v. Firestone and Co., 17 a 1963 Massachusetts case which has become the leading decision on notice-filing. In National Cash Register, defendant creditor claimed title to a cash register under its financing statement, which was on file at the time the debtor acquired the cash register from plaintiff. Plaintiff had sold and delivered the cash register to debtor on a conditional sales agreement. If plaintiff, although a subsequent creditor, had filed its financing statement within ten days of delivery of the cash register, it would have had priority in the item over the defendant’s earlier lien. 18 Plaintiff, however, waited almost a month before perfecting its security interest. Having failed to act in time, the plaintiff based its claim to the cash register on an action for conversion, challenging the sufficiency of the defendant’s financing statement and security agreement on the ground that the description of collateral in those documents would not embrace the cash register. The financing statement described as collateral:

All contents of luncheonette including equipment such as: booths and tables; stand and counter; tables; chairs; booths; steam tables; salad unit; potato peeler; U.S. slicer; range; case; fryer; compressor; bobtail; milk dispenser; silex; 100 Class air conditioner; signs; pastry case; mixer; dishes; silverware; tables; hot fudge; Haven Ex; 2 door station wagon 1957 Ford A57R107215.

The security agreement contained an identical description, but with the additional clause, “together with all property and articles now, and which may hereafter be, used or mixed with, added or attached to, and/or substituted for, any of the foregoing described property.” In both documents the debtor’s business was incorrectly identified as “Cozy Kitchen” instead of “Kozy Kitchen,” and the financing statement did not specifically mention after-acquired property.

15 Proposed changes or additions are indicated by underlining in the preliminary draft.
16 The committee explained in the forward to its final report that only those amendments which were designed to remedy “unworkable provisions” were adopted. Review Committee for Article 9 of the UCC, Final Report (Apr. 1971).
17 346 Mass. 255, 191 N.E.2d 471 (1963). The rationale of the decision has been adopted in numerous cases. See, e. g., Dubay v. Williams, 417 F.2d 1277, 1284 (9th Cir. 1969); Thompson v. United States, 408 F.2d 1075, 1084 (8th Cir. 1969); In re Thomas, 310 F. Supp. 338, 340 (N.D. Cal. 1970).
18 UCC §9-312(4) provides: “A purchase money security interest in collateral other than inventory has priority over a conflicting security interest in the same collateral if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within ten days thereafter.”
Plaintiff prevailed in the Boston Municipal Court, and the appellate division affirmed. The Supreme Judicial Court, however, reversed and held that the description of collateral in the security agreement was sufficient to identify all of the contents of the luncheonette under UCC §§9-110 and 9-402. The error in listing the name of the business was held not to be seriously misleading because the financing statement had not been filed under the business name, but rather had been correctly filed in debtor's name, “Carroll, Edmund d/b/a Cozy Kitchen.” The Court found the financing statement sufficient to give the required notice, even without the after-acquired property clause.

The framers of the Uniform Commercial Code, by adopting the “notice filing” system, had the purpose to recommend a method of protecting security interests which, at the same time, would give subsequent potential creditors and other interested persons information and procedures adequate to enable the ascertainment of the facts they needed to know.19

In Still Associates, the Supreme Judicial Court relied on the above theory of notice-filing and concluded: “Section 9-402(1) requires only a ‘statement indicating the types or describing the items, of collateral,’ and the concededly accurate description, ‘one (1) 1967 Dodge 6 cyl. D-100 pickup’ fully satisfied this requirement.”20 The Court then considered the effect of the serial number error on this otherwise sufficient description, and determined, without further explanation, that the one-digit mistake “is not on its face sufficiently serious to invalidate the financing statement.”21 In so holding, the Court apparently relied on UCC §9-402(5): “A financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading.” (Emphasis added.)

The comment to UCC §9-402(5) announces that the aim of this provision is to “discourage the fanatical and impossibly refined reading of such [filing statutes].” As an example of this rejected approach, the comment cites the Massachusetts decision in General Motors Acceptance Corp. v. Haley,22 where plaintiff claimed a security interest in certain equipment and in the proceeds of certain goods under trust receipt transactions with the “E. R. Millen Co., Inc.” The statement of trust receipt financing incorrectly identified debtor as “E. R. Millen Company,” the name under which debtor had done business prior to incorporation. Millen subsequently assigned all of its assets to defendant for the benefit of creditors, and plaintiff sued for a declaratory decree as to its rights in the collateral. The trial court ruled that the plaintiff had no rights in the collateral, holding the plaintiff’s filed statement was invalid because of the error. The Supreme Judicial Court affirmed.

21 Id. at 247, 267 N.E.2d at 218.
holding that there must be exact compliance with the statute for constructive notice to be valid:

It is urged . . . that the statute merely requires that the trustee be so designated that a creditor or other interested person would not be misled as to the identity of the trustee; and here it is said, no one could be deceived because of the resemblance of the name, the identity of address, and the description of the goods acquired by the trustee. . . . [W]e are nevertheless of the opinion that the designation was not in compliance with the [Uniform Trust Receipts] Act.\textsuperscript{23}

In rejecting the \textit{Haley} approach, UCC §9-402(5) sets forth a new test to determine the effect of error in a financing statement. The question now asked is whether the prudent title searcher would have been misled. If the court so finds, then the error is deemed to be “seriously misleading” and the financing statement is invalid. The new test can benefit even those purchasers who neglect to search for prior interests, for the court may find that a reasonable search would have been futile anyway.

No Massachusetts decisions under the UCC have examined the issue of “seriously misleading” error. However, some standards have emerged from other jurisdictions. In the case of \textit{In re Hodgin},\textsuperscript{24} debtor had executed a security agreement covering a 1969 Toyota, but creditor’s financing statement referred only to a “1969 Fiat.” Over the creditor’s objections, the trustee in bankruptcy of the debtor requested authority to sell the car free of encumbrances. The referee held that “such inaccurate description was a major rather than minor error, and resulted in ‘no filing at all.’ The instrument filed was completely misleading; rather than inviting further investigation by a prudent searcher, it foreclosed additional inquiry.”\textsuperscript{25} (Emphasis added.) Accordingly, the financing statement was invalidated.

\textit{Bank of North America v. Bank of Nutley},\textsuperscript{26} cited by the Court in \textit{Still Associates}, involved mistakes by both plaintiff and defendant. Defendant had repossessed a car under a security agreement perfected on March 24, 1965. His handwritten financing statement, however, identified debtor incorrectly as Joseph “Kaplas” instead of “Kaplan,” and the statement was filed alphabetically according to the erroneous identification. Plaintiff brought an action for conversion of the automobile, relying on a security agreement which was perfected after the repossession. His financing statement, however, contained a one-digit serial number error in its description of the car. On cross-motions for summary judgment, the New Jersey court ruled that defendant’s error in identifying the debtor invalidated his financing statement because it deprived subsequent creditors of the opportunity to discover his

\textsuperscript{23} Id. at 564, 109 N.E.2d at 146.
\textsuperscript{25} Id. at 616.
\textsuperscript{26} 94 N.J. Super. 220, 227 A.2d 535 (1967).
security interest in the car. On the other hand, plaintiff's financing statement was found to be valid because the serial number error was deemed "a minor error which is not seriously misleading."

Other courts have held financing statements to be invalid for errors of omission. A financing statement which said "see attached description" was held insufficient when no description was attached, and a financing statement containing only the serial number "1968 COF 4000D-35971-G288307," with no further description, was held invalid against the 1968 International tractor truck to which it was intended to refer. In the latter case, the referee reasoned that the year and serial number alone might sufficiently identify the item from others of the same type, but that such information does not indicate the type or describe the item of collateral within the meaning of UCC §9-402(1). A searcher seeing the serial number alone would have no idea as to what kind of property might be covered.

After finding that the one-digit error in Still Associates was not seriously misleading on its face, the Supreme Judicial Court went a step further:

There is no showing here that the defendant was prejudiced by the minor error made by plaintiff's agent, or that he would have been had he made the inquiry which the Code contemplates. In circumstances such as these, where the error is not on its face sufficiently serious to invalidate the financing statement, it appears proper to us to require the party seeking to invalidate it under §9-402(5) to make some showing of actual prejudice.

The term prejudice, which was used twice, does not appear anywhere in UCC §9-402 or in the comment to that section. Its use in the Court's opinion, however, suggests that if a defendant can prove he reasonably relied on the erroneous description, then the financing statement may be invalid as to him, despite the fact that the error is not a seriously misleading one.

27 Similarly, in In re Smith, 205 F. Supp. 27 (E.D. Pa. 1962), a financing statement which did not contain debtor's address was held to be invalid because it deprived subsequent creditors of information necessary for inquiry.


30 Compare with In re Bengtson, Bankruptcy No. 5483 (D. Conn., Dec. 15, 1965), 3 UCC Rep. Serv. 283. Debtor was an appliance dealer, and a serial number in the financing statement obviously referred to some appliance in his inventory which could be identified on request. The serial number reference was held sufficient because no one should have been seriously misled.


32 The Supreme Judicial Court cited Eastern Acceptance Corp. v. Camden Trust Co., 33 N.J. 227, 163 A.2d 134 (1960), in support of the requirement of actual prejudice, but that case is not really on point. It was decided before the UCC was enacted, and the only language in the opinion which is relevant simply states: "[T]here was no question as to the identity of the automobile which the parties properly intended to cover by the trust receipt, and the defendant was not prejudiced by and is in no just position to reap any
The "actual prejudice" test seems to be a form of the doctrine of estoppel, which was intended to supplement the code through Section 1-103:

Unless displaced by the particular provisions of this chapter, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.

Estoppel is the ancient equitable doctrine which may be invoked to bar a person from pleading the truth when he has made a representation to the contrary. The doctrine is invoked where there is a representation or conduct by one person which induces another to do something which he would not otherwise have done, and which causes him harm, in circumstances where the first person should reasonably have known that such consequences would follow.\(^{35}\)

The notice-filing system of Article 9 lends itself rather easily to the application of estoppel. The secured party makes a representation of fact in his financing statement with the knowledge that other interested persons will rely on it. When the statement contains an error which is attributable to the secured party's negligence, as was the case in Still Associates, the only element of estoppel which remains to be proved at trial is detrimental reliance. The effect of estoppel in this context would be to prevent a secured party from alleging a security interest in collateral which was not adequately described. The essential issue in estoppel is not whether the prudent searcher would have been misled, but whether the person who did search was in fact misled. In this respect, estoppel is different from the "misleading error" test of UCC §9-402(5). The emphasis is not on the severity of error, but on what the searcher actually believed.

There are no cases to date which have applied the doctrine of estoppel to descriptions of collateral under the UCC. In fact, there are relatively few cases challenging the sufficiency of financing statements, and none of them has involved actual reliance on a financing statement error. Nevertheless, the inclusion of the word prejudice in Still Associates may indicate that the Court was tracing the elements of estoppel on its own initiative, and this may foreshadow a new application of the doctrine within Article 9.

In the course of its opinion in Still Associates, the Supreme Judicial Court said that its 1924 decision in Wise v. Kennedy is no longer to be followed. It is submitted that Wise should have been distinguished on its facts and not overruled. The debtor in Wise was an agent for the sale of Jordan touring cars. Defendant claimed title to one of the cars advantage from the inadvertence." Id. at 236, 163 A.2d at 139. The issue of reliance on a financing statement error was not even discussed in the opinion.\(^{35}\) Nelson v. Wentworth, 243 Mass. 377, 379, 137 N.E.2d 646, 647 (1923).
under a mortgage whose description of collateral referred to "one new Jordan touring car number 6552." The actual serial number was 6557. Plaintiff, who had purchased the car from the debtor-dealer in good faith and without actual notice of defendant's mortgage, brought an action in replevin to recover the car, but the trial court found for defendant. On appeal, the Supreme Judicial Court held that within the automobile dealership context, automobiles of the same class can be distinguished with reasonable certainty only by serial number, and that a filed mortgage statement covering 6552 did not give reasonable notice as to 6557.

In overruling Wise the Supreme Judicial Court has invited confusion. The Court seems to have assumed that Wise stood for the proposition that a one-digit error in listing a serial number will always invalidate a particular filing. Such an assumption would be incorrect. Wise concerned a dealer in Jordan cars, and dealers can be expected to handle numerous cars for a particular manufacturer. Particularly today, a person buying from a dealer might well assume that sometimes the dealer receives shipments of automobiles with successive serial numbers. Accordingly, the purchaser might reasonably feel no alarm at seeing a notice of encumbrance listing an automobile with a serial number very similar to that on his car. The vehicle in Still Associates, on the other hand, belonged to a private party, and that private party was almost certain not to have two "1967 Dodge 6 cyl. D-100 pickup[s]" with ten-digit serial numbers identical except for the last digit. The Supreme Judicial Court should have distinguished Wise, for if a similar situation arose tomorrow, it would seem unreasonable to hold as a matter of law that "number 6552" is a description which gives fair notice of an interest in number 6557.

The notice-filing principles which were established in National Cash Register and confirmed in Still Associates cast doubt on the one other Massachusetts decision concerning descriptive requirements under Article 9. In Annawan Mills, Inc. v. Northeastern Fibers Co., defendant claimed a security interest in a cotton waste product known as cotton linters, under a financing statement and security agreement which described the collateral as "Cotton Waste and Proceeds." Plaintiff attached the cotton linters under trustee process, claiming that the description of collateral in defendant's financing statement was not sufficient to cover the linters. The trial court admitted expert testimony to the effect that in the textile industry, cotton waste and cotton linters meant two different things. Cotton waste is a waste produced from cotton mills, whereas cotton linters is a by-product of the manufacture of cottonseed oil. On the basis of that testimony, the trial court found for plaintiff. The appellate division agreed that the financing statement was insufficient to perfect an interest in cotton linters.

35 UCC §1-205(5) provides: "An applicable usage of trade in the place where any part of performance is to occur shall be used in interpreting the agreement as to that part of the performance."
The appellate division, however, did not properly consider whether "Cotton Waste and Proceeds" indicates a type of collateral which includes cotton linters for notice-filing purposes. It was simply assumed that once the meaning of cotton linters could be distinguished from the meaning of cotton waste, the description of collateral was insufficient. Annawan Mills was never appealed to the Supreme Judicial Court, but two weeks after the Annawan decision, the Supreme Judicial Court handed down its opinion in National Cash Register. It is submitted that the appellate division may well have applied the notice-filing principles to reach a different result if National Cash Register had been decided earlier.

It is appropriate here to mention a related issue which is not directly involved in Still Associates. The UCC is intended to permit "continued expansion of commercial practices through custom, usage and agreement of the parties."36 Two examples of such expansion which relate to the standards for description of collateral are inventory financing and the use of the term proceeds.

Inventory financing is the practice of securing a debt with an interest in debtor's inventory, even though the inventory is changing from day to day. This practice recognizes that the goods which constitute inventory at any given moment are flowing from manufacturer to consumer, but that the value of a debtor's inventory will usually remain relatively constant. The difficulty in drafting such an arrangement is in describing the collateral broadly enough so that any goods of value will be included in the security interest, yet specifically enough so that the agreement is enforceable. The description of collateral would necessarily include an after-acquired property clause in order to cover those goods purchased in replacement of goods sold. The object is to eliminate the need for a series of secured transactions by permitting collateral to be identified with broad descriptive terms.

The difficulty with broad descriptive terms, however, is that they are not always so broad as they would seem. UCC §9-109, for example, gives several broad definitions. Consumer Goods include goods used for personal, household, or family purposes. Inventory includes goods which are held for sale or lease, as well as raw materials, work in process, or materials used or consumed in a business. Equipment includes goods used for business purposes. The definitions are intended to be mutually exclusive,37 and superficially they would seem to be tailored for use in inventory financing arrangements. The problem with these terms, however, is indicated in a comment to UCC §9-109:

In borderline cases—a physician's car or a farmer's jeep which might be either consumer goods or equipment—the principal use to which the property is put should be considered as determinative. Goods can fall into different classes at different times: a radio is inventory in the hands of a dealer and consumer goods in the hands of a householder.38

36 UCC §1-102(2)(b).
37 UCC §9-109, Comment 2.
38 Ibid.
A creditor who uses such terms will have the burden of proving the primary use in cases of doubt. Perhaps the safest course, and the fairest to other interested persons, is to supplement the broad terms with specific examples and locations wherever possible. The description in National Cash Register, quoted in full earlier, is a model of this approach. The Supreme Judicial Court found the description broad enough to include the cash register, which plaintiff agreed did not have to be specifically described. "The agreement covers 'all contents of luncheonette including equipment such as,' which we think covers all those contents and does not mean 'equipment, to wit.'" 39 (Emphasis added.)

The use of the term proceeds presents a similar problem. UCC §9-203 (1)(b) provides that "in describing collateral, the word 'proceeds' is sufficient without further description to cover proceeds of any character," and UCC §9-306 defines proceeds as "whatever is received when collateral or proceeds is sold, exchanged, collected or otherwise disposed of." When collateral is continually being bought and sold, use of the term proceeds in describing collateral will protect the secured party by giving him an interest in whatever is received for goods which are sold. The difficulty with proceeds as a descriptive term, however, is that it does not indicate a type of collateral within the meaning of UCC §9-402. Incubating chickens, for example, could be the proceeds of an automobile if the seller wished to barter with a chicken farmer, but the prudent searcher would not necessarily be alerted in such a situation to inquire into the title of chickens. 40

The commercial utility of inventory financing and proceeds clauses is that they make credit easier to obtain for small businesses, and relatively, that they protect the lender who might not otherwise extend credit to marginal enterprises. For that reason they are sound developments. The problem which the courts must face is to balance commercial needs against the traditional standards of notice and fair play which the law and equity have always supported.

The decision in Still Associates confirms that the requirements for description of collateral in financing statements will be governed by the notice-filing theory in Massachusetts, and that UCC §§9-110 and 9-402 will be liberally construed. It also appears that a minor error of

40 "What information should a claim to 'proceeds' convey? The basic requirement of section 9-402(1) is that a financing statement shall indicate the types or describe the items of collateral. Where a description covers 'proceeds' it does not conform to this requirement and to the fundamental notice-giving purpose of the Code; indeed, one would question whether it satisfied section 9-402(1) if it were not that the sample form of financing statement in section 9-402(3) sanctions so uninformative a description of collateral. What may be the proceeds of a dealer's sale of, say, a new automobile, and what notice does a financing statement really give to the public if only the word 'proceeds' is used? Obviously, the proceeds of a new automobile may be cash, an open account, chattel paper, or a used car taken in trade; but, depending on the breadth of the dealer's business lines or his courage or imagination, the proceeds taken in trade might also be a used truck or mobile home, a used refrigerator, used furniture, new or used clothing or jewelry, or conceivably incubating chickens." Kripke, Suggestions for Clarifying Article 9: Intangibles, Proceeds and Priorities, 41 N.Y.U.L. Rev. 687, 705 (1966).
description will have to be misleading enough to confuse the prudent
title searcher before the financing statement will be held invalid. This
objective test, however, may yield to the doctrine of estoppel in cases
where one of the parties can prove actual prejudice by virtue of an
otherwise minor error in a financing statement.

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