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Article 3: Commercial Paper

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he would have been in had the contract been performed. Under Subsection (2) the measure of damages is expected profit (including reasonable overhead) which the seller would have made from full performance. The only requirement for the use of this alternative remedy is that the remedy in subsection (1) be inadequate.

B.E.R.

SECTION 2-723. Proof of Market Price: Time and Place

JAGGER BROS., INC. v. TECHNICAL TEXTILE CO.
202 Pa. Super. 639, 198 A.2d 888 (1964)
Annotated under Section 2-708, supra.

SECTION 2-725. Statute of Limitations in Contracts for Sale

GARDINER v. PHILADELPHIA GAS WORKS
413 Pa. 415, 197 A.2d 612 (1964)

Plaintiffs entered into an oral contract with the defendant for the sale by the latter of gas. Plaintiffs alleged that the defendant expressly and impliedly warranted that the gas would be safely transmitted into their home. The gas escaped from an underground conduit, causing the plaintiffs personal injury. The plaintiffs did not bring suit until two years and eight days after the alleged injury was incurred. The Act of 1895 provides a two-year statute of limitations for all personal injury actions and Section 2-725 of the Code provides a four-year statute for actions arising out of any breach of contract for sale.

The court held that Section 2-725 and the Act of 1895 were clearly inconsistent. However, since Section 10-103 repeals acts and parts of acts inconsistent with the Code, the four-year statute of limitations applied. Moreover, the intent of the legislature, manifested in part by Sections 1-102 and 2-715 of the Code, indicated that Section 2-725 was to be determinative.

M.L.A.

ARTICLE 3: COMMERCIAL PAPER

SECTION 3-104. Form of Negotiable Instruments; "Draft"; "Check"; "Certificate of Deposit"; "Note"

UNIVERSAL C.I.T. CREDIT CORP. v. INGEL
—— Mass. ——, 196 N.E.2d 847 (1964)

In return for siding work done on his house, the defendant executed a promissory note in favor of Allied Aluminum Associates, Inc. which subsequently negotiated the note to Universal C.I.T. Credit Corp., the plaintiff. At trial, the defendant admitted his signature on the note and on an accompanying completion certificate but alleged that the note failed to meet the requirements for negotiability set out in Section 3-104(1)(b)

and that it was thus non-negotiable as a matter of law. He further argued that even if the note were negotiable, the plaintiff could not recover since it was aware, prior to the taking of the note, that Allied had defrauded the defendant. At trial, the lower court rejected the defendant's attempt to introduce in evidence the plaintiff's credit report on Allied, which report indicated that the Better Business Bureau had censured Allied for its objectionable advertising methods. From a directed verdict for the plaintiff, the defendant appealed.

The Supreme Judicial Court held that as a matter of law the note was negotiable. First, the defendant had not shown that the note and the completion certificate were "part of the same instrument." Thus his contention that the completion certificate contained an "other promise" which rendered the note non-negotiable under Section 3-104(1)(b) was unavailing. Second, the holder's promise in the note to obtain insurance on the plaintiff's life was not an "other promise" rendering the note non-negotiable, since it was clear that the "no other promise" provision of Section 3-104(1)(b) referred only to promises made by the maker. Third, the provision in the note calling for "interest after maturity at the highest lawful rate" did not constitute an agreement that, after default, any rate other than the judgment rate would apply. This being so, the note was not materially different from one bearing the term "with interest," which latter note would be clearly negotiable under Section 3-118(d). Fourth, an alteration of the month on the face of the note had no effect, since the defendant had paid a particular sum on the note and the amount remaining was not in dispute. The court further held that the lower court's rejection of the plaintiff's credit report on Allied was proper. The findings of the district court were prima facie evidence that the plaintiff was a holder in due course and, notwithstanding Section 3-307(3), the burden was on the defendant to rebut the plaintiff's case. This could be done by showing that the plaintiff took the note with notice of the fraud; however, since the standard of notice under Section 3-302(1)(c) was actual knowledge, and not reasonable grounds for belief, the proffered testimony was inadmissible.

COMMENT

1. The defendant argued that the note and the completion certificate were "part of the same instrument" and that an additional provision in the completion certificate rendered the note non-negotiable as a matter of law. Exactly why the defendant thought the two writings were part of the same instrument is unclear, but it would seem, for example, that if a service contract were attached to a promissory note, either by a physical device or by perforation, it would not be unreasonable for a court to find the writings "part of the same instrument." Indeed, there is a significant difference between a separate agreement which is "part of the same instrument" and a separate agreement, contemporaneously executed, which is not "part of the same instrument." In the first situation, a promise included in the separate agreement might render the whole writing non-negotiable under Section 3-104(1)(b). In the second situation, the separate

agreement would in no way affect the negotiability of the contemporaneously executed promissory note under Section 3-119. The Code is clear on this latter point. So far as negotiability is concerned, contemporaneously executed writings which are not a "part of the same instrument" need not be read together. Negotiability is always to be determined by the face of the note alone.

2. The court did not really come to grips with the interest problem. It stated that the term "interest at the highest lawful rate" did not evidence an agreement to apply a rate of interest different from the judgment rate and that a note containing a provision for interest at the judgment rate would clearly be negotiable under Section 3-118(d). However, assuming the doubtful proposition that the term "interest at the highest lawful rate" does not evidence an agreement to apply a rate different from the judgment rate, the question arises whether the term "interest at the judgment rate" is a stated rate within Section 3-106. Unless the interest is "stated," there can be no "sum certain," and unless there is a promise to pay a "sum certain," the note is non-negotiable by virtue of Section 3-104. While it is true that Sections 3-118(d) and 3-122(4) strongly imply that a note which bears interest at the judgment rate is negotiable, it is also true that Official Comment 1 to Section 3-106 states that a note does not contain a stated rate of interest unless the "sum certain" can be computed "without reference to any outside source." Obviously, a holder of a note payable "with interest at the judgment rate" cannot compute the "sum certain" without referring to Mass. Gen. Laws Ann. ch. 107, § 3 (1958).

3. In order to show that the plaintiff was not a holder in due course under Section 3-302, the defendant attempted to prove that the plaintiff had taken the note with notice of the defendant's claim of fraud. But the court decided that the defendant had to show that the plaintiff had actual knowledge of the fraud and thus rejected the defendant's attempt to introduce in evidence a credit report which would have damaged the plaintiff's case. This was a mistake on the part of the court which might have meant the difference between defeat and victory for the defendant. As Section 3-302 makes clear, the standard of notice is not "actual knowledge," but "notice," and under Section 1-201(25), "a person has 'notice' of a fact when . . . (c) from all the facts and circumstances known to him at the time in question he has reason to know that it exists." Obviously one of the facts known to the plaintiff at the time it took the note was that Allied, the assignor, had been warned by the Better Business Bureau to cease its fraudulent advertising. This was information pertinent to the issue of whether the plaintiff *had reason to know* of Allied's fraud. And this is all the defendant had to prove, that the plaintiff had reason to know of the alleged fraud. He did not have to prove, as the court erroneously held, that the plaintiff had actual knowledge of the fraud. The rule of the white heart and the empty head had been abandoned by the Code in this situation, and the court was wrong in supporting its position with a precedent handed down twenty years before the Code became effective. Clearly, such disregard for the written statute will not lead to the

uniformity of decisions which the draftsmen envisaged and which the legislators authorized.

C.J.L.

SECTION 3-106. Sum Certain

UNIVERSAL C.I.T. CREDIT CORP. v. INGEL
—— Mass. ——, 196 N.E.2d 847 (1964)
Annotated under Section 3-104, supra.

SECTION 3-112. Terms and Omissions Not Affecting Negotiability

WESTRING v. CHEYENNE NAT'L BANK
—— Wyo. ——, 393 P.2d 119 (1964)

On August 7, 1961, Jack O'Dell sold a nonexistent truck to the defendant who signed a judgment note for the sum of $15,125.04. O'Dell assigned the note to the plaintiff who confessed judgment against the defendant when the latter defaulted. The defendant moved to vacate the judgment on the ground of fraud, claiming that the plaintiff had knowledge of the misrepresentation and was therefore not a holder in due course. From an order of the trial court denying the motion, the defendant appealed. HELD: reversed and remanded. A material question of fact had been presented as to the plaintiff's knowledge of O'Dell's fraud, and since judgment had been opened in the factually similar case of *Wilson Bros. Sand & Gravel Co. v. Cheyenne Nat'l Bank*, 389 P.2d 681 (Wyo. 1964), in the interest of justice it was necessary to open the judgment in the present case. In the course of its opinion the court noted that under Section 3-112(d) a term in a note authorizing judgment by confession does not affect negotiability.

B.E.R.

SECTION 3-113. Seal

THOMASIK v. THOMASIK
413 Pa. 559, 198 A.2d 511 (1964)

On June 10, 1960, appellant delivered to appellee a judgment note which was executed under seal. Judgment was entered for the principal sum the following day. In February, 1963, after paying $1700 on the note, the appellant sought to open the judgment, alleging lack of consideration. The lower court refused to open the judgment. On appeal, the appellant argued that Section 3-113 entitled him to raise the defense of lack of consideration despite the fact that the note was executed under seal. In affirming, the court stated that it did not have to reach the appellant's argument, since the lower court had found the note to be supported by consideration independent of the seal.

COMMENT

Section 3-113 provides that "an instrument otherwise negotiable is within this Article even though it is under a seal." In plain language, this

section places sealed instruments, so far as Article 3 is concerned, on the same footing as other negotiable instruments. In particular, a seal is no longer conclusive on the issue of consideration. Even if an instrument is under seal, consideration must be given and the defense of lack of consideration will be good against anyone but a holder in due course.

Previous to the adoption of the Uniform Commercial Code, the controlling statute was the Negotiable Instruments Law, Section 6, which read, "the validity and negotiable character of an instrument are not affected by the fact that it bears a seal." The vagueness of this provision left room for varying interpretations and the Pennsylvania court chose to interpret it to mean that a seal imported consideration and that, therefore, want of consideration would be no defense to any holder suing on the note. While Section 3-113 of the Code is not as vague as Section 6 of the NIL, it still falls far short of desired specificity. In terms of definiteness it compares unfavorably with Section 2-203 which wipes out the efficacy of seals in contracts for sale.

C.J.L.

SECTION 3-118. Ambiguous Terms and Rules of Construction

UNIVERSAL C.I.T. CREDIT CORP. v. INGEL
— Mass. —, 196 N.E.2d 847 (1964)
Annotated under Section 3-104, supra.

SECTION 3-302. Holder in Due Course

KORZENIK v. SUPREME RADIO, INC.
—— Mass. ——, 197 N.E.2d 702 (1964)
Annotated under Section 3-303, Infra.

BROWN v. SCALES
109 Ga. App. 138, 135 S.E.2d 525 (1964)
Annotated under Section 3-306, infra.

UNIVERSAL C.I.T. CREDIT CORP. v. INGEL
— Mass. —, 196 N.E.2d 847 (1964)
Annotated under Section 3-104, supra.

SECTION 3-303. Taking for Value

KORZENIK v. SUPREME RADIO, INC.
—— Mass. ——, 197 N.E.2d 702 (1964)

Supreme Radio gave Southern New England two trade acceptances which were later negotiated to the plaintiff as a "retainer for [legal] services to be performed." In fact the plaintiff did five days of legal work. When the plaintiff sued Supreme on the notes, Supreme alleged that Southern had obtained the instruments by fraud. The plaintiff claimed that he was a holder in due course and that personal defenses were unavailable against him. From a decision for Supreme, the plaintiff appealed.

The court, in affirming, held that since the defense of fraud in the inducement had been established by the defendant, the plaintiff was required by Section 3-307(3) to bear the burden of establishing that he was a holder in due course under Section 3-302. This burden he had failed to sustain since he had not proved that the notes were taken for value, as that term is defined by Section 3-303. A retainer, the court noted, is an executory promise to render services and "an executory promise to give value is not . . . value. . . ." Official Comment 3 to Section 3-303. Though the plaintiff under Section 3-303(a) might have given value to the extent that he had actually performed the executory promise and thus have been a holder in due course to that extent, he failed to prove how much value five days' work represented.

In a footnote the court further remarked that "the fraud was not such as to constitute a defense against a holder in due course" under Sections 3-305(2)(c) and 3-306(b).

COMMENT

Under Section 3-307, until it is shown that a defense exists, the issue of whether the holder is a holder in due course does not arise, and the holder may recover even if he is not a holder in due course. But when, as in the present case, the maker establishes a personal defense, the holder must either rebut this defense or prove that he is in all respects a holder in due course. Of course, if the maker can prove an absolute or real defense such as incapacity, illegality, duress, fraud in the factum, then the instrument itself is void and not even a holder in due course can prevail. Section 3-305.

C.J.L.

SECTION 3-305. Rights of a Holder in Due Course

KORZENIK v. SUPREME RADIO, INC.
—— Mass. ——, 197 N.E.2d 702 (1964)
Annotated under Section 3-303, supra.

SECTION 3-306. Rights of One Not Holder in Due Course

BROWN v. SCALES
109 Ga. App. 138, 135 S.E.2d 525 (1964)

Ann Wright leased from the defendant an apartment which she wished the plaintiff contractor to improve. The contractor, in order to induce the defendant to assent to the improvements and to cosign a bank loan made to Miss Wright, drafted and signed a statement that the defendant's cosigning would in no way make her liable for Miss Wright's debt. The loan was obtained, the defendant cosigning the note. After the work was completed, Miss Wright became bankrupt. The plaintiff, who had guaranteed the bank that the note would be paid, was forced to buy the note from the bank, and in the present action, he is suing the defendant-lessor on it.

The lower court held for the defendant and the appellate court affirmed.

Since the plaintiff had agreed that the defendant would not be held on the debt in order to induce her to sign the note, he was equitably estopped from now seeking to hold her responsible. Further, since the plaintiff took the note from the bank when it was past due, he could not recover as a holder in due course. Moreover, the plaintiff could not meet the terms of the prevailing statute which gave shelter to persons deriving their title from holders in due course, since, *inter alia*, the bank, as payee, could not under existing law be a holder in due course.

COMMENT

The court noted that under the prevailing Georgia statutes, the bank as payee could not be a holder in due course. In a footnote, however, the court pointed out that under Section 3-302(2) of the Uniform Commercial Code, a payee could be a holder in due course.

In further comparing the prevailing law with the newly adopted but not yet effective Uniform Commercial Code, the court noted that under Section 3-302(1)(c), a person who takes a note with notice that it is overdue cannot be a holder in due course. It also observed that Section 3-306, which provides that personal defenses shall be available against a holder not in due course, is similar to the prevailing statute which precludes a holder who derives his title from a holder in due course from enforcing the instrument when he himself was a party to some fraud or illegality affecting it.

G.M.D.

KORZENIK v. SUPREME RADIO, INC.
—— Mass. ——, 197 N.E.2d 702 (1964)
Annotated under Section 3-303, supra.

SECTION 3-307. Burden of Establishing Signatures, Defenses and Due Course

UNIVERSAL C.I.T. CREDIT CORP. v. INGEL
—— Mass. ——, 196 N.E.2d 847 (1964)
Annotated under Section 3-104, supra.

KORZENIK v. SUPREME RADIO, INC.
—— Mass. ——, 197 N.E.2d 702 (1964)
Annotated under Section 3-303, supra.

SECTION 3-403. Signature by Authorized Representative

BELL v. DORNAN
—— Pa. Super. ——, 201 A.2d 324 (1964)

This is a suit brought by the executrix of the estate of William Bell, the payee of a judgment note. When the note was executed in 1954, Bell was vice-president of Chet B. Earle, Inc., and Dornan, the defendant, was treasurer. The note was signed as follows:

Menna M. Good
(corporate seal) Chet B. Earle, Inc. (seal)
James G. Dornan (seal)

In 1963 the executrix entered judgment by confession against Dornan personally. Dornan petitioned to open judgment, alleging that the loan was made to the corporation, that he had signed in a representative capacity, that his title of treasurer was omitted inadvertently, and that Bell was fully aware that the sole obligation was that of the corporation. The defendant's deposition was taken and the judgment was opened.

On appeal, the court held that the defendant's deposition was inadmissible and reversed the order to open judgment. Since, under the dead man's statute, Dornan was incompetent to testify to transactions occurring prior to Bell's death, he was also incompetent to depose as to such transactions. There being nothing in the note itself to indicate that the defendant had signed in a representative capacity and no other evidence of a material nature, the defendant was personally liable under Section 3-403(2). *Pittsburgh Nat'l Bank v. Kemilworth Restaurant Co.*, 202 Pa. Super. 238, 195 A.2d 919 (1963), annot. 5. B. C. Ind. & Com. L. Rev. 606 (1964), was distinguished on the ground that in that case there were admitted facts and allegations of mutual error.

COMMENT

Because the note was executed in 1954, the 1953 Code controlled. Under Section 3-403(2) of that Code, a representative was personally liable unless the instrument itself clearly showed that he had signed only on behalf of another person whose name appeared on the writing. If the instrument did not indicate both representative capacity and the identity of the principal, the agent was personally liable. Parol evidence was inadmissible except in a subsequent action by the agent against the principal to recover the money he was compelled to pay or in a suit to reform the instrument. In the present case, the court, invested with equitable powers, treated the motion to open judgment as a motion to reform the instrument and permitted parol evidence to be introduced. However, the defendant's incompetency to depose left him helpless to establish representative capacity. In such Code states as Massachusetts, Connecticut and Rhode Island, which have competency of witness statutes, the defendant would not have been precluded from deposing and the result might well have been different.

The 1958 Code has somewhat eased the restrictive rule of Section 3-403(2) by permitting immediate parties to an instrument to establish representative capacity by parol. This change would not help a party in the defendant's situation, however, since he would still be incompetent to testify or depose against the deceased payee. In fact the change in the 1958 Code is essentially procedural, since it merely permits an immediate party to a note to do at law in some cases what he has always been able to do in an equitable suit of reformation, that is, establish representative capacity by parol and thus avoid liability. It should be noted, however,

that since the 1958 Code permits only immediate parties to establish representative capacity, there is still an area in which equitable reformation can effectively operate, for a court of equity can reform a note not only as between the immediate parties to a note but also "as to those claiming under them in privity, such as personal representatives, heirs, assigns, grantees, judgment creditors, or purchasers from them with notice of the facts." 5 Williston, Contracts § 1547 (Rev. ed. 1937), citing *Schneider v. Bulger*, 194 S.W. 737 (Mo. App. 1917), citing *Sicher v. Rambousek*, 193 Mo. 113, 91 S.W. 68 (1906).

C.J.L.

SECTION 3-407. Alteration

VAN NORDEN v. AUTO CREDIT CO.
109 Ga. App. 208, 135 S.E.2d 477 (1964)

The defendant-purchaser executed a conditional sales contract and promissory note with Spring Street Motors (apparently the trade name of R. C. Foster) for the purchase and sale of an automobile. The contract and the note were in the form of two separate writings on a single sheet of paper. The defendant signed the forms in blank in the presence of Foster, who, after the defendant left, filled in the blanks and added his own signature and notarial seal. The contract and note were then assigned to the plaintiff-credit corporation. When the defendant defaulted, the car was repossessed and sold, the proceeds were credited to the defendant's account, and the plaintiff brought the present action to recover the deficiency. The court, applying pre-Code law, held, *inter alia*, that Foster had implied authority to fill in the blanks in the form left with him by the defendant and that this authority extended to his signing the form as notary. Consequently, the addition of the notary's signature in the absence of the defendant did not constitute a material alteration so as to void the writing.

In the course of its opinion, the court noted that under the prevailing law a single writing consisting of a conditional sales contract and a promissory note was negotiable but that if the Uniform Commercial Code were controlling, the writing would be "chattel paper" under Section 9-105(1)(b) and thus "apparently" non-negotiable. The court further noted that under the prevailing law any material alteration of a negotiable instrument without the assent of all the parties thereon would void the note, notwithstanding the absence of fraud. However, it added that this rule was changed by Section 3-407 of the Code.

COMMENT

1. The court's suggestion that under the Code the writing in the present case would be chattel paper and thus apparently non-negotiable is misleading. It is true that a writing which evidences both a security interest and an obligation to pay is chattel paper, but it is not true that all chattel paper is non-negotiable. Whether or not chattel paper is negotiable depends upon whether it meets the requirements for negotiability set out in Sections 3-104 through 3-112. Since the court in the present case was faced with

a problem of negotiability, there was no need for it to introduce the Article 9 concept of "chattel paper," which concept is meaningful only when the validity and perfection of security interests are in issue.

2. The court's suggestion that under the Code a material alteration does not void a note without a showing of fraud is correct. As Section 3-407(2) and Official Comment 3(b) thereto make clear, "a material alteration does not discharge any party unless it is made for a fraudulent purpose."

3. As under the prevailing Georgia law, the unauthorized filling in of blanks in a negotiable instrument constitutes a material alteration. Section 3-115.

M.L.A.

SECTION 3-415. Contract of Accommodation Party

ROSE v. HOMSEY

—— Mass. ——, 197 N.E.2d 603 (1964)

The defendant signed, as accommodation maker, a $25,000 promissory note which had been signed and executed by her husband to evidence a substantial loan from the plaintiff. The defendant also signed, as security for the loan, a mortgage of realty owned by her husband. Both the note and the mortgage were delivered to the plaintiff in April, 1956, but at the husband's request, the mortgage was not recorded. Four and a half years later, and three months prior to the husband's bankruptcy, the plaintiff attempted to record the mortgage but this recording was defective. On the husband's death, the realty was taken by the trustee in bankruptcy of the husband's estate. The lower court found that the defendant, as accommodation maker, was indebted to the plaintiff for $25,000, plus interest, and ordered that her dower interest in his estate be reached and applied in satisfaction of the debt.

On appeal, the defendant alleged that under Section 3-415 of the Uniform Commercial Code an accommodation maker is liable as a surety and that she could therefore raise the defense that the plaintiff impaired the collateral by failing to record. The court rejected this argument, holding that since the relevant transaction occurred prior to the enactment of the Code, Section 29 of the Negotiable Instruments Law was applicable. Under that section and Sections 142 and 143 there was no provision for discharge of the accommodation maker because of impairment of collateral. The court stated, however, that the holding would be different if the Uniform Commercial Code were controlling, since Official Comment 1 to Section 3-415 makes it clear that "an accommodation maker is always a surety" and since Official Comment 1 to Section 3-606 states that "suretyship defenses . . . are available to any party who is in the position of a surety . . . including an accommodation maker. . . ."

COMMENT

It should be noted that while an accommodation maker under the Code has all the defenses of a surety, he first must prove that he is an ac-

commodation maker. This may be done by oral proof except as against a holder in due course who does not have notice of the accommodation.

C.J.L.

SECTION 3-606. Impairment of Recourse or of Collateral

ROSE v. HOMSEY
— Mass. —, 197 N.E.2d 603 (1964)
Annotated under Section 3-415, supra.

ARTICLE 9: SECURED TRANSACTIONS

SECTION 9-105. Definition and Index of Definitions

VAN NORDEN v. AUTO CREDIT CO.
109 Ga. App. 208, 135 S.E.2d 477 (1964)
Annotated under Section 3-407, supra.

SECTION 9-110. Sufficiency of Description

YANCEY BROS. CO. v. DEHCO, INC.
108 Ga. App. 875, 134 S.E.2d 828 (1964)

The defendent sold a caterpiller scraper to the plaintiff but identified it in the bill of sale by an incorrect serial number. The plaintiff resold the scraper to Gross, the bill of sale again identifying it by the incorrect serial number. The Cobb Exchange Bank financed Gross' purchase, with the plaintiff acting as Gross' guarantor. When Gross defaulted, the bill of sale was assigned back to the plaintiff who recorded it. Gross, who had retained possession of the scraper, sold it; and the defendant eventually re-acquired it for value under a bill of sale identifying the scraper by its correct serial number. The plaintiff sued in trover and received a judgment awarding him the scraper. On appeal, the court granted the defendant's motion for a new trial on the ground that there was no proof that the defendant had either constructive or actual notice of the plaintiff's interest. In its discussion the court noted that despite the incorrect serial number, the recorded bill of sale might still have served as constructive notice, had the description of the scraper appearing on the record provided a key to the identity of the property. But under Georgia decisions, the court concluded, no such key existed in the present case. The court further noted that an insufficient description would not have vitiated the plaintiff's interest as against the defendant if the defendant had had actual knowledge of the plaintiff's interest or sufficient information to put him on notice. However, in the present case there was no fact indicating that the defendant knew at the time of re-acquisition that the scraper was the same one that had been earlier sold under the misdescription.

COMMENT

Under the controlling pre-Code Georgia law, the mere statement of an incorrect serial number did not prevent the recorded instrument from giving