

**The
UNIFORM
COMMERCIAL
CODE
and the
HAWAII LAW**

LEGISLATIVE REFERENCE BUREAU

Report No. 5, 1963

S T A T E O F H A W A I I

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FOREWORD

Uniform state legislation has been an ideal and goal of American jurisprudence for over half a century and substantial progress has been made in the preparation and enactment of such legislation in a number of areas. By far the most ambitious and comprehensive draft of a proposed uniform law is the Uniform Commercial Code, which is the subject of this report. The Code has been adopted by eighteen states and is under consideration in many of the others.

This study of the provisions of the Uniform Commercial Code is designed to give an over-all analysis of the provisions of the Code and their potential effect upon the existing laws of the State of Hawaii. It includes explanatory notes on each section of the Code and references to the provisions of the Revised Laws of Hawaii 1955 which would be affected by the enactment of the Code in the State of Hawaii.

The explanatory notes are designed to highlight the significant points included in each of the Uniform Commercial Code sections, point out certain matters of doubt, suggest preferred or alternative interpretations, and recommend a few technical improvements. The references to existing Hawaii law, both statutory and decisional, are designed to place emphasis on those areas where the impact of the Code would constitute a significant departure from the existing law.

It may be well to emphasize that the purpose of this study is to gather together in convenient form pertinent data to assist the members of the state legislature, particularly the respective judiciary committees, in their consideration of the Code.

Drafts of the explanatory notes pertaining to each of the Articles of the Code were prepared by the Bureau. Upon completion, the drafts were reviewed by members of the Hawaii bar through arrangements made by the Commission to promote Uniform Legislation. Attorneys in the following law firms participated in the review process:

Stephenson, Ashford & Wriston
Pratt, Moore, Bortz & Vitousek
Heen, Kai & Dodge
Anderson, Wrenn & Jenks
Smith, Wild, Beebe & Cades
Marumoto & Marumoto
Yamaguchi & Tanaka
Henshaw, Conroy & Hamilton

The comments and suggestions of the reviewers were studied by the Bureau staff, and revisions were made to the draft in a number of places. By necessity, the Bureau staff exercised its own judgment as to the content and form of this publication and assumes the responsibility for its decisions.

The Bureau acknowledges with appreciation the cooperation of the members of the Commission--Clinton R. Ashford, E. J. Botts, J. Russell Cades, Harold W. Nickelsen and Ralph T. Yamaguchi and of the members of the bar who assisted in the review process.

John E. Parks, III, a University of California law student, assisted in preparation of portions of the study. Mrs. Patricia K. Putman of the Bureau staff served as project coordinator.

Tom Dinell
Director

March, 1963

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INTRODUCTION

The Uniform Commercial Code is the result of years of research and study of the legal problems in the field of commercial transactions. It is the product of the joint efforts of the American Law Institute and the National Conference of Commissioners on Uniform State Laws, and is offered to the states as a means of accomplishing greater uniformity and certainty in the area of commercial law.* During the course of its preparation, it has been scrutinized by lawyers, judges, professors and businessmen who are interested in various aspects of its subject matter.

The history of the Uniform Commercial Code is the history of uniform legislation in the United States. Beginning in 1896, when the Negotiable Instruments Law was promulgated and subsequently adopted by all the 48 states and the then Territory of Hawaii, a series

*The membership of the American Law Institute, which was organized in 1923, consists of the United States Supreme Court justices, the senior judges of the United States Circuit Courts of Appeal, justices of the highest courts of the various states, the president and members of the executive committee of the American Bar Association, the president of the National Conference of Commissioners on Uniform State Laws, the presidents of the state bar associations, deans of members of the Association of American Law Schools, and certain other members of which 750 are elected.

The purpose of the Institute is to improve the law. To achieve this purpose, in the intervening years, it has prepared an orderly and careful statement--published in book form--of the general common law of the United States, which is called The Restatement of the Law. These volumes are the result of a careful analysis of the subject, along with an examination of the pertinent cases, which are then restated with illustrations and comments. The Institute has published volumes covering the Law of Agency, Conflicts of Laws, Contracts, Judgments,

of other uniform state laws dealing with commercial transactions were promulgated and, with one or two exceptions, adopted by most of the states. These laws include the Uniform Sales Act, Warehouse Receipts Act, Stock Transfer Act (modified), Bills of Lading Act, Conditional Sales Act (modified), and Trust Receipts Act. Hawaii has enacted all of these uniform laws with the exception of the Bills of Lading Act; in 1961 the Conditional Sales Act (modified) was replaced by the Retail Installment Sales Act.

Since the promulgation of the foregoing uniform laws, a number of suggestions had been made to amend certain of the Acts to bring them up to date, and much work was done to that end. As amendments and revisions were made to the various Acts, however, it became more and more apparent that a comprehensive revision involving all of the uniform laws dealing with commercial transactions was called for.

After extensive explorations beginning in 1940 of the comprehensive project to be jointly undertaken by the two sponsoring agencies, the project officially got under way on January 1, 1945. An editorial board of five members under the chairmanship of Judge Herbert F. Goodrich was appointed to supervise the preparation

Property, Restitution, Security, Torts, and Trusts.

The National Conference of Commissioners on Uniform State Laws first met in 1892. Its purpose is to promote uniformity in state laws on all subjects where uniformity is desirable and practicable.

The Commissioners, who are appointed to serve for terms of approximately three years, are lawyers, judges, and law school teachers who meet a few days before the American Bar Association's annual convention. Proposals of subjects for legislation are presented to them for consideration and these are referred to a committee which investigates the desirability of drafting a uniform law on the subject. If the decision is favorable, an expert draftsman is then instructed to draft the act. The tentative draft is discussed, section by section, at subsequent meetings, and corrections are made until a final draft is approved. Then, the result--the uniform act--is recommended for general adoption by the various states through their legislative processes.

of the Code, and subcommittees were appointed to work on each of the Articles. In May, 1949 an integrated draft of nine articles with notes and comments was ready for further review, and during the summer of 1950 an enlarged editorial board of sixteen members was organized by the sponsors. In 1951 the draft of the Uniform Commercial Code was approved by the two sponsoring organizations and by the House of Delegates of the American Bar Association.

After another year of editorial work, writing of comments and printing, the full text of the Code together with comments became available in 1952. In 1952 and 1953, the Code was introduced in a number of state legislatures.

In April, 1953 Pennsylvania was the first state to enact the Uniform Commercial Code into law, and it became effective in that state on July 1, 1954. In 1953 the state legislatures of New York and Massachusetts both referred the Code for further study. In 1954 the Massachusetts recess commission recommended adoption of the Code. The New York Law Revision Commission, to which the New York State Legislature had referred the Code, undertook an extensive study lasting for three years and involving the expenditure of \$300,000; it rendered its report in 1956, together with a series of recommendations.

In the meantime, in 1954 the editorial board and the subcommittees were reactivated by the sponsoring agencies. These groups reviewed all suggestions, criticisms, and recommendations, including those offered by the New York Law Revision Commission, and in November, 1956 completed a revised text of the statute. The subcommittees also prepared revised official comments in 1956, and early in 1958 an edition containing a complete, revised text and comments was published. This publication, containing 713 pages and bound in a red paper cover, is referred to as the 1958 Official Text and constitutes the basic reference work on the Uniform Commercial Code.

In September, 1957 Massachusetts became the second state to adopt the Code, followed closely by Kentucky in March, 1958. Pennsylvania adopted amendments to incorporate changes proposed in the 1958 Official Text. As of this writing (March, 1963) eighteen states have enacted the Uniform Commercial Code. These states are listed below, together with the effective dates of the Code in those states:

<u>State</u>	<u>Effective Date</u>
Pennsylvania	Original version - July 1, 1954
Pennsylvania	1958 Official Text - January 1, 1960
Massachusetts	October 1, 1958
Kentucky	July 1, 1960
Connecticut	October 1, 1961
New Hampshire	July 1, 1961
Rhode Island	January 2, 1962
Wyoming	January 1, 1962
Arkansas	January 1, 1962
New Mexico	January 1, 1962
Ohio	July 1, 1962
Oregon	September 1, 1963
Oklahoma	December 31, 1962
Illinois	July 2, 1962
New Jersey	January 1, 1963
Georgia	April 1, 1963
Alaska	December 31, 1962
New York	September 30, 1964
Michigan	January 1, 1964

The significance of the enactment of the Code by the above eighteen states, particularly with the actions of the New York and Michigan state legislatures in 1962, is that the establishment of the Uniform Commercial Code as the fundamental law of commercial transactions in the United States is now assured, and the adoption of the Code by most, if not all, of the states is largely a matter of time. This observation is based on several considerations.

The total population of the eighteen adopting states is 85 million people, or roughly one-half of the 180 million people of the United States, according to the 1960 census. With the exceptions of California and Texas, all the large states with over 5,000,000 people are included. These states also include all of the important manufacturing and commercial states of the northeast and most of those in the midwest. Because of the above factors, most businessmen and lawyers will need to become familiar with the provisions of the Uniform Commercial Code whether their states adopt the Code or not. The house counsels of many manufacturing concerns in the Code states are redrafting their sales contracts with the provisions of the Uniform Commercial Code in mind. In many instances, the fine print will include a statement that the law of the state of the manufacturer will

apply to the contract. Accordingly, businessmen and lawyers having transactions with concerns in Code states will wish to become familiar with the provisions of the Code.

As set forth in the 1958 Official Text and as adopted by the eighteen states listed above, the Uniform Commercial Code contains ten articles, two of which deal with general matters, and eight of which each deal with one of the areas of commercial transactions. These articles are:

- Article 1. General Provisions
- Article 2. Sales
- Article 3. Commercial Paper
- Article 4. Bank Deposits and Collections
- Article 5. Letters of Credit
- Article 6. Bulk Transfers
- Article 7. Warehouse Receipts, Bills of Lading and Other Documents of Title
- Article 8. Investment Securities
- Article 9. Secured Transactions
- Article 10. Effective Date and Repealer

This report takes each of these Articles in sequence and explains their import and impact on Hawaii law. At the beginning of each Article there is a general explanation of the content of the Article and a reference to the prior uniform legislation which that particular Article would replace.

Although the precise meaning of much of the Code will have to await judicial interpretation, as is inevitable with any major statute, there is already a large body of literature written on various aspects of the Code in addition to the official commentary which accompanies the 1958 Official Text. In addition, there has recently been published a two-volume edition of the Uniform Commercial Code by the publishers of Uniform Laws, Annotated, thus collecting in convenient form all references to judicial interpretations of the Code. The existence of these materials will assist both lawyers and laymen in understanding the many ramifications of the Code.

ARTICLE 1

GENERAL PROVISIONS

PART 1

SHORT TITLE, CONSTRUCTION, APPLICATION AND SUBJECT MATTER OF THE ACT

- 1-101. Short Title
- 1-102. Purposes; Rules of Construction; Variation by Agreement
- 1-103. Supplementary General Principles of Law Applicable
- 1-104. Construction Against Implicit Repeal
- 1-105. Territorial Application of the Act; Parties' Power to Choose Applicable Law
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- 1-109. Section Captions

PART 2

GENERAL DEFINITIONS AND PRINCIPLES OF INTERPRETATION

- 1-201. General Definitions
- 1-202. Prima Facie Evidence by Third Party Documents
- 1-203. Obligation of Good Faith
- 1-204. Time; Reasonable Time; "Seasonably"
- 1-205. Course of Dealing and Usage of Trade
- 1-206. Statute of Frauds for Kinds of Personal Property Not Otherwise Covered
- 1-207. Performance or Acceptance Under Reservation of Rights
- 1-208. Option to Accelerate at Will

PART 1

SHORT TITLE, CONSTRUCTION, APPLICATION AND SUBJECT MATTER OF THE ACT

Each Article of the Code must be considered in light of the generally applicable definitions and

rules specified in Article 1. However, care must be taken to examine the provisions of each Article to ascertain whether the more general provision or definition has been modified to meet the needs of a particular situation.

U.C.C. Sec. 1-101. Explanatory Notes.

Each Article has its own title thereby calling attention to its identity and content without further elaboration.

U.C.C. Sec. 1-102. Explanatory Notes.

The Code is to be liberally construed to promote its underlying purposes and policies. The underlying purposes and policies of the Code are to simplify, clarify, and modernize the law governing commercial transactions, and to permit the continued expansion of established practices through custom, usage, and agreement of the parties.

The statement in subsection 1-102 (2)(c), that the policy of the Act is "to make uniform the law among the various jurisdictions", should serve to encourage the courts of the various jurisdictions in construing the several sections of the Code, to strive for uniformity of decisional law. Thus the codifiers of the Act hope to avoid the anomalous situation, as between courts of several states of having a Uniform Act and a diverse decisional law.

Subject to the explicit exceptions in subsection 1-102 (3), this section permits the parties to vary the effect of the Code provisions by agreement. Thus the Code generally espouses freedom of contract except for certain specific rules, such as the rights given to debtors in default under security agreements (section 9-501 and also see sections 1-105 (2), 1-208, 2-302, 2-719, 5-116 (2), and 9-318 (4)), and except for "obligations" such as "good faith, diligence, reasonableness and care" prescribed by the Code.

Subsection 1-102 (4) provides that the words "unless otherwise agreed" or words of similar impact do not imply that the effect of other provisions may not be varied by agreement under subsection (3).

PART 2

GENERAL DEFINITIONS AND PRINCIPLES OF INTERPRETATION

U.C.C. Sec. 1-201. Explanatory Notes.

The catalogue of 46 definitions contained in section 1-201 serves to give specified meaning to terms and phrases employed in the body of the Code. In order to forestall differing results in judicial decisions, the framers of the Code have been particularly careful to spell out the significance which they wanted to be attached to various expressions and formulations that otherwise might be construed in divergent fashion. Twenty-one of the definitions listed in section 1-201 are modeled after similar definitions found in the prior Uniform Acts the substance of which is absorbed by the Commercial Code. Twenty-five of the definitions (including that pertaining to "Security interest") are new.

As is to be expected, the definitions vary greatly in complexity and technical scope. Some of them specify the particular usage which the Code makes of a general term frequently employed in a looser or broader sense, as for instance the Code's differentiation between "Agreement" (subsection (3)) and "contract" (subsection (11)).

The definitions are applicable unless the context of the section which contains the term or phrase in question requires otherwise. The catalogue contained in section 1-201 is supplemented by a substantial number of additional definitions, given in the different articles of the Code. Following the example of the Federal Bankruptcy Act the definitions are couched in terms of "includes" and "means", the former verb indicating that the elements of the definition are illustrative or not exclusive, while the latter verb denotes that the content is complete.

A great number of the definitions are self-explanatory and need no separate discussion. Others have features which deserve special attention.

Three definitions deal with concepts which are basic for the applicability of certain parts of the Code, i.e., "Bill of lading" (1-201 (6)), "Document of title" (1-201 (15)), and "Security interest" (1-201 (37)).

- (a) Bill of lading as defined by the Code is couched in terms broader than those of the Uniform Bills of Lading Act, section 1, and is no longer restricted to documents issued by common carriers, but covers bills issued by contract carriers and freight forwarders as well. It is specifically extended to airbills, defined as documents serving for air transportation in the same fashion as ordinary bills of lading do for marine and rail transportation, including air consignment notes and airway bills.
- (b) Document of title is defined in phraseology different from that of the Uniform Sales Act, section 76, in order to eliminate certain ambiguities. The essence of the definition is its function and status, i.e. the document must be recognized in the regular course of business or financing as adequate evidence that the person possessing it is entitled to receive, hold, and dispose of the document and the goods covered thereby. Dock warrants and dock receipts remain specifically mentioned as possible examples of documents of title. The Code restricts the concept to documents purporting to be issued by or addressed to a bailee and purporting to cover either identified goods or fungible goods constituting portions of an identified mass which are in the possession of the bailee, thereby rendering it clear that conditional sales contracts are excluded.
- (c) Security interest is undoubtedly the most novel and one of the most technical concepts devised by the drafters of the Code. It signifies an interest in personal property or fixtures which secures the payment or other performance of an obligation regardless of the designation given to it by the parties. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer is expressly limited in effect to a reservation of a security interest.

However, in order to render the rules of Act 9 governing perfection, priorities and the rights of bona fide purchasers applicable thereto, the definition is specifi-

cally expanded so as to include the interest acquired by the buyer under an outright sale of accounts, chattel paper or contract rights, to the extent that such sale is covered by section 9-102 (1) (b) and not excluded by section 9-104.

The special interest of a buyer of goods on identification of such goods to a contract of sale under section 2-401 is as such not a security interest within the scope of the definitions.

The interest of consignor or lessor is not a security interest, unless the lease or consignment is intended as a security agreement. The Code recognizes that the existence of such intent depends on the circumstances of each case and gives certain guides for its determination.

The Code contains a number of definitions which are pertinent to the application of the rules governing the protection of third parties, i.e., "Buyer in ordinary course of business" (1-201 (9)), "Purchase" (1-201 (32)), "Purchaser" (1-201 (33)), "Value" (1-201 (44)), "Creditor" (1-201 (12)) and "Good faith" (1-201 (19)).

- (a) Buyer in the ordinary course of business is defined as a person, who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person, other than a pawnbroker, who is in the business of selling goods of that kind. Buying within the meaning of this definition embraces cash sales as well as sales on credit but does not include bulk sales and transfers as security or in satisfaction of a money debt.

The two principal sections dealing with the rights of a "buyer in the ordinary course of business" are sections 2-403 (2) and 9-307 (1). Comparable provisions were contained in the Uniform Conditional Sales Act, section 9 and the Uniform Trust Receipts Act, section 9 (2) (a) (I) and (II), but only the Uniform Trust Receipts Act, section 1 con-

tained a definition of the term "buyer in the ordinary course of trade", which served as model for the definition of the Code. The new phrasing makes it clear that the seller must be a person in the business of selling that type of goods (with the exception of pawnbrokers) and that installment buyers are within the scope of the definition.

Note that the knowledge which takes the buyer out of the definition is not knowledge of the mere existence of a security interest or of ownership rights of a person other than the seller, but knowledge that the sale is in violation of and interest or rights.

- (b) Purchase is defined as a very broad category and designates taking by any voluntary transaction creating an interest in property such as taking by sale, discount, negotiation, mortgage, pledge, concession or reservation of lien, issue, re-issue or gift. Purchaser is a person who takes by purchase. Note that purchaser and creditor are no longer mutually exclusive terms as under the Uniform Trust Receipts Act, section 1.
- (c) Creditor includes an unsecured creditor as well as a secured creditor, including a lien creditor. It also extends to any representative of creditors, including a receiver in equity, an executor or administrator of an insolvent debtor's or assignor's estate, and--in contrast to traditional common law rules--an assignee for the benefit of creditors. In the latter respect the Code follows the policy of the Uniform Trust Receipts Act. Note that section 9-301 (3) contains a special definition of "lien creditor".
- (d) Value, if used in the sense of giving value for rights obtained, means that such acquisition occurs in one of four different situations: in return for a binding commitment to extend credit or for the extension of immediately available credits; as security for, or in satisfaction of, a pre-existing claim; acceptance of delivery pursuant to pre-existing contract for purchase; or in return for any consideration sufficient to support a simple contract.

Only the third of the enumerated situations has no precedent in one of the other Uniform Acts.

- (e) Good faith, as a minimum standard, means honesty in fact in the conduct or transaction concerned, especially in the failure to acquire knowledge of a particular defect.

Four definitions deal with the giving, receiving and acquiring of "notice" (1-201 (25), (26), (27) and (38)).

- (a) Notice of a fact is acquired by a person, if one of three specified conditions are met:
(1) he has acquired actual knowledge of it;
(2) he has received a notice or notification of it; (3) he has reason to know its existence in view of the facts and circumstances known to him. The Code leaves expressly open to question as to when and under what circumstances a notice or notification ceases to be effective. Words like "discover" or "learn" mean the getting of knowledge rather than a reason to know.
- (b) To notify or give notice means to take steps as may be reasonably required to inform another person in ordinary course, regardless of the actual effect upon the knowledge of such person. Conversely notice is received by another person, if it either comes to his attention or is duly delivered at the place of business where the contract was made or any other place held out as the place for the receipt of such communications.
- (c) In case of an organization (as defined in section 1-201 (28)) notice or notification is effectively received or notice or knowledge is effectively acquired, when the attention of the individual conducting the transaction has been called thereto or when it would have been called to his attention if the organization had exercised proper care.
- (d) To send a notice means to deposit it in the mail or deliver it for transmission by any other usual means of communication with the proper address and the postage or cost of

transmission provided for. If the notice is received within the time at which it would have arrived if properly sent the effects of proper sending are accomplished.

Four concepts involve legitimation to deal with documents and instruments.

- (a) Bearer (1-201 (5)) is defined as a person in possession of an instrument, document of title or security payable to bearer or indorsed in blank. The definition is derived from N.I.L. section 191.
- (b) Holder (1-201 (20)) means a person in possession of an instrument, document of title or security drawn, issued or indorsed to him or his order or to bearer or in blank. Similar definitions are contained in the N.I.L., the Uniform Warehouse Receipts Act and Uniform Bills of Lading Act.
- (c) Unauthorized (1-201 (43)) as applied to a signature of indorsement denotes absence of actual, implied or apparent authority and includes forgery. The definition is new.
- (d) Delivery (1-201 (14)) with respect to instruments, documents, securities or chattel paper means voluntary transfer of possession. The definition corresponds to analogous provisions in other uniform acts.

Noteworthy is the distinction between "Agreement" (1-201 (3)) and "Contract" (1-201 (11)). The former term means the bargain of the parties in fact as found in their language or by implication upon the surrounding circumstances. The latter expression relates to the resulting total legal obligation. The effectiveness and consequences are determined by the Code in the cases where it makes special provisions, otherwise by the general principles of law.

The Code includes two new definitions relating to the process of proof: "Burden of establishing" and "Presumption" or "presumed". The definitions are influenced by the American Law Institute's Model Code of Evidence (1942), especially Rule 1 (3) and Rule 704 (1).

- (a) Burden of establishing a fact (1-201 (8)) is

defined as "burden of persuasion" which is discharged if the triers of fact conclude that the existence of the fact asserted is more probable than its non-existence.

- (b) Presumption or presumed (1-201 (31)) means that the triers of fact must find the existence of the fact presumed unless and until evidence is introduced which would support a finding of its non-existence.

Two definitions relate to "Insolvency" and "Insolvency proceedings".

- (a) The Code establishes three disjunctive criteria for the determination of whether or not a person is insolvent (1-201 (23)): cessation of the payment of debts in the ordinary course of business; inability to pay debts as they become due; the balance sheet test of the Federal Bankruptcy Act. The first criteria is new, permitting a person to be treated as insolvent, because he has ceased to pay his debts in ordinary course, although he may not in fact be unable to pay them or insolvent within the meaning of traditional definitions.
- (b) Insolvency proceedings (1-201 (22)) include judicial proceedings for the liquidation or rehabilitation of the estate of an insolvent as well as assignments for the benefit of creditors.

The remaining twenty-three definitions covering the terms "Action", "Aggrieved party", "Bank", "Branch", "Conspicuous", "Defendant", "Fault", "Fungible", "Genuine", "Honor", "Money", "Organization", "Party", "Person", "Remedy", "Representative", "Rights", "Signed", "Surety", "Telegram", "Term", "Warehouse receipt" and "Writing", although in part new, seem to be self-explanatory.

U.C.C. Sec. 1-202. Explanatory Notes.

A "document in due form" where authorized "by the contract to be issued by a third party", is declared to be "prima facie evidence of its authenticity and genuineness and of the facts stated". Therefore business records will be recognized for purposes of evi-

dence upon testimony by their custodian which identifies the instrument, describes its mode of preparation, and relates that it was made in the regular course of business at or near the time of the act, condition or event at issue.

Hawaii Law.

This section is new and would expand the usefulness of such documents.

U.C.C. Sec. 1-203. Explanatory Notes.

The principle that in commercial transactions good faith is required in the performance and enforcement of all agreements runs throughout the Code and is particularized in this section. For particular applications of this principle in the Code, see U.C.C. sections 1-201, 1-205, 1-208, 2-103, 2-508, 2-603, 2-614, 2-615.

Hawaii Law.

Although the part of the official comment to this section which is entitled "Prior Uniform Statutory Provision" states that there is no counterpart to this section in the various uniform laws, there is a general obligation of good faith explicitly set out in the Revised Laws of Hawaii sections 207-25 (attachment or levy upon goods for which negotiable receipt has been issued); 202-75 (b) and 172-79 (b) (a thing done in "good faith").

U.C.C. Sec. 1-204. Explanatory Notes.

Section 1-204 is in accord with case law generally as to "reasonable time", but expressly provides that any provision of the Code which requires action to be taken within a "reasonable time" may be modified by the parties if not "manifestly unreasonable". This is in line with the general provisions of section 1-102 (3).

Hawaii Law.

New law.

U.C.C. Sec. 1-205. Explanatory Notes.

Under section 1-205 effect and meaning are given to an agreement by examining the language used by the parties (trade usage) and the actions of the parties (prior course of dealing), in the light of commercial practices.

Hawaii Law.

No such general provision but see Revised Laws of Hawaii sections 202-9 (1) (definition and ascertainment of price), 202-15 (e) (implied warranties of quality), 202-18 (b) (property in specific goods passes when parties so intend), and 202-71 (variation of implied obligations) (USA). Note that subsection (6) imposes a procedural requirement in court actions, which has no precedent in Hawaii.

U.C.C. Sec. 1-206. Explanatory Notes.

Section 1-206 applies a statute of frauds provision to the oral sale of personal property where the amount exceeds five thousand dollars, other than the sale of goods (2-201), securities (8-319), or security agreements (9-203), which have their own applicable statutes. This section, therefore, primarily relates to the sale of intangibles, such as the assignment of claims.

Hawaii Law.

Rev. Laws Hawaii 202-4 (statute of frauds) (USA) similar in purpose but covering different subject matter. Cf: Chapter 190 (Frauds, Statute of), which does not require a writing to substantiate sales of personal property, of whatever value.

U.C.C. Sec. 1-207. Explanatory Notes.

Section 1-207 permits a party under a disputed U.C.C. transaction to accept whatever he can get by way of payment or performance without loss of legal rights, so long as he expressly reserves his rights. This makes explicit the common mercantile device of going ahead with a disputed transaction "under protest", "without prejudice", "under reserve" and the like.

Hawaii Law.

An analogous provision is in Revised Laws of Hawaii section 202-49 (USA), which provides that the acceptance of goods does not bar an action for breach of the agreement in the absence of an express or implied agreement of the parties to the contrary.

U.C.C. Sec. 1-208. Explanatory Notes.

This section is an application of section 1-203 which imposes a general obligation of good faith upon the parties in performing or enforcing obligations. Section 1-208 provides that acceleration or collateral or additional collateral may only be had when a party "in good faith believes that the prospect of payment or performance is impaired". "The burden of establishing lack of good faith is on the party against whom the power has been exercised."

Hawaii Law.

New law.

ARTICLE 2

SALES

This Article applies to transactions in sales of goods. As used in Article 2, "goods" includes movables and growing crops, and such items as timber and minerals when they are to be removed from the real estate by the seller. "Goods" does not include non-movables, investment securities and rights of action. Furthermore the Article does not include transfers which are intended only as security. Nor is Article 2 intended to supersede legislation relating to particular classes of buyers, such as consumers or farmers.

The principal impact of Article 2 on Hawaii law is that it would replace the Uniform Sales Act which was first enacted in Hawaii in 1929 and is codified as chapter 202 in the Revised Laws of Hawaii 1955. This annotation reviews briefly each of the sections of Article 2 and points out the particular sections of the Hawaii Statute which would be affected.

Although the Uniform Sales Act would be completely rewritten and although adjustments would be made in certain legal concepts of which the commercial community would need to be aware, the practical impact upon commercial transactions as such would not be great in the sense that businessmen would not need to alter their ways of doing business in any radical respects. As a matter of fact, one of the purposes of the Uniform Commercial Code was to bring the law in line with modern commercial practices.

PART 1
SHORT TITLE, GENERAL CONSTRUCTION AND
SUBJECT MATTER

- 2-101. Short Title
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PART I
SHORT TITLE, GENERAL CONSTRUCTION AND
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U.C.C. Sec. 2-101. Explanatory Notes.

Self-explanatory.

U.C.C. Sec. 2-102. Explanatory Notes.

Section 2-102 outlines the scope of Article 2, which applies to transactions in goods. It does not cover sales or contracts to sell which are intended as security devices; these are covered in Article 9. Neither does it affect any statute regulating sales to consumers.

Hawaii Law.

Rev. Laws Hawaii 202-74

The Hawaii statute has been rephrased.

U.C.C. Sec. 2-103. Explanatory Notes.

Section 2-103 corresponds to section 202-75, Revised Laws of Hawaii, and defines the important terms used in Article 2 of the Code. It also lists significant terms defined in other places in the Code.

The definitions of "buyer" and "seller" under the existing Hawaii statute have been slightly rephrased by omitting reference to "any legal successor in interest of such person". The official commentary explains that section 2-210 of the Code, which limits some types of delegation of performance on assignment of a sales contract, makes it clear that not every successor can be included in the definition. In ordinary cases, however, successors are included.

The definition of "receipt" under the Code differs from the definition of "delivery" under the Hawaii statute (section 202-75, Revised Laws of Hawaii) in this respect: "Receipt" of goods means "taking physical possession" of them whereas "delivery" is defined as "voluntary transfer of possession from one person to another".

Under the Hawaii statute a thing is done "in good faith" when in fact done honestly, whether negligently or not. Under the Code, "good faith" means "the observance of reasonable standards of fair dealing in the trade" as well as honesty in fact.

U.C.C. Sec. 2-104. Explanatory Notes.

Section 2-104 places more specific standards of conduct upon merchants than upon lay persons. It is based on the assumption that transactions between professionals in a given field require rules which may not apply to a casual or inexperienced seller or buyer. This section defines those who are to be regarded as professionals or merchants and when a transaction is deemed "between merchants".

The employment by a "person" of an agent or broker who has "such knowledge or skill" may cause the principal to come within the definition of merchant; such, for example, as a university which has a purchasing department of business personnel familiar with business practices.

Hawaii Law.

The Hawaii statute does not have a corresponding provision.

U.C.C. Sec. 2-105. Explanatory Notes.

Section 2-105 defines "goods" and other terms. The Code definition of "goods" in subsection 2-105(1) is based on the concept of movability and the term "chattels personal" is not used. It is intended to deal with things which are fairly identifiable as movables before the contract is performed. Investment securities (covered in Article 8 of the Code) and things in action, as well as money, when it is the medium of payment, are not included as "goods". Subsection 2-105(2) explains the effect of a purported sale of "future goods".

Section 202-5, Revised Laws of Hawaii, dealing with existing and future goods contain the comparable provisions. Section 202-75, Revised Laws of Hawaii, defines "goods" as "chattels personal". Section 202-17, Revised Laws of Hawaii, is similar to subsection 2-105(2). Subsections 2-105(3) and (4) deal with the sale of a part interest in goods and in an undivided share in fungible goods, respectively. Section 202-6, Revised Laws of Hawaii, on undivided shares, covers the same ground. There are no comparable provisions in the Hawaii statute to subsections 2-105(5) and (6) defining "lot" and "commercial unit".

Hawaii Law.

Rev. Laws Hawaii 202-5, 202-6, 202-17, 202-75

U.C.C. Sec. 2-106. Explanatory Notes.

Subsection 2-106(1) uses the phrase "contract for sale" as a general concept throughout Article 2, and includes both a present sale of goods and a contract to sell goods at a future time. The rights of the parties do not vary according to whether the transaction is a present sale or a contract to sell.

The comparable Hawaii statute, subsections 202-1(a) and (b), Revised Laws of Hawaii, dealing with contracts to sell and sales, is rewritten.

Subsection (2) generally continues the policy of requiring exact performance by the seller of his obligations as a condition of his right to require acceptance. There is no specifically comparable provision in the Hawaii statute, but sections 202-11 (effect of condition), 202-44 (delivery of wrong quantity), and 202-69, Revised Laws of Hawaii, (remedies for breach of warranty) set forth the requirements of performance.

Subsections 2-106(3) and (4) are new and are intended to make clear the distinction between "termination" and "cancellation".

Hawaii Law.

Rev. Laws Hawaii 202-1(a) and (b), 202-11, 202-44, 202-69

U.C.C. Sec. 2-107. Explanatory Notes.

Section 2-107 of the Code divides goods to be severed from realty into two categories: (1) timber, minerals, structures and the like, under subsection 2-107(1); and (2) growing crops and things other than those specified in the first category.

In the first category, the Code applies only if the timber, minerals or structure "are to be severed by the seller". If the buyer is to sever, the transaction presumably would be considered a contract affecting land.

In the second category, a contract for the sale of growing crops and other things would be a contract for the sale of goods regardless of whether buyer or seller is to sever. The use of the word "fixtures" is avoided because of its diverse definitions, and the reference is to "things attached to realty and capable of severance without material harm thereto".

Subsection 2-107(3) provides for recording such contracts as a means of preserving the buyer's rights.

Hawaii Law.

Rev. Laws Hawaii 202-75(a)

There is no specifically comparable provision in the Hawaii statute but subsection 202-75(a) defining "goods" would be affected.

PART 2 FORM, FORMATION AND READJUSTMENT OF CONTRACT

U.C.C. Sec. 2-201. Explanatory Notes.

Section 2-201 rephrases the statute of frauds, and restricts its application to the sale of goods. The changes in the phraseology are intended to make it clear that the required writing need not contain all the material terms of the contract and such material terms as are stated need not be precisely stated. The principal requirement is that the writing afford a basis for believing that the oral evidence rests on a real transaction. Only three requirements are made as to the memorandum; it must (1) evidence a contract for the sale of goods; (2) be "signed", a word which includes authentication; and (3) specify a quantity.

Subsection 2-201(2) introduces a significant innovation as to transactions "between merchants". Failure to answer a written confirmation of a contract within ten days of receipt is tantamount to a writing in that it will render the letter a sufficient writing against the recipient if it is also sufficient against the sender. There is no comparable provision under Hawaii law.

Hawaii Law.

Rev. Laws Hawaii 202-4

Section 202-4 entitled statute of frauds, is amended. The significant changes include (a) application of the Code to price of \$500 instead of value of \$100; (b) exclusion of "choses in action" from application of the Code; (c) "partial performance" under the Code would validate the contract only for the goods which have been accepted, or payment made; and (d) under the Code, it is not possible to admit a contract in one's pleadings and still avail himself of the statute.

U.C.C. Sec. 2-202. Explanatory Notes.

Section 2-202 applies the parol evidence rule to commercial contracts or confirmatory memoranda intended by the parties as a final expression of their agreement. Terms of the agreement may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement, but may be supplemented or explained by evidence of (a) course of dealings or usage of trade, and (b) consistent additional terms, unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-203. Explanatory Notes.

Section 2-203 amounts to a rewriting of that portion of the Hawaii law pertaining to seals; it makes clear that every effect of the seal which relates to "sealed instruments" as such is wiped out insofar as contracts for sale are concerned; under this section contracts or offers to buy or sell goods will require consideration, notwithstanding the presence of a seal.

Hawaii Law.

Rev. Laws Hawaii 202-3

Section 202-3 stating that a written contract to sell may be made with or without seal is rewritten.

U.C.C. Sec. 2-204. Explanatory Notes.

Section 2-204 provides that a contract will not fail for indefiniteness even though one or more terms are left open, provided that there is a reasonable certain basis for supplying the missing term. Other provisions of the Code go on to specify how certain missing terms are to be supplied.

Hawaii Law.

Rev. Laws Hawaii 202-1, 202-3

Sections 202-1 and 202-3 bear on this problem, but do not cover the "missing term" provisions of subsection 2-204(3) of the Code.

U.C.C. Sec. 2-205. Explanatory Notes.

Section 2-205 of the Code provides that a firm offer to buy or sell would not be revocable for lack of consideration. This provision applies only to signed offers made in writing by merchants. It applies only to current firm offers, and not to long-term options, and a time limit of three months during which such offers remain irrevocable has been set. As to irrevocability beyond three months, the normal rules regarding options will control.

Hawaii Law.

Rev. Laws Hawaii 202-1, 202-3

There is no directly comparable provision in the Hawaii statute, but sections 202-1 and 202-3 deal with the formation of contracts.

U.C.C. Sec. 2-206. Explanatory Notes.

The effect of section 2-206 is that any reasonable manner of acceptance may be regarded as available unless the offeror has made quite clear that it will not be acceptable. This section modifies former technical rules requiring that telegraphic offers be accepted by telegraphed acceptance, etc.

Hawaii Law.

Rev. Laws Hawaii 202-1, 202-3

Sections 202-1 and 202-3 would be modified.

U.C.C. Sec. 2-207. Explanatory Notes.

Section 2-207 of the Code attempts further to expedite formation of contracts and to avoid disputes where additional terms are stated in the acceptance or confirmation. "Between merchants" the additional terms become a part of the contract unless the offer has expressly limited acceptance to the terms or unless such terms "materially alter" the contract, or notification of objection to the new terms has been given within a reasonable time. By subsection (3) the conduct by both parties recognizing the existence of a contract for sale is declared sufficient to form a binding agreement, although the writings of the parties do not otherwise establish the contract.

Hawaii Law.

Rev. Laws Hawaii 202-1, 202-3

Sections 202-1 and 202-3 are completely rewritten by this and other sections of the Code.

U.C.C. Sec. 2-208. Explanatory Notes.

Section 2-208 of the Code expressly provides that a course of performance by the parties is relevant to determine the meaning of the agreement unless objection is interposed. Whenever possible, the express terms of the contract and the course of performance shall be construed as consistent with each other, but if this is not possible, the express terms shall control the

course of performance, and the course of performance shall control both the course of dealing and the usage of trade. The course of performance shall be relevant to show a waiver or modification of any inconsistent term.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-209. Explanatory Notes.

Section 2-209 of the Code is intended to protect and make effective any modification, rescission and waiver, since many sales agreements are complex and subject to changed conditions frequently overlooked and not within the contemplation of the parties at the time of inception. Subsection (1) abolishes the need for consideration in agreements modifying a contract. Agreements for rescission or modification are subject under subsection (3) to the provisions of the statute of frauds (Code, section 2-201) which must be satisfied. Subsections (2) and (3) are intended to protect against false allegations of oral modifications. Subsection (4) allows an oral modification which would be unenforceable under the statute of frauds to operate as a waiver of obligations under the contract. The effect of such conduct as a waiver is further regulated in subsection (5).

This section does not, however, contemplate unilateral modification or termination.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-210. Explanatory Notes.

Section 2-210 of the Code generally recognizes both delegation of performance and assignability as normal and permissible incidents of a contract for the sale of goods. Delegation of performance, either in conjunction with an assignment or otherwise, is provided for by subsection (1) where no substantial reason can be shown as to why the delegated performance will not be as satisfactory as personal performance.

Under subsection (2) rights which are no longer executory such as right to damages for breach or a right to payment of an "account" as defined in the Article on secured transactions (Article 9) may be assigned although the agreement prohibits assignment.

Subsection (3) provides a rule of construction where the parties agree that the contract is not assignable. Such a prohibition would bar only the delegation to the assignee of the assignor's performance.

Subsection (4) provides a rule of construction distinguishing between a normal commercial assignment and a financing assignment. In the commercial assignment, the assignee is substituted for the assignor as to rights and duties. In the financing assignment, only the rights of the assignor are transferred.

Where the nonassigning party believes himself insecure, he may, pursuant to subsection (5), demand assurances from the assignee without prejudice to his rights against the assignor.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

PART 3 GENERAL OBLIGATION AND CONSTRUCTION OF CONTRACT

U.C.C. Sec. 2-301. Explanatory Notes.

Section 2-301 restates the principle of law that the parties are obligated to perform their contract.

Hawaii Law.

Rev. Laws Hawaii 202-41

The Code provision substantially repeats the language of section 202-41, the principal change being that performance is made an "obligation" of the parties rather than a "duty".

U.C.C. Sec. 2-302. Explanatory Notes.

Section 2-302 of the Code authorizes the court to apply equitable considerations in the enforcement of a contract found to be unconscionable, by refusing to enforce the contract as a whole, or of any objectionable clause. If the issue is raised, the parties are permitted opportunity to present evidence as to the purpose, effect, and commercial setting of the contract to aid the court and the question of unconscionability is a question of law for the court to decide.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-303. Explanatory Notes.

Section 2-303 makes clear that the allocation of risks and burdens set forth in Article 2 of the Code may be varied by the agreement of the parties.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-304. Explanatory Notes.

Section 2-304 clarifies existing law. Subsection (1) applies to transactions where the "price" of goods is payable in something other than money. Subsection (2) provides, however, that when goods are to be exchanged for realty, the provisions of Article 2 apply only to those aspects of the transaction which concern the transfer of title to goods but do not affect the transaction of realty.

Hawaii Law.

Rev. Laws Hawaii 202-9(b) and (c)

Subsections (b) and (c) of section 202-9 are rewritten.

U.C.C. Sec. 2-305. Explanatory Notes.

Section 2-305 applies when the price term is left open on the making of an agreement which is nevertheless "intended" by the parties to be a binding agreement; it provides for a subsequent fixing of price, or, in the absence thereof, a reasonable price at the time of delivery.

When the price is left to be fixed "otherwise than by agreement of the parties" but is not fixed through the fault of one party, subsection (3) provides that the other party may either treat the contract as cancelled or fix a reasonable price himself.

Hawaii Law.

Rev. Laws Hawaii 202-9, 202-10

Section 202-9 (definition and ascertainment of price) and section 202-10 (sale at a valuation) are rewritten.

U.C.C. Sec. 2-306. Explanatory Notes.

Subsection (1) covers contracts in which the quantity is measured by the seller's output or the buyer's requirements. The Code adopts the view that such contracts are sufficiently definite to be enforceable. The party who will determine quantity must act in good faith. If an estimate is included in the agreement, no quantity unreasonably disproportionate may be tendered or demanded.

Relative to exclusive dealings, subsection (2) makes explicit the commercial rule whereby the parties to such contracts have impliedly bound themselves to use reasonable diligence in their performance of the contract.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-307. Explanatory Notes.

Section 2-307 provides that in the absence of circumstances indicating a contrary intent, delivery is to be in a single lot.

Hawaii Law.

Rev. Laws Hawaii 202-45(a)

The essential intent of subsection 202-45(a) is continued in effect.

U.C.C. Sec. 2-308. Explanatory Notes.

Section 2-308 specifies the place of delivery when the parties have not agreed otherwise. The place of delivery is to be the seller's place of business, unless at the time of contracting, the goods are known to be elsewhere.

Hawaii Law.

Rev. Laws Hawaii 202-43(a)

Subsection 202-43(a) is slightly modified.

U.C.C. Sec. 2-309. Explanatory Notes.

Section 2-309 deals with the situation where the contract does not specify the time for shipment, delivery or other action. Subsection (1) states a well-recognized rule of law that if a contract does not specify the time for performance, the law will imply an agreement to perform within a reasonable time.

Subsection (2) provides that contracts calling for successive performances for an indefinite period of time are valid for a reasonable time, but may be terminated at will by either party.

Subsection (3) provides that where a party has the authority to end the contractual relationship otherwise than for breach, the contract can be terminated only by reasonable notice.

Hawaii Law.

Rev. Laws Hawaii 202-43(b), 202-45(b), 202-47(a),
202-48

The following provisions of the Revised Laws of Hawaii provide for the policy continued under subsection 2-309(1) of the Code: sections 202-43(b), 202-45(b), 202-47(a), and 202-48. Subsections (2) and (3) of the Code do not have comparable provisions in the Hawaii statute.

U.C.C. Sec. 2-310. Explanatory Notes.

Section 2-310 of the Code deals with situations where the contract does not specify the time for payment or when the credit period begins to run. Subsection (a) provides that payment is due at the time and place the buyer is to receive the goods, rather than at the point of delivery, thereby affording the buyer opportunity to inspect the goods.

Section 2-310 postpones the buyer's obligation to pay until after the seller has relinquished physical possession. Subsection (b) attempts to assure the seller of receiving payment for the goods by providing that if the seller is "authorized" to send the goods to the buyer, he may ship them "under reservation" and demand payment against tender of "documents of title" after giving the buyer opportunity to inspect the goods.

Subsection (c) deals with cases where delivery of goods is deemed accomplished by delivery of documents of title. Payment would be due at the time and place the buyer is to receive the documents.

Paragraph (d) states a common commercial understanding that a credit period runs from the time of shipment or from the dating of the invoice.

Hawaii Law.

Rev. Laws Hawaii 202-42, 202-47(b)

Sections 202-42 (delivery and payment are concurrent conditions) and 202-47(b) (right to examine the goods) are rewritten.

U.C.C. Sec. 2-311. Explanatory Notes.

Section 2-311 of the Code allows the parties to leave certain detailed particulars of performance to be specified by one of the parties.

Subsection (3) clarifies the rights of the parties where one party fails to furnish specifications for performance or to cooperate; in such event the other party may perform in any reasonable manner.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-312. Explanatory Notes.

Section 2-312 deals with some of the implied warranties. It provides a warranty of good title, and of freedom from encumbrances. It adds a warranty against claims by third persons for infringement of patent or trademark rights, in a sale by a "merchant regularly dealing in goods of this kind". However, where a buyer furnishes specifications for the goods, the buyer would be required to "hold the seller harmless" from claims of infringement arising out of the specifications.

Hawaii Law.

Rev. Laws Hawai'i 202-13

Section 202-13 is completely rewritten. The principal change is in the elimination of the warranty of quiet possession and the addition of the warranty against infringement claims. However, disturbance of quiet possession may be one possible way in which a breach of warranty of title may be established.

U.C.C. Sec. 2-313. Explanatory Notes.

Section 2-313 attempts to consolidate and systematize basic principles. This section deals with affirmations of fact and promises by the seller, descriptions of the goods or exhibitions of samples in the same manner that any other part of a negotiation which ends in a contract is dealt with. No specific

intention to make a warranty is necessary. All that must be shown is that the representation forms a basis of the bargain or a part of it and that it relates to the goods.

Hawaii Law.

Rev. Laws Hawaii 202-12, 202-14, 202-16

Sections 202-12, 202-14, and 202-16 are combined and rewritten. Warranties of description and sample are designated as "express" rather than "implied" warranties.

U.C.C. Sec. 2-314. Explanatory Notes.

Section 2-314 of the Code deals with warranties of merchantability and warranties by usage of trade. This warranty applies to sales for use as well as for resale.

This section specifically provides that serving food or drink for consumption on the premises is a sale which can give rise to the warranty of merchantability.

Hawaii Law.

Rev. Laws Hawaii 202-15(b)

Subsection 202-15(b), which provides that the warranty of merchantability arises only in sales "by description", is completely rewritten.

U.C.C. Sec. 2-315. Explanatory Notes.

Section 2-315 provides that the implied warranty of fitness for a particular purpose arises when a seller has reason to know that the buyer intends to use the goods for a particular purpose and that the buyer is relying on the seller's skill or judgment.

Hawaii Law.

Rev. Laws Hawaii 202-15(a), (d) and (e)

Subsections 202-15(a), (d) and (e) are rewritten. The Code omits the provision in subsection 202-15(d)

which provides that no implied warranty of fitness for a particular purpose arises when an article is sold under its patent or trade name. The effect of this omission is that the existence of a trade name would be only one factor to be considered in determining whether the buyer relied on the seller.

U.C.C. Sec. 2-316. Explanatory Notes.

Section 2-316 seeks to protect the buyer from unexpected and unbargained for disclaimers of warranties. It deals with clauses in sales contracts seeking to exclude all warranties.

Subsection (1) provides a rule of construction when the contract contains an express warranty and also what appears to be a negation or limitation of such warranty. In such a situation the contract provisions shall, if possible, be construed as consistent with one another; if this is not possible, the disclaimer of warranty would be inoperative.

Subsection (2) prescribes strict requirements which must be met in disclaiming warranties. However, the impact of this subsection is modified somewhat by subsection (3) which sets forth circumstances under which implied warranties may be excluded.

Hawaii Law.

Rev. Laws Hawaii 202-15(c), 202-71

The Hawaii statute does not contain a comparable general provision. Sections 202-15(c) and 202-71 are modified.

U.C.C. Sec. 2-317. Explanatory Notes.

Section 2-317 provides rules for construing contracts which give rise to two or more warranties, express or implied. In general, all warranties are to be construed as cumulative and consistent unless such a construction is unreasonable, in which case the intention of the parties would determine which is dominant. Three rules help to ascertain the intention of the parties; the first two rules follow the canon of construction that the specific shall control the general in construing a contract, and the third provides that express warranties displace inconsistent implied warranties except for an implied warranty of fitness for a particular purpose.

Hawaii Law.

Rev. Laws Hawaii 202-14, 202-15, 202-16

Sections 202-14, 202-15, and 202-16 are rewritten into one section.

U.C.C. Sec. 2-318. Explanatory Notes.

Section 2-318 provides that the seller's warranties extend to the family and household of the buyer and guests in his home, if it is reasonable to expect that such persons may use the goods. Beyond this, the section is not intended to enlarge or restrict the case law as to "privity".

Hawaii Law.

The Hawaii statute does not contain a comparable provision.

U.C.C. Sec. 2-319. Explanatory Notes.

Section 2-319 seeks to eliminate uncertainty by defining the effect of shipping terms. F.O.B. (free on board) and F.A.S. (free alongside) are defined in accord with commercial understanding as the point to which the seller has responsibility for the risk and the expense of transportation.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-320. Explanatory Notes.

Section 2-320 deals with the terms, C.I.F. (cost, insurance, freight) and C. & F. or C.F. (cost and freight).

The term C.I.F. means that the price of the goods includes the cost of the goods, insurance, and freight to the named destination. In addition, the seller must also bear the risk and cost of putting the goods into the possession of the carrier at the port of

shipment. The seller must then forward and tender to the buyer the negotiable bill of lading, the receipt showing the freight has been paid or provided for, the policy or certificate of insurance, and the invoice for the goods. The buyer must make payment against the tender of these documents unless agreed otherwise. The buyer bears the risk of loss in transit.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-321. Explanatory Notes.

Section 2-321 amplifies the provisions of section 2-320 regarding C.I.F. and C. & F. contracts. Where the price is based on or adjusted to "net landed weights", "delivered weights" or "out turn" quantity or quality, the seller must make a reasonable estimate of the price. The buyer must then pay this estimated price when the necessary documents are tendered. When the goods arrive, weighing and inspection of the goods will determine the exact price due. Adjustment will then be made against the estimated price.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-322. Explanatory Notes.

Section 2-322 deals with delivery "ex-ship". This requires the seller to deliver the goods from a ship at the destination port free of all liens arising out of carriage of the goods. The seller must furnish the buyer with a direction which requires the carrier to deliver the goods. Risk of loss remains on the seller until the goods are unloaded.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-323. Explanatory Notes.

Section 2-323 deals with the form of the bill of lading required in overseas shipment and defines "overseas" in subsection (3).

Subsection (1) follows the rule that a regular bill of lading indicating delivery of the goods at the dock for shipment is sufficient, except under a term "F.O.B. vessel". If the term is "F.O.B. vessel", the seller must procure an "on board" negotiable bill of lading from the carrier.

Subsection (2) deals with the problem of bills of lading issued not as a single bill of lading but in a set of parts.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-324. Explanatory Notes.

Section 2-324 of the Code obligates the seller under "no arrival, no sale" terms to ship the goods and if they arrive to tender them. If there is a casualty in transit, the buyer has the choice of accepting or rejecting the goods that arrive.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-325. Explanatory Notes.

Section 2-325 of the Code expresses the established commercial and banking understanding as to the meaning and effects of terms calling for "letter of credit" or "confirmed credit". Under subsection (3), unless otherwise agreed, the term "letter of credit" or "bankers credit" in a contract for sale means an irrevocable credit. Also, "confirmed credit" means the credit must carry the direct obligation of such a financing agency which does business in the seller's financial market.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-326. Explanatory Notes.

Section 2-326 deals with a "sale on approval" and a "sale or return". The Code would identify both types of transactions by the fact that the "delivered goods may be returned by the buyer even though they conform to the contract". Where such right of return exists, the transaction would be a "sale on approval" if the goods were delivered primarily for use and a "sale or return" if the goods were delivered primarily for resale.

Subsection (3) resolves all reasonable doubt as to the nature of the transaction in favor of the general creditors of the buyer; as against them words such as "on consignment" or "on memorandum", with or without words of reservation of title in the seller, are disregarded when the buyer has a place of business at which he deals in goods of the kind involved. A necessary exception is made where the buyer is known to be engaged primarily in selling goods of others or selling under a relevant sign law, or the seller complies with the filing provisions of Article 9 as if his interest were a security interest.

Hawaii Law.

Rev. Laws Hawaii 202-19(3)

Section 202-19(3) is rewritten.

U.C.C. Sec. 2-327. Explanatory Notes.

Section 2-327, together with section 2-326 of the Code, amount to a rewriting and expansion of the Hawaii statute, although consistent with the general rules therein. The changes are intended to clarify that in a sale on approval, if goods conform to contract, the buyer's acceptance of part constitutes acceptance of the whole; this aspect is not set out in the Hawaii law.

In the case of sale or return, the Code provides that return of any unsold unit merely because it is unsold is the normal intent of the "sale or return", and therefore the right to return for this reason alone is independent of any other action under the contract which would turn on wholly different considerations.

In the case of sale on approval, the risk rests on the seller until acceptance of the goods by the buyer (see subsection 202-19(3)(b)(1), Revised Laws of Hawaii); while in a sale or return the risk remains throughout on the buyer; this latter provision alters the concept of subsection 202-19(3)(a), Revised Laws of Hawaii, wherein the property passes to the buyer on delivery subject to buyer's right to reinvest title in seller by returning or tendering the goods within the time fixed in the contract, or if no time fixed, within a reasonable time.

Hawaii Law.

Rev. Laws Hawaii 202-19(3)

Section 202-19(3) is rewritten.

U.C.C. Sec. 2-328. Explanatory Notes.

Section 2-328 of the Code amounts to a complete rewriting of the Hawaii statutory provisions dealing with sale by auction.

Subsections (1) and (2) of the Code are essentially the same as subsections 202-21(a) and (b), Revised Laws of Hawaii, except subsection (2) provides that where a bid is made while the hammer is falling, the auctioneer may accept the prior bid or reopen the bidding.

Subsection (3) of the Code provides more explicit rules for the sale of goods with reserve or without reserve than does subsection 202-21(c), Revised Laws of Hawaii.

Subsection (4) of the Code, with reference to bids by seller, goes beyond subsection 202-21(d), Revised Laws of Hawaii, by giving the buyer, in addition to the right to declare the sale fraudulent, the option to take the goods at the last bona fide bid.

Hawaii Law.

Rev. Laws Hawaii 202-21

Section 202-21 is rewritten.

PART 4
TITLE, CREDITORS AND GOOD FAITH PURCHASERS

U.C.C. Sec. 2-401. Explanatory Notes.

Section 2-401 of the Code deals with the issues between seller and buyer in terms of step by step performance or nonperformance under the contract for sale and not in terms of whether or not "title" to the goods has passed.

"Future" goods cannot be the subject of a present sale. Before title can pass the goods must be identified in the manner set forth in section 2-501. The parties, however, have full liberty to arrange by specific terms for the passing of title to goods which are existing.

The factual situations in subsections (2) and (3) upon which passage of title turn actually base the test upon the time when the seller has finally committed himself in regard to specific goods. In a "shipment" contract he commits himself by the act of making the shipment. If shipment is not contemplated, subsection (3) turns on the seller's final commitment, i.e., the delivery of documents or the making of the contract.

Hawaii Law.

Rev. Laws Hawaii 202-17, 202-18, 202-19, 202-20

Sections 202-17 to 202-20, which generally cover this area of law, are rewritten.

U.C.C. Sec. 2-402. Explanatory Notes.

Section 2-402 lays down the general rule that once goods are identified to the contract, the buyer's right to recover the goods upon the seller's insolvency

and to replevy the goods shall prevail over the rights of unsecured creditors of the seller. The rights of secured creditors of the seller are governed by Article 9. The buyer's priority over the seller's unsecured creditors is subject to important exceptions where the seller's transfer to the buyer is a fraudulent conveyance or a voidable preference.

Hawaii Law.

Rev. Laws Hawaii 202-26

Section 202-26, dealing with creditors' rights against sold goods in seller's possession, is rewritten.

U.C.C. Sec. 2-403. Explanatory Notes.

Section 2-403 lays down the basic rule that a purchaser of goods acquires all of the title which his transferor had or had power to transfer. This is similar to section 202-23, Revised Laws of Hawaii.

Section 202-24, Revised Laws of Hawaii, provides that a seller with voidable title can transfer good title to a purchaser in good faith and for value. Section 2-403 of the Code incorporates this principle and covers four specific situations.

Section 202-25, Revised Laws of Hawaii, provides that any seller left in possession of goods sold can transfer title to such goods to a bona fide purchaser. Under section 2-403 of the Code, if the seller left in possession is a "merchant who deals in goods of that kind", there may be an entrusting situation. If so, the seller would have the powers set forth in subsection 2-403(b).

Hawaii Law.

Rev. Laws Hawaii 202-20(d), 202-23, 202-24,
202-25, 206-9(b)

Sections 202-20(d), 202-23, 202-24, 202-25,
and 206-9(b) are combined and rewritten.

PART 5 PERFORMANCE

U.C.C. Sec. 2-501. Explanatory Notes.

Section 2-501 deals with the manner of identifying goods to the contract so that an insurable interest in the buyer and the rights set forth in the next section will accrue. Generally speaking, identification may be made in any manner "explicitly agreed to" by the parties.

Hawaii Law.

Rev. Laws Hawaii 202-17, 202-19

The provisions of section 202-17 (no property passes until goods are ascertained) and section 202-19 (rules for ascertaining intention) would be modified.

U.C.C. Sec. 2-502. Explanatory Notes.

Section 2-502 gives the buyer an additional right as a result of identification of the goods to the contract. He has a right to the goods if the seller should become insolvent within ten days after receiving the first installment on the price.

Hawaii Law.

Rev. Laws Hawaii 202-17, 202-18, 202-19

There is no comparable provision in the Hawaii statute, but sections 202-17, 202-18, and 202-19 would be affected.

U.C.C. Sec. 2-503. Explanatory Notes.

Section 2-503 sets forth the general rules governing the manner of proper or due tender of delivery. It provides for the method of tender of delivery in five categories: (1) tender of delivery in situations not otherwise specifically covered in section 2-503,

(2) tender of delivery under shipment contracts, (3) tender of delivery under destination contracts, (4) tender of delivery of goods in possession of a bailee where delivery is to be accomplished without moving the goods, and (5) tender of delivery where the contract requires delivery of documents.

Hawaii Law.

Rev. Laws Hawaii 202-11, 202-19, 202-20, 202-43(c) and (d), 202-46, 202-51

The Hawaii statute does not contain a similarly detailed treatment. The general policy provided in the following statutory provisions is continued and supplemented: sections 202-11, 202-19, 202-20, 202-43 (c) and (d), 202-46 and 202-51 except that subsection 2-503(3) of the Code changes the rule of 202-19(5) as to what constitutes a destination contract.

U.C.C. Sec. 2-504. Explanatory Notes.

Section 2-504 applies to shipment contracts and extends the application of subsection 2-503(2).

Unless otherwise agreed, effective tender would be made by the seller under a shipment contract as follows:

- (a) The seller must put the goods in possession of the carrier under a reasonable contract for their transportation.
- (b) The seller must tender "in due form" any "document" required for the buyer to obtain possession of the goods.
- (c) The seller must in every case "promptly notify" the buyer of the shipment.

Hawaii Law.

Rev. Laws Hawaii 202-46

Section 202-46 is rewritten.

U.C.C. Sec. 2-505. Explanatory Notes.

Section 2-505 deals with shipment by the seller under reservation. Under this section, the seller's procurement of a negotiable bill of lading (whether to his order or not) reserves a "security interest" in the goods.

This section also provides that a nonnegotiable bill of lading naming the seller or his nominee as consignee "reserves possession of the goods as security". It is not necessary that the seller retain possession of the bill. A nonnegotiable bill of lading naming the buyer as consignee "reserves no security interest" in the goods even though the seller retains possession of the bill of lading.

Subsection (2) provides that the seller's reservation of a security interest in goods where shipment under reservation is in violation of the terms of a contract for sale shall constitute an improper contract for transportation under section 2-504.

Hawaii Law.

Rev. Laws Hawaii 202-20

Section 202-20 is rewritten.

U.C.C. Sec. 2-506. Explanatory Notes.

Section 2-506 covers drafts relating to shipment of goods whether or not there are documents accompanying the draft. It covers only drafts which have been paid or purchased for value by a "financing agency".

Subsection (2) indicates that a financing agency is entitled to reimbursement from the buyer for a draft purchased or honored in good faith even though defects in documents accompanying the draft are later discovered so long as these defects were not apparent on the face.

Hawaii Law.

There is no comparable provision in the Hawaii law.

U.C.C. Sec. 2-507. Explanatory Notes.

Subsection (1) of section 2-507 of the Code restates the rule provided in section 202-42, Revised Laws of Hawaii, that tender of delivery and payment are concurrent conditions unless otherwise agreed.

Subsection (2) provides that if payment is due and demanded when the goods are delivered to the buyer, the buyer's right to retain the goods or to dispose of them is conditional upon payment being made. This concept of conditional delivery has no counterpart in the Hawaii statute.

Hawaii Law.

Rev. Laws Hawaii 202-11, 202-41, 202-42, 202-69

Sections 202-11, 202-41, 202-42, and 202-69 are affected.

U.C.C. Sec. 2-508. Explanatory Notes.

Section 2-508 deals with the seller's right to correct improper tender or delivery.

Section 2-601 of the Code provides that a buyer may reject "if the goods or the tender of delivery fail in any respect to conform to the contract". The impact of this broad right of rejection is softened by the provisions of section 2-508 giving the seller the opportunity to cure improper tender or delivery in certain circumstances.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-509. Explanatory Notes.

Section 2-509 allocates risk of loss in all situations where there has been no breach of the contract for sale except where there is "contrary agreement" or there is a sale on approval under section 2-327.

The Code allocates risk of loss without regard to title to the goods, the underlying theory being the adoption of a contractual approach rather than an arbitrary shifting of the risk with the "property" in the goods.

Under subsection 2-509(3) the risk of loss does not pass from a "merchant" to a buyer until the buyer has taken physical possession of the goods, i.e., until "receipt" by the buyer.

Hawaii Law.

Rev. Laws Hawaii 202-22

Section 202-22, which provides that risk of loss follows title to the goods, is rewritten.

U.C.C. Sec. 2-510. Explanatory Notes.

Section 2-510 deals with the effect of breach on the risk of loss. The basic philosophy of the Code is to place the risk of loss on the party who has broken his contract.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-511. Explanatory Notes.

Section 2-511, dealing with tender of payment, together with section 2-507, adopts the rule stated in section 202-42, Revised Laws of Hawaii.

Subsection (2) recognizes that tender of cash for goods is not always commercially feasible. Hence something less than cash may operate as proper tender of payment.

Hawaii Law.

Rev. Laws Hawaii 202-42

Section 202-42 is rewritten.

U.C.C. Sec. 2-512. Explanatory Notes.

Sections 2-512 and 2-513 establish the scope of the buyer's right to inspect. The Code contemplates that the buyer shall have an opportunity to inspect before acceptance and before payment unless the contract requires payment before inspection.

Section 2-512 applies to cases in which the contract requires payment before inspection either by the express agreement of the parties or by reason of the effect in law of that contract.

Subsection (2) makes explicit the general policy of the Hawaii statute that the payment required before inspection in no way impairs the buyer's remedies or rights in the event of a default by the seller.

Hawaii Law.

Rev. Laws Hawaii 202-47, 202-49

There is no comparable provision in the Hawaii statute, but sections 202-47 and 202-49 relate to this subject.

U.C.C. Sec. 2-513. Explanatory Notes.

Section 2-513, dealing with the buyer's right to inspection, is in general accord with section 202-47, Revised Laws of Hawaii, on the same subject. Unless otherwise agreed, the Code gives the buyer a right to inspect the goods at any reasonable time and place and in any reasonable manner.

Subsection (2), dealing with cost of inspection, is new.

Subsection (3) deals with situations where the contract requires the buyer to pay for the goods before inspection.

Subsection (4) provides that agreement as to the place for or method of inspection shall not affect the rules regarding identification, delivery, passage of title, and risk of loss.

Hawaii Law.

Rev. Laws Hawaii 202-47

Section 202-47 is rewritten.

U.C.C. Sec. 2-514. Explanatory Notes.

Section 2-514 would extend the rule found in section 41 of the Uniform Bills of Lading Act by including any document against which a draft is drawn--not just bills of lading.

Hawaii Law.

There is no comparable provision in the Hawaii statute since Hawaii has not adopted the Uniform Bills of Lading Act.

U.C.C. Sec. 2-515. Explanatory Notes.

Section 2-515 is intended to facilitate and encourage the private adjustment of disputes as to the kind, quality, or condition of goods identified to contracts for sale.

Subsection (a) gives either party the right to test, inspect, and sample the goods upon reasonable notification of the other party for the purpose of ascertaining facts and preserving evidence with respect to the goods.

Subsection (b) provides for inspection of the goods by a third party, but only by mutual agreement of the parties.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

PART 6 BREACH, REPUDIATION AND EXCUSE

U.C.C. Sec. 2-601. Explanatory Notes.

Section 2-601 of the Code consolidates in one section a catalogue of buyer's rights to accept or reject goods, and such rights are wholly independent of the status of title to the goods.

Hawaii Law.

Rev. Laws Hawaii 202-11, 202-44, 202-66(1)

There is no specifically comparable provision in the Hawaii statute, but several provisions deal with situations of nonconformity, including sections 202-11, 202-44, and 202-66(1).

U.C.C. Sec. 2-602. Explanatory Notes.

Section 2-602 is intended to make clear that a tender or delivery of goods made pursuant to a contract of sale, even though wholly nonconforming, requires affirmative action by the buyer to avoid acceptance. Under subsection (1), the buyer is given a reasonable time to notify the seller of his rejection, but without such seasonable notification his rejection is ineffective.

Subsection (2) lays down the normal duties of the buyer upon rejection. Beyond his duty to hold the goods with reasonable care for the buyer's disposition, this section continues the policy of the Hawaii statute in generally relieving the buyer from any duties with respect to them, except when the circumstances impose the limited obligation of salvage upon him under the next section.

Hawaii Law.

Rev. Laws Hawaii 202-50

Section 202-50 is rewritten.

U.C.C. Sec. 2-603. Explanatory Notes.

Section 2-603 creates a limited area in which the merchant buyer's obligations as to rightfully rejected goods is greater than those of other buyers. The merchant buyer would not only have the duty of reasonable care of the goods under section 2-602(2) (b) but also the duty to follow "reasonable instructions" from the seller with respect to the goods so long as the seller provides indemnity for expenses if demanded by the buyer, and even without instructions from the seller, to make "reasonable efforts" to sell goods which are "perishable or threaten to decline in value speedily".

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-604. Explanatory Notes.

Section 2-604 is designed to encourage salvage of rejected goods by the buyer. Proper salvage will often decrease the amount of damages to which the seller is exposed. The Code seeks to accomplish this end by making it clear that the buyer's storage or resale of the goods in proper circumstances will not constitute acceptance or conversion of the goods by the buyer.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-605. Explanatory Notes.

Section 2-605 rests upon a policy of permitting the buyer to give a quick and informal notice of defects in a tender without penalizing him for omissions in his statement, while at the same time protecting a seller who is reasonably misled by the buyer's failure to state curable defects.

In transactions between merchants, the merchant buyer would be required, upon request from the merchant seller, to give a "full and final written statement of all defects" on which he proposes to rely. All other buyers would be required to specify "defects" discernible on inspection if the seller could have cured the defect.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-606. Explanatory Notes.

Section 2-606 provides that under Article 2 of the Code, "acceptance" as applied to goods means that the buyer, pursuant to the contract, takes particular goods which have been appropriated to the contract as his own, whether or not he is obligated to do so.

Under this section acceptance of goods is always acceptance of identified goods which have been appropriated to the contract or are appropriated by the contract. There is no provision for "acceptance of title" apart from acceptance in general, since acceptance of title is not material under this Article to the detailed rights and duties of the parties.

Hawaii Law.

Rev. Laws Hawaii 202-48

Section 202-48 is rewritten.

U.C.C. Sec. 2-607. Explanatory Notes.

Section 2-607 would continue, in general, the policies with respect to acceptance of goods. Under subsection (1), once the buyer accepts a tender the seller acquires a right to its price on the contract terms.

Under subsection (2) acceptance of goods preclude their subsequent rejection. Any return of the goods thereafter must be by way of revocation of acceptance under the next section.

Subsection 2-607(3)(a), like section 202-49, Revised Laws of Hawaii, requires the buyer to notify the seller of "any breach" within a reasonable time after it is discovered or should have been discovered or be barred from any remedy.

In the event the seller breaches the warranty against infringement, the buyer must, if sued for infringement, notify the seller within a reasonable time "after he receives notice of the litigation" or be barred from any remedy over against the seller. This provision of subsection 2-607(3)(b) is new.

Subsection 2-607(5)(a) sets up a statutory procedure for "vouching in" a seller who is answerable over to a buyer for a breach of warranty or other obligation on which the buyer is being sued.

Hawaii Law.

Rev. Laws Hawaii 202-41, 202-49, 202-69

Sections 202-41, 202-49 and 202-69 are rewritten.

U.C.C. Sec. 2-608. Explanatory Notes.

Under section 2-608, the concept of revocation of acceptance would replace the remedy of rescission for breach of warranty under section 202-69, Revised Laws of Hawaii.

Under subsection 202-69(b), Revised Laws of Hawaii, election of the remedy of rescission forecloses the buyer from the remedy of damages for breach of warranty. The buyer is limited to the return of any part of the purchase price which has been paid. Under the Code, the revoking buyer may revoke acceptance and still use the remedies set out in section 2-711.

Section 202-69(c), Revised Laws of Hawaii, requires that the buyer must notify the seller of his election to rescind "within a reasonable time". The Code follows the same principle by requiring revocation "within a reasonable time after the buyer discovers or should have discovered" the grounds for revocation. In addition, the Code requires that the revocation must occur before the condition of the goods has substantially changed unless, of course, the change is due to the defect in the goods.

Hawaii Law.

Rev. Laws Hawaii 202-69

Section 202-69 is rewritten.

U.C.C. Sec. 2-609. Explanatory Notes.

Section 2-609 recognizes that a material part of any bargain for the sale of goods is the reasonable expectation that the contract will be performed. Impairment of this expectation, which is something short of actual breach, can create undue hazards unless a means of protection is devised.

The Code seeks to protect against impending breach by giving the threatened party (1) the right to demand adequate assurance of performance; (2) the right to suspend his performance, and (3) the right to treat the contract as repudiated if adequate assurance of performance is not given.

Hawaii Law.

Rev. Laws Hawaii 202-53, 202-54, 202-55, 202-63

There is no comparable provision in the Hawaii statute, but the sections 202-53, 202-54, 202-55, and 202-63 provide protection against impending breach.

U.C.C. Sec. 2-610. Explanatory Notes.

Section 2-610 deals with anticipatory repudiation. Under this section when such a repudiation substantially impairs the value of the contract, the aggrieved party may at any time resort to his remedies for breach, or he may suspend his own performance while he negotiates with, or awaits performance by, the other party.

Hawaii Law.

Rev. Laws Hawaii 202-63(b), 202-65

There is no comparable provision in the Hawaii statute, but sections 202-63(b) and 202-65 deal with breach of contract and rescission. The general effect of section 202-63(b) is continued in force.

U.C.C. Sec. 2-611. Explanatory Notes.

Section 2-611 makes it clear that the repudiating party's right to reinstate the contract is entirely dependent upon the action taken by the aggrieved party. If the latter has cancelled the contract or materially changed his position at any time after the repudiation, there can be no retraction under this section.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-612. Explanatory Notes.

Section 2-612 prescribes special rules for installment contracts.

Subsection 2-612(1) states that a contract may be an installment contract even though it contains the clause "each delivery is a separate contract" or its "equivalent".

Subsection 2-612(2) deals with the right of the buyer to reject nonconforming installments. The buyer may reject only (a) if the nonconformity substantially impairs the value of that installment and cannot be cured or (b) if there is a defect in required documents.

Subsection 2-612(3) deals with the problem of breach of the whole contract.

Hawaii Law.

Rev. Laws Hawaii 202-45(b)

Section 202-45(b) is rewritten.

U.C.C. Sec. 2-613. Explanatory Notes.

Sections 2-613 through 2-616 deal with various phases of the problem of impossibility of performance of the contract of sale.

Section 2-613 covers the problem of impossibility arising out of an inadvertent destruction or deterioration of specific goods which were supposed to be used to fill the terms of a contract for sale.

Hawaii Law.

Rev. Laws Hawaii 202-7, 202-8

Sections 202-7 and 202-8 are combined and rewritten.

U.C.C. Sec. 2-614. Explanatory Notes.

Section 2-614 deals with substituted performance. The Code philosophy with respect to frustration of the delivery or payment terms of a contract for sale is to save the contract if a reasonable substitute for the agreed performance can be found.

If the contract method of delivery is frustrated, the seller must avail himself of any "commercially reasonable" substitute mode of delivery and the buyer must accept the substituted performance.

If the contract method of payment fails because of government regulation, the buyer may tender a payment which is "commercially a substantial equivalent" to that contemplated by the contract. If so tendered, the seller must deliver the goods. If the goods have already been delivered to the buyer when the frustration occurs, the buyer may discharge his obligation by conforming to the regulations unless the regulation is "discriminatory, oppressive or predatory".

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-615. Explanatory Notes.

Section 2-615 excuses a seller from timely delivery of goods contracted for, where his performance has become commercially impracticable because of unforeseen supervening circumstances not within the contemplation of the parties at the time of contracting.

Only one situation in which there may be excuse of performance is expressly mentioned in section 2-615--excuse because of "foreign or domestic governmental regulation or order". Excuse in other situations depends on whether (a) a contingency has occurred "the nonoccurrence of which was a basic assumption on which the contract was made" and (b) the contingency has rendered performance of the contract "impracticable".

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-616. Explanatory Notes.

Section 2-616 deals with the procedure which may be followed by the buyer if he should receive a notice of excuse from the seller under section 2-615. He may (a) terminate the contract as to the delivery concern-

ed, (b) terminate the entire contract if the value of the whole contract is substantially impaired, or (c) acquiesce in a modification of the contract as per the seller's notification. The buyer's failure to select one of the foregoing alternatives within a reasonable time results in a lapse of the contract.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

PART 7 REMEDIES

U.C.C. Sec. 2-701. Explanatory Notes.

Section 2-701 makes clear that the remedies provided by the Code do not impair remedies for the breach of any obligation collateral to a contract for sale.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-702. Explanatory Notes.

Section 2-702 describes the remedies available to the seller upon discovery of the buyer's insolvency.

A critical factor in the insolvency situation will be whether the seller has relinquished possession of the goods to the buyer. The Code treatment of the problem breaks down essentially into description of the seller's rights where he still has possession of the goods when the buyer's insolvency is discovered and of the seller's rights where he has relinquished possession of the goods to the buyer before discovery of the insolvency.

Because the right of the seller to reclaim goods under this section constitutes preferential treatment as against the buyer's other creditors, subsection (3) provides that such reclamation bars all of his other remedies as to the goods involved.

Hawaii Law.

Rev. Laws Hawaii 202-53(a) (2), 202-54(a) (3), 202-57, 202-75 (3)

Sections 202-53(a) (2), 202-54(a) (3), 202-57, and 202-75 (3) are rewritten, the principal effect being to extend the protection given to a seller who has sold on credit and has delivered goods to the buyer immediately preceding the buyer's insolvency.

U.C.C. Sec. 2-703. Explanatory Notes.

Section 2-703 enumerates the remedies available to the seller when the buyer wrongfully rejects or revokes acceptance of goods, fails to make a payment due on or before delivery, or repudiates. The buyer's breach may give rise to remedies as to one lot of goods involved under the contract or as to the whole contract. The remedies are cumulative.

Hawaii Law.

There is no comparable index section in the Hawaii statute.

U.C.C. Sec. 2-704. Explanatory Notes.

Section 2-704 is designed to facilitate an intelligent selection of remedy by the seller upon the buyer's breach of contract. The Code would increase the flexibility of the seller's movements after the buyer's breach by giving the seller broad rights to identify goods to the contract for sale. These rights of identification of goods to the contract are significant in establishing the seller's right to price and in allowing resale of the goods to fix seller's damages.

Hawaii Law.

Rev. Laws Hawaii 202-63(c) 202-64(d)

Sections 202-63(c) and 202-64(d) are rewritten.

U.C.C. Sec. 2-705. Explanatory Notes.

Section 2-705 deals with the seller's stoppage of delivery in transit.

Subsection (1) describes the circumstances in which the seller shall have the right to stop delivery to the buyer of goods in the hands of a carrier or other bailee.

Subsection (2) describes the time at which the seller's right to stop delivery shall end.

Subsection (3) describes the obligations of a bailee to honor a stop-delivery order.

Hawaii Law.

Rev. Laws Hawaii 202-57, 202-58, 202-59

Sections 202-57, 202-58, and 202-59 are extended and developed in the light of the other provisions of the Code.

U.C.C. Sec. 2-706. Explanatory Notes.

Section 2-706 makes it clear that the remedy of resale by the seller is separate and distinct from the remedy of damages in section 2-708. In effect, under the Code the seller has two possible damage remedies available.

The Code requires that the resale be made "in good faith and in a commercially reasonable manner", and sets up some standards for judging whether the resale was so made. The resale may be made by way of one or more contracts to sell or by fulfilling an already existing contract to sell. It may be in one unit or in parcels. It may be made at any time and place and on any terms that are commercially reasonable. It may be a public or private sale.

Hawaii Law.

Rev. Laws Hawaii 202-60

Section 202-60 is rewritten.

U.C.C. Sec. 2-707. Explanatory Notes.

Section 2-707 provides that a person in the position of a seller is given certain of the seller's remedies--the right to withhold or stop delivery under section 2-705, the right to resell under section 2-706, and the right to recover incidental damages under section 2-710.

Hawaii Law.

Rev. Laws Hawaii 202-52(b)

Section 202-52(b) is rewritten.

U.C.C. Sec. 2-708. Explanatory Notes.

Section 2-708 spells out the seller's damage remedies for nonacceptance of the goods or repudiation of the contract for sale. Two possible remedies are contemplated--(1) damages measured by difference between market and contract price or (2) damages measured by loss of profits.

Hawaii Law.

Rev. Laws Hawaii 202-64

Section 202-64 is rewritten.

U.C.C. Sec. 2-709. Explanatory Notes.

Section 2-709 deals with action for the price by the seller.

Under section 202-63, Revised Laws of Hawaii, the seller may recover price where (a) title has passed, (b) price is payable on a certain day without regard to delivery or transfer of title and (c) the goods are not readily resalable. The Code eliminates (b) as a basis for recovery of price. As to (a), title is no longer the key to an action for price. Instead, the Code makes recovery of price dependent on (1) acceptance of the goods by the buyer or (2) loss or damage to conforming goods within a commercially reasonable time after risk of loss has passed to the buyer. As to (c), the change is in the mode of expression.

Hawaii Law.

Rev. Laws Hawaii 202-63

Section 202-63 is rewritten.

U.C.C. Sec. 2-710. Explanatory Notes.

Section 2-710 deals with incidental damages and authorizes reimbursement to the seller for expenses reasonably incurred by him as a result of the buyer's breach.

Hawaii Law.

Rev. Laws Hawaii 202-64, 202-70

Sections 202-64 and 202-70 are affected.

U.C.C. Sec. 2-711. Explanatory Notes.

Section 2-711 sets forth an index of the buyer's remedies. These remedies break down into two general categories--damages and rights in the goods.

Subsection (3) gives the buyer a security interest in the goods, if in his possession or control, for advances on price and expenses when the buyer rejects the goods or revokes his acceptance of the goods. This is similar to the buyer's lien under subsection 202-69(e), Revised Laws of Hawaii.

Hawaii Law.

Rev. Laws Hawaii 202-29(e)

There is no comparable index section in the Hawaii statute. Subsection 202-29(e) is rewritten by subsection 2-711(3).

U.C.C. Sec. 2-712. Explanatory Notes.

Section 2-712 authorizes the buyer to "cover" after a breach by the seller, and protects the buyer by providing that the measure of damages shall be "the difference between the cost of cover and the contract

price". However, the buyer has no obligation to cover and failure to do so will not affect other remedies available to him.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-713. Explanatory Notes.

Section 2-713 replaces section 202-67(c), Revised Laws of Hawaii. The damage formula--difference between contract price and market price--is unchanged. The principal changes under the Code relate to the time and place for determining market price.

Hawaii Law.

Rev. Laws Hawaii 202-67(c)

Section 202-67(c) is rewritten.

U.C.C. Sec. 2-714. Explanatory Notes.

Section 2-714 applies to those situations in which the buyer keeps nonconforming goods and seeks damages for the nonconformity. Such nonconformity goes beyond breach of warranty and includes late delivery and improper quantity.

Under the Hawaii statute, damages are computed "at the time of delivery to the buyer". The place for determination of damages is not expressly stated. Under the Code damages are computed "at the time and place of acceptance".

Hawaii Law.

Rev. Laws Hawaii 202-67(e) and (f)

Subsections 202-67(e) and (f) are rewritten.

U.C.C. Sec. 2-715. Explanatory Notes.

Section 2-715 provides for "incidental and consequential damages". The Code adopts the "foreseeability" test as to consequential damages tempered by the requirement that buyer must prevent enhancement of such damage by "cover or otherwise".

Hawaii Law.

Rev. Laws Hawaii 202-70

Section 202-70, dealing with interest and special damages, is rewritten.

U.C.C. Sec. 2-716. Explanatory Notes.

Section 2-716 continues the existing statutory policy as to specific performance and injunction against breach and seeks to further a more liberal attitude than some courts have shown in connection with the specific performance of contracts of sale.

The legal remedy of replevin is given the buyer in cases in which cover is reasonably unavailable and goods have been identified to the contract. This is in addition to the buyer's right to recover identified goods on the seller's insolvency (section 2-502).

Hawaii Law.

Rev. Laws Hawaii 202-68

Section 202-68 is rewritten.

U.C.C. Sec. 2-717. Explanatory Notes.

Section 2-717 permits the buyer to deduct from the price damages resulting from any breach by the seller and does not limit the relief to cases of breach of warranty as does the Hawaii statute.

Hawaii Law.

Rev. Laws Hawaii 202-69(a) (1)

Section 202-69(a) (1) pertains to remedies for breach of warranty.

U.C.C. Sec. 2-718. Explanatory Notes.

Section 2-718 condones liquidated damage clauses in contracts for sale so long as the amount is reasonable. Reasonableness is determined on the basis of three factors: (a) anticipated or actual harm caused by the breach; (b) difficulties of proof of loss; and (c) inconvenience or nonfeasibility of otherwise obtaining an adequate remedy.

The balance of section 2-718 revolves around the problem of a buyer's forfeiture of advances on the purchase price when he defaults under the contract.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-719. Explanatory Notes.

Section 2-719 provides that the parties are free to shape their remedies to their particular requirements, and reasonable agreements limiting or modifying remedies are to be given effect.

Hawaii Law.

Rev. Laws Hawaii 202-71

Section 202-71 deals with variation of implied obligations.

U.C.C. Sec. 2-720. Explanatory Notes.

Section 2-720 is designed to safeguard a person holding a right of action from any unintentional loss of rights by the ill-advised use of such terms as "cancellation", "rescission", or the like.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-721. Explanatory Notes.

Section 2-721 extends the remedies for fraud to coincide in scope with remedies for nonfraudulent breach. It does away with the election of remedies doctrine in connection with rescission situations.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-722. Explanatory Notes.

Section 2-722 of the Code states who shall be the party in interest in a sales transaction where third parties cause injury to the goods.

The provisions of this section apply only after identification of the goods. Prior to that time only the seller has a right of action.

Hawaii Law.

Hawaii Rules of Civil Procedure 17(a)

There is no comparable provision in the Hawaii statute. However, Rule 17(a) of the Hawaii Rules of Civil Procedure provides that "every action shall be prosecuted in the name of the real party in interest".

U.C.C. Sec. 2-723. Explanatory Notes.

Section 2-723 seeks to eliminate the most obvious difficulties arising in connection with the determination of market price, when that is stipulated as a measure of damages by some provision of this Article of the Code.

Subsection (1) establishes the time for determining market price in cases of anticipatory repudiation when the trial takes place prior to the time for performance provided in the contract.

Subsection (2) establishes the relevance of evidence of market prices in a substitute market.

Subsection (3) establishes a procedural requirement of notice to avoid surprise when evidence of a substitute market is going to be offered.

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-724. Explanatory Notes.

Section 2-724 forecloses objection to the competence of evidence in the form of market quotations for goods regularly traded on a commodity market where the quotations appear in "official publications or trade journals or in newspapers of general circulation".

Hawaii Law.

There is no comparable provision in the Hawaii statute.

U.C.C. Sec. 2-725. Explanatory Notes.

Section 2-725 introduces a uniform statute of limitations for sales contracts, thereby eliminating jurisdictional variations and providing relief for concerns doing business on a nationwide scale whose contracts have been governed by several different periods of limitation depending upon the state in which the transaction occurred. This Article takes sales contracts out of the general laws limiting the time for commencing contractual actions and selects a four-year period as the most appropriate to modern business practice.

Hawaii Law.

Rev. Laws Hawaii 241-1

There is no comparable provision in chapter 202 (Uniform Sales Act). Section 241-1 provides a six-year statute of limitations for actions for the recovery of any debt founded upon any contract. The application of this section would be modified as to contracts coming under Article 2 of the Code.

ARTICLE 3

COMMERCIAL PAPER

The Uniform Commercial Code in Article 3 completely revises and modernizes the Uniform Negotiable Instruments Law, which was the earliest of the uniform commercial laws. The Uniform Negotiable Instruments Law was drafted in 1896. Hawaii enacted it in 1907 (it appears as chapter 197 of the Revised Laws of Hawaii 1955), and has not since then amended it. The accumulated conflicting opinions and ambiguities involving many sections of the older law have been eliminated in Article 3 which has also streamlined the Negotiable Instruments Law to approximately half size. Article 3 is considered of merit by the authorities especially because of its precision and concision.

The Code omits from Article 3 provisions dealing with instruments such as bonds and debentures and deals with them more logically in Article 8, "Investment Securities".

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PART I
SHORT TITLE, FORM AND INTERPRETATION

U.C.C. Sec. 3-101. Explanatory Notes.

Self-explanatory.

U.C.C. Sec. 3-102. Explanatory Notes.

This section contains general definitions as used in Article 3 unless the context otherwise requires; also it contains an index of other definitions in other sections of Article 3 applying to Article 3, as well as definitions in other articles applying to Article 3. For the purpose of providing uniform definitions applicable to all articles and sections of the Code, the more general definitions appear in Article 1. In addition to adding many definitions not covered by the Hawaii law, the definitions in the Code modify some of the definitions contained in section 197-190, Revised Laws of Hawaii, as follows:

"Acceptance" (section 3-410) not only means an acceptance completed by delivery or notification, but has been expanded to mean "drawee's signed engagement to honor the draft as presented. It must be written on the draft, and may consist of his signature alone".

"Action" (section 1-201(1)) is expanded and, in addition to counterclaim and setoff, includes "in the sense of a judicial proceeding . . . suit in equity and any other proceeding in which rights are determined".

"Bearer" (section 1-201(5)) is made more comprehensive and is not limited to person in possession of a bill or note which is payable to bearer, but includes also "person in possession of an instrument, document of title, or security payable to bearer or indorsed in blank".

"Note" (section 3-104) expands upon "bill" and "note" used in the Hawaii law which cover, respectively, bill of exchange and negotiable promissory note; this now, for purposes of this section, means negotiable instruments which must meet certain requirements (section 3-104(1)) and writings complying with these

requirements which are "draft" (bill of exchange) if it is an order; "check" if it is a draft drawn on a bank and payable on demand; "certificate of deposit" if it is an acknowledgment by a bank of receipt of money with an engagement to repay it; and "note" if it is a promise other than a certificate of deposit.

"Delivery" (section 1-201(14)) enlarges the Hawaii law, which means actual or constructive transfer of possession from one person to another, to the voluntary transfer of possession with respect to instruments, documents of title, chattel paper, or securities.

"Holder" (section 1-201(20)) broadens the Hawaii law, which means the "payee or indorsee of a bill or note who is in possession of it or is the bearer thereof", to cover any person in possession of documents of title or an instrument or an investment security drawn, issued or indorsed to him or to his order or to bearer or in blank.

"Issue" (section 3-102(1)(a)) as defined adds "or a remitter" to the Hawaii law which reads "first delivery of the instrument . . . to a person who takes it as a holder".

"Value" (sections 1-201(44) and 3-303) under Hawaii law means "valuable consideration"; the Uniform Commercial Code is more specific and provides (section 1-201(44)) as used generally in the text a person gives value for rights if he acquires them in return for a binding commitment to extend credit; or as security for or in total or partial satisfaction of a pre-existing contract for purchase; or generally in return for any consideration sufficient to support a simple contract. The Code further provides (section 3-303), with respect to negotiable instruments, that a holder takes the instrument for "value" to the extent that the agreed consideration has been performed or that he acquires a security interest in or a lien on the instrument otherwise than by legal process; or when he takes the instrument in payment of or as security for an antecedent claim against any person whether or not the claim is due; or when he gives a negotiable instrument for it or makes an irrevocable commitment to a third person.

"Written" (section 1-201(46)) enlarges and clarifies the Hawaii law, which reads "written" includes "printed" and "writing", as follows: "written" or "writing" includes printing, typewriting, or any other intentional reduction to tangible form.

Hawaii Law.

Rev. Laws Hawaii 197-126, 197-184, 197-185, 197-190

U.C.C. Sec. 3-103. Explanatory Notes.

This section provides that Article 3 does not apply to money (section 1-201(24)), documents of title (section 1-201(15) and Article 7), and investment securities (Article 8), and that the provisions of this Article are subject to the provisions of Article 4, dealing with bank deposits, and Article 9, dealing with secured transactions. Many items in the course of bank collections will be negotiable instruments and the same may be true of collateral pledged as security for a debt. In such cases this Article, which is general, is, in case of conflicting provisions, subject to the articles which deal specifically with the type of instrument involved, i.e., Articles 4 and 9.

U.C.C. Sec. 3-104. Explanatory Notes.

The provisions of Hawaii law are combined and reworded by the Code and section 197-10, Revised Laws of Hawaii, is omitted as serving no useful purpose.

Subsection 3-104(1)(b) adds to section 197-1(b), Revised Laws of Hawaii, which reads that an instrument to be negotiable "must contain an unconditional promise or order to pay a sum certain in money", a further qualification that it must not contain any "other promise, order, obligation or power given by the maker or drawer except as authorized by this Article".

Subsection 3-104(1)(c) would eliminate from section 197-1(c), Revised Laws of Hawaii, the less specific phrase "or at a fixed or determinable future time" and add a more positive and more easily determinable requirement "or at a definite time".

Subsections 3-104(2)(a), (b), (c) and (d) specify further, writings, not specified in the Hawaii law, which meet the requirements of negotiability. These are:

- (a) "Draft" ("bill of exchange") if an order;
- (b) "Check" if a draft drawn on a bank and payable on demand;

- (c) "Certificate of deposit" if it is an acknowledgment by a bank of receipt of money with an engagement to pay;
- (d) "Note" if a promise other than a certificate of deposit.

Subsection 3-104(3) specifies that the terms used in subsection (2) and as used in other Articles of the Code may refer to instruments that are not negotiable within this Article as well as to instruments that are negotiable.

Hawaii Law.

Rev. Laws Hawaii 197-1, 197-5, 197-10, 197-126, 197-184, 197-185

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U.C.C. Sec. 3-105. Explanatory Notes.

This section of Article 3 would constitute a rewording and liberal expansion of the Hawaii law and its effect would be to broaden the scope of interpretation heretofore applied to the term "unconditional". Under Hawaii law, "an unqualified order or promise to pay to unconditional--though coupled with an indication of a particular fund out of which reimbursement is to be made, or a particular account to be debited with the amount, or a statement of the transaction which gives rise to the instrument".

Subsections 3-105(1)(a) to (h) and (2)(a) through (b) provide essentially as follows: a promise or order otherwise unconditional is not made conditional by the fact that the instrument is subject to implied or constructive conditions; or that it states its consideration, whether performed or promised, or the transaction which gave rise to the instrument, or that the promise or order is made or the instrument matures in accordance with or "as per" such transaction; or refers to or states it arises out of a separate agreement; or states it is drawn under a letter of credit; or states it is secured, whether by mortgage, reservation of title, or otherwise; or indicates a particular account to be debited or any other fund or source from which reimbursement is expected; or is limited to payment out of a particular fund, or proceeds of a

particular source, if the instrument is issued by a government, agency, or unit; or is limited to payment out of entire assets of a partnership, unincorporated association, trust or estate by or on behalf of which the instrument is issued. A promise or order is not unconditional if the instrument states it is subject to or governed by any other agreement; or states it is to be paid only out of a particular fund or source except as provided in this section.

Hawaii Law.

Rev. Laws Hawaii 197-3

U.C.C. Sec. 3-106. Explanatory Notes.

Subsections 3-106(1)(a) to (e) and (2) amount to a rewording of the Hawaii law. They would tend to clarify provisions as to interest, discounts or additions, exchange, costs and attorney's fees, and acceleration or extension.

Subsection 3-106(1)(a) is in accord with section 197-2(a) and (b), Revised Laws of Hawaii.

Subsection 3-106(1)(b) provides that a sum certain is stated although the instrument provides for different rates of interest before and after default or a specified date.

Subsection 3-106(1)(c) provides that a sum certain is stated although the instrument provides a discount or addition if paid before or after the date fixed for payment (this section rejects decisions denying negotiability to a note with a term providing discount for early payment since it is sufficient that the holder may determine the amount payable from the instrument itself).

Subsection 3-106(1)(d) is the same as subsection 197-2(d), Revised Laws of Hawaii, except for adding the phrase "or less exchange".

Subsection 3-106(1)(e) is the same as subsection 197-2(e), Revised Laws of Hawaii, except for the addition of the phrase "or both".

Hawaii Law.

Rev. Laws Hawaii 197-2, 197-6(e)

U.C.C. Sec. 3-107. Explanatory Notes.

The Hawaii law provides that the validity and negotiable character of an instrument are not affected by the fact that it "designates a particular kind of current money in which payment is to be made". Subsection 3-107(1) constitutes a complete revision of the Hawaii law, clarifies when an instrument is payable in money, and establishes rules applicable to instruments drawn payable in a foreign currency.

The term "money" is defined in section 1-201 as "a medium of exchange adopted by a foreign or domestic government as part of its currency"; this rejects the narrow view of early cases that money is limited to legal tender. Where the instrument states that it is payable in "currency" or "current funds", it is payable in money.

Subsection 3-107(2) provides for instruments payable in foreign currency.

Hawaii Law.

Rev. Laws Hawaii 197-6(e)

U.C.C. Sec. 3-108. Explanatory Notes.

Section 3-108 is identical with section 197-7, Revised Laws of Hawaii, except for the deletion in the latter of the last sentence making overdue instruments payable on demand under certain circumstances. The Code provides that instruments payable on demand include those payable at sight or on presentation and those in which no time for payment is stated.

Note: See section 3-302 (holder in due course); hereunder, there is no longer a possibility that one taking time paper after maturity may acquire due course rights against a post-maturity indorser. However, section 3-501(4) provides that neither presentment nor notice of dishonor, nor protest is necessary to charge an indorser who has indorsed after maturity.

Hawaii Law.

Rev. Laws Hawaii 197-7

U.C.C. Sec. 3-109. Explanatory Notes.

Section 197-4(a), Revised Laws of Hawaii, is essentially the same as section 3-109(1)(a) and (b); however, the balance of section 3-109 differs from the Hawaii law and represents a rewriting which would effect the purpose of providing certainty as to time in substitution for "fixed or determinable future time".

Subsection 3-109(1)(c) removes uncertainty as to acceleration clauses by providing that an instrument is payable at a definite time if payable "at a definite time subject to acceleration".

Subsection 3-109(1)(d) adopts the rule that a clause providing extension at the holder's option, does not affect negotiability since a holder is given only the same right he would have without the clause.

Subsection 3-109(2) is contrary to section 197-4(c), Revised Laws of Hawaii; it provides that an instrument is not payable at a definite time and negotiable where it is payable after events certain to happen but uncertain as to time.

Hawaii Law.

Rev. Laws Hawaii 197-4, 197-17(c)

U.C.C. Sec. 3-110. Explanatory Notes.

Subsections 3-110(1)(a), (b), (c) and (d) cover some of the provisions of the Hawaii law e.g., subsections 197-8(a), (b), (c), (d) and (e), Revised Laws of Hawaii; however, in general it would represent a rewriting of the law with new and expanded provisions.

Subsection 3-110(1)(e) seeks to clarify uncertainty in judicial decisions holding that an instrument payable to the order of an estate, trust, or fund is payable to the bearer since the payee's name does not appear, by providing that such an instrument is deemed payable to the representative of such estate, trust, or fund (see Shaw v. Smith (1889), 150 Mass. 166).

Subsection 3-110(1)(b) is substantially the same as section 197-8(b), Revised Laws of Hawaii, but the wording is clarified and expanded.

Subsection 3-110(1)(g) provides that an instrument payable to an unincorporated association or partnership is order and not bearer paper.

Subsection 3-110(2) makes certain that an instrument "payable upon return of this instrument properly indorsed" is not an "order" instrument.

Subsection 3-110(3) is intended to protect a drawer who fills in the payee's name on a printed form without noticing the printed word "bearer" thereon, and intending only an "order" instrument. Under such circumstances the name of the payee indicates intent that the "order" words shall control. The "bearer" words shall be given effect only if "handwritten or typewritten".

Hawaii Law.

Rev. Laws Hawaii 197-8

U.C.C. Sec. 3-111. Explanatory Notes.

Subsections 3-111(a) and (b) are comparable to subsections 197-9(a) and (b), Revised Laws of Hawaii; however, the entire section of the Code constitutes a broadening and a rewording; also, it omits other items in the Hawaii law relating to the fact an instrument is payable to bearer when, "made payable to a fictitious or nonexisting person" and "when the name of the payee does not purport to be the name of any person or when the only or last indorsement is in blank". These areas are covered in other sections of the Code, i.e., sections 3-204 (blank indorsement) and 3-405 (imposters).

Hawaii Law.

Rev. Laws Hawaii 197-9

U.C.C. Sec. 3-112. Explanatory Notes.

Section 3-112 constitutes a rewording of the Hawaii law with the omission of the provision in subsection 197-5(d), Revised Laws of Hawaii, that negotiability is not affected by a provision giving "the holder an election to require something to be done, in lieu of payment of money"; "undated"; "bears a seal"; "designates a particular kind of money".

Subsections 3-112(b), (d) and (e) are essentially similar to subsections 197-5(a), (b) and (c), Revised Laws of Hawaii, and subsection 3-112(a) is essentially similar to subsection 197-6(b) and (c), Revised Laws of Hawaii.

Subsection 3-112(c), authorizing a clause containing a promise or power to maintain or give collateral is new, and subsection 3-112(b) is new, providing that a term in a draft to the effect that the payee by endorsing or cashing acknowledges full satisfaction of an obligation of drawer, does not affect negotiability.

Subsection 3-112(g) is new, and provides that a statement in a draft drawn in a set, to the effect that the order is defective only if no other part has been honored, does not affect negotiability.

Subsection 3-112(2) is the same as the last paragraph of section 197-5, Revised Laws of Hawaii, "but nothing--shall validate any provision--otherwise illegal".

Hawaii Law.

Rev. Laws Hawaii 197-5, 197-6

U.C.C. Sec. 3-113. Explanatory Notes.

Sections 3-113 and 197-6(d), Revised Laws of Hawaii, are essentially the same in that negotiability is not affected by the fact that the instrument is under seal. The Code makes it clear that sealed instruments have no greater validity than other instruments as far as this Article on commercial paper is concerned.

Hawaii Law.

Rev. Laws Hawaii 197-6(d)

U.C.C. Sec. 3-114. Explanatory Notes.

Sections 3-114, 197-6(a), 197-11, 197-12 and 197-13, Revised Laws of Hawaii, accomplish essentially the same results. The Code constitutes a rewording and would serve to clarify and make the rules less ambiguous; part of section 197-12, Revised Laws of Hawaii, as to "illegal or fraudulent" purpose is omitted as inaccurate and misleading.

Subsection 3-114(2) is new, and subsection 3-114 (3) extends section 197-11, Revised Laws of Hawaii, to any signature on an instrument.

Hawaii Law.

Rev. Laws Hawaii 197-6(a), 197-11, 197-12, 197-13,
197-17(c)

U.C.C. Sec. 3-115. Explanatory Notes.

Section 3-115 exemplifies the beneficial effect of rewording complicates statutes. The related sections of the Hawaii law are lengthy, abstruse, and complex. This section of the Code by omitting parts of sections 197-14, 197-15 and 197-16, Revised Laws of Hawaii, attempts to balance the rights of a holder in due course in a paper completed after signing and the rights of the signer contrary to the Hawaii law which provided "where an instrument is wanting in any material particularly the person in possession has prima facie authority to complete it by filling up the blanks therein". The Code provides that if completion is unauthorized, the rules as to material alteration apply as provided in section 3-407 even though the paper is not delivered, but the burden of establishing that any completion is unauthorized is on the party so asserting.

Section 197-13, Revised Laws of Hawaii, is omitted.

Hawaii Law.

Rev. Laws Hawaii 197-13, 197-15, 197-16

29 H. 763

U.C.C. Sec. 3-116. Explanatory Notes.

Section 3-116 establishes a simple rule for all situations involving instruments payable to two or more persons. Section 197-41, Revised Laws of Hawaii, provides that where an instrument is payable to the order of two or more persons, who are not partners, all must indorse, unless the one indorsing has authority to indorse for the other. The Code, however,

is intended to make clear the distinction between an instrument payable to A or B (in the alternative) and one payable to A and B (not in the alternative), which distinction is not clear in the Hawaii law. The first situation names either A or B as payee so that either may negotiate, enforce or discharge the instrument; the second is payable only to A and B, and both must indorse to negotiate although one may be authorized to sign for the other. If the instrument is payable to A and/or B, it is considered to be payable in the alternative to A or B, or to A and B together.

Hawaii Law.

Rev. Laws Hawaii 197-41

U.C.C. Sec. 3-117. Explanatory Notes.

Section 3-117 would revise and broaden the Hawaii law, which covers only cashiers and fiscal officers of banks and corporations, to any case where a payee is named with words describing him as agent or officer of another named person.

Subsection 3-117(a) extends to all agents and officers of principals and not merely fiscal officers; subsection 3-117(b) provides that an instrument payable to a fiduciary may be negotiated, discharged or enforced by such officer; and subsection 3-117(c) provides that additional words added to the payee's name do not affect negotiability in the absence of actual notice of other facts, thus taking care of the situation where various descriptive words are added to the payee, such as "John Doe, Attorney", etc. In all such cases, the person named may negotiate, enforce or discharge the instrument, if otherwise identified, though he does not meet the description.

Hawaii Law.

Rev. Laws Hawaii 197-42

U.C.C. Sec. 3-118. Explanatory Notes.

Subsection 3-118(a) is essentially the same as subsection 197-17(e), Revised Laws of Hawaii, with the added provision that "a draft drawn on the drawer is effective as a note".

Subsection 3-118(b) is substantially the same as subsection 197-17(d), Revised Laws of Hawaii, except that it is modernized to provide that handwritten terms control typewritten, and typewritten control printed.

Subsection 3-118(c) is a mere simplification of subsection 197-17(a), Revised Laws of Hawaii, and subsection 3-118(d) is essentially the same as subsection 197-17(b), Revised Laws of Hawaii, with the addition that unless otherwise specified, the rate of interest shall be the judgment rate at the place of payment.

Subsection 3-118(e) is substantially the same as subsection 197-17(g), Revised Laws of Hawaii, combining and revising it and the last sentence of section 197-68, Revised Laws of Hawaii.

Subsection 3-118(f) is new and deals with consent to extension (also, in this connection see section 3-604). This provision has reference to terms inserted to obtain consent of indorsers and any accommodation maker to extension, without notice, which might otherwise discharge them under section 3-606.

Hawaii Law.

Rev. Laws Hawaii 197-17, 197-68

22 H. 140

U.C.C. Sec. 3-119. Explanatory Notes.

Subsection 3-119(1) is intended to resolve uncertainties as to the effect of a separate writing upon a negotiable instrument as between immediate parties and as to a holder in due course, i.e., writings executed as a part of the same transaction are to be read together as a single agreement. A purchaser with notice of such limitation, takes subject to the limitation; if he is without such notice, he is not affected by such a limiting clause in the separate writing.

Subsection 3-119(2) provides, in effect, that the negotiability of an instrument is always to be determined by what appears on the face of the instrument alone, and if negotiable in itself, a purchaser without notice of a separate writing is in no way affected by it.

U.C.C. Sec. 3-120. Explanatory Notes.

Section 3-120 states the commercial understanding as to the effect of language making an instrument payable through a bank. The bank is not named as drawee, ordered or authorized to pay. It is merely designated as a collecting bank through which presentment is properly made to the drawee.

U.C.C. Sec. 3-121. Explanatory Notes.

Section 3-121 presents two alternatives, A and B. "A" states the New York commercial understanding, i.e., that a note or acceptance stating it is payable at a bank is the equivalent of a draft drawn on the bank payable out of funds of the maker or acceptor in current account. "B" states the commercial understanding in the South and West, i.e., that the note or acceptance is treated as merely designating a place of payment; the bank's only function is to notify the maker or acceptor that the instrument has been presented and to ask for his instructions, and in the absence of such, it is not regarded as required or even authorized to pay. Section 197-87, Revised Laws of Hawaii, follows alternative "A".

Hawaii Law.

Rev. Laws Hawaii 197-87

U.C.C. Sec. 3-122. Explanatory Notes.

Section 3-122 is an extensive expansion of section 197-51, Revised Laws of Hawaii, which simply gives the holder of a negotiable instrument the right to sue. The Code section makes the accrual of a cause of action explicit in various contingencies, as follows:

Subsection 3-122(1)(a) provides that accrual of a cause of action against a maker or acceptor in the case of a time instrument is on the day after maturity.

Subsection 3-122(1)(b) provides that accrual of a cause of action against a maker or acceptor in the case of a demand instrument is upon the date of demand if no date is stated on the date of issue.

Subsection 3-122(2) provides that accrual of a cause of action against an obligor in case of a demand or time certificate of deposit is upon demand; but demand cannot be made until on or after the date of maturity.

Subsection 3-122(3) provides that accrual of a cause of action against a drawer of a draft or an indorser of an instrument is upon demand following dishonor.

Subsection 3-122(4) (a) provides that interest runs from the date of demand in the case of a maker of a demand note and, subsection 3-122(4) (b) provides that interest runs in all other cases from the date of accrual of a cause of action.

Hawaii Law.

Rev. Laws Hawaii 197-51

25 H. 646

PART 2 TRANSFER & NEGOTIATION

U.C.C. Sec. 3-201. Explanatory Notes.

Section 3-201 is a rewording of Hawaii law with expansion through the addition of new provisions.

Subsection 3-201(1) adds a provision that equitably takes away from a holder with notice, but who was not a party to a prior fraud, the right to take free of his knowledge.

Subsection 3-201(2) adds the provision that the transfer of rights is not limited to transfers for value; an instrument may be transferred as a gift, and the donee acquires whatever rights the donor had.

Subsection 3-201(3) is comparable to the Hawaii law in that it makes clear that the transferee is presumptively entitled to an unqualified indorsement; and that the negotiation takes effect only when the indorsement is made, and until that time there is no presumption that the transferee is the owner.

Hawaii Law.

Rev. Laws Hawaii 197-27, 197-49, 197-58

U.C.C. Sec. 3-202. Explanatory Notes.

Section 3-202 is a rewording of Hawaii law and the addition of a new provision.

Subsection 3-202(1) is in accord with section 197-30, Revised Laws of Hawaii; subsection 3-202(2) carries out the same intent as section 197-31, Revised Laws of Hawaii; and subsection 3-202(3) carries out the same intent as section 197-32, Revised Laws of Hawaii.

Subsection 3-202(4) is new and is intended to reject judicial decisions changing or limiting the effect of an indorsement when words of "assignment, condition, waiver, guaranty, limitation or disclaimer of liability" are included.

Hawaii Law.

Rev. Laws Hawaii 197-30, 197-31, 197-32

U.C.C. Sec. 3-203. Explanatory Notes.

Section 3-203 is a rewording of Hawaii law. This section is intended to permit indorsement of an instrument by a misspelled or another name. The Hawaii law is expanded by giving a person paying value for the instrument the right to require both the erroneous and the correct names to be signed.

Hawaii Law.

Rev. Laws Hawaii 197-43

U.C.C. Sec. 3-204. Explanatory Notes.

Section 3-204 combines and rewords the Hawaii law. The rule in section 197-40, Revised Laws of Hawaii, is reversed by the last sentence of subsection 3-204(1). The Hawaii law provides an instrument drawn payable to bearer and specially indorsed can be further negotiated by delivery alone. The principle here adopted is that the special indorser, as the owner even

of a bearer instrument, has the right to direct the payment and to require the indorsement of his indorsee as evidence of the satisfaction of his own obligation. The special indorsee may, of course, make it payable to bearer again by himself indorsing in blank.

Hawaii Law.

Rev. Laws Hawaii 197-9(e), 197-33, 197-34, 197-35,
197-36, 197-40

U.C.C. Sec. 3-205. Explanatory Notes.

Section 3-205 is a rewording and a combining of the Hawaii law. This section provides a definition of restrictive indorsements which includes the varieties of indorsements set forth in the Hawaii law.

Hawaii Law.

Rev. Laws Hawaii 197-36, 197-39

U.C.C. Sec. 3-206. Explanatory Notes.

Section 3-206 constitutes a complete revision of the Hawaii law. Subsections (1) and (2) apply to all four classes of restrictive indorsements defined in section 3-205. Conditional indorsements and indorsements for deposit or collection defined in section 3-205(a) and (c) are also subject to subsection (3); and trust indorsements, defined in section 3-205(d), are subject to subsection (4). This section negates the implication found in sections 197-37 and 197-47, Revised Laws of Hawaii, that under a restrictive indorsement neither indorsee nor any subsequent taker from him can be a holder in due course. By omitting the provisions contained in section 197-47, Revised Laws of Hawaii, this section also avoids any implication that a discharge is effective against a holder in due course.

Under subsection (1) an indorsement purporting to prohibit further transfer is without effect for that purpose. Hence this section gives such an indorsement the same effect as an unrestricted indorsement, i.e., "pay A only". The indorsee becomes a holder, and the indorsement does not of itself give notice to subsequent parties of any defense or claim of the indorser.

Subsection (2) permits an intermediary bank or payor bank, which is not a depository bank, to disregard any restrictive indorsement except that of the bank's immediate transferor. This provision does not affect the rights of the restrictive indorser against parties outside the bank collection process or against the first bank in the collection process; such rights are governed by subsections (3) and (4) and section 3-603.

Under subsection (3) any transferee under a conditional indorsement or one including the words "for collection", "for deposit", "pay any bank", or like terms, except an intermediary bank, becomes a holder for value to the extent that he acts consistently with the indorsement in paying or applying any value given by him for or on the security of the instrument. Contrary to section 197-39, Revised Laws of Hawaii, subsection (3) permits a transferee under a conditional indorsement to become a holder in due course free of the conditional indorser's claim.

Subsection (4), applying to trust indorsements, other than those for deposit or collection, is similar to subsection (3); but in subsection (4) the duty to act consistently with the indorsement is limited to the first taker under it.

Hawaii Law.

Rev. Laws Hawaii 197-36, 197-37, 197-39, 197-47

26 H.434

26 H.517

42 H.23

U.C.C. Sec. 3-207. Explanatory Notes.

Section 3-207 completely revises the Hawaii law. The revisions make it clear that section 197-22, Revised Laws of Hawaii, which covers only negotiation by an infant or corporation is extended by subsection (1)(a) of the Code section to "any other person without capacity".

Subsection (1)(b) provides that negotiation is effective although obtained by fraud, duress or mistake. Under subsection (1)(c) negotiation is

effective though "part of an illegal transaction". Under subsection (1)(d) negotiation is effective although made in breach of duty. Therefore the status of a taker of an instrument by unlawful means, as provided in subsection (a), (b), (c), and (d), is now changed from a party whose title to the instrument is defective, to that of a holder subject to divestment by the rightful owner.

Subsection (2) means that an instrument subject to the disability set out in (1)(a), (b), (c), and (d) may be subject to any remedy permitted by law because of the illegality, except as against a subsequent holder in due course.

Hawaii Law.

Rev. Laws Hawaii 197-22, 197-58, 197-59

U.C.C. Sec. 3-208. Explanatory Notes.

Section 3-208 combines and rephrases parts of sections of the Hawaii law. However, no change in the substance of the law is apparently intended. "Returned or reacquired by" is substituted for "negotiated back to" in section 197-50, Revised Laws of Hawaii, in order to clarify that the section applies to a return by an indorsee who does not himself indorse.

Hawaii Law.

Rev. Laws Hawaii 197-48, 197-50, 197-121

27 H. 763

PART 3 RIGHTS OF A HOLDER

U.C.C. Sec. 3-301. Explanatory Notes.

Section 3-301 rewords the Hawaii law. It is, however, essentially the same except that the provision in the Hawaii law as to discharge by payment is covered

by section 3-603(1). Section 3-301 is reworded to state in one provision all the rights of a holder and to make it clear that every holder has such rights.

Hawaii Law.

Rev. Laws Hawaii 197-51

25 H. 646

U.C.C. Sec. 3-302. Explanatory Notes.

Section 3-302 constitutes a rewording and adding of new provisions to the Hawaii law. The changes are intended to remove ambiguities.

Subsections (1)(a) and (b) are in accord with section 197-52(c), Revised Laws of Hawaii.

Subsection (1)(c) is in accord with section 197-52(b), Revised Laws of Hawaii, except it is made clear that the purchaser of an instrument which is overdue may still be a holder in due course if he takes it without notice that it is overdue.

Subsection (2) states that the payee may become a holder in due course to the same extent and under the same circumstances as any other holder. This is a new provision intended to settle any legal uncertainty as to that point.

Subsection (3) goes beyond section 197-52, Revised Laws of Hawaii, by providing that one not taking in the usual course of business does not qualify as a holder in due course. It is intended to state existing case law.

Subsection (4) adds a new provision to the effect that the purchaser of a limited interest, such as the pledgee in a security transaction can be a holder in due course only to the extent of the interest purchased (see also sections 1-201 and 197-27, Revised Laws of Hawaii).

Hawaii Law.

Rev. Laws Hawaii 197-52

28 H. 35

U.C.C. Sec. 3-303. Explanatory Notes.

Section 3-303 construes and rewords the Hawaii law. The changes would appear to remove uncertainties in the Hawaii law.

Subsection (a) limits the language of section 197-27, Revised Laws of Hawaii, by eliminating any person who acquires a lien by legal process.

Subsection (b) restates the last sentence of section 197-25, Revised Laws of Hawaii. It adopts the generally accepted rule that the holder takes for value when he takes the instrument as security for an antecedent debt even though there is no extension of time or other concession, and whether or not the debt is due. The provision extends the rule to any claim against any person; there is no requirement that the claim arise out of contract.

Subsection (c) is new but states generally recognized exceptions to the rule that an executory promise is not value.

Subsection (a), also, appears to resolve an apparent conflict between sections 197-54 and 197-25, Revised Laws of Hawaii, by requiring that the agreed consideration shall actually have been given.

Hawaii Law.

Rev. Laws Hawaii 197-25, 197-26, 197-27, 197-54

43 H. 98 (aff'd in 278 F. 2d 539)

U.C.C. Sec. 3-304. Explanatory Notes.

Section 3-304 combines and rewords the Hawaii law, and adds new provisions intended to remove uncertainties in the existing law.

Subsection (1)(a) replaces the provision in section 197-52(a), Revised Laws of Hawaii, requiring that the instrument be "complete and regular upon its face". Irregularity is properly a question of notice to the purchaser of something wrong, and is so treated by the Code.

Subsection (1)(b), pertaining to "voidable" obligations, is intended to limit the provision to a notice of defense which will permit a party to avoid his original obligation on the instrument, as distinguished from a setoff or counterclaim.

Subsection (2) specifies that mere notice of a fiduciary relationship is not enough to prevent a holder from taking in due course, in the absence of actual knowledge of a breach of duty.

Subsection (3) removes uncertainty by providing that "reason to know" of an overdue installment, in lieu of actual knowledge, is notice that the instrument is overdue and thus precludes the purchaser from taking in due course (see section 197-56, Revised Laws of Hawaii). This subsection also departs from section 197-52(b), Revised Laws of Hawaii, by providing that a purchaser may take accelerated paper or a demand instrument on which demand has in fact been made, as a holder in due course if he takes without notice of the acceleration or demand. With this change, section 197-45, Revised Laws of Hawaii, is eliminated, since the presumption that any negotiation has taken place before the instrument was in fact overdue is of importance only in aid of a holder in due course.

The "reasonable time after issue" is retained from section 197-53, Revised Laws of Hawaii, but paragraph (c) adds a presumption that a domestic check is stale after thirty days.

Subsection (4)(a) rejects judicial decisions holding that an instrument to be antedated or postdated is not "regular".

Subsection (4)(b) provides that mere notice of an executory promise or a separate agreement does not prevent a holder from taking in due course even though such notice may appear in the instrument itself.

Subsection (4)(c) provides that knowledge that one has signed for accommodation does not give notice of a defense or claim.

Subsection (4)(d) provides that a holder may take in due course even though a blank is filled in his presence, if he is without notice that the filling is improper (see section 197-56, Revised Laws of Hawaii).

Subsections (4)(e) and (4)(b) are self-explanatory.

Subsection (5) is new. It removes any uncertainty as to the effect of "constructive notice" through the public filing or recording of a document.

Subsection (6) is a new provision providing that notice to the purchaser must be received at such time and manner as to give a reasonable opportunity to act on it.

Hawaii Law.

Rev. Laws Hawaii 197-45, 197-52, 197-53, 197-55, 197-56

24 H. 263

25 H. 159

28 H. 35

U.C.C. Sec. 3-305. Explanatory Notes.

Section 3-305 combines, condenses and rewords the Hawaii law.

The term "takes" is substituted for "holds" in section 197-57, Revised Laws of Hawaii, because a holder in due course may still be subject to a claim or defenses against him after he has taken the instrument. Also the language "all claims to it on the part of any person" is substituted for "any defect of title of prior parties" to make it clear that a holder in due course takes the instrument free, not only from any claim of legal title, but also from all liens, equities or claims of any other kind.

The effect of section 3-305 is to cut off the defense of nondelivery of an incomplete instrument against a holder in due course, and to change the rule in section 197-15, Revised Laws of Hawaii.

Subsection (2)(a) is new. It follows the weight of the judicial decisions that the defense of infancy may be asserted against a holder in due course even though its effect is to render the instrument voidable but not void.

Subsection (2)(b) is new. It covers mental incompetence, and other incapacities. Such incapacity is largely statutory and its existence and effect is

left to the local law of each state. If under local law, the effect is to render the obligation entirely null and void, the defenses may be asserted against a holder in due course. If the effect is merely to render the obligation voidable at the election of the obligor, the defense is cut off.

Subsection (2)(c) is new. It follows the majority of the judicial decisions in recognizing the defense of "real" or "essential" fraud as effective against a holder in due course.

Subsection (2)(d) is new. It clarifies that discharge in bankruptcy is not cut off when the instrument is purchased by a holder in due course.

Subsection (2)(e) is new. A purchaser takes an instrument subject to any defense of discharge of which he has notice when taken (see section 3-304).

Hawaii Law.

Rev. Laws Hawaii 197-15, 197-16, 197-57

29 H. 763

U.C.C. Sec. 3-306. Explanatory Notes.

Section 3-306 combines, condenses, and rewords the Hawaii law.

Subsection (b), in effect, restates the first sentence of section 197-58, Revised Laws of Hawaii.

Subsection (c) condenses sections 197-16 and 197-28, Revised Laws of Hawaii. Want or failure of consideration is specifically mentioned to make it clear that either is a defense which the defendant has the burden of establishing. The language as to an "ascertained or liquidated amount or otherwise" in section 197-16, Revised Laws of Hawaii, is omitted because it is believed to be superfluous. The third sentence of section 197-16, Revised Laws of Hawaii, relating to a "holder in due course" is now covered by section 3-305.

Subsection (d) is substituted for the last sentence of section 197-59, Revised Laws of Hawaii, as a more detailed and explicit statement of the same policy.

Hawaii Law.

Rev. Laws Hawaii 197-16, 197-28, 197-58, 197-59
29 H. 763

U.C.C. Sec. 3-307. Explanatory Notes.

Section 3-307 constitutes a rewording of the Hawaii law and provides certain new provisions.

Subsection (1) is new, requiring specific denial in the pleadings of the authenticity of a signature in order to give notice to the plaintiff.

Subsections (1)(a) and (b) provide for the burden of proof and presumptions as to a denied signature.

Subsection (2) is substituted for the first clause of section 197-59, Revised Laws of Hawaii, and provides simply that once signatures are proved or admitted, the holder has discharged his burden and may recover in the absence of a defense.

Subsection (3) rephrases the last clause of the first sentence of section 197-59, Revised Laws of Hawaii. Until it is shown that a defense exists, the issue as to whether the holder is a holder in due course does not arise.

Hawaii Law.

Rev. Laws Hawaii 197-59

**PART 4
LIABILITY OF PARTIES**

U.C.C. Sec. 3-401. Explanatory Notes.

Section 3-401 represents a rewording of the Hawaii law and makes it clear that a signature may be made by "use of any name including any trade or assumed name, upon an instrument, or by any word or mark in lieu of a written signature".

Hawaii Law.

Rev. Laws Hawaii 197-18

U.C.C. Sec. 3-402. Explanatory Notes.

Section 3-402 effects a combination, condensation and clarification of the Hawaii law. The revised language is intended to provide that any ambiguity as to capacity in which a signature is made must be resolved by a rule of law that it is an indorsement.

Hawaii Law.

Rev. Laws Hawaii 197-17(f), 197-63

28 H. 275

U.C.C. Sec. 3-403. Explanatory Notes.

Section 3-402 effects a combination and rewording of the Hawaii law and eliminates section 197-21, Revised Laws of Hawaii.

Subsection (1) acknowledges the right of an agent to sign as in section 197-19, Revised Laws of Hawaii, and provides that this authority may be shown (see section 1-201).

Subsection (2) details the liabilities of an agent where authority to sign for another has been established. Subsection (3) expressly provides that a representative who signs his own name to the instrument, but does not show his representative capacity, is personally obligated. These provisions are essentially in accord with section 197-20, Revised Laws of Hawaii.

Section 197-21, Revised Laws of Hawaii, covering signatures by procuration is not covered by the Code, the view being that it is unique to English practice and virtually unknown in the United States.

Hawaii Law.

Rev. Laws Hawaii 197-19, 197-20, 197-21

34 H. 229

U.C.C. Sec. 3-404. Explanatory Notes.

Section 3-404 constitutes a rewording of the Hawaii law and provides new provisions.

"Unauthorized signature" is a defined term (see section 1-201). It includes both forgery and a signature made by an agent exceeding his actual or apparent authority.

The final clause of subsection (1) is new. It states the accepted rule that an unauthorized signature is wholly inoperative as that of the person whose name is signed, but it is effective to impose liability on the actual signer or to transfer any rights he may have in the instrument, limited, however, to parties who take or pay the instrument in good faith. One who knows the signature to be unauthorized cannot recover from the signer of the instrument.

Subsection (2) is new. It settles the conflict which has existed in judicial decisions as to whether a forgery may be ratified. It provides that an unauthorized signature may be ratified, following such cases as New Georgia National Bank v. J. & G. Lippmann (1928) 249 N. Y. 307, 164 N. E. 108, 60 ALR 1344. Such ratification, however, does not affect the criminal law, and ratification will not relieve the signer from criminal liability.

Hawaii Law.

Rev. Laws Hawaii 197-23

34 H. 228

U.C.C. Sec. 3-405. Explanatory Notes.

Section 3-405 is a rewording of the Hawaii law and adds new provisions.

Section 3-405 eliminates the concept of "fictitious or nonexistent person" as misleading since the existence or nonexistence of the named payee is not decisive and is important only as it may bear on the intent that he shall have no interest in the instrument. The instrument is not construed as payable to bearer; so indorsements are still necessary for negotiation.

Subsection (1)(a) is new. It rejects decisions which distinguish between face-to-face imposture and imposture by mail and which hold that where parties deal by mail, the dominant intent of drawer is to deal with a name rather than a person; so the instrument may be negotiated only by indorsement of the payee whose name has been taken in vain. The position here, then, is that loss, regardless of the type of fraud which the particular imposter has committed, should fall upon the maker or drawer.

Subsection (1)(b) restates the substance of section 197-9(c), Revised Laws of Hawaii. The test stated is not whether the payee is "fictitious" but whether the signer intends that he shall have no interest in the instrument.

Hawaii Law.

Rev. Laws Hawaii 197-9(c)

U.C.C. Sec. 3-406. Explanatory Notes.

Section 3-406 is new. It adopts the doctrine enunciated in Young v. Grote, 4 Bing. 253 (1827), holding that a drawer who negligently draws an instrument thus facilitating its material alteration is liable to a drawee who pays the altered instrument in good faith. The rule as stated in the Code, however, requires that the negligence "substantially" contributes to the alteration. The section extends the above principle to the protection of a holder in due course and of payors who may not technically be drawees.

U.C.C. Sec. 3-407. Explanatory Notes.

Section 3-407 effects a combining and rewording of the Hawaii law with new provisions, and reverses the rule in section 197-15, Revised Laws of Hawaii.

Subsection (1) substitutes a general definition for the list of illustrations in section 197-125, Revised Laws of Hawaii. An alteration is material only as it may change the contract of a party to the instrument, and the addition or deletion of words not affecting the contract of any previous signer is not material.

Subsection (1)(b) is to be read with section 3-115 on incomplete instruments

Subsection (2) modifies the rigorous rule of section 197-124, Revised Laws of Hawaii. The changes are:

- (1) Material alteration does not discharge a party, unless it is made by a holder. Spoliation by an intervenor does not affect the rights of the holder.
- (2) Material alteration does not discharge a party, unless made for a fraudulent purpose.
- (3) Discharge is a personal defense of a party whose contract is changed by the alteration, anyone whose contract is not affected cannot assert it.
- (4) If alteration is not material or if it is not made for a fraudulent purpose, there is no discharge and the instrument may be enforced according to its original tenor.

Subsection (3) combines the final sentences of sections 197-14 and 197-124, Revised Laws of Hawaii, and provides that a subsequent holder in due course takes free of discharge in all cases (see also, sections 3-406 and 4-401).

Subsection (3), together with section 3-115 on incompleting instruments, reverses the rule of section 197-15, Revised Laws of Hawaii.

Hawaii Law.

Rev. Laws Hawaii 197-14, 197-15, 197-124, 197-125

U.C.C. Sec. 3-408. Explanatory Notes.

Section 3-408 combines and rewords the Hawaii law. The term "consideration" is distinguished from "value" throughout the section. The "except" clause is intended to remove difficulties which have arisen where a note or draft, or indorsement of either, is given as payment or as security for a debt already owned by the party giving it, or by a third person. The provision is intended to alter the result of judicial decisions which hold that where no extension of time or other

concession is given by a creditor, the new obligation fails for lack of consideration. It is also intended to mean that an instrument given for more or less than the amount of a liquidated obligation does not fail by reason of the common law rule that an obligation for a lesser liquidated amount cannot be consideration for the surrender of a greater.

Hawaii Law.

Rev. Laws Hawaii 197-24, 197-25, 197-28

43 H. 98

U.C.C. Sec. 3-409. Explanatory Notes.

Section 3-409 is a combining and rewording of the Hawaii law with new provisions added.

Sections 197-127 and 197-189, Revised Laws of Hawaii, are combined and reworded to remove uncertainties. The language of the existing law that the drawee is not liable "to the holder" is changed as inaccurate and not intended. The drawee is not (section 3-409(1)) liable on the instrument until he accepts, but he remains subject to any other liability to the holder (see also section 4-307).

Subsection (2) is new. It is intended to make clear that this section does not affect liability which may arise apart from the instrument itself.

Hawaii Law.

Rev. Laws Hawaii 197-127, 197-189

26 H. 615

U.C.C. Sec. 3-410. Explanatory Notes.

Section 3-410 omits sections 197-161 to 170, Revised Laws of Hawaii, providing for acceptance for honor. This practice arose when communications were slow and has been obsolete for many years since the need for intervention by a third party has passed with development of the cable transfer by which a substitute arrangement can be promptly made.

Subsection (1) eliminates sections 197-134 and 135, Revised Laws of Hawaii, providing for virtual acceptance by a written promise to accept drafts to be drawn and collateral acceptance by a separate writing. Both have been anomalous exceptions to the policy that no person is liable on an instrument unless his signature appears on it. They are now obsolete.

Subsection (1) also eliminates section 197-137, Revised Laws of Hawaii, providing for acceptance by delay or refusal to return the instrument. However, the drawee may be liable for conversion of the instrument under section 3-419.

Subsection (3) changes the last sentence of section 197-138, Revised Laws of Hawaii. Its purpose is to provide a definite date of payment where none appears on the instrument. An undated acceptance of a draft "payable thirty days after sight" is incomplete, and unless the acceptor himself writes in a different date, the holder is authorized to complete the acceptance according to the terms of the draft by supplying a date of presentment.

Hawaii Law.

Rev. Laws Hawaii 197-132 to 197-139, 197-161 to 197-170, 197-191

28 H. 275

U.C.C. Sec. 3-411. Explanatory Notes.

Section 3-411 combines and rewords the Hawaii law and adds new provisions.

Subsection (1) continues the rule of section 197-188, Revised Laws of Hawaii, that while certification procured by a holder discharges the drawer and other prior parties, certification procured by the drawer leaves him liable.

Subsection (2) is new. It states the generally recognized rule that in the absence of agreement, a bank is under no obligation to certify a check because it is a demand instrument calling for payment rather than acceptance (see also section 3-409(1)).

Subsection (3) is new. It recognizes the banking practice of certifying a check returned for proper indorsement in order to protect the drawer against a longer contingent liability (see also section 3-410 (2)).

Hawaii Law.

Rev. Laws Hawaii 197-187, 197-188

U.C.C. Sec. 3-412. Explanatory Notes.

Section 3-412 effects a combination and rewording of the Hawaii law, and changes the law as to qualified acceptance.

Section 3-412 applies to the various kinds of qualified acceptances defined in section 197-141, Revised Laws of Hawaii, and provides that the rule is applicable to an "acceptance that in any manner varies the draft as presented".

The rule of section 197-140, Revised Laws of Hawaii, is changed to require that the assent of the drawer or indorser be affirmatively expressed. Mere failure to object within a reasonable time is not assent which will prevent discharge (section 3-412(3)).

The provision in subsection (1), otherwise in accord with section 197-141, Revised Laws of Hawaii, permitting the qualified acceptor to cancel his acceptance, is new.

Subsection (2) is in accord with section 197-140, Revised Laws of Hawaii, except for the new limitation "in the continental United States" (see also section 3-504(4)).

Hawaii Law.

Rev. Laws Hawaii 197-139 to 197-142

U.C.C. Sec. 3-413. Explanatory Notes.

Section 3-413 amounts to a combining and rewording of the Hawaii law. The Hawaii law is improved through the elimination of duplication in language and condensation. This section of the Code should be read in connection with sections 3-115, 3-406, 3-407, 3-412 and 3-418.

Hawaii Law.

Rev. Laws Hawaii 197-60, 197-61, 197-62

28 H. 35

28 H. 285

U.C.C. Sec. 3-414. Explanatory Notes.

Section 3-414 amounts to a combining and rewording of the Hawaii law.

It will be noted that section 197-44, Revised Laws of Hawaii, permitting a representative to indorse in such terms as to exclude personal liability, is omitted as unnecessary and included in the broader right to disclaim any liability. No change in the law is intended by this omission.

Subsection (2) amounts to a clarification of section 197-68, Revised Laws of Hawaii. This subsection states two presumptions:

- (1) that indorsers are liable to one another in the order in which they have in fact indorsed;
- (2) that indorsers have in fact indorsed in the order in which their names appear.

This latter presumption is not in the Hawaii law. The last sentence of sections 197-68, Revised Laws of Hawaii, is now covered by section 3-118(3).

Hawaii Law.

Rev. Laws Hawaii 197-38, 197-44, 197-66, 197-67,
197-68

22 H. 140

U.C.C. Sec. 3-415. Explanatory Notes.

Section 3-415 amounts to a combination and rewording of the Hawaii law with the addition of new provisions.

Subsection (1) recognizes that an accommodation party is always a surety (which includes a guarantor). His obligation is determined by the capacity in which he signs.

Under subsection (3), except as against a holder in due course without notice of the accommodation, parol evidence is admissible to prove that the party has signed for accommodation. In any case, however, under subsection (4), an indorsement which is not in the chain of title (the irregular or anomalous indorsement) is notice to all subsequent takers of the instrument of the accommodation character of the indorsement.

Subsection (1) eliminates the language of section 197-29, Revised Laws of Hawaii, requiring that the accommodation party sign the instrument "without receiving value therefor". The essential characteristic is that the accommodation party is a surety and not that he has signed gratuitously.

Subsection (2) is intended to change occasional decisions holding that there is no sufficient consideration where an accommodation party signs a note after it is in the hands of a holder who has given value. The party is liable to the holder in such a case even though there is no extension of time or other concession (see section 3-408). As a surety, the accommodation party is not liable to the party accommodated, but he is otherwise liable on the instrument in the capacity in which he has signed. This rule makes unnecessary the detailed provisions of section 197-64, Revised Laws of Hawaii, which are eliminated without any change in substance.

Subsection (5) provides expressly that the accommodation party, if he pays the instrument, has a right of recourse on the instrument against the accommodated party. This changes the result of such decisions as Quimby v. Varnum 190 Mass. 211, 76 N. E. 671 (1906) holding otherwise.

Hawaii Law.

Rev. Laws Hawaii 197-29, 197-64

43 H. 17

43 H. 98 (aff'd 278 F. 2d. 539)

U.C.C. Sec. 3-416. Explanatory Notes.

This section of the Code is new. It states the commercial understanding as to the meaning and effect of words of guaranty added to a signature. Where guaranties are written on a negotiable instrument, the guarantor is now recognized as a party. The section provides rules as to the rights of the holder in due course against a guarantor and also provides for the recourse of the guarantor against his principal on the instrument.

Note that words of guaranty do not affect the character of the indorsement as an indorsement (see section 3-202(4)), but the liability of the indorser becomes indistinguishable from that of a comaker.

U.C.C. Sec. 3-417. Explanatory Notes.

Section 3-417 effects a combination and rewording of the Hawaii law and adds new provisions.

Subsection (1) is new. Subsection (1)(a) states the accepted rule that a party who accepts or pays does not "admit" the genuineness of indorsements and may recover from the person presenting the instrument when they turn out to be forged. Subsection (1)(b) recognizes competing equities of parties accepting or paying instruments bearing unauthorized maker's or drawer's signatures and thus obtaining acceptances or receiving payment. The exceptions apply only in favor of a holder in due course, and, within the provisions of section 3-201, to all subsequent transferees from a holder in due course. Such a warranty is not given by a holder in due course acting in good faith to a maker with respect to the maker's own signature, to a drawer with respect to the drawer's own signature, or to an acceptor of a draft if the holder in due course took the draft after the acceptance or obtained the acceptance without knowledge that the drawer's signature was unauthorized.

Subsection (1)(c) retains the common law rule which permits a party paying a materially altered instrument in good faith to recover, and a party who accepts such an instrument to avoid such acceptance. (see National City Bank of Chicago v. National Bank of Republic of Chicago (1921) 300 Ill. 103, 132 N.E. 832, 22 ALR 1153 and Wells Fargo Bank & Union Trust Company v. Bank of Italy (1931) 214 Cal. 156, 4 P.2d 781.)

Subsection (2) changes section 197-65, Revised Laws of Hawaii, by extending warranties of any indorser beyond the immediate transferee in all cases. The language of subsections (2)(b) and (c) is substituted for "genuine and what purports to be" in subsection 197-65(a), Revised Laws of Hawaii. The language of subsection (2)(a) is substituted for subsection 197-65(b), Revised Laws of Hawaii, in order to cover the case of the agent who transfers for another. Subsection (2)(d) holds to the position that the buyer does not undertake to buy an instrument incapable of enforcement, and that in absence of contrary understanding, the warranty is implied.

Subsection (3) provides that an indorsement "without recourse" limits the (2)(d) warranty to one that the indorser has no knowledge of such defenses.

Subsection (2)(e) is a substitution for subsection 197-65(d), Revised Laws of Hawaii. The transferor does not warrant against difficulties of collection apart from defenses, or against impairment of the credit of the obligor or even his insolvency in the commercial sense.

Subsection (4) is substituted for section 197-69, Revised Laws of Hawaii. It applies only to a selling agent as distinguished from an agent for collection.

Hawaii Law.

Rev. Laws Hawaii 197-65, 197-69

U.C.C. Sec. 3-418. Explanatory Notes.

Section 3-418 is a complete restatement of the Hawaii law.

This section follows the classic rule (Price v. Neal, 3 Burr. 1354 (1762)), under which a drawee who accepts or pays an instrument on which the signature of the drawer is forged is bound on his acceptance and cannot recover back his payment. Payments are final in favor of any holder in due course subject to the exceptions stated, namely, the recovery of bank payments as provided in section 4-301 and the liability for breach of warranty on presentment under section 3-417.

Hawaii Law.

Rev. Laws Hawaii 197-62

U.C.C. Sec. 3-419. Explanatory Notes.

Section 3-419 changes the rule in the Hawaii law and adds new provisions.

Subsections (1) and (b) provide that a holder may recover in conversion, upon demand, where there has been an unjustified refusal to return or pay the instrument; this is contrary to section 197-137, Revised Laws of Hawaii, holding that refusal to return or pay the instrument constitutes an acceptance.

Subsection (1)(c) is new; it provides that payment on a forged indorsement constitutes conversion of the instrument.

Subsection (2) is new; it provides for the measure of liability being in most cases the face amount of the instrument (see also section 1-201).

Subsection (3) is new; it is intended to adopt the rule that a representative (broker, etc.), who deals with a negotiable instrument for his principal in good faith is not liable to the true owner for conversion of the instrument, except that he may be compelled to turn over to such owner the instrument itself or any proceeds in his hands (see also sections 3-205 and 3-206).

Hawaii Law.

Rev. Laws Hawaii 197-137

**PART 5
PRESENT, NOTICE OF DISHONOR,
AND PROTEST**

U.C.C. Sec. 3-501. Explanatory Notes.

Section 3-501 effects a combination and simplification of the Hawaii law.

Part 5 of this Article simplifies the requirements of the original Act as to presentment for acceptance or payment, notice of dishonor, and protest. It assembles in one place all provisions as to when any such proceeding is necessary.

Subsection (1)(a) retains the substance of sections 197-143, 197-144, and 197-150, Revised Laws of Hawaii. The last sentence states the generally accepted rule that the holder may at his option present any draft for acceptance, and is not required to wait until the due date to discover whether the drawee will accept it; but that if he does make presentment and acceptance is refused, he must give notice of dishonor.

Subsections (1)(b) and (c), on presentment for payment, follow section 197-70 of the Hawaii Act with one important change. The check rule of section 197-186, Revised Laws of Hawaii, (see section 3-502(1)(b) and comment thereto) is extended by subsection (1)(c) to all drawers, and also to the acceptors and maker of domiciled--"payable at a bank"--drafts and notes. Thus drawers of drafts other than checks are not, as they were under section 197-70, Revised Laws of Hawaii, wholly discharged by failure to make due presentment, but, like drawers of checks, are discharged only as they may have suffered loss as provided in section 3-502(1)(b). As to domiciled paper, section 197-70, Revised Laws of Hawaii provides that ability and willingness to pay at the place named at maturity are "equivalent to a tender of payment"--that is to say, would stop the running of interest, but have no other effect. Subsection (1)(c) eliminates the "tender" language of section 197-70, Revised Laws of Hawaii, and the result is a reversal of the rule of case law that makers and acceptors of domiciled paper are not discharged to any extent by the holder's failure to make presentment even when the obligor has funds available in the paying bank on the date for presentment and the bank subsequently fails.

Subsection (3) eliminates the requirement of protest except upon dishonor of a draft which on its face appears to be either drawn or payable outside the United States (see sections 197-129 and 197-152, Revised Laws of Hawaii). The formalities of protest are covered by section 3-509 and substitutes for protest as proof of dishonor are provided for in section 3-510.

Hawaii Law.

Rev. Laws Hawaii 197-70, 197-89, 197-118, 197-129,
197-143, 197-144, 197-150, 197-151, 197-152,
197-157, 197-158, 197-186

25 H. 646

26 H. 519

U.C.C. Sec. 3-502. Explanatory Notes.

Section 3-502 effects a combination and simplification of the Hawaii law.

This section is the compliment of the preceding section and covers many widely scattered provisions of the Hawaii law.

The circumstances under which presentment or notice of dishonor or protest or delay therein are excused are stated in section 3-511. When not excused, delay operates as a discharge as provided in this section.

Subsection (1)(b) applies to any drawer as well as makers and acceptors of drafts and notes payable at a bank. The rule of section 197-186, Revised Laws of Hawaii, provides for discharge only where the drawer of a check has sustained loss through the delay. This section expressly limits the rule to loss sustained through insolvency of the drawee or payer; the purpose of the rule is to avoid hardship upon the holder through complete discharge and unjust enrichment of the drawer or other party who normally has received goods or other consideration for the issue of the instrument.

Subsection (2) retains the rule of section 197-152, Revised Laws of Hawaii, that an unexcused delay of a required protest is a complete discharge of all drawers and indorsers.

Hawaii Law.

Rev. Laws Hawaii 197-7, 197-70, 197-89, 197-144,
197-150, 197-152, 197-186

U.C.C. Sec. 3-503. Explanatory Notes.

Section 3-503 amounts to a combination and amplification of the Hawaii law.

This section states in one place all the rules applicable to the time of presentment; excused delay is covered by sections 3-511 (waiver), and 3-502 (discharge).

Subsection (1) contains new provisions stating the commercial understanding as to presentment of instruments payable after sight, and of accelerated paper.

Subsection (2) retains the substance of section 197-192, Revised Laws of Hawaii, as to determination of a reasonable time. It provides specific time limits which are presumed, as the term is defined in this Act (section 1-201) to be reasonable for uncertified checks drawn and payable within the continental limits of the United States. The time limit provided differs as to drawer and indorser.

Subsection (3) replaces sections 197-85 and 197-146, Revised Laws of Hawaii. It is intended to make allowances for the increasing practice of closing banks or businesses on Saturday or other days of the week.

Subsection (4) eliminates the provision of subsection 197-75, Revised Laws of Hawaii, permitting presentment "at any hour before the bank is closed", if the drawer has no funds in the bank; the change is made to avoid inconvenience to the bank.

Hawaii Law.

Rev. Laws 197-71, 197-72, 197-75, 197-85, 197-86, 197-144, 197-145, 197-146, 197-186, 197-192

U.C.C. Sec. 3-504. Explanatory Notes.

Section 3-504 effects a combination and simplification of the Hawaii law. It simplifies the rules as to how presentment is made and provides that any demand upon the party to pay is a presentment no matter how or where. Former technical requirements of exhibition of the instrument and the like are not required unless insisted upon by the party to pay (see section 3-505).

Subsection (2)(a) authorizes presentment by mail directly to the obligor. Subsection (5) makes it clear that presentment made under section 4-210, is proper presentment.

Subsection (3)(a) eliminates the requirement of sections 197-78 and 197-145(a), Revised Laws of Hawaii, that presentment be made to each of two or more makers, acceptors or drawees unless they are partners or one has authority to act for the other. The holder is entitled to expect that any one of the named parties will pay or accept, and should not be required to go to the trouble and expense of making separate presentment to a number of them.

Subsection (4) makes it clear that a draft so accepted must be presented at the bank so designated (see sections 3-501 and 3-502).

Hawaii Law.

Rev. Laws Hawaii 197-72, 197-73, 197-77, 197-78,
197-145

U.C.C. Sec. 3-505. Explanatory Notes.

Section 3-505 expands and modifies the Hawaii law. It supplements the provisionf of the Hawaii law by permitting the party to whom presentment is made to insist on additional requirements, e.g., exhibition of the instrument, its production at the proper place, identification of party making presentment, and a signed receipt on the instrument, or its surrender on full payment. Failure to comply with any such requirement invalidates the presentment and means that the instrument is not dishonored. The time for presentment is, however, extended to give the person presenting a reasonable opportunity to comply with the requirements.

Hawaii Law.

Rev. Laws Hawaii 197-74

U.C.C. Sec. 3-506. Explanatory Notes.

Section 3-506 amounts to an expansion of the Hawaii law. Hawaii law covers only the time allowed the drawee on presentment for acceptance; this section also covers the time allowed on presentment for payment.

Hawaii Law.

Rev. Laws Hawaii 197-136

U.C.C. Sec. 3-507. Explanatory Notes.

Section 3-507 is a rewording of the Hawaii law. Subsection (3) is new. It states general banking and commercial understanding. The time within which a payor bank must return items, and the methods of returning are stated in section 4-301. Under section 3-411 (3) a bank may certify an item so returned.

Hawaii Law.

Rev. Laws Hawaii 197-83, 197-149

U.C.C. Sec. 3-508. Explanatory Notes.

Section 3-508 combines and simplifies numerous sections of the Hawaii law.

Subsection (1) is intended to encourage and facilitate notice of dishonor by permitting any party who may be compelled to pay the instrument to notify any party who may be liable on it. Except as to collecting banks (section 4-212), subsection (2) extends the time, within which necessary notice must be given, to three days after dishonor or receipt of notice from another party. This time leeway eliminates the elaborate provisions as to time of mailing contained in sections 197-103 and 197-104, Revised Laws of Hawaii.

Subsection (3) retains the substance of sections 197-95 and 197-96, Revised Laws of Hawaii.

Subsection (4) retains the substance of section 197-105, Revised Laws of Hawaii.

Subsection (7) permits notice to be sent to the last known address of a party who is dead or incompetent rather than to his personal representative; this provision is intended to save time, as the name of the personal representative often cannot be easily ascertained, and mail addressed to the original party will reach the representative.

Hawaii Law.

Rev. Laws Hawaii 197-89 to 197-108

U.C.C. Sec. 3-509. Explanatory Notes.

Section 3-509 effects a simplification and combination of the Hawaii law.

Subsection (1) eliminates the requirement of section 197-156, Revised Laws of Hawaii, that protest must be made at the place of dishonor; it eliminates also the provisions of section 197-154, Revised Laws of Hawaii, permitting protest "by any respectable

resident of the place where the bill is dishonored, in the presence of two or more credible witnesses". Protest need not be in any particular form, so long as it certifies the matters stated in subsection (2).

Subsection (3) recognizes the practice of including in the protest a certification that notice of dishonor has been given to all parties or to specified parties.

Subsection (4) extends the time for making a necessary protest to coincide with the time for giving notice of dishonor. Any delay due to circumstances beyond the holder's control is excused under section 3-511.

Subsection (5) retains from section 197-155, Revised Laws of Hawaii, the provision permitting the officer to note the protest and extend it formally later.

Hawaii Law.

Rev. Laws Hawaii 197-153 to 197-156, 197-158, 197-160

U.C.C. Sec. 3-510. Explanatory Notes.

Section 3-510 is new; it is in accord with modern reformed procedure as to the admissibility of books and records, and provides for the admissibility of documents, stamps, writings and so forth as presumptive evidence of dishonor.

U.C.C. Sec. 3-511. Explanatory Notes.

Section 3-511 effects a combination and simplification of many sections of the Hawaii law.

Subsection (1) combines provisions found in sections 197-81, 197-113, 197-147 and 197-159, Revised Laws of Hawaii. Delay in making presentment either for payment or acceptance, in giving notice of dishonor or in making protest is excused when the party has acted with reasonable diligence and the delay is not his fault. The words "not imputable to his default, misconduct or negligence" found in sections 197-81, 197-113 and 197-159, Revised Laws of Hawaii, are omitted as superfluous.

Subsection (5) retains as standard commercial usage the meaning attached to "protest waived" by section 197-111, Revised Laws of Hawaii.

Subsection (2)(b) combines the substance of provisions found in sections 197-78, 197-80, 197-114, 197-115 and 197-130, Revised Laws of Hawaii.

Subsection (2)(c) combines provisions found in sections 197-82(a), 197-112 and 197-159, Revised Laws of Hawaii.

Subsection (3)(a) is new; it excuses presentment in situations where immediate payment or acceptance is impossible or so unlikely that the holder cannot be reasonably expected to make presentment.

Subsection (3)(b) extends section 197-148(c), Revised Laws of Hawaii, to include any case where payment or acceptance is definitely refused and the refusal is not on the ground that there has been no proper presentment. The purpose of presentment is to determine whether or not the maker, acceptor, or drawee will pay or accept, and when that question is clearly determined the holder is not required to go through a useless ceremony.

Subsection (4) retains the rule of sections 197-116 and 197-151, Revised Laws of Hawaii.

Subsection (6) retains the rule of section 197-110, Revised Laws of Hawaii.

Hawaii Law.

Rev. Laws Hawaii 197-79 to 197-82, 197-109, 197-111 to 197-116, 197-130, 197-147, 197-148, 197-150, 197-151, 197-159

PART 6 DISCHARGE

U.C.C. Sec. 3-601. Explanatory Notes.

Section 3-601 combines and rewords portions of the Hawaii law, and adds new provisions.

Subsection (1) contains an index referring to all sections of the commercial paper Article which provide for the discharge of any party.

The language of section 197-119, Revised Laws of Hawaii, as to discharge of the instrument, has left uncertainties as to effect of discharge upon the rights of the holder in due course; the Code eliminates this section and subsection (2) now distinguishes instead between the discharge of a single party and the discharge of all parties. Subsection (2) retains from subsection 197-119(d), Revised Laws of Hawaii, the provision for discharge by "any other act which will discharge a simple contract for the payment of money", and specifically recognizes the possibility of a discharge by agreement.

Subsection (3) substitutes for "discharge of the instrument" the discharge of all parties from liability on their contracts on the instruments; it covers part of the substance of sections 197-119(a), (b) and (e); 197-120(a) and (c) and 197-121 (a) and (b), Revised Laws of Hawaii. It states a general provision in lieu of the original detailed provisions, the principle being that all parties to an instrument are discharged when no party is left with rights against any other party on the paper.

Hawaii Law.

Rev. Laws Hawaii 197-119, 197-120, 197-121

27 H. 537

31 H. 12

31 H. 537

36 H. 509

43 H. 18

U.C.C. Sec. 3-602. Explanatory Notes.

Section 3-602 broadens the Hawaii law. It provides that any discharge of a party under any section of this Article is a personal defense of the party which is cut off when a subsequent holder in due course takes the instrument without notice of the defense.

The Hawaii law refers only to renunciation by a holder of his rights against any party to the instrument as a discharge, except as to a holder in due course without notice, and does not refer to any discharge as does the Code.

Hawaii Law.

Rev. Laws Hawaii 197-122

U.C.C. Sec. 3-603. Explanatory Notes.

Section 3-603 combines and rewords parts of the sections of the Hawaii law; and effects a change of the law in part. This section eliminates "payment in due course" found in sections 197-51, 197-88 and 197-119, Revised Laws of Hawaii.

Sections 197-171 to 197-177, Revised Laws of Hawaii, provide for payment of a draft "for honor" after protest; this is eliminated in the Code as obsolete, and subsection (2) provides that any person may pay with the consent of the holder.

Subsection (1) changes the law by eliminating the requirement in section 197-88, Revised Laws of Hawaii, that the payment be made in "good faith and without notice". It adopts the position that a payor is not required to obey an order to stop payment received from an indorser, but this is qualified by subsections (1)(a) and (b) respecting persons who acquire an instrument by theft, or through a restrictive indorsement (see sections 3-205 and 3-306). With the elimination of "payment for honor", sections 197-171 to 197-177, Revised Laws of Hawaii, subsection (2), provides that with consent of the holder, payment may be made by anyone, including a stranger. This subsection omits the provision of section 197-171, Revised Laws of Hawaii, by which a payor is "remitted to his former rights". Upon payment and surrender of the paper, the payor succeeds to the rights of the holder, subject to the limitation found in section 3-201 on transfer, that one who is a party to fraud or illegality affecting the instrument or who as a prior holder had notice of a defense or claim against it cannot improve his position by taking from a later holder in due course.

Hawaii Law.

Rev. Laws Hawaii 197-51, 197-88, 197-119, 197-121,
197-171 to 197-177

25 H. 646

31 H. 12

U.C.C. Sec. 3-604. Explanatory Notes.

Section 3-604 effects a combination and rewording of the Hawaii law with new provisions added.

Subsection (1) is new; it states the generally accepted rule as to the effect of tender.

Subsection (2) rephrases section 197-120(d), Revised Laws of Hawaii. The party discharged is one who has a right of recourse against the party making tender, whether the latter be a prior party or a subsequent one who has been accommodated.

Subsection (3) rewords the final clause of the first sentence of section 197-70, Revised Laws of Hawaii, and expands it to include instruments payable at more than one place (see also sections 3-501, 3-502 and 3-504).

Hawaii Law.

Rev. Laws Hawaii 197-70, 197-120

27 H. 537

31 H. 537

36 H. 509

43 H. 18

U.C.C. Sec. 3-605. Explanatory Notes.

Section 3-605 combines and rewords the Hawaii law.

The Hawaii law does not state how cancellation is to be effected, except as to striking indorsements

under section 197-48, Revised Laws of Hawaii. Subsection (1)(a) provides it must be done so as to be apparent on the face of the instrument, and the methods stated are exclusive.

Subsection (1)(b) restates section 197-122, Revised Laws of Hawaii, but is essentially in accord with it.

Subsection (2) is new and is intended to make clear that the striking of an indorsement, or any other cancellation or renunciation, does not affect the title.

Hawaii Law.

Rev. Laws Hawaii 197-48, 197-119(c), 197-120(b),
197-122, 197-123

U.C.C. Sec. 3-606. Explanatory Notes.

Section 3-606 effects a rewording of the Hawaii law and adds new provisions.

The words "any party to the instrument" in subsection (1) remove any uncertainty arising under the Hawaii law. The suretyship defenses provided are not limited, as in the Hawaii law, to parties who are "secondarily liable", but are available to any party in the position of a surety.

Subsection (1)(b) is new. The suretyship defense stated has been generally recognized as available to indorsers or accommodation parties.

Subsection (2) is new and states the generally accepted rule that reservation of rights against certain parties to be effective must be accompanied by notification to any party against whom rights are so reserved; notification of such reservation is not included in section 197-120(e), Revised Laws of Hawaii.

Hawaii Law.

Rev. Laws Hawaii 197-120

27 H. 537

31 H. 537

36 H. 509

43 H. 18

PART 7 ADVICE OF INTERNATIONAL SIGHT DRAFT

U.C.C. Sec. 3-701. Explanatory Notes.

Section 3-701 states the usual bank practice as to a "letter of advice" which has reference to certain established practices of international banking.

PART 8 MISCELLANEOUS

U.C.C. Sec. 3-801. Explanatory Notes.

Section 3-801 combines and rewords the Hawaii law. The revised language makes no important change in substance, and results only in a clarification and supplementation of the various sections of the Hawaii law.

Hawaii Law.

Rev. Laws Hawaii 197-178 to 197-183

U.C.C. Sec. 3-802. Explanatory Notes.

Section 3-802 is new and intended to settle conflicts in the decisional law as to the effect of an instrument as payment of the obligation for which it is given.

Subsection (1)(a) provides that the instrument is taken in absolute payment if a bank is obligated upon it.

Subsection (1)(b) provides that in all cases if there is an underlying obligation, the presumption is that the instrument is taken in conditional payment.

Subsection (2) is intended to remove any implication that a check given in payment of an obligation discharges a surety; the thirty-day period for presentment specified in section 3-503 does not affect the surety's liability.

U.C.C. Sec. 3-803. Explanatory Notes.

Section 3-803 is new. It is intended to supplement, not to displace existing procedures for interpleader or joinder of parties (see analogous provisions in section 2-607).

U.C.C. Sec. 3-804. Explanatory Notes.

Section 3-804 is new and is intended to provide a method of recovery on instruments which are lost, destroyed or stolen.

U.C.C. Sec. 3-805. Explanatory Notes.

Section 3-805 is new. It covers "nonnegotiable commercial instruments", which is to say, an instrument otherwise negotiable, but which is not payable to order or to bearer. This section resolves the uncertainties by making all of the provisions of Article 3 applicable to such instruments which are otherwise negotiable but which are not payable to order or to bearer, except that as to such there cannot be a "holder in due course".

ARTICLE 4

BANK DEPOSITS AND COLLECTIONS

The provisions of Article 4 of the Uniform Commercial Code codify rules and practices necessarily involved in the bank collection process and in the relationship between a bank and its depositors. The significance of uniformity in this field of commercial activity is dramatic from a purely quantitative viewpoint, as stated in the introductory comment to Article 4 in the official text of the Uniform Commercial Code:

The tremendous number of checks handled by banks and the country-wide nature of the bank collection process require uniformity in the law of bank collections. Individual Federal Reserve banks process as many as 1,000,000 items a day; large metropolitan banks average 300,000 a day; banks with less than \$5,000,000 on deposit handle from 1,000 to 2,000 daily. There is needed a uniform statement of the principal rules of the bank collection process with ample provision for flexibility to meet the needs of the large volume handled and the changing needs and conditions that are bound to come with the years.

Banking law in most jurisdictions, including Hawaii, which have not enacted the Uniform Commercial Code presents a haphazard amalgamation of common law principles of contract, agency and trust law; Federal Reserve regulations and operating letters; clearing house rules; and customs and usages.

The Hawaii Bank Act of 1931 has not undergone overall amendment to conform to modern conditions, and it is presently far from comprehensive in its coverage of bank collections and of the relationship between a bank and its customers.

Certain general policies are discernible throughout Article 4 and should be kept in mind when an analysis of any specific provision is under consideration.

The Time Factor in the Collection Process

Speed, as such, is highly desirable in the

collection process and furthers the interests of both banks and depositors. When problems arise in a complex transaction, which is operated mechanically to an ever increasing extent, it is important to have available quick and clear-cut answers. The sooner a depositor's check is collected, the less chance there is of defeating his right to draw against it. The sooner the bank completes the collection process, the more man-hours of labor are saved and the greater the decrease in outstanding items, which make up the "float", considered to offer a dangerous threat if allowed to become over-sized.

Flexibility

Improved collection methods and the solution of future and as yet unforeseeable intricacies would be thwarted by mandatory, rigid statutory rules. Section 4-103 of the Code, therefore, specifically permits "variation by agreement" of any section of the Article, subject to the basic liability imposed upon banks to act in good faith and to use ordinary care.

The Empirical Approach

In most part, Article 4 codifies, with relatively few changes, existing law and commercial practices as they have developed in the United States banking system. It is obvious that such banking processes as deposits, collections, payments, withdrawals, in the ordinary course of events function expeditiously. It is only in extraordinary situations, as when a check is not paid, a stop order is disobeyed, or a forged signature is discovered that it is necessary to consult the rules in order to determine rights and liabilities of parties concerned.

Scope of Article 4

Article 4 covers two basic areas of banking law. The first comprises collection and payment of deposited items, remittance of their proceeds, charge back of uncollected items, and circumstances under which a bank can recover payments improperly made. The second includes rights, duties, and liabilities vis-a-vis a bank and its depositor arising from the payment or non-payment of a check. Article 4 is divided into five parts: General Provisions and Definitions; Collection of Items: Depositary and Collecting Banks; Collection of Items: Payor Banks;

Relationship Between Payor Bank and Its Customer;
and Collection of Documentary Drafts.

Notable Precedents, Common Law and Otherwise

1. The rights of a depositor frequently depend upon a determination, based on the so-called intention of the parties or on custom and usage, of status. The determination of whether a collecting bank owns an item or is merely an agent for collection might hinge upon the form of indorsement, e.g. "for collection", "for deposit", or in blank. Section 4-201 of the Code states a basic presumption that a collecting bank is an agent for collection, regardless of the form of indorsement or lack of indorsement.

2. There are two conflicting decisional rules which may be applied in determining the liability of a collecting bank for loss sustained by a depositor resulting from the negligence or default of a subsequent bank in the collection chain. The New York rule makes the forwarding bank liable for such loss; the Massachusetts rule limits each bank's liability to its own negligence, subject to the duty of selecting proper intermediaries. Section 4-202 of the Code adopts the Massachusetts rule.

It should be noted that even in non-Code jurisdictions which find that a bank is a purchaser of an item received for collection or which follow the New York rule, banks have arrived at the same result reached by the Code by providing in the legends appearing on signature cards and deposit tickets that the bank is an agent for collection until it has realized on the item and that liability is limited to the bank's own negligence. This practice of determining rights and liabilities by setting forth the terms of the collection agreement in legends on deposit tickets, etc. might be subject to challenge on the grounds that the customer has not in fact assented to the terms of such adhesion contracts.

3. A common law rule provides that it is negligence per se for a collecting bank to accept anything except cash in payment of a collection item. In fact, the only items ever paid in cash are those paid over the counter of the drawee bank, a very small fraction of all items paid. Thus, according to common law, all banks are negligent most of the time in the remittances they accept. This absurd rule which requires all remittances and payments to be in

legal tender is set aside by section 4-211 of the Code which conforms the law with a long accepted and recognized practice.

Although in form Article 4 constitutes a large body of new statutory law, it is largely a matter of statutory sanction and recognition of banking practices and procedures, Federal Reserve regulations, and clearing house rules. Many inconsistencies are eliminated, gaps are filled, and certainty established.

PART I GENERAL PROVISIONS AND DEFINITIONS

- 4-101. Short Title
- 4-102. Applicability
- 4-103. Variation by Agreement; Measure of Damages; Certain Action Constituting Ordinary Care
- 4-104. Definitions and Index of Definitions
- 4-105. "Depository Bank"; "Intermediary Bank"; "Collecting Bank"; "Payor Bank"; "Presenting Bank"; "Remitting Bank"
- 4-106. Separate Office of a Bank
- 4-107. Time of Receipt of Items
- 4-108. Delays

PART 2 COLLECTION OF ITEMS: DEPOSITORY AND COLLECTING BANKS

- 4-201. Presumption and Duration of Agency Status of Collecting Banks and Provisional Status of Credits; Applicability of Article; Item Indorsed "Pay Any Bank"
- 4-202. Responsibility for Collection; When Action Seasonable
- 4-203. Effect of Instructions
- 4-204. Methods of Sending and Presenting; Sending Direct to Payor Bank
- 4-205. Supplying Missing Indorsement; No Notice From Prior Indorsement
- 4-206. Transfer Between Banks
- 4-207. Warranties of Customer and Collecting Bank on Transfer or Presentment of Items; Time for Claims

- 4-208. Security Interest of Collecting Bank in Items, Accompanying Documents and Proceeds
- 4-209. When Bank Gives Value for Purposes of Holder in Due Course
- 4-210. Presentment by Notice of Item Not Payable by, Through or at a Bank; Liability of Secondary Parties
- 4-211. Media of Remittance; Provisional and Final Settlement in Remittance Cases
- 4-212. Right of Charge-Back or Refund
- 4-213. Final Payment of Item by Payor Bank; When Provisional Debits and Credits Become Final; When Certain Credits Become Available for Withdrawal
- 4-214. Insolvency and Preference

PART 3 COLLECTION OF ITEMS: PAYOR BANKS

- 4-301. Deferred Posting; Recovery of Payment by Return of Items; Time of Dishonor
- 4-302. Payor Bank's Responsibility for Late Return of Item
- 4-303. When Items Subject to Notice, Stop-Order, Legal Process or Set-off; Order in Which Items May Be Charged or Certified

PART 4 RELATIONSHIP BETWEEN PAYOR BANK AND ITS CUSTOMER

- 4-401. When Bank May Charge Customer's Account
- 4-402. Bank's Liability to Customer for Wrongful Dishonor
- 4-403. Customer's Right to Stop Payment; Burden of Proof of Loss
- 4-404. Bank Not Obligated to Pay Check More Than Six Months Old
- 4-405. Death or Incompetence of Customer
- 4-406. Customer's Duty to Discover and Report Unauthorized Signature or Alteration
- 4-407. Payor Bank's Right to Subrogation on Improper Payment

PART 5 COLLECTION OF DOCUMENTARY DRAFTS

- 4-501. Handling of Documentary Drafts; Duty to Send for Presentment and to Notify Customer of Dishonor
- 4-502. Presentment of "On Arrival" Drafts
- 4-503. Responsibility of Presenting Bank for Documents and Goods; Report of Reasons for Dishonor; Referee in Case of Need
- 4-504. Privilege of Presenting Bank to Deal With Goods; Security Interest for Expenses

PART 1 GENERAL PROVISIONS AND DEFINITIONS

U.C.C. Sec. 4-101. Explanatory Notes.

Self-explanatory.

U.C.C. Sec. 4-102. Explanatory Notes.

Article 3 governs commercial paper, an area larger in scope than the Uniform Negotiable Instruments Law since it includes non-negotiable commercial instruments, and applies to items collected through banking channels in the absence of a specific provision in Article 4. In the case of conflict, Article 4 controls.

Investment securities under Article 8 may be handled by banks for collection purposes. In the case of conflict, Article 8 controls.

The conflict of laws rule provides that the liability of a bank in respect to presentment, payment, or collection is determined by the law of the place where the bank or its branch is located. This conflicts rule is subject to variation by agreement as provided in section 4-103(1).

Hawaii Law.

Rev. Laws Hawaii 178-39.5 .

In connection with the conflict of laws rule, it should be noted that in 1960 out-of-state branch banks were authorized (Session Laws of Hawaii 1960, Act 9).

U.C.C. Sec. 4-103. Explanatory Notes.

The basic liability imposed upon banks by Article 4 is to act in good faith and to use ordinary care in handling items for deposit, collection, and payment. Section 4-103 which provides the particular flexibility applicable to banking processes by authorizing "variation by agreement" also confines the flexibility by providing that no agreement is effective which purports to disclaim the basic liability.

Hawaii Law.

Rev. Laws Hawaii 178-79, 178-98, 178-35 (f) and (h), 178-37, 178-99, 178-106, 178-95

Hawaii statutes do not confer a blanket power to vary by agreement all provisions dealing with bank deposits and collections. However, two sections of the Revised Laws make certain specified actions subject to variation under certain kinds of agreements. Section 178-79 provides that the time and conditions on which repayment is made to depositors by a savings bank or a bank savings department shall be prescribed by by-laws or by contract between the bank and its depositors.

Section 178-98 provides that any provisions of that section may be modified or set aside by an agreement in writing between the bank and the person from whom a check, note or other instrument is received.

The Code recognizes Federal Reserve regulations and operating letters as effective to vary the provisions of Article 4. Two sections of the Revised Laws of Hawaii concerning power of members of the Federal Reserve System present contradictory provisions governing jurisdiction as between state banking laws and Federal Reserve regulations.

Section 178-35 (h) grants members of the Federal Reserve System "all powers not in conflict with the laws of the (State) which are conferred upon member banks by the Federal Reserve Act. Such member bank and its directors, officers and shareholders shall continue to be subject, however, to all liabilities and duties imposed upon them by any law of the (State)". Section 178-37, on the other hand, grants to members of the Federal Reserve System all powers conferred by the Federal Reserve Act, to be exercised subject to all restrictions and limitations imposed by the Act or by regulations of the Federal Reserve Board. The latter statute does not contain any limitation relating to State-imposed powers, liabilities, or duties.

The Hawaii statutes contain no provision dealing generally with clearing house rules, which, under the Code are effective to vary the provisions of Article 4. Clearing house rules, however, might be considered as included under section 178-35 (f) granting to banks those powers that "are usual in carrying on a banking business..."

The Revised Laws of Hawaii do not define "ordinary care", nor is the term used in the Hawaii banking law. Section 178-99 defines the term "due diligence" in respect to forwarding instruments for collection, and section 178-106 employs the term "care and diligence" with respect to fraudulent insolvency.

The Code limits damages for failure to exercise ordinary care to the amount of the item less the amount which could not have been realized by the use of ordinary care, and, if there is bad faith, other proximately caused damages. Section 178-95 limits recovery to a depositor in the case of non-payment of a check in the absence of malice to actual pecuniary damages.

U.C.C. Sec. 4-104. Explanatory Notes.

Subsection (1)(c): "Banking Day". Under this definition, when a bank is open only for limited functions, e.g., to receive deposits and cash checks, but with other departments closed, it is not part of the banking day.

Subsection (1)(d): "Clearing House". The definition is not limited to an association of banks since sometimes express companies, governmental agencies, and other non-banks deal directly with a clearing house.

Subsection (1)(e): "Customer". This term includes a bank carrying an account with another bank.

Subsection (1)(g): "Item". Item is a banking term and includes negotiable and non-negotiable paper calling for money and also similar paper governed by Article 8, Investment Securities, and Article 3, Commercial Paper.

Subsection (1)(h): "Midnight Deadline". A uniform, definite time limit is a valuable device under the mechanical approach employed in Article 4.

Subsection (1)(j): "Settle". This is a new term in bank collection language. When used without the qualifying adjective "provisional" or "final", it is unnecessary or unwise to determine whether the debit, credit or payment is tentative or final.

Subsection (1)(k): "Suspends payments". This term provides an objective test to determine when a bank is no longer operating as a part of the banking system.

Hawaii Law.

None.

U.C.C. Sec. 4-105. Explanatory Notes.

Banks are defined as determined by their duties in the processing of an item.

The definitions exclude banks to which items are issued as they do not take by transfer except where an item is issued to a payee for collection. A depository bank does not include the bank to which a check is made payable if given in payment of a mortgage. Under Article 3, Commercial Paper, such a bank has the status of a payee and not of a collecting bank.

A payor bank includes a drawee bank and also a bank at which an item is payable if the item consti-

tutes an order on the bank to pay, for it is then "payable by" the bank. If the "at" item is not an order (see section 3-121) then the bank is not a payor but will be a presenting or collecting bank.

If an item is "payable through" a bank, (see section 3-120) the bank will be a collecting bank if it handles the item and often a presenting bank; it is not a payor bank.

An intermediary bank includes the last bank in the collection process if the payor is not a bank. Usually, the last bank is also a presenting bank.

Hawaii Law.

Rev. Laws Hawaii 178-2, 178-3, 178-4, 178-5.

The Revised Laws of Hawaii define "bank", "commercial bank", "savings bank", and "foreign bank" as determined by organization and type of business operation.

U.C.C. Sec. 4-106. Explanatory Notes.

The bracketed phrase "maintaining its own deposit ledgers" is optional language available to make maintenance of its own deposit ledger a prerequisite of separate status of a branch bank.

It is assumed that it is not desirable to make each branch a separate bank for all purposes; for instance, warranties by one branch to another branch do not make sense.

Hawaii Law.

Rev. Laws Hawaii 178-39.5, 178-98.

Section 178-39.5 requires out-of-state branches to maintain separate accounts, and section 178-98 provides that branches of a bank are deemed separate banks for purposes of receiving for deposit, collection, or other purposes checks, notes, or other instruments, drawn on or payable at another branch of the same bank.

These provisions of Hawaii law pertaining to the status of branch banks are narrower than the

Uniform Commercial Code section since the presumption of separate status applies only as to branches of the same parent bank. On the other hand, Hawaii law is broader than the Code section in treating a branch as a separate bank "for any other purpose" whereas the Code treatment is limited to the purpose of "computing time within which and determining the place at or to which action may be taken or notices or orders shall be given."

U.C.C. Sec. 4-107. Explanatory Notes.

In order to facilitate the processing of items received and the completion of the accounting operations, a bank may establish a 2 p.m. or later cut-off hour. Items or money received after the cut-off hour or after the close of the banking day (as defined in section 4-104) (c) may be treated as received at the opening of the next business day. This section codifies a widespread banking practice which is commonly set forth in bank collection agreements.

Hawaii Law.

None

U.C.C. Sec. 4-108. Explanatory Notes.

Other sections of the Code impose time limits for the handling of items (4-202 (2), 4-212, 4-301, 4-302). These limits may be varied by agreement, by Federal Reserve regulations or operating letters, clearing house rules, or the like under section 4-103.

In addition, this section permits a collecting bank to extend the time limit an additional banking day in a good faith effort to secure payment with respect to specific items and in the absence of instructions to the contrary. This provision is an instance of compromise between two of the general principles underlying Article 4, flexibility and speedy collections.

The time extension does not operate to discharge secondary parties; therefore, it also extends the time for presentment or payment under sections 3-503 and 3-506 of Article 3. Where Article 3 and Article 4 conflict, this Article controls (section 4-102 (1)).

Extension of time limits in cases of certain emergencies applies not only to time limits imposed by the Code but also to those imposed by instructions, agreements, Federal Reserve regulations or operating letters, clearing house rules, or the like. The bank has the burden of proof as to the exercise of such diligence as the circumstances require (section 4-202 (2)).

Hawaii Law.

Rev. Laws Hawaii 178-99, 197-71, 197-186, 197-192, 197-81.

The Hawaii law does not specify precise terms for time limits in the collection process but is in terms of "reasonable time" in regard to laws governing the presentation of negotiable instruments (section 178-99). Section 197-71 pertaining to time of presentment of negotiable instruments and section 197-186 pertaining to time of presentment of checks specify that presentment must be made within a reasonable time. Finally, section 197-192 provides that "reasonable time" must be determined in the light of the nature of the instrument, business usage, and the facts of the particular case.

Section 197-81 which provides that delay in presentment of negotiable instruments is excused when caused by circumstances beyond the control of the holder probably has substantially the same effect as the Code provision for extension of time limits in cases of certain emergencies.

PART 2 COLLECTION OF ITEMS: DEPOSITARY AND COLLECTING BANKS

U.C.C. Sec. 4-201. Explanatory Notes.

A major problem in the bank collection process has been to determine whether a bank is a purchaser of an item or an agent for collection. This section of the Code establishes a strong presumption that the relationship between a customer initiating collection

and a depository or a collecting bank is one of principal and agent. The presumption of agency pertains regardless of indorsement, unless a contrary intent clearly appears, and continues until the settlement given by the collecting bank becomes final. An example of a clear contrary intent that would rebut the presumption is the case of collateral papers establishing or an item with a legend stating that the item is sold absolutely to the bank.

The presumption of agency is consistent with prevailing law and practice today and with other provisions of Article 4 (section 4-212, Right of Charge-Back or Refund, and section 4-214, Insolvency and Preference). The practical significance of the agency concept to the depositor is that he bears the risk of loss in the event of non-payment or insolvency of a bank in the collection chain prior to final settlement; he has preference rights as an owner against a collecting or a payor bank under the provisions of section 4-214 (except in cases of National Banks); and the dollar limitations of Federal Deposit Insurance are measured by his claim rather than that of the collecting bank.

The ownership rights of a customer initiating collection or of a bank with a security interest are protected with respect to an item indorsed "pay any bank" or the like. Only a bank may acquire the rights of a holder unless it transfers the item so indorsed out of banking channels by special indorsement. In such a case, the transferee might become a holder in due course free of the ownership rights of the customer initiating collection. A bank making such a transfer, however, would be liable to the customer if the transfer was prompted by lack of good faith or lack of ordinary care.

Hawaii Law.

Rev. Laws Hawaii 178-98

Section 178-98 is consistent with the Code provision to the extent that credit allowed by a bank is provisional, and collection risks are placed on the depositor. Section 178-99 similarly exempts "forwarding bank and intermediate agencies" from liability in cases of insolvency or other default of a collecting or payor bank. 28 H 35 (decided before the Hawaii Bank Act of 1931) held that an indorsement to "pay to any bank or banker or order, prior indorsements guaranteed" is not a restrictive

indorsement and that title to an item so indorsed passes to a collecting bank although a collecting or depository bank may be considered an agent under certain circumstances.

U.C.C. Sec. 4-202. Explanatory Notes.

Section 1-203 of the U.C.C. sets forth a basic principle that good faith is required in the performance or enforcement of every contract and duty under the Code. In addition, section 4-202 requires that a bank must use ordinary care in performing its collection functions. Section 4-103 proscribes any variation of the two fundamental requirements of good faith and ordinary care.

The time within which a collecting bank is required to perform the various tasks in the collection process is midnight on the next banking day following the banking day on which the bank receives the item or notice. Flexibility is provided by permitting action within a reasonably longer time, but the bank has the burden of proof; the time limit is also subject to variation by agreement (section 4-103), under the provisions regarding time of receipt of items (section 4-107), and in the case of delay (section 4-108).

The U.C.C. adopts the Massachusetts rule that subject to the duty of using ordinary care in selecting intermediary banks and in giving proper instructions, a bank is not liable for the misconduct or insolvency of another bank, nor is a bank liable for the loss of or destruction of an item in transit or in the possession of others.

Hawaii Law.

Rev. Laws Hawaii 178-23.5, 178-98, 178-99, 197-71, 197-81, 197-144, 197-186, 197-192

The statutory law of Hawaii contains no general provision relating to the standard of care required of collecting banks in the collection process, but it does include provisions that are equivalent to the "Massachusetts rule". Hawaii statutes provide certain standards of care applicable to collecting banks: Specifications of acts in the collection process which constitute "due diligence"; a requirement that notice of dishonor or non-payment or

return of an item must be "duly sent"; a requirement that items for collection shall be forwarded "in the usual course of business"; a requirement that certain actions shall be performed by the next succeeding business day following receipt of an item; and a requirement that the length of time taken for collection shall be a reasonable time as prescribed by the laws applicable to presentation of negotiable instruments.

It should be noted that the last paragraph of section 178-98 (Rev. Laws Hawaii) allows variation by written agreement thus providing for flexibility in the collection process although not specifically limited by the good faith and ordinary care limitations set forth in the Code.

U.C.C. Sec. 4-203. Explanatory Notes.

This section adopts a "chain of command" theory which renders it unnecessary for an intermediary or collecting bank to determine whether its transferor is authorized to give instructions. A rule is established whereby in general only a collecting bank's immediate transferor can give it instructions which affect it or constitute notice.

Instructions from a transferor cannot relieve a collecting bank of the underlying obligations of good faith and ordinary care. The remedy of the owner who suffers a loss lies against the transferor if wrongful instructions have been given.

It should be noted that this section applies only to collecting banks, for payor banks have a duty to make proper payment based upon all of the rules of Articles 3 and 4.

Hawaii Law.

None.

U.C.C. Sec 4-204. Explanatory Notes.

This section of the Code, after listing factors to be considered by a collecting bank in selecting a method and routing for sending and presentment purposes, codifies the practice of direct sending to a

payor. Direct presentment to a payor bank is consistent with existing banking practice and is justified by the need for speed, the general responsibility of banks, and Federal Deposit Insurance protection. Direct sending to a non-bank payor also is approved when authorized by Federal Reserve regulation or operating letter, clearing house rule, or the like. In the case of direct sending to a non-bank payor authorized only by instructions of the collecting bank's transferor, the transferor (other than the owner of the item) is responsible for the propriety of the authorization.

Hawaii Law.

Rev. Laws Hawaii 178-98, 178-99

Existing statutes do not prescribe general standards for proper sending of items but merely provide that items shall be sent in course of collection by mail, in the usual course of business, or otherwise.

Direct sending is authorized in the case of a payor bank and to certain non-bank payors. Section 178-98 specifies that an item for collection may be sent to the bank by or on which it is drawn or at which it is made payable, to any Federal Reserve bank, or to any other bank in the usual course of business. The last paragraph of this section which permits modification of its provisions by written agreement might be interpreted to include authorization of direct presentment to a non-bank payor if the agreement is to that effect. Section 178-99 authorizes forwarding of an item for collection to the bank on which it is drawn or at which it is payable, to a Federal Reserve bank, to any banking agency, or to a clearing house if both the collecting bank and the bank on which the item is drawn or at which it is payable are members. This section does not provide for direct sending of items to non-bank payors.

U.C.C. Sec. 4-205. Explanatory Notes.

The approval of the present bank practice of supplying missing indorsements of depositors is designed to speed up collections. It enables a depositor to give instructions that checks payable to him be sent directly to his bank for deposit and eliminates any necessity to return to a depositor items he may have failed to indorse.

Another rule designed to speed up the collection process permits an intermediary bank, or a payor bank which is not also a depository bank, to ignore restrictive indorsements of any person except the bank's immediate transferor. However, when the owner of an item indorses it "for deposit" or "for collection", he is entitled to rely on such an indorsement as reasonable protection against further negotiation of the item to a holder in due course by a finder or thief; therefore one bank in the collection chain is held responsible for acting in accord with the endorsement, and the rule established by the Code places this responsibility on the depository bank.

Hawaii Law.

None.

U.C.C. Sec. 4-206. Explanatory Notes.

Transfer of an item between banks may be effected by any agreed method which identifies the transferor for tracing purposes or in case recourse is necessary. Simplicity furthers the aim of speed in the collection process, and since the responsibilities of the various banks are established by the Code, liability is no longer dependent on the formal requirements of sections 30 to 32 of the Negotiable Instruments Law.

Hawaii Law.

Rev. Laws Hawaii 197-30 to 197-32.

Sections 197-30 to 197-32 as applied to transfer of an item between banks would be inapplicable.

U.C.C. Sec. 4-207. Explanatory Notes.

This section applies to customers and collecting banks the warranties which apply to a holder or transferor of commercial paper (U.C.C. 3-414 and 3-417). The warranties under Article 4 cover "items", a broader category than the "instruments" governed by Article 3.

A customer or a collecting bank makes the following warranties to a payor who in good faith pays or accepts an item: a) Good title, b) No knowledge of unauthorized signature, and c) No material alteration. Warranty (b) is not given by a holder in due course acting in good faith to a maker with respect to the maker's signature, to a drawer with respect to the drawer's signature, or to an acceptor if the holder in due course took the item after the acceptance or obtained the acceptance without knowledge that the drawer's signature was unauthorized.

Warranty (c) is not given by a holder in due course acting in good faith to the maker of a note, to the drawer of a draft, to an acceptor with respect to an alteration made prior to the acceptance of an item taken by the holder in due course after acceptance, or to an acceptor with respect to an alteration made after acceptance.

A customer or collecting bank warrants to a transferee upon receipt of settlement or other consideration, or to a subsequent collecting bank warranties similar to those given to payors as listed above. In addition, a transferee or a subsequent collecting bank are given warranties that no defense is good against the transferor and that the transferor has no knowledge of insolvency proceedings with respect to the maker, acceptor, or drawer of an unaccepted item. A transferor who receives consideration for an item also engages to pay the amount of the item upon dishonor and protest. This is equivalent to the indorser liability under the Uniform Negotiable Instrument Law.

The warranties and engagement to honor imposed by this section arise even in the absence of an indorsement or words of warranty. A bank can probably transfer an item for consideration without incurring the engagement liability by exercising its right to vary by agreement the provisions of Article 4 (section 4-103) and employing a "without recourse" indorsement. Damages for breach of warranty or engagement to honor are limited to the amount of consideration plus related charges and expenses, and a claim for breach of warranty must be made within a reasonable time.

The Code, by this section, adopts the rule of Price v. Neal, 3 Burr. 1354 (1762) which imposes on the payor bank the responsibility to know its drawer's signature. In the case where a drawer's

signature is forged and neither the depositor nor any collecting bank has knowledge of the forgery, the payor bank will bear the loss. If one of the prior parties in the collection chain had knowledge of the forgery at the time he transferred the item, the payor bank can recover from that party on a breach of warranty.

In the case where an indorsement is forged or missing, the payor can recover payment which it has made from the collecting bank or prior indorsers since the collecting bank warrants good title.

The effect of the warranties established by the Code is tantamount to the relief afforded against forged indorsements by the "prior indorsements guaranteed" indorsement. Banks may continue to use this indorsement, however, until the Code is uniformly adopted because some presentments will originate or come from non-Code states.

Hawaii Law.

Rev. Laws Hawaii 197-65 and 197-66

This section of the Code rewords, combines, and modifies sections 197-65 and 197-66 of the Revised Laws of Hawaii, as applied to the bank collection process.

U.C.C. Sec. 4-208. Explanatory Notes.

A collecting bank which extends credit on an item, accompanying document or the proceeds of either has a security interest to the extent stated in this section and to that extent is a holder for value and a holder in due course if other requirements for that status are satisfied.

The security interest covers all items in a single deposit or received under a single agreement and a single extension of credit.

The great majority of items handled for collection are in fact collected, and in such normal cases the bank's security interest is self-liquidating. Until final settlement and in cases of non-collection, the security interest is subject to the provisions of Article 9 of the Code, except that there is no requirement of a security agreement or of filing and the bank's security interest is accorded a priority.

Hawaii Law.

None.

U.C.C. Sec. 4-209. Explanatory Notes.

The security interest of a bank is "value" for the purpose of determining status as a holder in due course. This section is in accord with Article 3 and the Uniform Negotiable Instruments Law.

Hawaii Law.

Rev. Laws Hawaii 197-26 and 197-52

This section of the Code is in accord with sections 197-26 and 197-52 as to what constitutes a holder in due course.

U.C.C. Sec. 4-210. Explanatory Notes.

This section codifies the existing practice of presentment by notice by a collecting bank of trade acceptances and documentary and other drafts drawn on non-bank payors. If the payor receives the notice and ignores it, the item is dishonored. Notice of dishonor charges parties secondarily liable. A payor may, however, require a collecting bank to meet the requirements of section 3-505 of the Code which include exhibition of the item.

Hawaii Law.

Rev. Laws Hawaii 197-72 to 197-75

This section of the Code creates an exception as to collecting banks to section 197-72 to 197-75 regarding requirements of place of presentment and exhibition of items.

U.C.C. Sec. 4-211. Explanatory Notes.

This section sets forth in detail the various authorized forms of remittances which a collecting bank may properly receive in settlement of an item without incurring liability if the remittance itself is not paid. The risk of non-payment is placed on

the owner of the item rather than on the collecting bank. Settlements by remittance drafts usually occur when the banks in the collection chain do not have accounts with one another. Use of the remitting bank's own cashier's check is strictly circumscribed. It may be used only to pay a collecting bank which is a member of the same clearing house or group as is the remitting bank. While not specifically mentioned, cash is an authorized media of remittance although rarely employed.

When settlement is made by remittance draft or authorization to charge, the depositor does not become a creditor of the depository bank until the remittance draft or authorization is itself finally paid to the depository bank. In this situation, the depositor bears the loss if the remittance is not paid, provided the collecting bank takes timely action in processing the remittance upon receipt. If the collecting bank fails to process the remittance by its midnight deadline, the collecting bank is accountable to the depositor for the proceeds of the check, even if the remittance is not ultimately paid. If the person receiving the settlement authorizes remittance by a check or obligation not specifically approved under this section, the settlement becomes final at the time of receipt of the remittance, and the person receiving the settlement assumes the risk of non-payment of the remittance instrument. A collecting bank which receives an unauthorized form of remittance may, before its midnight deadline, forward it for collection without liability even if the remittance is dishonored. However, if a collecting bank makes a practice of accepting unapproved remittances from a specific payor bank, the presenting bank is deemed to have authorized the improper remittances, and the burden of risk of non-collection of the improper remittance shifts from the owner of the original item to the presenting bank.

This section conforms the law to banking practice since bank collection agreements have generally authorized banks to accept drafts, checks or credit as conditional payment in lieu of cash.

Hawaii Law.

Rev. Laws Hawaii 178-98, 178-99

Section 178-99 provides that a collecting bank may accept the exchange or draft of a collecting bank "of payor bank". The word "of" is probably a typographical or clerical error since the wording of the

section as enacted in 1931 (not since amended) and as set forth in the Revised Laws of 1935 and 1945 is "collecting bank or payor bank".

The Hawaii statutes authorize the following forms of remittance: money, a check or draft of a bank on or by which the instrument is made payable, a check or draft of a bank to or through which the instrument is forwarded for collection, credit with a Federal Reserve bank, and credit with a bank designated as a depository by the forwarding bank. There is no specific authority comparable to that found in the Code for a collecting bank to accept cashier's checks or certified checks.

A collecting bank is not liable under the Hawaii statutes if it acts within a reasonable time and if the remittance is approved. The case of an unauthorized or improper remittance is not covered, nor are there any provisions governing final settlement. However, section 178-98 states that until the proceeds of any check or instrument providing for the payment of money have been received in actual money or in solvent credit on the books of a Federal Reserve bank or a bank designated as a depository by a forwarding bank, the receiving bank is not liable.

U.C.C. Sec. 4-212. Explanatory Notes.

This section of the Code provides a statutory right of charge-back or refund available to a collecting bank which has made a provisional settlement on learning that it will not receive a final settlement for an item. The right terminates when the collecting bank receives final settlement. In order to charge-back an item, unless direct returns are authorized, each collecting bank in the collection chain must return the item or send notification of the facts by its midnight deadline or within a longer reasonable time after it learns the facts.

Subsection (2) providing for so-called "direct returns" is made optional. It authorizes an intermediary or payor bank to return an unpaid item directly to the depository bank and obtain reimbursement. The rationale of the "direct returns" machinery is that there is no need to send an item back through the collection chain in order for each intermediary bank which has credited the amount of the item to its predecessor in the chain to make an off-setting debit entry. The off-setting debit is unnecessary because each intermediary bank, as the item

progresses to the payor, both gives and receives a credit; thus the two entries cancel each other. Therefore there is no need for an intermediary bank to handle the item after dishonor or even to receive notice of the dishonor. The payor, which may have remitted for the item to the presenting bank, must get a refund; it draws a draft to its own order on the depositary bank and sends the draft along with the dishonored item; the depositary debits its customer's account, pays the draft, and the collection transaction is at an end.

If the optional provision authorizing direct returns is omitted, the election to use direct returns would be on the depositary bank. If the provision is included, the payor bank, unless otherwise specifically instructed, is given the election. The direct returns provision is consonant with the underlying philosophy of the Code to speed up the collection process and to provide flexibility.

Subsection (3) authorizing charge-back or refund by a depositary bank which is also the payor is made subject to the rules of section 4-301, the deferred posting statute of the Code.

Subsection (4) relating to charge-back, as distinguished from the right of refund, states that charge-back is permitted irrespective of the cause of non-payment, including the depositary bank's own negligence. The customer is protected by the general obligation of good faith (sections 1-203 and 4-103) and the liability of any bank for failure to exercise ordinary care (4-103).

The final subsection fixes a rule for determining the rate of exchange if there is a charge-back or refund of a credit given in dollars for an item payable in a foreign currency. If the parties wish to be governed by a different rule, they may vary this provision by agreement.

Hawaii Law.

Rev. Laws Hawaii 178-98

The Hawaii statute provides a similar permissive right of charge-back or refund, regardless of whether or not the item itself can be returned, but does not provide specifically for sending notification of the facts within the deadline time in case the item is not returned. The statute does not have a "midnight deadline", but a bank of deposit is required to act

with respect to an item at or before the end of the business day next succeeding the day on which an item is deposited, and a collecting bank under section 178-99 is required to act within a reasonable time as established by rules applicable to presentation of negotiable instruments.

Hawaii law has no direct returns statute or rule for determining the amount of charge-back or refund in the case of an item payable in foreign currency. Its deferred posting provision is generally in accord with the Code, except for the midnight deadline.

U.C.C. Sec. 4-213. Explanatory Notes.

One of the key provisions of Article 4 is the concept of "final payment" as applied to a payor bank. Specific rules are prescribed to determine at what point of time the payor bank has made final payment and can no longer revoke the provisional credit and return the item. Final payment marks the last step in the collection process and the beginning of the return flow of the proceeds of the item. An item is finally paid when the payor bank has done any of the following:

- 1) Paid in cash;
- 2) Settled without reserving a right to revoke the settlement and without having such a right by statute, clearing house rule, or agreement;
- 3) Completed the process of posting; or
- 4) Made a provisional settlement and failed to revoke the settlement in the time and manner permitted by statute, clearing house rule, or agreement.

In practice, most final payments are accomplished when a payor bank has completed the process of posting an item to the account of the drawer. The time of final payment, then, turns on the individual payor bank's own practices and procedures. The process of posting involves at least two steps, a decision to pay or to dishonor is made depending upon whether the item is found to be in good form and whether there are sufficient funds in the drawer's account; and the item is actually posted to the account. Both of these steps must be completed. The mechanical act of posting may occur either before or after the decision. Until the process is completed,

the credit belongs to the drawer and is subject to his control and to the claims of his creditors. Once the posting process is accomplished, the payor bank's liability runs to the owner of the item. In normal practice under deferred posting, provisional credit will be given on receipt of an item; so the decision to pay is automatic, unless there is insufficiency of funds in the account, unless there is an outstanding stop order against the check, unless the check is a forgery, unless the check has been altered, unless etc. The crucial point is that the decision is made when the determination is to dishonor and return, not when the determination is to pay.

When provisional credits are given along the chain of collection through a clearing house or by debits and credits in an account between them, they all become firm and final without further action when the process of posting is completed by the payor bank. Each intermediary bank which has given a provisional credit then becomes a debtor of the bank to which the credit was given, and the agency status between a depositor and his bank terminates and the bank becomes a debtor to the depositor for the amount of the item.

Under non-Code law there are two lines of decisions as to what constitutes final payment. One is the "power to recapture" theory which holds that payment is not final so long as the bank has the power to recapture the payment. The other line of cases adopts the "intention to honor" theory, which is the one adopted by the Code--a payment is final when the bank has indicated an intention to honor the item.

The Code specifically in subsections (4) and (5) provides when a credit given by a bank to its customer for a deposited item becomes available for withdrawal by the customer as of right. In a case where the bank receives a provisional settlement for the item, the credit becomes available for withdrawal by the customer as of right when the settlement becomes final and the bank has had a reasonable time to learn that the settlement is final. In a case where the bank is both the bank of deposit and the payor bank and it has finally paid the item, the credit becomes available for withdrawal by the customer as of right at the opening of the bank's second banking day following receipt of the item. In case a bank permits withdrawal before the elapse of the time periods indicated and an item is dishonored and returned, the depository bank has the right of charge-back under section 4-212 (4). In a case of a deposit in cash in a bank,

it is final when made, but the deposit does not become available for withdrawal by the depositor as of right until the opening of the next banking day following receipt of the deposit. The right of withdrawal in all the cases mentioned above is subject to the bank's right of set-off against any indebtedness the depositor may owe the bank.

Hawaii Law.

Rev. Laws Hawaii 178-98

The Hawaii statute provides that any credit allowed by any bank is provisional, subject to final payment. In the case of a payor bank, an item must either be "found good or else returned unpaid, or notice of dishonor duly sent, at or before the end of the business day next succeeding the day on which the item was deposited". There is no statutory provision establishing rules for determining finality of payment by a payor bank, finality of provisional settlement between presenting and payor banks, or availability of credits for withdrawal.

U.C.C. Sec. 4-214. Explanatory Notes.

This section of the Code fixes the cut-off point of time for the completion or cessation of the collection process for items when a bank suspends payments. To the extent that the provisions give the owner of a collection item a priority claim against the assets of a failed drawee bank, this section is not applicable to National Banks without amendment of the National Bank Act. Jennings v. Guaranty Co., L. Ed. 869, 99 A.L.R. 1248 (1935). Under the severability section of the Code (section 1-108) there is no reason why this section should not apply to banks other than National Banks.

If payment is suspended by a payor or collecting bank before final payment of an item (section 4-213), the item should be returned to the presenting bank or the closed bank's customer.

If payment is suspended by a payor bank after final payment of an item but before final settlement (section 4-211 (3)) for it with a customer or the presenting bank, the owner has a preferred claim against the payor bank.

If payment is suspended by a payor or collecting bank after provisional settlement of an item, the suspension has no effect on the settlement becoming final if the finality occurs automatically (sections 4-211 (3); 4-213 (1)(d), (2) and (3)).

If payment is suspended by a collecting bank after it has received settlement but before making a final settlement with its customer, the owner has a preferred claim against the collecting bank.

Hawaii Law.

Rev. Laws Hawaii 178-98, 178-99, 178-131

Hawaii law has no statutory provisions to establish rules for cut-off times for items in the collection process at the time a bank suspends payment. Sections 178-98 and 178-99 provide that banks shall not be liable for loss occasioned by the insolvency of another bank.

It should be noted that there are at least two National Banks in Hawaii which would not be subject to this section of the Code by reason of the Jennings rule. Section 178-131 of the existing law prohibits preference on any assets of an insolvent bank unless a valid lien has been established or unless a priority is pursuant to the separation of assets of a bank's commercial and savings departments.

PART 3 COLLECTION OF ITEMS: PAYOR BANKS

U.C.C. Sec. 4-301. Explanatory Notes.

The deferred posting statute of the Code provides that a payor bank may revoke a provisional credit, if before its midnight deadline (midnight of the next banking day following the banking day on which it receives the item) or before it has made final payment, whichever is earlier, it returns the item or sends written notice of dishonor or non-payment if the item is unavailable for return. Similar rules are made applicable to cases where the payor bank is also the depositary bank but without the requirement of a settlement on the day of receipt.

Deferred posting is another device aimed at speeding up the collection process. A payor is permitted to remit first, then process all its items, and return those items not good for a refund within the deadline. It enables banks to organize a smoother flow of work.

It should be noted that if an item has been finally paid under section 4-213 (1), it cannot be revoked or the item returned, even though the return time has not yet run.

An item is dishonored when it is returned or notice sent. The Code provides in section 3-508 (2) and (4) that notice of dishonor by a bank must be sent before its midnight deadline and is deemed given when sent although not received.

Banks may agree upon the manner of returning items. An item received through a clearing house is considered returned when it is delivered to the presenting or last collecting bank, to the clearing house, or sent or delivered in accordance with clearing house rules. Other items are considered returned when sent or delivered to the bank's customer or pursuant to his instructions.

Hawaii Law.

Rev. Laws Hawaii 178-98, 197-104, 197-105

Hawaii's deferred posting and delayed return provisions are similar to those in the Code, but the deadline under section 178-98 is the end of the business day next succeeding the day on which an item is deposited, rather than the midnight deadline of the Code. The provisions of Hawaii Negotiable Instruments Law regarding the requirement of sending notice of dishonor are in substantial agreement with the Code, save the absence of a midnight deadline. There is no Hawaii statutory law comparable to the Code rules for determining when an item is returned.

U.C.C. Sec. 4-302. Explanatory Notes.

A payor bank is required to give the presenting bank a provisional credit by midnight of the banking day of receipt of an item or become liable to the depositor for the amount of the item, even in the case when the drawer does not have sufficient funds on deposit. Thus it is apparent that the payor bank must

process all of its checks prior to its midnight deadline. Retention of an item past that time to give the drawer additional time to cover the item will result in the bank becoming liable for the item and unable to revoke the provisional credit and return the item should the drawer be unable to raise sufficient funds. It should be observed that this automatic liability to be accountable for the amount of an item because it has been retained past the bank's midnight deadline applies only to a payor bank and not to a collecting bank and covers only checks, not drafts drawn on non-bank payors. A collecting bank's liability for failure to forward item within a reasonable time after receipt is not necessarily for the full amount of the item, but the amount of the item reduced by any amount which could not have been realized by the use of ordinary care (section 4-202).

Hawaii Law.

Rev. Laws Hawaii 178-98

Hawaii's deferred posting and delayed return statute grants a bank the right to give a provisional credit and have until the end of the business day next succeeding the day on which an item is deposited to dishonor or refuse payment of the item. It does not spell out the rights of the parties if the bank does not act within this time limit.

U.C.C. Sec. 4-303. Explanatory Notes.

Any knowledge, notice, legal process, or stop-order received by a bank or set-off exercised by a bank comes too late to prevent payment of an item and charging it to the customer's account if the bank has done any of the following:

- 1) Accepted or certified the item;
- 2) Paid the item in cash;
- 3) Settled for the item without reserving or having the right to revoke the settlement;
- 4) Completed the posting of the item to the customer's account or otherwise indicated an intention to pay, as by examination and action; or
- 5) Become liable for the item because of failure to settle for or return the item in time.

There is no priority as between items presented to a bank on a given day when the balance on hand is

insufficient to pay them all. Such items may be paid and charged to the customer's account in any order convenient to the bank which has the right to pay items for which it is itself liable ahead of those for which it is not even though the result is the dishonor of some items.

Hawaii Law.

Rev. Laws Hawaii 178-96

Hawaii's stop payment statute is less specific than the Code and merely provides that a bank which in good faith acts upon such an order shall be protected against the drawer or other parties.

PART 4 RELATIONSHIP BETWEEN PAYOR BANK AND ITS CUSTOMER

U.C.C. Sec. 4-401. Explanatory Notes.

The Code specifically grants a bank the right to charge a customer's account with any item which is otherwise properly payable from the account, even if the charge creates an overdraft. This carries with it an implied promise of the customer to reimburse the bank for the amount of the overdraft.

In the case of an altered item, a bank may charge a good faith payment against a customer's account according to the original tenor of the item. If an item has been completed by an unauthorized person, a bank may in good faith pay to a holder according to the tenor of the completed item unless the bank has notice that the completion is improper.

This section follows the policy of sections 3-115 and 3-407 (3) of the Code by protecting the drawee who pays an altered or completed instrument in good faith.

Hawaii Law.

Rev. Laws Hawaii 197-14, 197-124.

The Hawaii Negotiable Instruments Law would be modified by Article 3 of the Code (sections 3-115 and 3-407 (3)) to the extent that a holder in due course is protected in respect to altered and completed instruments. These provisions are parallel to this section of Article 4 in respect to drawee banks.

U.C.C. Sec. 4-402. Explanatory Notes.

A payor bank has a duty to honor its customer's items when there are sufficient funds in his account, and the bank is liable to its customer for damages proximately caused by wrongful dishonor of items. When dishonor occurs through mistake, as distinguished from willful or malicious dishonor, liability is limited to actual damages proved. The Code rejects the rule of defamation per se to the effect that wrongful dishonor of an item in itself entitles a merchant, trader or fiduciary to substantial damages without proof of actual damages, but it specifically provides that damages may include damages for an arrest or prosecution if proximately caused and proved.

Hawaii Law.

Rev. Laws Hawaii 178-95

The Hawaii statute limits damages for non-payment of a check through mistake or error to actual pecuniary damage, alleged and proved, caused by non-payment.

U.C.C. Sec. 4-403. Explanatory Notes.

Only a customer has the right to stop payment on an item drawn on his account, but once a check is certified or otherwise accepted, the customer cannot stop payment whether certification was secured by the customer or the payor bank. The acceptance is the drawee's engagement to pay, and he is not required to impair his credit by refusing payment for the convenience of the drawer.

The purport of this section is that stopping payment is a service which depositors expect and are entitled to receive.

The effective time for an oral stop order is fourteen days unless confirmed in writing within that period, and for a written order six months unless renewed in writing.

If a bank pays an item over a stop order, it is prima facie liable to its customer, but the burden of establishing the amount of loss resulting from such payment is on the customer.

Hawaii Law.

Rev. Laws Hawaii 178-96

Existing Hawaii statutory law recognizes the right of stop orders but does not prescribe the parties authorized to give the order or the time within which an order must be received by the bank. Further, the Hawaii statute applies only to a check or draft whereas the Code applies to the more comprehensive category of "any item".

The present Hawaii statute authorizes both oral and written stop orders which are made effective for a period of four months from the time of service on the bank; renewals, also effective for four-month periods, must be in writing.

U.C.C. Sec. 4-404. Explanatory Notes.

The Code provides that a bank is under no obligation to its customer to pay a check, other than a certified check, which is presented more than six months after date. The bank is not required to refuse payment of a stale check, but at its option may in good faith pay and charge the customer's account. If the customer does not want a stale check paid, it is his duty to make a stop payment order.

Certified checks are excluded from the general rule because they are primary obligations of the certifying bank the customer's account is charged at the time of certification and the obligation runs direct to the holder of the check (3-411 and 3-413).

Hawaii Law.

Rev. Laws Hawaii 178-97, 197-186, 197-187

Section 178-97 authorizes a bank to refuse payment for any demand instrument presented more than

six months from its date unless the drawer or maker expressly instructs the bank to pay. Section 197-186 provides, however, that a check must be presented for payment within a reasonable time after issue or the drawer will be discharged from liability to the extent of the loss caused by the delay. Section 197-187, in effect, exempts certified checks from the time limit by making certification by the drawee bank equivalent to an acceptance.

U.C.C. Sec. 4-405. Explanatory Notes.

Death or incompetency of a person generally terminates the authority of others to act on behalf of such person. However, in view of the tremendous volume of checks and other items handled by the banking system, a rule which would require banks to verify the continued life and competency of depositors would be unworkable. The Code legislates for this situation by providing that neither death nor incompetency of a depositor revokes the bank's authority to accept, pay, collect, or account for an item, until the bank has actual knowledge of the fact of death or of an adjudication of incompetence and has reasonable opportunity to act on the knowledge.

The Code also provides that even with knowledge, a bank may for ten days after the date of death, pay or certify checks drawn on or prior to the date of death, unless ordered to stop payment by a person claiming an interest in the account. This provision permits holders of checks issued shortly before death to cash them without the necessity of filing a claim in probate proceedings.

The term "a person claiming an interest in the account" is not precisely defined. It apparently includes anyone who claims an interest in the estate of the depositor as an executor, a creditor, an heir, or a beneficiary, and probably includes any other person asserting a claim, whether or not colorable. Since this provision is permissive, a bank may safely refuse to pay regardless of who requests the stop payment.

Hawaii Law.

Rev. Laws Hawaii 178-93

Hawaii statutory law has no express provision governing death or incompetence of a bank's customer;

however section 178-93 is pertinent in that it provides that adverse claimants to a deposit are not entitled to recognition by a bank without appropriate court process or indemnity bonding acceptable to the bank.

U.C.C. Sec. 4-406. Explanatory Notes.

A drawee bank has no right to charge the account of its customer with forged or with the raised amounts of altered items (sections 3-404, 3-418, 4-401). However, under the Code the customer has a duty to examine his bank statement and canceled items for his own forged or unauthorized signature and for alterations within a reasonable time after they are returned or are available and to report such irregularities to the bank. Failure to examine and notify bars him from asserting these matters against the bank if the bank establishes that it has suffered a loss by reason of such failure. The Code does not specify how many days constitute a reasonable time within which the customer must examine and report, but where there are successive forgeries or alterations by the same wrongdoer, the customer's failure to exercise reasonable care to examine and notify within fourteen days after the first item and statement were available to him will bar him as to any subsequent items paid by the bank in good faith prior to notification.

The customer's failure to examine and report will not protect the bank if the bank has been negligent, except that there is an absolute bar against a customer asserting a forged signature on an item after one year from the time the item and statement are made available. The absolute bar is also effective as to unauthorized indorsements which are not discovered and reported within three years.

Hawaii Law.

Rev. Laws Hawaii 178-97

The Hawaii statute, applicable only to checks, prescribes a time limit of one hundred and twenty days from the date of return to the depositor of a forged or raised check within which the depositor must notify the bank in order to charge it with liability. The statute further provides that unless a depositor calls at his bank within five months from date of payment to secure the return of his voucher, the bank's liability is cut off. The section probably does not apply to unauthorized indorsements since it is in terms of "forged or raised" checks.

U.C.C. Sec. 4-407. Explanatory Notes.

A bank's right of subrogation for instance in case of payment over a stop order, is for the purpose of preventing unjust enrichment to the extent necessary to prevent loss to the bank. In a proper case the payor bank is subrogated to the rights of a holder in due course against the drawer or maker, of a payee or other holder against the drawer or maker, and of a drawer or maker against the payee or other holder.

Hawaii Law.

None.

PART 5
COLLECTION OF DOCUMENTARY DRAFTS

U.C.C. Sec. 4-501. Explanatory Notes.

The Code defines a "documentary draft" (section 4-104 (f)) as a negotiable or non-negotiable draft with accompanying document, securities, or other papers to be delivered against honor of the draft.

The duty of a bank in handling a documentary draft for collection is to present it and accompanying documents, and if the draft is not paid or accepted in due course, to notify seasonably the customer. The duty exists even if the bank has bought the draft or extended credit for withdrawal as of right.

Hawaii Law.

None.

U.C.C. Sec. 4-502. Explanatory Notes.

A collecting bank need not present "on arrival" drafts until in its judgment a reasonable time for arrival of the goods has expired. The bank must notify its transferor of a refusal to pay or accept but need not present the draft again until it is so instructed or learns of the arrival of the goods.

Normally, the buyer-drawee will want the goods and will call for the documents and take and take up the draft when the relevant goods do arrive.

Hawaii Law.

None.

U.C.C. Sec. 4-503. Explanatory Notes.

This section states the rules applicable in the absence of instructions.

The duty of a presenting bank in case of honor or dishonor of a documentary draft is to deliver the documents to the drawee on acceptance if payable more than three days after presentment, otherwise on payment; and upon dishonor, to follow instructions from a referee in case of need or use diligence and good faith to ascertain the reason for dishonor, and to notify its transferor.

A presenting bank has a duty to follow reasonable instructions seasonably received with respect to goods represented by the documents and is entitled to reimbursement for expenses so incurred.

Section 2-514 of the Code provides the rules applicable when documents are deliverable on acceptance and when on payment.

If a draft is under a letter of credit, Article 5 of the Code controls.

Hawaii Law.

None.

U.C.C. Sec. 4-504. Explanatory Notes.

This section deals with situations in which storage of goods or other action becomes commercially necessary pending receipt of requested instructions, even if requested instructions are later received.

A presenting bank may deal with the goods in any reasonable manner after dishonor of a documentary draft and in the absence of seasonably requested instructions. The bank is given a lien on the goods or their proceeds to the extent of reasonable expenses, and the lien may be foreclosed in the same manner as an unpaid seller's lien (section 2-706).

"Reasonable manner" means reasonable in the light of business factors and the judgment of a business man.

Hawaii Law.

Rev. Laws Hawaii 178-71.

The Hawaii statute prohibits a bank from dealing in goods except property held as security for loans or in the collection of debts.

ARTICLE 5

LETTERS OF CREDIT

History of Letters of Credit

A letter of credit is a mercantile mechanism used almost exclusively at present in international trade but predicted for a role of ever-increasing importance in domestic trade. The historic connotation of a letter of credit dates back at least to the seventeenth century and is described in Davis, The Law Relating to Commercial Letters of Credit, p. 1 (second ed. 1954) as a document carried by a traveler in order to have ready access to cash or credit in a foreign country. The good name and financial status of the traveler's bank were substituted for his own less attractive personal credit. Story, in Story on Bills, para. 459 (1860 ed.), described a letter of credit as

an open letter of request, whereby one person (usually a merchant or banker) requests some other person or persons to advance money or give credit to a third person named therein, for a certain amount, and promises that he will repay the same, or accept bills drawn upon himself, for the like amount.

The simple traveler's letter of credit has evolved to become a primary device employed in financing international sales. As might well be expected, the development of practices involving commercial letters of credit and the consequent case law has centered in New York City and, in particular, has centered around a relatively few banking institutions.

Nature of a Commercial Letter of Credit

The primary mercantile function of a letter of credit is to facilitate sales of goods between remote buyers and sellers. The financial responsibility of a bank is substituted for that of the customer and at the same time it protects the customer by making payment conditional on the presentation of certain documents (typically documents of title) by the beneficiary.

A simplified plot will serve to illustrate the

letter of credit system. A buyer (termed "customer" under the Code) needs credit in order to arrange a long-distance sale. He arranges for his bank to issue a letter of credit in favor of his seller (termed "beneficiary" under the Code). The letter of credit provides that the bank will honor a draft drawn by the seller for the price of the goods, provided certain documents (bill of lading, invoice, insurance, etc.) accompany the draft upon presentment. The buyer promises to reimburse the bank and pay a commission. The bank issues the letter of credit and notifies the seller who, if he complies with the terms of the credit, is assured of payment by the bank.

Advantages of a Letter of Credit

(1) The buyer (customer) enjoys multi-benefits of efficiency and economy of financing. His working capital has not been encumbered, he can reimburse the issuer from the proceeds of the sale of the goods, he has assurance that the goods conform to the contract.

(2) The seller does not run the risk of non-payment, he is assured of immediate payment on shipment, he can readily transfer the proceeds of the credit to finance further transactions.

Principles of Letter of Credit Financing As Codified in Article 5

(1) The machinery of letters of credit deals with documents and is a structure apart from the intricacies ancillary to the underlying transaction. If that transaction be one of sale of goods, the rights of the parties affected depend upon principles set forth in Article 2; if the transaction involves the sale of investment securities, Article 8 is applicable; if the transaction involves the transfer of commercial paper, Article 3 will be applicable; if documents of title are transferred, Article 7 will be applicable; and if the transaction is intended to create a security interest, Article 9 will apply.

(2) The Code provides the basic ground rules defining and governing the legal relations, rights and duties among some of the various parties to a credit --especially between the issuer of a letter of credit and the beneficiary and between the issuer and a customer.

(3) A letter of credit is a contract indepen-

dent of the sales contract between the buyer (customer) and seller (beneficiary). The bank (issuer) is directly liable to the seller whether or not the buyer or seller has breached the underlying sales contract. Since a bank issuing letters of credit assumes no risks with respect to performance of the sales contract and functions only to finance the transaction, letters of credit can be written cheaply. The function is limited to three actions: receipt, examination and payment against documents.

(4) Article 5 is designed as a flexible codification of the law of letters of credit in order to admit of further development, in recognition of the changing patterns of commercial usage, and for lack of prescience of the future evolution and future problems which may arise in the field. Balance is sought through the allocation of commercial risks and responsibilities among the parties to a letter of credit transaction. For instance, on the one hand a high duty of care is placed upon the issuer to ensure that the terms of a credit are observed before payment is effected. On the other, the Code recognizes that issuers are primarily dealers in documents and should not be obligated to oversee underlying commercial transactions.

Precedents

There are existing rules governing letters of credit, but they are generally not rules of law. Most of the mercantile nations of the world subscribe to a system of customs and practices which has been devised by the International Chamber of Commerce, "The Uniform Customs and Practice for Commercial Documentary Credits". These rules are not considered controlling in the case of domestic letters of credit, and hence there is some confusion as to whether the principles of the Uniform Customs and Practice or principle of common law should govern in a given instance.

Since letters of credit have not been a matter of prior case law or legislation in Hawaii--they are mentioned only perfunctorily in one section of the Revised Laws, section 178-61--except for overlapping provisions of the Uniform Negotiable Instruments Law, the Explanatory Notes to the sections under Article 5 do not refer to Hawaii law.

ARTICLE 5

LETTERS OF CREDIT

- 5-101. Short Title
- 5-102. Scope
- 5-103. Definitions
- 5-104. Formal Requirements; Signing
- 5-105. Consideration
- 5-106. Time and Effect of Establishment of Credit
- 5-107. Advice of Credit; Confirmation; Error in Statement of Terms
- 5-108. "Notation Credit"; Exhaustion of Credit
- 5-109. Issuer's Obligation to Its Customer
- 5-110. Availability of Credit in Portions; Presenter's Reservation of Lien or Claim
- 5-111. Warranties on Transfer and Presentment
- 5-112. Time Allowed for Honor or Rejection; Withholding Honor or Rejection by Consent; "Presenter"
- 5-113. Indemnities
- 5-114. Issuer's Duty and Privilege to Honor; Right to Reimbursement
- 5-115. Remedy for Improper Dishonor or Anticipatory Repudiation
- 5-116. Transfer and Assignment
- 5-117. Insolvency of Bank Holding Funds for Documentary Credit

U.C.C. Sec. 5-101. Explanatory Notes.

Self-explanatory.

U.C.C. Sec. 5-102. Explanatory Notes.

The fundamental distinctions that are crucial in delimiting the scope of Article 5 are between bank and non-bank credits, and between documentary and "clean credits". Credits issued by a bank are covered by Article 5 if honor is conditioned upon presentation of a document of title or a documentary demand for payment. Credits issued by anyone other than a bank are within the scope of Article 5 only if honor is conditioned upon presentation of a document of title. The distinction between bank and non-bank credits is not pertinent to scope of coverage in the case of a

credit which is not conditioned on presentation of documents (a "clean credit") provided that it conspicuously states that it is a letter of credit or is conspicuously so entitled. "Conspicuous" is defined in part in section 1-201 (10) of the Code as "so written that a reasonable person against whom it is to operate ought to have noticed it. A printed heading in capitals...is conspicuous. Language in the body of a form is 'conspicuous' if it is in larger or other contrasting type or color. But in a telegram any stated term is 'conspicuous'. Whether a term or clause is 'conspicuous' or not is for decision by the court."

By eliminating those "clean credits" which are not clearly labeled, the Code obviates the question of admissibility of parol evidence to prove whether or not a given agreement is a letter of credit.

U.C.C. Sec. 5-103. Explanatory Notes.

Certain rights and duties of the parties to letters of credit are detailed in varying degrees under Article 5; therefore it is necessary to define precisely several terms employed only in respect to this Article and to refer to definitions of other terms that are employed throughout the Code or in other Articles.

The definition of "credit" or "letter of credit" is clearly inclusive of papers called "authorities to purchase or pay". Although the engagement to honor drafts or other demands for payment may be revocable or irrevocable, Article 5 does not provide a rule or presumption to determine which classification is applicable to any given unlabelled credit. This issue is left for determination according to general law in the light of particular facts (section 1-103) and with due regard to commercial practice (section 1-105). Section 2-325 of the Code, on the other hand, provides that in a contract for sale a letter of credit means an irrevocable credit. Legal significance of the classification for Article 5 purposes is spelled out in section 5-106 of the Code which deals with the time and effect of establishment of a credit.

A "documentary draft" or "documentary demand for payment" is defined so as to clarify the broad meaning of the word "document" as used in Article 5. This

definition is consistent with the definition of "documentary draft" under section 4-104 (f) but is to be differentiated from the definition of "document" in Article 9 on secured transactions where it is limited to documents of title (section 9-105 (1)(e)).

The definition of "issuer" makes it clear that non-banks may issue letters of credit, but the definitions of "advising bank" and "confirming bank" confine confirming and advising functions of credits to banks alone and evidently preclude non-banks from advising or confirming credits.

The definition of "customer" specifically includes a bank which requests another bank to issue a letter of credit for the former bank's customer. A particular transaction, therefore, may involve two customers, the buyer and his bank which requested the issuance of a credit. A consequence of the broad definition of "customer" involves the right of an issuing bank to reimbursement and apparently entitles the issuing bank to reimbursement both from the bank which requested the issuance of credit and from the ultimate customer.

The Uniform Customs and Practice is not clear on the matter of the responsibility of a bank which makes provisions with another bank to issue a letter of credit for its customer. The actual custom of New York banks is for the issuer first to seek reimbursement from the buyer and from the buyer's bank only in case of default of the buyer.

The definition of "customer" under Article 5 is to be distinguished from the meaning in Article 4 as defined by section 4-104 (1)(e).

The other definitions of this section will be noted where appropriate in the context of the sections in which they are used.

U.C.C. Sec. 5-104. Explanatory Notes.

This section provides that no particular form or phrasing is required for a letter of credit, except that a "clean credit" must conspicuously state that it is a letter of credit or must be conspicuously so entitled. A letter of credit must be in writing and signed by the issuer; these requirements, which can

be said to constitute a Statute of Frauds of a limited character, apply also to a confirmation or a modification of a credit or confirmation. A telegram satisfies these requirements if it identifies its sender by an authorized authentication which may be in Code.

U.C.C. Sec. 5-105. Explanatory Notes.

This section eliminates any question of whether consideration is necessary for a letter of credit. The rule is consistent with the results of case law which have generally reached the same conclusion under a number of different theories, such as a holding that consideration may move from either the customer or the beneficiary (Evansville Nat. Bank v. Kaufmann, 93 N.Y. 273, 279 (1883)) or estoppel (Johannessen v. Munroe, 158 N.Y. 641, 53 N.E. 535 (1899)).

U.C.C. Sec. 5-106. Explanatory Notes.

The issuer of a letter of credit is bound by its engagement from the time the credit is established. The rule of this section provides that a credit is established between the issuer and the customer as soon as the letter is sent to the customer or as soon as the letter or an authorized written advice of its issuance is sent to the beneficiary. The rule further provides that a credit is established between the issuer and the beneficiary as soon as the beneficiary receives the letter of credit or an authorized written advice of its issuance.

The leading case on the question of when a credit is established holds that mailing rather than receipt is the determinative moment (Bril v. Suomen Pankki Finlands Bank, 199 Misc. 11, 22, 97 N.Y.S. 2d 22 (1950)).

The rights of modification or revocation of a credit depend on whether it is classified as revocable or irrevocable, but the Code fails to provide guidelines or presumptions in making this determination. Existing law presents a conflict. The Uniform Customs and Practice contains a *presumption of revocability* while New York case law holds that there is

a presumption of irrevocability. Ernesto Foglino & Co. v. Webster, 217 App. Div. 282, 216 N.Y.S. 225, modified 244 N.Y. 516, 155 N.E. 878 (1926); Laudisi v. American Exchange Nat. Bank, 239 N.Y. 234, 146 N.E. 347 (1924).

The significance of a revocable letter of credit is the obligation it imposes upon the issuer to innocent third parties who have negotiated or honored drafts drawn under a credit before receiving notice of its revocation or modification. The obligation is not unduly burdensome for under section 5-114 (3) of the Code the customer has a general duty to reimburse the issuer, and this duty is made explicit in section 5-106. Although innocent third parties who have negotiated or honored drafts drawn under a revocable credit before receiving notice of its revocation or modification are protected, the Code curiously omits spelling out comparable protection in the case of an irrevocable credit.

U.C.C. Sec. 5-107. Explanatory Notes.

The obligation of an advising bank, defined in section 5-103 (e) as a bank which gives notification of the issuance of a credit by another bank, is to transmit accurately, but it does not include a duty to honor drafts drawn or demands for payment made under the credit. Decisional law would seem to be in accord with the rule that an advising bank which inaccurately states the terms of the credit is liable to the beneficiary. Murray Oil Products Co. v. Poons Co., 190 Misc. 110, 74 N.Y.S. 2d 814 (1947).

If the advice is not accurately transmitted by an advising bank, the issuer is bound only by the original terms of the credit.

The obligation and right of a confirming bank, defined in section 5-103 (f) as a bank which engages either that it will honor a credit already issued or that such a credit will be honored by the issuer or a third bank, are, to the extent of the confirmation, those of an issuer. A beneficiary who has received a confirmed credit, consequently, is entitled to the independent engagements of both the issuer and the confirming bank, including the right of reimbursement.

The provision which places the risk of accuracy of transmission and translation of messages relating to a credit on the customer, rather than on the issuer, is a codification of existing practice.

U.C.C. Sec. 5-108. Explanatory Notes.

This section of the Code provides rules applicable to notation credits, an area of letters of credit in which practice has been varied and in which there has been no case law directly in point. Much of the confusion has resulted from a failure to distinguish between two types of credit: a) notation credit and b) credit not requiring notation.

The general problem is one of identifying the drafts which the issuer is obligated to pay under a letter of credit engagement and consequentially codifying the rights and duties of the issuer and the holders of the drafts. Section 5-110 of the Code provides that a credit may be used in portions; thus a beneficiary may draw several drafts under a single credit. Even in the case of a credit that is not available in portions, the beneficiary may draw several drafts on the issuer, some or all of which may or may not comply with the letter of credit.

A credit which specifies that it is a notation credit must be noted appropriately by each purchaser of a draft so as to relate the draft to the credit. Such notation is made a condition to the issuer's obligation to honor immediately the draft. The notation requirement is most useful where the credit is intended for roving use.

In the case of a credit which does not require notation, the issuer is protected in regard to any drafts which he honors in good faith in the order in which they are presented. The rights of successive good faith purchasers of drafts under such a credit are regulated as with drafts in a set under section 3-801 of the Code.

U.C.C. Sec. 5-109. Explanatory Notes.

This section restates the settled principle of letter of credit financing that the issuer is not responsible for the performance of the underlying sales contract; the usual understanding that the primary obligation of an issuer is to examine documents with normal banking care to determine whether or not on their face they appear to comply with the terms of the credit; and the general obligations under the Code (sections 1-203 and 1-205) of good faith and observation of course of dealing or usage of trade, (in this case, general banking usage) except that a non-bank issuer is not bound by unknown banking usages.

U.C.C. Sec. 5-110. Explanatory Notes.

The rule of this section prohibits a person who presents documentary drafts under a letter of credit from reserving a claim to the documents after honor. A typical situation in which the rule applies would involve a seller-beneficiary who has overshipped, attempts to collect the amount available under the credit, and expects to secure a claim against the buyer-customer for the excess by retaining a lien on the documents which control the goods. Although the issuer's duty to honor a draft is governed by the terms of the letter of credit, the seller-beneficiary can protect himself by an agreement with the buyer-customer in the underlying contract; then failure to provide a sufficient letter of credit may be treated as a breach of that contract.

U.C.C. Sec. 5-111. Explanatory Notes.

A distinction is made between warranties of a beneficiary and those of intermediary parties. A beneficiary, by transferring or presenting a documentary draft or demand for payment, warrants to all interested parties that the necessary conditions of the credit have been complied with. This obligation includes a warranty of genuineness of documents, which stems from decisional law under the tort or quasi-contract theory that one who causes or participates in the issuance of false or fraudulent documents is liable to any party who suffers injury in reliance on them. The rule of this section which is based on warranty makes liable an innocent beneficiary who through inadvertence or mistake has failed to satisfy the necessary conditions of the credit.

The limited warranties given by the negotiating, advising, confirming, collecting, or issuing bank do not include a warranty of genuineness of documents. This codifies the existing law to the effect that the handling of documents in a commercial credit transaction does not involve any warranty of genuineness.

U.C.C. Sec. 5-112. Explanatory Notes.

A bank which is presented with a documentary draft or demand for payment under a letter of credit is given until the close of the third banking day

following receipt of the documents to honor. Honor may be further postponed if the presenter consents to the deferment. To the extent that an issuer of a letter of credit has an obligation to examine documents with care, as required under section 5-109 of the Code, a longer period of time may be necessary for the inspection than the time allowed for acceptance of ordinary drafts under section 3-506 of the Code (until the close of the next business day following presentment).

It is clear that a "clean credit", i.e., a credit not conditioned on the presentation of documents is not subject to the three-day rule but that drafts drawn under a "clean credit" must be processed in accord with the general rule of section 3-506.

Failure to honor within the specified time constitutes dishonor of the draft or demand and of the credit.

The optional clause pertaining to conditional payment is in response to a situation incident to currency restrictions of certain nations under which payment is required before there is an opportunity to examine documents. Payment under these circumstances is recognized as conditional and may be reversed by subsequent timely discovery of defects in the documents. Eight adopting states have incorporated the optional clause, and ten have omitted it.

U.C.C. Sec. 5-113. Explanatory Notes.

A bank seeking to induce payment, acceptance, negotiation or reimbursement under a credit in a case where the documents do not conform to the terms of the credit may execute an indemnity without being considered to have engaged in an ultra vires act. The Code leaves moot the question of whether or not an issuer is under any obligation to accept an indemnity in lieu of strict compliance with the terms of the credit. The holding of Dixon, Irmaos & CIA v. Chase National Bank, 144 F. 2d 759 (2d Cir. 1944), cert. den., 324 U.S. 850 (1944); Backus and Harfield, Custom and Letters of Credit: The Dixon Irmaos Case, 52 Col. L. Rev. 589 (1952), that the issuing bank is required to pay upon presentation of imperfect documents if the presenting bank writes a letter of indemnity to cover the imperfection, is neither accepted nor rejected by this section of the Code. The obligation of the issuer to honor in such a situation is determined by construing the terms of the credit and usage.

U.C.C. Sec. 5-114. Explanatory Notes.

An underlying principle of letter of credit financing, that the letter of credit agreement is independent of the sales contract, is restated. The provision prohibiting a requirement that all documents must be satisfactory to the issuer before a duty to honor arises is substantially subverted by the further provision that permits an issuer to determine in its own discretion whether or not specified documents are satisfactory.

The duty of an issuer to honor in the case of forged or fraudulent documents varies according to the status of the party presenting a draft or demand for payment. If the presentment is made by a negotiating bank or other intermediary party which can qualify as a holder in due course, the issuer must honor it. In other cases, e.g. presentment by a beneficiary, the issuer has an option to honor or set up a defense of fraud or forgery. If the issuer in good faith honors forged documents presented by a beneficiary, it is entitled to reimbursement from the customer. This section of the Code places the risks of bad faith action of the beneficiary or of fraud in the transaction on the customer rather than on innocent third parties or the issuer. The customer, in the case of honor, or a party who has parted with value, in the case of dishonor, may recover against the beneficiary either by virtue of the underlying contract or under section 5-111 (1) of the Code pertaining to warranties.

The optional subsections (4) and (5) refer to the situation discussed in connection with section 5-112. The states which have rejected the optional provisions have indicated that there is little need for codifying rules to apply to a situation which is special and seldom arises. States which have adopted the optional provisions did so on the basis that although the situation might seldom arise, it is just as well to include a solution.

U.C.C. Sec. 5-115. Explanatory Notes.

This section codifies decisional law to the effect that the beneficiary's measure of damages for wrongful dishonor is the same as a seller's damages upon a buyer's breach of contract.

Although subsection (1) imposes no specific duty on an aggrieved party to mitigate damages, subsection (2) incorporates by reference section 2-610 under which mitigation seems to be required.

It is self-evident that the rules governing improper dishonor and anticipatory repudiation apply only to irrevocable letters of credit since revocable credits may be modified or revoked without notice to beneficiary or customer. Rights of innocent third parties in such cases are governed by section 5-106 (4).

U.C.C. Sec. 5-116. Explanatory Notes.

Although the Code permits assignment or transfer of the right to draw under a letter of credit only when the credit expressly so provides, the proceeds of a letter of credit can always be assigned. The first part of this rule is based on the theory of case law which recognizes that when a customer causes a bank to issue a letter of credit in favor of a named beneficiary, he may contemplate performance by that beneficiary alone, and such an expectation would be defeated if the beneficiary were permitted to assign the benefits of the credit indiscriminately.

On the other hand, the assignment of the proceeds of the letter of credit does not defeat the customer's protection and expectations. In such a situation the party least protected is the assignee. In the usual case he is a manufacturer or supplier whose performance enables his assignor (the original beneficiary) to complete his performance of the underlying contract to the letter of credit. The assignee needs assurance that the assignor will pay him, and the assignment of the proceeds of the credit is the method of furnishing this assurance. The assignee must then promptly notify the issuer of the assignment, but his right to the proceeds will depend on the assignor's performance, and he has no guarantee that the assignor has not made a prior assignment. A more sophisticated financing device than the assignment of proceeds, known as the "back-to-back credit", affords the assignee greater protection and is permissible under the Code. It is discussed in Harfield, *Secondary Uses of Commercial Credits*, 44 Col. L. Rev. 899, 908 (1944).

Where the right to draw under a letter of credit is assignable under subsection (1) of this section, a question arises as to how many times it may be assigned. The Code is silent on this matter, but existing practice limits the right to one transfer.

U.C.C. Sec. 5-117. Explanatory Notes.

The preferences established by the Code in the event of insolvency of an issuer or an advising or confirming bank or a bank which has procured a credit for a customer are probably inapplicable to national banks under the decision in Jennings v. United States Fidelity & Guaranty Co., 294 U.S. 216 (1935).

A customer is given a preference on insolvency of the issuer over depositors or general creditors to the extent of any funds or collateral turned over before or after insolvency as indemnity or for the purpose of paying drafts under a letter of credit; a beneficiary is given a preference on insolvency of an issuer or confirming bank over depositors or general creditors to the extent of any funds or collateral turned over before or after insolvency to cover payments under the credit; an intermediary is given the same preference as a beneficiary on insolvency of the issuer.

The preferences are made to apply only to documentary credits and not to "clean credits" and are based on the theory that the nature of letters of credit is essentially a device to facilitate the movement of goods.

Variations from Official Text

The sole substantial variation to Article 5 by any adopting State is the New York amendment to section 5-102:

Section 5-102. Scope.

- (1) Unless a letter of credit or a credit is by its terms or by agreement or by custom subject in whole or in part to the Uniform Customs and Practice for Commercial Documentary Credits fixed by the Thirteenth or by any subsequent Congress of the International Chamber of Commerce, this [This] Article applies . . .

The New York amendment is discussed in Penney, New York Revisits the Code: Some Variations in the New York Enactment of the Uniform Commercial Code, 62 Colum. L. Rev. 1004 (1962) in which it is pointed out that the two compilations overlap only in part, that there are conflicting provisions with respect

to only two matters, and that the Code permits parties wide latitude to contract themselves out of Article 5.

The New York amendment will probably be subject to future clarification as to when the Uniform Customs apply and the applicability of Article 5 when its provisions are not in conflict with the Uniform Customs. Therefore, it would appear to be inadvisable for other jurisdictions to follow the New York variation until the matter is finally considered in full especially in the light of potential intricate conflict of laws questions.

ARTICLE 6

BULK TRANSFERS

The Bulk Sales Law of Pennsylvania, prior to 1953 when the Uniform Commercial Code was first enacted, furnished the model for Hawaii's legislation in this field. Chapter 200, Revised Laws of Hawaii 1955, as amended is entitled, Sale of Merchandise in Bulk. Following the example of Louisiana in 1894, almost all of the other states currently have such a law although there is little uniformity of provisions.

The purpose of Bulk Sales statutes is to require that notice be given to the seller's creditors of the impending transfer. This helps prevent two common forms of commercial fraud, namely:

(1) The case of the merchant selling to a friend at a low price and paying his creditors less than he owes with the intent of coming back into the business at some future date.

(2) Where the merchant sells his business, pockets the proceeds and departs. This is the most common.

The statutes are of three types: the first, such as the New York statute, requiring notice to creditors; the second, such as Kentucky, requiring, in addition to notice, that the buyer make certain that the proceeds of the sale be applied to the debts; and the third, such as the California statute, which uses a public record as a means of notifying creditors of the impending sale. Hawaii presently requires both notice to creditors and public recordation of the sale.

This portion of the report deals with Article 6, Bulk Transfers, of the Uniform Commercial Code. This Article, if adopted in Hawaii, would replace our present Bulk Sales Law. Such adoption would result in several changes in the Hawaii law, but none would be serious unless section 6-106 were adopted along with the Code.

Section 6-106 of the U.C.C. provides that the purchaser of goods in bulk must see that the proceeds of the sale are applied, so far as necessary, to pay any debts of the seller. However, the Code is designed so that it is possible for a state to adopt Article 6 without adopting section 6-106 thereof.

Other innovations include an expansion of coverage by the inclusion of provisions for auction sales in section 6-108, the provision for a different statute of limitations in section 6-111, and the expansion of the class of protected creditors in section 6-109. The article also clarifies and simplifies the procedural steps in the preparation of the schedule, in the content of the notice to creditors, and otherwise, necessary to be followed if civil liability is to be avoided.

The chief objections to such a law are delay and red tape which impede legitimate transactions, and the possibility of a trap for the unwary buyer. No Hawaii case law has been found on its Sales of Merchandise in Bulk Act.

ARTICLE 6

BULK TRANSFERS

- 6-101. Short Title
- 6-102. "Bulk Transfer"; Transfers of Equipment;
Enterprises Subject to This Article; Bulk
Transfers Subject to This Article
- 6-103. Transfers Excepted From This Article
- 6-104. Schedule of Property, List of Creditors
- 6-105. Notice to Creditors
- 6-106. Application of the Proceeds
- 6-107. The Notice
- 6-108. Auction Sales; "Auctioneer"
- 6-109. What Creditors Protected
- 6-110. Subsequent Transfers
- 6-111. Limitation of Actions and Levies

U.C.C. Sec. 6-101. Explanatory Notes.

Self-explanatory.

U.C.C. Sec. 6-102. Explanatory Notes.

Section 6-102 defines the kinds of businesses and transactions covered by this Article. There is no bulk transfer unless (1) there is a transfer out of the ordinary course of trade; (2) of a sufficient amount of certain kinds of property; (3) by a transferor engaged in a particular kind of business.

Subsection 6-102 (1) uses the term "major part" in defining the amount of materials, supplies, merchandise or other inventory which must be transferred to constitute a bulk transfer. "Obviously the term major part means more than one-half of the transferor's total stock." 1952 Wis. L. Rev. 312, 318; 1954 Wash. U. L. Q. 283, 313.

Hawaii Law.

Rev. Laws Hawaii 200-1

Hawaii requires "the whole, or a large part" of a stock of merchandise and fixtures, or merchandise, or fixtures to be sold in bulk and not in the usual course of the seller's business.

Neither the U.C.C. nor the Revised Laws of Hawaii includes those businesses whose principal element is not the sale of merchandise, but of services --e.g. farming, contracting and hotels. This is true also in respect to transfers of investment securities, accounts receivables and things in action generally, which are dealt with in other Articles of the U.C.C.

There is no similar limitation, as that contained in subsection (2) (the transfer of a substantial part of the equipment along with inventory), in the present Hawaii statutes. Notice the absence of the term "fixtures" in the U.C.C.

Subsections (3) (enterprises subject to Article) and (4) (transfers covered by Article) have no corresponding Hawaii law.

U.C.C. Sec. 6-103. Explanatory Notes.

Section 6-103 enumerates eight different transfers which are not subject to this Article.

Hawaii Law.

Rev. Laws Hawaii 200-3

Subsections (2) (general assignments), (4) (sales by executors, administrators, etc.) and (5) (dissolution or re-organization of a corporation) of section 6-103 of the Code are in general accord with section 200-3. The remaining subsections have no corresponding Hawaii law.

U.C.C. Sec. 6-104. Explanatory Notes.

Transfers, even though covered by Article 6, are not subject to attack if the transferor and transferee comply with the provisions of this Article. Compliance provisions, enacted to safeguard the creditors of the transferor, embrace two features, which, if satisfied, eliminate the bulk transfer risk: (1) a scheduling of property to be transferred and a listing of the transferor's creditors; and (2) notice to these creditors of the proposed transfer (section 6-105).

Subsection (1)(c) requires the transferee to either preserve the list and schedule for six months and permit inspection and copying by any creditor or to file them in some designated public office, e.g. the bureau of conveyances in Hawaii.

By the provisions of subsection (3), the transferor is made responsible for the completeness and accuracy of the list and the transfer is not rendered ineffective because of omissions unless the transferee had knowledge.

Hawaii Law.

Rev. Laws Hawaii 200-1, 200-2, and Chapter 299

Hawaii has no scheduling of property requirement, but does require personal notice to creditors of the proposed sale and public recordation of the bill of sale.

The term "fraudulent and voidable" is used in Hawaii, while Article 6 uses "ineffective". It is believed that the words "voidable" and "ineffective", as used in these two statutes, have the same or similar meanings.

The U.C.C.'s sanction for the accuracy of the list of creditors is the criminal law of the state relative to false swearing. This is Chapter 299, Revised Laws of Hawaii 1955, made applicable by U.C.C. section 6-104 (2), which provides a penalty of imprisonment at hard labor for not more than twenty years. Section 200-2 presently imposes a fine of not more than \$500, or imprisonment of not more than six months, or both, on the seller, for knowing and willful violations of the chapter's provisions.

U.C.C. Sec. 6-105. Explanatory Notes.

The transferee is required by this section to give the transferor's creditors notice of the proposed transfer, ten days before he takes possession of the goods or pays for them, whichever happens first. Auction sales (section 6-108) are excluded from this requirement. This giving of notice is one of the primary reasons for bulk sales statutes. Once the creditor has notice he can take appropriate steps to protect himself.

Hawaii Law.

Rev. Laws Hawaii 200-1

The ten-day notice requirement of this section and section 6-107 of the Code is more specific than the fourteen-day notice requirement set out in section 200-1. The legislative history of this Hawaii statute, as revealed in the Senate Committee hearings report discloses the reason for this longer period between notice and sale which currently exists in Hawaii. "It is believed, however, that the notice should be fourteen days rather than ten days owing to delays that may be experienced in the sailing of steamers carrying mail between the Islands."

U.C.C. Sec. 6-106. Explanatory Notes.

This section places upon the transferee the duty of seeing that the consideration he pays is applied so far as necessary to the debts indicated on the transferor's list which has either been furnished to the transferee or is on file in writing, within thirty days of mailing notice. The transferee may have to withhold unliquidated or disputed sums and may also have to make pro-rata payments.

This section is bracketed to indicate division of opinion as to whether or not it is a wise provision, and to suggest that this is a point on which state enactments may differ without serious damage to the principle of uniformity.

In any state where this section is omitted, the following parts of sections should also be omitted, namely:

- (a) optional subsection 6-107 (2)(e), which provides that the notice must indicate the time and place for the filing of such claims;
- (b) optional subsection 6-108 (3)(c), which requires the auctioneer to assume that the proceeds are applied to creditors' claims; and
- (c) optional subsection 6-109 (2), which gives the transferor or auctioneer credit for sums paid to particular creditors of the transferor, limited to the sums believed in good faith at the time of payment to be properly payable to such creditors.

In any state where this section is enacted, these other provisions should be also.

Five states, Alaska, Kentucky, New Jersey, Oklahoma and Pennsylvania have adopted these optional sections. The other thirteen have not.

Hawaii Law.

Rev. Laws Hawaii - none

There is no duty to recognize any creditor under Chapter 200. The Hawaii law simply gives a form of notice so that creditors have a target of time and place upon which they may levy their process.

U.C.C. Sec. 6-107. Explanatory Notes.

Section 6-107 specifies the contents and manner of giving the notice in all cases specified in section 6-105. If the debts of the transferor are to be paid in full as they fall due, a short form of notice is provided. However, if the debts are not to be paid, then under subsection (2), several additional items of information must be contained in the notice.

Hawaii Law.

Rev. Laws Hawaii 200-1

Hawaii has present law corresponding to subsection (3) (delivery of notice to creditors), of section 6-107, but none similar to subsection (1) (contents of notice) or (2) additional information needed where transferor's debts are not paid when due).

U.C.C. Sec. 6-108. Explanatory Notes.

Bulk transfer laws place a duty on the transferee to see that various steps are taken to protect the creditors of the transferor. It is impossible to place this duty on the transferee of an auction sale, because neither the price nor the identity of the transferee is known until the sale occurs, and, consequently, advance notice of these matters cannot be given.

It is obvious that the exclusion of auctions from bulk sale coverage gives the debtor an opportunity to carry out a bulk transfer of his property in fraud of his creditors. Recognizing this, the Code treats an auction sale like any other transfer, but imposes the liability for failure to give notice on the auctioneer, rather than on the transferee. The definition of "auctioneer" in subsection (3) is broad enough to include the transferor's lawyer if he directs, controls, or is responsible for the auction.

Subsection (4) is the only provision in the Article which imposes a sanction for non-compliance specifically and in defined terms. The validity of the auction sale may not be affected by non-compliance. The auctioneer, and those who by definition are associated with him in joint and several liability, may be accountable to the "creditors...as a class", but such liability is limited to the net proceeds of the auction.

Hawaii Law.

New law in this area.

U.C.C. Sec. 6-109. Explanatory Notes.

This section defines the class of creditors entitled to protection under Article 6. The class apparently includes any holder of any claim arising out of any transaction which has occurred before the actual bulk transfer. Official comment 1 of section 6-109 states that creditors with unliquidated claims are within the protected group. This is consistent with the requirements in section 6-104 that all listed creditors must include all persons "known to the transferor to assert claims against him even though such claims are disputed"; and in section 6-107 that all listed persons must receive notice of the transfer.

Creditors are not entitled to notice if they became such after the transferee has complied with the statute but before the sale is consummated.

Subsection (2) gives the transferee or auctioneer appropriate credit for honest payments to particular creditors. If section 6-106 is omitted this subsection should be also.

Hawaii Law.

New law.

U.C.C. Sec. 6-110. Explanatory Notes.

In protecting a subsequent good faith purchaser for value without notice of any non-compliance, section 6-110 adopts the generally accepted principle in respect of fraudulent conveyances that a transferee, holding property as a result of a fraudulent conveyance, can pass unimpaired title to a bona fide purchaser for value without notice. Where the resale by the non-complying bulk transferee is also a non-complying bulk sale, creditors of the original transferor probably would be able to upset it.

Hawaii Law.

Rev. Laws Hawaii - none

The Hawaii Sales of Merchandise in Bulk Act declares that non-compliance with the Act results in a "voidable" transfer, section 200-1. There are no Hawaii cases construing this section, but the traditional view of a voidable sale is that a bona fide purchaser cuts off the right of avoidance. The Hawaii law, therefore, would seem to be in accord with this section.

U.C.C. Sec. 6-111. Explanatory Notes.

In view of the fact that the Article imposes unusual obligations on purchasers, the short statute of limitations period for bringing an action of six months is appropriate.

Hawaii Law.

Rev. Laws Hawaii 200-1

The statute of limitations starts to run in Hawaii, not from the time the transferee takes possession, but from the date of recordation of the bill of sale in the bureau of conveyances. In Hawaii this period ends after ninety days, instead of six months.

Supplementary Notes to Article 6.

Note that in Hawaii a further duty is imposed on the parties to a bulk sale by the provision of section 117-40 of the Revised Laws of Hawaii 1955, as amended. This section's purpose is not to protect private creditors, but to give the tax commissioner notice of the bulk sale so he may collect the proper taxes which consequentially arise. This tax is a lien on the personal property if not paid and has the same priority as the lien of state real property taxes.

The section provides that where there is a bulk sale:

(1) The seller must give to the commissioner, no later than ten days after the possession, or control, or title of the property has passed to the purchaser, a written and verified report of the sale which contains certain specified information. This report may instead be made by the purchaser.

(2) The purchaser must withhold payment of the purchase price until he receives a certificate from the commissioner to the effect that all taxes, penalties and interest levied or accrued under this chapter, against the seller, have been paid. This certificate constitutes a tax clearance, which is binding on the commissioner.

(3) The purchaser will be personally liable to pay to the state such taxes, penalties and interest if the required report is not made, or if these debts are not paid within twenty days after the possession, control, or title passes, or within such further time as the tax commissioner may allow. This liability, however, shall not exceed the amount of the purchase price.

(4) Failure to make the report is punishable by a fine up to \$100. Delinquent taxes are subject to the normal penalties and interest for late payment.

(5) The purchaser shall have his remedy against the seller for the amount of taxes, penalties or interest paid by him.

Hawaii's enactment of the Uniform Commercial Code would not affect this section of the Revised Laws of Hawaii.

ARTICLE 7

WAREHOUSE RECEIPTS, BILLS OF LADING AND OTHER DOCUMENTS OF TITLE

Article 7 of the Uniform Commercial Code is to a large extent an integration and recodification of prior uniform legislation and existing common law and commercial usage governing documents of title as these documents are employed in intrastate transactions to represent goods received for storage or shipment. Warehouse receipts and bills of lading are the two documents of title most commonly issued by commercial bailees to evidence an interest in goods.

Existing Law

Article 7 would replace the Uniform Warehouse Receipts Act (UWRA) which became law in Hawaii in 1945 (chapter 207, Revised Laws of Hawaii 1955); the Uniform Bills of Lading Act (UBLA) which has not been enacted in Hawaii; and those sections of the Uniform Sales Act (USA), adopted in Hawaii in 1929, dealing with negotiation and transfer of documents of title (chapter 202, Revised Laws of Hawaii 1955).

Bills of lading covering interstate and international shipments are subject to the Federal Bill of Lading Act (49 USC 81-124 (1946)); this field of commerce, pre-empted by Congressional legislation, would not be affected by the enactment of the Uniform Commercial Code. There is some effort now being directed toward repeal of the Federal Bill of Lading Act and substitution therefor of Article 7 of the Code. Since it is estimated that approximately 85 per cent of bills of lading issued relate to interstate commerce, uniformity in the law would seem to require Congressional enactment of Article 7 if most states adopt the Code.

Scope

Warehouse receipts, in the case of bailment of goods for storage, and bills of lading, in the case of bailment of goods for transportation, present many common problems and, to the extent of such provisions as a uniform terminology; obligations and liabilities of bailees under documents of title; negotiation and transfer of documents of title, all such documents are subject to the general provisions of Article 7.

However, to the extent that warehouse receipts and bills of lading present particular problems, they are handled in parts 2 and 3 of Article 7 respectively.

The documents of title which constitute the substance of Article 7 represent goods or commodities and should be distinguished from commercial paper which represents money (drafts, checks, certificates of deposit, and notes) covered by Article 3 and from investment securities which represent invested capital (bonds, debentures, and stock) covered by Article 8.

Changes in the Existing Law

Most of the changes effected by Article 7 are in the nature of clarifying, integrating, consolidating and modernizing changes. A few changes in basic policy reflect a modification of the concept of due negotiation and some significant exceptions to the doctrine of caveat emptor.

PART I GENERAL

- 7-101. Short Title
- 7-102. Definitions and Index of Definitions
- 7-103. Relation of Article to Treaty, Statute, Tariff, Classification or Regulation
- 7-104. Negotiable and Non-Negotiable Warehouse Receipt, Bill of Lading or Other Document of Title
- 7-105. Construction Against Negative Implication

PART 2 WAREHOUSE RECEIPTS: SPECIAL PROVISIONS

- 7-201. Who May Issue a Warehouse Receipt; Storage Under Government Bond
- 7-202. Form of Warehouse Receipt; Essential Terms; Optional Terms
- 7-203. Liability for Non-Receipt or Misdescription
- 7-204. Duty of Care; Contractual Limitation of Warehouseman's Liability

- 7-205. Title Under Warehouse Receipt Defeated in Certain Cases
- 7-206. Termination of Storage at Warehouseman's Option
- 7-207. Goods Must Be Kept Separate; Fungible Goods
- 7-208. Altered Warehouse Receipts
- 7-209. Lien of Warehouseman
- 7-210. Enforcement of Warehouseman's Lien

PART 3

BILLS OF LADING: SPECIAL PROVISIONS

- 7-301. Liability for Non-Receipt or Misdescription; "Said to Contain"; Shipper's Load and Count"; Improper Handling
- 7-302. Through Bills of Lading and Similar Documents
- 7-303. Diversion; Reconsignment; Change of Instructions
- 7-304. Bills of Lading in a Set
- 7-305. Destination Bills
- 7-306. Altered Bills of Lading
- 7-307. Lien of Carrier
- 7-308. Enforcement of Carrier's Lien
- 7-309. Duty of Care; Contractual Limitation of Carrier's Liability

PART 4

WAREHOUSE RECEIPTS AND BILLS OF LADING: GENERAL OBLIGATIONS

- 7-401. Irregularities in Issue of Receipt or Bill or Conduct of Issuer
- 7-402. Duplicate Receipt or Bill; Overissue
- 7-403. Obligation of Warehouseman or Carrier to Deliver; Excuse
- 7-404. No Liability for Good Faith Delivery Pursuant to Receipt or Bill

PART 5
WAREHOUSE RECEIPTS AND BILLS OF LADING:
NEGOTIATION AND TRANSFER

- 7-501. Form of Negotiation and Requirements of "Due Negotiation"
- 7-502. Rights Acquired by Due Negotiation
- 7-503. Document of Title to Goods Defeated in Certain Cases
- 7-504. Rights Acquired in the Absence of Due Negotiation; Effect of Diversion; Seller's Stoppage of Delivery
- 7-505. Indorser Not a Guarantor for Other Parties
- 7-506. Delivery Without Indorsement: Right to Compel Indorsement
- 7-507. Warranties on Negotiation or Transfer of Receipt or Bill
- 7-508. Warranties of Collecting Bank as to Documents
- 7-509. Receipt or Bill: When Adequate Compliance With Commercial Contract

PART 6
WAREHOUSE RECEIPTS AND BILLS OF LADING:
MISCELLANEOUS PROVISIONS

- 7-601. Lost and Missing Documents
- 7-602. Attachment of Goods Covered by a Negotiable Document
- 7-603. Conflicting Claims; Interpleader

PART 1
GENERAL

U.C.C. Sec. 7-101. Explanatory Notes.
Self-explanatory.

U.C.C. Sec. 7-102. Explanatory Notes.

This section defines eight terms and lists other terms which apply to Article 7 but are defined elsewhere in the Code.

The definition of "bailee" makes the issuer of a document of title a bailee and bound by the provisions of Article 7 without reference to actual possession of the goods.

The definition of "warehouse receipt" found in the general definitions section of the Code (section 1-201 (45)) eliminates the requirements of UWRA that the issuer must be "lawfully engaged" in business "for profit". The warehouseman's compliance with state regulations is not pertinent to his obligations under Article 7, nor is the profit motive pertinent to the obligations under Article 7 of state operated or cooperative warehouses.

The definition of "document" is provided in the general definitions section of the Code (section 1-201 (15)) where "document of title" includes, in addition to a bill of lading and warehouse receipts, any document "which in the regular course of business or financing is treated as adequately evidencing that the person in possession of it is entitled to receive, hold, and dispose of the document and the goods it covers." Since the "person in possession" may have no right to the document, it has been suggested that the phrase "person entitled under the document" be substituted for "person in possession". (Journal of the State Bar of California, Vol. 31, March-April 1962, p. 180)

The definition of "delivery order" which had been included under the USA definition of "document of title to goods" makes such a document essentially equivalent to a warehouse receipt upon its acceptance by a bailee.

The definition of "goods" is narrower than the definition provided by section 2-105 of the Code since the subject matter of a sale may properly include items which are neither stored nor transported, such as the unborn young of animals or growing crops.

Other definitions will be noted in the context of the sections to which they relate.

Hawaii Law.

Rev. Laws Hawaii 202-75 (USA), 207-57 (UWRA)

All definitions of USA and UWRA have been consolidated, revised and supplemented. The following terms have not previously been defined in the Revised Laws of Hawaii: "bailee", "consignee", "consignor", "issuer".

U.C.C. Sec. 7-103. Explanatory Notes.

The introductory remarks to Article 7 pointed out that interstate and international transactions are governed by federal legislation. This section restates the constitutional rule that federal law is paramount under the supremacy clause of the United States Constitution. Regulatory statutes of the State, such as those fixing or authorizing a commission to fix rates and prescribe services, authorizing charges, and limiting liability for loss are not affected by Article 7 and are controlling on matters which they cover.

Hawaii Law.

Rev. Laws Hawaii Chapters 104 and 106C.

Adoption of Article 7 would not affect existing legislation pertaining to the administration of public utility regulation by the public utilities commission.

U.C.C. Sec. 7-104. Explanatory Notes.

The distinction between negotiable and non-negotiable documents of title is important because it characterizes the nature of the documents, affects duties and rights of parties, and determines transferability of title to goods. A negotiable document more effectively represent the goods, for the bailee is under a duty not to deliver the goods until the document is surrendered, and a purchaser of a negotiable document can cut off some prior rights to the goods and the document. A non-negotiable document, on the other hand, is usually only evidence of the contract of bailment.

The distinction between negotiable and non-negotiable documents is purely a matter of form, depending on the manner in which the document states the goods are deliverable.

Under prior uniform legislation, the Warehouse Receipts and Sales Acts provided for "bearer" documents of title while the Bills of Lading Act did not; thus this section of the Code would remove the differential treatment as between warehouse receipts and bills of lading. The requirement under UWRA and UBLA that a non-negotiable title document must bear on its face the legend "non-negotiable" or "not negotiable" is eliminated under Article 7, and the presence of such language on a document that otherwise meets the formal test of negotiability is probably nugatory. (The use of the phrase "Non-Negotiable Bill of Lading" as an example in the definition of "conspicuous" in section 1-201 (10) may be unfortunate as misleading.) Other instructions relative to delivery may be regarded as insistence by the bailee upon a particular kind of receipt.

Subsection (1)(b) would apply only to a very limited situation, for absent federal enactment of Article 7, bills of lading for outward shipments in foreign commerce are governed by the Federal Bill of Lading Act and other federal legislation and regulation. Inward bills of lading are not covered by the federal Act although they are frequently governed by the law of the foreign country where the bill was executed and issued. The rule of this subsection is contrary to prior case law. In Gubelman v. Panama R. Co., 192 App. Div. 165, 182 N.Y.S. 403 (1920) a bill of lading used in an overseas shipment was made consigned to a specified person "or assigns" and was held to be non-negotiable.

Hawaii Law.

Rev. Laws Hawaii 202-27, 202-30 (USA), 207-2, 207-3, 207-4, 207-5, 207-7 (UWRA)

Existing Hawaii law (section 207-7) includes the UWRA requirement that non-negotiable warehouse receipts must be marked "non-negotiable" or "not negotiable". Otherwise the existing law is in general accord with the chief categorization of Article 7 as between negotiable and non-negotiable documents of title.

It should be noted that the provision of subsection 7-104 (1) (b) of the Code relating to documents of title in overseas trade when considered in conjunction with subsection 2-323 (3) which defines "overseas", could be applicable to an extensive amount of Hawaii commerce.

U.C.C. Sec. 7-105. Explanatory Notes.

Although Article 7 consolidates much of the law of bills of lading and warehouse receipts, there are considerations particularly applicable to bills of lading and carriers which are treated specifically in part 3 of Article 7, and there are considerations particularly applicable to warehouse receipts and warehousemen which are treated specifically in part 2 of Article 7.

This section of the Code makes it clear that when a right is stated in one part, and a corresponding right is not stated in the other part, the omission is not to be construed as impairing any corresponding common law or statutory law which otherwise would be available, for example, any common-law right of indemnity a warehouseman may have corresponding to section 7-301 (5), or any contractual security interest a carrier might have corresponding to section 7-209 (2).

PART 2

WAREHOUSE RECEIPTS: SPECIAL PROVISIONS

U.C.C. Sec. 7-201. Explanatory Notes.

This section of the Code authorizes the issuance of warehouse receipts in cases not covered by UWRA, namely by one who is (a) not lawfully engaged in the business of warehousing and (b) at no profit. This expanded coverage is consistent with the definition of "warehouse receipt" in section 1-201 (45) of the Code as "a receipt issued by a person engaged in the business of storing goods for hire".

The California State Bar Committee on the Commercial Code (Journal of the State Bar of California, Vol. 37, March-April, 1962, p. 179) has recommended amendments to the definition of warehouse receipt (and of bill of lading) to preclude a presumption that every document issued by a warehouseman (or a carrier) is a document of title, even in cases of transactions involving paper which is not by usage regarded as representing title to goods. The recommendation is to restrict the definition to "documents which the issuer intends shall evidence the right of the person entitled under the document to hold and dispose of the document and the goods it covers", and to provide that the designation of a document as a "warehouse receipt" (or "bill of lading") would be conclusive evidence of the issuer's intention to issue a document of title.

Existing law to the effect that one cannot be a warehouseman of his own goods is modified by subsection (2) in the case of receipts issued by the owner for whiskey or other goods stored under statutory schemes which require a bond against withdrawal or a license for the issuance of receipts.

Hawaii Law.

Rev. Laws Hawaii 207-1, 207-57 (UWRA)

Section 207-1, Revised Laws of Hawaii 1955, is in accord with the Code, but the definition of "warehouseman" in section 207-57 contains the limitations of UWRA that a warehouseman must be lawfully engaged in the business of storing goods for profit.

U.C.C. Sec. 7-202. Explanatory Notes.

Although a warehouse receipt need not be in any particular form, it must contain the following essential terms: location of the warehouse, date of issue of the receipt, number of the receipt, statement designating the person to whom the goods are to be delivered, rate of storage and handling charges, description of the goods, signature of the warehouseman, the fact of any ownership interest in the goods on the part of the warehouseman, and provisions relating to a warehouseman's lien or security interest.

Liability is imposed for damages caused by the omission of any essential term, thus indicating that despite such an omission, the receipt is still a document of title carrying with it obligations and rights; this matter is made more explicit in section 7-401 of the Code.

Hawaii Law.

Rev. Laws Hawaii 207-2, 207-3 (UWRA)

The essential terms which must be included in warehouse receipts are the same under existing law as under the Code, except that the Code requires "rate of storage and handling charges" instead of "rate of storage charges" and the Code states "lien or security interest" instead of "lien".

Under the Code, liability for omission of an essential term is imposed whether the receipt is negotiable or non-negotiable while under the Revised Laws only omission from a negotiable receipt creates a statutory liability.

U.C.C. Sec. 7-203. Explanatory Notes.

This section imposes liability on the issuer of a document of title, other than a bill of lading, to a party to or purchaser for value in good faith for damages caused by non-receipt or misdescription of the goods. The bailee may disclaim liability by conspicuously inserting on the receipt a statement of his actual knowledge of the facts of description of and existence of the goods where he does not know the facts other than through markings on the goods or statements of the depositor. "Conspicuous" is defined in section 1-201 (10) of the Code as "so written that a reasonable person against whom it is to operate ought to have noticed it".

Hawaii Law.

Rev. Laws Hawaii 207-20 (UWRA)

The existing law in Hawaii provides that the warehouseman's liability for non-existence or misdescription of goods runs to the "holder" of a receipt while this section of the Code imposes liability only as against a "party to" or a "purchaser for value in good faith" of a receipt.

The disclaimer provision of existing law does not include a "conspicuous" requirement.

U.C.C. Sec. 7-204. Explanatory Notes.

A warehouseman is subject to ordinary negligence liability for damages to goods resulting from failure to exercise reasonable care. Damages, and the time within which claims must be brought therefor, may be limited by the terms of the receipt or storage agreement, except with respect to liability for conversion. The provisions of this section of the Code are generally in accord with prior uniform legislation and the principles of the common law of contract.

All of the adopting states have either omitted subsection (4) or failed to name an existing statute which would impose a higher responsibility or would invalidate contractual limitations as authorized under Article 7.

Hawaii Law.

Rev. Laws Hawaii 207-3, 207-21 (UWRA)

The standard of care required under the Code is that which a "reasonably careful man would exercise under like circumstances" and might be considered less stringent than the existing standard which is that which a "reasonably careful man would exercise in regard to similar goods of his own" (section 207-3, Revised Laws of Hawaii 1955) or "a reasonably careful owner of similar goods" (section 207-21, Revised Laws of Hawaii 1955).

The codification of the authority to limit liability contractually is not a part of the existing statutory law but seems to follow common law rules.

U.C.C. Sec. 7-205. Explanatory Notes.

This section, a special application of the sales law rule set forth in section 2-403 (2) of the Code, permits a buyer in the ordinary course of business to take free and clear of the rights of a holder of a warehouse receipt covering fungible goods and issued by a warehouseman who is in the business of buying and selling such goods. This rule would seem to be contra

to cases holding that a purchaser who buys fungible goods subject to a warehouse receipt is liable to the holder of the receipt. However, courts have come to the conclusion adopted in this section by finding that the owner of the receipt is estopped to complain by virtue of the fact that he left fungible goods in the hands of a dealer. Preston v. Witherspoon, 109 Ind. 457, 9N.E. 585 (1886).

A similar rule was enacted by Congress in 1955 (15 U.S.C.A. 714 (p)) to protect innocent purchasers of fungible goods from claims of the Commodity Credit Corporation for conversion where the purchase is made for value in good faith and in the ordinary course of business from a person regularly engaged in buying and selling such goods.

U.C.C. Sec. 7-206. Explanatory Notes.

A warehouseman has a general right, applicable to all goods and regardless of whether or not the bailor has paid accrued storage charges to terminate storage at the end of a specified storage period or at the end of thirty days if no storage period is specified. He must notify all known claimants to the goods, and if the goods are not removed, he may sell them in accordance with the provisions provided for enforcement of his lien, as set forth in section 7-210 of the Code.

The warehouseman has a supplementary right to terminate storage if he believes in good faith that the goods will deteriorate or fall in value below the amount of his lien within a period which is shorter than the period in which he could dispose of them under his general right of termination. If he exercises this supplementary right, he may specify a shorter reasonable time and sell the goods one week after the expiration of the period specified in the notice and after advertisement.

A third right of termination is permitted in the case of hazardous goods. This right can be exercised, by public or private sale on reasonable notice but without advertisement, only if the warehouseman had no notice of the quality or condition of the goods at the time of storage, probably on the theory that a summary power of removal is not justified when the warehouseman accepted the goods knowing of the risk

they involved. Any lawful manner of disposal is authorized after an unsuccessful attempt to sell. Of course, even though he had knowledge of the hazardous quality of the goods at the time of their deposit, he may still avail himself of the general right of termination.

Hawaii Law.

Rev. Laws Hawaii 207-33, 207-34, 207-36 (UWRA)

Existing law contains no specific provisions authorizing either a general right of termination of storage nor imposing a duty to continue storage. Section 207-34 authorizes the right of sale or disposal in the limited cases of perishable goods, goods which by their nature will deteriorate greatly in value, and goods which by their odor, leakage, inflammability, or explosive nature will be liable to injure other property. There is no requirement of advertisement. The existing right of redemption extends only to those entitled to notice while the Code extends the right to any person entitled to the goods.

U.C.C. Sec. 7-207. Explanatory Notes.

In addition to consolidating prior uniform statutory provisions relating to keeping goods separate and commingling fungible goods, this section eliminates the qualification to the authorization to commingle fungible goods. The change permits commingling whether or not specifically authorized by agreement or custom. It should be noted that commingling is further widely authorized by reason of the definition of "fungible" under section 1-201 (17) of the Code which includes goods fungible by nature or usage and also goods deemed fungible under a particular agreement or document.

The first part of subsection (2) is a restatement of the UWRA provision that fungible goods commingled by a warehouseman are owned in common by persons entitled thereto. However, under UWRA if there is an overissue with respect to fungible goods, each depositor becomes entitled to a pro rata share of the mass, whereas under Article 7 of the Code a holder of a duly negotiated receipt is also permitted to claim his pro rata share of the mass, even though his receipt, in fact, might not represent a deposit. This situation is specifically included as an exception to the general rule provided in section 7-402 of the Code relating to duplicate documents of title.

Hawaii Law.

Rev. Laws Hawaii 207-22, 207-23, 207-24, 207-57 (UWRA)

Existing law pertaining to keeping goods separate and commingling of fungible goods would be modified by Article 7 of the Code in respect to broadening the authority to commingle goods, extending the definition of "fungible", and expanding the right to share in the mass of commingled fungible goods in case of overissue, as noted above.

U.C.C. Sec. 7-208. Explanatory Notes.

Article 7 provides different treatment for two kinds of unauthorized alterations of warehouse receipts. In the case of blanks and unauthorized completions of negotiable warehouse receipts, the warehouseman is held responsible for the receipt, as altered, to a bona fide purchaser for value. The liability extends, evidently, to include damages for the non-existence of the goods. This approach is consistent with sections 3-115, 3-407 (3), and 8-206 of the Code dealing with other incomplete instruments, but there is no comparable treatment accorded bills of lading (section 7-306). Other unauthorized alterations leave warehouse receipts enforceable according to their original tenor, even by the alterer or one who received the receipt with notice of the alteration.

Hawaii Law.

Rev. Laws Hawaii 207-13 (UWRA)

Existing law does not differentiate alterations on the basis of unauthorized completions and other alterations. The general rule is that a purchaser for value may enforce an altered receipt only according to its original terms.

U.C.C. Sec. 7-209. Explanatory Notes.

Under the Code the warehouseman's lien is categorized into a specific lien, a general lien, and a security interest, and different consequences flow depending on whether the receipt in question is negotiable or non-negotiable.

Charges Covered. A specific lien, which attaches automatically, is limited to the usual charges arising out of a storage arrangement. It covers such charges only in relation to the particular goods stored under the receipt. Where the goods are stored under a non-negotiable receipt, the warehouseman may convert the specific lien into a general lien, i.e., one covering charges on other goods, by a notation on the receipt that the lien is claimed for such charges and expenses in relation to other goods even those previously surrendered.

The same rules apply to negotiable receipts, except that, as against a person to whom the receipt has been "duly negotiated" (section 7-501), the lien is limited to the amount or rate specified on the receipt. Here the notation must be more particular, and if no such notation is made, the lien is limited to "a reasonable charge for storage of the goods covered by the receipt subsequent to the date of the receipt".

Advances. The Code requires that the maximum amount of charges for which a security interest is claimed must be specified on the receipt on the theory that an advance, unlike charges, is not directly related to the storage contract (e.g. loans, sales commissions, interest). In all other respects the validity of a security interest is governed by Article 9 which deals with secured transactions.

Section 7-202 of the Code, which requires a statement of the amount or the fact of advances for which the warehouseman claims a lien or a security interest, relates not to enforcement of such interests but to the liability of the warehouseman for damages incurred by omission of terms from the receipt.

Depositor's Interest in Goods

A warehouseman's lien claim or security interest is effective against the owner of goods in the case of unauthorized bailment only where the depositor would have had the power to make a pledge of the goods which would be valid as against the true owner.

Other provisions of this section are largely a rewriting of UWRA rules that provide for the attachment of a general lien to the balance of goods remaining in the hands of a warehouseman, and for the loss of a lien when a warehouseman voluntarily delivers or unjustifiably refuses to deliver.

Hawaii Law.

Rev. Laws Hawaii 207-27 to 207-32 (UWRA)

Existing law provides for a general lien in cases involving non-negotiable receipts without the requirement of a notation and limits the coverage of the lien to charges for storage in cases of negotiable receipts on which charges are not enumerated. In the latter case, section 207-30, Revised Laws of Hawaii 1955, requires only a statement of charges and not a specific enumeration of amount and rate.

U.C.C. Sec. 7-210. Explanatory Notes.

This section sets forth procedures for the sale of the goods to satisfy a warehouseman's lien without judicial proceedings. A distinction is made between foreclosure proceedings for goods stored by a merchant in the ordinary course of his business and for goods stored by a non-merchant. In the case of goods stored by a merchant, a simplified procedure is in order and is valid if "commercially reasonable". If a warehouseman is uncertain as to the status of his depositor, he may use the alternative procedure which is available to him but required in non-commercial storage cases. If the goods are stored by a non-merchant, e.g. a private party who deposits household goods in a warehouse, the detailed procedures of UWRA are applicable.

The distinction made in this section between merchant and non-merchant is consistent with section 2-706 of the Code dealing with a seller's right to resell goods upon a buyer's breach.

Enforcement of a warehouseman's lien by a merchant under the new liberal procedure may be by public or private sale, must be on terms which are commercially reasonable, must be preceded by notice to known claimants, and does not require notice in a newspaper.

The method of lien enforcement which is mandatory in non-commercial storage cases and optional in commercial storage cases follows the requirements of UWRA, including a public sale, notice, and publication.

Other changes in UWRA provisions made by this section include the following: a warehouseman is given the right to bid at a public sale (by negative implication this right is denied at a private sale);

the title of a purchaser in good faith at a foreclosure sale is protected although the seller fails to comply with all technical requirements; and after a person claiming a right in the goods pays the amount of the lien and expenses, the warehouseman is required to retain the goods thus reinstating the bailment.

Hawaii Law.

Rev. Laws Hawaii 207-31, 207-32, 207-33, 207-35,
207-36 (UWRA)

Existing law is generally in accord with those provisions of Article 7 which rewrite the UWRA procedures for enforcement of liens in non-commercial storage cases. The liberal procedure available for goods stored by a merchant in the ordinary course of his business is a novel change in the law.

The provisions of subsection (4) and (5) of section 7-210 of the Code would modify existing law by permitting a warehouseman to bid at public sales and by confirming the title of purchasers at foreclosure sales. These changes are designed to make such sales more attractive and to obtain better prices.

This section of the Code contains a subsection stating the liability of a warehouseman for damages for failure to comply with the requirements for foreclosure sales; there is no comparable rule under existing law.

PART 3 BILLS OF LADING: SPECIAL PROVISIONS

U.C.C. Sec. 7-301. Explanatory Notes.

This section sets forth the liability of a carrier for non-receipt, misdescription, misdating, and improper handling. The provisions applicable to instances of misdating follow an amendment to the Federal Bills of Lading Act (44 Stat. 1450 (1927), as amended 49 U.S.C. 102) which has not been incorporated into UBLA. Liability extends to a consignee of a non-negotiable bill who has given value in good faith or to a holder to whom a negotiable bill has been duly

negotiated; it does not extend to a bank or other non-consignee of a non-negotiable bill which contains a misdate, misdescription or is issued without goods having been received. Liability for non-receipt or misdescription may be disclaimed by the issuer's notation on the bill that he does not know (if in fact that is so) whether part or all of the goods were received or conform to the description. The parallel section (7-203) applicable to warehouse receipts requires that such exonerating statements be "conspicuous".

Other provisions pertaining to exoneration for damages resulting from improper loading are consistent with common law and the Federal Bills of Lading Act to the effect that the carrier is relieved of liability only for damages caused by act or default of the shipper.

The shipper is made absolutely liable to the issuer against damages caused by inaccuracies furnished in regard to goods shipped. This is the adoption of a practice used in instances of special shipments where certain information constitutes the bases for some of the terms of the bill of lading.

Hawaii Law.

Rev. Laws Hawaii 106C-21

Existing law does not prescribe the form or content of bills of lading; in fact, there is almost no state legislation dealing with bills of lading. Under the Motor Carrier Law, enacted in 1961, the public utilities commission is authorized to prescribe the form and content of bills of lading for traffic regulated under Chapter 106C, Revised Laws of Hawaii 1955, as amended, and the length of time they must be preserved. The Code does not list essential terms for bills of lading, as it does for warehouse receipts, evidently because it was thought that their contents should be determined by state regulatory agencies. (See sections 7-103 and 7-105 of the Code.)

U.C.C. Sec. 7-302. Explanatory Notes.

This section, which establishes liability of originating and connecting carriers under a through bill of lading, is patterned after the Carmack Amendment to the Interstate Commerce Act, 49 U.S.C. 20 (11)

and (12). Although the federal law requires common carriers receiving goods to be shipped in interstate commerce or for export to an adjacent foreign country to issue a receipt or bill of lading under a through bill of lading, the Code does not make issuance of a through bill mandatory. A connecting carrier is made liable for its own wrongdoing, and the initial carrier, though liable for damages caused by a breach of duty of a connecting carrier, is given a right over against the carrier on whose line the damage is sustained.

The rules of this section will be limited to intrastate shipments since federal statutes pre-empt the field of interstate shipments.

Hawaii Law.

Rev. Laws Hawaii 104-21.5

The exception, which authorizes variance of liability by agreement, to the general rule of liability stated in this section of the Code, i.e., "an undertaking to be performed overseas or in territory not contiguous to the continental United States", will be more or less applicable to inter-island shipping depending on an interpretation of the terms "overseas" and "territory not contiguous to the continental United States". This interpretation, in turn, will ultimately depend on the jurisdictional question now before federal tribunals involving the status of inter-island waters.

Section 104-21.5 places liability for loss, damage or injury to property on the issuer of a through bill of lading, even if such loss, damage or injury is caused by a connecting carrier.

U.C.C. Sec. 7-303. Explanatory Notes.

This section covers the carrier's duty to obey or disregard changed instructions and provides a remedy for the carrier in the event of conflicting claims. Circumstances are listed under which the carrier may deliver the goods and be protected from liability for misdelivery, thus facilitating prompt disposition of the goods. In the case of a negotiable bill of lading, the Code permits a change of instructions to be made

only by the holder and requires notation of such changes on the bill in order to protect subsequent purchasers. If the bill is non-negotiable, the carrier can obey the consignor, even if he receives conflicting instructions from the consignee. The carrier is less safe in obeying the consignee but may do so with complete safety if there are no contrary instructions from the consignor and the consignee is in possession of the bill, or the goods have arrived at their billed destination. In the absence of these conditions, the carrier is still protected in obeying the consignee if the latter is entitled to the goods.

The rules established under this section are designed to permit diversions and reconsignments to be made with speed and safety.

U.C.C. Sec. 7-304. Explanatory Notes.

Bills in a set of parts, commonly called "bills in sets", whether negotiable or non-negotiable, are prohibited except "where customary in overseas transportation". Violation of the prohibition is treated like any other overissue, and the carrier is made liable for failure to deliver goods to anyone who purchases the bill or a part of it for value in good faith. The European practice of carriers issuing a number of originals covering the same goods has been condemned in the United States as constituting a direct invitation to fraud.

The exception to the prohibition also is specified as one of the exceptions to the general rule covering duplicate documents and overissue of section 7-402 of the Code.

Where bills in sets are authorized, the person to whom the first due negotiation is made acquires title to the goods, but the carrier is protected if it delivers in good faith against any part of the set. The party to whom the first due negotiation has been made can then replevy the goods obtained from the carrier by a holder who took his part of the set subsequently but who first presented it for delivery. The latter party has his remedy in a cause of action against his transferor.

The Code makes no specific provisions determining title to goods for which non-negotiable bills in a set have been issued, but the result would be governed by section 7-504 (1) and (2)(b). The first purchaser

would be protected unless a subsequent purchaser was a buyer in the ordinary course of business from the transferor who either first notified the carrier or obtained delivery of the goods.

Hawaii Law.

The exception to the prohibition against issuance of bills in a set in cases of overseas transportation requires reference to the definition of "overseas" in section 2-323 of the Code and is subject to a similar geographical-jurisdictional question presented by sections 7-104 and 7-302.

U.C.C. Sec. 7-305. Explanatory Notes.

A new type of bill of lading, "destination bill" has developed in order to cope with high-speed transportation which results in goods arriving before accompanying documents can be cleared through bank channels. The Code authorizes the use of this device to facilitate the employment of order bills in connection with fast shipments.

The destination bill is issued at the point of destination on the request of the consignor or any one entitled to the goods under an already issued bill. In the latter case the outstanding document must be surrendered. The shipper-seller wires a draft on the buyer-consignee which is attached to the bill and both are presented to the buyer before the goods arrive.

U.C.C. Sec. 7-306. Explanatory Notes.

It is interesting to compare this section, which provides that an unauthorized alteration or filling in of a blank in a bill of lading leaves the bill enforceable according to its original terms, with section 7-208 which provides that where a blank in a negotiable warehouse receipt has been filled in without authority, the insertion may be treated as authorized by a purchaser for value without notice. The differential treatment accorded the two classes of documents may be justified on the reasoning that warehouse receipts are issued on actual receipt of the goods by one who should know that blank receipts are dangerous; but bills of lading are made out by the

shipper whose description of the goods is accepted as correct or occasionally by a truck driver, thus accounting for the imposition of a lower standard. This rationale ignores the difference between the carrier signing a bill for goods already loaded, with a disclaimer of liability for the accuracy of the description, and the carrier signing on a blank bill of lading. In the latter case the invitation for fraud is obvious since it would permit sale of the document without the bother of loading anything aboard the carrier.

U.C.C. Sec. 7-307. Explanatory Notes.

A carrier is given a specific possessory lien (i.e., attaches only to goods covered by the bill) for enumerated charges and expenses subsequent to the date of its receipt of the goods in cases involving both negotiable and non-negotiable bills of lading. This lien is more limited than the one granted to a warehouseman under section 7-209 of the Code, which provides for both a specific and a general possessory lien as well as a security interest for charges other than those normally associated with warehousing, such as for money advanced, interest, or sales commissions. No specific provision is made for a general lien or a security interest in favor of a carrier because a carrier does not commonly claim a lien for services performed in connection with other goods nor does it normally lend money. Further, a carrier is usually subject to published charges and is not free to make special arrangements with particular shippers; so there is infrequent occasion for the imposition of a general lien or security agreement. If the practice of a carrier is otherwise, however, the Code would not deny it a general lien or security interest, valid under other state law, since section 7-105 of the Code would proscribe a negative implication to be drawn from the fact that such security is provided for in section 7-209.

In cases of negotiable bills of lading held by purchasers for value the lien is limited to the charges stated in the bill or tariffs or to a reasonable charge if no charges are stated. The cut-off protection is not contingent on good faith; therefore a purchaser for value of a negotiable bill who knows that the carrier is claiming a lien may not be liable for charges.

Where a common carrier is required by law to accept goods for transportation, its specific lien is valid as against any person, unless the carrier had notice that the consignor lacked authority to ship the goods, even if the consignor was a thief. If the carrier is not required to accept the goods, the specific lien is valid against anybody entrusting possession to the consignor, including one holding a recorded security interest (see section 9-310) unless the carrier has notice that the bailor lacked such authority.

U.C.C. Sec 7-308. Explanatory Notes.

Enforcement of the carrier's lien has traditionally been governed by contract between the carrier and shipper, rather than by specific statute. This section of the Code is almost identical to section 7-210 regulating enforcement of the warehouseman's lien. The explanatory notes to that section are equally applicable to the carrier's lien enforcement.

Hawaii Law.

Rev. Laws Hawaii 193-4, 193-5, 193-6

Existing law authorizes common carriers to sell at public auction goods unclaimed for six months. The lien is specific and attaches automatically. The right to foreclose on such a lien accrues after the six-month period or as soon as necessary in the case of perishable goods. The lien covers transportation, storage, advertising, and sales charges. The sale must be preceded by advertisement, except in the case of perishable goods in which event the sale may be either public or private.

After sale, the carrier is required to keep records of the transaction and preserve them for five years. Any excess in the proceeds of the sale must be paid to claimants within the five-year period and after that time escheat to the State.

The Code is silent on the problems presented by unclaimed and perishable goods held by carriers. Under the Code a carrier would have a right to terminate storage and dispose of the goods only after it had acquired the status of a warehouseman. Since a carrier seeking to dispose of goods in this situation is actually seeking to terminate its status as a warehouseman, the rules of section 7-206 of the Code would logically apply.

U.C.C. Sec. 7-309. Explanatory Notes.

This codification of a carrier's duty of care and the extent to which liability can be limited by contract is patterned after the Carmack Amendment to the Interstate Commerce Act, 49 U.S.C.A. section 20 (11). The standard of care imposed by the Code is that of a reasonably careful man under like circumstances. Limitations on financial responsibility and specifications pertaining to the time and manner of making claims for damages are proper within prescribed limits. Any stricter rule of law imposing liability on a carrier is explicitly continued.

Hawaii Law.

Rev. Laws Hawaii 104-21.5

Existing law places liability on the carrier for the full actual loss, damage or injury to property, but does not specify the standard of care required by the carrier. It permits limitation of liability in special excepted cases. The section provides that the period for filing claims cannot be made shorter than four months.

PART 4
WAREHOUSE RECEIPTS AND BILLS OF LADING:
GENERAL OBLIGATIONS

U.C.C. Sec. 7-401. Explanatory Notes.

The obligations and rules imposed by Article 7 apply to issuers of documents of title notwithstanding the fact that the documents do not conform to the requirements of the Article or other laws and regulations and notwithstanding other irregularities regarding issue, form or content. This section applies, however, only when the issuer has issued a document of title, defined in section 1-201 (15) of the Code as any "document which in the regular course of business or financing is treated as adequately evidencing that the person in possession of it is entitled to receive, hold and dispose of the document and the goods it covers. To be a document of title a document must

purport to be issued by or addressed to a bailee and purport to cover goods in the bailee's possession which are either identified or are fungible portions of an identifiable mass."

Examples of irregularities which do not relieve the issuer of Article 7 obligations include the following: a bailee is not permitted to avoid his obligation to deliver the goods (7-403) or his obligation of due care with respect to them (7-204 and 7-309) by taking the position that no valid document was issued because he failed to file a statutory bond or did not disclose the place of storage in the document.

Hawaii Law.

Rev. Laws Hawaii 207-1, 207-2, 207-3, 207-53 (UWRA)

Existing law prescribes certain essential terms which must be included in warehouse receipts. Under these rules a failure to include an essential term or the insertion of an improper term may mean that the document is not a warehouse receipt, and the issuer in such a case might be relieved of obligations which otherwise would be imposed upon him. This uncertainty is at least partially removed by broadening under section 7-201 of the Code the definition of "warehouse receipt" to include warehousemen who are not storing goods for profit and warehousemen who are acting illegally and by revising under section 7-202 of the Code the essential terms which must be included in a warehouse receipt.

The Hawaii statute requiring a statement of the warehouseman's ownership on the receipt and making non-compliance a crime has no counterpart in the Code which does not include any criminal provisions.

U.C.C. Sec. 7-402. Explanatory Notes.

The exceptions to the rule that duplicate documents purporting to cover goods already represented by an outstanding document of the same issuer do not symbolize the goods that are discussed in the sections where the exceptions are stated: the "bills in set" exception in section 7-304; the "overissue of warehouse receipts for fungible goods" in section 7-207; and the "substitutes for lost, stolen or destroyed documents" herein.

The holder of an original warehouse receipt or bill of lading, whether negotiable or non-negotiable, cannot be divested of his rights under the document by the subsequent issue of a second or duplicate warehouse receipt or bill of lading covering the same goods.

The transferee of an overissue or non-marked duplicate document acquires no title but has a right of damages against the issuer.

Although the general rule is that the transferee of a non-negotiable document acquires only the rights of his transferor, the official comment No. 2 to this section states that the transferee of a non-negotiable document who acquires an unmarked duplicate from a transferor who knew the facts has a right to damages. The only case on this point is Brock v. Atteberry, 153 La. 649, 96 So. 505 (1923).

Disputes between holders of documents not of the same issuer are provided for in section 7-503 of the Code.

Hawaii Law.

Rev. Laws Hawaii 207-6, 207-14, 207-52 (UWRA)

The provision of the Code is broader than existing statutory law which makes the issuer only of an unmarked duplicate negotiable warehouse receipt liable to anyone who purchases it for value supposing it to be the original. Hawaii law does not provide for exceptions in the cases of overissue of receipts for fungible goods; or of substitutes for lost, stolen or destroyed receipts. The criminal provisions of section 207-52, which are not applicable where indicated procedures are followed in cases of lost or destroyed receipts, would not be affected by the Code.

U.C.C. Sec. 7-403. Explanatory Notes.

Bailee Excused from Duty to Deliver the Goods.

The bailee is required as his primary obligation to deliver the goods to the person entitled to them under a document of title unless one of the following listed excuses is established by the bailee.

1. Delivery to a person whose title is paramount to the rights represented by the document, for example, the goods have been deposited with the bailee by a person not entitled to them, such as a thief, and returned to the owner upon his demand, provided the owner has not acted in a manner to prevent him from later claiming title.
2. The bailee has observed the required standard of care, but the goods have nevertheless been damaged or destroyed. The optional language has been adopted in five states and follows the prevailing rule for interstate carriers.

The minimum standard of reasonable care under the Code is prescribed in sections 7-204 and 7-309.

3. Previous sale or other disposition pursuant to the provisions of sections 7-206, 7-209, 7-210, 7-307, and 7-308 of the Code dealing with enforcement of a lien and termination of storage.
4. Seller's exercise of his right to stop delivery pursuant to section 2-705 of the Code. This excuse might also be classified under the category of delivery to a person lawfully entitled to the goods. Since the excuse depends on the validity of the stoppage, and the bailee may be liable to the buyer if the stoppage is unjustified, the bailee is given a right to recover from the seller damages resulting from honoring an improper order to stop (see section 7-504 of the Code).
- 5) Diversion, reconsignment or other disposition pursuant to section 7-303 of the Code or to tariff regulations. See the explanatory notes to sections 2-705, 7-303, 7-504 and 7-603 of the Code.
- 6) Release, satisfaction, or other personal defense against a claimant, such as delivery of goods represented by a negotiable document to one member of a partnership without canceling the receipt. The bailee would not be liable to the other partner on the ground that delivery can probably be made to one partner as bailor.

7. Any other lawful excuse precludes the possibilities, for instance, that a bailee might be subjected to double liability if he surrendered goods under compulsion of legal process or liable for disposition of hazardous goods.

Condition to Claimant's Right of Delivery.

The claimant must satisfy the bailee's lien only when requested by the bailee or when the bailee is prohibited by law from delivery until the charges are paid. This subsection (2) operates as a condition precedent to the claimant's right of delivery. The bailee's right to detain until paid is implied.

Bailee's Duty to Cancel or Note Partial Delivery Upon Negotiable Documents.

The holder of a negotiable document must offer to surrender it to the bailee as a condition precedent to compelling delivery, and the bailee must cancel the document or note on it partial delivery. If he neglects to do so, he will be liable to any person to whom the document is duly negotiated. An outstanding negotiable document, however, need not be surrendered if the claimant is the true owner, and the document has been procured by a thief.

"Conspicuous" as pertains to notation of partial delivery is defined in section 1-201 (10) of the Code.

Definitions.

The definition of the phrase "person entitled under the document" makes clear the right of the holder of a written delivery order to have the goods which are covered by a non-negotiable document of title. It should be noted, in this connection, that under section 7-503 (2) of the Code delivery orders cannot properly be honored by a bailee if a negotiable document issued by him is outstanding.

The duty of the bailee to deliver the goods runs to the holder of a negotiable document or the person to whom delivery is to be made by the terms of written instructions under a non-negotiable document. Due negotiation is not needed in order to qualify as a holder; mere possession of a properly indorsed document of title suffices. The bailee is compelled to make delivery only of what he has. The liability of a bailee in cases of misdescription is prescribed in sections 7-203 and 7-301 (1) of the Code.

Hawaii Law.

Rev. Laws Hawaii 202-59, 202-62 (USA), 207-8 to 207-12, 207-16, 207-19, 207-21, 207-36, 207-54, 207-56 (UWRA).

Existing law governing the obligation of the warehouseman to deliver is similar in substance to the Code provisions which constitute largely a consolidation and rewriting of prior uniform legislation.

There are some minor modifications that would be effected by the Code. Under section 207-8, Revised Laws of Hawaii 1955, the claimant of the goods must inter alia offer to satisfy the warehouseman's lien, as a condition precedent to his right of delivery. Under subsection 7-403 (2) of the Code, however, the claimant is required to satisfy the bailee's lien only when requested by the bailee or when the bailee is prohibited by law from delivery until the charges are paid.

Section 207-54 makes it a crime for a warehouseman to surrender goods covered by a negotiable receipt without requiring presentment of the receipt for cancellation. Since the Code contains no criminal penalties, retention of such sanctions will require special legislation to that effect if the Code becomes law, for Article 10 specifically repeals the UWRA.

Section 207-8, Revised Laws of Hawaii 1955, does not impose an obligation on a warehouseman to deliver to the holder of a delivery order, and section 207-9, Revised Laws of Hawaii 1955, provides that a warehouseman is justified in so delivering. Thus, it would seem that although he is not obligated to honor a delivery order, he is protected in the event that he does. Subsection 7-403 (4) of the Code would clarify the right of the holder of a written delivery order to have the goods covered by a non-negotiable document of title.

The optional language in subsection 7-403 (1)(b) of the Code would not need to be adopted in Hawaii since the subsection is consistent with present statutory law as provided in section 207-21, Revised Laws of Hawaii 1955.

U.C.C. Sec. 7-404. Explanatory Notes.

The Code confers immunity on a bailee who acts in accord with the terms of a document of title or Article 7 of the Code in good faith including the observance of reasonable commercial standards. The immunity extends to cases where the depositor is a thief, where the bailee delivers to a fraudulent holder of a valid document and where the bailee delivers to a holder of an invalid document.

When there are conflicting claims this section might protect the bailee if he delivered to the claimant not entitled to the goods. However, "observance of reasonable commercial standards" might require the bailee to force an action of interpleader.

Hawaii Law.

Rev. Laws Hawaii 207-57 (b) (UWRA).

Existing law is somewhat more explicit than the Code in defining the term "good faith". Section 1-201 (19) of the Code defines good faith as "honesty in fact in the conduct or transaction concerned". Section 207-57 (b), Revised Laws of Hawaii 1955, defines a thing done 'in good faith' as "in fact done honestly, whether it be done negligently or not".

PART 5
WAREHOUSE RECEIPTS AND BILLS OF LADING:
NEGOTIATION AND TRANSFER

U.C.C. Sec. 7-501. Explanatory Notes.

Title to goods in possession of a third person may be transferred from seller to buyer through a normal corporeal sale of the goods. A more convenient means of transferring title is provided by the use of documents of title which permits the parties to deal solely with documents and which leaves possession of the goods unchanged. The holder of a document of title acquires full protection under the Code only if he takes the document by due negotiation. Due negotiation involves four elements: (1) negotiation, (2) good faith, (3) value, and (4) regular course of business or financing.

The provisions of this section describing the formal mechanics of negotiation whether by indorsement, delivery, or indorsement and delivery are generally consistent with prior uniform legislation.

The important innovation, introduced in subsection (4), is the requirement of "regular course of business or financing" as one of the elements of due negotiation. The phrase is not defined, but the official comments of the Code suggest that it relates to the person making the transfer and the nature of the transaction, in addition to the traditional red-light concepts of staleness, suspiciously low prices, and defects apparent on the instrument. Apparently, "due negotiation" will not exist where the person attempting to negotiate the document is one with whom it is not customary to deal in the trade. The example given in the official comments is illustrative: No commercial purpose is served by allowing persons like tramps or [law] professors to cut off the rights of the owner of a car of hides or of a bale of warehoused cotton. "Due negotiation" then would only be established where the transferor's possession of the document appears congruous with normal commerce, as a person who deals normally in the trade. The new qualification for due negotiation may be equated with the "prudent man" test of good faith, for a prudent man does not take an instrument in good faith if it is negotiated outside the stream of commerce. The prudent man test is not used in Article 3 of the Code for commercial paper (see section 3-302).

Another significant change in the concept of "due negotiation" eliminates those transfers in which a document is taken in payment of, rather than as security for, a money debt. This qualification precludes a creditor under the guise of demand for increased collateral from "snatching a plank in the shipwreck" and thus claiming rights under "due negotiation".

The value element of "due negotiation" in accord with the definition in section 1-201 (44) of "value" includes a pre-existing debt.

Prior uniform law (UBLA) does not specifically recognize bearer bills of lading, but they are so recognized by section 7-104 of the Code. Subsection 7-501 (2) (a) provides that such bills are negotiated by delivery alone.

It should be noted that subsections 7-501 (2) (a) and 7-501 (3), taken together, make clear that the Code rejects the old rule of "once bearer always bearer" and adopts Britton's interpretation of the rule as it pertains to negotiable instruments that the last endorsement controls.

Subsection 7-501 (2) (b) which is parallel to section 3-302 (2) extends to documents of title the rule that a payee of a negotiable instrument can be a holder in due course entitled to rights created by negotiation. Thus, a person named in the document, whether he is a depositor, buyer or financing bank, may claim rights such as a claim for commingled fungible goods in case of overissue (section 7-207 (2)); title to the document and goods in case of bills in a set (section 7-304 (3)) and the rights enumerated in section 7-502. Of course, knowledge of a defense defeats "due negotiation" and such a holder would not be entitled to cut-off protection.

Hawaii Law.

Rev. Laws Hawaii 202-27 to 202-32, 202-35, 202-38 (USA), 207-37 to 207-40, 207-43, 207-47 (UWRA)

The most notable changes in existing law that would be imposed by the Code are the requirement of "regular course of business or financing" as an element of "due negotiation", and the exclusion from due negotiation of transfers in which a document is taken in payment of a money debt.

U.C.C. Sec. 7-502. Explanatory Notes.

By due negotiation as required under section 7-501 of the Code, the holder of a document acquires perfect title to the document, the goods, and the issuer's direct obligation to hold the goods for, and deliver them to, his disposition, except against persons who have perfected legal or security interests in them before the document was issued.

This section is expressly subject to sections 7-205 and 7-503 of the Code. Section 7-205 permits a purchaser of fungible goods from a warehouseman who is in the business of buying and selling such goods to prevail over the holder of a duly negotiated warehouse

receipt. Section 7-503 is a more comprehensive limitation upon the rights acquired by due negotiation, particularly in a "title paramount situation", and establishes the classic rule that one can acquire through a document of title no greater interest than that owned by the bailor of the goods. Thus, a thief cannot strip an owner of his rights by placing stolen goods in a warehouse or on a carrier and duly negotiating the warehouse receipt or bill of lading to an innocent purchaser for value.

Subsection 7-502 (1)(c) is a codification of the common law rule in the situation known as "feeding the estoppel". The leading case is Baldin v. Childs, 249 N.Y. 212, 163 N.E. 737 (1928). Feeding the estoppel arises where a bailee issues a document before receipt of the goods. Upon subsequent receipt of the goods, the bailee is estopped to deny the terms of the document. In effect, the subsequently acquired goods makes valid the earlier issued document.

Subsection 7-502 (1)(d) clarifies the rights acquired by due negotiation of delivery orders. Section 7-102 (1)(d) of the Code defines a delivery order as a written order to deliver goods addressed to any issuer of warehouse receipts or bills of lading. It is analogous to a check drawn on a bank, and a bailee's obligation under a delivery order is similar to a bank's obligation under a check, at least insofar as that the obligation accrues only upon acceptance.

In contrast to the rule of subsection 7-502 (1) which prevents a thief of goods from defeating the interests of the true owner, subsection 7-502 (2) establishes a different rule applicable to theft of a negotiable document. In the latter case, if the true owner puts the goods in a warehouse or on a carrier and takes back a negotiable document in bearer form which is stolen and eventually sold to a holder for value in good faith, the holder becomes the perfect owner of the goods. This rule follows the developing case law which has moved away from the "symbolic theory", which minimized the negotiable nature of documents of title, and instead favors the view that a holder by due negotiation of a document of title is given greater rights than he would have acquired had he bought the goods themselves.

Hawaii Law.

Rev. Laws Hawaii 202-20 (d), 202-25, 202-33, 202-38, 202-62 (USA), 207-41, 207-47 to 207-49 (UWRA), 26 H. 517.

Sections 202-20 (d), 202-33, and 207-41, Revised Laws of Hawaii 1955, which state the rights acquired by due negotiation of negotiable bills of lading and warehouse receipts explicitly enumerate "title to the goods". The Code would expand this to include, also explicitly, title to the documents and would extend applicability of the rule to include rights acquired under negotiable delivery orders upon acceptance.

The limitations of this section of the Code, which follow from making it subject to sections 7-205 and 7-503 dealing with fungible goods and paramount title, would constitute new statutory law in Hawaii.

The codification of the rule for "feeding the estoppel" situation would also be a novel statutory approach in Hawaii.

See Sumitomo v. Hawaii Nosan, 26 H. 517, 531 (1922) (dictum) following the "symbolic theory".

U.C.C. Sec. 7-503. Explanatory Notes.

As discussed in connection with the preceding section, the "title paramount" situation is the most important exception to the rule that a holder by due negotiation of a document of title gets perfect title to the goods.

This section provides a special rule, apart from the general duplicate document rule of section 7-402 of the Code, to determine rights to goods where conflicting claims might arise if a delivery order were accepted without taking up the negotiable document of title originally covering the goods. It is made clear that the holder of a negotiable warehouse receipt or bill of lading prevails over the holder of a negotiable delivery order, regardless of time of issue. The consequences of this rule entail certain precautions. A delivery order issued by a holder of a negotiable warehouse receipt or bill of lading cannot be safely honored or accepted by a bailee unless he receives, or conspicuously notes partial deliveries on, the negotiable document. Furthermore, one should not pay value for a delivery order until he is sure that the bailee has taken up or marked the controlling document of title.

Rights and duties in the special case of freight forwarders are regulated by subsection 7-503 (3) of the Code. Freight forwarders in the regular course of their business consolidate smaller shipments into carloads to obtain lower rail or motor freight rates for carload lots. Interstate Commerce Commission regulations require them to issue bills of lading to their shippers (Bills of Lading of Freight Forwarders, 259 I.C.C. c 13 (1944) and 49 U.S.C. 13 (1952)). The freight forwarders, in return, receive bills of lading from their carriers when the shippers' goods are loaded on board. Thus, the law requires two different documents to cover a single lot of goods. The Code provides, in this instance of "overissue" that a person to whom a freight forwarder's bill is duly negotiated prevails over title based on the carrier's bill. The rationale of the rule is that a bill of lading issued by a carrier to a freight forwarder on its face gives notice that the forwarder has issued bills of its own. Criticism of this rule, advanced primarily by representatives of railroads, is that it neglects consideration of two factors: that the Code recognizes bearer bills of lading and that the names of freight forwarding companies do not always readily identify them as freight forwarders.

Hawaii Law.

Rev. Laws Hawaii 202-33 (USA) and 207-41 (UWRA)

The provisions of this section of the Code would modify existing law to protect further the title of a holder by due negotiation of a document of title. The exceptions would be made explicit in regard to "title paramount" cases; new rules would be codified to govern situations where the true owner "acquiesced" in the procurement of a document of title or where a conflict was created because a delivery order was accepted after issuance of a negotiable bill of lading or warehouse receipt covering the same goods; and rules would be established to determine the conflict between a freight forwarder's bill of lading and the corresponding, underlying bill of lading.

U.C.C. Sec. 7-504. Explanatory Notes.

This section governs the rights of a transferee of a document of title in the absence of due negotiation. The situations covered encompass negotiable documents of title that have not been "duly negotiated"

and non-negotiable documents. In both situations purchasers receive only the title which their transferor had or had actual authority to convey; this is substantially less protection than is given a holder through due negotiation.

The transferee of a non-negotiable document runs the risk that creditors of the transferor may be successful in reaching goods in the hands of a bailee. The Code restricts the right of a transferor's creditor to defeat the title of the transferee before the bailee is notified through attachment or execution by limiting the right to those creditors who could attack the transfer as being fraudulent under the terms of section 2-402 of the Code. It should be noted that rights of creditors under section 2-402 should be distinguished from claims of secured creditors of a seller, which are governed by Article 9 on secured transactions.

The rights of the transferee of a non-negotiable document may also be defeated by a second sale of the goods by the transferor if the second purchaser first notifies the bailee and if he is a buyer in the ordinary course of business from the transferor. The second purchaser is not protected if he is a bulk buyer or takes the goods as security for, or in satisfaction of, a money obligation.

The right of a transferee of a non-negotiable document to hold a bailee liable for non-receipt of goods is defeasible if the bailee in good faith disposes of the goods upon instruction of the transferor. The transferee, in this case, may still be able to claim the goods from the transferor. However, if the transferor has sold the goods, the transferee may be barred from asserting his title against the buyer if the buyer first notified the bailee and was a buyer in the ordinary course of business from the transferor, as noted above.

A carrier is protected against claims of a consignee of a non-negotiable bill of lading if the carrier honors an order of reconsignment or diversion. Other rules applicable to reconsignment and diversion are set forth in section 7-303 of the Code, but subsection 7-504 (3) makes it clear that a substituted consignee who is a buyer in the ordinary course of business from the consignor takes the goods free of any claim by the original consignee. This danger is limited to non-negotiable bills since only the holder of a negotiable bill may divert (section 7-303 (1) (a)).

Finally, this section provides that a carrier has a right to indemnity for losses or expenses caused by honoring a seller's request to stop delivery.

Hawaii Law.

Rev. Laws Hawaii 202-34, 202-57 to 202-59 (USA),
207-42 (UWRA)

This section of the Code would supplement existing statutory law by providing additional specific rules on reconsignment and diversion and by providing for carrier indemnity when a seller exercises its right to stop delivery. It would limit protection of subsequent purchasers to those who qualify as "buyers in the ordinary course of business".

U.C.C. Sec. 7-505. Explanatory Notes.

The indorsement of a document of title is essentially a conveyance of a property interest and is not a contractual act by which the indorser assumes secondary liability. It should be noted, however, that there is at least one case in which indorsement guarantees future action. If a bailee has not yet become liable upon a document at the time of the indorsement, the indorser engages that the bailee will appropriately honor the document. Subsection 7-502 (1)(d) provides, for instance, that the issuer and any indorser of a negotiable delivery order are obligated to the holder to procure acceptance by the bailee.

Hawaii Law.

Rev. Laws Hawaii 202-37 (USA), 207-45 (UWRA).

Existing law would not be altered by this provision of the Code.

U.C.C. Sec. 7-506. Explanatory Notes.

The Negotiable Instruments Law rule giving a transferee the right to compel an indorsement is a measure intended to protect a holder for value. Other uniform acts (UBLA, USA, UWRA) have parallel provisions which require the transferee to be a holder for value before he can insist on an indorsement. Since an indorser of a document of title, in contrast to an

indorser of commercial paper, does not assume secondary liability (section 7-505 of the Code) but indorses only to convey, there is no reason to require the transferee to take for value in order to be entitled to an indorsement. This section of the Code, therefore, eliminates the requirement that the transfer must be for value and expands the right to compel indorsement to include the right to demand that the transferor secure indorsements of other necessary parties. Lack of consideration, of course, will prevent a transferee from claiming due negotiation, and even though a purchaser secures missing indorsements in good faith, if he acquires the document for the purpose of settling a money obligation, he cannot, under section 7-501 (4) of the Code, claim due negotiation.

Hawaii Law.

Rev. Laws Hawaii 202-35 (USA), 207-43 (UWRA).

Existing law is in accord with the uniform legislation which requires that a transfer must be "for value" in order to authorize the transferee to compel his transferor's indorsement. The Code would eliminate this requirement and would expand the right to include indorsements of other necessary parties.

U.C.C. Sec. 7-507. Explanatory Notes.

This section sets forth the three warranties which are undertaken by transferors for value of documents of title. If a sale is involved in the same transaction in which the documents are employed, the sales warranties codified in Article 2 are applicable as relating to the underlying contract of sale. The three warranties run only to the immediate purchaser, unless otherwise agreed, and the parties also may agree that there are to be no warranties. This treatment of warranties is in contrast to that accorded warranties accompanying commercial paper as provided in section 3-417 of the Code.

Hawaii Law.

Rev. Laws Hawaii 202-36 (USA), 207-44 (UWRA)

The warranties which accompany documents of title under USA and warehouse receipts under UWRA include the three warranties of the Code plus warranties as to the goods, such as implied warranties of title to the goods, of merchantability and of fitness for the purpose. Existing law is not clear on the question of whether the warranties extend to remote purchasers; the Code would specifically provide that warranties concerning documents of title run only to the immediate purchaser unless otherwise agreed.

U.C.C. Sec. 7-508. Explanatory Notes.

The exception to the general warranty rules of section 7-507 of the Code occurs under the following common circumstances: A seller ships goods to a buyer and then forwards through a bank, or other agent for collection, the bills of lading and a draft drawn on the buyer. When the buyer pays or accepts the draft, he is given the bills of lading. The seller is thus able to retain a security interest in the goods until he is paid. Sometimes the collecting bank advances funds to the seller when it takes the draft for collection.

This section of the Code provides that the collecting bank does not assume warranty liability, going to the genuineness of the document or the condition of the goods, to the buyer when presenting the draft for collection, but does warrant its own good faith and authority. The bank may still be liable under warranty, however, if it acts as agent for the seller or otherwise assumes the seller's obligations.

Hawaii Law.

Rev. Laws Hawaii 207-46 (UWRA).

Existing law is in terms of negative warranties in contrast to the Code which would state affirmative warranties of good faith and authority. The Code would also explicitly assign warranties to a holder for collection whereas existing law applies only to a "mortgagee, pledgee or holder for security".

U.C.C. Sec. 7-509. Explanatory Notes.

This section provides a cross-reference to other articles of the Code which govern substantive matters of sales and letters of credit rules.

Hawaii Law.

Rev. Laws Hawaii 202-73 (USA), 207-56 (UWRA).

Existing law includes wide cross-references to rules of law and equity, including the law merchant, as well as explicit referrals such as to the rules relating to the law of principal and agent.

PART 6
WAREHOUSE RECEIPTS AND BILLS OF LADING:
MISCELLANEOUS PROVISIONS

U.C.C. Sec. 7-601. Explanatory Notes.

If a document is lost, stolen, or destroyed, the goods must still be disposed of. At the same time, it is necessary to reconcile the various interests of the bailee, the person claiming under the missing document, and the person who may present the missing document at a later date.

The Code provides that a court may order delivery of the goods or issuance of a substitute document. Protection for a person later presenting the missing document is obtained by requiring the posting of a bond before the duplicate is issued in the case of a negotiable document. If the missing document is non-negotiable, the bond requirement is within the discretion of the court. The bailee may deliver pursuant to the terms of the missing document without securing a court order, but then he risks liability for improper delivery although he would not be liable for conversion if delivery is made in good faith.

Hawaii Law.

Rev. Laws Hawaii 207-14, 207-54 (UWRA).

Existing law provides for judicial orders of delivery as to lost or destroyed negotiable warehouse receipts. The Code would extend these provisions to negotiable and non-negotiable documents of title and to stolen documents.

The Code would also authorize judicial orders to issue duplicate documents instead of delivery of the goods, would limit the holder's recourse to the bond, and would eliminate liability for conversion if the bailee delivers in good faith.

U.C.C. Sec. 7-602. Explanatory Notes.

The primary duty of a bailee is to have goods ready to be delivered to the holder of a negotiable document of title. This section of the Code protects the bailee from attachment of goods covered by negotiable documents unless the documents are first surrendered or their negotiation enjoined. The protection is not available, however, where the person asserting rights has a claim independent of and adverse to the document.

Hawaii Law.

Rev. Laws Hawaii 207-25 (UWRA).

Existing law would not be changed significantly except for the additional provision that defeats the lien by extending protection to a purchaser who acquires a document without notice.

U.C.C. Sec. 7-603. Explanatory Notes.

This section authorizes a bailee to use the procedural device of interpleader in cases of conflicting claims to the goods.

Hawaii Law.

Rev. Laws Hawaii 207-17, 207-18 (UWRA).

Existing laws pertaining to interpleader procedures available to a warehouseman are consistent with the Code provision which applies to any bailee.

ARTICLE 8

INVESTMENT SECURITIES

Prefatory Observations

Article 8 codifies the law of investment securities, including bearer bonds, registered bonds, stock certificates and other types of investment paper, such as equipment trust certificates or warrants. The securities governed by Article 8 are "negotiable instruments" (section 8-105) but they are not "commercial paper" (Article 3). Article 8 covers instruments which formerly were in part regulated by the NIL, in part by the Uniform Stock Transfer Act and in part by no uniform legislation.

Article 8 retains but clarifies much of the prior law. It makes, however, some important innovations, as, for instance, extending the rights of a "purchaser for value who has taken without notice of a particular defense" (section 8-202 (4)) and of a "purchaser for value in good faith and without notice of any adverse claim" (section 8-302) to purchasers who become such after maturity (subject to limitations stated in section 8-203 and 8-305), or negating the liability of an indorser for the issuer's obligations (section 8-308 (4)).

Generally speaking Article 8 reflects the efforts of the framers of the Code to organize the various branches of the law of negotiable instruments and documents along functional lines and to stay abreast of modern commercial developments.

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SHORT TITLE AND GENERAL MATTERS

- 8-101. Short Title
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- 8-201. "Issuer"
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- 8-301. Rights Acquired by Purchaser; "Adverse Claim"; Title Acquired by Bona Fide Purchaser
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- 8-313. When Delivery to the Purchaser Occurs;
Purchaser's Broker as Holder
- 8-314. Duty to Deliver, When Completed
- 8-315. Action Against Purchaser Based Upon Wrongful
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PART 4 REGISTRATION

- 8-401. Duty of Issuer to Register Transfer
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PART 1 SHORT TITLE AND GENERAL MATTERS

U.C.C. Sec. 8-101. Explanatory Notes.

Self-explanatory.

U.C.C. Sec. 8-102. Explanatory Notes.

Subsection 8-102 (1) (a) gives a comprehensive definition of the instruments that are classified as investment securities. The concept is the result of four functional criteria all of which must be concurrently fulfilled. The criteria are: form; place of trading therein or recognition as medium of investment; being one of a class or series; type of right evidenced thereby. Subsection 8-102 (1) (b) specifies that if an instrument qualifies as security, its status is governed by Article 8 and not by Article 9.

Subsection 8-102 (1)(c) and (d) define the differences between securities in "registered form" and "bearer form". The distinction is important in view of the formalities required for a perfect transfer (see section 8-302).

Subsections 8-102 (2) and (3) define the technical terms "proper form" and "subsequent purchaser". One who takes by original issue is a purchaser, but not a subsequent purchaser.

U.C.C. Sec. 8-103. Explanatory Notes.

Section 8-103 extends the rule of section 15 of the Uniform Stock Transfer Act to all securities covered by Article 8. While section 15 of the Uniform Transfer Act required that the right of the issuer to the lien is stated upon the certificate, the Code prescribes that it be conspicuously noted. "Noted" does not imply reproduction hic verbis. Conspicuously is defined in section 1-201 (10).

Hawaii Law.

Rev. Laws Hawaii 172-73

Hawaii adopted section 15 of the Uniform Stock Transfer Act in a greatly modified form, Hawaii Revised Laws 1955, section 172-73. No reference to formal requirements for a lien in favor of the corporation was made. Hence section 8-103 alters existing law.

U.C.C. Sec. 8-104. Explanatory Notes.

The elevation of investment securities to the status of negotiable instruments has the result that a security may be validated or required to be issued or re-issued even though the original issue or the original transaction compelling its issue or re-issue were defective. Section 8-104 (1) excludes this result to the extent that validation, issue or re-issue would result in overissue.

In such case the person who otherwise would be entitled to issue or validation is entitled to a substitute security of the same type if it is reasonably available for purchase; otherwise he is entitled to be reimbursed for the price that he or the last purchaser for value paid with interest from the date of his demand.

U.C.C. Sec. 8-105. Explanatory Notes.

Subsection 8-105 (1) states the fundamental rule governing the Code's regime of investment securities: securities governed by Article 8 are negotiable instruments. This position climaxes a development which has been foreshadowed by modern decisional law and statutory enactments.

Subsection 8-105 (2) deals with certain matters of pleading and proof in actions on a security. The subsection requires specific denials in order to challenge the genuineness or authority as to a particular signature. In case of such denial the party claiming under the challenged signature has the "burden of establishing" it (as defined in section 1-201 (8)) but is aided by a presumption (as defined in section 1-201 (31)) in his favor.

Note that subsection (2) adapts analogous rules stated in section 3-307 for commercial paper to the law of securities.

U.C.C. Sec. 8-106. Explanatory Notes.

Section 8-106 states a specific conflicts rule applicable in the securities field: the controlling contact for the choice of law determining the validity of a security and the rights and duties of the issuer with respect to registration of transfer is the locality of the organization of the issuer. Other conflicts rules applicable to Article 8 are stated in section 1-105.

U.C.C. [Sec. 8-107 - adopted by New York.] Explanatory Notes.

Action for Price.

Where, pursuant to a contract to sell or sale, a security has been delivered or tendered to the purchaser, and the purchaser wrongfully fails to pay for the security according to the terms of the contract or the sale, the seller may in addition to any other remedy recover the agreed price of the security. This provision does not affect the remedy of a seller if the security has not been delivered or tendered.

Comment.

Adoption of this New York addition is not recommended. The provision was inserted in order to overcome objections raised by the New York Clearing House Association. Since the section as enacted in New York is in conflict with the policy of section 2-709 which permits an action for the price only after acceptance, Hawaii should not follow this deviation. The Permanent Editorial Board for the Uniform Commercial Code has recommended a different version of section 8-107.

PART 2
ISSUE — ISSUER

U.C.C. Sec. 8-201. Explanatory Notes.

The principal parties to the legal relations flowing from the distribution of investment securities are the "issuer" and the "holder". The latter term is defined in section 1-201 (20). Note that the holder is ordinarily also a "purchaser" as defined in section 1-201 (32), since that definition covers a person taking by original issue.

Subsection 8-201 (1) gives a broad disjunctive definition of "issuer" to cover the various kinds of securities governed by Article 8. The principal branch of the definition contained in section 8-201 (1) (a) corresponds to the definition of "security" given by section 8-102 (1) (a) (IV).

Subdivision (2) places a guarantor to the extent of his guaranty on equal footing with the issuer with respect to obligations on or defenses to a security. It is immaterial whether or not the guaranty is noted on the security.

Subdivision (3) narrows the definition of issuer for purposes of registration of transfer.

U.C.C. Sec. 8-202. Explanatory Notes.

Section 8-202 contains the key provisions regulating the effect of defects and other causes for defenses of the issuer on the rights of a purchaser for value and without notice vis-a-vis the issuer. The section distinguishes between different types of defects and reasons for defenses.

Subsection (1) entitles an issuer even against a purchaser for value and without notice to supplement the stated terms of a security with references to another instrument, indenture or document or to constitution, statute, bylaw, regulation, etc., provided that the terms so referred are not in conflict with the stated terms. But the reference does not suffice to charge a purchaser with notice of a defect going to the validity of the security, even if a clause to that effect is contained in the security.

Subsection (2) validates securities issued by private issuers despite defects going to their validity, if they are in the hand of purchasers for value without notice of those defects; but if the defect is caused by constitutional mandates, the validation benefits only subsequent purchasers (as defined in section 8-102 (3)) for value and without notice. In the case of governmental securities the rules of validation are much more limited. Validation occurs in two types of cases: if there was either substantial compliance with the legal requirements governing the issue or if the governmental issuer received substantial consideration and had power to borrow money or issue the security for the stated purpose.

The rules contained in subsection (2) are a codification of decisional trends following the policy that it is more equitable to other investors to validate the security than to allow damages.

Subsection (3) upholds forgery as a defense against purchasers for value and without notice, subject to the limitation that the issuer bears the risk of unauthorized signatures placed on the security by persons entrusted by the issuer with the issuance or handling of the security as specified in section 8-205.

All other defenses including--in change of prior law--those based on non-delivery and conditional delivery are cut off against a purchaser for value without notice.

Subsection (5) preserves the right of a party to a "when, as and if" or "when distributed" contract to cancel the contract in case of a material change. New York has modified this subsection by replacing the words expressing the conditions for the cancellation of such contracts with the phrase "according to its terms". The reason for this change is the fact that frequently the exchanges where the securities are traded or the National Association of Securities Dealers are entrusted with the determination of whether such contracts are cancellable. See Penney, New York Revisits the Code: Some Variations in the New York Enactment of the Uniform Commercial Code, 62 Colum. L. Rev. 992 at 1008 (1962).

U.C.C. Sec. 8-203. Explanatory Notes.

Under former law maturity terminated negotiability. The Code modifies this policy and protects a purchaser as holder in due course as long as he has no notice that the instrument is overdue. Sections 3-302 and 3-304 state the rules to that effect applicable to commercial paper; section 8-203 adapts these rules to securities.

Subsection (1) proceeds on the theory that staleness of the instrument charges a purchaser thereof with notice of any defect in the security's issue or any defense of the issuer. If the rights of the holder are for the payment of money or the delivery of securities or both on presentation or surrender of his security and such funds or securities are available on the date set for the payment or exchange, a purchaser who takes more than one year after that date is no longer protected by the rules of negotiability. In all other cases the purchaser loses this protection if it takes more than two years after the date set for presentation or surrender or the due date of performance of the principal obligation.

Subsection (2) clarifies that revoked calls are not within the operation of subsection (1).

U.C.C. Sec. 8-204. Explanatory Notes.

Restrictions on transfers are valid against persons without actual notice only if noted conspicuously on the security. Section 8-204 is the counterpart to section 8-103 and likewise derived from section 15 of the Uniform Stock Transfer Act.

Hawaii Law.

Rev. Laws Hawaii 172-73

Hawaii adopted section 15 of the Uniform Stock Transfer Act in a greatly modified form. Section 8-204, accordingly, introduces a new statutory rule.

U.C.C. Sec. 8-205. Explanatory Notes.

Section 8-205 regulates the effect of unauthorized signatures placed on a security prior to or in the course of issue. While in general such signatures are ineffective, the Code precludes the issuer from setting up the defense of forgery against purchasers for value and without notice of the defect if the signing was the act of persons entrusted by the issuer with the signing or the preparation for signing, or of employees of the issuer entrusted with responsible handling of the security.

The section broadens the existing decisional law on the responsibility of the issuer for forgeries by persons whom he has entrusted with the responsible handling of the security prior to and in the course of issue.

U.C.C. Sec. 8-206. Explanatory Notes.

Subsection 8-206 (1) regulates the effects of the completion of an instrument which contains the signatures necessary to its issue or transfer but is incomplete in other respects. The need for such regulation results from the fact that the defenses of non-delivery or conditional delivery are abrogated against purchasers for value without notice of these defects by section 8-202 (4). Subdivision (a) permits any person to fill in the blanks as authorized. Subdivision (b) protects purchasers for value and without notice, if the blanks are incorrectly filled in.

Subsection 8-206 (2) provides that a complete security which has been improperly altered remains enforceable even though the alteration was due to fraud, but is enforceable only according to the original terms. This rule follows from the nature of the securities and the investment normally involved.

Note that the rule of subsection (1) is qualified by the overriding principle of section 8-104.

U.C.C. Sec. 8-207. Explanatory Notes.

Section 8-207 is derived from section 3 of the Uniform Stock Transfer Act. It is designed to shield the issuer or indenture trustee of securities in registered form from burdensome duties by permitting him to treat the registered owner as the person entitled to vote, receive notifications and exercise all other rights and powers of an owner until the security is duly presented for registration of transfer as specified in Part 4. This provision does not preclude the practice of closing the transfer books or setting a record date for dividend, voting and other purposes as provided for in bylaws, charters and statutes. The section does not compel the issuer to deal exclusively with the registered owner, but it makes it clear that mere notice of a pledge does not bar him from doing so.

Subsection (2) is inserted to dispel any doubts about the continued effectiveness of existing legislation imposing liabilities of registered owners or of the rules permitting them to disclaim ownership for such purposes.

U.C.C. Sec. 8-208. Explanatory Notes.

Section 8-208 regulates the scope of the warranty against particular defects which an authenticating trustee, registrar, transfer agent or similar party assumes vis-a-vis purchasers for value without notice of such effects, by placing his signature upon a security. The section lists three types of such defects:

- (1) that the security is not "genuine" and "in proper form" (as defined in sections 1-201 and 8-102);
- (2) that his own participation in the issue is not within his own capacity and within the scope of the authorization given him by the issuer; and
- (3) that he has reasonable grounds to believe that the security is overissue.

Subsection (2) rejects former case law which imposed an implied warranty of the absence of other defects going to the validity of the security.

Note that the warranty seems to be subject to the "unless otherwise agreed" rule of section 1-102 (3) and (4), but apparently only if such exclusion is conspicuously noted on the instrument.

New York modified subsection 8-208 (1) by replacing the warranty of "proper form" in subdivision (a) with a warranty of "the form which such person has been authorized to authenticate, sign or countersign". The reason was to exclude a warranty of compliance with statutory requirements such as adequate disclosures in the prospectus. See Penney, New York Revisits the Code: Some Variations in the New York Enactment of the Uniform Commercial Code, 62 Colum. L. Rev. 992, 1008 (1962). A similar change in Hawaii should await approval by the Permanent Editorial Board.

PART 3 PURCHASE

U.C.C. Sec. 8-301. Explanatory Notes.

Section 8-301 states the basic rules governing the effect of transfers. Following settled principles worked out for the law of negotiable instruments, the Code differentiates between bona fide purchasers (as defined in section 8-302) and other purchasers (as defined in section 1-201 (31) and (32)).

Any purchaser acquires the rights which his immediate transferor had or had authority to transfer. This principle, however, is qualified by an important exception: a purchaser who has been a party to any fraud or illegality affecting the security or as a prior holder had notice of an adverse claim cannot improve his position by taking from a later bona fide purchaser.

"Adverse claim" is defined as including a claim that a transfer was or would be wrongful or that a particular adverse person is the owner or has an interest in the security. In New York this definition is limited by the qualification "and in the case of a purchase of a limited interest includes only a claim adverse to the interest purchased". The change has been said to merit national adoption, Penney, New York Revisits the Code: Some Variations in the New York Enactment of the Uniform Commercial Code, 62 Colum. L. Rev. 992, 1009, 1015 (1962).

Bona fide purchasers acquire free of any adverse claim, and purchasers of limited interests acquire rights only to the extent purchased.

U.C.C. Sec. 8-302. Explanatory Notes.

Article 8 differentiates sharply between two different aspects of negotiability: its effect upon defenses available to the issuer and its effect on adverse claims to the instrument. A purchaser for value without notice of a particular defect may take free of a defense based thereon even without a formally perfect transfer, but in order to take free of adverse claims the purchaser for value must not only be without notice of these claims but must base his rights upon a formally perfect transfer. Hence the definition of a purchaser who takes free of adverse claims--bona fide purchaser in the technical sense--varies from the definition of a purchaser who takes free of defenses. Compare section 8-302 with section 8-202 (4).

If the security is in bearer form the requisite transfer requires delivery; if the security is in registered form it is also necessary that the security was issued or indorsed to the purchaser.

U.C.C. Sec. 8-303. Explanatory Notes.

Section 8-303 gives a definition of "broker" for the purposes of Article 8. The criteria selected by the definition are functional and focus largely on the role played in a particular transaction.

Under the regime of Article 8 brokers are entitled to rights and privileges of a purchaser. He is not an intermediary within the meaning of Article 8, see section 8-306.

U.C.C. Sec. 8-304. Explanatory Notes.

Section 8-304 deals with specific situations in which a purchaser is or is not a bona fide purchaser because he is or is not charged with notice of adverse claims or because he has or has not a duty to inquire.

Subdivision (1) charges a purchaser (including a broker, as defined in section 8-303, but excluding an intermediary bank, as defined in section 4-105) with notice if a security is indorsed "for collection" or "for surrender" or for some other purpose not involving transfer or, if in bearer form, carries an unambiguous statement that it is the property of a person other than the transferor.

Subdivision (2) deals with some situations involving purchase from one described or identifiable as fiduciary. If the purchaser (excluding an intermediary bank) has knowledge that the proceeds are being used or that the transaction is in breach of the trust, he is charged with notice of adverse claims. Mere notice of the fiduciary relation imparts neither notice of adverse claims nor destroys good faith.

The rules stated are in accord with prior law and follow the policy of Uniform Fiduciaries Act.

U.C.C. Sec. 8-305. Explanatory Notes.

Section 8-305 is the counterpart to section 8-203 and regulates the effect of staleness at the time of the purchase on the purchaser's freedom from notice of adverse claims. A purchaser is charged with such notice, if he acquires the security:

- (a) after one year from the date set for presentment or surrender for redemption or exchange; or
- (b) after six months from any date set for payment of money against presentation or surrender, if funds are available for payment on that date.

Note that the periods of time destroying lack of notice of adverse claims are shorter than those destroying lack of notice of defects or defenses of the issuer.

U.C.C. Sec. 8-306. Explanatory Notes.

Section 8-306 deals with the general subject of warranties on presentment and transfer. The warranties on transfer codify pre-existing statutory and decisional law, corresponding to sections 65, 66, 67, 69 of the Uniform Negotiable Instruments Law and section 11, 12 of the Uniform Stock Transfer Act. The warranties are extended, under appropriate circumstances, to the issuer.

Subsection (1) specifies the warranties to the issuer. Any holder who presents a security for registration of transfer, payment or exchange warrants his entitlement thereto. A purchaser for value without notice of adverse claims, however, who receives a new, re-issued or re-registered security warrants only that he has no knowledge of any unauthorized signature in a necessary indorsement. This rule corresponds to the basic change in policy, incorporated in section 8-311, which protects a purchaser for value and without notice, who has received a new, re-issued or registered security against the claim of forgery.

Subsection (2) specifies the warranties of a transferor to a purchaser for value. These warranties are threefold and are incurred only unless otherwise agreed (section 1-102 (3)).

Subsections (3) and (4) exclude substantive warranties in the cases of deliveries by intermediaries, known to be such, and of redeliveries or deliveries on order of the debtor after payment by pledgees. Such parties warrant only their own good faith and authority, even though they have purchased or made advances against the claim to be collected.

A broker is not an intermediary and his warranties to his customer, the issuer or a purchaser are regulated by subsections (1) and (2).

U.C.C. Sec. 8-307. Explanatory Notes.

Section 8-307 determines the effect of the delivery of a security in registered form to a purchaser without a necessary indorsement. Such purchaser is a bona fide purchaser as defined in section 8-302 only upon indorsement, but the delivery transfers the transferor's rights and entitles the purchaser to obtain the necessary indorsement. This rule constitutes a change of the rule of the Uniform Stock Transfer Act, section 9.

U.C.C. Sec. 8-308. Explanatory Notes.

Section 8-308 regulates the form and effects of indorsements.

Subsection (1) specifies the general requirements of an indorsement. According to its simple mandates, indorsements are made when an appropriate person (as defined in subsection (3)) signs on the instrument or a separate document an assignment or transfer of the security or a power to assign or transfer it or when he merely places his signature without more on the back of the security.

Subsection (2) differentiates between special and blank indorsements. Indorsements to bearer are considered as blank indorsements. A holder may convert a blank indorsement to a special indorsement. The rules conform with those applicable to commercial paper, section 3-204.

Subsection (3) lists the cases where a person other than the registered owner or special indorsee is entitled to make an indorsement. The subsection pursues a liberal policy.

Subsection (4) relieves an indorser of liability for honor of the instrument by the issuer. He is, of course, liable for a breach of the warranties specified in section 8-306 (2). The regime adopted flows from the nature of the investment securities and the circumstances under which they are usually transferred.

Partial indorsement covering part of the units represented by the security are recognized, if the units are intended to be separately transferable.

The qualification of a person as an appropriate person is determined as of the date of his signing.

Subsection (7) specifies that certain omissions by a fiduciary go to the rightfulness of the transfer rather than to the validity of the indorsement.

U.C.C. Sec. 8-309. Explanatory Notes.

Section 8-309 specifies that an indorsement, regardless of its form, does not constitute a transfer unless it is followed by a delivery of the security on which it appears or if it is placed upon a separate document by a delivery of both the security and the document.

Section 10 of the Uniform Stock Transfer Act states that an indorsement without delivery amounts to a promise to transfer. The Code deletes this provision, leaving the matter to state law. Contrast section 8-307 which gives the person who obtains delivery of a security in registered form a specifically enforceable right to have the indorsement supplied.

U.C.C. Sec. 8-310. Explanatory Notes.

If a security is in bearer form, it is normally transferred without indorsement. An indorsement may give notice of adverse claims if it is of a form envisaged by section 8-304. Otherwise it does not affect any rights the holder may possess.

Note that in the field of securities regulated by Article 8, indorsers assume no liability for the honor of the instrument by the issuer.

U.C.C. Sec. 8-311. Explanatory Notes.

Generally speaking an owner may assert the ineffectiveness of an unauthorized indorsement vis-a-vis the issuer or a purchaser unless he has ratified the indorsement or is otherwise precluded from invoking the forgery or lack of authority. The Code, however, introduces an important modification of this rule by barring the owner's right to assert the ineffectiveness against a purchaser for value and without notice of adverse claims who has in good faith received a new, re-issued or re-registered security on registration of transfer.

The owner may rely on the issuer's liability for improper registration as specified in section 8-404.

U.C.C. Sec. 8-312. Explanatory Notes.

Section 8-312 defines the scope of the warranties contained in two different types of guarantees: guarantee of the signature of an indorser and guarantee of an indorsement. In the first type of guarantee the guarantor warrants only the genuineness of the signature, the qualification of the signer as an appropriate person to indorse and the signer's legal capacity to sign. The second type of guarantee the guarantor warrants also the rightfulness of the particular transfer.

The last sentence of subsection (2) prohibits an issuer from requiring a guarantee of indorsement as a condition to registration of a transfer. Subsection (3) extends the warranties to any person taking or dealing with the security in reliance on the guarantee.

U.C.C. Sec. 8-313. Explanatory Notes.

Section 8-313 determines what constitutes delivery for the purposes of a transfer of the security to a purchaser. It constitutes an enlargement and liberalization of the concept of possession while the security is still in the hands of a broker.

Subsection (1) lists the conditions under which a security is deemed to be delivered to the purchaser while still in the possession of a broker or of a third person. The significance of deeming the security to be delivered in these cases lies in the fact that supervening notice of adverse claim after that time no longer destroys the purchaser's status as bona fide purchaser.

Subsection (2) makes it clear that apart from the cases specified in subsection (1) (b) and (c), securities in the hands of a broker are not "held" by the purchaser but by the broker, even though the broker indicates by book entry or otherwise that the security is part of a fungible bulk held for customers and despite the customer's acquisition of proportionate co-ownership in the fungible bulk.

Since the broker is viewed as the holder and, accordingly, in appropriate cases as a bona fide purchaser, he is shielded from liability for innocent conversion except where such liability can be asserted against a bona fide purchaser (section 8-311).

New York has rejected adoption of subsection (2) in view of certain difficulties created thereby in a broker's bankruptcy, by the federal government's general tax lien in case of the broker's failure to pay federal taxes and by the possible liability of national banks which have acted as brokers under the federal statute limiting the purchase of securities by national banks; see Penney, New York Revisits the Code: Some Variations in the New York Enactment of the Uniform Commercial Code, 62 Colum. L. Rev. 992, at 1010 (1962).

New York has replaced subsection (2) by the following new subsections (2) and (3):

- "(2) The purchaser is the owner of a security held for him by his broker, but is not the holder except as specified in subsections (b) and (c) of subsection (1). Where a security is part of a fungible bulk the purchaser is the owner of a proportionate property interest in the fungible bulk and is a bona fide purchaser if when the broker takes delivery as a holder neither he nor the purchaser has notice of any adverse claim and the purchaser takes his interest for value.
- 3) Notice of an adverse claim to the broker or to the purchaser after the broker takes delivery as a holder without notice of any adverse claim to either the broker or the purchaser."

The new provisions, by differentiating between the status as holder and the status as owner meet the objections raised against the official version but eliminate the purchaser's right to refuse acceptance in the event he learns of an adverse claim prior to the delivery to him. The Permanent Editorial Board for the Uniform Commercial Code has recommended amendments to this section.

U.C.C. Sec. 8-314. Explanatory Notes.

Section 8-314 specifies how delivery is to be made, differentiating between sales made on an exchange or otherwise through brokers (subsection (1)) and sales not consummated on an exchange or through brokers (subsection (2)). It constitutes a new statutory regulation.

In the cases falling under (subsection (1)) the Code distinguishes between the selling customer and the selling broker:

- (a) The selling customer performs his duty to deliver either by placing the security in the possession of the selling broker or a person designated by the latter or, if requested, by procuring an acknowledgment that the security is held for the selling broker.

- (b) The selling broker fulfills his duty to deliver either by placing the security or a like security in the possession of the buying broker or a person designated by the latter or by effecting clearance in accordance with the rules of the exchange at which the sale was transacted.

In cases falling under subsection (2) delivery must be made either by placing the security in the possession of the purchaser or a person designated by him or, at the purchaser's request, by procuring an acknowledgment that the security is held for him.

A broker buying for his own account outside an exchange falls under the rules of subsection (2) and not of subsection (1).

U.C.C. Sec. 8-315. Explanatory Notes.

Section 8-315 codifies the cases in which a person against whom the transfer of a security is wrongful for any reason, including his own incapacity, may obtain restoration of the security or obtain a new security evidencing all or part of the same rights. He is entitled to such restitution of the transferred or of a substitute security against any person other than a bona fide purchaser and, if the transfer is wrongful because of an unauthorized indorsement, even against a bona fide purchaser except one who in good faith has received a new, re-issued or re-registered security on registration of transfer (section 8-311 (a)).

The right to restoration or return of a substitute security may be specifically enforced and safeguarded by injunction or sequestration.

The qualification introduced by sections 8-311 (a) and 8-315 (2) is new law.

The right to specific restitution does not prevent claims for damages by reason of conversion, except where section 8-318 accords an immunity.

U.C.C. Sec. 8-316. Explanatory Notes.

Section 8-316 entitles a purchaser to be supplied by the transferor with the documentation necessary to obtain registration of the transfer. In case the transfer is not for value, the purchaser must furnish the necessary expenses. Upon failure of the transferor to comply with a demand within a reasonable time, the purchaser may rescind or reject the transfer, claim damages or, in appropriate cases, seek specific performance.

The section represents new statutory law.

U.C.C. Sec. 8-317. Explanatory Notes.

Subsection 8-317 (1) regulates the methods by which a creditor may reach a security or any share or other interest evidenced thereby in order to collect his debt. In view of the elevation of investment securities to the status of negotiable instruments, the Code provides (in somewhat inept language) that if such security or any share or interest evidenced thereby is outstanding, an attachment thereof under a writ of attachment or a levy thereon under a writ of execution shall be made and only be made by actual seizure of the security. If the security has been surrendered to the issuer, the attachment or levy of the execution may be made by serving a proper notice to the issuer.

Subsection (2) provides that a creditor whose debtor is the owner of a security is entitled to all remedies for the purpose of reaching such security or satisfying his claim by means thereof as are available at law or equity in regard to property which cannot be readily reached by writ of attachment or writ of execution.

The Code omits any specific reference to the process of garnishment, but there can be little doubt that garnishment is an aid in reaching a security within the meaning of section 8-317 (2). The result of this position is that a defiant garnishee can still validly transfer the garnished security to a purchaser for value without notice section 8-106, prescribing applicability of the law of the jurisdiction where the issuer is organized, relates only (a) to the validity of a security, and (b) to the rights and duties with respect to the registration of transfer; section 1-105

applies to transactions bearing an appropriate relation to this state. Perhaps it can be concluded from the combined result of both sections referred to, that the rules of section 8-317 govern the attachment of or levy on outstanding investment securities either when the instrument is in within the territorial limits of the forum (even though the issuer is organized elsewhere) or when the issuer is organized in the forum although the instruments are located elsewhere.

Hawaii Law.

Rev. Laws Hawaii 172-72, 233-9 (c), 233-46, 233-47,
and chapters 233, 237, 335

Enactment of section 8-317 will result in and require some radical changes of Hawaii law. Section 8-317 reproduces with some modifications in language and substance--the system of reaching stock introduced by the Uniform Stock Transfer Act. The framers of that legislation and following them the draftsmen of the Commercial Code thought that the provisions adopted by the uniform acts corresponded best to the general policy of treating shares of stock and other investment securities as negotiable instruments. Just as in case of commercial paper the obligation is reached by seizing the instrument and not by garnishing the maker, thus in the case of stock where the certificate is outstanding, seizure of the instrument and not notification of the issuer may be deemed to be the appropriate method of executing a writ of attachment or execution. Although the Uniform Stock Transfer Act was adopted by all states a substantial number of them, including Hawaii, either refused to enact sections 13 and 14 or imposed substantial limitations on its applicability. See in general note, Attachment of Corporate Stock: The Conflicting Approaches of Delaware and the Uniform Stock Transfer, 73 Harv. L. Rev. 1579 (1960).

The Hawaii statute, section 172-72, which takes the place of Uniform Stock Transfer Act, section 13 retained only one single sentence of that section (with additions not contained in the Uniform Act) to wit: "Except where [when] a certificate is [has been] lost or destroyed [or . . .] such [a] corporation shall not be compelled to issue a new certificate for the stock [shares] until the old certificate is surrendered to it." All the rest pertaining to the perfection of a levy under a writ of attachment or execution was deleted.

The current Hawaii law governing the method of reaching corporate stock under a writ of attachment or writ of execution is contained primarily in sections 233-9 (c) and 233-46 and -47. Section 233-9 (c) goes back to the Act Relating to Attachments, passed in 1905 (Act 84, Session Laws of Hawaii 1905) while sections 233-46 and -47 were enacted in 1927 (Act 264, Session Laws of Hawaii 1927) and amended in 1939 (Act 76, Session Laws of Hawaii 1939). The passage of the Uniform Stock Transfer Act in 1947 (Act 136, Session Laws of Hawaii 1947) brought no formal amendment of these sections, although it may have affected their effect.

The Hawaii system as presently operative is an ingenious attempt to reconcile the traditional approach which considers shares as choses-in-action with the modern trend which considers stock certificates as negotiable instrument. The traditional approach is followed in the method of the levy, but modern needs are taken into consideration in regulating the modalities and effects of the execution sale.

According to section 233-9 (c) and 233-46 the method of levying on stock under a writ of attachment or writ of execution is by notifying the president, secretary, treasurer, or managing agent of the corporation of the fact that the stock has been levied upon under a writ of attachment or execution. In the case of an attachment the defendant, if within the state, must be notified of the levy. In the case of an execution levy no similar requirement is made.

Section 233-46,--but not section 233-9 (c)[!]- specifies that service of such notice shall operate as a bar to the transfer or any such stock on the book of the corporation and provides that disregard of such bar except as provided by statute shall render the corporation liable to penalties.

In regulating the execution sale of stock so levied upon the Hawaii statute (section 233-46, par. 2-5) provides for some procedures to implement the levy and enable the creditor where feasible to gain possession of the certificates prior to and for purposes of the sale.

Section 233-46, par. 2 states the general rule that where the judgment debtor or any other person are subject to the jurisdiction of the court the latter may order the production and delivery to the officer

of the stock levied upon. Upon the execution sale the officer shall endorse the certificates over to the purchaser and thereupon the purchaser is entitled to a transfer on the book of the corporation.

Section 233-46, par. 3 qualifies this rule in cases where the stock is pledged. In such case the pledgee cannot be required to give up the possession of the stock. As a result the execution sale transfers merely the rights of the pledgor subject to all pledges and hypothecations made prior to the levy and the purchaser, upon receiving a certificate of transfer, from the officer, in effect obtains the right to redeem and to the surplus, if any, upon the sale by the pledgee.

Section 233-46, par. 4 regulates the case where the certificates appear to be lost or destroyed. In such case likewise only a sale without transfer of the original outstanding certificates is possible. The purchaser at the execution sale acquires merely the rights of an owner of stock claimed to be lost or destroyed.

Section 233-46, par. 5, finally, regulates the cases where the certificates cannot be produced for purposes of transfer either because the judgment debtor is not within the jurisdiction or for any other reason. Under such circumstances the officer must sell the stock without delivery of the original certificates and furnish to the purchaser with a "transfer" and a certificate stating the reasons why the original certificates are not delivered. Such certificate of transfer vests the purchaser with all rights of the judgment debtor and upon presentation of such transfer and certificate to the corporation the purchaser shall have all the rights of a holder (sic!) of a lost or destroyed certificate.

Unfortunately the provisions outlined above have never been construed by the Supreme Court and prompt a great number of perplexing questions:

- (a) It is doubtful, for instance, whether the only stock which can be reached under sections 233-9 (c) and 233-46 is stock in domestic corporations and in such foreign corporations that have one of the specified officers operating in the state or whether the requisite notice may be given even to the specified officers functioning outside

of the state, see Riesenfeld, Creditors' Remedies and the Conflict of Laws, 60 Colum. L. Rev. 659 (1960), at 679, especially footnote 125. In Utah the latter possibility has been answered affirmatively by dictum in Glenn v. Farrell, 5 Utah (2d) 439, 304 P. 2d 380 (1956), but quaere.

- (b) If a debtor transfers the certificates after levy and before turnover order or while outside the state, is the bona fide purchaser for value protected? It seems to be arguable that he is protected despite the "bar" of section 233-46, par. 1 since the gist of the Uniform Stock Transfer Act, especially sections 172-63 and 172-67, seem to require such result and section 233-46, par. 1 is expressly subject to a "except as otherwise provided by statute" clause.
- (c) The special judicial aids for the production of the certificates under section 233-46, par. 2 apply only to the time after the levy of execution. Chapter 233 part 1 relating to attachment contains only a general provision as to examination of an attachment defendant (section 233-12). Does this imply that a creditor is unable to compel delivery of the certificates prior to judgment and levy of an execution, thus giving the defendant the chance to effectively dispose of the certificates? Note that the "bar" provision of section 233-46, par. 1 does not occur in section 233-9 (c) and that Hawaii does not aid a creditor by means of a creditor's bill prior to reduction of his claim to judgment, placing a narrow construction on section 335-2 (k), Middeditch v. Kalaniana'ole, 18 Haw. 272 (1907); D'Herblay v. Macomber, 20 Haw. 274 (1910); H.B.S.M. Co. v. Bartlett, 23 Haw. (1916); Lyle v. Slegman, 26 Haw. 351 (1922).
- (d) Finally garnishment (chapter 237, Revised Laws of Hawaii 1955) may be an additional remedy to reach corporate stock in the hand of a person other than judgment debtor, since stock is "effects" within the meaning of the garnishment statute, Nichols v. Mossman, 35 Haw. 772 (1941). If the garnishee discloses possession of such stock without entitlement to paramount rights or his possession of such stock without paramount rights is deter-

mined pursuant to section 237-8 and 237-9 the creditor may seek satisfaction of his judgment according to section 237-2.

There is no question that enactment of section 8-317 should be accompanied with an apposite change of the various provisions relating to creditors' remedies, as follows:

- (1) True, section 8-317 of the Code provides that no attachment or levy upon a security or any share or interest evidenced thereby which is outstanding shall be valid until the security is actually seized . . ., permitting accordingly a system of levy which requires both notice to specified corporate officers and seizure of outstanding certificates. But such system would seem to be unnecessarily cumbersome. Generally speaking a writ of attachment or writ of execution should be executed with respect to investment securities, including corporate stock, by seizure of the certificates.
- (2) This method of levy should apply to all investment securities located within the state, regardless whether the issuer is organized in Hawaii or elsewhere. It is believed that the Full Faith and Credit Clause, as construed by the Supreme Court in the case of Huron Corp. v. Lincoln Corp. (312 U.S. 183) would require recognition of the effect of such "proceedings".
- (3) Section 8-317 entitles a creditor to aid from the courts as is allowed at law or in equity in regard to property which cannot readily be attached or levied upon by ordinary legal process. While garnishment would be such an aid to a creditor before judgment in case a third person holds the stock, no such aid may be available in case the debtor holds the stock, unless either section 233-12 or section 335-2 (k) is amended to that effect.
- (4) Section 8-317 states that a security that has been surrendered to the issuer may be attached or levied upon "at the source". This provision needs implementation as to the modalities.

- (5) Section 8-317 fails to provide for two important situations, viz. (a) the cases where outstanding stock or other investment securities is lost, destroyed or stolen; (b) the cases where the certificates are held by a third party under a paramount possessory right such as a pledge or statutory lien. It is recommended that special provisions be enacted to take care of these cases.
- (a) In the case of lost, destroyed or stolen certificates the existing system seems to be appropriate since the creditor reaches and the purchaser acquires only the limited rights of the owner of such certificates (see section 8-405).
- (b) In the case of pledged stock (as in case of other pledged chattels) several approaches to the procedure to be followed are possible. One system considers garnishment of the pledgee the proper method, reaching in effect the pledgor's interest in a possible surplus and his right to redeem. Another system permits the creditor to pay off all parties entitled to paramount rights and then to levy on the property in the hand of the pledgee by seizure. Certainly either method is more logical than the levy on the pledgor's interest by means of a notice to the issuer. It is recommended that one of the two other suggested systems be adopted. Both are consonant with the general approach of section 8-317 since the attachment or judgment debtor is not in possession of the outstanding certificates.

Finally it is recommended that the Code should not be cluttered up with detailed provisions which logically belong in chapters 233, 237 and 335 but that the pertinent sections in these chapters be amended to conform with the policy of section 8-317 and that section 8-317 be modified so as to read:

"Section 8-317. Attachment or Levy of Execution Upon Security."

"An attachment of, or levy of an execution upon, a security or any share or interest evidenced thereby which is outstanding and not in the possession of a third party under a security interest, lien or right

of retention, shall be made by the officer executing the writ of attachment or writ of execution by actual seizure of the security as provided in sections 233-9 (c) and 233-46 (1). An attachment of, or levy of an execution upon, a security or any share or interest evidenced thereby which is outstanding but in the possession of a third party under a security interest, lien or right of retention shall be made by garnishment of the third party as provided in chapter 237. A security or any share or interest evidenced thereby which has been surrendered to the issuer or appears to have been lost, destroyed or wrongfully taken shall be attached or levied upon pursuant to a writ of execution by notice to the issuer as provided in section 233-46 (3) and the sale following such levy shall be made as provided in section 233-46 (4).

A creditor whose debtor is the owner of a security shall be entitled to such aid from the courts, by injunction or otherwise, in reaching such security or in satisfying the claim by means thereof as is provided in sections 233-12 and 233-46 (1) or allowed in equity in regard to property which cannot readily be attached or levied upon by ordinary legal process."

U.C.C. Sec. 8-318. Explanatory Notes.

Section 8-318 protects agents, including brokers, and bailees against liability for innocent conversion or for innocent participation in a breach of fiduciary duty, if he has received securities and sold, pledged or delivered them according to the instructions of the principal, although the principal may be guilty of such conversion or breach.

The rule corresponds to the policy of section 7 (a) of the Uniform Act for Simplification of Fiduciary Security Transfers, 9C U.L.A. (1961 Supp.) 62.

Hawaii Law.

Since Hawaii has adopted the Uniform Fiduciary Act (chapter 189, Revised Laws of Hawaii 1955) but not the Uniform Act for Simplification of Fiduciary Security Transfers, the effect of section 8-318 would be to introduce new statutory law.

U.C.C. Sec. 8-319. Explanatory Notes.

Section 8-319 contains the statute of frauds relating to the sale of investment securities. Such provision is necessary since Article 2, concerning sales of goods, does not apply to sales of investment securities, (section 2-102 in conjunction with section 2-105 (1)). On the other hand the regulation of section 8-319 conforms closely to the regulation of section 2-201.

Section 8-319 (a) makes a few simple formal requirements as to the necessary memorandum: first it must indicate that a contract for the sale of securities has been made; second it must be signed by the party sought to held or by his authorized agent or broker; third it must specify the quantity and the price of the securities.

Section 8-319 (b) governs partial performance as a substitute for the required memorandum, section 8-319 (c) specifies occurrences which are tantamount to a writing for the purpose of cutting off the defense of the Statute of Frauds and section 8-319 (d) precludes the defense of the Statute of Frauds in case of an admission in court.

Hawaii Law.

Section 8-319 is an adaptation of the statute of frauds currently contained in section 4 of the Uniform Sales Act, to the extent that that provision relates to the sale of choses-in-action. Section 4 of the Uniform Sales Act is adopted in Hawaii and is found in section 202-4. The insertion of a special statute of frauds for the sale of securities was the consequence of restricting Article 2 to the sale of goods.

The provisions of section 8-319 of the Code are to a large extent merely a rephrased version of section 4 of the Uniform Sales Act, the change in wording having been made mainly for the sake of clarification. There are, however, some minor changes in the existing law. It may be helpful to point out the following clarifications or changes:

- (1) The new rules apply to all contracts for the sale of securities, while at present contracts for the sale of securities having a value of less than \$100 are exempted.

- (2) The new rules clarify that the memorandum need not contain all substantial terms but must only afford a basis for a finding that the oral evidence offered rests on a real transaction.
- (3) The new rules clarify that part performance validates the contract only to the extent of such part performance.
- (4) Section 8-319 (c)--following the rule given for the sale of goods between merchants in section 2-201 (2)--is new law and makes failure of objecting promptly to a letter confirming a sale or purchase tantamount to a writing.
- (5) Section 8-319 (d) clarifies that the requirement of the statute of frauds as relating to the sale of securities is merely evidentiary in character and may be superseded by evidence of the type listed in that subsection.
- (6) The reference to earnest money or similar tokens of a binding contract has been eliminated.

Since section 202-4 has apparently not been construed by the Supreme Court of Hawaii it is not clear whether the Hawaii courts would have reached similar results in many cases under the existing form of the statute.

U.C.C. [Sec. 8-320 - adopted by New York.]
Explanatory Notes.

Transfer or Pledge Within a Central
Depository System.

New York has added a special section governing the transfer or pledge of securities "in the custody of a clearing corporation or of a custodian bank or nominee of either subject to the instructions of the clearing corporation". The regulation of a transfer or pledge under this section is declared to be in addition to other methods specified in Article 8.

The lengthy and complex provision should be adopted on a nation-wide basis since it has been recommended by the Permanent Editorial Board for the Uniform Commercial Code.

See Penney, New York Revisits the Code: Some Variations in the New York Enactment of the Uniform Commercial Code, 62 Colum. L. Rev. 992, at 1011 (1962).

PART 4 REGISTRATION

U.C.C. Sec. 8-401. Explanatory Notes.

Section 8-401 imposes upon the issuer (as defined in section 8-201 (3)) of a security in registered form a duty of complying promptly with a request to register a transfer if a set of five conjunctive conditions is met. Subsection (1) specifies the five conjunctive conditions as follows:

- (a) Indorsement of the security by the appropriate person or persons (section 8-308);
- (b) Reasonable assurance that those indorsements are genuine and effective (section 8-402);
- (c) Absence of a duty to inquire into adverse claims or discharge of such duty (section 8-403);
- (d) Compliance with applicable law relating to the collection of taxes; and
- (e) Rightfulness in fact of the transfer or bona fide purchaser status of the transferee.

Since the Code greatly relieves the issuer of any duty of inquiry into adverse claims, his duty of prompt registration is correspondingly expanded.

Unreasonable delay in registration of a transfer to which the issuer is obligated or non-performance or refusal thereof renders him liable to the person presenting the security or his principal for resulting loss.

U.C.C. Sec. 8-402. Explanatory Notes.

Under the regulation introduced by Article 8 an issuer incurs absolute liability for wrongful registration of transfer where and only where the signature of the indorser is unauthorized (section 8-311 (b)) is not that of an appropriate person (section 8-404 (1) (a) in conjunction with section 8-308). In consequence of this potential liability the issuer may require reasonable assurance that each necessary indorsement is genuine and effective.

Subsection 8-402 (1) lists the assurances which the issuer may require for the purpose of verifying the genuineness and effectiveness of the necessary indorsements:

- (a) In any case, a guarantee of the signature of the person indorsing;
- (b) In cases where the indorsement is signed by a person other than the person specified by the security or by special indorsement, such as an agent, fiduciary, more than one fiduciary or other appropriate person, the issuer may require assurances appropriate to the circumstances as exemplified by the statutory catalogue in subdivisions (b), (c) and (d).

Recall that in no event may the issuer require a guarantee of the indorsement as a condition to registration of transfer, section 8-312 (2) second sentence.

Subsection (2) states that the guarantor of a signature must be a person reasonably believed by the issuer to be responsible and that the issuer has the liberty of setting standards for such responsibility that are not manifestly excessive.

Subsection (3) spells out in what type of documentation or other proof "appropriate evidence of appointment or incumbency" of an indorsing fiduciary may consist. The detailed regulation reflects the policy of the draftsmen aiming at discouraging issuers from requiring excessive documentation and at reducing incentives to such requirements by restricting the scope of his liability. In accordance with that basic approach subdivision (3) (b) relieves the issuer from being charged with the notice of the contents of a document showing the appointment or incumbency of a fiduciary and obtained for that purpose, except to the

extent that the contents relate directly to the appointment or incumbency.

Where circumstances make it reasonable for the issuer to require assurance beyond that specified in section 8-402 and for a purpose other than to obtain appropriate evidence of appointment or incumbency of a fiduciary subsection (4) entitles him to do so. But if he does and obtains a copy of a will, trust, indenture, articles of co-partnerships or other controlling instrument he is charged with notice of all matters contained therein affecting the transfer.

Section 8-402 is not based on prior uniform legislation.

U.C.C. Sec. 8-403. Explanatory Notes.

Section 8-403 specifies the conditions under and the extent to which an issuer is obligated to inquire into adverse claims. The section imposes such duty in and, at the same time, limits such duty to two specific situations, subject to the overriding duty of good faith (section 1-203).

Subsection (1) enumerates the two instances in which an issuer is held to inquire into adverse claims prior to a registration:

- (a) receipt of a written notification of an adverse claim at a time and in a manner which afford the issuer a reasonable opportunity to act thereon prior to the issuance of a new, re-issued or re-registered security;
- (b) request and receipt of a controlling instrument charging him with notice of an adverse claim, if such request and receipt was under section 8-402 (4) and not under section 8-402 (3) (b).

Subsection (3) is the converse to subsection (1) spelling out that except in the cases specified in subsection (1) the issuer, upon presentation of a security for registration indorsed by the appropriate person, is under no duty to inquire into adverse claims. Subsection (3) adds three specific situations where the Code intends to clarify the law in the sense of an absence of a duty of inquiry. Noteworthy in particular is the rule that an issuer who has registered a security in the name of a person who is or is described as

fiduciary may assume that the registered owner continues to be in that role until he receives written notice of the termination of the fiduciary's rights and duties with respect to the particular security (section 8-403 (3) (a)). The rule of subdivision (3) (b) is the corollary of the provision contained in section 8-308 (7).

Subsection (2) states the means by which the duty of inquiry into adverse claims may be discharged. The Code sanctions any reasonable means, but provides a suggested procedure, following accepted commercial practice.

U.C.C. Sec. 8-404. Explanatory Notes.

Section 8-404 is the key section defining the scope of the immunity of the issuer from liability for improper registration. Such immunity exists if:

- (a) the security carried or was accompanied by the necessary indorsements, and
- (b) the issuer had no duty to inquire into adverse claims or had discharged such duty.

Note that the section is supplemented by other sections which spell out that certain circumstances do not affect the presence of the necessary indorsements (see sections 8-308 (6), 8-308 (7), 8-308 (1) (a) in conjunction with section 8-403 (3) (a)).

A true owner who has been deprived of his security as the result of improper registration not covered by the immunity is entitled to a new security, unless he is guilty of a violation of his duty of prompt notification of loss, theft, apparent destruction, etc. under section 8-405. If the issue of a new security would result in overissue and a similar security is not reasonably available for purchase the true owner is entitled to indemnification in money. Otherwise he is required to take a similar security.

U.C.C. Sec. 8-405. Explanatory Notes.

Section 8-405 states the rights and duties of the owner of a security and of the issuer where the security is lost apparently destroyed or wrongfully taken or claimed to have been lost, destroyed or wrongfully taken.

Subsection (1) imposes upon the owner the burden of notifying the issuer, within reasonable time after the owner has notice of it, that a security has been lost, apparently destroyed or wrongfully taken. Failure to discharge this burden bars the owner from claiming a new security either under section 8-404 if the issuer wrongfully registers a transfer of the lost or stolen security or, under the replacement provisions of subsection (2).

Subsection (2) entitles the owner who has discharged his duty of prompt notification to receive a new security in lieu of a security claimed to be lost, destroyed or wrongfully taken, if the owner:

- (a) files with the issuer a sufficient indemnity bond and complies with other reasonable requirements imposed by the issuer, and
- (b) requests replacement before the issuer has notice that the original security has been acquired by a bona fide purchaser.

Issuance of a replacement security does not bar a bona fide purchaser of the original security from his right of having the issuer register the transfer, unless such registration results in overissue; in the latter case the rights of the bona fide purchaser are determined by section 8-104.

If the original security has reached the hands of a bona fide purchaser the issuer may recover the replacement security unless it has likewise reached the hands of a bona fide purchaser. In any event the issuer may rely on the indemnity bond.

Section 8-405 modifies the Uniform Stock Transfer Act., section 17 which predicated the right to the issuance of a new certificate upon a court order to that effect and in such case reduced the rights of a bona fide purchaser of the original security to a right to damages.

U.C.C. Sec. 8-406. Explanatory Notes.

Section 8-406 regulates the duties and liabilities of authenticating trustees, transfer agents, registrars or other such agents. The section imposes upon them not only a duty vis-a-vis the issuer (subsection (1)(a)), but subjects them to same obligations vis-a-vis the holder or owner of a security as are imposed on the issuer in regard to those functions (subsection (1)(b)).

As a result of this new order of things the persons envisaged by section 8-406 are liable to the owner of a security for wrongful refusal to register a transfer or for wrongful registration of a transfer as the case may be, and for the issuance of a replacement security where the Code grants such a right.

Notice to an authenticating trustee, transfer agent, registrar or other such agent is notice to the issuer with respect to the functions performed by such person.

ARTICLE 9

SECURED TRANSACTIONS; SALES OF ACCOUNTS, CONTRACT RIGHTS AND CHATTEL PAPER

Article 9, codifying the law of secured transactions and the sale of accounts, contract rights and chattel paper, is admittedly the most novel, most important and most complex portion of the new Code. Preparation of the final text required more drafts and revisions of the underlying premises and policies than were necessary for any other Article. See Birnbaum, Article 9--A Restatement and Revision of Chattel Security, 1925 Wisc. L. Rev. 348. As a result the 53 sections constituting Article 9, either in toto or individually, have attracted the comments of a vast number of writers in the professional journals and even become the subject of a separate small treatise written by one of the advisers.

Article 9 sets out a comprehensive and inclusive scheme for the regulation of security interests in personal property and fixtures. Its basic aims and policies may be summarized as follows:

- (1) Facilitating secured financing transactions by providing a simple and unified structure in lieu of the multiplicity of security devices with its resulting overlaps and gaps that have come into use in the course of time;
- (2) Disregarding all distinctions based solely on form and technicality and making distinctions where necessary solely along functional lines;
- (3) Enhancing the legal security in credit transactions by permitting flexibility, without impairing the legal validity of the transaction, to a greater degree than is possible under existing law, but leaving the resulting risks of the debtor's dishonesty upon the creditor;
- (4) Simplifying the formal requirements for the creation of security interests;
- (5) Removing outmoded restraints on realization of the security after default by permitting all commercially reasonable methods of enforcement.

Broadly speaking the system adopted by Article 9 is an expansion and improvement of that previously followed by the Uniform Trust Receipts Act, sections 206-1 to 206-17, Revised Laws of Hawaii. But while the Uniform Trust Receipts Act applied only to the financing of the acquisition of new inventory, Article 9 of the Code applies to the creation of consensual security interests in all types of collateral, consisting of personal property and fixtures. Perhaps the most important single feature of the new regime of security interests introduced by the Code is the recognition of a "continuing general lien" or "floating charge" as a proper and legal security device, U.C.C. sections 9-204 and 9-205.

In addition to the regulation of secured transactions governing security interests in all types of personal property and fixtures Article 9 covers the sale of accounts, contract rights and chattel papers, whether intended for security or not. The reason for this combination is the fact that the perfection of the transfers of accounts, contract rights and chattel paper, the priorities of third parties, and the conflict of laws are governed by identical rules, regardless of purpose of the transfer.

The broad coverage of Article 9 supersedes a vast area of statutory and decisional law of the State. Fields of law affected by Article 9 are:

- (1) [The law of pledges, including decisions such as Okada v. Akahoshi, 29 Haw. 719 (1927);
- (2) The law of conditional sales, except to the extent that the provisions of Retail Installment Sales Act, chapter 201A, Revised Laws of Hawaii, do not contain inconsistent provisions;
- (3) The law of chattel and crop mortgages, as contained in chapter 196, sections 343-23, 343-51 and 343-52, Revised Laws of Hawaii, and the pertinent judicial decisions, except to the extent that the Code permits special regulations for motor vehicles and other excluded types of personal property;
- (4) The law of trust receipts, as specified in chapter 206, Revised Laws of Hawaii;
- (5) The law relating to the assignment of accounts

receivable, chapter 187, Revised Laws of Hawaii;

- (6) The law of the Uniform Stock Transfer Act, chapter 172, Revised Laws of Hawaii, so far as governing security transactions;
- (7) The law of fixtures, so far as pertinent to the rights of secured parties claiming a security interest in fixtures.

In consolidating all transactions intended to create security interests in personal property and fixtures and substituting the single term "security interest" for the variety of descriptive labels that has grown up at common law and the array of statutes supplementing it, the Code eliminates, for the purposes of the regime created by it, any practical importance of the vexing questions as to the nature of a particular security transaction or the location of the title. To that extent, judicial discussions as to whether a particular transaction is a pledge or a chattel mortgage, or a sale with a conditional resale or a chattel mortgage, or whether the chattel mortgagee has title or only a lien, see e.g. Spreckels v. Macfarlane, 6 Haw. 166 (1893) George Hess v. Sam Paulo, S. R., 38 Haw. 279, 289 (1949) have lost all relevancy.

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PART 1 SHORT TITLE, APPLICABILITY AND DEFINITIONS

U.C.C. Sec. 9-101. Explanatory Notes.

Self-explanatory.

U.C.C. Sec. 9-102. Explanatory Notes.

Subsection (1) of this section delimits the functional and territorial scope of Article 9. In the first place it provides that, subject to the exception of a catalogue of particular transactions which are listed in section 9-104 and are excluded for a variety of reasons, the regime of Article 9 applies: (a) To all transactions (regardless of form) intended to create a security interest in personal property, whether tangible or intangible, and in ~~fixtures~~ fixtures, and (b) To all sales of accounts, contract rights and chattel paper, as defined in sections 9-106 and 9-105(1)(b) in conjunction with sections 1-201 (11) and 9-105(1)(f).

In the second place it specifies that it applies to such transactions, provided that the personal property or the fixtures which serve as "collateral" (as defined in section 9-105(1)(c)) are "within the jurisdiction of the state". If the collateral is of a tangible character this rule means, in general, that the location controls without regard to possible contacts in other jurisdictions. The rule, however, is qualified by section 9-103 which contains special rules relating to the applicability of Article 9 where the collateral consists of certain types of intangibles or mobile equipment or of property which is brought into this state subject to a security interest which attached in another jurisdiction.

Subsection (2) specifies that the rules of Article 9 supersede the existing local law pertaining to pledges, assignment for security, chattel mortgage, conditional sale, trust receipts, factor's lien or any other consensual security interest. Statutory liens are not affected, except as to the matter of priority regulated in section 9-310.

Subsection (3) renders it clear that Article 9 applies to security interests in a secured obligation although the security for the obligation does not consist of personal property or fixtures to which Article 9 applies. Thus if the holder of a note secured by a real estate mortgage wishes to secure a loan by means of such collateral, the transaction is governed by Article 9; but in order to give the secured party resort to the real estate mortgage, compliance with local conveyancing and recording acts, such as sections 196-5 and 343-23 et seq., Revised Laws of Hawaii, is required.

Hawaii Law.

Rev. Laws Hawaii chapters 187, 196, 201A, 206, 343

The new regime of secured transactions will require the repeal or amendment of a number of Hawaiian statutes dealing with subjects falling within the purview of Article 9. Repeal is appropriate for chapter 187 (accounts receivable; assignment and notice) and chapter 206 (Uniform Trust Receipts Act).

Amendments are in order in chapter 196 (mortgages); chapter 343 (recording) and chapter 201A (retail installment sales). See infra comments to section 9-203.

U.C.C. Sec. 9-103. Explanatory Notes.

Section 9-103 states the following special rules for the choice of law where the collateral consists of certain types of intangibles or mobile equipment or inventory or of property which is brought into the state subject to a security interest which attached in another jurisdiction:

- (1) In the case of sales or security transactions relating to accounts and contract rights, the location of the office where the assignor keeps the pertinent records is the determining factor.
- (2) In the case of sales or security transactions relating to general intangibles or of security transactions relating to equipment or inventory which are normally used in more than one jurisdiction, the location of the chief place of business of the debtor as defined in section 9-105(1)(f) is the determining factor.
- (3) In the case of personal property other than that governed by the rules summarized under (1) and (2), if such property is already subject to a security interest when brought into the state, generally speaking the law of that jurisdiction controls where the property was located when the security attached. The Code, however, adds certain qualifications: The law of this state applies, if the parties contemplated that the property would be kept here and it was brought here within thirty days. Vice versa perfection in the jurisdiction where the property was kept before removal to this state continues for four months. Lapse of perfection does not take place if, within the four months, the perfection requirements of this state are complied with.
- (4) The rules summarized under (2) and (3) are inapplicable with respect to collateral which is covered by a certificate of title pursuant to a local statute to that effect, such as a certificate of ownership pertaining to automobiles, see sections 160-10, 196-6, Revised Laws of Hawaii.

U.C.C. Sec. 9-104. Explanatory Notes.

Section 9-104 contains a catalogue of exclusions from the application of Article 9. Such exceptions are made because

- (1) The subject is governed to that extent by a federal statute: subsection (a);
- (2) The property subject to the security interest is neither personal property, nor fixtures: subsections (b) and (j);
- (3) The security interest is not of a consensual character: subsection (c);
- (4) The subject is especially sensitive to local policies: subsection (d);
- (5) The persons affected preferred to remain outside the Code: subsection (e);
- (6) The transfers are not commercial transactions: subsection (f);
- (7) The type of collateral involved does not fit easily within the pattern of the Code or does not customarily serve as commercial collateral: subsections (g), (h), (i) and (k). Consequently all transfers of tort claims and judgments in particular are outside the pale of Article 9.

In many instances the exclusions of section 9-104 do no more than render specific what would otherwise be implied from other sections of Article 9.

U.C.C. Sec. 9-105. Explanatory Notes.

Section 9-105 contains nine definitions of terms which contain a clue to the correct understanding of the rules laid down by Article 9. The definitions are self-explanatory.

Special attention, however, is called to the definition of "chattel paper" which introduces a novel term into legal phraseology. Moreover it should be noted that the terms "debtor" and "collateral" are given a broader meaning than would be ordinarily

implied, in order to render it clear that they include a seller of accounts, contract rights or chattel paper, or such assets, respectively, although the transaction relating thereto is not for the purpose of creating a security interest but of an outright sale. The definitions differentiate between "debtor" who is the person owing payment or other performance of the obligation secured and "account debtor" who is the person obligated on an account, chattel paper, contract right and chattel paper or general intangible.

Note also the definition of "security agreement" and "secured party".

"Goods" excludes from its scope money, documents, instruments, accounts, chattel paper, contract rights and general intangibles in view of special rules applicable to the latter types of collateral.

In addition section 9-105 includes an index of ten definitions contained in other sections of Article 9 and five definitions in other Articles, but applicable also to Article 9.

U.C.C. Sec. 9-106. Explanatory Notes.

This Article contains three important definitions, specifying and differentiating between the three important terms "account", "contract right" and "general intangible".

In understanding the rules employing these terms it should be borne in mind that "tort claims", "judgments" and bank accounts are excluded from Article 9 by virtue of section 9-104.

Hawaii Law.

Rev. Laws Hawaii chapter 187

The Code clarifies certain problems of interpretation which had arisen in several jurisdictions under the definitions of "account" and "account receivable" contained in statutes governing the assignment of accounts receivable, such as are found in chapter 187.

U.C.C. Sec. 9-107. Explanatory Notes.

Section 9-107 contains a definition of "purchase money security interest". Such definition is needed since an interest of that type is privileged in various respects:

- (1) Priority over an interest acquired under an after-acquired property clause (section 9-312);
- (2) Grace period of ten days vis-a-vis creditors and transferees in bulk where filing is required (section 9-301(2));
- (3) Exemption from filing requirements in case of farm equipment and consumer goods (section 9-302).

Purchase money security interests may arise in favor of: (1) The seller, if he retains a security interest in the collateral sold; and (2) A third party financier, if he either advances money or incurs an obligation which enables the buyer to make the purchase or if he makes such advances to the seller, taking back an assignment of chattel paper. Security interests taken merely as security for or in satisfaction of a pre-existing claim or antecedent debt do not qualify.

U.C.C. Sec. 9-108. Explanatory Notes.

Section 9-108 states the conditions under which security interests in after-acquired collateral shall be deemed to be taken for new value and not as security for an antecedent debt. The matter is primarily of importance for the determination of whether or not the attachment of such security interests falls within the scope of the preference section of the Bankruptcy Act or not. According to the official comments such determination "is largely left by the Bankruptcy Act to state law". Recent writers have questioned the soundness of this proposition. See Gordon, The Security Interest In Inventory Under Article 9 U.C.C. And The Preference Problem, 62 Colum. L. Rev. 49 (1962) (who calls the section "ludicrous" and "inartistic"), and Friedman, The Bankruptcy Preference Challenge To After-Acquired Property Clauses Under The Code, 108 U. Pa. L. Rev. 194 (1959) (who calls the section a "possibly self-defeating" "special gimmick").

Section 9-108 restricts the "deemed to be taken for new value"--rule to after-acquired collateral acquired either in the ordinary course of the debtor's business or under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given.

The Code refrains from defining new value, but illustrates the concept by example.

U.C.C. Sec. 9-109. Explanatory Notes.

Section 9-109 contains a classification of "goods" (as defined in section 9-105(f)) into four principal mutually exclusive categories, designated as consumer goods, equipment, farm products and inventory. The classification is important since the Code, within the unified structure of security interests, makes certain differentiations in treatment predicated upon the different character of the collateral involved.

The definitions are self-explanatory. It should be noted that goods may change their classification as they pass into different hands. Thus a refrigerator is inventory in the hands of a dealer but consumer goods when acquired by a householder; crops or live-stock are farm products while in the hand of a person engaged in farming operations but become inventory, if passing into the possession of a marketing agency or processor.

U.C.C. Sec. 9-110. Explanatory Notes.

Section 9-110 relaxes the standards of specificity required in descriptions, changing decisional requirements developed in older cases pertaining to chattel mortgages.

U.C.C. Sec. 9-111. Explanatory Notes.

Section 9-111 merely reiterates the rule of section 6-103(1) which excludes security agreements from the sweep of the provisions governing bulk transfers.

U.C.C. Sec. 9-112. Explanatory Notes.

Section 9-105(d) defining the term "debtor" specifies that where the obligee and the owner of the collateral are not the same person the term "debtor" means the owner of the collateral in any provision dealing with the collateral and may include such owner in other provisions where the context so requires.

Section 9-112 spells out some of the rights of an owner of the collateral who is not the debtor of the secured party vis-a-vis the latter, provided that the secured party knows the situation. The section also renders it clear that subjecting one's personal property and fixtures to a security interest securing the obligation of another person does not imply liability for the debt or for a deficiency remaining after exhaustion of the collateral.

U.C.C. Sec. 9-113. Explanatory Notes.

The Article on sales (Article 2) provides for the creation of certain security interests in the goods sold either by operation of law or agreement and regulates particular incidents of such security interests. Section 9-113 has the purpose of subjecting such security interests to the regime of Article 9. At the same time section 9-113 exempts security interests arising solely under Article 2 from three classes of provisions contained in Article 9 to the extent that and so long as the debtor does not have or does not lawfully obtain possession of the goods. The three classes of provisions rendered inapplicable under such conditions are:

- (1) The requirement of a security agreement;
- (2) The requirement of filing to perfect the security interest;
- (3) The default provisions of Article 9, part 5.

It should be noted that section 9-113 applies only to "security interests" that are "arising solely under the Article on Sales". Whether certain rights regulated in Article 2 may be classified as "security interests" and whether certain such rights are to be considered as arising solely under that Article may

not always be an easy question, see Hogan, The Marriage of Sales to Chattel Security in the Uniform Commercial Code: Massachusetts Variety, 38 Boston U. L. Rev. 571 (1958), Selected Priority Problems in Secured Financing Under the Uniform Commercial Code, Note, 68 Yale L. J. 751, 757.

PART 2

VALIDITY OF SECURITY AGREEMENT AND RIGHTS OF PARTIES THERETO

U.C.C. Sec. 9-201. Explanatory Notes.

Section 9-201 expresses the general principle that,--in the ~~absence~~ both of any provision to the contrary in the Code and of any prohibition in local regulatory statutes designed to protect the general public, especially consumers, against particular abuses and nefarious practices--, security agreements are effective according to their terms between the parties thereto as well as against third parties.

Section 9-201 refers specifically to usury laws, small loans legislation and retail installment sales acts as not being inconsistent as such with the adoption of the Uniform Commercial Code. Nevertheless the official notes to sections 9-102 and 9-203 indicate that some changes in those acts may be needed to "conform" them to Article 9 and that "provisions on filing, rights on default, etc." therein "should be repealed as inconsistent with [that] Article". The repeals and amendments necessary will be discussed separately at Article 10.

U.C.C. Sec. 9-202. Explanatory Notes.

Section 9-202 spells out that the location of the title to the collateral is not regulated by the Code and is immaterial for any and all incidents of a security interest falling under Article 9.

The official comment recognizes that this issue may still be important for purposes of other laws, such as revenue acts, but leaves the determination thereof to "other rules of law or the agreement of the parties".

U.C.C. Sec. 9-203. Explanatory Notes.

Section 9-203(1) provides that, unless the collateral is in the possession of the secured party, a security interest is enforceable against the debtor or third parties only if the debtor has signed a security agreement which contains a description of the collateral (in conformity with the standards specified in section 9-110) and, when the security interest covers crops or oil, gas or minerals to be extracted or timber to be cut, of the land concerned. If the secured party fails to insist on observance of this minimum formal requirement, he is deprived of resort to the collateral, except as a general creditor by means of attachment, garnishment, execution or similar creditors' remedy.

Section 9-203(1) does not abrogate the established doctrine that a bill of sale although absolute in form may be shown, by parol evidence, to be merely a security agreement. The rule to that effect, recognized in Hilo Fin. & Thrift Co. v. De Costa et al., 34 Haw. 407 (1937), remains in full force.

Section 9-203(2) recognizes that existing provisions of regulatory statutes covering the field of consumer finance and specified in that subsection remain applicable and prevail over the regime of Article 9 in case of conflict. Failure to comply with the applicable regulatory statute has only the effects prescribed in such legislation.

Hawaii Law.

Rev. Laws Hawaii chapter 201A

Section 9-203 specifies that a transaction, although subject to Article 9, may also be subject to a statute such as the Retail Installment Sales Act and that in a case of conflict between the provisions of this Article and such statute, the provisions of such statute shall control.

A special "Note" appended to the section elaborates on that relation between the Code and special consumers' protection statutes as follows:

"Such acts may provide for licensing and rate regulation and may prescribe particular forms of contract. Such provisions should remain in force despite the enactment of this Article. On the

other hand if a Retail Installment Selling Act contains provisions on filing, right on default, etc., such provisions should be repealed as inconsistent with this Article." (emphasis added)

The Hawaiian Retail Installment Sales Act contains a number of provisions which conflict and overlap with provisions of the Code governing the legality and effect of certain clauses in the security agreement and the rights and remedies of the secured party on default. The question therefore arises to what extent the Hawaiian Act should be amended or repealed in order to be in conformity with the Code as contemplated by the authors of the special Note.

U.C.C. Sec. 9-204. Explanatory Notes.

Section 9-204 is one of the key sections in the new regime of secured transactions introduced by Article 9. It regulates the permissible scope of consensual security interests, both with respect to the obligations secured thereby and the assets subjected thereto, as well as the time when such interests attach. Although generally very liberal in approach, the section contains important limitations with respect to crops and consumer goods.

Subsection 9-204(1) states the general rule that a security interest "attaches" when there is concurrence of three essential conditions: agreement that the interest attach, value given, and rights of the debtor in the collateral. As long as one of these conditions is not met, no security interest can attach. It should be noted that a security interest may have "attached" although it is not "perfected", because of noncompliance with prescribed further steps. A security interest which has attached, but is not perfected may be inferior to the interests of third parties. The latter matter is regulated in Article 9, part 3.

Subsection 9-204(2) states the time at which the debtor has rights in particular types of property in several controversial cases, viz.:

- (1) Crops and issue of livestock;
- (2) Fish, oil, gas or minerals, timber;
- (3) Contract rights;
- (4) Accounts.

In the case of accounts, no periodic list is required. A list is only necessary where the accounts transferred need identification.

Subsections 9-204(3) and (5) permit a security agreement to subject collateral whenever acquired to a security interest securing all obligations specified in the agreement, including future advances or other value regardless of whether or not there is a commitment to give such advances or other value. The Code, accordingly, adopts a liberal approach both with reference to open-ended security interests and after-acquired property clauses and thereby validates the so-called cross-security clause under which collateral acquired at any time may secure advances whenever made. Moreover, subsection 9-204(3) in conjunction with section 9-205, infra, validates the so-called "floating charge" or lien on shifting or rotating stock.

Subsection 9-204(4) makes some very important restrictions upon this liberal approach in case of crops and consumer goods:

- (1) Future crops which become such more than one year after the security agreement is executed, may be subjected to a security interest under an after-acquired property clause only if it is given in conjunction with a lease or a land purchase or improvement transaction to the purchaser, lessor, mortgagee, trustee or beneficiary under a trust deed and if it pertains to crops to be grown on the land during the period of such real estate transaction.
- (2) Consumer goods other than accessions may form additional security under an after-acquired property clause only if the debtor acquires rights therein within ten days after the secured party gives value.

Hawaii Law.

Rev. Laws Hawaii 196-1, 196-2, 201A-15

The regime of the Commercial Code with respect to open-ended security, after acquired property clauses, and liens on rotating stock will be a lesser departure from existing law in Hawaii than in many other jurisdictions.

In Sumitomo v. Hawaii Nosan, 26 Haw. 515 (1922) the Supreme Court sustained a mortgage securing "all such sums of money...as the mortgagee may have advanced or shall hereafter advance to the said mortgagor ...". Although the Court held that an advance signified "that the mortgagee furnished to the mortgagor money or its equivalent upon a contract expressed or implied", close reading of the decision shows that the Court did not require a commitment to make advances when requested. To the same effect is the holding in Lose v. Davies & Co., 10 Haw. 591 (1897). In that case the Court upheld a mortgage on stock in trade securing an existing indebtedness, "and also such indebtedness, if any, as should in the future be incurred by the mortgagor to the mortgagee for new goods". The Court held "As to future advances a mortgage is good for such advances as have been made, whether the mortgagee was bound to make them or not, and whether there was any limit fixed or not."

As to mortgages on shifting stock in trade the older case law was not clear. In the early case of Hardy v. Ruggles, 1 Haw. 250 (447) (1856) the Court held that a mortgage covering "stock in trade now at on hand...together with all incoming stock in trade of every kind and character whatsoever" was ineffective, at least so far concerned incoming stock "not purchased and paid for with the proceeds of original stock". But in Lose v. Davies & Co., *supra*, the court sub silentio seems to have abandoned this view.

At any rate the Act of 1939 to Authorize Mortgages of Revolving Stock in Trade and After-Acquired Property and to Cover Future Advances and Imposing Limitations and Conditions Thereon clarified and in some respects modified the pre-existing situation. The Act in question validated mortgages of unplanted crops and unborn offspring of animals as well as of stock in trade, including additions, improvements, and purchases or substitutions made to supply the place of any property disposed of, and of all other after-acquired property referred to in the mortgage. The special reference to accounts receivable makes it clear that such mortgage may also extend to the proceeds from the stock-in-trade sold. Conversely the Act of 1939 restricted the priority of mortgages for future advances against subsequent encumbrances intervening before such advances are actually made, unless the mortgagee is under a contractual duty to make such advances within a limit stated in the mortgage.

The Retail Installment Sales Act of 1961 introduced a further limitation by limiting liens on after-acquired goods as the security for the price to accessories, special or auxiliary equipment used in connection with, or in substitution, in whole or in part, for, any of the goods sold.

As a result the Code departs from the existing situation in the following respects:

- (1) Under the Code security interests for future advances prevail over subsequent security interests (excepting purchase money security interests under stated conditions, see section 9-312), regardless of a commitment or stated maximum, while under existing law they prevail only to the extent that there is a contractual duty and a stated maximum in the mortgage.
- (2) Under the Code the creation of security interests in future crops is subject to important limitations not contained in the existing law.
- (3) The Code adds restrictions on the subjection of after-acquired consumer goods to security interests, even where such subjection is not part of an installment retail sales contract.

U.C.C. Sec. 9-205. Explanatory Notes.

Section 9-205 specifies that liberty granted the debtor to use, commingle or dispose of all or part of the collateral (including returned or repossessed goods or to collect or compromise accounts does not render a security interest invalid or a fraudulent conveyance, even where the debtor is not required to account for the proceeds or to replace the collateral. The last sentence of the section makes it clear that the rule stated does not relax the requirements of possession where the perfection of a security interest depends thereon.

Hawaii Law.

Section 9-205 has the purpose of abolishing the rule of Benedict v. Ratner, 268 U. S. 353 (1925) in jurisdictions like New York, where reservation of

dominion by an assignor over the chose-in-action assigned was held to render the assignment fraudulent against creditors.

Apparently Hawaii does not follow the rule of Benedict v. Ratner, especially in view of the broad recognition of liens on rotating stock-in-trade. Hence no change in the existing law is apparent.

U.C.C. Sec. 9-206. Explanatory Notes.

Subsection 9-206(1) validates clauses whereby a buyer, except a buyer of consumer goods, agrees that he will not assert against an assignee any claims or defenses which he may have against the seller. The binding force of such waiver is restricted to assignees who have taken the assignment for value and without knowledge of a claim or defense and does not cover defenses which are not cut off by a negotiable instrument.

A waiver of the above mentioned type is implied if the buyer executes a negotiable instrument in connection with a security agreement.

Subsection 9-206(2) makes it clear that sales with the retention of a purchase money security interest by the seller are governed by Article 2, including any disclaimer, limitation or modification of the seller's warranties.

Hawaii Law.

Rev. Laws Hawaii 201A-17

Subsection 9-206(1) provides specifically that the prohibition of the Retail Installment Sales Act, against waivers of claims or defenses arising out of retail installment sales would remain unaffected by the adoption of the Code.

U.C.C. Sec. 9-207. Explanatory Notes.

Section 9-207 codifies the duties and rights of the secured party prior to default by the debtor when the collateral is in the secured party's possession. The rules stated are in agreement with the common law precedents mainly as developed for the law of pledges.

Subsection 9-207(3) renders it clear that violation by the secured party of his duty of care in the custody and preservation of the collateral in his possession does not entail a forfeiture of his secured interest but merely liability in damages.

Subsection 9-207(4) prescribes the conditions under, and the extent to, which the secured party may use the collateral. Except in the case of consumer goods, the parties may regulate the matter in the security agreement.

U.C.C. Sec. 9-208. Explanatory Notes.

Section 9-208 provides a procedure by which a debtor may obtain from the secured party a statement of the amount of unpaid indebtedness as of a specified date and, under certain conditions, of the collateral covering the indebtedness. A procedure of this type is needed in order to enable the debtor to supply interested third parties, such as creditors or prospective purchasers with reliable information regarding the scope of outstanding security interests. The section is largely self-explanatory.

PART 3
RIGHTS OF THIRD PARTIES; PERFECTED AND
UNPERFECTED SECURITY INTERESTS;
RULES OF PRIORITY

U.C.C. Sec. 9-301. Explanatory Notes.

Section 9-301 regulates the status of security interests that have attached but are not perfected. While such security interests are valid and enforceable against the debtor and third parties (section 9-201) they may be subordinate to the rights of third parties in certain cases and under certain conditions. Attention is called again to the fact that Article 9 applies only to consensual security interests (section 9-102(2)) but that the term "security interest" includes the assimilated interest of a buyer of accounts, chattel paper and contract rights to the extent that it is subject to Article 9 (sections 1-201(37), 9-102(1)(b) and 9-104(f)).

Section 9-301 differentiates between different types of collateral and contains a special rule with respect to purchase money security interests (subsection (2)).

Subsection 9-301(1) subordinates non-perfected security interests:

- (1) In all types of collateral to the rights of persons who would have priority even if the security interest were perfected;
- (2) In all types of collateral to the rights of creditors who have obtained liens by judicial process bona fide prior to the perfection of the security interests and of certain assimilated parties;
- (3) In goods, instruments, documents and chattel paper to the rights of transferees in bulk and other buyers not in the ordinary course of business to the extent that they give value and receive delivery of the collateral without knowledge of the security interest and before it is perfected;
- (4) In accounts, contract rights and general intangibles to the rights of a transferee to the extent that he gives value without knowledge of the security interest and, before it is perfected.

Subsection (2) accords priority to the holder of a purchase money security interest who has filed a financing statement prior to, or within ten days after, the collateral is received by the debtor over the rights of a transferee in bulk or a lien creditor which arise in the period between the attachment of the security interest and the filing.

Subsection (3) assimilates assignees for the benefit of creditors, receivers in equity, and trustees in bankruptcy to lien creditors "armed with process". Such persons are deemed to be bona fide, regardless of personal knowledge, as long as at least one creditor represented was without knowledge of the security interest. The inclusion of the trustee in bankruptcy is subject to the overriding regulation by the Bankruptcy Act and probably ineffective, since the Bankruptcy Act declares knowledge of all actually existing creditors to be immaterial (Bankruptcy Act, Section 70c).

U.C.C. Sec. 9-302. Explanatory Notes.

In most types of collateral security, interests may be perfected by one of two alternative modes: taking possession or filing a financing statement. With respect to a few types of personal property, only one or the other method is appropriate. In the case of instruments, taking possession is the only effective method of perfection (section 9-304). Vice versa in the case of accounts, contract rights and general intangibles the rights of a transferee can be perfected only by filing, except where no special perfection is needed in view of the casual or isolated character of the transfer.

Part 3 of Article 9 is not couched in terms of two principal alternatives for the method of perfection. Rather, filing is declared to be the basic method of perfection subject to a catalogue of exceptions, one of which is present when the security interest is perfected by the secured party taking possession of enumerated types of collateral.

Subsection (1) requires filing to perfect all security interests except in six types of cases:

- (1) Security interests in collateral of the kind specified in section 9-305 which the secured party has taken possession;
- (2) Security interests which are temporarily perfected for a limited period under special rules applicable to instruments and documents (section 9-304) or to proceeds (section 9-306);
- (3) Purchase money security interests in farm equipment other than fixtures or motor vehicles subject to licensing, if the price of the farm equipment is \$2,500 or less;
- (4) Purchase money security interests in consumer goods, again with the exception of motor vehicles subject to licensing and fixtures;
- (5) Assignments of accounts or contract rights which alone or in conjunction with other assignments to the same assignee transfer a significant portion of the assignor's outstanding accounts or contract rights;

(6) Security interests arising under the Articles on sales or bank deposits and collections.

Subsection (3) specifies that assignments of perfected security interests remain perfected without further filing against creditors of and transferees from the original debtor. Filing may be needed to protect the assignee against creditors of and purchasers from the assignor.

The filing requirements are inapplicable to security interest which are subject to a federal recording or filing system and to security interests in motor vehicles if the local law requires indication of such interests on a certificate of title. To that extent the existing provisions remain in force and must be observed, in order to give the security interest perfected status. Since Hawaii has such a statute pertaining to motor vehicles, it is recommended to delete the words "or for a motor vehicle required to be licensed" in subsection (1)(c) and (d), and to rephrase subsection (3) as follows:

"(3) The filing provisions of this Article do not apply to a security interest in (a) property subject to a statute of the United States, etc. and (b) motor vehicles subject to chapter 196."

U.C.C. Sec. 9-303. Explanatory Notes.

Section 9-303 regulates the commencement and the duration of the perfection of security interests. If the steps necessary for perfection have been taken prior to the attachment of the security interest, perfection coincides with attachment. Otherwise, perfection dates from the time that all necessary steps are completed.

If a security interest is originally perfected in one way and subsequently in some other way without an intermediate interval when it was unperfected, the security interest is continuously perfected and remains perfected until the effects of both methods have lapsed.

U.C.C. Sec. 9-304. Explanatory Notes.

Section 9-304 deals with the perfection of security interests in instruments, documents and goods covered by documents. The Code differentiates the applicable rules according to whether the document covering the goods is negotiable or nonnegotiable.

Subsection (1) prescribes that security interests in instruments as defined in section 9-105(g), other than instruments which constitute part of chattel paper, can be perfected only by the secured party taking possession, except in the cases where subsections (4) and (5) provide for "temporary perfection" without this step. Security interests in chattel paper or negotiable documents may be perfected by filing or taking possession (sections 9-304(1) and 9-305).

Subsection (2) provides that security interests in goods which are covered by a negotiable document, as long as they are in the possession of the issuer of such documents, are perfected by perfecting a security interest in the document. Any security interest in the goods which is perfected directly during that period are subordinate to the security interests perfected in the documents.

Subsection (3) takes a different approach with respect to goods covered by a nonnegotiable document or not covered by any document while in the possession in the bailee. Security interests in such goods may be perfected in three different ways: (1) filing a financing statement, (2) issuance of the document in the secured party's name, or (3) notification to the bailee of the secured party's interest.

Subsections (4) and (5) provide for "temporary perfection" during a twenty-one day period in two special cases:

- (1) A security interest in instruments and negotiable documents is perfected for twenty-one days from the date of attachment to the extent that it arises for new value given under a written security agreement, although there is no filing, and the instrument or negotiable document is in the debtor's possession.
- (2) A perfected security interest in instruments, negotiable documents, or goods not covered

by a negotiable document in the possession of a bailee remains perfected for twenty-one days if the secured party releases the goods or documents to the debtor for the purpose of facilitating their sale or exchange or hands the instruments over to him for the purposes of sale, exchange, collection or taking steps necessary for their preservation. The reason for this exception is to prevent an unnecessary cluttering up of the records.

After the expiration of the twenty-one day period, in both cases, perfection depends on compliance with the applicable rules.

U.C.C. Sec. 9-305. Explanatory Notes.

Security interests in chattels and in choses in action that are "reified" by incorporation in a paper, i.e., in all types of collateral except accounts, contract rights and general intangibles, may be perfected by the secured party taking possession thereof. If such collateral, except goods covered by a negotiable document, are held by a bailee, notification to the bailee of the secured party's interest is equivalent to the latter's taking possession.

The perfection dates from the time possession is taken without relation back and continues only so long as possession is retained save for the exceptional cases of "temporary perfection" specified in section 9-304(4) and (5).

The last sentence contains a truism: before or after possession by the secured party, the security interest may be perfected by other available methods.

U.C.C. Sec. 9-306. Explanatory Notes.

Section 9-306 extends the security interest on collateral to its proceeds and regulates the relative priorities between the secured party and other persons claiming rights to such proceeds. Subsection (1) defines proceeds; subsection (2) states the basic rule of the extension to proceeds; subsection (3) deals with the aspect of perfection; subsection (4) regulates the effect of insolvency proceedings; and subsection (5) deals with the relative rights in proceeds consisting of accounts or chattel paper in case goods are returned or repossessed.

Subsection 9-306(1) defines proceeds as whatever is received when collateral or proceeds is disposed of, including the accounts arising from such disposition. Money, checks, etc., are "cash proceeds", all other proceeds are "non-cash proceeds".

Subsection 9-306(2) contains the basic rule to the effect that, except where the Code accords protection to bona fide purchasers, a security interest in collateral remains unaffected by an unauthorized disposition thereof by the debtor and, in addition and in any case, extends to and "continues" in any identifiable proceeds, including collections received by the debtor.

Subsection 9-306(3) provides that a perfected security interest in the collateral continues as perfected security interests for ten days and thereafter ceases to be perfected, unless either the financing statement covering the original included proceeds or the security interest in the proceeds is perfected as such prior to the expiration of the ten-day period.

Subsection 9-306(4) states special rules for the case of insolvency for the purpose of safeguarding the priority of the secured party over the general creditors:

- (1) Subsection (4), subdivision (a) to (c) specify that a party with a perfected security in proceeds retains the same, if the proceeds consist of identifiable non-cash proceeds or identifiable cash proceeds which were not deposited in a bank account and remained uncommingled with other money prior to the insolvency proceedings.
- (2) Subsection (4), subdivision (d) continues a perfected security interest in cash and bank accounts of the debtor, if other cash proceeds have been commingled or deposited in a bank account, in an amount equal to the amount of the cash proceeds received and commingled or deposited within the ten days preceding the institution of the insolvency proceedings less the amount of cash proceeds received and paid over to the secured party during that period. Such security interest, in addition, is subject to any right of setoff. Note that subsection (4) (d) is drafted in terms of a

perfected security interest in order to overcome the unfavorable results of the decision is In re Crosstown Motors, Inc., 272 F 2d 224 (7 Cor. 1959), reached under the different language of section 10 of the Uniform Trust Receipts Act which served as model for the proceeds section of the Code.

Subsection 9-306(5) regulates the relative priorities between a transferee of accounts and chattel paper, constituting proceeds of collateral subject to a security interest, and the holder of such interest in case the goods sold are returned or repossessed:

- (1) An original security interest reattaches to the goods if the indebtedness of the seller secured thereby is still unpaid. If the security interest was originally perfected by filing and such filing is still effective the reattaching security interest continues with perfected status without further steps to be taken. If the security interest was perfected in any other manner and remained perfected when the goods were sold, it continues as perfected security interest upon reattaching only if the secured party takes possession of the returned or repossessed goods or files.
- (2) An unpaid transferee of the account or chattel paper likewise has a security interest in the goods. But the security interest of a transferee of an account is inferior to the original security interest and that of a transferee of chattel paper is likewise subordinate unless the transferee was entitled to priority under special rules giving priority to purchasers of chattel paper claimed as proceeds (section 9-308, *infra*). In any case the security interest in returned or repossessed goods of a transferee of the account or chattel paper must be perfected for protection against creditors of the seller or purchasers of the returned or repossessed goods.

U.C.C. Sec. 9-307. Explanatory Notes.

Sections 9-307, 9-308 and 9-309 specify cases in conditions under which purchasers of different categories of collateral may prevail over perfected and, a portion of, unperfected security interests therein. Section 9-307 deals with goods, section 9-308 with chattel paper and nonnegotiable instruments, and section 9-309 with negotiable instruments, negotiable documents of title and securities.

Subsection 9-307(1) deals primarily with inventory and subsection 9-307(2) with consumer goods and certain farm equipment.

Subsection 9-307(1) provides that a buyer who, in good faith and without knowledge that the sale to him is in violation of a security interest created by the seller, purchases in ordinary course from a person in the business of selling goods of that kind takes free and clear of such security interest even though the security interest is perfected and its existence known to the buyer. This rule does not apply to a buyer from a pawnbroker or of farm products from a person engaged in farming operations. Thus, if a consumer buys some item of durable consumer goods in a store knowing that the inventory is subject to a security interest of a bank but without knowing that the store has no liberty of sale, he acquires the item free and clear.

Subsection 9-307(2) provides that a buyer of consumer goods and of farm equipment having an original purchase price of not more than \$2,500 takes free of a perfected security interest if he buys without knowledge of the security interest, for value and for his own personal, family or household purposes or his own farming operation unless prior to such purchase the secured party has filed a financing statement covering such goods. Hence, if A buys a used television set from B without knowing that the set is subject to a purchase money security interest of the department store from which B originally procured the set, A will acquire free and clear of the store's interest, unless the store had filed a financing statement covering the set although such filing is not necessary for the perfection (section 9-302(1)(c)).

U.C.C. Sec. 9-308. Explanatory Notes.

Section 9-308 provides that a purchaser (as defined in section 1-201(32) and (33)) of a chattel paper or a nonnegotiable instrument may under certain conditions obtain superior rights despite the existence of a perfected security interest, if the perfection was otherwise than by possession.

Section 9-308 differentiates two situations of nonpossessory perfected security interests in chattel paper: (1) If the security interest in chattel paper is perfected by filing (section 9-304(1)) or under the rules of temporary perfection (section 9-304(4) and (5)), a purchaser obtains priority if he gives new value, takes possession of the chattel paper in the ordinary course of his business and has no knowledge of the outstanding security interest. (2) If the security interest in chattel paper is claimed merely as proceeds of an inventory subject to a security interest, a purchaser giving new value and taking possession of it in the ordinary course of his business obtains priority, even though he knows of the inventory financier's security interest.

A security interest in a nonnegotiable instrument which is perfected without possession under the rules of temporary perfection (section 9-304(4) and (5)) will be postponed to a purchaser who gives new value, takes possession of it in the ordinary course of business and is without knowledge of the outstanding security interest.

U.C.C. Sec. 9-309. Explanatory Notes.

Section 9-309 renders it clear that negotiation of negotiable paper (whether negotiable instruments, negotiable documents of title or investment securities) to bona fide purchasers cuts off outstanding perfected security interests. Filing, although a method of perfection for security interests in documents, does not impart constructive notice to purchasers thereof.

U.C.C. Sec. 9-310. Explanatory Notes.

Section 9-310 grants common law or statutory liens for services or materials furnished by a person in the ordinary course of his business with respect to goods over a perfected security interest therein unless the governing statute provides expressly otherwise. If the governing statute is silent, the Code supplies a rule of construction that the lien shall have priority.

U.C.C. Sec. 9-311. Explanatory Notes.

Section 9-311 provides that the debtor's rights in the collateral are alienable and subject to the reach of his creditors, any stipulation in the security agreement to the contrary notwithstanding.

U.C.C. Sec. 9-312. Explanatory Notes.

Section 9-312 regulates some of the most fundamental and most complex aspects of the new system introduced by Article 9. Although the heading reads "priorities among conflicting security interests in the same collateral", its range slightly exceeds that indicated by the heading. The 1958 version of this section is the product of two consecutive, rather radical, revisions of the original 1952 form of the text. Braucher, The Legislative History of the Uniform Commercial Code, 58 Colum. L. Rev. 798 (1958); Selected Priority Problems in Secured Financing Under the Uniform Commercial Code, Note, 68 Yale L. J. 751 (1959). Even now the section raises baffling problems of construction, see Selected Priority Problems in Secured Financing Under the Uniform Commercial Code, cit. supra.

Section 9-312 is divided into six subsections. Subsection (1) contains a catalogue of references to other sections of the Code embodying rules for determining priorities between security interests and conflicting claims of interests, whether security interests or other interests, in the same property. The remaining subsections state general rules of priority among conflicting security interests in the same collateral.

Subsection 9-312(2) gives a special security to a perfected new value security interest in crops based on a current crop production loan over an earlier perfected security interests in the crop securing obligations which fall due more than six months before the crops become growing crop. Knowledge of the prior security interests by the maker of the crop production loan has no adverse effect on his priority.

Subsections (3) and (4) establish a special regime governing the priority between purchase money security interests (as defined in section 9-107) and conflicting security interests in the same collateral. The rules vary according to whether the collateral is inventory or property other than inventory. The rules prescribed in subsections (3) and (4) for the priority of purchase money security interests are not exclusive. In cases where such interests do not qualify for the special priority under these subsections they still may have priority over conflicting interests under the general priority rules stated in subsections (5) and (6):

- (1) In the case of inventory collateral, the priority of the purchase money security interest depends upon the fulfillment of two requirements: (a) the purchase money security interest must be perfected (usually by way of filing) at the time the debtor obtains possession of the collateral, and (b) the holder of the security interest must have given timely notification of his purchase money security interest or of his expectation of acquiring such interest to any other secured party whose security interest is known to the holder of the security interest or who prior to the filing by the holder of the security interest had filed a financing statement covering that inventory. The notification must be given prior to the receipt of possession to the debtor.
- (2) In the case of non-inventory collateral, the purchase money security interest has priority over a conflicting security interest if it is perfected at the time the debtor receives possession of the collateral or within ten days thereafter. In other words, in the case of non-inventory collateral, the Code dispenses with the notification requirement and provides for a ten days grace (relation back) period.

Subsections (5) and (6) contain a hierarchy of three general rules which apply to all cases of conflicts between security interests where the special rules stated in subsections (1) to (4) do not control. These three rules are: (1) the first-to-file rule, (2) the first-to-perfect rule, and (3) the first-to-attach rule. The first-to-file rule governs where both security interests are perfected by filing. The date of attachment in such case is immaterial. The first-to-perfect rule applies, unless both security interests are perfected by filing. The date of attachment again has no effect or relevancy. The first-to-attach rule applies so long as neither of the conflicting security interests is perfected.

Subsection (6) specifies that for the purpose of applying the hierarchy of the three general rules, the original method of perfecting a continuously perfected security interests determines the applicable rule. If filing follows perfection by possession, the first-to-perfect rule rather than the first-to-file rule governs and vice versa.

U.C.C. Sec. 9-313. Explanatory Notes.

Section 9-313 governs the conflict between security interests in goods that have become fixtures created under the provisions of Article 9 and other interests in such fixtures created under the rules of local real estate law. The regime of the Code constitutes in several respects an important departure from the traditional approach and its solution has been the object of a somewhat critical appraisal, Coogan, Security Interests in Fixtures Under the Uniform Commercial Code, 75 Harv. L. Rev. 1319 (1962).

Section 9-313 ~~does~~ not apply to building materials incorporated into a structure and leaves it to applicable local law to determine when goods become fixtures. Finally, section 9-319 does not prevent creation of an encumbrance extending to fixtures pursuant to the applicable local land law.

Section 9-313 differentiates between the status of security interests which attach before the goods become fixtures (pre-affixation security interests) and security interests which attach to goods after such date (post-affixation security interests):

- (1) Pre-affixation security interests take priority as to the goods over all interests in the real estate, except over three categories of such interests enumerated in subsection (4).
- (2) Post-affixation security interests are valid against all interests in real estate acquired subsequent to their attachment except against the three categories listed in subsection (4). Pre-existing interests in real estate prevail except where the holder of such pre-existing interests in real estate as consented in writing to such security interest or disclaimed an interest in the goods as fixtures.

Subsequent purchasers for value of any interest in the real estate, creditors subsequently obtaining a lien by judicial proceedings on the real estate and creditors with a pre-existing encumbrance of record on the real estate to the extent that they make subsequent advances are entitled to priority in any case if the purchase is made, the lien obtained or the advance arranged, without knowledge of the security interest and before its perfection. A purchaser of the real estate at a foreclosure sale, other than an encumbrancer purchasing at his own foreclosure sale, is a subsequent purchaser for value.

A secured party having priority over interests in real estate may, on default, sever his collateral from the real estate for the purpose of collecting out of the collateral. Any encumbrancer or owner of the real estate who is not the debtor and has not otherwise agreed to the removal is entitled to reimbursement for the cost of repair of any physical injury but not for any diminution in value of the real estate caused by the absence of the goods removed and the need for replacement. A person entitled to reimbursement may insist on adequate security for the reimbursement prior to the severance.

U.C.C. Sec. 9-314. Explanatory Notes.

Section 9-314 applies the same policy which is adopted in the case of fixtures to the case of accessions, i.e., goods installed in or affixed to other goods without losing their identity. Components used in a manufacturing process or as structural parts of a machine are governed by section 9-315 (Commingled or Processed Goods).

Preinstallation security interests take priority as to the goods installed over the claims of all persons to the whole, except for three categories of subsequent interests enumerated in subsection (3). Post-installation security interests are valid against subsequent interests except the three categories enumerated in subsection (3) but invalid against prior interests in the whole, except those held by persons who have consented in writing to the security interest or disclaimed an interest in the goods as part of the whole.

The three categories of subsequent interests enumerated in subsection (3) repeat, mutatis mutandis, the regulation given for the case of fixtures. The right of the secured party to remove the accessions in case of default for the purpose of collecting out of them is likewise parallel to that provided for in the case of fixtures.

U.C.C. Sec. 9-315. Explanatory Notes.

Section 9-315 governs the effect of subsequent comminglement or processing of goods which are subject to a perfected security interest. The section continues the pre-existing perfected security interest in the product or mass if either the goods lose their identity in the product or mass or a financing statement covering the original goods cover, also the product. The latter case and the case of accessions are mutually exclusive. If this section results in the attachment to the product or mass of more than one security interest, they have equal rank and share in the ratio that the cost of the goods to which they originally attached bears to the cost of the total product or mass.

U.C.C. Sec. 9-316. Explanatory Notes.

Section 9-316 states the truism that a person entitled to priority, and only such person, may conclude subordination agreements.

U.C.C. Sec. 9-317. Explanatory Notes.

Section 9-317 makes it clear that the existence of a security interest or authority given to the debtor to dispose of or use the collateral does not create an agency relation so as to render the secured party liable for the debtor's acts or omissions.

U.C.C. Sec. 9-318. Explanatory Notes.

Section 9-318 regulates the effects of an assignment on the relative rights of an account debtor (i.e., a person obligated on an account, chattel paper, contract right or general intangible) the assignor and the assignee. The section applies to all sales of accounts, contract rights or chattel paper (section 9-102(1)(b)), except the cases excluded by section 9-104, regardless of whether or not filing is required for perfection (section 9-302(1)(e)).

Unless the account debtor has made an enforceable agreement to the contrary (section 9-206), the assignee takes subject to any defense and claim of the debtor against the assignor arising from the contract and any other defense or claim of the debtor against the assignor accruing before the debtor receives notification of the assignment. The rule is in accord with settled principles.

Subsection (2) permits the original parties to make modifications of or substitutions for the contract, provided they are agreed upon in good faith and in accordance with reasonable commercial standards, as long as the performance upon which the right to payments is conditioned is not completed. No consent of the assignee is required, but he is entitled to the assigned payments as modified. The assignment may provide that such modification or substitution renders the assignor liable.

Subsection (3) regulates the conditions under which the account debtor may make payments to the assignor with liberating effect despite the assignment. Such liberating effect is cut off after the debtor has received notification identifying the rights assigned and, if he so requests, reasonable proof of the assignment.

Subsection (5) outlaws anti-assignment clauses. It constitutes a break with traditional contract principles still recognized by the Restatement of Contracts, but, according to the draftsmen, is in conformity with recent decisional law and the views of the commercial world.

PART 4 FILING

Prefatory Observations

Part 4 regulates the formal and administrative aspects of filing.

It must be kept in mind that filing is needed for perfection of a security interest except where:

- (1) A different mode of perfection is available and resorted to (sections 9-302(1)(a), 9-304(3) and 9-305);
- (2) A different method of perfection is the sole sanctioned method (section 9-304(1), second sentence); or
- (3) No special step is needed for perfection or temporary perfection (section 9-302(1)(b)-(f)).

It is important to bear in mind further that the filing provisions of Article 9 are inapplicable to security interests in property which either is subject to a federal statute which provides for national registration or filing of all security interests in such property, or governed by a local statute which requires indication on a certificate of title of such property (section 9-302(3)(b)).

The State of Hawaii has two statutes of this type which must be considered:

- (1) Chapter 160, Revised Laws of Hawaii, relating to certificates of title to motor vehicles, and

(2) Chapter 342, Revised Laws of Hawaii, relating to certificates of title to registered land.

Certainly the filing provisions of Article 9 do not replace or supersede section 160-10. Perfection of a security interest in a registered motor vehicle (be it equipment or consumer goods) will depend on compliance with and be governed by the provisions of that section.

On the other hand, the possible effects of Article 9, especially of section 9-313 (dealing with fixtures) on the provisions governing voluntary and involuntary dealings with registered land (chapter 342, Revised Laws of Hawaii, especially sections 342-50, 342-51, 342-52, 342-57, 342-59, 342-60, 342-61) need some further discussion.

It might be thought, at first blush, that the filing provisions of the Code are not applicable at all to security interests in fixtures affixed to registered land, the certificate of title governed by chapter 342 being a certificate of title requiring the indication of all security interests in property covered thereby within the meaning of section 9-302(b), Alternative A. But further reflection shows that such an approach would lead to gaps and incongruities and, most of all, would still leave open the question as to how and when a security interest in registered land fixtures is perfected within the meaning of section 9-313(4). Of course, this problem arises only upon the assumption that section 9-313(4) is intended to cover fixtures even where the pertinent land is registered land.

Present practice is not too helpful for the solution. The registrar of the land court (section 342-7, Revised Laws of Hawaii), and the assistant registrar (section 342-9, Revised Laws of Hawaii) do not accept separate mortgages on fixtures affixed to registered land for registration in the office of the assistant registrar, but refer such instruments for recording as chattel mortgage in the bureau of conveyances. A mortgage of registered land which expressly covers specified fixtures will be accepted for registration in the land court, office of the assistant registrar, but the memorandum "of the purport of the mortgage deed" (section 342-16, Revised Laws of Hawaii) will not specifically list the fixtures enumerated in the mortgage. If the parties wish, they may also record the mortgage as chattel mortgage in the bureau of conveyances.

It seems clear that the adoption of the Code would require a modification of the existing practice. It is important to note that Massachusetts, from which Commonwealth the Hawaiian Land Registration Act was borrowed, adopted a statute in 1960 which modified the filing provisions of the official text of the Code of 1958 and inserted a special section relating to filings as to fixtures in order to take care of the perfection of the security interests in fixtures, including fixtures affixed to registered land (Mass. Acts and Resolves 1960, chapter 379). Even so, a number of difficulties are bound to arise; see Coogan, Security Interests in Fixtures Under the Uniform Commercial Code, 75 Harv. L. Rev. 1318, at 1341.

It is recommended that modifications and additional provisions following the pattern of those adopted in Massachusetts be enacted in Hawaii, but that certain further matters be taken care of which are not specifically included in the Massachusetts revision.

The particular difficulties of reconciling the system of the Code with the Land Registration Act lie in the fact that under the Code, filing is only a method of perfection whereas under the land registration law, voluntary transactions creating or transferring interests in registered land are operative as to the land only upon registration (section 342-50, Revised Laws of Hawaii). Moreover, while financing statements under the Code are filed by presentation of the financing statement and tender of the fee, instruments for voluntary creation of interests in land are not accepted for registration unless the owner's duplicate certificate is presented at the same time.

It is recommended:

- (1) that separate present and prospective security interests in fixtures constituting part of the reality of registered land be capable of being shown as separate interests in the fixtures by appropriate memorandum on the certificate of title and the owner's duplicate certificate;
- (2) that financing statements covering goods that are or are to become fixtures affixed to registered land are to be filed in the land court, office of the assistant registrar;

- (3) that such present or prospective security interests in fixtures are to be accepted for registration and indexed in accordance with the provisions of chapter 342 (including the presentation of the owner's duplicate certificate);
- (4) that the date of acceptance for filing constitute filing for the purposes of perfection within the meaning of section 9-313(4) of the Code.

U.C.C. Sec. 9-401. Explanatory Notes.

Section 9-401 regulates the proper place of filing in order to perfect a security interest and the effects of erroneous filing. Once the adoption of the Uniform Commercial Code is settled in an affirmative sense, the establishment of the proper filing system is the most crucial determination to be made. One of two disparate systems or a mixture thereof must be selected: local filing or central filing. The draftsmen of the Code offer two arrangements: one constituting a mixed system, the other prescribing primarily unified central filing, but allocating the filing concerning security interests in goods which at the time such interests attach are or are to become fixtures, to the office where a mortgage on the real estate affected would be filed or recorded.

In Hawaii practically all filing or recording governed by existing statutes is central filing and is within the jurisdiction of the bureau of conveyances, (section 343-1, Revised Laws of Hawaii). The only two registration laws which are administered by different offices are the registered land law (chapter 342, Revised Laws of Hawaii) and the law relating to the registration of motor vehicles (chapter 160, Revised Laws of Hawaii). The first of these two exceptions is likewise a central registration system, administered by the land court through the land registration office and the office of the assistant registrar. Motor vehicle registration, on the other hand, is a local system administered by the county treasurers (section 160-1, Revised Laws of Hawaii).

In view of the existing situation, it is recommended that the purely central filing system be maintained and that all filing be made with the registrar of conveyances in the bureau of conveyances, except filing to perfect a security interest in goods which at the time the security interest attaches are or are to become fixtures pertaining to registered land. Filing in that case is to be made in the land court, office of the assistant registrar.

Accordingly section 9-401(1) should be enacted in the following form:

- "(1) The proper place to file in order to perfect a security interest is as follows:
- (a) When the collateral is goods which at the time the security interest attaches are or are to become fixtures affixed to registered land, then in the land court, office of the assistant registrar;
 - (b) In all other cases with the registrar of conveyances, bureau of conveyances."

Subsection (2) specifies that a filing which is made in good faith in an improper place or not in all places required by this section is nevertheless effective with regard to any collateral as to which filing complied with the requirements of this Article and is also effective with regard to collateral covered by the financing statement against any person who has knowledge of the contents of such financing statement.

This subsection would find practical application, for example, where a financing statement covers goods which when the security interest attaches are or are to become fixtures affixed in part to registered land and in part to other land. In such case the proper places of filing would be both the land court, office of the assistant registrar and the registrar of conveyances, bureau of conveyances.

Subsection (3) contained in the official text should be deleted. It covers the cases where the debtor's residence or place of business or the location of the collateral or its use, whichever controlled the original filing, is thereafter changed. Since in Hawaii with a purely central filing system, none of the factors listed controls the place of filing, the subsection would have no practical importance.

Subsection (4) determines the filing aspects of changes of location between states.

U.C.C. Sec. 9-402. Explanatory Notes.

Section 9-402 specifies the extremely simple formal requirements of the "financing statement" and the effect of minor errors. The method of filing employed is so-called "notice filing". It may be made either in advance of the conclusion of a security agreement or of the time when the security interest attaches as well as subsequent thereto. The Code does not require filing of the security agreement but considers a copy of the security agreement as satisfactory financing statement if it contains the requisite information and signatures.

Subsection (1) deals with the ordinary cases. All that is mandatory as information is: (1) signatures of both parties, (2) addresses of both parties, and (3) a description of the types or items of the collateral. In the cases of crops and goods which are or are to become fixtures, the statement must also contain a description of the real estate concerned.

In two special cases the signature of the secured party is sufficient:

- (1) Where collateral already subject to a security interest in another jurisdiction is brought into the state; and
- (2) Where the security interest sought to be perfected is in proceeds of original collateral in which the security was perfected.

Subsection (4) sets out a form. Massachusetts, by amendment of 1958, made minor changes. The Massachusetts form seems to be an improvement, except that the deleted words "or assignor" and "or assignee" should be restored.

Subsection (5) deals with amendments, subsection (6) with the effects of minor errors. Both subsections are self-explanatory.

U.C.C. Sec. 9-403. Explanatory Notes.

Section 9-403 determines what constitutes filing, the duration of the effectiveness of filing and the consequences of lapsed filing.

Subsection (1) states that a financing statement is filed by presentation of the statement for filing and tender of the filing fee or acceptance of the statement by the filing officer. This provision is intended to relieve the secured party of the risk that the filing officer will not properly perform his duty.

Massachusetts and Connecticut (following the Massachusetts example) have modified subsection (1) in order to conform with the special provisions made for filing as to fixtures. Massachusetts and Connecticut differentiate between "filing officer" (defined as filing officer other than a register of deeds or town clerk, respectively) and register of deeds or town clerk, respectively.

In Hawaii security interests in present or prospective fixtures are to be filed either with the office of the registrar of conveyances, bureau of conveyances (in the case of unregistered land) or with the land court, office of the assistant registrar (in the case of registered land). In the case of registered land, voluntary instruments are not accepted for registration unless accompanied by the owner's duplicate certificate. It is recommended to leave this requirement intact. Even in the case of security interests in fixtures pertaining to unregistered land, acceptance only should constitute filing. Since notation of the time of reception in the entry book determines the time of registration (section 342-56, Revised Laws of Hawaii) a security interest in goods which are or are to be fixtures affixed to registered land are perfected as of the time of acceptance without a further provision to that effect. Accordingly section 9-403(1) should be modified to read as follows:

- "(1) Except when collateral is goods which are or are to become fixtures, presentation for filing of a financing statement and tender of the filing fee or acceptance of the statement by the filing officer constitutes filing under this Article. When collateral is goods which are or are to become fixtures acceptance by the filing officer constitutes

filing under this Article. When the collateral is goods which are or are to become fixtures affixed to registered land the debtor's duplicate certificate shall be produced and presented with the presentation for filing of the financing statement or an amendment adding such collateral."

Subsection (2) specifies, how long a filing remains effective. The Code differentiates two situations: if the financing statements indicate a maturity date of the obligation secured of five years or less, the effectiveness of the filing continues until the expiration of sixty days following the maturity date. Otherwise, the filing is effective for a period of five years from the date of filing. Upon the expiration of such sixty days after the indicated maturity date or the five-year period, as the case may be, the effectiveness of the filing lapses unless a continuation statement is filed prior to the lapse. Upon such lapse the security interest become unperfected, that is to say--despite the lack of precision of subsection (2) in that respect--unless perfection is continued by some available method other than filing.

Subsection (3) regulates the filing of continuation statements specifying the conditions of timely filing and the form. A continuation statement may be filed by the secured party alone. There is no reason why such continuation statement signed by the secured party alone should not be effective, even where the continuation statement relates to a security interest in fixtures affixed to registered land. In such case there is also no need for production and presentation of the debtor's duplicate certificate. It is recommended to insert the following sentence after the second sentence in subsection (3):

"When the collateral is fixtures affixed to registered land the secured party may present the continuation statement for filing without production and presentation of the debtor's duplicate certificate."

The last sentence in subsection (3) provides for removal and destruction of lapsed statements. It is recommended to delete the sentence and regulate the matter in a separate section (section 4-409), following the example of Massachusetts in that respect.

Subsection (4) prescribes the method of filing and indexing of original and continuation statements. It

is recommended that the applicability of this subsection be restricted to collateral other than goods that are or are to become fixtures and that the filing and indexing of statement relating to security interests in fixtures be regulated in a separate section, numbered 9-403.1. Accordingly subsection (4) should read: "Except as otherwise provided in section 9-407(1) collateral is goods which at the time a filing officer shall mark etc."

Subsection (5) specifies a uniform filing fee for filing, indexing and furnishing filing data, leaving the amount to the determination of the individual states. Following the amount specified for the filing of notice of assignment of accounts receivable (section 187-3(h), Revised Laws of Hawaii) and of trust receipt financing statements (section 206-13(c), Revised Laws of Hawaii) the amount should be \$1.50. In view of the special provisions for the filing fees in case of security interests in fixtures, subsection (5) should read: "Except as otherwise provided in section 9-407 (3) the fee for . . . shall be \$1.50."

The contents of this section are modelled after the Massachusetts changes contained in section 9-403 (5) and in section 9-409 as adopted there. The language is changed to fit the local situation.

It should be noted that Massachusetts and Connecticut have added in their section 9-409(1) a particular clause relating to indexing. The Connecticut text reads as follows:

"In particular each financing statement, security, agreement, continuation statement and amendment shall be indexed in the grantor index according to the name of the debtor and if it shows the name of a record owner of the real estate which is other than the debtor, it shall also be indexed according to the name of such owner. All such items shall also be indexed in the grantee index according to the name of the secured party."

Adoption of a clause to that effect is not recommended, as it is apt to create confusion. The secured party will be the grantee in any case, and if the debtor is not the owner of, and grantor of the security interest in, the fixtures the appearance of his name in the index as grantor would only be misleading.

U.C.C. Sec. 9-404. Explanatory Notes.

Section 9-404 provides a procedure for noting a discharge of the secured obligation or a termination of a financing arrangement on the records.

In view of the proposed special provisions governing termination statements relating to security interests in fixtures sections 9-404 and 9-407 should be modified by:

- (1) Rephrasing the third sentence in subsection (1) to read: "Except as otherwise provided in section 9-409 the fee for filing and indexing such an assignment or statement thereof shall be \$1.50."
- (2) Rephrasing subsection (2) to read: "Except as otherwise provided in section 9-407(1) and (2) the filing officer, on presentation of such a termination statement, must note it in the index and shall remove etc. . . ."
- (3) Rephrasing subsection (3) to read: "Except as otherwise provided in section 9-407(3) the fee for filing . . . shall be \$1.50."

U.C.C. Sec. 9-405. Explanatory Notes.

Section 9-405(1) deals with the case where the original financing statement indicates or contains an assignment. In view of the proposed special provisions relating to goods which are or are to become fixtures, the second and third sentence of subsection (1) should be rephrased so as to read:

"On presentation to the filing officer of such financing statement the filing officer, according to the type of collateral concerned shall process the same as provided in section 9-403(4) or 9-407(1) and (2). The fee for filing, indexing and furnishing filing data for a financing statement shall be \$1.50 except as is otherwise provided in section 9-407(3)."

Section 9-405(2) deals with subsequent separate statements of assignment. In view of the special provisions relating to filings of fixtures, the first and the three last sentences need slight rephrasing and should read:

"(2) A secured party may assign of record all or a part of his rights under a financing statement by the filing of a separate written statement of assignment signed by the secured party of record. Such statement shall set forth the name of the secured party of record and the debtor, the name and address of the assignee, the date of filing of the financing statement and, except as otherwise provided in section 4-407(2), the file number and shall contain a description of the collateral assigned . . . Except as otherwise provided in section 4-407(1) and (2) the filing officer, on presentation of such a separate statement, shall mark such separate statement with the date and hour of filing and shall note the assignment on the index of the financing statement. Except as otherwise provided in section 4-407(3) the fee for filing . . . shall be \$1.50."

A separate statement of assignment relating to a perfected security interest need not be filed to continue the perfected status of the security interest against creditors of or transferees from the original debtor, but filing may be necessary to perfect the assignment against creditors of and transferee from the assignor.

U.C.C. Sec. 9-406. Explanatory Notes.

Section 9-406 regulates the filing of statements of releases. There is no requirement that releases of collateral be filed.

Again the official text of the provisions governing the processing of and the fee for filings of statements of releases must be modified, in view of the special provisions relating to fixtures. Hence the two last sentences should read:

"Except as otherwise provided in section 9-407(1) and (2) the filing officer etc. Except as otherwise provided in section 9-407(1) the fee for filing and noting such a statement of release shall be \$1.50."

U.C.C. Sec. 9-407. Explanatory Notes.

This section is inserted to regulate certain matters pertaining to the processing of filings relating to security interests in goods which are or are to become fixtures. Such filings are properly treated like the recording or registration of voluntary transactions relating to land.

[Section 9-407. Special Provisions for Processing of Filings as to Fixtures; Fees; Combined Real Estate and Fixture Mortgage.

- (1) Filings of financing statements, security agreements, amendments, continuation statements, termination statements, statements of assignment and statements of release complying with the requirements of section 9-402 and relating to security interests in goods which are or are to become fixtures shall be processed by the filing officer in the manner provided in chapter 343 if they concern unregistered land and in the manner provided in chapter 342 if they concern registered land.
- (2) In addition to the other requirements specified in this part an amendment, continuation statement, termination statement, statement of assignment or statement of release relating to security interests in goods which are or are to become fixtures must contain a reference to the book and page of the record of the original financing statement if it relates to unregistered land and to its file number if it relates to registered land. The filing officer shall enter upon the margin of the record or registration of the original financing statement a notation of the record or registration of any amendment or other subsequent statement.
- (3) The fee for the recording of a financing statement (including a statement disclosing an assignment), a security agreement or an amendment adding new collateral relating to goods which are or are to become fixtures affixed to unregistered land shall be \$4 and for the recording of all other subsequent statements listed in subsection (1) and relating to such goods \$2. The fee for the

registration of any statement, agreement or amendment listed in subsection (1) and relating to goods that are or are to become fixtures affixed to registered land shall be the amount specified in section 342-105(22).

- (4) Provision for a security interest in goods which are or are to become fixtures may be included in a mortgage or other like instrument transferring an interest in the real estate concerned. If such instrument complies with the requirements for a financing statement specified in section 9-402, is recorded or registered as an instrument affecting real estate, and has the appropriate recording or registration fee paid for it, such recording or registering and payment of fee shall be effective filing under this part without the necessity of any separate filing or payment of any separate fee under this part.]

U.C.C. Sec. 9-408. Explanatory Notes.

Subsection 9-408(1) entitles a person filing one of the specified statements to have the filing officer note upon a copy of such statement the file number and hour of filing of the original. While there is no similar provision in any of the Uniform Acts, Hawaii has a similar provision, relating to the filing of instruments affecting registered land, section 342-56, Revised Laws of Hawaii. The list in subsection (1) appears to be incomplete. It is recommended to insert the words "security agreement, amendment, continuation statement" after the words "financing statement".

Subsection (2) entitles any person to obtain from the filing officer a certificate showing whether any currently effective financing statement and statement of assignment is on file against a particular debtor and if so, indicating the particulars. It is recommended that the text be rephrased by inserting "or owner of fixtures" after "a particular debtor" in order to take care of the situation where fixtures are subjected to a security interest to secure a debt not owned by the recorded or registered owner of the land. The fee for the certificate should be a uniform fee of \$2 regardless of which indices and books have to be searched by the filing officer.

Subsection (2) entitles any person to obtain a copy of any filed financing or statement of assignment. Following a change made in Massachusetts, it is recommended that the provision be expanded to cover other statements and that the fee vary according to the length of the statement. Accordingly, the last sentence of subsection (2) should read:

"Upon request the filing officer shall furnish a copy of any filed financing statement, security agreement, amendment, continuation statement, termination statement, statement of assignment or statement of release for a fee of \$1 and, of any such statement, agreement or amendment consists of more than three pages, an additional fee of fifty cents for the fourth and each succeeding page."

U.C.C. Sec. 9-409. Explanatory Notes.

Section 9-409 is a new section not contained in the official text of the Code. It is inserted because a sentence covering the same subject contained in section 9-403(3) is deleted. The proposed new section follows a similar provision, numbered section 9-408 in the Massachusetts version of the Uniform Commercial Code. In the recommended form an exception is made with respect to filings relating to fixtures since records pertaining to real property should not be removed or destroyed. The Massachusetts section does not contain a reservation relating to filings concerning fixtures since it only applies to "filing officers" and registers of deeds are in Massachusetts excluded from the term filing officer.

[Section 9-409. Destruction of Old Records.]

Except insofar as it relates to fixtures a filing officer, unless he has notice of an action pending in respect thereto, may remove from the files and destroy

- (a) a lapsed financing statement, a lapsed continuation statement, a statement of assignment or release relating to either, and any index of any of them, one year or more after lapse; and
- (b) a termination statement and the index on which it is noted, one year or more after the filing of the termination statement.]

PART 5 DEFAULT

Prefatory Observations

The rights of the secured party in the collateral after the debtor's default are the essence of a security transaction. It is then that the purpose of the security, i.e., to provide the means for the satisfaction of the secured party, is materialized. Traditionally the steps which the secured creditor had to follow in order to collect out of the collateral were rather burdensome and the methods available were rather limited. Part 5 tries to bring about a significant liberalization of the whole process of realization out of the collateral without disregarding needed protection of the debtor's interests.

Part 5 applies only to enforcement without resort to judicial procedure and does not apply to the realization of the secured claim out of fixtures by means of foreclosure or execution sales of real estate.

U.C.C. Sec. 9-501. Explanatory Notes.

Section 9-501 deals with the general aspects of the rights and duties of the secured party and the debtor after default.

Subsection (1) spells out that the parties may regulate these rights by agreement within the limits specified in subsection (3). The subsection makes it also clear that the rights and remedies of the secured party under sections 9-501 to 9-507 are not exclusive and do not bar enforcement of the security by judicial procedure. In case of documents the secured party may proceed with respect to either the documents or the goods covered thereby.

Subsections (1) and (2) provide further that the rights, remedies and duties specified in part 5 are cumulative to those regulated in section 9-207 for the case where the secured party is in possession of the collateral. In other words, section 9-207 applies also after default, and it is immaterial whether possession is acquired before or after default.

Subsection (3) prohibits waivers or modifications of the rights of the debtor and the duties of the secured party, except in so far as it is expressly otherwise provided in sections 9-505(1) and 9-506, with respect to the accounting for a surplus, the disposition of the collateral, acceptance of the collateral as discharge of the obligation, redemption and liability of failure to observe the mandates of this part. The parties may, however, agree upon the standards to be observed as long as they are not manifestly unreasonable.

Subsection (4) gives the secured party the option of resorting to the procedures applicable to real estate if the security interest covers both real and personal property.

Subsection (5) concerns the case where the secured party levies an execution upon the collateral under a judgment recovered upon the secured claim. The lien of the levy is declared to relate back to the date of perfection of the security interest in such collateral, and a judicial sale, pursuant to such executive, is stated to be a foreclosure sale within the meaning of this section, permitting the secured party to purchase at such sale and thereafter to hold the collateral free and clear of any other requirements of Article 9.

Note that this section applies only to levies by virtue of an execution and not by virtue of an attachment and that the relation back reaches only to the date of the perfection and not the date of the attachment of the security interest. The reasons for this limitation are not revealed. Moreover the cryptic phrase "judicial sale, pursuant to such executive" probably are meant to include sheriff's sales, although they do not qualify as judicial sales in the technical sense.

U.C.C. Sec. 9-502. Explanatory Notes.

Section 9-502 regulates the collection rights and duties of a secured party where the collateral consists of accounts, contract rights, chattel paper or instruments. It also deals with the right to take control of the proceeds to which the security attaches upon the sale of the collateral.

Subsection 9-502(1) provides that upon default, or at an earlier date if there is an agreement to that effect, the secured party is entitled to notify an account debtor or the obligor upon an instrument to make payment to him. Under the same conditions the subsection entitles the secured party "to take control of any proceeds" to which the security interest attaches. Unfortunately, the scope of this right to take control is not clearly delineated. Apparently, it enables the secured party not only to collect directly from purchasers of the collateral but also to demand turnover of all cash proceeds or trade-ins in the hands of the debtor.

Subsection 9-502(2) imposes upon the secured party the duty of proceeding in a commercially reasonable manner in the collection if his agreement with the debtor entitles him to a charge-back of uncollected collateral or to other full or limited recourse against the debtor. He may deduct his reasonable expenses of realization from the collections. If the assignment secures an indebtedness, the secured party must account for any surplus and, unless otherwise agreed, is entitled to recover a deficiency from the debtor. If the underlying transaction is a sale, the assignee is bound by and entitled to the fruits of his collection, except where the parties have contracted differently.

U.C.C. Sec. 9-503. Explanatory Notes.

Except where the security agreement provides otherwise, default entitles the secured party to take possession of the collateral either by replevin or its modern statutory equivalents (claim and demand, chapter 244, Revised Laws of Hawaii) or by nonjudicial steps, if no breach of the peace is involved. The security agreement may include a stipulation requiring the debtor to assemble the collateral and make it available to the secured party at a convenient place designated by the latter. Section 9-503 authorizes the secured party to render equipment unusable in lieu of removing it and to dispose thereof on the debtor's premises if such disposition is commercially reasonable.

U.C.C. Sec. 9-504. Explanatory Notes.

Section 9-504 regulates the satisfaction of the secured indebtedness by means of a disposition of the collateral (as distinguished from collection which is regulated by section 9-502). The gist of this regulation is to make all commercially reasonable methods of disposition legitimate and to dispense with the need of special agreement between the parties in order to authorize valid methods of disposition other than sale at public auction.

Subsection (1) provides that the right to dispose of the collateral by sale, lease or otherwise accrues upon default and may be exercised without any time limitation, except in the cases of consumer goods (section 9-505). The secured party may prepare or process the collateral for purposes of disposition, if such steps are commercially reasonable. The subsection specifies the order in which the proceeds of disposition must be applied: First priority is given to the reasonable expenses incurred in the steps needed to effectuate the disposition, including attorneys' fees and legal expenses if there is an agreement to that effect. Next ranks the indebtedness to the secured party who undertakes the disposition. Proceeds remaining after that must be paid over to holders of junior security interests in the collateral if a written demand therefore is received (as defined in section 1-201(26)) prior to the distribution. Mere knowledge, actual or constructive, of the existence of a junior security does not result in a special duty of the party making the distribution. But note that holders of security interests in the collateral who have filed a financing statement or are known to the secured party are entitled to notice of the intended disposition (subsection (3)). Any ultimate surplus goes to the debtor or other owner of the collateral.

Subsection (2) reiterates the rules as to the debtor's right to surplus and duty to pay a deficiency stated in section 9-502(2). The reason for the duplication is the fact that section 9-502 deals with collection of collectible types of collateral and section 9-504 with the disposition of collateral, whether collectible or not.

Subsection (3) puts public and private proceedings for the disposition of collateral on equal footing. Except where notification is inapposite because of the perishable character or unstable value of the collateral

or superfluous because of a regular market price of the commodity, "reasonable notification" of the particulars of the public sale or of the time after which a specified private disposition will take place must be sent to the debtor and (except in the case of consumer goods) to any other party having a security interest in the collateral who has filed a financing statement in the state or is known by the party making the disposition to have such interest. Reasonable notification implies that the party entitled thereto has sufficient time to protect his interest by participating in the sale or other disposition if he so desires. The secured party may buy at any public sale but may not do so at a private sale unless the collateral has a regular market price.

Disposition of the collateral by a secured party after default discharges the security under which it is made and subsequent security interests or liens. The purchaser acquires free and clear title despite any defects in the proceedings if

- (a) in the case of a public sale, he has no knowledge of the defects and is not guilty of collusion, or
- (b) in the case of private disposition, he acted in good faith.

Subsection (5) governs the cases where a person who is liable to the secured party under a guaranty, indorsement, repurchase agreement or similar arrangement for indemnification acquires the collateral by transfer from or subrogation to the secured party. Such a transfer or subrogation is not a sale or disposition under Article 9, and such transferee or subrogee has the rights and duties of the secured party.

U.C.C. Sec. 9-505. Explanatory Notes.

Section 9-505 deals with two separate items: compulsory and prompt disposition of consumer goods where sixty per cent of the price or the loan secured thereby has been paid (subsection (1)); option to accept collateral in satisfaction of the indebtedness in all other cases (subsection (2)).

Subsection (1) specifies that in the case of consumer goods where sixty per cent of the cash price or of a loan secured thereby has been paid, the secured party must dispose of them within ninety days. Failure to do so subjects the secured party to liability for conversion or to the special liability imposed by section 9-501(1), third sentence. The debtor, after default, may renounce or modify his rights in writing.

Except in the cases specified in section 9-505(1), the secured party may, upon default, propose to retain the collateral in satisfaction of the obligation. The debtor and, except in the case of consumer goods, other secured parties, who have filed a financing statement or are known by the party wishing to retain the collateral to have a security interest, are entitled to a notice of such proposal. If the debtor or other persons entitled to notification, within thirty days from the receipt thereof, or other secured parties, within thirty days after the taking of possession by the secured party, object in writing to that method of liquidation, the secured party must proceed by disposition under section 9-304. In the absence of any written objection the secured party may retain the collateral in satisfaction of the obligation owed to him.

U.C.C. Sec. 9-506. Explanatory Notes.

Section 9-506 incorporates the principle, recognized by modern statutes and case law, that the debtor or other secured parties may redeem the collateral or any remaining part of it from the secured party even after default as long as he has not disposed of the collateral or any part thereof. Since section 905(2) permits retention of the collateral by the secured party in discharge of the obligation, section 9-506 adds the provision that the redemption rights are cut off likewise if the right to retain the property in discharge of the obligation has become final.

Section 9-506 defines the redemption price to be tendered: fulfillment of all obligations secured by the collateral plus the expenses reasonably incurred by the secured party in proceeding to a disposition. Reasonable attorney's fees and legal expenses must be included to the extent provided in the agreement and not prohibited by law.

The debtor and other parties entitled to redeem may waive their rights after default and by agreement in writing.

U.C.C. Sec. 9-507. Explanatory Notes.

Section 9-507 deals with two different matters. Subsection (1) deals with the enforcement of the observance of the provisions regulating the realization of the indebtedness out of the collateral and the liability of the secured party in case of noncompliance. Subsection (2) states some tests as to what is commercially reasonable.

Subsection (1) makes it clear that observance of the rules prescribed by part 5 may be enforced by court order. If disposition has already occurred, injured parties whose interests must have been, or were made, known to the secured party prior to the disposition may recover any loss caused by the failure to comply with the provisions protecting them. Special damages may be recovered in the case of consumer goods, fixed at an amount not less than either the credit service charge plus ten per cent of the principal owed or the time price differential plus ten per cent of the cash price.

Subsection (3) states rules for determining whether a particular method or time of disposition is or is not "commercially reasonable". The approved methods are neither fixed requirements nor exclusive in character. This applies in particular with respect to the approval by a bona fide creditors' committee or representative of creditors.

ARTICLE 10

EFFECTIVE DATE AND REPEALER

- 10-101. Effective Date
- 10-102. Specific Repealer; Provision for Transition
- 10-103. General Repealer
- 10-104. Laws Not Repealed

1962 Official Recommendations for the Amendment of the Uniform Commercial Code.

The Permanent Editorial Board for the Uniform Commercial Code has recommended twenty-seven amendments of the 1958 Official Text of the Code as follows:

Sec.

- 1-201. Subsec. (27)
- 3-105. When Promise or Order Unconditional
- 3-112. Terms and Omissions Not Affecting
Negotiability
- 3-122. Accrual of Cause of Action
- 3-142. Acceptance Varying Draft
- 3-504. How Presentment Made
- 4-106. Separate Office of a Bank
- 4-109. Process of Posting
- 4-204. Methods of Sending and Presenting;
Sending Direct to Payor Bank
- 6-103. Transfers Excepted From This Article
- 6-104. Schedule of Property, List of Creditors
- 6-106. Application of the Proceeds
Subsec. 4. (Optional)
- 6-107. The Notice
- 6-108. Auction Sales; "Auctioneer"
- 7-210. Enforcement of Warehouseman's Lien
- 8-102. Definitions and Index of Definitions
- 8-107. Securities Deliverable; Action for Price
- 8-208. Effect of Signature of Authenticating
Trustee, Registrar or Transfer Agent
- 8-306. Warranties on Presentment and Transfer
- 8-308. Indorsement, How Made; Special Indorse-
ment; Indorser Not a Guarantor; Partial
Assignment
- 8-313. When Delivery to the Purchaser Occurs;
Purchaser's Broker as Holder
- 8-320. Transfer or Pledge within a Central
Depository System

- 9-103. Accounts, Contract Rights, General Intangibles and Equipment Relating to Another Jurisdiction; and Incoming Goods Already Subject to Security Interest
- 9-206. Agreement Not to Assert Defenses Against Assignee; Modification of Sales Warranties Where Security Agreement Exists
- 9-401. Place of Filing; Erroneous Filing; Removal of Collateral
- 9-403. What Constitutes Filing; Duration of Filing; Effect of Lapsed Filing; Duties of Filing Officer
- 10-104. Laws Not Repealed
Optional Subsection

The National Conference of Commissioners on Uniform State Laws is interested in seeing that the Code as enacted or to be enacted will be amended in conformity with the above recommendations so that the Code's provisions will be as uniform as possible.

U.C.C. Sec. 10-101. Explanatory Notes.

Although the Code provides an effective date, midnight on December 31 following enactment, the official comment explains that this date is merely a suggestion. In fact, many jurisdictions that have enacted the Code provided for a more extended period of time between enactment and effective date.

U.C.C. Sec. 10-102. Explanatory Notes.

Following is a list of the Hawaii laws which would be repealed by the enactment of the Code:

- Chapter 172, Part IV, Revised Laws of Hawaii 1955, The Uniform Stock Transfer Act (modified)
- Chapter 187, Revised Laws of Hawaii 1955, Accounts Receivable; Assignment and Notice
- Chapter 194, Revised Laws of Hawaii 1955, The Uniform Negotiable Instruments Act
- Chapter 200, Revised Laws of Hawaii 1955, Sales of Merchandise in Bulk
- Chapter 202, Revised Laws of Hawaii 1955, The Uniform Sales Act
- Chapter 206, Revised Laws of Hawaii 1955, The Uniform Trust Receipts Act

Chapter 207, Revised Laws of Hawaii 1955, The Uniform Warehouse Receipts Act
Sections 178-93 and 178-95 to 178-99, Revised Laws of Hawaii 1955, pertaining to banks
Section 189-3, Revised Laws of Hawaii 1955, pertaining to the Uniform Fiduciaries Act
Sections 193-4 to 193-6, Revised Laws of Hawaii 1955, pertaining to liens
Sections 343-51 and 343-52, Revised Laws of Hawaii 1955, pertaining to chattel mortgages.

In addition to the above laws which would be repealed by enactment of the Code, it would be necessary to amend the following laws to conform to the Code provisions:

Sections 104-21.5, 178-23.5, 178-39, 179-39.5
178-71, 178-131, 178-144, 241-1

Other existing laws specifically affected by enactment of the Code are discussed and amendatory language is suggested below.

Suggested Amendments - Chapter 160, Part I, Revised Laws of Hawaii 1955, as amended.

Registration of Vehicles

The filing provisions of Article 9 of the Code are not applicable to interests in motor vehicles to the extent that they are subject to chapter 160, part I. Conversely, the substantive provisions of Article 9 do apply. The Code requires filing or some other modes of perfection to determine priorities. Filing is specifically contemplated as a mode of perfection of purchase money security interests in motor vehicles required to be licensed, even when they are consumer goods or equipments (sections 9-302 (c) and (d)). Although deletion of these provisions is recommended in view of the exclusion of motor vehicles from the filing provisions by virtue of section 9-302(3) in the form recommended in this report, complete freedom from some formal steps for perfection is not intended. It is recommended that chapter 160, part I, be amended in the following respects so as to conform with the terminology and substantive rules of the Code:

- (1) to redefine legal owner so as to include any secured party;

- (2) to determine perfection as of the time of the receipt by the treasurer either of an application for registration and issuance of a certificate of legal ownership to the holder of a security interest or of a properly endorsed certificate of ownership.

The definition of legal owner in section 160-1 is suggested as follows:

"'Legal owner' means a person who holds the legal title to a motor vehicle or a security interest therein, as defined in U.C.C., Article 9."

The provision for determining perfection in subsection 160-10(e) is suggested as follows:

"Until the treasurer has issued the new certificate of registration and certificate of ownership as provided in subsection (d) delivery of such vehicle shall be deemed not to have been made and title thereto shall be deemed not to have passed and the intended transfer shall be deemed to be incomplete.

A security interest in motor vehicles shall be perfected within the meaning of Article 9 of the Uniform Commercial Code at the time when the treasurer receives either an application for registration and the issuance of a certificate of ownership to the holder of such interest by or on behalf of the same or a certificate of ownership properly indorsed to such holder."

Suggested Amendments - Chapter 196, Revised Laws of Hawaii 1955.

"Chapter 196

Mortgages of Real Property

Sec. 196-1. Lien of mortgages of real property; future advances; priorities. Every transfer of an interest in real property made as security for the performance of another act or subject to defeasance upon the payment of an obligation, whether such transfer is made in trust or otherwise, is to be deemed a mortgage and shall create a lien only as security for the obligation and shall not be deemed to pass title. It may secure the repayment of past debt, a debt incurred at the time the mortgage is

executed or a debt incurred for advances which may be made by the mortgagee subsequent to the execution of the mortgage even though the mortgagee is under no contractual duty to make such advances. Except as is otherwise provided in U.C.C. section 9-313 with respect to security interests in fixtures, in any case where the mortgagee is under no contractual duty to make future advances the mortgagee lien, to the extent . . . but in the event the mortgagee is under such contractual duty and the maximum amount is stated in the mortgage, the lien therefor shall be superior to that of any subsequently recorded mortgage or other lien, except liens for taxes and for public improvements, even though such subsequently recorded mortgage or other security interest or lien, except liens for taxes and for public improvements, is recorded or perfected prior to the date upon which any such advance or advances have been made.

Sec. 196-2. Mortgage of after-acquired real property. If a mortgage so provides it may embrace after-acquired real property and the lien of the mortgage attaches to such after-acquired real property when the mortgagor acquires an interest therein to the extent of such interest but subject to existing liens and the lien of a purchase money mortgage given by the mortgagor of any such after-acquired property. The mortgage shall operate only as a contract between the parties with respect to, and shall not create, a lien upon real estate acquired in any manner by the mortgagor subsequent to the execution of the mortgage and not described therein unless and until the mortgagor or the mortgagee at the time of or subsequent to

Sec. 196-2(1). On what property. If the mortgage so provides, it may embrace after-acquired property referred to in the mortgage when the mortgagor acquires an interest therein to the extent of such interest, but subject to existing liens and the lien of a purchase money mortgage given by the mortgagor of any of such after-acquired property. Any such mortgage, except to the extent provided in this chapter, shall be enforceable against the mortgagor, creditors of the mortgagor, and against subsequent purchasers, mortgagees, assignees, and transferees, who take without valuable consideration or with notice, actual or constructive, even though the mortgaged property may have been moved to a location different from that occupied by it at the time of the execution of the mortgage.

Sec. 196-2(2). After-acquired land. The mortgage shall operate only as a contract between the parties with respect to, and shall not create a lien upon real property acquired in any manner by the mortgagor subsequent to the execution of the mortgage and not described therein unless and until the mortgagor or the mortgagee at the time of or subsequent to such acquisition executes and duly records in the bureau of conveyances an instrument or affidavit containing a reference to the book and page number where such mortgage is recorded and also a reference to such real property sufficient to identify and locate the real property, which reference may be made by describing the deed or other instrument of conveyance by which the real property was acquired or by describing the land by metes and bounds.

Sec. 196-3. Mortgage of interests in recorded mortgages and leases. If a mortgage embraces any recorded mortgage or lease of real property it shall operate only as a contract between the parties with respect to, and shall not create a lien upon, any such recorded mortgage or lease, unless and until a specific reference to the mortgage or lease in the manner contemplated by section 343-23 is contained in an instrument or affidavit executed by the mortgagor or mortgagee and duly recorded in the bureau of conveyances at Honolulu.

Sec. 196-4. Use and possession of mortgaged property. In the absence of an agreement to the contrary, the mortgagor of real personal property under a duly recorded mortgage shall be entitled to the use or possession thereof until default.

Sec. 196-5. Registered land. Nothing in this chapter shall be deemed to modify or amend the provisions of chapter 342."

Retail Installment Legislation and the Uniform Commercial Code.

The scope and compass of the existing retail installment legislation in the United States shows considerable variations as to the type of goods and services covered as well as to the extent of the special regime provided. Obviously no comprehensive discussion can be given in this report. For recent discussions of the coverage of the various acts see

Note, Retail Installment Sales Legislation, 58 Colum. L. Rev. 854 (1958); Note, Legislative Regulation of Retail Installment Financing, 7 U.C.L.A. L. Rev. 623 (1960); Britton and Urich, Illinois Retail Installments Sales Act - Historical Background and Comparative Legislation, 53 Northwestern L. Rev. 137 (1958); Retail Installment Sales - Consumer Protection, 4 Villanova L. Rev. 408. Sher, The Unruh Act & Chattel Mortgages - A Case of Legislative Oversight, 13 Stanford L. Rev. 282 (1961).

In reviewing the action of other states with respect to a removal of possible incongruities between the regime of the Code and the provisions of the applicable retail installment sales legislation the following picture appears.

Illinois adopted the Uniform Commercial Code (Illinois Revised Statutes 1961, ch. 26), without any conforming amendments of the Retail Installment Sales Act of 1957 (Illinois Revised Laws 1961, ch. 121-1/2, section 223-253).

California proposed certain conforming amendments of the Retail Installment Sales Law of 1959 (Cal. Civil Code, section 1801-1812.9) in connection with the proposed adoption of the Uniform Commercial Code (Calif. Senate Bill No. 1093, sec. 110102, subsecs. 6 and 7). At the same time the California bill on the Uniform Commercial Code has deleted one special provision of the Code dealing with this area, viz., the necessity of a compulsory resale of a repossessing secured party whenever a buyer of consumer goods has paid sixty per cent of the cash price. Calif. Senate Bill No. 1093, section 19505, see Special Report by the California State Bar Committee on the Commercial Code, 37 Calif. State Bar Journal 119 at 220 (1962).

The history of the events in Connecticut illustrates best the uncertainties and policy questions arising in this connection. When the Uniform Commercial Code was adopted in that state, the enacting statute specifically repealed one section of the Retail Installment Sales Financing Law (Gen. Stats. of Connecticut, 1958 Revision, secs. 42-83 to 42-100) viz., the section on foreclosure (sec. 42-98), Conn. Publ. Acts 1959, P.A. No. 133, sec. 10-102(1); yet, the repealer was repealed in turn and the section was reinstated in the same year (Conn. Publ. Acts 1959, P.A. No. 615, sec. 28). In addition, Connecticut

passed a battery of amendments doctoring up the basic concepts such as "goods" (Conn. Publ. Acts 1959, P.A. 589, sec. 2) and "retail buyer" (Conn. Publ. Acts 1959, P.A. 495), although a revision of these terms had been made as late as in 1957 (Conn. Publ. Acts 1957, ch. 357). Finally, in 1961 Connecticut passed another extensive amendment for the purpose of conforming the Retail Installment Sales Financing Law to the concept and rules of the Commercial Code Conn. Publ. Act 1961, P.A. 116, secs. 20-24). The coverage of the retail installment sales legislation was extended to "consumer goods" and "equipment" as defined by the Uniform Commercial Code, retail installment contract was defined as being in the nature of "a security agreement" within the meaning of the Code and other terminological changes were made for purposes of congruity. In addition, the reinstated foreclosure provisions were modified to be more consistent with Article 9, part 5.

In analyzing the extent to which the Uniform Commercial Code and the Hawaii Retail Installment Sales Act are in conflict or, at least, overlap, attention must first be directed to the type of transactions regulated by the Hawaii Retail Installment Sales Act. Without going into the exact details, it may be pointed out that the Act applies to retail installment sales of goods which in the hands of the buyer are either "consumer goods" or "equipment" within the terminology of the Code and that the term goods is defined to include services whether for private or commercial use. While the Code authorizes some special local exceptions for buyers of consumer goods (sec. 9-206(1)) and itself contains some special rules governing security agreements relating to consumer goods (sec. 9-204(4)(b)) and security interests in consumer goods (sec. 9-505(1)) which in part pursue a similar policy as the Retail Installment Sales Act, the latter legislation conflicts with the Code to the extent that it covers installment purchases made by buyers of equipment.

The following table presents a synopsis of the areas in which the Uniform Commercial Code and the Retail Installment Sales Act either overlap or conflict.

<u>Subject</u>	<u>Retail Installment Sales Act</u>	<u>Uniform Commercial Code</u>
Payment to assignor without notice of assignment.	Sec. 201A-9 Similar provisions: overlap; no conflict.	Sec. 9-318
Information about amount of unpaid balance.	Sec. 201A-10 Slight differences in procedure. No major conflict.	Sec. 9-208(1)
Invalidity of add-on clauses.	Sec. 201A-15 (Limited to accessories, special or auxiliary equipment, and substitutions): Major discrepancy with U.C.C.	Sec. 9-204(4) (b) (Limited to accessories and goods acquired within ten days in case of consumer goods, no limitation in case of equipment).
Invalidity of waiver of defenses vis-a-vis an assignee.	Sec. 201A-17 (Applies to installment sales covering purchase of consumer goods or equipment): Major discrepancy with U.C.C.	Sec. 9-206(1) (Invalidity applies only to purchases of consumer goods, if local statute so specifies).
Rights and remedies after default.	Secs. 201A-23 to 27 (Provisions safeguarding the rights of the installment buyer). Considerable variations from system of U.C.C.	Secs. 9-503 to 506 (Provisions safeguarding the rights of the debtor).
Time of disposition after retaking.	Secs. 201A-23 and 24 (Secured party must hold goods for ten days, unless he mails advance notice of intention to retake): Important	Sec. 9-504 (Secured party may dispose of collateral at any time, provided debtor has received reasonable advance notice of

<u>Subject</u>	<u>Retail Installment Sales Act</u>	<u>Uniform Commercial Code</u>
	difference.	time of sale).
Protection of buyer who has paid a substan- tial portion of price: compulsory sale	Sec. 201A-25 (Buyer who has paid 50 per cent of price may insist on sale rather than reten- tion in satisfac- tion of unpaid balance).	Sec. 9-505 (Debtor who has paid 60 per cent of price may insist on sale rather than reten- tion in satisfac- tion of unpaid balance).
limitation on deficiency judgment	Sec. 201A-27 (Buyer who has paid 80 per cent of price may force secured party to elect between retention of goods without right to defi- ciency or release of goods and ex- clusive reliance on collection of unpaid balance).	- - - No such provision.
limitation on private sale	Sec. 201A-25 (No provisions on method of private sale except "rea- sonable effort to secure fair price" and preservation of records for one year).	Sec. 9-504 (Resale must be commercially reasonable; no provision for preservation of records).

This report refrains from recommending any major change in the Retail Installment Sales Act so as to curtail its protection of retail installment buyers of equipment or to substantially reduce its safeguards against excessive losses on default.

It is recommended:

- (1) to amend the Retail Installment Sales Act so as to
 - (a) harmonize the definition of "retail installment contract" with the terminology of the Code;
 - (b) adjust the provision specifying formal requirements so as to not fall short of the requirements of the Code;
 - (c) restrict the right to compulsory resale to buyers who have paid sixty per cent of the price rather than fifty per cent; and
 - (d) add a requirement in sec. 201A-25 which incorporates the standards of the Code in the choice of the methods of disposition.
- (2) to modify the provisions of the Code by
 - (a) adding in sec. 9-204(4) a subsection (c) reading:

"(c) to the extent that such clause contravenes the provisions regulating retail installment sales."
 - (b) changing the savings clause in sec. 9-206 so as to read:

"Subject to any statute which establishes a different rule for retail buyers or any decision which establishes a different rule for buyers of consumer goods."
 - (c) adding in sec. 9-501(2):

"Subject to the special provisions governing retail installment sales, after default."

Suggested Amendments - Chapter 201A, Revised Laws of
Hawaii 1955, as Amended.

Sec. 201A-1, par. 7 as follows:

"'Retail installment contract' or 'contract' means any agreement to pay the purchase price or monies advanced in payment of the purchase price, of goods, by payment thereof in two or more installments over a period of time, whether or not such contract contains a provision by which a purchase money security interest is taken or retained. This term includes but is not limited to a security agreement and a contract for the bailment or leasing of goods by which the bailee or lessee contracts to pay as compensation a sum substantially equivalent to or in excess of its value and by which it is agreed that the bailee or lessee is bound to become, or has the option of becoming the owner of the goods upon full compliance with the terms of the contract."

Sec. 201A-2(b), par. 2 as follows:

"The contract shall contain the names of the parties and their respective places of business or residence. Either the contract, or the sales slip or other written statement or evidence of the purchase required to be furnished to the buyer under this section, shall contain a description of the goods, including make, model and identification number or marks, if any. If the contract contains or is coupled with a security agreement the requirements of U.C.C. section 9-203 must be likewise observed."

Sec. 201A-25, second sentence as follows:

"subject, however, to the requirements of U.C.C. section 9-504(3) and the requirements and conditions of this section."

Sec. 201A-25, first sentence as follows:

Change fifty per cent to sixty per cent.

Suggested Amendments - Chapter 233, Revised Laws of
Hawaii 1955.

Sec. 233-9(c) as follows:

"A security or any share or any interest evidenced thereby shall be attached in the same manner as is provided for the levy of an execution thereon."

Sec. 233-12 as follows:

"Sec. 233-12. Examination of defendant, where no property known; order requiring delivery of property for purposes of levy. Whenever it appears by the affidavit of the plaintiff or by the return of the attachment that no property is known to the plaintiff or officer on which the attachment can be executed, or not enough to satisfy the plaintiff's claim, the defendant may be required by the court or judge to attend before it or him and give information on oath respecting the same.

If it appears that the defendant or other person, having no security interest, lien or right of retention therein which entitles him to possession, has possession of chattels, securities or other negotiable instruments which must be attached by seizure, the court or judge, upon application by the plaintiff or officer executing the writ, may summarily direct such defendant or other person to produce and deliver them to the officer for the purpose of attachment."

Sec. 233-46 as follows:

"Sec. 233-46. Levy on and execution sale of investment securities; garnishment the proper procedure when the security is subject to right of possession of third party, levy and sale if security is surrendered or claimed to be lost, destroyed or wrongfully taken.

(a) A security or any share or other interest evidenced thereby which is outstanding and not in the possession of a third party who has a security interest, lien or right of retention therein which entitles him to possession shall be levied upon under a writ of execution by being actually seized by the officer executing the writ.

At any time after the issuance of the writ, upon application of the judgment creditor or the officer

executing the writ and upon due notice to the defendant or other person having possession of the security without being entitled thereto under a security interest, lien or right of retention, the court or judge may summarily direct the defendant or such other person so having possession of the security to produce the same and deliver it to the officer for the purpose of levy and sale. The security so levied upon shall be advertised for sale and sold in the manner provided in section 233-42. After the sale the levying officer shall deliver to the purchaser the security endorsed or assigned by him as the agent of the judgment debtor, which delivery and endorsement or assignment shall entitle the purchaser to all the right, title and interest of the judgment debtor in the security and to registration of the transfer as provided in U.C.C. Article 8. This subsection shall apply to any security which is either within the State or which is in the possession of an owner or other person subject to the jurisdiction of this State.

(b) A security or any share or other interest evidenced thereby which is outstanding and in the possession of a person who is entitled to such possession under a security interest or lien or other right of retention therein shall be reached by garnishment as provided in chapter 237.

(c) A security which has been surrendered to the issuer or which is claimed by the debtor to have been lost, destroyed or wrongfully taken shall be levied upon by notifying the president, secretary, treasurer or managing agent of the issuer or authenticating trustee, transfer agent, registrar or other such agent that such security has been levied upon. Service of such notice shall operate as a prohibition of the registration of a transfer of such security, pending sale upon such execution, to any one except a person who is entitled to registration of such transfer under Article 8.

(d) The sale of a security levied upon pursuant to the preceding subsection shall be made in the manner provided in section 233-42. The officer shall issue a certificate of transfer to the purchaser stating that the security sold is surrendered to the issuer or is claimed by the debtor to have been lost, destroyed or wrongfully taken. The transfer shall vest in the purchaser all rights and remedies which the judgment debtor had in the surrendered security

or in such security which is claimed to have been lost, destroyed or wrongfully taken."

Suggested Amendments - Chapter 237, Revised Laws of Hawaii 1955, as Amended.

Sec. 237-1 as follows:

"Sec. 237-1. Garnishee process; "garnishee fund".

(a) Before judgment. When any goods or effects of a debtor are concealed in the hands of an attorney, agent, factor, or trustee (in this chapter jointly and severally included in the term "garnishee") so that they cannot be found to be attached or levied upon, or when any goods or effects of a debtor are in the possession of another person (also included under the term "garnishee") under a claim of a security interest, lien or right of retention therein, or when any debt is due from any person (also included under the term "garnishee") to a debtor, or when any person has in his possession for safekeeping any moneys of the debtor, any creditor may bring his action against a debtor and in his petition for process, or by subsequent ex parte motion and amendment of the complaint at any time before judgment, may request the court to insert in the process a direction to the officer serving the same to leave a true and attested copy thereof with the garnishee to appear personally upon the day or term appointed in the process for hearing the action or at any other time appointed by the court and then and there on oath to answer all of the following inquiries herein inclusively referred to as the "disclosure": (1) whether he has, or at the time the copy was served on him had, any of the goods or effects of the defendant in his hand, and if so the nature, amount and value thereof; and (2) whether he holds or at the time of the service held such goods or effects under a claim of a security interest, lien or right of retention therein to secure the payment of a debt or performance of another obligation, and, if so, the amount or nature thereof; or (3) or (4)

From the time of leaving such copy, the garnishee shall secure in his hands to pay such judgment as the plaintiff shall recover in the action, the following property or choses (1) all the goods and effects of the defendant then in the hands of the garnishee and

not held under a claim of a security interest, lien or right of retention; (2) any surplus owed to the debtor, from the disposition of any goods or effects held by the garnishee under the claim of a security interest, lien or right of retention therein; (3) . . . or (4)"

Sec. 237-2 as follows:

"Sec. 237-2. Garnishee, rights, duties. The plaintiff on praying out execution shall be entitled to have included in such execution an order directing the officer serving the same to make demand of the garnishee for the goods and effects of the defendant secured in his hands not held under a security interest, lien or right of retention or, if held under a security interest, lien or right of retention to secure payment of a debt then to make such demand, upon payment by the judgment creditor of such debt and all other debts which are secured by a perfected security interest in or lien on such goods and effects acquired prior to the time of the service of the garnishee service. Upon such demand the garnishee shall expose the same to be taken on execution and when appropriate to indorse or assign the certificates to the sheriff as agent of the execution debtor. The order may direct the officer also to make demand of the garnishee for the debt, surplus or wages secured in his hands or the moneys held by him for safekeeping. . . . If the garnishee has in any manner wrongfully disposed of such goods and effects or does not expose and subject the same to be taken on execution as demanded, or if the garnishee does not pay to the officer, when demanded, such debt, surplus, wages or moneys held for safekeeping, the garnishee shall be liable to satisfy such judgment out of his own estate, as his own proper debt, if such goods or effects, or debt, surplus, wages or money held for safekeeping be of sufficient value or amount, and if not"

Sec. 237-8 as follows:

"Sec. 237-8 Execution when. If the garnishee fails to appear . . . or having appeared he refuses to disclose upon oath whether he has or at the time of the service had goods or effects of the defendant in his hands, and their nature and value and whether he holds or at the time of the service held such goods or effects under a claim of a security interest, lien or right of retention and the amount of the debt or the nature of the obligation secured thereby or

whether a debt is due from him . . . provided that if it appears that the goods and effects, if not held under a security interest, lien or right of retention, are of less value, and, if so held, the surplus to which the debtor is entitled, and the debt and the moneys in safekeeping are of less amount than the judgment recovered against the debtor, judgment shall be rendered . . . and if it appears that the garnishee has no goods or effect of such debtor in his hands, not held under a security interest, lien or right of redemption or, if so held, does or will not owe any surplus to such debtor or is not indebted to him, or has no moneys in his possession for safekeeping then However, if he appears and on oath discloses fully whether he has in his hands goods or effects of the defendant"

Sec. 237-10 as follows:

"Sec. 237-10. Surplus or debts payable in future. If from the disclosure made on oath by the garnishee it appears that upon disposal of goods or effects of the defendant held under a security interest, lien or right of retention, he owes the surplus if any to the defendant or that he is indebted to the defendant . . . then such judgment . . . shall constitute a lien upon the obligation to pay such surplus or the debt until and at the time it becomes due and payable."

Suggested Amendment - Section 343-23, Revised Laws of Hawaii 1955.

"Sec. 343-23. Identification of assignments, etc., of mortgages and leases by reference to registration of original. It shall not be lawful for the registrar to record any assignment, extension or release of mortgage or real property, or a certificate of entry for the purpose of foreclosure under mortgage, or an affidavit of foreclosure under a power contained in any mortgage, or an affidavit of entry, or an execution, order or decree, for possession of the premises covered by any mortgage, or an assignment, extension or cancellation of lease, unless the same contains a reference to the book and page of the registration of the original mortgage or lease, as the case may be. No amendment, continuation statement, termination statement, statement of assignment, or statement of release relating to security interests in goods which are or are to become fixtures shall be filed unless it complies with the requirements of

U.C.C. 9-407(2). This section shall not apply to any document mentioned herein executed prior to April 13, 1915; and this section shall not apply to any document mentioned herein which refers to an unrecorded mortgage or lease, if such fact be recited therein."

U.C.C. Secs. 10-103 and 10-104.

These sections of the Code are self-explanatory.

Miss Nancy Takei prepared the manuscript for printing.