January 1980

Contracts and Commercial Law

James S. Rogers
Boston College Law School, james.rogers@bc.edu

Follow this and additional works at: https://lawdigitalcommons.bc.edu/lsfp

Part of the Bankruptcy Law Commons, Commercial Law Commons, and the Contracts Commons

Recommended Citation

This Article is brought to you for free and open access by Digital Commons @ Boston College Law School. It has been accepted for inclusion in Boston College Law School Faculty Papers by an authorized administrator of Digital Commons @ Boston College Law School. For more information, please contact nick.szydlowski@bc.edu.
CHAPTER 3

Contracts and Commercial Law

JAMES STEVEN ROGERS*

§ 3.1 Reformation of Usurious Loans. In *Begelfer v. Najarian* the Supreme Judicial Court considered for the first time problems presented by Massachusetts' unique criminal usury statute. While the Court's decision resolves a number of significant interpretive problems concerning the statute, the decision is in some respects unsatisfying. Yet it must be admitted that the source of the problem lies principally in the peculiarity of the Massachusetts provision.

Since 1867 Massachusetts has had no generally applicable usury statute, although a variety of statutes do impose maximum interest rates on specific types of loans. In 1970 the General Court, acting upon the recommendation of the Governor, enacted a criminal usury statute, section 49 of chapter 271. The scant legislative history suggests that the measure was adopted in order to provide a mechanism for the prosecution of loansharks. Section 49(a) of chapter 271 provides that contracting for or receiving interest and expenses at a rate in excess of 20% per year is a criminal offense punishable

* JAMES STEVEN ROGERS is an Assistant Professor of Law at Boston College Law School.


Four months before the Supreme Judicial Court's decision in *Begelfer*, the Massachusetts Appeals Court rendered a decision dealing with similar issues. *Beach Assoc. Inc. v. Fauser*, 1980 Mass. App. Ct. Adv. Sh. 525, 401 N.E.2d 858. The two cases adopt essentially the same approach to the problem of the effect of the criminal usury statute in civil litigation. In *Begelfer* the Massachusetts provision which is the source of many of the interpretive difficulties, section 49(d) of Chapter 271 which provides that the statute does not apply to lenders who register with the Attorney General, appears to be unique.


* E.g., G.L. c. 140, § 73 (pawnbrokers); G.L. c. 140, § 90A (small home mortgage loans); G.L. c. 140, § 100 (small loan businesses); G.L. c. 255B, § 14 (retail installment sales of motor vehicles); G.L. c. 255D, § 11 (retail installment sales).

* The bill which became G.L. c. 271, § 49 was proposed by Governor Sargent as part of a
by fine and imprisonment.\(^7\) Section 49(d), however, provides that the statute shall not apply to any person who files a notification with the Attorney General of his intention to enter into a loan which would otherwise violate section 49(a) and maintains records of the transaction.\(^8\) Section 49(c) provides that upon the petition of the borrower any loan on which the interest and expense charges exceed 20% "may be declared void" by the Supreme Judicial Court or the Superior Court.\(^9\)

*Begelfer v. Najarian\(^{10}\)* was an action brought by borrowers under section 49(c) seeking to have their loans declared void. Plaintiffs were developers who had raised funds for a real estate project by borrowing from a variety of persons, including the defendant Najarian, a pharmacist.\(^{11}\) The promissory note signed by the plaintiffs provided for monthly payments of principal and interest, with interest at the rate of 15%, later raised to 17%.\(^{12}\) The note also provided for default charges on late payments of up to 15% of the overdue installment and made the borrower liable for the lender's attorneys' fees in collection proceedings.\(^{13}\) The parties made no filing with the Attorney General. After defaulting on the note, plaintiffs brought suit under section 49(c) seeking a declaration that the loan was void.\(^{14}\) On appeal from a grant of summary judgment for defendant, the Supreme Judicial Court held that default charges and attorneys' fees were to be included in the computation of the interest and expense charges on the loan and that the loan therefore violated the criminal usury statute.\(^{15}\) The Court ruled, however, that the language of section 49(c) confers discretion upon the courts to fashion appropriate equitable remedies for violations of the statute, rejecting the contention that any loan found to violate the statute must be declared void in toto.\(^{16}\) Acting on this equitable remedy theory, the Court refused to enforce the default charge provision and directed that reasonable attorneys' fees should be recomputed such that the lenders' total recovery on the loan would not exceed 20%.\(^{17}\)

---

\(^7\) G.L. c. 271, § 49(a).
\(^8\) G.L. c. 271, § 49(d). As initially proposed by the Governor the bill did not include an exemption for persons who register with the Attorney General. 1970 House Doc. No. 5439, App. F. The exemption now found in section 49(d) was added by the House Committee on Banks and Banking. 1970 House Doc. No. 5931.
\(^9\) G.L. c. 271, § 49(c).
\(^11\) Id. at 1723, 409 N.E.2d at 170.
\(^12\) Id. at 1724, 409 N.E.2d at 170.
\(^13\) Id.
\(^14\) Id. at 1722, 409 N.E.2d at 169-170.
\(^15\) Id. at 1725-29, 1733 n.16, 409 N.E.2d at 171-73, 175 n.16.
\(^16\) Id. at 1730-33, 409 N.E.2d at 173-75.
\(^17\) Id. at 1733 & n.16, 409 N.E.2d at 175 & n.16.
Justice Abrams' opinion for the unanimous Court considered first whether the default charge should be included in the 20% ceiling on interest and expenses. The specific language of section 49(a) is as follows:

Whoever in exchange for either a loan of money or other property knowingly contracts for, charges, takes or receives, directly or indirectly, interest and expenses the aggregate of which exceeds an amount greater than twenty per centum per annum upon the sum loaned or the equivalent rate for a longer or shorter period, shall be guilty of criminal usury . . . . For the purposes of this section the amount to be paid upon any loan for interest or expenses shall include all sums paid or to be paid by or on behalf of the borrower for interest, brokerage, recording fees, commissions, services, extension of loan, forbearance to enforce payment, and all other sums charged against or paid or to be paid by the borrower for making or securing directly or indirectly the loan . . . .

The Court concluded that a default charge falls within the statutory definition of "interest and expenses." The Court rested its conclusion on the "all inclusive language used by the legislature" and the failure of the legislature to provide specifically for the treatment of default charges, as it had done in certain other interest regulation statutes.

Although the principal issue in Begelfer concerning the meaning of the

---

18 G.L. c. 271, § 49(a).
20 Id.
21 Id. (citing G.L. c. 255B, §§ 11, 20 (Retail Installment Sales of Motor Vehicles Act); G.L. c. 255D, § 9C (Retail Installment Sales and Services Act)).

The Court also referred to several other statutes which provide inferential support for the conclusion that default charges are included within the definition of interest and expenses in the criminal usury statute. The Small Loans Act, G.L. c. 140, §§ 96-114B, provides for the licensing and regulation of persons in the business of making small loans who charge interest and expenses in excess of 12%. The coverage provision of the Small Loans Act, id. § 96, contains a definition of interest and expenses identical to that in the criminal usury statute. The Court cited the case of Greenleaf Fin. Co. v. Small Loans Regulatory Bd., 1979 Mass. Adv. Sh. 356, 363, 358 N.E.2d 1364, 1369, upholding a Small Loans Regulatory Board rate order which included a provision regulating late charges. The Small Loan Regulatory Board's rate-making authority is based on section 100 of chapter 140 of the General Laws, which empowers the Board to establish "a maximum rate of charge" for loans subject to the act. Thus, assuming that the term "rate of charge" in section 100 of chapter 140 of the General Laws is to be read as covering only the items in the definition of "interest and expenses" in section 96, Greenleaf provides support for the inclusion of default charges within the term "interest and expenses" in section 49 of chapter 271.

The Court also referred to section 114A of chapter 140 which exempts banks from the Small Loans Act but limits the interest and expenses charged by banks on loans which would otherwise be covered by the Act to the rates established pursuant to section 100. Section 114A contains a provision expressly including default charges in the computation of permissible interest and expenses.
term "interest and expenses" involved the default charge, the Court noted in a footnote that the defendants' request for enforcement of all provisions of the note also raised the issue of the treatment of attorneys' fees.\(^2\) The Court stated that "As we read § 49, the legislature has determined that an unregistered lender may not recover in excess of twenty per cent for a loan. The twenty per cent must cover all the interest and expenses including the expenses of services."\(^3\) Thus, the Court concluded that attorneys' fees for collection services upon default are to be included in the computation of the permissible "interest and expenses" under section 49(a).\(^4\)

Having concluded that the default charge and attorneys' fees provisions of the note caused the loan involved in \textit{Begelfer} to violate the criminal usury statute, the Court turned to the matter of the remedy available to the borrower. Section 49(c) of the statute provides that a loan which violates section 49(a) "may be declared void" upon a petition in equity brought by the borrower.\(^5\) Plaintiffs argued that this language requires that any loan made in violation of the statute be declared void in total, relieving plaintiffs of any obligation for the payment of interest or repayment of principal.\(^6\) Justice Abrams rejected this contention and concluded that "the permissive language of § 49(c) ... empower[s] a court to utilize its full range of equitable powers, including cancellation, in order to reach an appropriate result in each case."\(^7\) Noting that voiding the loan in its entirety would produce an "undeserved windfall to the plaintiffs,"\(^8\) the Court concluded that the appropriate remedy was to reform the loan contract to comply with the 20% limitation on interest and expenses.\(^9\) Thus, the Court refused to enforce the default charge provision of the note and directed that the assessment of attorneys' fees be recomputed so that the lenders' total recovery on the loan would not exceed 20%.\(^10\)

\(^{21}\) 1980 Mass. Adv. Sh. at 1733 n.16, 409 N.E.2d at 175 n.16.
\(^{22}\) Id.
\(^{23}\) Id.\(^\text{1}\)
\(^{24}\) G.L. c. 271, § 49(a).
\(^{26}\) Id. at 1730, 409 N.E.2d at 173.
\(^{27}\) Id. at 1733, 409 N.E.2d at 175.
\(^{28}\) Id.
\(^{29}\) Id. at 1733 & n.16, 409 N.E.2d at 175 & n.16. In granting reformation as a remedy for violations of section 49, the Court followed the approach adopted by the Appeals Court in \textit{Beach Assoc. Inc. v. Fauser}, 1980 Mass. App. Ct. Adv. Sh. 525, 401 N.E.2d 858. In \textit{Beach Assoc.}, however, the Appeals Court suggested that an alternative equitable basis for reformation was available on the particular facts involved. Like \textit{Begelfer}, \textit{Beach Assoc.} involved loans by investors for a real estate development project. Plaintiffs and defendants, all apparently experienced businessmen, negotiated a loan bearing interest at 1½% per month and an additional charge denominated a "finders fee" of ½% per month. The defendant investors, residents of New York, placed the money in escrow pending receipt of advice from Massachusetts counsel on the legality of the interest rate. After receiving erroneous advice that
As an alternative basis of its decision with respect to the default charge, the Court noted that the default charge provision might be viewed as a liquidated damage provision for breach of the repayment provision of the note.\footnote{11} Such a liquidated damage provision could be held unenforceable if it is "so disproportionate to the damages caused . . . by the . . . breach of the agreement that it amounts to a penalty." \footnote{32} The inclusion of default charges and attorneys' fees within the coverage of the usury statute highlights the unique nature of the Massachusetts provision. Justice Abrams acknowledged that the courts of most American jurisdictions have excluded default charges from the computation of interest for purposes of usury statutes, on the theory that the borrower may avoid the charge by paying the loan when due.\footnote{33} Attorneys' fees incurred by the lender in connection with collection of the loan are also generally excluded from the coverage of usury laws.\footnote{34} The ruling in \emph{Begelfer} that both default charges and attorneys' fees for collection fall within the purview of the Massachusetts criminal usury statute suggests that the Court will interpret the statute as covering charges of any nature imposed in connection with a lending transaction. These would include charges generally considered to fall within usury laws, such as points, discounts, compensating balances, and fees not related to specific services, such as origination fees and service charges.\footnote{35} They might also include, however, a variety of charges which might be excluded from the scope of the usury laws of other jurisdictions, such as brokers' and finders' fees, commitment fees, contingent interest, credit life or disability insurance premiums, and reimbursement of actual costs of preparing the loan terms were lawful, defendants disbursed the funds. No filing was made with the Attorney General under § 49(d). Plaintiffs defaulted on the loan and brought suit under § 49(c) seeking to have the loans declared void. On these facts the Appeals Court ruled that the loan could be reformed on the basis of the equitable doctrine that "[r]eformation is available to parties where there has been a mutual mistake which is material to the instrument and where no rights of third persons are affected." The court concluded that "it was known by all the parties that the defendants intended to charge a legal rate of interest." Since the parties entered into the transaction "in the mistaken belief that the interest rate was proper," it was appropriate for the court to reform the interest provision of the note to the lawful rate of 20%. This approach of reformation for mistake rests on a peculiar factual assumption. The Appeals Court's approach seems to assume that had the parties received correct advice concerning the Massachusetts statute, they would have charged interest at 20% per annum. Surely, though, had the parties understood the Massachusetts law they would have charged just the rate they had previously negotiated, 24%, and made a filing with the Attorney General under § 49(d).

\footnote{32} Id. at 1729, 409 N.E.2d at 173 (quoting Manganro Drywall, Inc. v. Penn-Simon Constr. Co., 357 Mass. 653, 658, 260 N.E.2d 182, 185 (1970)).
\footnote{33} Id. at 1728, 409 N.E.2d 172.
\footnote{34} E.g., Crowder v. First Fed. Sav. & Loan Ass'n, 567 S.W.2d 550, 554 (Tex. Civ. App. 1978).
\footnote{35} See generally \textsc{Practicing Law Institute, Usury Laws and Modern Business Transactions} (1979).
expenses incurred by the lender such as recording costs, escrow fees, title insurance premiums and the like. 36

The Court suggested, however, that the broad scope of the definition of interest and expenses in the Massachusetts criminal usury statute should not prove problematic for lenders since a lender can avoid the application of the statute by registering with the Attorney General. 37 In view of this avenue of escape from the statute, the Court evidently will not look with favor on arguments for a narrow construction of the coverage of the statute. Although the exemption for lenders who have registered with the Attorney General does provide an easy means for the careful and well-advised lender to avoid any problems with the criminal usury statute, the statute is undoubtedly a trap for the unwary—and becomes a more serious trap the more broadly it is construed.

Nonetheless, the language of section 49(a) is hardly susceptible to the sort of limiting construction often given to other usury provisions. In construing usury provisions courts have often noted that the statutes are intended to regulate interest charges in the sense of compensation for the use of money. Thus, charges for other specific services provided or expenses incurred in connection with the loan, such as recording fees, title insurance premiums, attorneys' fees, and the like, may be excluded from computation of regulated "interest" charges. 38 The Massachusetts provision, however, expressly includes at least some categories of reimbursement of the lender's actual incidental expenses, e.g., "brokerage, recording fees, commissions, services." 39 Thus, the argument that a distinction should be drawn between charges for the use of money and charges for incidental services or expenses seem foreclosed by the text of the Massachusetts provision.

The Begelfer Court's conclusion that default charges fall within the scope of section 49(a) is difficult to resist. In addition to the general language of the statute covering "all other sums charged against ... the borrower," the statute explicitly covers charges for "forebearance to enforce payment" which might well be taken to cover default charges. 40 The inclusion of attorneys' fees for collection is somewhat less defensible. Although the statute probably must be read to cover attorneys' fees incurred in connection with the negotiation and documentation of the loan, it is less clear that attorneys' fees for collection of the loan upon default can be considered charges "for making or securing ... the loan." 41 In addition, the inclusion of attorneys'

36 Id.
39 G.L. c. 271, § 49(a).
40 Id.
41 Id.
fees for collection presents substantial planning problems in that it may be impossible at the time the loan is made to predict the amount of attorneys' fees for collection. How, then, is the lender to determine whether the total interest and expense charges may exceed 20%? The moral seems to be that a filing with the Attorney General under section 49(d) should be made in connection with virtually any loan not otherwise exempt.

The Begelfer Court's treatment of the issue of the remedy for violations of the criminal usury statute is somewhat troublesome. The Court's rejection of the interpretation of section 49 which would require that any loan found to violate the statute be declared void seems entirely appropriate in view of the permissive language of the statute and the windfall which the borrower would receive if that argument were accepted. The Court may, however, have given insufficient consideration to the contrary view that a violation of section 49 may not require any remedy in a civil suit.

Notwithstanding the Court's language concerning equitable discretion in fashioning remedies to fit the particular circumstances of each case, it is probably realistic to read the case as standing for the proposition that whenever a violation of section 49 is shown, the courts should, at the minimum, reform the contract to reduce the total interest and expenses to 20%. The key to the Court's conclusion that such reformation is appropriate is the assumption that the criminal usury statute embodies a public policy that lenders who have not registered with the Attorney General under section 49(d) may not charge interest and expenses in excess of 20%. That assumption, however, may well be questioned.

The Court noted that by virtue of another provision of the general laws, parties may lawfully contract for any rate of interest, except as otherwise provided in certain specific regulatory acts. This general absence of a usury proscription is modified by section 49 to the extent that persons who wish to charge interest and expenses of more than 20% are required to

---

41 The problem is made even more acute by the absence in the statute of any principles for determining how one-shot charges are to be spread over the term of the loan. Consider, for example, a one year loan of $1000 with interest at 19% on the $1000 principal and initial charges for recording fees or the like of $20. The interest expense is $190. If the $20 charge is considered as reducing the principal amount loaned to $980 the effective rate is $190 divided by $980, or 19.39%. If, however the $20 initial charge is added to the $190 interest charge and considered as interest and expense charged on the $1000 principal amount, the effective rate, $210 divided by $1000, is 21%. Attorneys' fees for collection are even more problematic. Consider a demand loan of $1000 with interest at 6% per annum, and suppose that attorneys' fees for collection if the borrower defaults are $100. If the borrower defaults after one year, the total interest and expense charge is $160, or an effective annual rate of 16%. If the borrower defaults after one month, the total interest and expense charge for the one month period is $105, or an effective annual rate of 126%.

43 G.L. c. 107, § 3.
register with the Attorney General. The key to the Begelfer Court’s ruling on remedies for violation of section 49 lies in the identification of the policy embodied in the criminal usury statute. The Court viewed section 49 as embodying the policy that lenders not registered with the Attorney General may not charge more than 20% interest. On that interpretation of the statute, the Court’s conclusion with respect to the remedy follows easily: the defendants in Begelfer were persons not registered with the Attorney General and hence may not charge more than 20%. Reformation of the interest and expense charges to 20% is a remedy aptly designed to implement this policy.

It is, however, far from clear that the statute can plausibly be read to embody this policy. If the legislature were genuinely concerned with excessive interest charges, it is difficult to see what difference it would make whether the lender has filed a notification with the Attorney General. Unlike some of the other interest limitation statutes, the criminal usury statute does not establish any mechanism for the supervision or regulation of the practices of lenders who file notices under section 49(d). Apparently the section 49(d) notices are simply filed and forgotten. Such a statute is a most peculiar response to concern over excessive interest charges. Apparently, the malicious usurer is transfigured into an honorable man by the simple expedient of filing a piece of paper with the Attorney General’s office. Even a lawyer should be puzzled by a rule which imputes such mystical powers to a document.

Rather than embodying a policy that lenders who do not register may not charge interest in excess of 20% per annum, the criminal usury provision should be seen as embodying the very different policy that those lenders who do charge more than 20% interest must register with the Attorney General. It must be borne in mind that section 49 is a criminal statute adopted as part of a package of measures designed to facilitate the prosecution of organized crime—specifically loansharking operations. Were one inclined to impute a remarkable degree of naivete to the legislature, the criminal usury statute might be viewed as a mechanism designed to bring to the Attorney General’s attention those persons whose activities may warrant further investigation and perhaps prosecution under other criminal provisions directed at loansharking. However, those engaged in otherwise unlawful loansharking operations are unlikely to be the sort of law-abiding folk who comply with registration provisions. Thus, the more plausible view of section 49 is that it rests on the assumption that loansharks are likely

---

46 Id., at 1729, 409 N.E.2d at 173 ("In sum, the legislature has determined, as it may, that a lender who does not comply with the requirements of § 49 may not charge interest and expenses in excess of twenty percent a year.")

47 See statutes cited in note 4 supra.

48 Note 6 supra.
to charge more than 20% interest, and are unlikely to register with the Attorney General. Hence, persons who, by means other than section 49, come to the attention of prosecutors as being engaged in genuine loansharking operations—charging outrageous interest and enforcing their loans through violence and threats of violence—will be subject to prosecution under a statute which obviates some of the difficulties often encountered in the prosecution of loansharks. All the prosecutor need show is that the defendant charged more than 20% interest and that he did not register.49

One might, of course, raise questions about the wisdom of section 49 as a criminal loansharking statute. The statute is hardly designed to cover only those who genuinely merit condemnation as loansharks, and thus leaves entirely to prosecutorial discretion the identification of those warranting criminal prosecution. There is also something unsettling about a legislature enacting a criminal statute requiring a class known to include both criminals and non-criminals to perform an insignificant act, registration, simply because it is expected that the criminals will not comply and can then be prosecuted for the failure to perform the meaningless act.50

Whatever one may think of section 49 as a criminal statute, the question remains of the effect to be given the statute in civil litigation of the sort exemplified by the Begelfer case. If, as is suggested herein, one cannot plausibly read the statute as embodying a policy against charging interest and expenses in excess of 20%, even by unregistered lenders, then the Begelfer Court was certainly correct in declining to read the statute as requiring that loans calling for interest in excess of 20% be declared void. Yet, for the same reason, it is difficult to see why the courts should grant reformation of a loan made by an unregistered lender to reduce the charges for interest and expenses to 20%. A decree of reformation, albeit to a lesser extent than a decree voiding the contract, gives the borrower a windfall not clearly justified by any coherent legislative policy.51
The fact remains, of course, that the provision is on the statute books and it does provide that loans made in violation of section 49(a) may be declared void by the courts upon petition of the borrower. Presumably the legislature intended this provision to have some effect. One might say, as the Begelfer Court did, that section 49(c) confers discretion on the courts to fashion an appropriate remedy in proceedings under section 49(c) guided "by balancing a number of factors including the importance of the public policy against usury, whether a refusal to enforce the term will further that policy, the gravity of the misconduct involved, the materiality of the provision to the rest of the contract, and the impact of the remedy on the parties rights and duties." Yet, one is immediately faced with the problem that it is difficult to find that the statute does embody any "public policy against usury." Perhaps though, if the statute is viewed as directed at loansharking, not simply usury, some role can be found for section 49(c). If the evidence suggests that the transaction was infected by vices beyond simply a high interest rate, that is, if a court concludes that the transaction is of the sort usually associated with loansharking, then, and only then, the court should enter a decree voiding the loan under section 49(c).

To be sure, it is somewhat problematic to suggest that the effect of section 49(c) should be limited to cases of proven loansharking, since the statute itself says nothing about loansharking, let alone provide a definition of the term. One might object that it would be a peculiar bit of statutory construction to suggest that the scope of section 49(c) is so substantially narrower than the scope of section 49(a). Yet section 49(a) cannot plausibly be applied as broadly as its language suggests either. Consider the possibility of criminal prosecutions under section 49(a). Aside from the process concerns expressed above, no one would be terribly offended by a prosecution of a genuine loanshark under section 49(a). Yet if there were a prosecutor sufficiently hardhearted to initiate a criminal prosecution of the pharmacist-investor Najarian, one would certainly hope that the Supreme Judicial argument, however, is open to the obvious rejoinder that the genuine loanshark is no more likely to be persuaded to register by the possibility of a civil penalty than by the possibility of criminal prosecution. Rather, the civil penalty of reformation is likely to fall on the unwary, though not blameworthy, lender who enters into a loan in ignorance of the registration requirement of the statute.

§ 3.1


It is less clear whether circumstances can be envisioned warranting reformation of the interest and expense charges to 20%. If the court is convinced that the lender is guilty of loansharking it is difficult to imagine that the court would wish to assist him in collecting the loan, even at a reduced interest rate. Yet if the lender is not properly viewed as a loanshark, then, for the reasons discussed above, it is not clear that even reformation is warranted. There is, of course, nothing in the text of § 49(c) suggesting that reformation must be appropriate in certain cases. The statutory language "may be declared void" certainly permits, even if it does not compel, an all or nothing approach.

See text and note at note 50 supra.
§ 3.2 CONTRACTS AND COMMERCIAL LAW

Court would find a way to narrow the scope of section 49(a). The legislature simply could not have intended section 49(a) to be taken literally.

The implicit premise of section 49—that charging interest in excess of 20% may provide some sort of operative definition of loansharking—may have seemed more plausible in 1970, a year during which the prime interest rate ranged from 8 1/2% to 7%, than it does today. Yet even in 1970 the legislature was unwilling to accept that equation. As initially proposed, the bill which became section 49 did not contain an exception for lenders who register with the Attorney General. Had the legislature been willing to subject to criminal penalties any lender who charged more than 20% interest and expenses, there would be nothing anomalous about declaring that such loans may be voided. Once the registration exception was included, and the normative content of the provision thereby rendered ambiguous, it is far less clear that the legislature intended to impose any civil penalty on all persons who may have fallen within the scope of the proscription by failing to register.

Given the peculiarity of the Massachusetts criminal usury statute, and the difficulty of identifying a coherent public policy embodied in the statute, it is perhaps hard to fault the Court too much for its interpretation of the act in Begelfer. As Justice Jackson once suggested in another context, the most apt authority on this statute may be Twain—"The more you explain it, the more I don't understand it." 18

§ 3.2 Termination of Franchise Agreement—Unconscionability and Good Faith Performance. In Zapatha v. Dairy Mart, Inc., the Supreme Judicial Court rejected the argument that a franchise agreement may not lawfully be terminated without good cause. The opinion provides the first extended discussion by the Massachusetts Court of the concepts of unconscionability and good faith under the Massachusetts Uniform Commercial Code ("Code") and related principles of general law.

In 1973, plaintiff Zapatha contacted representatives of Dairy Mart, Inc. to discuss the possibility of operating a convenience store under a franchise from Dairy Mart. Zapatha was given a brochure describing Dairy Mart's franchise operations and a form of franchise agreement. The agreement

---

56 FED. RES. BULL. A33 (Dec. 1970). And that was high!

18 In the doubly vain hope that this may be read at some future time when 20% again seems usurious, I should perhaps note that as of this writing the prime rate stands at 18 1/2%. Wall St. J., March 4, 1981, at 45, col. 2.

18 See note 8 supra.


2 Id. at 1853, 408 N.E.2d at 1380.

3 G.L. c. 106, §§ 1-101 et seq.

provided that Dairy Mart would license Zapatha and his wife to operate a Dairy Mart store, using the franchisor's trademark and merchandising methods. The franchisor would provide the store and fixtures and would pay rent and utility bills and certain other expenses. The franchisee would be required to pay for the starting inventory, to maintain a minimum inventory thereafter, and to pay employees' wages and sales taxes. The franchisor would receive a percentage of gross revenues as a franchise fee. The agreement contained a termination provision allowing either party, after one year, to terminate the agreement without cause on ninety day's notice. In the event that it terminated the agreement without cause, Dairy Mart would be required to purchase the salable inventory at 80% of its retail price.

Dairy Mart's representative advised Zapatha to read the agreement and specifically reviewed the termination clause with him. Zapatha was advised to consult with an attorney, which he did not do, although Dairy Mart told Zapatha that the terms of the agreement were not negotiable. The Zapathas signed the agreement and took charge of a store in Agawam. Within a year, the Zapathas availed themselves of an opportunity to transfer to another store in Springfield, and signed a new agreement in the same form concerning the new store. Several years later Dairy Mart asked the Zapathas to sign a new form of franchise agreement, some of the terms of which were less favorable to the franchisee. When the Zapathas refused to execute the new form of agreement, Dairy Mart gave notice that the franchise agreement would be terminated in ninety days. In the termination notice Dairy Mart suggested that it remained willing to discuss the execution of the new form of agreement and indicated that on termination Dairy Mart would purchase the Zapthas' inventory pursuant to the franchise agreement.

The Zapathas brought suit to enjoin the termination. The trial court found that Dairy Mart's only reason for terminating the agreement was the Zapathas' refusal to sign the new form of agreement and declared the attempted termination void. The trial judge's conclusion rested on rulings that the clause permitting termination without cause was unconscionable,
that the termination without cause violated Dairy Mart’s obligation of good faith, and that the termination without cause constituted an “unfair method of competition and unfair and deceptive act” under chapter 93A, section 2." On direct appeal the Supreme Judicial Court reversed.\textsuperscript{16}

The Court first considered the question whether the franchise agreement was governed by Article Two of the Code. Section 2-102 provides that Article Two applies to “transactions in goods.”\textsuperscript{19} Although “transaction” is undefined, section 2-105(1) does provide a definition of “goods” as “things \ldots which are movable \ldots”\textsuperscript{20} Although the franchise agreement required the Zapathas to purchase some goods from Dairy Mart, about 70% of the goods sold by the Zapathas were purchased from other sources.\textsuperscript{21} Perhaps more significantly, the Court noted that the essence of the agreement was the exchange of intangible rights, obligations, and services, whereby Dairy Mart licensed its business methods and trademark to the Zapathas in exchange for the franchise fee and the expectation that the Zapathas would enhance the reputation of the Dairy Mart franchise chain.\textsuperscript{22} Since the sale of goods from Dairy Mart to the Zapathas was only a minor aspect of the entire relationship,\textsuperscript{23} the Court concluded that the agreement was not explicitly governed by the sales article of the Code.\textsuperscript{24} Nonetheless, the Court ruled that the Article Two provisions concerning unconscionability and good faith expressed legislative statements of policy of wider application than the scope of the Sales Article of the Code, and therefore these provisions could be applied to the franchise agreement by analogy.\textsuperscript{25}

\textsuperscript{17} Id.
\textsuperscript{18} Id. at 1838, 408 N.E.2d at 1372.
\textsuperscript{19} G.L. c. 106, § 2-102.
\textsuperscript{20} G.L. c. 106, § 2-105(1).
\textsuperscript{22} Id. at 1843 n.9, 408 N.E.2d at 1375 n.9.
\textsuperscript{23} Id. at 1843, 408 N.E.2d at 1375.
\textsuperscript{24} Id.
\textsuperscript{25} Id. In dictum the Court stated that it would be disinclined to apply Article Two selectively to those aspects of an agreement which do concern transactions in goods, since different principles of law might then apply to different parts of the same agreement. Were the Court confronted with such a situation—for example, disputes over shipment or price terms, or issues of passage of title, breach of warranty—it would seem anomalous not to apply Article Two simply because the agreement also involved matters other than the sale of goods. Applying different principles of law to similar sales transactions is no less undesirable than applying different rules to different portions of an agreement. Of course, the Court might resolve the problem by the technique of applying Article Two by analogy to the goods aspects of mixed agreements. Moreover, to the extent that Article Two principles become a source of guidance in the development of the common law of contracts, See U.C.C. § 1-102, Comment 1; Landis, Statutes and the Source of Law, in HARVARD LEGAL ESSAYS (R. Pound ed. 1934); Note, The Uniform Commercial Code as a Premise for Judicial Reasoning, 65 COLUM. L. REV. 880 (1965), the likelihood that non-Article Two law will be significantly different is diminished. Article Two coverage problems are likely to be most difficult where the applicable non-Article Two law would be statutory. For example, the Article Two statute of limitations is four years,
The Court rejected plaintiffs' argument that the clause in the franchise agreement permitting termination without cause was unconscionable. Section 2-302 of the Code provides that:

If the Court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause, as to avoid any unconscionable result.26

The term "unconscionable" is undefined in the Code and the text of section 2-302 provides little guidance in identifying relevant considerations. Among the many issues left open by the text of the statute is whether the section is directed at defects in the bargaining process or the unfairness of particular contract terms.27 In the Zapatha case, the Court noted that the official comments to the section state, inter alia, that "[t]he principle is one of prevention of oppression and unfair surprise . . . ."28 Drawing on this comment, the Zapatha Court appeared to take the position that unconscionability requires findings of both "procedural" defects, under the heading of "unfair surprise," and "substantive" unfairness, under the heading of "oppression."29

In analyzing the contention that the termination clause was unconscionable, the Court first noted that the Code itself appears to sanction clauses permitting termination without cause.30 Section 2-309, dealing explicitly with termination clauses, provides that:

Termination of a contract by one party except on the happening of an

§ 2-725, while the general contracts statute of limitation in Massachusetts is six years, G.L. c. 260, § 12.

With respect to the Code obligation of good faith, the Article Two coverage issue might at first seem irrelevant, since the obligation of good faith is imposed in Article One, § 1-203. There is, however, no general scope provision for Article One or the Code as a whole. Thus Article One applies only if a transaction or contract falls within the scope of one of the specific Articles of the Code.

26 G.L. c. 106, § 2-302.
29 "[U]nconscionability must be determined on a case by case basis . . . giving particular attention to whether, at the time of execution of the agreement, the contract provision could result in unfair surprise and was oppressive to the allegedly disadvantaged party." 1980 Mass. Adv. Sh. at 1845, 408 N.E.2d at 1376 (emphasis added). "This two-part test for unconscionability involves determining whether there was 'an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party.' . . . The inquiry involves a search for components of 'procedural' and 'substantive' unconscionability." Id. at 1846 n.13, 408 N.E.2d at 1377 n.13 (quoting Williams v. Wallker-Thomas Furniture Co., 350 F.2d 445, 449 (D.C. Cir. 1965)).
agreed event requires that reasonable notification be received by the other party and an agreement dispensing with notification is invalid if its operation would be unconscionable.  

Since termination other than "upon the happening of an agreed event," would include termination without cause, the Court reasoned that section 2-309 may be taken to authorize such terminations, at least when proper notice is given.  

Reviewing the various aspects of unconscionability the Court found no basis for ruling that the termination clause was vulnerable because of unfair surprise. The Court noted that the clause was not obscurely worded or buried in fine print; that Dairy Mart's representative specifically called Zapatha's attention to the provision and suggested that Zapatha consult an attorney; and that Zapatha had significant experience and education in business matters. Similarly, the Court concluded that the termination clause was not oppressive, in the sense of substantively unfair. In its analysis of substantive fairness the Court focused on issues of forfeiture and unjust enrichment. Termination of franchise agreements may present particularly troublesome issues where the termination prevents the franchisee from recouping his investment in the franchise. This is particularly the case when a substantial initial franchise payment or investment is required and the franchisor terminates the agreement shortly after its inception. The franchisee may then be left with assets of little value other than in connection with the franchise operation, such as special purpose fixtures, equipment, signs, and the like. The problem is also apparent where the franchisee has devoted substantial effort and investment to the promotion of the franchisor's goodwill. The Court observed that such elements were

31 G.L. c. 106, § 2-309.  
32 The fact that the Zapatha Court did not conclude its analysis of the unconscionability issue upon discussion of § 2-309 suggests that the Court does not view § 2-309 as precluding a finding that a termination without cause provision is unconscionable. But see Artman v. International Harvester, Co., 355 F.Supp. 482, 490 (W.D. Pa. 1972) (termination permitted by § 2-309 "is simply not an unconscionable practice within the meaning of § 2-302."). This is but one illustration of the general question whether a provision which is permissible under a specific section of the Code may be held unconscionable under § 2-302. See Leff, supra note 27, at 522-24.  
34 1980 Mass. Adv. Sh. at 1846-47, 408 N.E. 2d at 1376-77. Mr. Zapatha testified that he understood the termination provision and considered it straightforward; however, he understood it to mean that Dairy Mart could terminate the agreement only for cause. Id. at 1839, 1846, 408 N.E.2d at 1373, 1377.  
35 Id. at 1847, 408 N.E.2d at 1377.  
37 Id.
largely absent in the Zapatha case. Dairy Mart provided the Zapathas with a going business at a fully equipped store. The Zapathas were required only to purchase the inventory, and upon termination Dairy Mart was required to repurchase the inventory at a fair valuation. The Zapathas received their net profits from the operation during the term of the agreement and had not been required to make any unrecoverable financial investment. Thus, upon termination the Zapathas were in substantially the same economic position as prior to the arrangement. Accordingly, the Court ruled that the termination clause was not unconscionable.

The Zapathas also argued that the exercise of the termination clause violated section 1-203 of the Code, which provides that “[e]very contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.” Good faith, for purposes of the Code in general, is defined in section 1-201(19) as “honesty in fact in the conduct or transaction involved.” The term, however, is given a special definition in Article Two. Section 2-103(1)(b) provides that, “[i]n this Article unless the context otherwise requires . . . ‘good faith’ in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.” Though the Court considered this special definition of good faith applicable to the Zapatha case, the requirement of observance

Id. at 1847-48, 408 N.E.2d at 1377-78.
Id. at 1848, 408 N.E.2d at 1378.
Id.
G.L. c. 106, § 1-203.
G.L. c. 106, § 1-201(19).
G.L. c. 106, § 2-103(1)(b).

Some textual problems are presented by the assumption that in the context of sales transactions the § 1-203 good faith obligation is to be tested by the § 2-103(1)(b) definition of good faith as including observance of reasonable commercial standards. Section 2-103(1)(b) is, in terms, simply a definition of the words “good faith” as used in Article Two. Thus, on a literal reading the stricter standard of good faith would be applicable only where the term “good faith” explicitly appears in the provisions of Article Two. The general obligation of good faith performance, however, is found in Article One. Some commentators who have noted the textual problem have urged that in transactions governed by Article Two the Article Two definition of good faith be considered applicable to the § 1-203 obligation of good faith performance. Farnsworth, Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code, 30 U. Chi. L. Rev. 666, 675-76 (1963). Cf. Summers, “Good Faith” in General Contract Law and the Sales Provisions of the Uniform Commercial Code, 54 Va. L. Rev. 195, 212-13 (1968). The courts seem to have assumed that interpretation without discussion. See, e.g., Sherrock v. Commercial Credit Corp., 269 A.2d 407 (Del. Sup. Ct. 1970) (dictum), rev’d, 290 A.2d 648 (Del. 1972). Indeed, the Delaware Superior Court in Sherrock was so captivated by the notion that merchants should be held to a more stringent standard of good faith that it applied the § 2-103(1)(b) definition to the interpretation of “good faith” in Article Nine! The Delaware Supreme Court set things straight on that score.

The application of the stricter definition of good faith in the Zapatha case also requires that Dairy Mart be considered a “merchant,” defined in § 2-104 as one “who deals in goods of the
of reasonable commercial standards was of little assistance to the Zapathas. The Court stated that there was no evidence that Dairy Mart failed to observe such standards.\textsuperscript{46} Thus, the good faith analysis was reduced to an examination of Dairy Mart’s honesty. The Court noted that Dairy Mart clearly expressed its right to terminate in the franchise agreement and exercised that right for an openly disclosed reason—the Zapathas’ refusal to sign the new form of agreement.\textsuperscript{47} Some problem was presented by a brochure Dairy Mart provided to the Zapathas before the agreement was signed. The brochure somewhat misleadingly described the franchise arrangement as providing the franchisee “a life of security and comfort.”\textsuperscript{48} The Court, however, ruled that in view of the explicit termination clause of the franchise agreement, Dairy Mart’s use of the brochure could not support a finding of dishonesty.\textsuperscript{49}

Although the Court found no violation of the unconscionability or good faith provisions of the Code, the Court suggested that the agreement and Dairy Mart’s performance thereunder should be tested against general principles of law designed to “provide protection from conduct that has produced an unfair and burdensome result, contrary to the spirit of the bargain, against which the law should reasonably provide protection.”\textsuperscript{50}

The Court indicated that such principles might have a wider scope than the unconscionability and good faith provisions of the Code.\textsuperscript{51}

kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transactions . . . .’’ The Court stated that ‘‘[t]here is no doubt that Dairy Mart is a merchant,’’ 1980 Mass. Adv. Sh. at 1842 n.7, 408 N.E.2d at 1374 n.7, a somewhat peculiar conclusion given that the Court had previously stated that the sale of goods aspect of the transaction was insignificant, \textit{id.} at 1843, 408 N.E.2d at 1375. Perhaps the Court was applying the term ‘‘merchant’’ by analogy in a non-sales transaction, or perhaps the use of the word ‘‘practices’’ in the definition of ‘‘merchant’’ is to be considered significant.

\textsuperscript{46} \textit{Id.} at 1848, 408 N.E.2d at 1378. The assumption that reliance on the reasonable commercial standards aspect of the Article Two good faith definition requires proof of the existence of such standards in the trade finds some support in the case law. \textit{See} Eastern Air Lines, Inc. v. Gulf Oil Corp., 415 F. Supp. 429 (S.D. Fla. 1975); First Nat’l. Bank v. Crone, 157 Ind. App. 665, 301 N.E.2d 378 (1973). On the other hand, the very wording of the provision, referring to ‘‘reasonable commercial standards of fair dealing’’ (emphasis added) suggests that existing practices should not necessarily be determinative. A general trade practice of cheating should hardly be definitive of good faith. \textit{Cf.} The T.J. Hooper, 60 F.2d 737 (2nd Cir.), \textit{cert. denied}, 287 U.S. 662 (1932).

\textsuperscript{47} 1980 Mass. Adv. Sh. at 1848, 408 N.E.2d at 1378.

\textsuperscript{48} \textit{Id.} at 1838 n.3, 408 N.E.2d at 1372 n.3.

\textsuperscript{49} \textit{Id.} at 1849, 408 N.E.2d at 1378.

\textsuperscript{50} \textit{Id.} at 1850, 408 N.E.2d at 1379.

\textsuperscript{51} In a footnote the Court noted that the unconscionability provision focuses on the terms of the contract, as distinguished from the character of a parties’ performance under the contract, and that the inquiry must be directed to the terms of the contract at the time it is executed. \textit{Id.} at 1850 n.17, 408 N.E.2d at 1379 n.17. With respect to the good faith obligation, the Court noted that a party’s conduct might be honest, and, in the case of a merchant, adhere to standards of his trade, yet be unfair and unreasonably burdensome. \textit{Id.}
In assessing Dairy Mart’s performance under these general principles, the Court considered the effect of the recent decision in *Fortune v. National Cash Register* on contract provisions permitting termination without cause. In *Fortune* a salesman employed under a contract permitting termination without cause was fired shortly before he would have become entitled to certain bonus payments. The *Fortune* Court held that although the termination complied with the contract provision, the contract “contains an implied covenant of good faith and fair dealing, and a termination not made in good faith constitutes a breach of the contract.” Although it has been suggested that the *Fortune* good faith standard is tantamount to a holding that an at will employment contract may not be terminated without cause, the Zapatha Court’s reading of *Fortune* casts doubt on that interpretation. The Court indicated that the determinative factor in *Fortune* was not that the employee was discharged without cause, but that that employer fired the employee “in order to avoid the payment of amounts earned, but not yet payable.” Applying *Fortune* principles to the instant case, the Court noted that the termination of the Zapathas’ franchise did not deprive the Zapathas of income which they had fairly earned, usurp funds to which they were entitled, or appropriate the benefit of goodwill generated through their efforts. Thus, the termination could not be considered a violation of implied requirements of good faith and fair dealing, unless such good faith

As a source of authority for these general principles, the Court cited Restatement (Second) of Contracts § 231 (Tent. Drafts Nos. 1-7 1973), which states that “[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.” Although the Restatement comments refer to the Code definition of good faith, it is clear that a broader concept is embodied in the Restatement provision. Concerning good faith performance of a contract, Comment a to § 231 states that the concept “emphasizes faithfulness to an agreed common purpose and consistency with the justified expectation of the other party; it excludes a variety of types of conduct characterized as involving ‘bad faith’ because they violate community standards of decency, fairness or reasonableness.” Also, Comment d notes that “fair dealing may require more than honesty.” *Id.*

*§ 3.2*
principles were extended to prohibit any termination without cause. The Court expressly declined to adopt such a position. The Zapatha Court's refusal to adopt a principle prohibiting the use of termination without cause provisions in franchise agreements is not surprising. Franchisees have met with little success in arguing that such termination clauses violate the unconscionability or good faith requirements of the Code or are otherwise unlawful. The Zapatha opinion, however, contains suggestive dicta indicating that on different facts judicial relief against franchise terminations may be available. The Court's emphasis on the Zapathas' failure to demonstrate that the termination would effect a forfeiture of their reasonable investment expectations may be taken to suggest that the presence of such factors would lead to a different result. Thus, if the termination deprives the franchisee of an opportunity to recoup its original investment, or leaves the franchisee with unsaleable inventory or special purpose equipment and supplies of little value except in connection with the franchise operation, an action by the franchisee to enjoin the termination or seek damages should certainly not be foreclosed by the Zapatha decision. Indeed, Zapatha would be a useful precedent for the franchisee in such a case.

Although the absence of elements of forfeiture of reasonable investment expectations or appropriation of goodwill makes the Zapatha case a less than egregious instance of franchise termination, the franchisee may have other interests deserving of protection. Whether or not the franchise agree-

---

"Id.

Considering the Zapathas' claim under section 2 of chapter 93A, the Court noted that that section provides that the interpretations of the Federal Trade Commission Act are to serve as a guide to the meaning of the phrase "unfair or deceptive acts or practices," and that the Zapathas cited no case or Federal Trade Commission ruling suggesting that termination of a franchise agreement without cause is an unfair or deceptive act or practice. 1980 Mass. Adv. Sh. at 1852, 408 N.E.2d at 1350.

"See generally Gellhorn, supra note 36.

"1980 Mass. Adv. Sh. at 1847, 408 N.E.2d at 1377

"It is not entirely clear, however, precisely how the analysis would proceed in such a case. Since the Zapatha opinion appears to require a showing of both procedural and substantive unconscionability under U.C.C. § 2-302, that provision would be of little use to a franchisee if the termination clause has been adequately brought to his attention. Similarly, the good faith obligation of U.C.C. § 1-203 will not avail the franchisee absent a factual showing that the termination was not consistent with the commercial standards of franchisors. Presumably then, the franchisee would have to rely on the general principles of law to which the Zapatha Court alluded. The Zapatha Court did not explicitly consider whether such general principles of law would warrant relief against a substantively unfair termination in the absence of any procedural defects in the contract formation process. Perhaps the Fortune case can be taken as supporting an affirmative answer, since there appears to have been no inquiry in Fortune concerning whether the employee could plausibly claim surprise over the operation of the termination clause.
ment includes a termination without cause provision, a person entering into a franchise business doubtless anticipates that he is embarking on a continuing venture, and it is surely in the franchisor’s interests that the franchisee entertain such expectations. Having devoted his working efforts to a particular endeavor, and foregone other opportunities, the franchisee’s expectations of a continuing relationship are not insubstantial. At one point in the Zapatha opinion the Court suggested that in order to demonstrate unconscionability, in the substantive sense, the franchisee must “sustain [the] burden of showing that the agreement allocated the risks and benefits connected with termination in an unreasonably disproportionate way and that the termination provision was not reasonably related to legitimate commercial needs of [the franchisor.]” If it is assumed that the franchisor has terminated the agreement literally without cause, that standard can be considered satisfied only if no weight at all is given to the franchisee’s interests in maintaining the relationship. Perhaps the Court feared that requiring the franchisor to demonstrate cause would impose an undue burden on even legitimately motivated terminations, if only because of the franchisor’s fear of litigation costs. Moreover, there is some suggestion in the opinion that imposition of a cause standard should be left to the legislature. The Court noted that Massachusetts has adopted statutes requiring cause for the termination of only certain types of franchises.

Even if a cause standard is not implied, there may be reason to question the legitimacy of the termination involved in the Zapatha case. The Fortune case surely may be taken to mean that a termination in bad faith would be impermissible. In Zapatha the trial court found that the sole reason for the termination was the Zapathas’ refusal to sign the new form of franchise agreement suggested by Dairy Mart. In effect, then, the franchisor was using the termination clause as a way of permitting it unilaterally to change any of the other terms of the agreement. The good faith issues raised by such a use of a termination clause are not insubstantial. The general

---

42 Thus, in the Zapatha case, Dairy Mart’s brochure soliciting franchisees was hardly designed to attract persons expecting a short-term arrangement. “We’re looking for a partner... who can take the tools we offer and build a life of security and comfort...” 1980 Mass. Adv. Sh. at 1838 n.3, 408 N.E.2d at 1372 n.3
43 See generally Glendon & Lev, supra note 55; Reich, The New Property, 73 Yale L. J. 733 (1964).
45 Id. at 1851 & n.18, 408 N.E.2d at 1379 & n.18 (citing G.L. c. 93B, § 4(3)(e) (motor vehicle dealers); G.L. c. 93E, §§ 5, 5A (gasoline stations)).
47 Cf. Summers, supra note 45, at 243-48 (bad faith in raising and resolving contract disputes to obtain favorable modifications); U.C.C. § 2-209, Comment 2 (“[A]n agreement modifying a sales contract needs no consideration to be binding. However, modifications must meet the test of good faith imposed by this Act. The effective use of bad faith to escape performance on the original contract terms is barred, and the extortion of a ‘modification’
obligation of good faith performance of contracts may be taken to pro-
scribe the use of contract provisions to achieve results "contrary to the
spirit of the bargain." The Restatement (Second) of Contracts states that
"good faith performance or enforcement of a contract emphasizes
faithfulness to an agreed common purpose and consistency with the
justified expectations of the other party . . . ."  

A party's invocation of a termination without cause provision to force
the other party to accept a modification of other provisions of the contract
may or may not be consistent with the obligations of good faith, depending
on the parties' understanding, at the time the contract is formed, of the ef-
fect of the termination clause. If the parties' attention has been directed to
the termination clause in such fashion that they understand that no commit-
ment whatsoever is being made to continue the relationship on the existing
terms, then there can be little objection to a termination motivated by one
party's refusal to accept a proposed modification. Perhaps the Zapatha
opinion is to be understood as resting on the conclusion that the Zapathas
did or should reasonably have understood the termination provision to have
this effect. The difficulty with such an approach is the likelihood that ter-
mination clauses are frequently included in agreements simply as a matter
of drafting tidiness, without great consideration being given to the effect of
the clause. Even where the parties have focused their attention on the ex-
istence of a termination without cause provision, it is by no means clear that
they will have contemplated that such a provision may effectively render the
balance of the contract nugatory. It seems more likely that one who accepts
a termination without cause provision assumes that the other party will not
actually terminate for no reason whatsoever—we are simply not in the habit
of viewing the decisions of competent adults as the product of mental
Brownian motion. Rather, one assumes that the other party is unwilling to
subject his actual, and probably not invalid, reasons for termination to ex-
amination in litigation. It is a different matter, however, fully to realize
that a termination clause may be used not for the purpose of actually ter-
minaling the arrangement but for the purpose of altering its terms. It might
not have been inappropriate to have ruled that Diary Mart's exercise of the
termination power was sufficiently inconsistent with the reasonable expec-
tations of the parties to the contract as to amount to bad faith, at least in the
absence of evidence suggesting that the franchisor had apprised the fran-
chisee in advance of the possibility that it might propose a modification of
the agreement on a take it or leave it basis.

§ 3.2 CONTRACTS AND COMMERCIAL LAW 89

without legitimate commercial reason is ineffective as a violation of the duty of good faith.

45 Restatement (Second) of Contracts § 231, Comment a (Tent. Drafts Nos. 1-7 1973).
47 Cf. Leff, supra note 27, at 507.
§ 3.3 Insurance Policies—Effect of Untimely Notice—Prospective Overruling. In *Johnson Controls, Inc. v. Bowes*, the Supreme Judicial Court announced a significant change in Massachusetts law concerning the effect of an insured’s breach of a provision of a liability insurance policy requiring that the insured give timely notice of occurrences and claims. Henceforth the insurer will be permitted to disclaim coverage on the grounds of untimely notice only if the delay has prejudiced the insurer’s interests. The new rule, however, will be given only prospective application.

In 1973 Johnson Controls brought a malpractice action against its attorney, Bowes. Although Bowes carried malpractice insurance, he did not notify his insurer of the action. The insurer first learned of the suit when contacted by Johnson Controls’ attorney some six months after suit was filed. The insurer notified Bowes that it disclaimed coverage and would not defend the action, on the grounds of Bowes’ failure to comply with the notice provision of the policy. Johnson Controls was awarded a judgment in excess of thirty thousand dollars in the malpractice action. It then brought an action against the insurer to reach and apply the proceeds of the insurance policy. The superior court granted the insurer’s motion for summary judgment. On direct appellate review the Supreme Judicial Court overruled its prior decisions on the effect of an insured’s noncompliance with notice provisions of an insurance policy and held that untimely notice should relieve the insurer of liability only if the insurer proves that it has sustained prejudice as a result of the delay. Noting that the decision represented “a drastic or radical incursion upon existing law,” the Court confined its decision to claims arising after the date of the opinion. Accordingly, the Superior Court’s dismissal of Johnson Controls’ claim was affirmed.

The Supreme Judicial Court indicated that in Massachusetts, as in many
other jurisdictions, the courts have traditionally construed the notice provisions of liability insurance policies strictly.\(^\text{13}\) Viewing compliance with notice provisions as a condition precedent to coverage, the insurer has been relieved of liability where the insured failed to give timely notice, irrespective of whether the insurer's position has been prejudiced by the delay.\(^\text{14}\)

The *Johnson Controls* Court noted that there is a trend in recent decisions away from the strict contractual approach toward the view that delayed notice should absolve the insurer of liability only in the event that the insurer has sustained prejudice.\(^\text{15}\) The Court cited decisions in Pennsylvania and New Jersey noting that an approach based on strict construction of the parties' contractual arrangements is inapt in light of the insured's general inability to negotiate the terms of an insurance policy, and that strict application of notice provisions effects a forfeiture of the coverage for which the insured has paid.\(^\text{16}\) Inasmuch as the purpose of notice clauses is to ensure that the insurer has an adequate opportunity to investigate and defend claims, the Court concluded that it is inappropriate to relieve the carrier of liability where timely notice would not substantially have improved the insurer's position.\(^\text{17}\) Accordingly, the Court ruled that in order for the insurer

\(^{13}\) Id. at 1833, 409 N.E.2d at 187.

\(^{14}\) E.g., Rose v. Regan, 344 Mass. 223, 226, 181 N.E.2d 796, 798 (1962); Comment, *The Materiality of Prejudice to the Insurer as a Result of the Insured's Failure to Give Timely Notice*, 74 DICK. L. REV. 260 (1970). Though adopted here as a convenient locution, the reference to a "traditional approach" to untimely notice issues probably overstates the uniformity of the decisions. The view that prejudice to the insurer is material has long been adopted in many jurisdictions. Cases are collected in Annot., 76 A.L.R. 23, 201 (1932); Annot., 123 A.L.R. 950, 984 (1939); Annot., 18 A.L.R.2d 443, 479 (1951).


With respect to motor vehicle liability policies, the law concerning the effect of delayed notice has recently been reformed by the Massachusetts Legislature. Section 112 of chapter 175 of the General Laws, as amended in 1977, provides that a motor vehicle liability insurer "shall not deny insurance coverage to an insured because of failure of the insured to seasonably notify an insurance company of an occurrence, incident, claim or a suit founded upon an occurrence, incident or claim, which may give rise to liability insured against unless the insurance company has been prejudiced thereby." In *Spooner v. General Accident Fire & Life Assur. Corp.*, 1979 Mass. Adv. Sh. 2657, 397 N.E.2d at 1290, the Court declined to abrogate the strict approach to untimely notice with respect to claims under motor vehicle liability policies arising prior to the effective date of the 1977 amendment. Noting that the Legislature had not made the change in the common law retroactive, and that the Court had not previously questioned the soundness of the traditional approach, the *Spooner* Court declined to "depart retroactively from the meaning and import ... given for at least two generations to a significant condition of contracts of insurance." 1979 Mass. Adv. Sh. at 2659, 397 N.E.2d at 1291. Since *Johnson Controls* involved an insurance policy not covered by section 112, the Court concluded that the case "presented a more appropriate vehicle for reconsideration of our common law." 1980 Mass. Adv. Sh. at 1833, 409 N.E.2d at 187.


to be relieved from liability due to untimely notice, "the insurance company will be required to prove both that the notice provision was in fact breached and that the breach resulted in prejudice to its position."[18]

The determination that the insurer should not be permitted to disclaim coverage in the absence of prejudice does not, of course, answer the critical issue of the burden of proof. Curiously, however, the Johnson Controls opinion does not expressly address the issue. Those jurisdictions which consider the issue of prejudice to the insurer relevant have divided on the burden of proof issue.[19] In some jurisdictions the insurer is presumed to have sustained prejudice from delayed notice unless the insured proves the absence of prejudice.[20] In other jurisdictions the insurer bears the burden of proving prejudice in order to escape liability.[21] Authorities supporting the view that the insured must prove the absence of prejudice note that it may be extremely difficult for the insurer to demonstrate actual prejudice. Since, by hypothesis, the insurer has not had the opportunity to conduct a prompt investigation, it may be difficult or impossible for the insurer to show with specificity what it might have been able to accomplish by such an investigation. Moreover, it is said that since the insured is seeking to absolve itself of the consequences of an admitted breach of the policy conditions, it is not unfair to require the insured to establish adequate grounds of excuse.[22] On the other hand, the fact that the insurer’s claim of prejudice may often be speculative can be taken to support the view that prejudice to the insurer should not be presumed.[23] Furthermore, the experience of jurisdictions which place the burden of proof on the insurer indicates that the insurer’s burden is not insurmountable. Insurers have in various situations been able to satisfy the burden of proving prejudice, as where witnesses have disappeared in the period between the occurrence and notification of the insurer.[24]

Although the Johnson Controls Court did not discuss the issue of burden of proof, the Court’s language makes it quite clear that the insurer bears the burden of proving prejudice.[25] Given that the arguments on the issue are

[18] Id. at 1835, 409 N.E.2d at 188.
[22] 8 J. Appleman, supra note 19.
[25] 1980 Mass. Adv. Sh. at 1835, 409 N.E.2d at 188 ("[W]here an insurance company attempts to be relieved of its obligations under a liability policy . . . on the ground of untimely
nearly in equipoise, the Court’s ruling is certainly not inappropriate, though
the failure to discuss the issue is puzzling. Support for the Court’s conclu-
sion on the issue may be found in the fact that the Massachusetts
legislature’s recent statutory abrogation of the traditional approach to un-
timely notice in the field of motor vehicle liability policies seems to place
the burden of proving prejudice on the insurer. There could be little
justification for adopting different rules on the burden of proof for motor
vehicle liability policies and for other types of liability insurance.

The Court’s treatment of the retroactivity issue seems unsatisfactory. The
Court stated that since the “reform of the notice requirements constitutes ‘a
drastic or radical incursion upon existing law,’ which would disturb retroac-
tively the contractual arrangements of the insurer and the insured, and
since ‘reliance interests exert a strong influence’ in matters of contact
law, the new rule is to be confined “to claims arising after the date of the
opinion.” The Court rejected the alternative of giving the new ruling
limited retroactive application by applying the new rule to the specific case
before the Court, on the grounds that the justification for such limited
retroactivity—encouraging litigants to challenge outmoded doctrines—was
outweighed by the unevenness in treatment of similarly situated insurers.

notice, the insurance company will be required to prove both that the notice provision was in
fact breached and that the breach resulted in prejudice to its position."

See note 15 supra.

G.L. c. 179, § 112 (Motor vehicle liability insurer “shall not deny insurance coverage to
an insured” because of untimely notice “unless the insurance company has been prejudiced
thereby.”)


Id. at 1836, 409 N.E.2d at 188.

Id. at 1836 n.4, 409 N.E.2d at 188 n.4.

One may question whether the concern with uneven treatment is significant in the context of
liability insurers as defendants. The objection to this form of limited retroactivity rests on the
unfairness of singling out one out of a class of similarly situated defendants to pay the cost of
inducing socially desirable challenges to outmoded judicial doctrines. However, of the class of
pre-Johnson Controls incidents of untimely notice not yet disposed of by settlement, judg-
ment, or the statute of limitations, see Pevoski v. Pevoski, 371 Mass. 358, 361, 358 N.E.2d 418
(1976), the insurer involved in the Johnson Controls litigation may well have been the carrier
for many other similar incidents to which the Johnson Controls rule would not be applied
under the sort of limited retroactive application here under consideration.

The rejection of such limited retroactivity rests on the assumption that the hope of per-
suading the court to overrule with full retroactivity will suffice to induce litigants to bring
desirable challenges. R.E. KEETON, VENTURING TO DO JUSTICE 36 (1969). This rationale,
however, has the perverse consequence that it is desirable for courts to remain unpredictable as
to whether new decisions will be applied retroactively. Cf. P. MISHKIN & C. MORRIS, ON LAW
IN COURTS 311-12 (1965). At the least, the Supreme Judicial Court’s rejection of this limited
retroactivity technique should lead the Court to be rather reluctant to limit decisions to purely
prospective effect absent a compelling justification for so doing.
The question whether a judicial decision effecting a significant change in
the law should be given retroactive or prospective effect is a notoriously dif-
ficult one. The ordinary function of judicial adjudication—arbitration of
disputes among parties concerning events which have already oc-
curred—suggests that retroactivity is the usual course. Although at one
time it may have been thought that prospective judicial decisions were un-
justifiable on the theory that in overruling prior decisions the courts "do
not pretend to make a new law, but to vindicate the old one from
misrepresentation," this Blackstonian declaratory view has largely passed
out of fashion and the legitimacy of prospective overruling is widely con-
ceded. The appropriate conditions for prospective overruling, and even the
meaning of prospectivity or retroactivity, however, remain problematic.

Although the Johnson Controls opinion does not discuss the retroactivity
issue at length, the Court has previously stated the factors relevant to the
issue of retroactivity in customary terms: "(1) whether a new principle has
been established whose resolution was not clearly foreshadowed, (2)
whether retroactive application will further the rule, and (3) whether in-
equitable results, injustice or hardships will be avoided by a holding of
nonretroactivity." Brief consideration of the first two factors suggests
that in Johnson Controls, the key to the retroactivity issue should be the
third factor—justifiable reliance. Given that the Massachusetts Court does
not appear to have suggested previously that the traditional approach to
problems of delayed notice was a likely candidate for reconsideration, it is
difficult to suggest that the Johnson Controls decision was "clearly
foreshadowed." On the other hand, it may be argued that judicial
developments in other jurisdictions should have alerted insurers to the
possibility of a change in the Massachusetts rule.\[3\] In any event, the issue of

\[3\] See generally R.E. Keeton, supra note 31, at 39-53; P. Mishkin & C. Morris, supra note
31, at 293-317; Currier, Time and Change in Judge-Made Law: Prospective Overruling, 51 VA.
L. Rev. 201 (1965); Mishkin, The Supreme Court, 1964 Term — Foreword: The High Court,
The Great Writ, and the Due Process of Time and Law, 79 Harv. L. Rev. 56 (1965); Note,
Prospective Overruling and Retroactive Application in the Federal Courts, 71 Yale L.J. 907
(1962).

\[3\] P. Mishkin & C. Morris, supra note 31, at 60.

\[3\] W. Blackstone, Commentaries *70.

(1979) (citing Chevron Oil Co. v. Huson, 404 U.S. 97, 106-07 (1971)).

\[3\] The Massachusetts Legislature's abrogation of the traditional approach to delayed notice
in the context of motor vehicle liability insurance, see note 15 supra, might be thought relevant
on the issue whether the Johnson Controls ruling was foreshadowed, in the sense that the
legislative action indicates dissatisfaction with the traditional approach. The argument,
however, is problematic on the facts presented in Johnson Controls, since the insurer there
disclaimed coverage in 1974 while the amendment concerning motor vehicle insurance was not
enacted until 1977. On the other hand, to the extent that the Johnson Controls Court's ruling
on retroactivity responds to the reliance interests of insurers and, to the extent that the Johnson
Controls Court's ruling on retroactivity responds to the reliance interests of insurers generally,
forseeability bears on whether reliance was justifiable, and thus does not arise until it is determined that insurers have in fact relied on the pre-
Johnson Controls rule. Consideration of whether "retroactive application will further the rule" enunciated in Johnson Controls clearly militates in favor of retroactivity. The policy of avoiding forfeitures of insurance coverage where the insurer has sustained no prejudice from untimely notice is no less weighty with respect to occurrences before the decision than after the decision.

In analyzing the issue of justifiable reliance, it is useful to distinguish two senses in which insurers might be said to have relied on the pre-Johnson Controls rule: First, insurers may have relied in the sense that they anticipated being able to avoid the cost of providing coverage to insureds who gave untimely notice. Second, insurers may have relied in the sense that they did not, at the time of receiving notice, make any investigation to determine whether the delay may have prejudiced their interests. These two senses of reliance should be considered separately, for they have very different consequences.

Viewing reliance in the sense of the insurer's expectations of being permitted to disclaim coverage, it should be noted that the mere fact that retroactive application would increase the insurer's liability cannot be dispositive. The Court has frequently given retroactive effect to newly enunciated rules in just such circumstances. Rather, the question must be whether the assumption that the insurer would be permitted to disclaim coverage on the grounds of untimely notice has led it to take action or make commitments which cannot easily be undone. Whether the insurer could make a plausible claim of such detrimental reliance is uncertain.

Notwithstanding the Johnson Controls Court's rather facile assertion that in matters of contract law "reliance interests exert a strong influence," it seems clear that all matters of contract law do not implicate reliance interests to the same extent. In the present case, the extent of insurer's reliance on the prior Massachusetts rule would seem to depend primarily on the actuarial and accounting practices of liability insurers.
Presumably, premiums for liability insurance for a given time period are computed on the basis of an actuarial prediction of the anticipated losses which will have to be paid for occurrences during that period. It seems unlikely that insurers explicitly consider the rules of particular jurisdictions concerning untimely notice in making the actuarial computations upon which premium structures are designed. Rather, it seems likely that predictions of anticipated losses are based principally on loss experience for prior periods.

It might be argued that the pre-Johnson Controls approach to untimely notice kept the insurer's loss experience lower than it would have been had the new rule been applicable in the past, and thus the insurer could claim that it had relied on the prior law in computing premiums. One may well wonder, however, about the magnitude of such an effect. The insurer's loss experience is, of course, a product of innumerable factors, from the accident-proneness of its insureds to the unpredictable decisions of juries on damages for pain and suffering. Any change in the law which might alter an insurer's liability—including not only changes in the interpretation of insurance contracts, but also any changes in the law affecting the liability of its insureds—might have an effect on an insurer's loss experience, yet it is difficult to believe that prospectivity is to become the rule in judicial decisionmaking rather than the exception. Indeed, if the Court is genuinely willing to credit the insurer's generalized reliance argument, then all of the Courts prior decisions giving retroactive effect to changes in tort law which can be anticipated to increase the liability of defendants likely to carry insurance were wrongly decided.

Furthermore, in assessing the insurer's claim that it has, in effect, relied on the pre-Johnson Controls rule in making its actuarial computations, it would be relevant to inquire whether the insurer's loss predictions have been computed separately for each jurisdiction. If the insurer's rate calculations are based on nationwide loss experience, the judicial developments in jurisdiction other than Massachusetts become relevant. If, as the Johnson Controls Court noted, there is "a recent trend" toward the abrogation of the traditional approach, the effects of this trend should appear in the general loss experience of the multi-state carrier. The all-knowing actuary,

40 See cases cited in note 37 supra.

41 See R.E. Keeton, supra note 31, at 42-43.

seeing the resultant trend of increases in loss experience, would project increases in the necessary premiums. Thus, changes in the law of other jurisdictions would "foreshadow" further such changes, diminishing the strength of the reliance argument.

Thus, if the reliance argument is taken to mean simply that the insurer has relied on the expectation that its liability would be limited by the pre-\textit{Johnson Controls} rule, the existence and extent of insurer's reliance is open to question. Some more substantial basis for crediting the insurer's reliance argument should be required if the plaintiff in cases such as \textit{Johnson Controls} is to be deprived of the benefit of the newly announced rule.

Aside from the generalized reliance argument considered above, the insurer might claim that it has relied on the pre-\textit{Johnson Controls} rule in a more specific sense. The insurer might contend that, relying on the pre-\textit{Johnson Controls} rule, it did not, at the time it received notice, undertake any investigation to determine whether the delay in notification may have prejudiced its interests. It may be far more difficult for the insurer to adduce evidence bearing on the issue of prejudice many years after the fact than it would have been at the time the insurer received notice.

For example, suppose that a witness whose testimony might have been significant to the defense of the underlying suit cannot now be located. If \textit{Johnson Controls} were given full retroactive effect, for the insurer to satisfy its burden of proof it would be required to show not only that the witness is now unavailable, but that he or she could not have been located in 1974. Thus the insurer may well have a legitimate claim of reliance on the pre-\textit{Johnson Controls} rule in the sense that having assumed that prejudice was irrelevant, it forwent the opportunity to develop evidence relevant to the issue of prejudice. Consideration of reliance in this sense, however, does not compel the limitation of the \textit{Johnson Controls} result to purely prospective application.

In response to the insurer's legitimate reliance interests, the Court might

\footnote{The extent to which this argument seems fanciful merely illustrates the doubt that one feels about the proposition that the rules of particular jurisdictions on delayed notice actually have a determinable effect on insurance premium calculations.}

\footnote{Operating under the rule that prejudice must be demonstrated, the insurer must first assess whether the delay may have been prejudicial, and then decide whether to disclaim coverage and whether to assume the defense of the action. If the insurer is willing to assume the expense of litigation, it can defend the suit under a nonwaiver agreement or reservation of rights to preserve its right to disclaim coverage if the defense is unsuccessful. See Salonen v. Paanenen, 320 Mass. 568, 71 N.E.2d 227 (1947). The insurer might also bring a declaratory judgment action to litigate the issue whether it may disclaim coverage on the basis of prejudice alleged to have resulted from delayed notice. See St. Paul Fire & Marine Ins. Co. v. Petzold, 418 F.2d 303 (1st Cir. 1969). Alternatively, the insurer might simply refuse to defend or provide coverage, taking the risk that it will be unable to establish prejudice if the insured, or the insured's claimant, brings suit to establish the insurer's liability under the policy. See Miller v. Lindgate Developers, Inc., 274 F. Supp. 980 (E.D. Mo. 1967).}
have considered a limited form of retroactive application of the new rule, whereby the insurer would be relieved of liability if it could prove that its interests would be prejudiced on the hypothetical assumption that it were now required to investigate and defend the 1973 occurrence. Thus, the *Johnson Controls* rule could be applied as if the date of the decision were the date on which the insurer first received notice. In effect, this approach would make the issue of the insurer’s detrimental reliance on the pre-*Johnson Controls* rule a matter for proof in each specific case, where detrimental reliance is taken not in the sense that the insurer relied on the old rule in expecting to avoid coverage, but in the sense that the insurer relied on the old rule in not investigating the occurrence at the time it was reported to determine whether the delayed notice may have prejudiced its interests.

The Court is to be commended for its abrogation of the traditional inflexible approach to problems of delayed notice of occurrences covered by liability insurance. It is, however, unfortunate that the Court did not engage in a more detailed analysis of the problems of prospective or retroactive application of the newly announced rule. It is unsettling to see the Court applying in the case before it a rule which it has found to be unjust, on the basis of nothing more than a perfunctory analysis of the retroactivity issue. One does not envy the attorney for Johnson Controls faced with his client’s question whether they won the lawsuit.

Other possible approaches are suggested by the decision of the Pennsylvania Supreme Court in *Brakeman v. Potomac Ins. Co.*, 472 Pa. 66, 371 A.2d 193 (1977). There the insurer disclaimed coverage on the grounds of untimely notice and the insured settled the claim. The Pennsylvania court overruled prior decisions and held that the insurer could escape liability only if it was prejudiced by the untimely notice. The *Brakeman* court remanded the case with instructions that the insurer be given an opportunity to show prejudice from the delay in notification and an opportunity to litigate the issues of the insurer’s liability to the claimant. *Id.* at 77, 371 A.2d at 198. A concurring and dissenting opinion suggested that the insured should be permitted to litigate the issue of prejudice and the issue of whether the settlement was made in good faith, but not the issue of the insured’s liability. *Id.* at 87, 371 A.2d at 200 (Roberts, J., concurring and dissenting). Affording the insurer some opportunity to litigate the issue of the insured’s liability responds to the problem suggested above that the insurer may have relied on the prior law in foregoing the opportunity to assume control of the defense of the action at the time the delayed notice was given. *See id.* at 77-78, 371 A.2d at 198-99.

It appears, however, that the *Brakeman* approach has not been consistently applied in Pennsylvania. In *August v. Stask*, 253 Pa. Super. 310, 384 A.2d 1259 (1978), two judges of the Pennsylvania Superior Court dissented from the court’s *per curiam* order without opinion. The dissent’s one sentence opinion states “the rule of *Brakeman* ... should be applied, as it was applied in *Brakeman*, to all cases pending on appeal.”

The likelihood that full analysis of retroactivity issues may present complex factual issues raises procedural questions. For the plaintiff in *Johnson Controls* to have won his case he needed to establish both that the prior Massachusetts law should be overruled and that the new rule should be applied retroactively. Considerations of judicial economy and concern for the parties’ expenses may suggest that decision on retroactivity be postponed until after decision on the merits, and that the parties be given an opportunity to develop a factual record on the issues bearing on retroactivity.
§ 3.4. Construction Contracts — Unpaid Subcontractors Right to Recover from Owner — Unjust Enrichment. The problem of sorting out the rights of owners, contractors, subcontractors, financiers, sureties, and others upon the default of a construction contractor has troubled the courts for nearly a century. During the Survey year the Supreme Judicial Court was confronted with a rather unusual variation of these problems in Superior Glass Co. v. First Bristol County National Bank. Although the factual situation involved in Superior Glass was considerably simpler than often confronts the courts, the resolution of the problem seems no less difficult.

The defendant bank awarded a contract to Thomson Construction Co. for the construction of a branch bank building. At the time, Thomson was indebted to the bank on various unrelated unsecured loans. Although the construction contract called for Thomson to procure performance and payment bonds, Thomson proved to be unbondable because of its financial condition. The bank waived the bond requirement. Plaintiffs, subcontractors engaged by Thomson, were shown copies of the contract between Thomson and the bank, read the provision requiring a payment bond, and claimed to have relied upon it. The bank did not inform the subcontractors that a bond had not been supplied, nor did the subcontractors make any inquiries on the subject until after they had completed work. Apparently, the bank’s architect requested, and perhaps received, releases of liens from the subcontractors as a condition of making progress payments to the general contractor. In any event, neither of the plaintiffs took any action to perfect liens for labor and materials. Upon completion of the job, the bank issued to Thomson a check for the balance due on the contract. Thomson immediately endorsed the check to the bank, which then applied most of the amount of the check to unrelated debts due from Thomson to the bank. At that time the bank knew of Thomson’s financial difficulties and knew that Thomson had not paid amounts owed to various subcontractors, including plaintiffs.

3 Id. at 1420, 406 N.E.2d at 673.
4 Id.
5 Id.
6 Id.
7 Id.
8 Id.
9 Id. at 1421, 406 N.E.2d at 673.
10 See G.L. c. 254, § 4.
12 Id.
Plaintiffs sued the bank for the amounts due them from the general contractor, contending that the bank was liable in contract, tort, and equity. Judgment for the plaintiffs was affirmed by the Appeals Court, on the theory that in the particular circumstances the bank, as owner, owed a fiduciary duty to the subcontractors. In an opinion by Justice Braucher, the Supreme Judicial Court rejected the Appeal Court's fiduciary duty theory, but affirmed the judgment for plaintiffs on an unjust enrichment theory.

As had the Appeals Court, Justice Braucher rejected plaintiffs' contract argument. The contract between the bank and Thomson expressly disclaimed the existence of any contractual relationship between the owner and the subcontractors. Prior case law established that a provision in a construction contract calling for the general contractor to provide a bond does not give rise to any contractual obligation of the owner to the subcontractors to see that the bond is provided. The Court also affirmed the Appeals Court's ruling that the bank had made no express or implied representations on which plaintiffs could rely that a bond had been furnished. Furthermore, the Court agreed with the Appeals Court that liability could not be imposed on the bank "solely on the basis of its requests for waivers of lien.

Plaintiffs' argument that the bank had violated fiduciary duties owed to the subcontractors was dismissed by the Court. The relationship between the bank and the subcontractors was an arm's-length business relationship, and could not be transformed into a fiduciary one by the plaintiffs "reposing trust and confidence in the defendant." Thus, the bank, either as lender or as owner, had no fiduciary obligations to see that the general contractor applied money received from the bank to obligations due to subcontractors.

The Court then considered whether plaintiffs could recover on an unjust enrichment theory. In holding that the plaintiffs could recover on this theory, the Court relied upon the often cited passage in the United States
Supreme Court’s opinion in *United States v. Munsey Trust Co.*, recognizing “the peculiarly equitable claim of those responsible for the physical completion of building contracts to be paid from available money ahead of others whose claims come from the advance of money.” It noted that under Massachusetts law a surety who pays subcontractors has a claim to funds retained by the owner prior to the claim of a bank which lent money to the contractor on the security of the contractor’s accounts receivable. That the bank in this case combined the roles of owner and financier should not, the Court stated, diminish its equitable obligations. The Court then noted that by its various actions the bank “ lulled the subcontractors into assuming that their creditor positions were protected”; that it received the benefit of their work with knowledge of the likelihood that they would not be paid by the general contractor; and that it “gave itself a preference as a creditor out of the final payment to the contractor.” In these circumstances, the Court ruled that the amount which the bank received from the final contract payment and applied to other debts due from the contractor was “subject to the peculiarly equitable claims of the subcontractor plaintiffs, enforceable by way of ‘constructive trust.’” Thus, the judgments for plaintiffs were affirmed.

The Court’s reasoning concerning the unjust enrichment theory is not easily unraveled. It should be noted that subcontractors have generally had little success in attempting to recover from owners on an unjust enrichment theory. The Court’s conclusion that such recovery was appropriate in *Superior Glass* appears to have been based on two factors. First, there is the notion that the subcontractors had “peculiarly equitable claims” to receive payment from funds due from the owner to the contractor. Second, it seems to have been significant that the bank used the final payment due to the contractor to satisfy other debts of the contractor to the bank.

The concept that subcontractors have an equitable claim to funds due from the owner under the contract with the general contractor derives from cases involving priority conflicts between sureties and financiers of general contractors. In the usual case, the contractor’s surety, having paid subcontractors upon the contractor’s default, seeks priority in payment out of funds owed by the owner to the contractor over a bank or other financier.

---

25 *Id.*
26 *Id.* at 1423-24, 406 N.E.2d at 675.
27 *Id.* at 1424, 406 N.E.2d at 675.
which has lent money to the contractor secured by an assignment of the contractor’s right to payment from the owner.\textsuperscript{33} Much of the law in this area has evolved in cases concerning federal government construction contracts. A line of Supreme Court cases beginning with Prairie State Bank v. United States\textsuperscript{34} and Henningsen v. United States Fidelity & Guaranty Co.,\textsuperscript{35} establishes that, at least with respect to amounts admittedly due from the United States as owner which the United States holds merely as stakeholder, the surety’s claim has priority over that of the assignee. The cases are based on a subrogation theory — specifically, that a surety is subrogated to the rights not only of the subcontractors which it has paid, but also to the rights of the United States as owner.\textsuperscript{36} The assignee, of course, derives its rights only from the contractor. Thus, the surety will prevail over the assignee if the owner has the right to pay funds due under the construction contract to the subcontractors rather than to the general contractor. In private construction contracts, it seems sensible to conclude that the owner may pay amounts due under the contract to the subcontractors rather than the general contractor. Since the subcontractors may have the benefit of mechanics’ and materialmen’s liens enforceable against the owner’s property, payment to the subcontractors not only benefits the general contractor by discharging its obligations, but also protects the owner by discharging the mechanics’ and materialmen’s liens.\textsuperscript{37} The case of government construction contracts, however, is more complicated since subcontractors do not have the right to obtain mechanics’ and materialmen’s liens on federal property.\textsuperscript{38} Nonetheless, the cases have recognized that the United States has the right to make payment to the subcontractors rather than the general contractor on the theory that the United States has at least a moral or equitable obligation to see that the subcontractors are paid.\textsuperscript{39} 

\textsuperscript{33} See generally II G. Gilmore, supra note 1; Speidel, supra note 1.

\textsuperscript{34} 164 U.S. 227 (1896).

\textsuperscript{35} 208 U.S. 404 (1908).


\textsuperscript{37} In fact, however, the law seems to have developed first in the area of federal contracts. Cases involving private contracts seem to rest primarily on the “equitable obligation” theory developed in government contract cases, without recognition that the surety’s subrogation theory is even stronger in private contracts. See Framingham Trust Co. v. Gould-National Batteries, Inc., 427 F.2d 856 (1st Cir. 1970).


\textsuperscript{39} United States v. Munsey Trust Co., 332 U.S. 234, 240 (1947); National Surety Corp. v. United States, 133 F. Supp. 381 (Ct. Cl.), cert. denied, 350 U.S. 902 (1955); Speidel, supra note 1 at 646. The precise nature of the subcontractor’s claim has never been made clear. See Bank of Ariz. v. National Sur. Corp., 237 F.2d 90, 93 (9th Cir. 1956). Massachusetts case law
It is important to note that this moral or equitable obligation of the owner to the subcontractors, and the subcontractors' corresponding "peculiarly equitable claims," appear in the surety-assignee cases as a predicate to the conclusion that the owner has a right to pay subcontractors in preference to the general contractor. The surety-assignee cases cannot be read as holding that the owner has a duty, enforceable by the subcontractor, to pay subcontractors for work performed by them. Indeed, in United States v. Munsey Trust Co., the Supreme Court rejected any such claim by the subcontractors. In Munsey Trust the contractor completed the construction job leaving subcontractors unpaid, and the surety, who paid the subcontractors' claims under a payment bond, brought suit against the United States seeking to recover the retained amounts due under the contract. The United States had set off the retained percentages against an unrelated debt of the contractor to the United States. The Supreme Court distinguished the surety-assignee cases on the grounds that in such cases the United States as owner made no claim to the retained percentages, but held them as a mere stakeholder. Whatever the nature of the subcontractors' "equitable claims" to receive payment from funds due to the contractor, Munsey Trust clearly indicates that the subcontractors' claims do not preclude the owner from asserting its own claim to funds otherwise due the contractor. As Justice Jackson stated, "nothing is more clear than that laborers and materialmen do not have enforceable rights against the United States." Thus, the Superior Glass Court's reliance on the surety-assignee cases and the subcontractors' "peculiarly equitable claims" seems misplaced. The surety prevails over the assignee not because it is subrogated to rights of subcontractors enforceable against the owner, but because it is subrogated to the rights of the owner against the contractor, and hence against the contractor's assignee. In Superior Glass, however, it is the rights of the subcontractor against the owner which must be determined. As Munsey Trust indicates, the subcontractors' "peculiarly equitable claims" are of little significance in this setting.

establishes only that the subcontractor's right does not rise to the status of an equitable lien. Ehrlich v. Johnson Service Co., 272 Mass. 385, 172 N.E. 508 (1930).

40 332 U.S. 234 (1947).
41 Id. at 241.
42 Id. at 236-38.
43 Id. at 240.
44 Id.
45 Id.
46 Id. at 241.
47 The existence of statutory provision for mechanics' and materialmen's liens can be taken as some indication of a public policy that owners are obliged to see to the payment of subcontractors. Thus, it is difficult to argue that the equities lie strongly with the owner who obtains the benefit of the work of unpaid subcontractors. The owner, of course, has not obtained the...
Although it has never been entirely clear whether the Supreme Court cases such as *Munsey Trust* are applying federal or state law, such decisions are not, of course, binding on state courts applying state law. Thus, while *Munsey Trust* seems to be on all fours with *Superior Glass*, the Supreme Judicial Court might take the position that the owner should not be permitted to set off other claims against amounts due to the owner under the contract, at least where it is apparent that so doing will make it unlikely that the subcontractors will be paid. Some of the language of the *Superior Glass* opinion, and, indeed, the remedy adopted by the Court — imposition of a constructive trust on the funds which the bank received back from the contractor and applied to unrelated debts — may suggest that the bank’s receipt of this preference was the determinative factor. That view is not entirely without appeal. To the extent that the contractor’s inability to pay subcontractors can be viewed as a result of the owner’s application of payments due under the contract to other debts of the contractor to the owner, it may seem unjust for the owner to retain the benefits of the subcontractors’ work and remit the subcontractor to its action against the contractor. Yet acceptance of such an application of the unjust enrichment principle would come very close to rejecting the well-established principle that receipt of a preference is not wrongful.

The proposition that a creditor who receives a preferential payment has been unjustly enriched, at least if the funds used by the debtor in paying the preferred creditor are in some sense the product of other creditors’ advances of goods, services, or funds, would have far-reaching consequences. Thus, a bank which sets off a debtor’s deposited funds against the debtor’s obligations to the bank could be required to disgorge the setoff at the suit of the unpaid trade creditors whose advances of supplies enabled the debtor to generate the funds on deposit. It seems inconceivable that the Court would extend unjust enrichment principles to that extent.

benefit of the work without payment — he has or is obliged to pay the contractor. Yet the lien statutes effectively impose on the owner the obligation of seeing that the contractor pays the subcontractors. In *Superior Glass*, however, the subcontractors did not avail themselves of the protection of the lien statutes. Elevating the amorphous “peculiarly equitable claims” of the subcontractor to the level of claims against the owner enforceable by subcontractors who have not filed liens would countenance an “end run” around the procedural requirements of the lien statutes.

44 See II G. Gilmore, *supra* note 1, § 361 at 949.

45 In *Superior Glass* the amount owed to the plaintiff subcontractors was less than the amount applied by the bank to other debts due it from the contractor. 1980 Mass. Adv. Sh. at 1420, 406 N.E.2d at 673. It is unclear from the opinion what the Court would have done had the plaintiffs’ claims exceeded the amount of the preferential payment to the bank. The Court’s emphasis on the bank’s receipt of a preference, and the use of the constructive trust remedy, may suggest that the subcontractors’ recovery from the owner would be limited to the amount of the preferential payment.

Moreover, the *Superior Glass* Court's emphasis on the bank's receipt of a preferential payment ignores the fact that the effect of the Court's ruling was to give the subcontractors a preference over other creditors of the general contractor. The general contractor's right to receive payment from the bank on the construction contract is an asset of the general contractor to which all of its creditors have legitimate claims. To be sure, if the bank is permitted to set off its obligations to the general contractor against unrelated claims of the bank against the contractor, the bank has received a preference over the other creditors of the general contractor, including the plaintiff subcontractors. Yet, if the subcontractors are permitted to recover from the owner amounts owed to the general contractor, the subcontractors are given a preference over other creditors, including the bank. Curiously, the situation involved in *Superior Glass* is one where support can be found for both forms of preference. The right of setoff against an insolvent is a well recognized ground for preference, even in proceedings under the federal bankruptcy act. On the other hand, the premise of the surety-assignee cases—that the owner has the right to pay amounts due under the contract to the subcontractors rather than the general contractor—is, in effect, a recognition that it is not inappropriate for the subcontractors to be given a preferential payment over other creditors of the general contractor. Accordingly, the unjust enrichment concept in itself appears to provide little basis for choosing between these two recognized bases for preferential payments.

Thus, if only by process of elimination, it seems that the *Superior Glass* holding must rest principally on something akin to a misrepresentation theory. The bank's actions were hardly calculated to apprise the subcontractors of the risks they faced or their need to take steps to protect themselves. Having circulated a contract containing a provision requiring payment and performance bonds, the bank surely should have realized that its decision to waive the bonding requirement was a matter of some significance to the subcontractors. Of course, the payment bond may be viewed as primarily a mechanism for protecting the owner from the imposition of mechanics' and materialmen's liens. Thus, waiver of the bond requirement, in itself, might not be seen as wrongful toward the subcontractors since they can protect themselves by filing liens against the property pursuant to chapter 254, section 4 of the General Laws. In *Superior Glass*, however, the bank's actions seem to have been designed to dissuade the subcontractors from filing liens. Apparently the bank required the contractor to obtain waivers of liens from the subcontractors before progress payments were made to the contractor. As the Court suggested, a theory basing the bank's liability on the requests for lien waivers is somewhat problematic in

view of chapter 254, section 32 of the General Laws, which declares that agreements waiving the protection of mechanics’ and materialmen’s liens are unenforceable as contrary to the public policy. The subcontractors, however, may have been unaware of this provision and may have been dissuaded from filing liens by their agreement to waive this protection. In any event, it seems clear that a pure misrepresentation theory on the facts of Superior Glass would raise a variety of difficulties, given that the situation was one of nondisclosure rather than positive misrepresentation and given that the subcontractors could have protected themselves by making inquiries concerning a payment bond or filing liens.

Thus, Superior Glass may simply be a case where, faced with a record which would not unequivocally support recovery on a misrepresentation theory, the Court invoked the pliable concept of unjust enrichment to achieve what appeared to the Court to be an equitable result.

Moreover, the Court appears to have been presented with a somewhat murky record concerning the lien waiver requests. The waivers were not in the record, and the trial judge made no findings on the matter. 1980 Mass. Adv. Sh. at 1422, 406 N.E.2d at 674.

§ 3.5. Arbitrability of Dispute Concerning Fraudulent Inducement. In *Quirk v. Data Terminal Systems, Inc.* the Supreme Judicial Court considered whether parties must arbitrate claims of fraud in the inducement when the contract calls for arbitration of any dispute "arising out of, or relating to" the contract. In confronting this issue for the first time the Court held that a claim of fraudulent inducement of the contract as a whole, as distinguished from a claim of fraudulent inducement of the specific arbitration clause, should be resolved through arbitration.

Plaintiff entered into a contract providing that it would convey land to defendant and construct a building thereon. Upon timely completion of the construction, plaintiff was to have the option of repurchasing the property. The agreement provided that "[a]ll claims, disputes and other matters in question arising out of, or relating to, this Contract or the breach thereof," with certain exceptions not here relevant, were to be decided by arbitration. A dispute arose and plaintiff commenced arbitration proceedings. Plaintiff then filed suit contending that it was induced by fraud to enter into the contract and that it had not learned of the facts on which this claim was based until after it had initiated arbitration proceedings. Defendant's motion to compel arbitration and stay court proceedings was denied by the superior court. A single justice of the Appeals Court reversed and the case was transferred to the Supreme Judicial Court on the Court's own motion for direct appellate review.

The Court first ruled that the language of the arbitration provision "clearly encompasses a claim of fraud in the inducement of the contract." The plaintiff, however, contended that the Massachusetts arbitration statute, chapter 251, precluded arbitration of this dispute. Section 1 of chapter 251 provides that "a provision in a written contract to submit to arbitration any controversy thereafter arising between the parties shall be valid, enforceable and irrevocable, save upon such grounds as exist at law or in equity for revocation of any contract."

Chief Justice Hennessey's opinion for the Court noted that there is a con-
flict in the decisions of other jurisdictions having similar arbitration statutes on the arbitrability of claims of fraudulent inducement.\textsuperscript{14} Decisions in a few jurisdictions have held that such statutory language precludes arbitration of fraudulent inducement claims.\textsuperscript{15} In many other jurisdictions, however, it has been held that absent a claim that the arbitration provision itself was induced by fraud, such claims should be resolved by arbitration.\textsuperscript{16} The Court concluded that the latter view is the preferable one.\textsuperscript{17}

Viewing the issue as whether the parties had actually agreed to arbitrate, the Court reasoned that where there was no claim of fraudulent inducement of the arbitration provision itself, the policy of the arbitration statute that "the arbitration procedure, when selected by the parties to a contract, should be speedy and not subject to delay and obstruction in the courts," dictates that claims of fraudulent inducement of the contract as a whole should be resolved by arbitration.\textsuperscript{18} The Court's conclusion seems entirely sound, particularly in view of the ease with which virtually any breach of contract dispute can be turned into a claim of fraudulent inducements. All a party need do to claim fraudulent inducement is allege that at the time the contract was signed the other party intended not to perform.\textsuperscript{19} To be sure, such a claim may ultimately be proved groundless. Nevertheless, recognition of such claims as nonarbitrable would provide an all too easy method for a party to circumvent arbitration.


\textsuperscript{15} \textit{E.g.}, George Engine Co. v. Southern Shipbuilding Corp., 350 So.2d 881 (La. 1977); Atcas v. Credit Clearing Corp., 292 Minn. 334, 197 N.W.2d 448 (1972).


\textsuperscript{17} 1980 Mass. Adv. Sh. at 392-93, 400 N.E.2d at 861-62.

\textsuperscript{18} \textit{Id}.

\textsuperscript{19} This appears to have been the nature of the fraudulent inducement claim in the \textit{Quirk} case. \textit{See id.} at 390, 400 N.E.2d at 860.
§ 3.6 Bank's Liability on Certified Checks. The courts have had considerable difficulty with the question whether a bank may avoid liability on a cashier's check, bank check, or certified check under the provisions of the Uniform Commercial Code ("Code"). Much of the difficulty stems from confusion over the concept of stopping payment on a check. The Massachusetts Appeals Court was presented with such a question in Travi Construction Corp. v. First Bristol County National Bank. With but a few missteps in the course of its analysis, the court arrived at the correct result.

Lesser issued its personal check, drawn on the defendant bank, to Travi Construction Corp. (Travi). Travi took the check to the bank, which issued Travi its cashier's check in exchange for Lesser's personal check. Prior to issuing the cashier's check, Lesser had delivered an effective stop payment order to the bank on his personal check drawn to Travi. When the cashier's check was subsequently presented to the defendant bank by Travi's bank, it was not honored. Travi then brought suit against the defendant bank on the cashier's check.

The Appeals Court indicated that two conflicting lines of authority exist on whether a bank can dishonor its cashier's check. Under the first view considered by the Court, dishonor is flatly prohibited on the theory that a cashier's check is a draft drawn by the bank on itself and is thereby accepted in advance by the act of its issuance. This theory is based on section 4-303(a) of the Code which indicates that a stop-payment order must be made prior to acceptance of the instrument. The second view rejects this "iron-clad rule," and the bank may dishonor its cashier's check in certain situations; primarily if there has been a failure of consideration. Under this theory, the bank may assert its own defenses against one who is not a holder in due course.

The Appeals Court noted a number of objections to what it described as the "flat prohibition" rule, but ultimately rested its holding that a bank

§ 3.6 1 These are not defined terms under the Uniform Commercial Code, however, their meaning is fairly settled in ordinary usage. A cashier's check is a check on which the bank is both the drawer and the drawee. A bank check or bank draft is a check drawn by one bank on its account with another bank. A certified check is a check drawn by an individual on its account with a bank which the bank has accepted. R. BRAUCHER & R. RIEGERT, INTRODUCTION TO COMMERCIAL TRANSACTIONS 88-94 (1977).
2 G.L. c. 106, §§ 1-101 et seq.
4 Id.
5 Id.
6 Id.
7 Id.
8 Id. at 1120, 405 N.E.2d at 667.
9 Id.
10 G.L. c. 106, § 4-303(a).
may refuse to honor its cashier’s check after a failure of consideration when
the check is held by a party to the instrument with whom it has dealt, upon
the grounds that in this limited situation the policy concerns which justify a
rule against dishonor do not exist. Since the dispute was solely between the
bank and Travi, and the rights of third parties were not involved, the court
perceived no reason to prevent the bank from asserting the defense of
failure of consideration.

Discussion of whether a bank has accepted its own cashier’s check or can
stop payment on its own cashier’s check is virtually meaningless. A cashier’s
check is a check on which the bank is both the drawer and the drawee. A
stop payment order is simply an instruction from the drawer to the drawee
not to pay the check to the payee. Thus, asking whether a bank can stop
payment on its own cashier’s check is asking whether a bank can tell itself
not to pay its own check — an issue of little significance. In any event, stop-
ning payment has no effect on the liability of the drawer to the payee. The
critical issue in this problem is whether the drawer has any defense which it
can raise against the party seeking payment. Similarly, asking whether a
bank has accepted its cashier’s check is a bit peculiar. Acceptance is simply
the drawee’s engagement to pay — the effect of acceptance is that the
drawee becomes liable on the check under section 3-413 of the Code. Since
the bank is the drawer of a cashier’s check it has already undertaken the sec-
tion 3-413 obligations in its role as drawer, and acceptance is irrelevant.
Again, the critical issue is whether the bank, as drawer, has any defense
available to it.

Once the distractions of stopping payment and acceptance are put to one
side, the resolution of the problem presented in Travi is simple. The issue is
whether the bank, as drawer, can assert the defense of failure of considera-
tion against the payee, Travi. As the Appeals Court ultimately recognized, the
answer to that question is readily provided by the Code. Whether or not
Travi could claim status as a holder in due course, the defense was open to
the bank. Under section 3-306 a holder who is not a holder in due course

\[12\] Id. at 1122, 405 N.E.2d at 668.
\[13\] Id.
\[14\] See note 1, supra.
\[15\] See G.L. c. 106, § 3-413.
\[16\] G.L. c. 106, § 3-410.
\[17\] G.L. c. 106, § 3-413.
\[18\] Which is not to say that banks don’t do such silly things. I once asked a major commercial
bank in Boston to certify my personal check which I was going to use to purchase a car. The
bank clerk explained that they couldn’t do that, but would issue a cashier’s check instead and
would certify that. I decided it was easier to sit back and grin than to try to explain. No doubt
the dealer from which I purchased the car was pleased to know that by virtue of the certifica-
tion the bank had agreed to pay the check both as drawer and as acceptor.
clearly takes subject to the drawer's defense of failure of consideration.\textsuperscript{20} Similarly, even if Travi were a holder in due course, section 3-305(2) provides that a holder in due course takes subject to defenses of any party with whom he has dealt.\textsuperscript{21} Travi clearly dealt with the bank in obtaining the cashier's check. Thus, there was no need to resort to discussions of whether "policy considerations" warranted an exception to the "rule against dishonor."\textsuperscript{22}

\textsuperscript{20} G.L. c. 106, § 3-306.
\textsuperscript{21} G.L. c. 106, § 3-305(2).
\textsuperscript{22} Since the bank was seeking only to assert its own defense of failure of consideration, the \textit{Travi} case did not present the more difficult question of whether a bank which has issued a bank check or cashier's check at its customer's request or certified its customer's check can raise defenses of its customer when sued by a holder of the instrument. \textit{See generally} B. CLARK & A. SQUIRANTE, \textit{The Law of Bank Deposits, Collections and Credit Cards} 51-56 (1970).