UNIVERSITY OF HAWAII
Legislative Reference Bureau

March 11, 1968

MEMORANDUM

Re: "Practical Guide to the Uniform Commercial Code in Hawaii, Articles 1, 2, 6, 7 and 9. Report No. 1, 1968.

Certain inaccuracies in the text of the Practical Guide to the Uniform Commercial Code in Hawaii, Articles 1, 2, 6, 7, and 9 have come to the attention of the Legislative Reference Bureau and the author of the Study, Professor Riesenfeld. In order to prevent confusion, I am enclosing appropriate corrections which you should insert at the appropriate pages of your copy of the Study.

Sincerely yours,

Herman S. Doi
Director

HSD:eg

Enc.

2425 Campus Road · Honolulu, Hawaii 96822 / Cable Address: UNIHAW

Corrections to the PRACTICAL GUIDE
to the UNIFORM COMMERCIAL CODE in
HAWAII, ARTICLES 1, 2, 6, 7 and 9

The text of the Practical Guide to the Uniform Commercial Code should be corrected in order to clarify the discussion of the interrelation between the Code, especially Article 9, and the Motor Vehicle Registration Law, Revised Laws of Hawaii 1955, Subsection 160-10(e),* as amended by Act 79, Session Laws of Hawaii 1967. Other corrections are needed because of the repeal of U.C.C. Subsection 9-204(4)(a) by the same Act.

The necessary deletions and additions are as follows:

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Top of page: delete Explanatory Note 7 and substitute the following:

"Article 9 applies to security interests in motor vehicles, including motor vehicles required to be registered under the Motor Vehicle Registration Law, Revised Laws of Hawaii 1955, Chapter 160. Article 9 contains no general exclusion for transactions creating security interests in motor vehicles that are subject to registration. The only special rule relates to the perfection of a security interest in a motor vehicle which is required to be registered under Chapter 160 and which is equipment or consumer goods, Uniform Commercial Code, Subsections 9-302(3)(b) and (4), last sentence, as amended by Act 18, Session Laws of Hawaii 1966. In that case a security in such vehicle may be perfected only by registration pursuant to Section 160-10, Revised Laws of Hawaii 1955, Subsection 160-10(e), as amended by Act 79, Session Laws of Hawaii 1967, which specifies in addition that the Uniform Commercial Code shall exclusively control the attachment and perfection of a security interest in a registered vehicle. Since registration is necessary only for the perfection and not the attachment of a security interest in

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*Note that section 160-10, RLH 1955, was also amended by Act 214, SLH 1967, and renumbered section -49 of the new chapter entitled Highway Safety.

a registered vehicle which is equipment or consumer goods, parties who are not protected against unperfected security interests may be subordinate to a security interest in such vehicle although it is not noted on the certificate of ownership. See also Section 9-302, Explanatory Note 5. Of course, whether the debtor has rights in the collateral as is required for the attachment of a security interest, Subsection 9-204(1), will depend upon compliance with Revised Laws of Hawaii 1955, Section 160-10."

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Add on bottom of the page under No. 6, right column: "motor vehicles subject to registration under Revised Laws of Hawaii 1955, Chapter 160, if they are equipment or consumer goods."

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Delete the last paragraph of Explanatory Note 3 and substitute the following:

"An analogous problem arises in Hawaii as a result of the provisions, discussed *infra* Explanatory Note 5, which provide different perfection methods applicable to security interests in motor vehicles subject to registration, according to whether such collateral is inventory on the one hand or consumer goods or equipment on the other. Security interests in motor vehicles subject to registration which are inventory are perfected by filing or possession, while security interests in such vehicles which are equipment or consumer goods may be perfected only by compliance with the registration provisions. For example, if a used motor vehicle is sold by a dealer to a buyer under circumstances which are not covered by Section 9-307 and therefore do not defeat the continuation of an existing security interest of an inventory financer pursuant to Subsection 9-306(1), does such security interest nevertheless become unperfected, if the transfer converts the vehicle into equipment or consumer goods and the security interest is not reperfected by compliance with the registration provisions? Apparently the answer must be in the affirmative."

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Delete the last paragraph in Explanatory Note 5 and substitute the following:

"Note, Subsection 9-302(3)(b), as amended in 1966, declares that the filing provisions of this Article do not apply to a security interest in a vehicle required to be registered under Chapter 160, Revised Laws of Hawaii 1955, unless such vehicle is inventory. This subsection is supplemented by the last sentence in Subsection 9-302(4): " A security interest in a vehicle required to be registered under Chapter 160 which is not inventory may be perfected only by registration thereunder." Both clauses must be read in conjunction with Revised Laws of Hawaii 1955, Subsection 160-10(e), as amended in 1967, which specifies "that the Uniform Commercial Code shall exclusively control the attachment and perfection of a security interest in such vehicle." The effect of this reciprocal cross-reference is that security interests in motor vehicles required to be registered are perfected by filing or possession if such vehicles are inventory but by registration if such vehicles are consumer goods or equipment. The legislative history as well as an opinion of the Attorney General of September 28, 1967 (Op. 67-21) supports this construction.

The provision that "a security interest in a vehicle required to be registered. . .may be perfected only by registration" raises the question of whether it renders inapplicable provisions of the Code which provide for temporary perfection (Section 9-306) or retroactive perfection (Subsection 9-301 (2)). Apparently the answer must again be in the affirmative. If, e.g., the owner of a registered motor vehicle which is equipment replaces the same with a new motor vehicle, giving the old vehicle as a trade-in, does a security interest which existed in the old equipment shift to the new equipment and enjoy the benefits of temporary perfection? It can be argued that the new equipment is proceeds of the traded in old equipment, and there is judicial authority supporting this proposition, Universal C.I.T. Credit Corp. v. Prudential Investment Corp., 222 A. 2d 571 (R.I. 1966). Nevertheless, the shift to the proceeds would not be accompanied by temporary perfection (as it would be in the case of other goods) since the language of Subsection 9-302(4) does not permit perfection, including temporary perfection, without registration, if the collateral is a motor vehicle subject to registration which is classified as consumer goods or equipment. Similarly it must be concluded that a financer of the acquisition of a motor vehicle which is to be used as equipment or consumer goods and which is transferred to the buyer without notation of the security interest on the certificate of ownership cannot invoke the ten days clause of Subsection 9-301(2), even if he succeeded in having his purchase money security interest registered within ten days after the collateral comes into the possession of the debtor. Subsection 9-306(2) by its terms applies only to perfection by filing. As a result Subsection 9-306(2) is inapplicable, even if one were otherwise pursuaded by the argument that temporary perfection is a "form" of perfection, while retroactive perfection is an "effect" of perfection."

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Top of page: delete Explanatory Note 5 and substitute the following:

"Possession may be an alternative method for perfection of security interests in motor vehicles required to be registered only if they are inventory. Security interests in registered motor vehicles which are equipment or consumer goods can be perfected only by registration under the Motor Vehicle Registration Law, Subsection 9-302(4), last sentence."

Page 267

Delete the last paragraph and substitute the following:

"Security interests in motor vehicles may be perfected by filing, if such vehicles are either not required to be registered under Chapter 160 of the Revised Laws of Hawaii 1955, or though required to be registered under that chapter, constitute inventory. Security interests in motor vehicles which are required to be registered under Chapter 160 of the Revised Laws of Hawaii 1955 and which are consumer goods or equipment are not capable of perfection by filing or possession but must be perfected by registration. The filing provision in Subsection 2-326(3) will ordinarily not be affected by Subsection 160-10(e) since cars on consignment or similar arrangements will usually be new cars and not subject to registration."

Page 220

Delete Explanatory Note 6 and substitute the following:

"Subsection (4) (as amended by Act 79, Session Laws of Hawaii 1967, which deleted subdivision (a) relating to crops) places a limitation on the validity of security agreements covering after-acquired collateral by proscribing add-on clauses extending to "consumer goods" as defined in Subsection 9-109(1) other than accessions. Such clauses are declared to be inoperative except with respect to consumer goods in which the debtor acquires rights within ten days after the secured party's giving value. This provision supplements but does not supersede similar and often more stringent prohibitions in local Retail Installment Sales Acts, such as Revised Laws of Hawaii 1955, Section 201A-15. The latter section proscribes any add-on provision in a retail installment contract to secure the time sale price with after-acquired goods except auxiliary parts or substitutes. It should be noted that the definition of retail installment contract in Revised Laws of Hawaii 1955, Section 201A-1, includes the purchase of equipment and that the prohibition against add-on clauses is not limited to after-acquired consumer goods."

Page 223

Modify the second paragraph of Explanatory Note 8 by deleting subparagraph (c) and by replacing the introductory sentence with the following:

"As a result Section 9-204, as amended in 1967, makes two important changes in the pre-Code law:"

Uniform legislation - Hawaii
Business - Law - Hawaii

PRACTICAL GUIDE to the UNIFORM COMMERCIAL CODE in HAWAII, ARTICLES 1, 2, 6, 7 and 9

STEFAN A. RIESENFELD
Professor of Law

Report No. 1, 1968

LEGISLATIVE REFERENCE BUREAU

UNIVERSITY OF HAWAII
Honolulu, Hawaii 96822

Price $2.00

FOREWORD

This is the second Legislative Reference Bureau publication dealing with the Uniform Commercial Code. At the time of the Bureau's 1963 study, The Uniform Commercial Code and the Hawaii Law, eighteen states had enacted the Code. The Code today applies in fifty-one jurisdictions--in all states, except Louisiana; the District of Columbia; and the Virgin Islands.

The purpose of the earlier study had been "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."

In 1965 the Third Hawaii Legislature enacted the Uniform Commercial Code with an effective date of January 1, 1967. After the enactment, it became evident to the chairman of the judiciary committees of the Hawaii Legislature, Senator Sakae Takahashi and Representative James H. Wakatsuki, that a new study on the Code was called for since the earlier study, which was out of print, had been based on the 1958 Official Text which was amended in some twenty-seven respects by the 1962 Official Text, the latter being the basis of Hawaii's enactment. Furthermore, the Permanent Editorial Board for the Uniform Commercial Code in its Report No. 3 recommended additional amendments and optional amendments of the Code.

Most important of the reasons calling for this study is the need by the public for guidance in their functioning under the Code regime. Practical experience with the Code now reaches back more than a dozen years, Pennsylvania having put it into force on July 1, 1954. By now it has become evident that the Code with its newest provisions, although a tremendous achievement in modernization, still poses difficult questions of interpretation especially relating to internal consistency and harmonization with other statutes on both federal and state levels.

The study deals with Articles 1, 2, 6, 7 and 9--General Provisions; Sales; Bulk Transfers; Warehouse Receipts, Bills of Lading and Other Documents of Title; and Secured Transactions, including Sales of Accounts, Contract Rights and Chattel Paper--and their interrelated legal concepts and commercial practices. This selection is dictated by the notion that these articles, focusing on the marketing and distribution aspects rather than the payment and investment transactions, form a coherent and distinct portion of the Code.

The study was prepared for the Legislative Reference Bureau by Dr. Stefan A. Riesenfeld, Professor of Law at the University of California at Berkeley, with the assistance of Mrs. Patricia K. Putman and Mr. Wayne Minami of the Bureau staff.

Herman S. Doi
Director

January, 1968

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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.*

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*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 <u>The Restatement of the Law</u>. 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, 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.

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 forty-eight states and the then Territory of Hawaii, a series 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 included the Uniform Sales Act, Warehouse Receipts Act, Stock Transfer Act (modified), Bills of Lading Act, Conditional Sales Act (modified), and Trust Receipts Act. Hawaii had 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 apparent that a comprehensive revision involving all of the uniform laws dealing with commercial transactions was needed.

After extensive explorations beginning in 1940, the project officially got under way on January 1, 1945. An editorial board of five members was appointed to supervise the preparation of the Code, and subcommittees were appointed to work on each of the Articles. In 1949 an integrated draft of nine articles with notes and comments was ready for further review, and during the summer of 1950 an Editorial Board 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 1953 Pennsylvania became the first state to enact the Uniform Commercial Code, effective 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 which lasted for three years and involved 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 1956 completed a revised Code, the 1957 Official Text, which was enacted in 1957 by Massachusetts, followed closely by Kentucky in 1958.

The Editorial Board promulgated additional amendments in 1958 and republished the Code as the 1958 Official Text. This version of the Code was then enacted successively by Connecticut, New Hampshire, Rhode Island, Wyoming, Arkansas, New Mexico, Ohio, Oregon, Oklahoma, Illinois, New Jersey, Georgia, Alaska, New York and Michigan. Over the next five years the Code was adopted by all the remaining states, except Louisiana. In 1959 Pennsylvania, the pioneer Code state, re-enacted the Code, substituting the 1958 version for its original 1953 enactment.

By 1961, it became apparent that almost every state enacting the Code was making its own amendments thereby endangering a primary object of the Code--the achievement of uniformity in the laws of the various states dealing with commercial transactions. In order to curb this tendency, there was established an eleven-member Permanent Editorial Board with the Director of the American Law Institute as chairman and five members each selected by the two sponsoring agencies. The Permanent Editorial Board examines every amendment to the Code made or proposed by the states, recommends amendments to the Code and to the Official Comments and states the reason for its rejection of amendments made in the various states. The jurisdiction of the Permanent Editorial Board is set forth in the agreement under which the Board was established:

> It shall be the policy of the Board to assist in attaining and maintaining uniformity in state statutes governing commercial transactions and to this end to approve a minimum number of amendments to the Code. Amendments shall be approved and promulgated when
>
> (a) It has been shown by experience under the Code that a particular provision is unworkable or for any other reason obviously requires amendment; or
>
> (b) Court decisions have rendered the correct interpretation of a provision of the Code doubtful and an amendment can clear up the doubt; or

(c) New commercial practices shall have rendered any provisions of the Code obsolete or have rendered new provisions desirable; or

(d) An amendment or a group of amendments would, in the opinion of the Board after investigation, lead to the wider acceptance of the Code by states which have not as yet enacted it, and would likely be enacted by those states which have already adopted the Code.

The first report of the Permanent Editorial Board, in 1962, contained some twenty-seven official recommendations for the amendment of the Uniform Commercial Code; these changes to the 1958 Official Text constitute the 1962 Official Text which was the basis for Hawaii's enactment of the Code, Act 208, Session Laws of Hawaii 1965.

The second report of the Permanent Editorial Board, in 1964, listed every nonofficial amendment to the Code along with the objection of the Board. The attitude of the Board towards the Code and its amendments is stated in the letter of submittal of the second report:

> Lest the position of the Board be misunderstood, it may be worth while to say that the Board does not take the position that the 1962 Official Text is "the last word" and that the Code may not be improved as experience under its provisions develops. In due time, the Board intends to make a comprehensive examination of the Code from beginning to end. But experience has taught those interested in the uniformity of our statutory law that it has been much easier to get "uniform laws" on the books in the first instance than it has been to interest legislatures in bringing them up to date by amendment.
>
> Uniformity of commercial law was the impelling goal of those who worked hard and long for the preparation of the Code and any future revision must, before its promulgation, be appraised from the standpoint of the likelihood of its prompt acceptance by all of the jurisdictions then operating under the Code. Amendments should be the result of experience rather than of theory.

The third report of the Permanent Editorial Board, in 1966, contained official recommendations for three amendments and four optional amendments of the Uniform Commercial Code, additional non-official amendments along with their objections, and an announcement of a comprehensive review of Article 9 of the Code dealing with secured transactions:

> A number of suggested amendments to Article 9 were discussed...without definite decisions. This was due to some extent to the fact that the various people who wanted to see changes in certain sections of the Article were by no means agreed as to how the sections should be changed.
>
> ...337 non-uniform, non-official amendments had been made to the various sections of Article 9. Some sections had been amended by as many as 30 jurisdictions, each jurisdiction writing its own amendment without regard to the amendments made by other jurisdictions and, of course, without regard to the Official Text. Forty-seven of the 54 Sections of Article 9 had been non-uniformly amended.
>
> In view of this distressing situation and in view also of the fact that various practicing lawyers and law teachers have written articles or textbooks pointing out certain respects in which Article 9 might be improved, the Board decided that the time had arrived for a restudy in depth of Article 9 on Secured Transactions.
>
> It must be remembered that the Code has been in operation since July 1, 1954, so that a really impressive body of experience has been built up under which to make this restudy in depth.

At this writing the goal of uniformity of commercial law throughout the United States appears attainable. The Uniform Commercial Code has been enacted by all of the states, except Louisiana, by Congress for the District of Columbia, and by the Legislature of the Virgin Islands. Below are listed the effective dates of the fifty-one Code jurisdictions:

State	Effective Date
Alabama	1-1-1967
Alaska	1-1-1963
Arizona	n.a.
Arkansas	1-1-1962

State	Effective Date
California	1-1-1965
Colorado	7-1-1966
Connecticut	10-1-1961
Delaware	7-1-1967
District of Columbia	1-1-1965
Florida	1-1-1967
Georgia	1-1-1964
Hawaii	1-1-1967
Idaho	1-1-1968
Illinois	7-2-1962
Indiana	7-1-1964
Iowa	7-4-1966
Kansas	1-1-1966
Kentucky	7-1-1960
Maine	12-31-1964
Maryland	2-1-1964
Massachusetts	10-1-1958
Michigan	1-1-1964
Minnesota	7-1-1966
Mississippi	3-31-1968
Missouri	7-1-1965
Montana	1-2-1965
Nebraska	9-2-1965
Nevada	3-1-1967
New Hampshire	7-1-1961
New Jersey	1-1-1963
New Mexico	1-1-1962
New York	9-27-1964
North Carolina	7-1-1967
North Dakota	7-1-1966
Ohio	7-1-1962
Oklahoma	1-1-1963
Oregon	9-1-1963
Pennsylvania	7-1-1954
Rhode Island	1-2-1962

State	Effective Date
South Carolina	1-1-1968
South Dakota	7-1-1967
Tennessee	7-1-1964
Texas	7-1-1966
Utah	1-1-1966
Vermont	1-1-1967
Virgin Islands	7-1-1965
Virginia	1-1-1966
Washington	7-1-1967
West Virginia	7-1-1964
Wisconsin	7-1-1965
Wyoming	1-2-1962

Other tools have been devised to assist in achieving uniformity under the Code: the setting up of machinery to enable any appellate court in the United States to call upon the Permanent Editorial Board for a brief amicus curiae in any case involving what appears to the court to be a difficult question under the Code; and the establishment of three complete Code libraries, at the law schools of the University of Pennsylvania, the University of Chicago, and the University of California at Berkeley.

The only deviations from the 1962 Official Text of the Code in Hawaii are found in Article 9, Secured Transaction, and generally are not departures from essential uniformity since they reflect primarily the state's system of recordation of security interests and the Hawaii property law.

The Uniform Commercial Code (Act 208, S.L.H. 1965, as amended by Act 18, S.L.H. 1966, and as amended by Act 79, S.L.H. 1967) contains ten articles:

Article 1. General Provisions
" 2. Sales
" 3. Commercial Paper
" 4. Bank Deposits and Collections
" 5. Letters of Credit
" 6. Bulk Transfers
" 7. Warehouse Receipts, Bills of Lading and Other Documents of Title
" 8. Investment Securities

Article 9. Secured Transactions: Sales of Accounts, Contract Rights and Chattel Paper

" 10. Effective Date and Repealer

This practical guide analyzes Articles 1, 2, 6, 7 and 9 in section-by-section detail with particular attention to the unitary approach of the Code, relationship of the Code to the Bankruptcy Act, reconciliation between the Code and other Hawaii statutes and references to leading cases and other authorities' interpretation of the Code.

ARTICLE 1.

GENERAL PROVISIONS

PART 1

Short Title, Construction, Application and Subject Matter of Act

<u>Section 1-101. Short title</u>. This section gives a short title to the Act as a whole. Article 1 and Article 10 are of a general nature. Articles 2 to 9 apply to particular areas of commercial law. Each of these eight articles is given a special short title set forth in the initial section of the respective articles.

<u>Section 1-102. Purposes; rules of construction; variation by agreement</u>. This section specifies guidelines for the construction and application of the Code.

1. Subsections (1) and (2) are of a general character and set forth the three main underlying purposes and policies in the light of which the Code ought to be construed. Apart from the goal of uniformity, which the courts of the various jurisdictions should heed, emphasis is placed on the aim of the framers not to freeze the law but to permit continued expansion of commercial practices.

2. Subsections (3) and (4) are designed to remove any doubt about the policy that few of the provisions of the Code are mandatory and that, in general, the parties are free to vary by agreement the effect of most of the rules specified in the Code. The only limitation on party autonomy is the broad principle that the obligations of good faith, diligence, reasonableness and care prescribed by the Code cannot be contracted away although the parties are free to fix standards for the performance of their obligations as long as the standards are not manifestly unreasonable.

3. Subsection (5) contains technical rules relating to the effect of the use of numbers and genders.

4. Generally speaking, these rules of construction agree with the provisions on that subject governing in Hawaii, see <u>e.g.</u> Revised Laws of Hawaii 1955, Section 1-8 (power of parties to vary statutory rules); Section 1-18 (importance of underlying legislative policy); Section 1-22 (number and gender).

5. Special attention is drawn to the Official Comment, Point 1 to this section, dealing with the application by analogy of appropriate rules contained in the Code to transactions intentionally excluded from the general coverage of a particular article. Thus the Comment approves specifically the holding in Agar v. Orda, 264 N.Y. 248, 190 N.E. 479 (1934) which applied the change in seller's remedies made by the Uniform Sales Act to a sale of a chose in action although the Act limited its general coverage to chattels personal other than things in action.

Section 1-103. Supplementary general principles of law applicable.

1. This section continues the supplementary resort to the principles of law and equity, with illustrative listing of particular aspects thereof, that was contained in some of the former uniform acts now superseded by the Code, especially the Uniform Sales Act, Section 73, Revised Laws of Hawaii 1955, Section 202-73; Uniform Warehouse Receipt Act, Section 56, Revised Laws of Hawaii 1955, Section 207-56; Uniform Stock Transfer Act, Section 18, Revised Laws of Hawaii 1955, Section 172-76.

   The standard boiler plate is expanded by adding specific references to estoppel and validating cause.

2. The reference to the law merchant adds special support to principles of construction such as "mercantile terms in mercantile contracts are given the meaning merchants ordinarily give them", In re Taxes, AIEA Dairy, Ltd., 46 Haw. 292 (1963).

3. The reference to the law of bankruptcy has been criticized as being beyond the pale of state legislation. While this is true, no trouble may be anticipated from this fact.

Section 1-104. Construction against implicit repeal. This section guards against implied repeal by state legislation which is neither uniform nor comprehensive. It makes it clear that the possibility of an implied repeal which is generally recognized, e.g. Revised Laws of Hawaii 1955, Section 1-12, is particularly inappropriate in relation to legislation of the type represented by the Uniform Commercial Code.

Section 1-105. Territorial application of the Act; parties' power to choose applicable law.

1. This section specifies certain conflict-of-laws rules applicable in Code states.

2. Subsection (1) authorizes the parties to choose by agreement between application of the Code and non-Code law in the case of a transaction which bears a reasonable relation to a state that has adopted the Code and to another state or nation that has not done so. In the absence of such agreement, the Code prescribes the application of its provisions if the transaction bears an appropriate relation to the state that has adopted the Code.

   The difference between "reasonable" and "appropriate" and the meaning to be given to either term is discussed in the Official Comment, Points 1 to 3 to this section.

3. Subsection (2) governs the effect of six provisions in the Code specifying the applicable law, viz. Sections 2-402, 4-102, 6-102, 8-106, 9-102 and 9-103. In these cases parties are free to make different arrangements only to the extent that the law so specified, including its conflict-of-laws rules, permits such change.

4. Section 1-105 is couched in terms of "this state". Usually this will be in the forum if it has adopted the Code, but this is not necessarily always true. If the forum is a non-Code state or nation whose conflicts rules require application of the law of a Code state, including its conflicts rules, this section may be applicable.

5. In view of the adoption of the Code by nearly all jurisdictions in the United States, the main application of this section will relate to transaction that have contacts with foreign nations and are not governed by an international treaty.

Section 1-106. Remedies to be liberally administered. This section prescribes a liberal administration of the remedies given by the Code and, to that extent, supplements the rule of liberal construction and application, specified in Section 1-102.

In particular, this section addresses itself to the matter of damages by declaring that compensation should place the injured party in as good a position as he would have been in had the other party fully performed, but that consequential or special damages or penal damages should not be included except in cases specifically provided in the Code or by other rule of law. Following the former Uniform Sales Act, Section 72, Revised Laws of Hawaii 1955, Section 202-72, this section provides that, absent any mandate to the contrary, rights and obligations created by the Code should be enforceable by action, defined in the broad terms of Subsection 1-201(1).

Section 1-107. Waiver or renunciation of claim or right after breach.

1. This section gives effectiveness to a written waiver or renunciation by an aggrieved party of a claim or right resulting from the breach of a contract governed by the Code, despite the absence of consideration.

2. Although the section uses the term "alleged" breach, the express reference to an absence of consideration seems to indicate that the framers intended to go beyond situations of dispute settlement. The section proceeds on the modern notion that the time-honored doctrine of consideration is no longer in full accord with modern needs.

3. The Official Comment states that oral waivers or renunciations supported by consideration are likewise valid, so long as the rules of the statute of frauds and on the modification of signed writings (Section 2-209) do not entail a different result.

4. The express recognition of estoppel in Section 1-103 may prevent a party from invoking a breach even without formal waiver or renunciation if the circumstances of the case give rise to such estoppel.

Section 1-108. Severability. This is the model severability section found in all uniform laws of extensive coverage. A similar provision is contained in the Revised Laws of Hawaii 1955, Section 1-29.

Section 1-109. Section captions. This section prescribes a rule of construction, uniform in all enacting states, to the effect that the section captions are parts of the Code and not mere orientation aids without legal significance. This rule conforms to the rule applicable in Hawaii that a heading within a Code enacted in that form is "a portion of the . . . Code", In re Fernandez, 12 Haw. 120 (1899).

PART 2

General Definitions and Principles of Interpretation

This part contains an extensive catalogue of definitions of terms applicable throughout the Code. It is supplemented by similar sets of definitions contained in the various Articles of the Code and primarily applicable for the interpretation of the respective Articles. Sometimes the same term has a varying scope for the purposes of different Articles, e.g. the definitions of "goods" in Sections 2-105 and 9-105. In addition, Part 2 prescribes some general rules of interpretation for the meaning of certain standards prescribed by the Code or employed in stipulations by the parties. Finally, Part 2 incorporates a residual statute of frauds for sales not governed by either Article 2 or Article 9.

Section 1-201. General definitions.

1. This section contains a catalogue of 46 definitions of terms or phrases employed throughout the Code. Its purpose is to set forth the precise technical significance that the makers of the Code wished to ascribe to a term in order to forestall different results in judicial decisions or a conflict of judicial authority on its meaning. The framers of the Code have been careful to use consistent and carefully considered language throughout the Code and for that purpose have coined novel technical expressions,--such as "security interest" (Subsection 1-201(37)), "organization" (Subsection 1-201(28)), "chattel paper" (Subsection 9-105(1)(b)) or "issuer" (Subsection 8-201(3)),--sharply differentiated between terms, often used loosely and synonymously,--as in the cases of "contract" and "agreement" (Subsections 1-201(3) and (11)) or "document" and "instrument" (Subsections 1-201(15), 9-105(1)(e) and 9-105(1)(g)),--or narrowed or broadened standard legal terms,--such as "delivery" (Subsection 1-201(14)) or "bill of lading" (Subsection 1-201(6)). Mastery of the vocabulary of the Code is imperative for the avoidance of pitfalls. Twenty-one of the definitions listed in Section 1-201 are patterned after similar definitions given by the prior uniform acts, the subject matter of which is incorporated in the Code. Twenty-one of them are new.

   The definitions of the Code vary greatly in complexity and technical scope. With the exception of the definition of the term "security interest" (Subsection 1-201(37)) the most involved and original definitions of the Code are not contained in Section 1-201, but are found in the Article on Secured Transactions. This is in part due to the decision of the framers to merge the subject of chattel security with the subject contained in the former statutes on the assignment of accounts receivable which included outright sales. As a result the terms "creditor", defined in Subsection 1-201(12) and "debtor", defined in Subsection 9-105(1)(d) are no longer correlative terms.

Following the example of the Bankruptcy Act, the Code's definitions are couched in terms of either "means" or "includes". The former verb indicates that the definition is complete and exclusionary, while the latter verb connotes that the definition is merely illustrative and open-ended, see American Surety Co. v. Marotta, 287 U.S. 513, 517 (1933). Moreover, the definitions are applicable according to the meaning ascribed by Section 1-201 only "unless the context otherwise requires".

The following notes do not purport to deal with all definitions or all aspects of any of them but only with some features of individual definitions or groups of them that may require special comments, especially in view of definitions contained in other parts of the Code.

2. A number of definitions are important in conjunction with the protection of the rights of "third parties" accorded in various parts of the Code. Definitions belonging in this class are "buyer in ordinary course of business" (Subsection (9)), "creditor" (Subsection (12)), "good faith" (Subsection (19)), "notice" (Subsection (25)), "third party" (Subsection (29)), "purchase" (Subsection (32)), "purchaser" (Subsection (33)), and "value" (Subsection (44)).

   (a) The term "purchase" which was defined by a number of the former uniform acts now superseded by the Code, especially by the Uniform Trust Receipts Act, Section 1, Revised Laws of Hawaii 1955, Section 206-1, is expanded to include any taking by a transaction creating an interest in property. "Purchasers", accordingly, mean persons taking in that fashion, and exclude "creditors" and, where material, "statutory lienors" (Section 9-310).

   (b) "Creditor" includes a general creditor as well as a lien or secured creditor. Note that the term "lien creditor" is specially defined for purposes of Section 9-301 in Subsection (3) of that section.

   (c) While the term "buyer" is defined primarily for purposes of Article 2 in Subsection 2-103(1)(a), Subsection 1-201(9) defines "buyer in ordinary course of business" and "buying" for the purposes of that phrase. The various parts of the definition must be read with care. A person is a buyer in ordinary course of business only if he (1) buys from a person in the business of selling goods of the kind involved, other than a pawnbroker, and (2) does so in good faith and without knowledge that the sale is in violation of the ownership rights or security interest of a third party. In other words, mere knowledge of the existence of the ownership rights or security interest of a third party does not destroy the status described in the definition unless the buyer has notice that his purchase is in violation of such rights or has not acted in good faith. The term "buyer", for purposes of this definition, excludes a purchaser whose acquisition is in total or partial satisfaction of a money debt. The reasons and the effects of the definition are elucidated in the Official Comments to Sections 2-403 and 9-307.

(d) The Code differentiates sharply between "good faith" and absence of "notice". "Good faith" is defined as honesty in fact in the conduct or transaction concerned. "Notice" of a fact is possessed if the person to whom it is attributed (1) has actual knowledge of it, or (2) has received a notice thereof, or (3) from the facts or circumstances known to him ought to have concluded its existence. The acquisition of notice by an "organization", as defined in Subsection 1-201(28), is regulated by rules set forth in Subsection 1-201(27).

(e) "Value" is defined in Subsection (44) and, in general, may consist of any consideration sufficient to support a simple contract. In particular, "value is given" by a binding commitment to extend credit (Subsection 44(a)) a matter which is of importance for fixing the moment at which a security interest attaches (Subsection 9-204(1)).

3. The definition of "document of title" broadens and clarifies the definition of that term given by the former Uniform Sales Act, Section 76, Revised Laws of Hawaii 1955, Section 202-75. In addition to the retention of the verb "includes", it is now expressly stated that the definition not only includes the slightly expanded catalogue of documents listed but also 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". A document of title under this definition, which is incorporated by reference to the definitions of "document" in Subsections 7-102(1)(e) and 9-105(1)(e), may be either negotiable or non-negotiable. Where the Code differentiates between negotiable or non-negotiable documents, the pertinent sections employ the respective qualifying adjectives, <u>e.g.</u>, Sections 2-705(3)(c) and (d), 7-504,

9-304(1), 9-305, 9-308 and 9-309. The Code pursues different draftsmanship with respect to "instruments". "Instrument", unless specifically qualified means "negotiable instrument" (Subsections 3-102(1)(e), 9-105(1)(g), 9-304(1) and (4)). If a non-negotiable instrument is involved, the Code so specifies (Section 9-308). Moreover, Article 1 does not contain a general definition of "instrument".

While Articles 7 and 9 use the term "document" in the sense of "document of title", other articles of the Code employ the term "document" in a broader sense. Subsection 5-103(1)(b) specifies expressly that document, for the purposes of Article 5, means "any paper including document of title, security, invoice, certificate, notice of default and the like". The same definitional breadth should, if need be, be ascribed to the term "document" used in Subsection 4-104(1)(f), although the reference there to "other papers" probably covers all residual cases.

4. "Delivery" is defined only with respect to instruments, documents of title, chattel paper and securities and means, in that connection, voluntary transfer of possession (Subsection 1-201(14)). Delivery with respect to goods is not so restricted and may take various forms, see Official Comment, Point 2 to Section 2-103.

5. The definition of insolvency (Subsection (23)) is enlarged by adding to the so-called equity test and bankruptcy test a third and new test: cessation of payments in the ordinary course of business.

6. Two definitions relate to the law of evidence, viz. "burden of establishing" (Subsection (8)) and "presumption" (Subsection (31)). The terminology employed is based on that of the American Law Institute's Model Code of Evidence. Accordingly, it differs in certain respects from that found in the Uniform Rules of Evidence (approved in 1953). These Rules differentiate between "burden of producing evidence" and "burden of proof". Fortunately, the latter concept is stated to be synonymous with "burden of persuasion", the phrase used by the Code in defining "burden of establishing". Conversely, the "burden of producing evidence" denotes merely the burden of introducing sufficient evidence to prevent a directed verdict or to make prima facie proof.

   The phrase "prima facie evidence" is used by the Code in a few places, e.g., Section 1-202, but left undefined.

Section 1-202. Prima facie evidence by third party documents. This section deals with the evidentiary value attributable to writings that purport to be documents authorized or required by a contract to be issued by a third party (i.e., a person other than a party to the contract), such as bills of lading, policies or certificates of insurance, official weigher's or inspector's certificates, consular invoices and the like. According to the Code, documents of that kind constitute prima facie evidence of their authencity (a term not defined by the Code, but meaning that they stem from the person from whom they purport to have been issued) and genuineness (as defined in Subsection 1-201(18)) and of the facts stated therein. They possess this value only in actions arising out of the contracts that called or allowed for them, the Code thus recognizes the preferred status that the parties themselves have granted to them.

Former uniform acts did not contain similar provisions.

Section 1-203. Obligation of good faith. This section prescribes an overriding duty of good faith (as defined in Subsection 1-201(19) in general and in Subsection 2-103(1)(b) with respect to merchants in reference to transactions governed by the Article on Sales (Article 2)) for the performance and enforcement of contracts. Section 1-203 applies to all aspects thereof although the Code in certain sections invokes this standard specifically. These applications, as e.g., Sections 1-208, 2-603(3) and 2-615, are merely illustrative of the general principle. It applies in suitable cases even to the determination of terms, as defined in Subsection 1-201(42), of contracts that have been left open, e.g., Subsection 2-305(2).

Section 1-204. Time; reasonable time; "seasonably". This section defines the meaning of the expressions "within a reasonable time" or "seasonably" which are employed in certain sections of the Code to indicate the time within which certain action must be taken. Instances where the first phrase is used are Subsections 2-201(2), 2-207(1), 2-309(1), 2-503(4)(b), 2-508(2), 2-602(1), 2-607(3)(a) and (b), 2-616(2); examples for the employment of the second term are Subsections 2-207(1), 2-311(3), 2-319(3), 2-325(2), 2-503(4)(b), 2-508(1) and (2), 2-602(1), 2-605(1)(a), 2-607(5)(a), 2-612(3), and 2-615(c). The reasonableness depends on the nature, purpose and circumstances of the action to be taken. "Within a reasonable time", denotes lesser urgency than "with commercial promptness", a term used in Subsection 2-320(2)(e). Occasionally, the Code uses the term "commercially reasonable time" in order to indicate the standard of reasonableness to be employed under the particular circumstances (Subsection 2-402(2)) or uses the expression "within any reasonable time" without reference to any action to be taken (Section 2-723(2)). In the latter case, Section 1-204 should apply by analogy.

Where the Code requires that a particular action be taken within a reasonable time, the parties may agree upon any period not manifestly unreasonable. "Seasonably" means at or within a time agreed upon or within a reasonable time.

Section 1-205. Course of dealing and usage of trade.

1. This section defines the terms "course of dealing" and "usage of trade" and specifies the effects to be given to a course of dealing or a usage of trade in construing agreements governed by the Code.

2. Subsection (1) defines a course of dealing as "a sequence of previous conduct between the parties to a particular transaction". Although this phraseology could cover transactions under an agreement, the thrust of this section concerns the interpretative value to be attributed to a course of dealing with reference to an agreement and therefore seems to envisage primarily a course of dealing previous thereto. This does not exclude subsequent conduct of the parties that may have equivalent significance, and at any rate the Code, in a separate section, attributes an analogous interpretative value to a course of performance, regulating therein also the relative effects of a prior course of dealing and a subsequent course of performance (Section 2-208). The Official Comment, Point 2 agrees with this analysis.

3. Subsection (2) defines "usage of trade" in terms different from the cases pertaining to "custom". A usage of trade is a practice or method of dealing that has such regularity of observance in a particular locality or trade as to justify the expectation that it will be observed with respect to the transaction in issue. Its existence is to be proved as a fact, but evidence of a relevant usage of trade is admissible only after the party offering it has given the other party fair notice (Subsections (2)(6)). The interpretation of written trade codes or similar compilations are treated as questions of law (Subsection (2)).

4. Subsections (3) and (4) regulate the conditions for, and the scope of, the interpretative significance of a course of dealing and usage of trade, and the hierarchy existing between express terms, course of dealing and usage of trade, respectively.

5. Subsection (5) attributes relevance to a local usage of trade existing at a place where any part of the performance takes place.

Section 1-206. Statute of frauds for kinds of personal property not otherwise covered. This section is a residual statute of frauds, applicable to sales of personal property not covered by three other statute of frauds provisions applicable to sales of particular classes of personal property, viz. goods (Section 2-201 in conjunction with Subsection 2-105(2)), securities (Section 8-319 in conjunction with Section 8-102) and accounts, contract rights and chattel papers to the extent that such sales are not excluded from the application of Article 9 (Subsection 9-203(1)(b) in conjunction with Subsections 9-102(1)(b), 9-104(f), 9-105(1)(b) and 9-106)). This statute, accordingly, applies to contracts for the sale of general intangibles and of instruments other than securities and not constituting part of chattel paper, see the Explanatory Notes to Section 2-201, infra.

In view of the usual informality of such arrangements, the dollar limit for the enforceability is lifted to $5,000 in amount or value of remedy, changing in that respect the statute of frauds contained in the former Uniform Sales Act, Section 4, Revised Laws of Hawaii 1955, Section 202-4, which covered choses in action in addition to goods and in Hawaii applied in all cases to sales of chattels personal having a value of $100 or more.

Section 1-207. Performance or acceptance under reservation of rights. This section recognizes performance or acceptance under reservation of rights as an effective device that permits a party to yield temporarily to the demands or assertions of the other party in the course of performance without prejudicing its rights by such conduct.

Section 1-208. Option to accelerate at will. This section construes the reservation by a party of a right to accelerate performance or to demand security or additional security either in his discretion or if he feels insecure, as giving such power only if the party in good faith (Subsections 1-201(19) and 2-103(1)(b)) believes that the prospect of payment or performance is impaired. The other party has the burden of proof of lack of good faith.

This section has no counterpart in prior uniform acts and is designed to clarify the conflicting case law on that point.

ARTICLE 2.
SALES

This article deals with transactions in sales of goods. It does not apply to sales of land. Next to the completely revolutionary Article 9, dealing with secured transactions, this article contains probably the farthest reaching and most radical changes to pre-existing law. Far from being a mere revision and recodification of the sales law as developed under the Uniform Sales Act and its common law ancestors, the sales article of the Uniform Commercial Code proceeds on an entirely novel theory and adopts an original step by step approach. While it is impossible to give a complete list of the countless departures which the article makes from the former law, it may be helpful to summarize some of the more fundamental innovations brought about by the article. They are:

1. Abandonment of the passage of title concept as the principal basis for adjusting the rights and remedies of the parties and a shift to the contract and the actions taken thereunder as the chief determinants of legal consequences.

2. Provision for particular rules applicable to merchants and governing transactions between merchants, without necessarily subjecting a casual or inexperienced buyer or seller thereto.

3. Modernization of the rules relating to the formation and construction of sales agreements.

4. Redefinition of the scope of the obligations of sellers and buyers, particularly of the law of warranties.

5. Reallocation of the various contractual risks coupled with the elaboration of a new operational concept: identification to the contract.

6. Expansion of the rights of buyers or sellers to the possession of goods sold in case of insolvency of the other party and simplification of the remedies available to buyers or sellers in the case of breach.

The Code divides the rules governing sales into seven parts aiming at a chronological and functional arrangement. Actually, however, the various parts are so closely interrelated that frequently a full understanding of sections contained in one part requires reference to sections in other parts. Moreover, to the extent that Article 2 creates security interests in a buyer or seller, Article 9 may have to be resorted to for ascertaining their effect, (Section 9-113), see Hogan, The Marriage of Sales to Chattel Security in the Uniform Commercial Code, in 2 Coogan, Hogan and Vagts, Secured Transactions Under the U.C.C., Ch. 18A (1966). Most of all, it should be noted at the outset that the effect of the Bankruptcy Act on the various rights and remedies of both the parties to a sale of goods and their creditors is a matter in regard to which state legislation is subject to federal limitations. This aspect has provoked many controversies and doubts, see Kennedy, Trustee in Bankruptcy Under the U.C.C.: Some Problems Suggested by Articles 2 and 9, 1 Coogan, Hogan and Vagts, Secured Transactions Under the U.C.C., Ch. 10 (1966); Note, Bankruptcy and Article Two of the U.C.C.: The Right to Recover the Goods Upon Insolvency, 79 Harv. L. Rev. 598 (1966).

Despite its profound innovation in draftsmanship, technique and conceptual framework, Article 2 will not require businessmen to alter their way of doing business in any radical respect. In fact, one of the purposes of this article is to bring the law into conformity with modern commercial practices.

The article supplants the Uniform Sales Act, adopted by Hawaii in 1929 and codified in Chapter 202 of the Revised Laws of Hawaii 1955; accordingly, this chapter is now repealed (Section 10-102(1)). Article 2 expressly leaves unimpaired "any statute regulating sales to consumers, farmers or other specified classes of buyers" (Section 2-102). Hence, the Retail Installment Sales Act of Hawaii, Chapter 201A of the Revised Laws of Hawaii 1955, as amended, is still in force and not included in the general repealer provisions (Sections 10-103 and 10-103.1). Likewise unaffected is the Uniform Sale of Securities Act, Chapter 199 of the Revised Laws of Hawaii 1955, as amended, for the double reason that Article 2 applies only to transactions in goods and not in investment securities (Sections 2-102 and 2-105) and that buyers of investment securities appear to be a specified class of buyers within the meaning of Section 2-102.

PART 1

Short Title, General Construction and Subject Matter

This part deals primarily with the type of transactions governed by the rules of this article and contains definitions particularly applicable to its construction.

Section 2-101. Short title. Like other uniform acts, including the Uniform Sales Act, Section 79, this section gives a short title to Article 2 for the ease of citation. Section 79 of the Uniform Sales Act was omitted in Hawaii.

Section 2-102. Scope; certain security and other transactions excluded from this Article. This section contains the basic provision defining the scope of coverage of Article 2. According to the terms of this section, the article applies, except where the context requires otherwise, to "transactions in goods". Although this term would include leases, bailments and similar contracts, other provisions of this article, especially the definitions of "contract" and "agreement" in Subsection 2-106(1) make it clear that the primary area of applicability of Article 2 is the present or future sale of goods. It may, however, be held that various provisions of this article will also govern the steadily expanding business of leasing machinery to various types of commercial users, as is indicated in the definition of inventory in Subsection 9-109(4). See the comments to that effect by Peters, Remedies for Breach of Contracts Relating to the Sale of Goods Under the U.C.C.: A Roadmap for Article Two, 73 Yale L.J. 199, at 200, ftn. 4 (1963).

The section specifies expressly that it does not apply to transactions in the form of an unconditional contract to sell or present sale which is intended to operate as a security transaction. A similar provision was incorporated in Section 75 of the former Uniform Sales Act, Revised Laws of Hawaii 1955, Section 202-74. Article 2 does apply, however, to genuine sales with an option to re-buy as well as to the sales aspects of sales of goods with the reservation of a security interest in the seller (Subsections 2-401(1) and 2-505 (1)(a)).

The section expressly saves any statute regulating sales to consumers, farmers or other specified classes of buyers, thereby leaving unimpaired the Retail Installment Sales Act, Chapter 201A of the Revised Laws of Hawaii 1955, as amended, and the Uniform Sale of Securities Act, Chapter 199 of the Revised Laws of Hawaii 1955, as amended.

Section 2-103. Definitions and index of definitions.

1. This section provides four definitions ("buyer", "good faith", "receipt" and "seller") which are particularly applicable to Article 2. It adds a list of references to other definitions contained in Article 2 and applicable thereto or to specified parts thereof. Furthermore, it contains an index of definitions contained in

other articles which apply also to Article 2 and recalls that the general definitions in Article 1 also govern the construction of the provisions of Article 2.

2. The definitions of the terms "buyer" and "seller" are slightly rephrased versions of the corresponding definitions in Section 76(1) of the former Uniform Sales Act, Revised Laws of Hawaii 1955, Section 202-75(a). The reference to "any legal successor in interest of such person", contained in the former definitions was dropped, since not every legal successor may be included in all provisions of the article. Generally speaking, however, such inclusion will be the case.

3. Subsection (1)(b) contains a special definition of "good faith" in the case of a merchant, requiring "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade". The second part of this definition varies the requirements for "good faith", as specified in the general definition (Subsection 1-201(19)) applicable to non-merchants. The definition of good faith in the former Uniform Sales Act, Section 76(2), Revised Laws of Hawaii 1955, Section 202-75(b) corresponded to the general definition of the Code (Subsection 1-201(19)) since the former Uniform Sales Act did not provide special rules for merchants.

4. Section 2-103 defines a new term: "receipt" of goods. The new definition is necessary since "delivery" within the meaning of Article 2 no longer connotes a uniform physical occurrence. As a result, the definition of delivery applicable to sales of goods that was contained in the former Uniform Sales Act, Section 76(1), Revised Laws of Hawaii 1955, Section 202-75(a), was dropped, and the corresponding general definition of delivery, contained in the Code (Subsection 1-201(14)) is restricted to instruments, documents of title, chattel paper and securities, <u>i.e.</u> excluding goods.

<u>Section 2-104. Definitions: "merchant"; "between merchants"; "financing agency"</u>.

1. This section contains two sets of basic definitions, <u>viz.</u> 1) "merchant" and "between merchants", and 2) "financing agency". The first set is necessary because of the new Code policy of expressly stating rules applicable "between merchants" and "as against a merchant". Even the former Uniform Sales Act contained rules which applied only to purchases from a "seller who deals in goods of that description", former Uniform Sales Act, Section 15(2), Revised Laws of Hawaii 1955, Section 202-15(b), or from a "dealer in goods of that kind", former Uniform Sales Act, Section 16(c),

Revised Laws of Hawaii 1955, Section 202-16(c); or whose applicability depended upon the circumstances of the case, former Uniform Sales Act, Section 45(2), Revised Laws of Hawaii 1955, Section 202-45(b), the usage of the trade, former Uniform Sales Act, Section 15(5), Revised Laws of Hawaii 1955, Section 202-15(e), or custom binding both parties to the transaction, former Uniform Sales Act, Section 71, Revised Laws of Hawaii 1955, Section 202-71. The Code, however, extends this policy and renders the rules applicable between or against merchants more explicit.

Rules which are stated in terms of applicability "between merchants" or "as against a merchant" are, however, not expressly excluded from applicability to non-merchants. The Official Comment, Point 1 to this section only suggests that such rules "may not" apply to a casual or inexperienced seller or buyer. This open-endedness of the scope of applicability was stated in a positive form in the drafts of both the text of the Code and the comments thereto and drew severe attacks from Professor Williston, <u>The Law of Sales in the Proposed Uniform Commercial Code</u>, 63 Harv. L. Rev. 561, at 573 and 584 (1950). As the quoted passage in the Comment indicates, it was subsequently reduced to a mere comment suggestion phrased in the negative, but it still leaves a lingering uncertainty.

The Code's definition of the term "merchant" possesses great plasticity. It depends primarily on the chargeability, for specified reasons, with knowledge or skill peculiar to either the practices or to the goods involved in the transaction. If the practice involved in the transaction is of a non-specialized character and is normally carried on by any person in business, all persons who engage in activities of that type or have had such activities conducted in their behalf will be merchants to the extent that such practices are concerned. Instances of this aspect of the definition are various rules relating to the formation and terms of contract (Sections 2-201(2), 2-205, 2-207(2), 2-209(2)).

Conversely, the "goods" aspect of the definition requires that the person in question be a dealer in goods of the kind involved. Hence, the applicability of this facet of the definition is restricted to a much smaller group of persons. It comes into play in regard to warranties (Subsection 2-314(1)) and the effect of keeping, or being entrusted with, possession of goods (Subsections 2-402(2) and 2-403(2)).

Sections in which both aspects of the definition ("practices" and "goods") may be material are Sections 2-103(1)(b), 2-327(1)(c), 2-509, 2-603, 2-605, and 2-609.

It should be noted that the definitional cross references appended to the official comments to other sections of Article 2 contain references to the definitions of "merchant" or "between merchants" which are no longer applicable because they relate to abandoned versions of Article 2 drafts (see, e.g., Sections 2-326, 2-602, 2-615, 2-706).

2. The second definition in this section relates to the term "financing agency". The definition is important in view of Section 2-506 relating to the rights of a financing agency, Subsection 2-505(1)(a) relating to the effect of the procurement by a seller of a negotiable bill of lading to the order of a financing agency and Section 2-603 relating to the merchant buyer's duties of a salvage resale of rejected goods when the seller has no agent at the market of rejection.

Section 2-105. Definitions: transferability; "goods"; "future" goods; "lot"; "commercial unit". This section defines four terms employed by provisions of Article 2: "goods", "future goods", "lot" and "commercial unit".

1. Since Article 2 pertains primarily, if not wholly, to contracts for the sale of goods, the definition of the term "goods" is of pivotal importance. It should be noted that Article 9 on Secured Transactions, which applies to the creation of security interests in personal property, including goods (Section 9-102) likewise contains a definition of the term "goods" (Subsection 9-105(1)(f)). The two definitions of goods in the Code are parallel but by no means identical, the definition of Subsection 9-105(1)(f) being somewhat more limited in scope than that of Subsection 2-105(1).

   "Goods", within the meaning of the sales definition, means all things (including specially manufactured goods) which are movable at the time of identification to the contract other than the money in which the price is paid, investment securities and things in action. "Goods", within the meaning of the secured transaction definition, includes all things which are movable at the time the security interest attaches or which are fixtures but does not include money, documents, instruments, accounts, chattel paper, general intangibles, contract rights and other things in action.

   Apart from the difference as to the time at which movability must exist and the difference in the manner of the inclusion of fixtures (which are dealt with in the sales definition of "goods" in a special sentence, Subsection 2-105(1), second sentence) the chief disparities between the two definitions of "goods" consist in the identification of the exclusions. Subsection 2-105(1) excludes money in which the price is to be paid, investment securities and things in action while Subsection 9-105(1)(f) excludes all money and a longer list of types of personal property, specially defined in Article 9. Actually, however, the practical difference between the two definitions is much smaller than appears at first blush. Foreign currency, although money under the definition of Subsection 1-201(24) is nevertheless subject to Article 2 in the cases where it is treated as a commodity and sold for domestic currency or traded against other assets, cf. Official Comment, Point 1 to Section 2-105 and Section 2-304, and likewise may be subject to Article 9 in the cases where it is used as collateral. The specific exemption of investment securities in Subsection 2-105(1) does not mean that other "instruments" within the meaning of Subsection 9-105(1)(g) are considered as goods rather than things in action for purposes of Section 2-105. A real difference, however, relates to "documents", as defined in Subsections 1-201(15) and 9-105(1)(e). Goods covered by documents are treated as goods within the meaning of Section 2-105 while Article 9 considers the documents, rather than the goods covered thereby, as collateral. Unborn young of animals and growing crops are goods within the meaning of both definitions. Other real differences exist in regard to timber and minerals (compare Subsections 2-107(1) and 9-204(2)(b)) as well as to other identifiable things attached to reality (compare Sections 2-107(1) and (2) and 9-313)).

2. Only existing, identified goods can form the object of a "present sale", i.e., support transferable interests. Goods which are not both existing and identified are "future" goods and, as such, are only capable of being the object of a "contract to sell". Undivided shares in an identified bulk of fungible goods may be subject to a present sale or contract to sell, although the quantity of the bulk is not determined (Subsection (4)).

   Subsections (1) to (4) cover subject matter contained in the former Uniform Sales Act, Sections 5, 6, 17 and 76(1), Revised Laws of Hawaii 1955, Sections 202-5, 202-6, 202-17 and 202-75(a). The phraseology is changed for purposes of clarification and modernization in terminology. Some of the provisions are dropped as self-evident, e.g. Revised Laws of Hawaii 1955, Section 202-5(b).

3. Sales of personal property other than goods may, in certain respects, be governed by Article 9 which applies to sales of accounts, contract rights or chattel paper (Section 9-102) or may call for application by analogy of particular sections contained in Article 2, see Official Comment, Point 1 to Section 2-105. Recall also Subsection 1-102(2).

4. Subsections (5) and (6) contain new but self-explanatory definitions of the terms "lot" and "commercial unit". One or both of these terms are employed in Sections 2-307, 2-327, 2-328, 2-601, 2-602, 2-606 and 2-608.

Section 2-106. Definitions: "contract"; "agreement"; "contract for sale"; "sale"; "present sale"; "conforming" to contract; "termination"; "cancellation".

1. Subsection (1) of this section, by limiting "contract" and "agreement" as used in Article 2 to those relating to present or future sales of goods, makes it clear that this article, despite the broad language of Section 2-102, applies primarily to the sale of goods. Sales of personal property other than goods, as well as contracts relating to goods other than sales, may call for the application of rules contained in this article but such application is only one by analogy.

   For the difference between agreement and contract in general, see Subsections 1-201(3) and (11).

2. Subsection (1) also clarifies the meaning of "present sale" and "contract for sale". It designates the expression "contract for sale" as a generic concept, including both a present sale and a contract to sell. Contracts to sell may relate either to sales of existing goods at a future time or to sales of future goods at or after the time of their coming into existence.

3. Subsections (2), (3) and (4) define the terms "conforming to the contract", "termination", and "cancellation". Both termination and cancellation denote a transaction by a single party ending the contract, the former consisting in the exercise of a power created by agreement or law for reasons other than breach, while the latter is predicated on breach. Termination discharges all obligations that are still executory, whereas cancellation does not affect remedies for the breach that has caused the cancellation. Different from either termination or cancellation is "rescission", which the Code uses in the sense of an agreement by both parties to put an end to the contract (Section 2-209, see also Section 2-720).

4. The definitions contained in Subsection (1) correspond to those contained in the former Uniform Sales Act, Section 1, Revised Laws of Hawaii 1955, Section 202-1. The definition of "conforming" in Subsection (2) is new but continues the policy of the former Uniform Sales Act requiring compliance with the contractual undertaking.

Section 2-107. Goods to be severed from realty; recording.

1. This section deals with sales of identified things (other than crops) attached to, but to be severed from, realty. It implements the clause in the definition of "goods", relating to such items in Subsection 2-105(1), second sentence.

   Sections 2-105 and 2-107 avoid the chameleon-like term "fixtures", used nevertheless in Article 9 on Secured Transactions (Section 9-313).

   The Code differentiates between contracts for the sale of timber, minerals or the like or a structure or its materials, to be removed from realty (Subsection 2-107(1)) and contracts for the sale, apart from the land, of growing crops or other things not mentioned before which are attached to realty and capable of severance without material harm thereto (Subsection 2-107(2)). Items listed in Subsection 2-107(1) may, prior to severance, only be the object of a contract to sell and that, only if severance <u>by the seller</u> is contemplated. Items listed in Subsection 2-107(2) may be the object of a contract to sell, whether severance by the seller or by the buyer is contemplated. Moreover, they may be the object of a present sale even before severance, provided they are identified at that time.

   The rules pertaining to security interests in fixtures (Section 9-313) are substantially different, primarily for the reason that they contemplate the creation of security interests which become or remain such after affixation.

2. Contracts for the sale of the things attached to realty, governed by Subsections (1) and (2) do not create buyer's rights superior to third parties who acquire rights in the realty by conveyances and comply with the applicable laws on land records. In order to be protected against subsequent purchasers of the realty, the contract for sale of the things falling under Subsections (1) and (2) may and must be executed and recorded as prescribed by the applicable law of conveyances. In other words, if properly executed and recorded, a contract for such sale may operate as a conveyance of a real property right of or to severance. Such right may also be created by a properly executed and recorded conveyance to a buyer of the right to sever and remove by himself the items falling under Subsection (1).

   Although the section speaks only of recordation, in Hawaii the same rules should apply to registration of such rights in realty of or to severance of things attached thereto, in compliance with the provisions relating to registered land, especially Revised

Laws of Hawaii 1955, Sections 342-52 and 342-55. In other words, the owner's duplicate certificate and the instrument transferring such right of or to severance must be presented together.

3. The rules applicable under the former Uniform Sales Act, Section 76, Revised Laws of Hawaii 1955, Section 202-75, were much less explicit and couched in somewhat archaic terms.

PART 2

Form, Formation and Readjustment of Contract

This part contains provisions which modernize the existing rules of the statute of frauds, clarify the parol evidence rule as applicable to sales, and profoundly alter the traditional rules governing the formation and assignment of contracts.

Section 2-201. Formal requirements; statute of frauds. This section revamps and in general greatly relaxes the statute of frauds as applicable to sales and stated in the former Uniform Sales Act, Section 4, Revised Laws of Hawaii 1955, Section 202-4. The only change in the opposite direction is the extension of the statute to sales of goods other than staple articles to be manufactured especially for the buyer, a class that was formerly exempted.

1. Subsection (1) applies both to sales other than between merchants and to sales between merchants, and requires a writing with minimal content if the price of the goods amounts to $500 or more. The writing, as defined in Subsection 1-201(46) must fulfill three minimum requirements. It must (a) afford evidence to the effect that a contract of sale has been made between the parties, (b) be signed, as defined in Subsection 1-201(39) by the party sought to be charged or by his authorized agent or broker, and (c) show the quantity of goods sold. It need not indicate all terms, including the price, and it may be incorrect, except that the quantity of goods indicated fixes the extent to which it may be enforced.

2. Subsection (2) further liberalizes the requirements of the statute of frauds with respect to sales between merchants. A writing which (a) constitutes a confirmation of the contract, and (b) is sufficient against the seller, is also sufficient against the party receiving it, if (c) it was received within a reasonable time, (d) the party receiving it had reason to know its content, and (e) no written notice of objection is given (as defined in Subsection

1-201(26)) within ten days after such receipt. All five elements must be present to have compliance with that aspect of the statute.

3. Failure to comply with the statute is cured if one of three sets of facts, specified in Subsection (3) occurs:

   (a) admission in court that a contract of sale was made, or

   (b) in the case of a sale of goods, other than staple articles, to be specially manufactured for the buyer, a substantial beginning of their manufacture or commitment for their procurement made before receipt of a notice of repudiation, or

   (c) receipt and acceptance of goods or payment made for them. In that case, however, failure to observe the statute of frauds is cured only to the extent that goods have been accepted or paid for. The limitation on the enforceability of the contract proved in this fashion constitutes a change of the law as it existed under Section 4 of the former Uniform Sales Act, Revised Laws of Hawaii 1955, Section 202-4. Moreover, applicability of the new rule requires that the performance under the contract sought to be enforced is capable of just apportionment.

4. The statute of frauds contained in the former Uniform Sales Act, Section 4, Revised Laws of Hawaii 1955, Section 202-4, applied to sales of goods or choses in action; Section 2-201 applies only to contracts for the sale of goods. The gap so created is filled by three special statutes of fraud in the Code: Section 8-319, applicable to the sale of investment securities; Section 9-203, in conjunction with Subsections 1-201(37) (security interest) and 9-105(1)(d) (debtor), applicable to the sale of accounts, contract rights and chattel paper; and Section 1-206, applicable to contracts for the sale of personal property other than goods, investment securities or property the sale of which constitutes a security agreement.

<u>Section 2-202. Final written expression: parol or extrinsic evidence</u>. This section codifies the parol evidence rule applicable to terms of commercial agreements that have been finalized in writing. This reduction to writing may be in the form of confirmatory memoranda which are in agreement to that extent or which are set forth in a writing intended as a final expression of agreement on the terms included therein. The rule bars any contradiction of these terms by evidence of an antecedent agreement or of a contemporaneous oral understanding, but it permits explanation or supplementation thereof by (a) a course of dealing, usage of trade or course of performance as well as, (b)

evidence of consistent additional terms unless the court finds that the parties intended the terms as reduced to writing to be an integration of the whole extent of the agreement.

The rule as included in the Code agrees with modern thought on the scope and function of the parol evidence rule, see Corbin, The Interpretation of Words and the Parol Evidence Rule, 50 Cornell L. Q. 161 (1965), and removes two unsound barriers traditionally held to be implied in the rule. In the first place, the rule as adopted by the Code militates against the existence of an irrebuttable or rebuttable presumption to the effect that a writing or set of writings which finalizes terms of an agreement is intended as complete and exclusive integration of the whole agreement. Such intention, if asserted, must be proven as fact with the court as the proper fact finder on that issue. Secondly, the rule as codified levels the famous "semantic stone wall" and admits interpretative evidence resulting from a course of dealing, usage of trade or course of performance, whether or not the court finds the terms as stated to be ambiguous.

To the extent that the rule as stated in the Code bars the introduction of evidence of previous negotiations and agreements for the purpose of varying terms finalized in a writing, it is in accord with prior judicial expression in Hawaii, Chang v. Meagher et al., 40 Haw. 96, at 106 (1953).

Section 2-203. Seals inoperative. This section declares the common law with respect to sealed instruments inapplicable to contracts for the sale of goods or offers to buy or sell goods even when a seal has been affixed to such writing. The section does not affect state statutes which relate to the signing or authentication of writings by means of affixing a seal. There is no statute to that effect in Hawaii, and the common law relating to sealed instruments has never been part of the law of this State, Allied Amusements, Ltd. v. Glover et al., 40 Haw. 92 (1953). The former Uniform Sales Act, Section 3, Revised Laws of Hawaii 1955, Section 202-3, left the legal effect of the affixation of a seal undetermined.

Section 2-204. Formation in general. This section and the following three sections introduce, with respect to contracts for the sale of goods, some extensive modifications of the traditional common law rules relating to the formation of contracts.

1. Subsections (1) and (2) continue and expand the policy adopted by the former Uniform Sales Act, Section 3, Revised Laws of Hawaii 1955, Section 202-3, and permit the conclusion of a contract for the sale of goods in any manner sufficient to show agreement.

Conduct by both parties is sufficient for that purpose if it recognizes the existence of such a contract. It is irrelevant that the moment at which the contract was concluded cannot be determined with precision.

2. Subsection (3) declares that a contract for sale does not fail for indefiniteness because one or more terms are left open if the parties meant to be bound and there are reasonably certain bases for appropriate enforcement. In implementation of the policy so adopted, the Code in Article 2, Part 3, provides rules for supplying missing terms.

   Of course, if the parties intended that they themselves should fix the missing terms by agreement, the courts cannot substitute terms or compel the parties to agree. The law as declared in Paris v. Greig, 12 Haw. 274, 281 (1899) is not changed in that respect.

Section 2-205. Firm offers. This section modifies the traditional common law rule which denies binding effects to firm offers unless sustained by consideration. Under the new system adopted by the Code, an offer made by a merchant may be binding for a stated period or, in the absence of such statement, for a reasonable period, though in no case for longer than three months, provided that the offer is by its terms expressly made irrevocable and contained in a signed writing. "Signed" is used in the broad sense of the term defined in Subsection 1-201(39) and does not require a formal subscription. Nevertheless, where the firm offer is extended in a clause contained in a form supplied by the offeree, such clause must be separately signed in order to safeguard the offeror against inadvertence. If the offer is to remain binding for a period exceeding three months, the normal rules regarding options become applicable after the first three months have elapsed unless the offer is renewed at that time.

Section 2-206. Offer and acceptance in formation of contract.

1. This section deals with the formation of contracts by means of offer and acceptance. Since the offer vests the offeree with the power of acceptance, the mode in which this power is to be exercised is determined by the terms of the offer. The section prescribes liberal rules of construction as to the mode of acceptance authorized or called for by offers relating to contracts for the sale of goods.

2. Subsection (1)(a) states the general principle that, unless a different result is indicated by the language or circumstances, an offer to make a contract is to be construed as calling for accep-

tance in any manner and by any medium reasonable under the circumstances. The subsection rejects any artificial limitations, such as that offer and acceptance must employ the same medium, etc.

Subsection (1)(b) concerns orders or other offers to buy goods for prompt shipment. Such an offer is to be construed as inviting acceptance by either a promise to ship or by the shipment itself. The promise to ship must be made promptly and not only within a reasonable time, see the discussion supra in Explanatory Notes to Section 1-204. The shipment must likewise be prompt or current. If the goods so shipped are non-conforming, the seller may obviate the effect of the shipment as an acceptance (possibly entailing a liability for breach) by seasonably notifying the buyer that the shipment is offered only as an accommodation to the buyer.

4. Subsection (2) deals with the special case in which the beginning of a requested performance constitutes a reasonable mode of acceptance. In such case the offeree must notify the offeror of his acceptance within a reasonable time; otherwise the offeror may thereafter treat his offer as having lapsed prior to the acceptance. This rule effectuates a modification of the rules set forth in the first Restatement of Contracts. According to Section 45 of that Restatement, giving part of the consideration requested may amount to an acceptance, resulting in a contract binding the offeror. However, a beginning of the actual performance, which must go beyond mere preparations of performance however necessary, is required for that purpose, see Comment a to Section 45 and Comment a to Section 53, Restatement of Contracts. Notification of the offeror is not prescribed unless the offeror has no adequate means of ascertaining with reasonable promptness that the requested performance has been given and the offeree should know this, Restatement of Contracts, Section 56. Hence, Subsection 2-206(2) increases the protection of the offeror in that respect. Whether this will entail a broader construction of the term "beginning of a requested performance" is at present an open question.

Section 2-207. Additional terms in acceptance or confirmation.

1. This section is one of the key provisions in the Code's efforts to modernize the traditional principles governing the formation of contracts. It rejects as commercially undesirable the time-honored rule that a qualified acceptance operates as a rejection of the offer and a counter-offer and replaces it with the more flexible precept that a clear and unconditional acceptance, though coupled with new terms, normally will bind the offeree either to the terms of the offer or to the modified terms according to the particular circumstance.

2. Subsection (1) states the new basic rule that a definite and seasonable expression of acceptance or a written confirmation sent within a reasonable time effectuates an acceptance although it states terms additional to or different from those offered or agreed upon except where the acceptance is expressly conditioned on assent to the additional or different terms. Subsection (1) accordingly envisages two types of situations: One is present where an agreement has been reached either by oral negotiation or informal correspondence, and one or both parties send written confirmations embodying the terms agreed upon and including terms not discussed. The other occurs when there is a formal offer responded to by an acceptance coupled with additional or different terms. In either case a definite acceptance or confirmation operates as an acceptance, despite the addition of new terms, "unless acceptance is expressly made conditional on assent to the additional or different terms."

3. Subsection (2) deals with the effect of the addition of terms with reference to the new terms themselves. The subsection qualifies the inclusion of the new terms as "proposals for addition to the contract", <u>i.e.</u> as an offer containing these new terms. This offer may be accepted by the other party according to the general principles, but the subsection adds some special rules applicable between merchants (as defined in Subsection 2-104(3)). In that case the additional terms will become part of the contract, unless one of three qualifying conditions exist:

   (a) the original offer limits the acceptance to the terms of the offer, or

   (b) the new terms materially alter the contract that has come into existence, or

   (c) the other party (<u>i.e.</u> in the second situation mentioned in Explanatory Note 2, <u>supra</u>, the original offeror) has already notified the party proposing the new terms of his objection thereto or does so within a reasonable time after he receives notice of them.

4. Subsection (3) reiterates the rule stated in Subsection 2-204(1) which declares that conduct by both parties which recognizes the existence of a contract for sale creates such contract. To that extent this subsection--which was added in 1957 and has remained outside the coverage of either the section caption or the Official Comment--adds nothing new. Subsection (3), however, expands the matter also contained in Subsection 2-204(1) in two important respects: In the first place, it provides expressly that a contract is formed although the writings of the parties do not otherwise

establish a contract. The subsection thus removes any doubt on the applicability of the contract by conduct rule even in the setting of Subsections 2-207(1) and (2). Secondly, the subsection clarifies the terms of the contract so concluded by declaring that they consist of those terms on which the writings of the parties agree, together with any supplementary terms supplied by the Code.

It has been agreed by Dean Hawkland that the express conditioning of an acceptance on assent to additional terms made under Subsection 2-207(1) will become ineffectual if the offeree subsequently ships the ordered goods, with the result that the contract so created includes the terms on which there is agreement, and despite any disagreement of the parties in that respect, only supplementary terms supplied by the Code, Hawkland, Transactional Guide to the Uniform Commercial Code, 18, 21 (1964). Whether the courts will follow this analysis remains to be seen.

5. This section may lead to practical difficulties in application as is demonstrated by the first decision rendered under it, Roto-Lith, Ltd. v. F.P. Bartlett, 297 F. 2d. 497 (1st Cir. 1962). That case involved an action for breach of warranty. Buyer, a manufacturer of cellophane bags, purchased emulsion, used as a cellophane adhesive in his manufacturing processes, from defendant. The emulsion failed to adhere and the action resulted. Defendant pleaded disclaimer of all warranties as defense. The negotiations between the parties consisted primarily of a written order by plaintiff for a drum of N-132-C emulsion for use in wet pack vegetable bags and a printed acknowledgment by defendant expressly excluding any and all warranties and including the sentence: "If these terms are not acceptable, buyer must so notify seller at once". The court found specifically that the acknowledgment was received no later than the goods and that plaintiff accepted the goods without protesting the terms of the acknowledgment. The court affirmed a judgment for defendant. It rejected plaintiff's contention that he did not have to protest the disclaimer of the warranties since the exclusion thereof materially altered the contract which was established without this limitation by the acknowledgment. The court opined that the section was "not too happily drafted" and that to construe it in a fashion that "a reply to an offer stating additional conditions unilaterally burdensome upon the offeror is a binding acceptance of the original offer plus simply a proposal for the additional conditions . . . would lead to an absurdity". The decision has evoked uniform and severe criticism in the literature, see especially the comments in 76 Harv. L. Rev. 1481 (1963); 111 U. Pa. L. Rev. 132 (1962); 42 B. U. L. Rev. 373 (1962) and 57 Nw. U. L. Rev. 477 (1962). Actually the court lost sight of the fact that not every "reply" to an

offer operates as an acceptance, but only a "definite expression of acceptance" or a "confirmation". Moreover, even writings of this nature do not constitute an acceptance if the acceptance is expressly made conditional on assent to the additional terms. The court discussed neither the question of whether the printed acknowledgment of seller constituted a written confirmation or definite expression of acceptance within the meaning of Subsection (1) nor the problem of whether the clause in the acknowledgment calling for immediate notification, if the terms of it were not acceptable, made the acceptance expressly conditional on assent to the new terms. All these issues called for judicial clarification. Most of all the court failed to appreciate the significance of Subsection (3). Certainly the case is a good illustration of the problems prompted by the draftsmanship of the section, including the puzzling switch from "additional or different terms" in Subsection (1) to merely "additional terms" in Subsection (2).

Section 2-208. Course of performance or practical construction.

1. Subsections 1-205(3) and (4) regulate the effect of a course of dealing and of a usage of trade on the interpretation of an agreement. A course of dealing is defined as a sequence of conduct previous to a particular transaction. Since a course of performance thus seems to fall outside of Section 1-205 and since, at any rate, the effect of a course of performance calls for some special rules, the framers of the Code have devoted a separate section to a course of performance.

2. Subsection (1) declares that a course of performance, pursued under a contract for sale involving repeated occasions for performance by either party, shall be relevant for the interpretation of the governing agreement if the other party accepted or acquiesced in such course without objection although he had knowledge of the nature of the performance and opportunity to object thereto.

3. Subsection (2), parallel to Subsection 1-205(4), prescribes that express terms, course of performance, course of dealing and usage of trade shall be harmonized, whenever reasonably possible. Otherwise, the subsection establishes a hierarchy between these four sources of interpretation, again parallel to Subsection 1-205(4), but with the qualification that the course of performance in that respect outranks course of dealing and usage of trade.

4. A course of performance, however, being subsequent to the governing agreement, may also indicate a modification or waiver of terms inconsistent with it, to the extent that an oral modification or

waiver is permissible under the circumstances in accordance with the rules of the Code on that subject (Section 2-209). Subsection (3) declares expressly that this possibility is not foreclosed by the hierarchy specified in Subsection (2).

Section 2-209. Modification, rescission and waiver.

1. This section deals with the subjects of modification, rescission and waiver, supplementing Sections 1-106 (estoppel), 1-107 (waiver or renunciation after breach), 2-201(statute of frauds), and 2-106 (termination and cancellation). Modification and rescission within the meaning of this section are agreements, changing the terms of a previous agreement between the same parties or, subject to the limitation of Section 2-720, terminating the effect thereof, respectively.

2. Subsection (1) prescribes that an agreement modifying a contract governed by Article 2 is effective without consideration even if it increases the rights or decreases the duties of only one party.

3. Subsection (2) provides that a signed agreement may effectively require that a modification or rescission must be by a signed writing. Except as between merchants, however, such requirement must be signed separately by the non-merchant party if it is contained in a form supplied by a merchant. The rule in that respect varies from the special signing requirement for firm offers contained in a form supplied by the other party which must be signed even by merchants (Section 2-205).

4. The modification must comply with the statute of frauds of Section 2-201 if the contract as modified is within its coverage.

5. Subsection (4) saves an attempt at modification or rescission which has remained inoperative because of non-compliance with the writing requirements as a waiver, provided the circumstances warrant such conclusion. Conversely, an otherwise valid agreement of modification, especially if made without consideration, may be ineffective if the modification was induced in bad faith or prompted by bad faith (Section 1-203).

6. A waiver affecting an executory portion of the contract may be retracted by notification made within a reasonable time (Section 1-204) and received by the other party (Subsection 1-201(27)) to the effect that strict performance of the term will be required. Under appropriate circumstances, however, the party may be estopped from retracting his waiver (Subsection 2-209(5)).

Section 2-210. Delegation of performance; assignment of rights.

1. This section deals with the question of the entry of a third person into the position of one of the parties to a contractual legal relationship. It is one of the tenets of the law of obligations that the passive side, i.e., the duties, cannot be transferred to a third party without novation and that only contract rights are transferable. The performance of duties, however, may be delegable.

2. Subsection (1) permits delegation of the performance of a duty created by a contract for sale either in conjunction with an assignment of rights or without it, unless the agreement excludes such delegation, or the other party has a substantial interest in personal performance or control by the original promisor. Responsibility for proper performance remains in any case with the party to the contract. Subsection (4) clarifies the proposition that unless the contrary is indicated by the language or the circumstances, an assignment of "the contract", "all my rights under the contract" or an assignment in similar general terms is also a delegation of performance of the assignor's duties under the contract and that acceptance by the assignee constitutes a promise to perform the respective duties which is enforceable by both parties to the contract. Subsection (5) makes it clear that any assignment which delegates performance creates "reasonable grounds for insecurity" within the meaning of Section 2-609, entitling the affected party to demand assurances from the assignee without amounting to an election of remedies. An assignment of all rights as security does not involve a delegation of the performance of the concomitant duties.

3. The remaining parts of the section deal with the assignment of rights in the traditional sense. Subsection (2) declares that the rights of either seller or buyer are assignable unless such assignment materially (a) changes the duty of the other party, or (b) increases the burden or risk imposed upon him by the contract, or (c) impairs his chance of obtaining return performance. Rights that are no longer executory, as the right to damages for breach of the contract as a whole or to payment for the whole performance are assignable even though the agreement bars assignment. A prohibition against assignment of "the contract" bars only a delegation to the assignee of the assignor's performance but leaves the assignability of his executory rights untouched unless the circumstances indicate the contrary.

4. The parts of the section dealing with an assignment of rights do not govern all aspects of the assignment. Such assignment may be regulated further by Article 9 if the assignment is either a sale

or an assignment for security of contract rights, accounts or chattel paper (as defined in Sections 9-105(1)(b) and 9-106) or an assignment for security of general intangibles within the meaning of Article 9 and not a transaction excluded from that article under Section 9-104.

PART 3

General Obligation and Construction of Contract

This part, which contains more sections than any of the other six parts of the Sales Article, deals with a vast array of matters pertaining to the general obligations of either party to a contract for the sale of goods and to the construction of such contract, including the law of warranties, standard commercial terms, and common types of sales.

Section 2-301. General obligation of parties.

1. This section summarizes the fundamental obligations of buyer and seller. Buyer and seller denote the parties to a contract for sale as defined in Subsections 2-103(1)(a) and (d) and Section 2-106. Section 2-301 employs the expression "obligation" as a common denominator for the responsibilities formerly classified as duties or conditions. The differentiation between duties and conditions, made by the former Uniform Sales Act, Sections 11 and 41, Revised Laws of Hawaii 1955, Sections 202-11 and 202-41, is eliminated. Warranties, now divided into three parts (Sections 2-312, 2-313, 2-314), are special individualized aspects of the fundamental obligation of the seller, see also the expression "breach of a warranty or other obligation" in Subsection 2-607(5).

2. The Code now clarifies the extent of the seller's obligation by adding the obligation to transfer to the obligation to deliver which the former Uniform Sales Act, Section 41, Revised Laws of Hawaii 1955, Section 202-41, specified as his sole duty.

3. The obligations stated in this section are enforceable by action (Subsection 1-106(2)) pursuant to the particular provisions of Article 2, the general law of contracts, including equity (Sections 1-103 and 1-201(3) and (11)) and the overriding principles of good faith (Section 1-203 in conjunction with Subsections 1-201(19) and 2-103(1)(b)). This simplification obviates the mostly academic discussions of the nature and scope of the rights and

remedies of either party in particular types of defective performance.

Section 2-302. Unconscionable contract or clause.

1. This section empowers the courts to refuse to lend their arms to the enforcement of an unconscionable contract or clause. The modern amalgamation of law and equity renders it incongruous to confine the withholding of relief in such cases to equitable remedies only. The scope of the court's redress in such cases depends on the extent of the unconscionable content. If the entire agreement is affected, the court may refuse enforcement of the whole contract; if only individual clauses are unconscionable, the court may reject the clauses in toto or strike down their enforceability to the appropriate balance.

2. The test to be applied is whether, in the light of "its commercial setting, purpose and effect", the contract or a clause thereof is, at the time of the agreement, so one-sided and oppressive as to be unconscionable. The court may hear evidence on this issue and determine it "as a matter of law" without a jury.

3. A recent case applying the principles of this section and extending them to a pre-Code contract is Williams v. Walker-Thomas Furniture Company, 350 F. 2d 445 (D. C. Cir. 1965). In that case the sales contract contained a clause which kept an unpaid balance on every item bought then or thereafter until all items, regardless of the time and order of purchase, were paid in full. The appellate court remanded for determination of the issue of unconscionability.

Section 2-303. Allocation or division of risks. Article 2 allocates risk of loss and certain burdens between buyer and purchaser, dependent upon specified circumstances, see e.g., Sections 2-320(2), 2-327(1)(a) and (c) and (2)(b), 2-509(1)(a) and 2-510, usually with the qualification "unless otherwise agreed". This section clarifies the fact that party autonomy in this respect includes division in addition to reallocation of the whole.

Section 2-304. Price payable in money, goods, realty or otherwise. This section deals with contracts in which a transfer and delivery of goods is made or promised for a price not payable wholly in money but in whole or in part in other property. If the price is payable in whole or in part in other goods, each party is a seller of the goods which he bargains away. If the price consists in whole or in part of an interest in realty, only the transfer of the goods and the seller's obligation with reference thereto are governed by Article 2. The section corrects ambiguities of the former Uniform Sales Act, Section 9(2) and (3), Revised Laws of Hawaii 1955, Section 202-9(b) and (c).

Section 2-305. Open price term.

1. Subsection 2-204(3) attributes effectiveness to the intention of the parties to conclude a binding contract even though one or more terms are left open, so long as there is a reasonably certain basis for supplying the missing determinations. Section 2-305 supplements this rule in the cases where the price term is left open and provides a reasonably certain basis for such determination in a variety of situations.

2. In a number of instances, set forth in Subsection (1), the missing price is a reasonable price at the time of the delivery. The subsection lists three sets of contingencies where this standard applies:

   (a) the parties have left the matter completely open, or

   (b) the price is left to subsequent agreement which fails to materialize, or

   (c) the price is to be fixed by a third person on the basis of some tangible criteria to be applied or supplied by a third person, but he fails to act for reasons other than the fault of one of the parties.

3. In other instances the price may be fixed by one of the parties who in such case may not act arbitrarily. Subsections (2) and (3) differentiate two contingencies:

   (a) the contract left the matter expressly to the discretion of one of the parties. In that case he must act in good faith, as defined in Subsections 1-201(19) and 2-103(1)(b);

   (b) the contract left the price to be fixed otherwise than by agreement of the parties, but no determination is made because of the fault of one party. In that case the other party may fix a reasonable price unless he prefers to cancel the contract.

4. Where the parties do not intend to be bound without settlement of the price, --a matter to be determined by the trier of facts--, no contract is concluded unless that condition is fulfilled. In such case the buyer must return any goods already received or, if

he is unable to do so, pay for their reasonable value at the time of delivery. Conversely, the seller must return any money received on account.

5. This section constitutes a modification and expansion of the rules contained in the former Uniform Sales Act, Sections 9(1) and (4) and 10, Revised Laws of Hawaii 1955, Sections 202-9(a) and (d) and 202-10.

Section 2-306. Output, requirements and exclusive dealings.

1. This section deals with the quantity aspects of contracts for the sale of goods. Subsection (1) regulates the construction of contracts in which the quantity is determined by the requirements or the output of one of the parties, while Subsection (2) governs certain quantity aspects of exclusive dealing agreements.

2. Output and requirements contracts do not create obligations for the supply or acceptance of quantities unreasonably disproportionate to either a stated estimate or, in the absence thereof, to any normal or otherwise comparable prior output or requirements.

3. Exclusive dealing arrangements between buyers and sellers create obligations to use best efforts in the supply and the marketing of the goods covered.

4. Contracts of the type covered by Section 2-306 may be affected by the antitrust laws. Requirement and output contracts which contain no unreasonable restraints of trade are valid, Tampa Electric Co. v. Nashville Co., 365 U.S. 320 (1961). Similarly, exclusive dealing contracts are valid unless the commerce affected possesses quantitative substantiality relative to the relevant market, Standard Oil Co. v. United States, 337 U.S. 293, especially 299, footnote 5 (1949). Even where a contract for the sale of goods contains prohibited restraints, the defense of illegality under the antitrust laws of the United States cannot be raised in an action for the price, Kelly v. Kosuga, 358 U.S. 516 (1959). Although Subsection 2-306(2) refers specifically to "lawful" agreements of the exclusive dealing type, it cannot be assumed that the framers of the Code meant to create a defense of illegality under the federal antitrust laws as a matter of Code law, rather than merely to indicate deference to the bounds of the governing federal law.

Section 2-307. Delivery in single lot or several lots.

1. This section is the first of three sections dealing with modalities (severability, place and time) of delivery. According to this sec-

tion, delivery in single lot is required unless otherwise agreed; delivery in several lots, however, may be made if under the circumstances, it is not commercially feasible to accomplish or accept single lot delivery.

2. The required mode of delivery affects the time for payment. Where a single delivery is apposite, payment is only due upon compliance with that requirement. Where delivery in several lots is in order, payment may be demanded for each lot if the price is capable of apportionment. Other aspects of the time and place of payment are governed by Sections 2-310 and 2-513.

Section 2-308. Absence of specified place for delivery.

1. If there is no agreement to the contrary, the proper place for delivery of goods is, in general, the seller's place of business or, in the absence thereof, his residence. In the case of identified goods which at the time of the sales negotiations are known to the parties to be at some other place, the proper place for delivery is that place. These rules, however, are displaced by the special rules of Section 2-504 in case of delivery by carrier, authorized or required by the agreement.

2. Documents of title may be delivered through customary banking channels.

3. The rules stated in Explanatory Note 1 are in accord with those of the former Uniform Sales Act, Section 43, Revised Laws of Hawaii 1955, Section 202-43.

Section 2-309. Absence of specific time provisions; notice of termination.

1. This section deals with the time aspects of contracts for the sale of goods, namely, time of performance and duration of the contract.

2. Subsection (1) declares that, unless the parties have agreed upon different terms, shipment or delivery must be made within a reasonable time, as defined in Subsection 1-204(2). The time for payment depends on the time for delivery (Sections 2-307, 2-310 and 2-513) and therefore is indirectly likewise subject to Subsection (1), unless the parties have agreed otherwise. Other actions under the contract are governed by the same rule.

3. Subsections (2) and (3) specify rules for the termination (as defined in Subsection 2-106(3)), of contracts for the sale of

goods. Contracts concluded for an indefinite duration and calling for successive performance are binding for a reasonable period but, with that qualification, may be terminated by either party at any time. Such termination and any other termination not depending upon the happening of an agreed event requires reasonable notification and receipt thereof (as defined in Subsections 1-201(26) and (27)). The Code's policy against unconscionable agreements (Section 2-302) is expressly reiterated with respect to dispensations from notification.

Section 2-310. Open time for payment or running of credit; authority to ship under reservation.

1. This section is the principal provision of the Sales Article regulating details of time and place of payment in the absence of specific agreement between the parties. Related matters are contained in Sections 2-307, 2-505, 2-507(1), 2-511(1) and 2-513 which should be consulted with this section. This section contains three rules that apply to various forms of contracts for the sale of goods which do not provide for shipment on credit. Subsection (1) sets forth a general rule while Subsections (2) and (3) regulate sales where delivery is made by way of documents of title.

2. According to the general rule, the buyer must make payment at the time and place where he is to receive the goods, as defined in Subsection 2-103(1)(c), whether or not the place of receipt is the place of delivery. In the cases within the purview of this rule, the receipt of the goods will usually be subsequent to a tender of proper delivery, see Sections 2-307, 2-507(1) and 2-511(1), and may also be preceded by an inspection by the buyer (Section 2-513).

3. Subsection (b) pertains to the special case where the seller is authorized and does ship the goods "under reservation". In such case the buyer is entitled to inspection after their arrival, except where such inspection is excluded by the terms of the contract, and must make payment upon tender of the documents of title only after inspection. The seller may "ship under reservation" whenever he is required or authorized to send the goods to the buyer (Sections 2-310(b) and 2-504).

4. Subsection (c) states the rules as to time and place of payment for the cases where delivery is authorized and made by way of documents of title otherwise than by shipment under reservation. In these cases payment is due at the time and place at which the buyer is to obtain delivery of the documents, regardless of where the goods are to be received.

5. Subsection (d) applies to sales which require or authorize the seller to ship goods on credit. In such cases the credit period runs from the time of shipment, but the start of the running of the credit period will be delayed by delaying the dispatch of the invoice or by post-dating the same.

6. The provisions of the former Uniform Sales Act, Sections 42 (delivery and payment are concurrent conditions) and 47(2) (right to examine the goods), Revised Laws of Hawaii 1955, Sections 202-42 and 202-47(b), are modified and expanded substantially and completely rephrased by the rules of the Code.

Section 2-311. Options and cooperation respecting performance.

1. This section implements the broad policy of Subsection 2-204(3) and sustains the validity of a contract for sale intended to be binding despite the fact that particulars of performance are left to the discretion of either party or left open entirely.

2. Where one party is entitled to specify particulars of performance by reason either of the terms of the agreement or of the supplementary rules of the Code, the party's action must be in good faith (Subsections 1-201(19) and 2-103(1)(b)) and be commercially reasonable.

3. In the absence of other agreement on these matters, specifications relating to assortment of the goods are at the buyer's option while shipping arrangements, except in sales F.O.B. vessel, are left to the seller.

4. Except under the special circumstances set forth in Section 2-614, if a party fails to make seasonably a specification which would materially affect the other party's performance or to cooperate seasonably in the agreed performance where such cooperation is necessary, the other party, in addition to other remedies, may either delay his performance until the specification or cooperation is forthcoming or proceed to perform in any reasonable manner. He also may treat such failure as a breach.

Section 2-312. Warranty of title and against infringement; buyer's obligation against infringement.

1. Section 2-312 is the opening section in the Code's seven sections on the subject of warranties. Mainly for reasons of convenient draftsmanship, the Code abandons the traditional bipartition into express and implied warranties and classifies the subject into

three categories which may be designated (in analogy to the law of covenants) as statutory warranties (Section 2-312), express warranties (Section 2-313) and implied warranties (Sections 2-314 and 2-315).

2. Statutory warranties are those which result from the fundamental obligation of the seller "to transfer" (Section 2-301). The Code establishes two general warranties of this type:

   (a) good title and rightfulness of the transfer,

   (b) freedom from security interests and other liens or encumbrances, not known to the buyer at the time of the contract.

3. The two general statutory warranties may be excluded or modified only by <u>specific</u> language to that effect or by circumstances which give the buyer reason to know that the seller purports to sell only such right or title as he or a third person may have. The second alternative is important in respect to execution or foreclosure sales, etc., where the special character is obvious to the buyer.

4. The warranty of title extends not only to the <u>effectiveness</u> of the transfer but also to its <u>rightfulness</u> (Subsection (1)(a)). The seller thus breaches this warranty even if his transfer is effective by reason of the rules protecting bona fide purchasers or buyers in ordinary course of business (Section 2-403). The reason for the broad scope of the warranty is the Code's solicitude for the buyer's need of protection against lawsuits, see Official Comment to Section 2-312, Point 1. The seller may cure the breach by timely negotiation and settlement with the former true owner. It is not clear, however, whether the vouching-in provisions of Subsection 2-607(5) apply to an action by the purported owner against the buyer since a replevin or conversion action does not seem to be a suit for <u>breach of an obligation</u> for which the seller is answerable.

5. In the case of a merchant seller regularly dealing in goods of the kind, an additional warranty is imposed, protecting the buyer against claims for infringement or the like. This warranty is subject to disclaimer by agreement and is mirrored by the liability of a buyer who furnishes specifications, for indemnification of the seller in case of claims arising out of compliance with the specifications.

6. The Official Comment, Point 2 calls special attention to the fact that the Code's provisions with respect to notice of breach after acceptance (Subsection 2-607(3)(a)) and to the accrual of causes of action for breach and the limitation period applicable thereto

(Subsection 2-725(2)) apply to a breach of the statutory warranties. The pertinent date governing accrual of an action for breach is that of the tender of delivery.

7. The Code suppresses as superfluous the special warranty of quiet possession imposed by the former Uniform Sales Act, Section 13(2), Revised Laws of Hawaii 1955, Section 202-13(b) and introduces the new warranty against liability for infringement discussed <u>supra</u> in Explanatory Note 5.

<u>Section 2-313. Express warranties by affirmation, promise, description, sample</u>.

1. This section deals with express warranties of conformity made by affirmation, promise, description or sample. In all cases it is necessary that the representation has been made part of the basis of the bargain. It is not necessary that the seller has a specific intention to make a warranty.

2. An affirmation creating an express warranty must be one of a fact relating to the goods. An affirmation merely of the value of the goods or a statement purporting to be not more than the seller's opinion or commendation of the goods does not suffice to create a warranty.

3. The warranty of conformity to a description is created by <u>any</u> description in whatever form if it is made part of the basis of the bargain. Such warranty is not disclaimed by a general disclaimer of "all warranties, express or implied" since, in general, such construction would be unreasonable (Subsection 2-316(1) and Official Comment, Point 4 to Section 2-313).

4. Warranties by model or sample follow the general rules. A model or sample exhibited during the negotiations for merchandise not at hand, however, may be shown simply as illustration rather than as a true model or sample.

<u>Section 2-314. Implied warranty: merchantability; usage of trade</u>.

1. This section deals with the implied warranty of merchantability and with other implied warranties that may arise from a course of dealing or usage of trade. The implied warranty of fitness for a particular purpose is treated in a separate section.

2. Unless excluded or modified pursuant to the rules of Section 2-316, a contract for sale by a seller who is a merchant with respect to goods of that kind implies a warranty that the goods shall be merchantable. Serving food or drink to be consumed either on the premises or elsewhere is a sale for purposes of the creation of the implied warranty of merchantability if the serving is for value. Since this implied warranty arises only if the seller is a merchant with respect to goods of that kind, it will also be necessary that the serving of food or drink is done under circumstances which constitute the seller a merchant within the meaning of Subsection 2-104(1). A cafeteria for employees will make an organization a merchant to that extent even if it otherwise is not engaged in any commercial activity. Although the warranty of merchantability is imposed only with respect to sales of goods, it may be extended by analogy to other contracts relating to goods, such as bailments for hire of machinery and other equipment, see the Official Comment to Section 2-313, Point 2.

In contrast to the former statutory law, as contained in the former Uniform Sales Act, Section 15(2), Revised Laws of Hawaii 1955, Section 202-15(b), which left the concept of merchantability undefined, the Code in Subsection 2-314(2) sets forth a minimum catalogue of six attributes which must be possessed by goods of different varieties to be merchantable. The list is not exclusive and permits other characteristics to be added by case law or usage of trade.

Without discussing in detail each of the six particulars of their interrelation, it should be noted that in the case of fungible goods, as defined in Subsection 1-201(17), it is not enough that the goods are of the lowest quality that "pass without objection in the trade under the contract description", as required under Subsection (2)(a), but that they must be "of fair average quality within the description", Subsection (2)(b). A general and fundamental element of merchantability consists in the requirement covered in Subsection (2)(c) that the goods "are fit for the ordinary purposes for which such goods are used".

The two final constituents of the statutory list relate to containers and packaging. Subsection (2)(e) envisages cases where the nature of the goods or the terms of the contract require containers, packaging and labels. In such cases the warranty of merchantability includes the adequacy of these auxiliary items.

Conversely Subsection (2)(f) applies whenever there is a label or container on which representations are made even though the contract did not call for the label or the representation. In such cases the seller warrants conformity of the goods to the promises and affirmations. Apparently, this obligation exists even in cases where the seller is not a manufacturer but only a commercial distributor of such goods, see Explanatory Note 3, unless in such cases the warranty of conformity is considered as excluded by usage of trade (Subsection 2-316(3)(c)).

3. The warranty of merchantability is imposed upon any merchant dealer in the respective goods, whether or not he is a manufacturer or grower. The deletion of the specific caveat to that effect, contained in the former Uniform Sales Act, Section 15(2), Revised Laws of Hawaii 1955, Section 202-15(b), is not meant to change the law in that respect. The warranty of merchantability, especially in the aspect of fitness for the ordinary purposes for which such goods are used, protects any buyer regardless of whether he purchases the goods for his own use or consumption or for resale. The Code deletes the restriction of the implied warranty of merchantability to purchases by description contained in the former Uniform Sales Act, Section 15(2), Revised Laws of Hawaii 1955, Section 202-15(b), and extends it to all sales. Consequently it attaches to the purchase of single items chosen directly. Hence the sale of a flammable hula skirt would now constitute a breach of the warranty of merchantability, in addition to a breach of a warranty of fitness for a particular purpose, as was held in Brown v. Chapman, 304 F. 2d. 149 (9. Cir. 1962), affirming Chapman v. Brown, 198 F. Supp. 78 (D. Hawaii 1961) although the lower court intimated that the purchase in the case at bar could have been found to be one by description, 198 F. Supp. 78 at 115 ftn. 70.

4. Subsection (3) declares specifically that other implied warranties may arise from a course of dealing or usage of trade, thus negativing in advance any possible "freezing effect" of the Code in this area.

Section 2-315. Implied warranty: fitness for particular purpose.

1. This section retains the implied warranty of fitness for a particular purpose arising in cases where the seller at the time of contracting has reason to know that the goods are required for such purpose and that the buyer relies on the seller's skill or judgment to select or furnish suitable items.

2. This section applies to a warranty of fitness for a particular purpose as distinguished from a warranty of fitness for ordinary purposes which is included in the warranty of merchantability (Subsection 2-314(2)(c)).

3. This section deletes the ambiguous provision, contained in the former Uniform Sales Act, Section 15(4), Revised Laws of Hawaii 1955, Section 202-15(d), which excluded an implied warranty of fitness for a particular purpose in contracts for the sale of a specified article under its patent or other trade name. Previous case law had limited the application of this subsection to cases where the buyer had bought an article which is patented or sold under a trade name in reliance on that fact alone and not in reliance on the seller's skill or judgment in the selection of goods suitable for an indicated particular purpose. Hawaiian decisions to that effect are <u>Hurd-Pohlmann Co. v. Sugita</u>, 32 Haw. 577 (1932) and <u>Moses Stationery Co. v. Shindo</u>, 32 Haw. 690 (1933). The Code approves and codifies this rule.

4. The facts giving rise to the implied warranty of fitness for a particular purpose may be proven unless the warranty is excluded or modified in compliance with Section 2-316. The mere fact that it is not included in confirmatory memoranda or in a written formalization of the agreement does not exclude such proof (Section 2-202). It is necessary that the exclusion be by a writing and conspicuous (Subsection 2-316(2)). The Code reaffirms and, perhaps, extends the rules to that effect laid down in <u>Moses Stationery Co. v. Shindo</u>, 32 Haw. 690 (1933). In that case, defendant, in an action for the balance of the purchase price, had bought a commercial ice cream freezer under its patent designation. He claimed that the machine was not suitable for his purposes and that he had informed plaintiff that he needed a machine capable of a particular performance and offered evidence to that effect. The written agreement did not exclude any implied warranty. The Court held that under these circumstances the parol evidence rule did not bar defendant's offered proof.

<u>Section 2-316. Exclusion or modification of warranties</u>.

1. This section manifests the solicitude of the Code for the buyer and its policy of protecting him against all-inclusive disclaimer clauses in sellers' forms without adequate warning as to their scope.

2. Subsection (1) deals with the negation or limitation of express warranties. The Code calls for accommodation of words and conduct relevant to the creation of an express warranty and seemingly conflicting words or conduct tending to negate or limit warranty, wherever such construction is reasonable. Correspondingly, negation or limitation is inoperative to the extent that such construction is unreasonable, except where reliance on words or conduct creating express warranties is excluded by the parol evidence rule as stated in Section 2-202.

3. Subsections (2) and (3) deal with the exclusion and modification of implied warranties, in particular the implied warranty of merchantability and the implied warranty of fitness for a particular purpose. It should be recalled that exclusion or modification of the statutory warranties is separately regulated in Subsection 2-312(2).

   (a) Exclusion or modification of the implied warranty of merchantability <u>or any part of it</u> requires language which mentions merchantability and, if in a writing, is of a conspicuous character.

   (b) Exclusion or modification of "any implied warranty of fitness" must be in writing and conspicuous. If a disclaimer is made in this form, it is operative even though it excludes "all implied warranties of fitness". Apparently, however, such disclaimer is not sufficient to exclude the implied warranty of "fitness for the ordinary purposes for which such goods are used" (Subsection 2-314(2)(c)) arising from sales by merchant sellers of that type of goods, since a disclaimer of that kind affects "a part of merchantability" and therefore falls under the first part of the first sentence of Subsection (2). If it is desired to extend a disclaimer to this warranty of fitness, its text must specifically mention the fitness aspect of merchantability.

4. Subsection (3) recognizes three sets of rules which override the requirements for exclusion or modification of implied warranties, specified in Subsection (2), in view of the fact that the circumstances envisaged by these rules suffice to bring it to the buyer's attention that no implied warranties are made or that certain implied warranties are disclaimed:

   (a) All implied warranties, whether arising under Sections 2-314 or 2-315, may be excluded by qualification of the sale in terms such as "as is", "without fault" or language of similar import which renders it plain to a buyer that no implied warranties exist.

   (b) Examination of the goods, or of the sample or model, made as fully as desired prior to the conclusion of the contract, or failure to utilize an offered opportunity for such examination, excludes an implied warranty against defects which ought to have been discovered in that fashion.

   (c) Existence of a course of dealing, course of performance or usage of trade can modify or exclude an implied warranty.

5. The rules relating to the modification or exclusion of implied warranties do not govern the question of limitation of remedy which is controlled by Sections 2-718 and 2-719.

6. Most of the rules stated in this article are new. The former Uniform Sales Act, Section 15(3), Revised Laws of Hawaii 1955, Section 202-15(c), however, provided that if the buyer has examined the goods, no implied warranty exists as regards defects which such examination should have revealed.

Section 2-317. Cumulation and conflict of warranties express or implied.

1. This section states the applicable rules for the solution of possible conflicts between several warranties, whether express or implied. The principal rule calls for cumulative and consistent construction whenever feasible. If such construction is unreasonable, the intention of the parties determines which warranty is dominant. For the ascertainment of the intention, the section sets forth three auxiliary rules of construction. Two of them concern the hierarchy between exact or technical specifications, samples or models and general language of description. The third rule gives priority to an express warranty over inconsistent implied warranties other than an implied warranty of fitness for a particular purpose. The latter warranty displaces all other warranties inconsistent therewith, but, of course, there is no room for the application of this rule where the buyer does not rely on the seller's skill or judgment in selecting suitable goods, see Official Comment to Section 2-315, Point 2.

2. Section 2-317 is a consolidation and revision of the rules on cumulation of warranties contained in the former Uniform Sales Act, Sections 14 and 15(6), Revised Laws of Hawaii 1955, Sections 202-14 and 202-15(f). The rule of Section 202-15(f) which gives priority to an express warranty over implied warranties inconsistent therewith was discussed by the Supreme Court of Hawaii in Moses Stationery Co. v. Shindo. 32 Haw. 690, at 697 (1933). "Subsection 6 of Section 15 . . . also means that if the express warranty is inconsistent there is no implied warranty. In other words, the statute leaves it open to the parties to expressly agree, each with the other, that the warranty implied by law shall not exist in their case; but it does say with equal clearness that when the parties do not thus waive this provision the implication of a warranty of fitness for a particular purpose does exist." The Code strengthens this position by providing that an inconsistent express warranty must yield to an implied warranty of fitness for a particular purpose which can be limited only by a conspicuous writing (Subsection 2-316(2)).

Section 2-318. Third party beneficiaries of warranties express or implied.

1. This section rejects the unqualified privity doctrine and provides for a mandatory extension of express or implied warranties by the seller to any natural person who is in the family or household of the buyer, or is a guest in his home, if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured in person by breach of the warranty.

2. According to the Official Comment to this section, Points 1 and 2, the thrust of this provision is to extend the implied warranty of merchantability, especially that of fitness for the ordinary purposes for which the goods are used, rather than the warranty of fitness for a particular purpose, to the class of persons enumerated in the section, with the implicit consequence that they are entitled to a direct action against the seller.

3. This section has been criticized in some quarters as restricting the benefits of express and implied warranties to too narrow a class. Perhaps to forestall attacks on that score, the Official Comment to this section, Point 3, states explicitly: "Beyond this, the section is neutral and is not intended to enlarge or restrict the developing case law on whether the seller's warranties, given to his buyer who resells, extend to <u>other persons in the distributive chain</u>."

   If this statement implies that this is the <u>only</u> door that is left open, it leads to the uncomfortable result that the courts will endeavor to fit persons, who normally would not be so considered, into the distributive chain and conversely, leave other persons outside although they deserve protection under modern enlightened standards. The following cases may serve to illustrate this point.

   In <u>Henningsen v. Bloomfield Motors, Inc.</u>, 32 N.J. 358, 161 A. 2d. 69, 75 A.L.R. 2d. 1 (1960), a case decided under the former Uniform Sales Act, the buyer bought a car as a Mother's Day present for his wife, communicating this intention to the dealer. The wife was injured in an accident which was caused by a defect in the steering mechanism. In allowing recovery by the wife both against the manufacturer and the dealer for breach of implied warranty, the court stated (161 A. 2d. 69 at p. 100): ". . . it is our opinion that an implied warranty of merchantability chargeable to either an automobile manufacturer or a dealer extends to the purchaser of the car, members of his family, and to other persons occupying or using it with his consent. It would be wholly opposed to reality to say that use by such persons is not within the anticipation of parties to such a warranty of reasonable suitability of an automobile for ordinary highway operation. Those persons must be considered <u>within the distributive chain</u>."

In <u>Yentzer v. Taylor Wine Company</u>, 414 Pa. 272, 199 A. 2d. 463 (1964), a case decided under the Code, plaintiff, a hotel manager, purchased four bottles of champagne in the state liquor store on behalf of his employer. The wine was intended for use and consumption by the guests of the hotel. While plaintiff and other employees were preparing to serve the wine, a cap from one of the bottles suddenly popped out and hit plaintiff in the eye, causing serious injury. Plaintiff brought an action against the manufacturer of the wine for breach of the warranties of merchantability. The court permitted recovery on that ground, holding that the plaintiff was in the distributive chain. In distinguishing the previous case of <u>Hochgertel v. Canada Dry Corp.</u>, 409 Pa. 610, 187 A. 2d. 575 (1963), in which the court had held that an employee of the buyer is not within the purview of Section 2-318 and therefore not entitled to recover in the absence of negligence, the court stated (199 A. 2d. 463 at p. 464): "In Hochgertel we . . . recognized that we . . . now permit . . . the extension of the warranty of merchantability to persons <u>within the distributive chain</u>. While this statement in Hochgertel specifically referred to employer sub-purchasers, we did not foreclose the inclusion of the actual purchaser even though he be an employee of the party to whom title to the product passed. 'Buyer' is defined in Section 2-103 of the Code . . . as 'a person who buys or contracts to buy.' Plaintiff is clearly a buyer within this definition and he is therefore definitely in the distributive chain. Were he an employee who had not 'contracted to buy' the product, Hochgertel would control."

While the Official Comment speaks of the distributive chain only in conjunction with a buyer who <u>resells</u>, it probably would not do violence to the alleged "neutrality" of the Code to extend the benefits of Section 2-318 to disclosed donees, even where they are not "in the family" of the buyer. Beyond this point, however, the area left open by the Official Comment can hardly be extended. To differentiate between employees who, by coincidence, were involved in the buying activities and those who were not seems highly artificial. The case of casual borrowers, even though related to the buyer, as the injured niece in the ignited hula skirt case, <u>Brown v. Chapman</u>, 304 F. 2d. 149 (9. Cir. 1962), affirming <u>Chapman v. Brown</u>, 198 F. Supp. 78 (D. Haw. 1961) may also present legitimate doubts.

Two approaches seem to be acceptable. One is the solution advocated by tort experts and accepted by the California and Illinois courts, <u>viz.</u> as well as the courts of some other jurisdictions, that liability for personal injuries suffered as a result of defects in goods by persons who are expected to be in contact with them in the course of their normal use, including resale and preparation for consumption, is a matter independent of, although overlapping with, the warranty of merchantability and therefore not within the purview of the Code at all. The other approach is the one adopted by the courts in the hula skirt case, in relation to the Uniform Sales Act, a clear recognition of the fact that the Code only specifies a minimum scope of liability on warranties, leaving the courts free to add thereto, in all respects, to third party beneficiaries, even at the price of uniformity. Which of the two avenues is preferable seems to be debatable, see the discussion by Shanker, Strict Tort Theory of Products Liability and the Uniform Commercial Code: A Commentary on Jurisprudential Eclipses, Pigeonholes and Communication Barriers, 17 Western Res. L. Rev. 5 (1965). Certainly the basic policy considerations should be the same regardless which road is selected. Incidental differences, if any, such as the period of the statute of limitations, provability and dischargeability in bankruptcy etc. should be minimized whenever possible. Even within the confines of the statutory language, the phrases "person . . . in the family" and "injured in person" should receive a liberal construction. Again it seems artificial to differentiate between liability on the warranty and liability in tort, in the latter respect, especially when persons other than the immediate buyer are involved, cf. Seely v. White Motor Co. 63 Cal. 2d. 9, 403 P. 2d. 145, 45 Cal. Rptr. 17 (1965), commented in 52 Va. L. Rev. 509 (1966).

It should be noted that it is by no means clear what components of damages may be recovered by persons who belong to the class of third party beneficiaries envisaged by Section 2-318 and who are "injured in person". Are they entitled to include property damage under the rule of Subsection 2-715(2)(b), or does Section 2-318 limit Subsection 2-715(2)(b) and exclude property damage components where warranty is broken vis-a-vis persons other than the buyer?

The Permanent Editorial Board in 1966 recommended three forms of optional amendments of Section 2-318, Report No. 3 of the Permanent Editorial Board, at p. 13. Alternative C corresponds most closely to the position taken in the Explanatory Notes and is recommended for adoption in this State.

4. Note that the notice requirement of Section 2-607 does not apply to third party beneficiary plaintiffs since they have not accepted the goods within the meaning of Article 2, see Official Comment to Section 2-607, Point 5. The discussion of the notice requirements which were deemed to be necessary by the U.S. District Court for the District of Hawaii in Chapman v. Brown, 198 F. Supp. 78, at 82 and 83, therefore, is no longer applicable.

5. Although the Official Comment, Point 1 states that the invalidity of an attempted exclusion or limitation of this section does not preclude a seller from excluding or limiting a warranty which might otherwise arise in connection with the sale, an exclusion of the warranty of defects causing personal injury may be held to be invalid as unconscionable, under Section 2-302. Certainly it should not make any difference in that respect whether the "contract", the "tort" or the "statutory obligation" label is employed, see also the discussion by Shanker, op. cit. supra, at p. 43; Comment, 52 Va. L. Rev. 509, at 519-521 (1966).

Section 2-319. F.O.B. and F.A.S. terms.

1. This section and the following five sections deal with the effects of certain commercial terms used in relation to sales where the buyer is not to take possession of the goods at the seller's place of business (cf. Section 2-308) but in which the contract envisages transportation of the goods to some other place. Sales which involve such transportation are customarily classified into two main categories: destination sales and shipment sales. In sales falling in the first class, the seller bears the full responsibility for transferring the goods to the specified place; in sales falling in the second class, the seller is responsible for proper shipment of the goods. The general rules governing delivery in destination sales are contained in Section 2-503, those applying to shipment sales in Section 2-504. Sections 2-319 to 2-324 contain rules dealing with the effect of customary terms relating to the transportation aspects of destination or shipment sales.

2. Subsection (1) provides for rules governing the clause "F.O.B. at a named place", either the place of shipment or the place of destination, and declares that it must be construed as a delivery term, rather than a price term, even though used only in connection with the stated price.

   If the term is "F.O.B. place of shipment", the seller must at that place ship the goods as required in Section 2-504 and bear the expense and risk of placing them into the hands of the carrier. If the term is "F.O.B. place of destination", the seller bears the expense and the risk of the transport to that place and must tender delivery there as required in Section 2-503.

   If in either case the term F.O.B. vessel, car or other vehicle is used, the seller, in addition, must, at his own expense and risk, load the goods on board. If the term is "F.O.B. vessel", the buyer must seasonably name the ship and, in the case of overseas shipment, the seller must procure a negotiable bill of lading stating that the goods have been loaded on board (Subsection (1)(c) in conjunction with Subsection 3 of this Section and Subsections 2-311(3) and 2-323(1)).

3. Subsection (2) deals with the effects of a clause "F.A.S. vessel at a named port". That clause is likewise declared to be a delivery term rather than a price term and to entail the obligation of the seller to deliver the goods alongside the vessel in the manner usual at that port or on a dock designated and provided by the buyer and to obtain and tender a dock receipt entitling the holder to subsequent exchange against a bill of lading, see Official Comment to Section 1-201, Point 15.

4. Subsection (3) imposes upon the buyer the duty of seasonable cooperation in the cases falling under this section where instructions or other information from him are needed. If such instructions and information are not forthcoming seasonably, the seller may assert his rights under Subsection 2-311(3) and, in addition, proceed with all reasonable preparatory moves of the goods.

5. Under the terms F.O.B. vessel or F.A.S. vessel, the buyer must make payment against tender of the required documents. Substituted delivery of the goods may neither be tendered or demanded.

Section 2-320. C.I.F. and C. & F. terms.

1. This section deals with the import of the terms C.I.F. and C. & F. It specifies the meaning of these terms, as expressing the price as a lump sum including cost of the goods, insurance and freight to the named destination in the case of C.I.F. and cost of the goods and freight to the named destination in the case of C. & F., and sets forth the various rules flowing from the principle that, unless otherwise agreed, C.I.F. and C. & F. are to be construed not as price terms but as delivery terms in shipment rather than destination contracts.

2. Since in shipment contracts the buyer ordinarily bears the risk of loss subsequent to the shipment, the Code enumerates the shipment duties of the seller under the indicated terms in a catalogue containing five requirements for C.I.F. contracts and four requirements (which to that extent are identical with those under C.I.F. contracts) in C. & F. contracts.

Under C.I.F. and C. & F. contracts the seller must at his own expense and risk:

(a) put the goods into the possession of a carrier at the port of shipment and obtain a negotiable bill or bills of lading, with the content specified in Subsection 2-323(1), covering the entire transportation to the named destination;

(b) load the goods and obtain a receipt from the carrier showing that the freight has been paid or provided for;

(c) prepare an invoice of the goods and procure any other documents required to effect shipment or to comply with the contract (document apparently used in the broad sense of Subsection 5-103(1)(b)); and

(d) forward and tender with commercial promptness all the documents in due form and with any indorsement necessary to perfect the buyer's rights.

In the case of a C.I.F. contract the seller must, in addition, obtain a policy or certificate of insurance of a kind and on terms current at the time and place of shipment, the valuation of the goods likewise to be made as of that time and locality. The seller must add customary war risk insurance but may add the amount of the premium to the price.

3. Subsection (4) requires the buyer to make payment upon tender of the needed documents and excludes tender or demand of the goods in substitution for the documents. In that respect the rules applying to C.I.F. and C. & F. terms are identical with those for F.O.B. and F.A.S. terms.

4. Like Section 2-319 this section pertains to a newly codified area of the law, designed to settle and harmonize prior decisional law.

Section 2-321. C.I.F. or C. & F.: "net landed weights"; "payment on arrival"; warranty of condition on arrival.

1. This section deals with certain standard variations of C.I.F. or C. & F. contracts which leave the basic regime of these arrangements untouched. Certain clauses like "net landed weights", "delivered weights", or "out turn" quantity or quality impose upon the seller the risk of ordinary shrinkage or deterioration in transportation but do not affect the time and place of identification to the contract, (Subsection 2-501(1)(b) in conjunction with Subsection 2-105(2)), delivery, or the passing of the risk of loss (Section 2-509). The use of such clauses, however, imposes a duty upon the seller to reasonably estimate the price which must be paid upon tender of the documents called for by the contract, subject to a final adjustment to be made "with commercial promptness", a term stricter than "seasonably" (Section 1-204).

2. If a C.I.F. or C. & F. contract provides for "payment on or after arrival", the seller must permit a preliminary inspection prior to payment. In case of loss of the goods, delivery of the documents and payment must be made at the time fixed for arrival of the goods.

<u>Section 2-322. Delivery "ex-ship"</u>. This section regulates the import of the clause delivery "ex-ship". It denotes a species of destination sale and requires delivery from a ship in the port of destination at a place where cargo of that kind is usually discharged. The risk of loss does not pass to the buyer until the goods leave the ship's tackle or are otherwise properly unloaded. The seller is not required to tender a bill of lading, but he must furnish the buyer with a direction to the carrier to deliver the goods and discharge all liens for freight, etc.

<u>Section 2-323. Form of bill of lading required in overseas shipment; "overseas"</u>.

1. This section, which is newly codified law without statutory precedent, deals with the bill of lading aspects of contracts contemplating overseas shipment and containing C.I.F., C. & F., or F.O.B. vessel clauses.

2. Subsection (1) declares that contracts of this type call for procurement of negotiable bill of lading, stating that the goods have been loaded on board or, in the case of C.I.F. or C. & F. contracts, received for shipment. In C.I.F. and C. & F. shipment cases, accordingly, the Code recognizes the so-called "American rule" which is satisfied with bills of lading acknowledging receipt of the goods for shipment.

3. Subsection (2) envisages cases within the purview of this section where the bill of lading has been issued in a set of parts. If the documents are sent from abroad, only one part need be tendered, otherwise the buyer may demand tender of a full set. If the governing agreement requires tender of a full set, even though transmissal from abroad in an overseas shipment is involved, tender of a single part is nevertheless acceptable as between the parties if the improper delivery is cured pursuant to Section 2-508, and the person tendering the part may demand payment upon furnishing an indemnity.

4. "Overseas", as related to shipment by water or air, signifies that by usage of trade or agreement it is subject to the commercial, financing or shipment practices commonly employed in international deep water commerce.

Section 2-324. "No arrival, no sale" term.

1. This section deals with the commercial significance of the "no arrival, no sale" clause. It denotes a particular variety of overseas destination sales. Like all destination sales, it leaves the risk of loss during the transport upon the seller, but it relieves him of liability for non-delivery unless he has caused the non-arrival. The seller must properly ship conforming goods, and if they arrive, he must tender them. If the goods have lost their conformity to the contract during the trip, are lost in part or arrive after the agreed time, the buyer may proceed as if there had been casualty to identified goods (Section 2-613).

2. This section is newly codified law without statutory precedent.

Section 2-325. "Letter of credit" term; "confirmed credit".

1. This section, likewise without statutory precedent deals with the construction of contracts for the sale of goods calling for a "letter of credit" or "confirmed credit" on the part of the buyer. Letter of credit in this context means an irrevocable credit issued by a financing agency of good repute, and in overseas sales, of good international repute. Confirmed credit means that credit issued by a financing agency which does not do business in the seller's financial market, is directly guaranteed by a financing agency of good repute which does operate in such market.

2. Failure of the buyer seasonably to furnish the stipulated letter of credit is a breach. Delivery of a proper letter of credit suspends the buyer's obligation to pay. If the letter of credit is dishonored, the buyer's duty to pay is reinstated.

Section 2-326. Sale on approval and sale or return; consignment sales and rights of creditors.

1. This and the following section deal with the creditors' remedies aspects and the interparty incidents of "sales on approval" and "sale or return" agreements. The sections proceed on the premise that these two types of transactions, although both permit the return of delivered goods despite their conformity to the contract and both partake of a certain element of contingency, are nevertheless clearly differentiable _inter sese_ and possess distinct areas of normal applicability. Moreover, both are to be distinguished from other types of arrangements with which they are frequently confused.

2. Subsection (1) specifies a rule of construction for the determination of whether an agreement for the sale of goods permitting return of the delivered goods even though they conform to the contract is to be treated as a "sale on approval" or "sale or return" contract. According to this subsection, such an agreement is a "sale on approval" if the goods are delivered primarily for use, and a "sale or return" if the goods are delivered primarily for resale. The parties may, of course, agree otherwise.

3. Vis-a-vis creditors the difference between the two types of arrangements governed by this section lies in the element that goods held on approval are not subject to the claims of the buyer's creditors until acceptance; while goods held on sale or return are subject to such claims so long as they are in the buyer's possession. Unfortunately, the Code does not attach any precise significance to the phrase "subject to such [i.e. the buyer's creditors'] claims while in the buyer's possession." The most rational interpretation of this clause would warrant the conclusion that general creditors may obtain a lien by judicial process, such as levy of an attachment or execution on the goods while they are in the buyer's possession and that a subsequent return of the goods, if possible, cannot defeat such lien. Conversely, if creditors have not obtained such a lien, the buyer may return the goods, and the creditors may not impeach such return either on the basis of the law against fraudulent conveyances or because they extended credit in reliance on the buyer's possession. Of course this construction has important results in case bankruptcy intervenes prior to the return or within four months thereafter.

The trustee in bankruptcy could claim the goods under Section 70c of the Bankruptcy Act if the buyer had not returned the goods prior to the filing of the petition. If the goods are no longer in the possession of the buyer but are subject to a judicial lien obtained by a creditor of the buyer, the trustee may subrogate himself to such lien under the conditions of Section 67a of the Act and, at any rate, claim the surplus under Section 70c of the Act, invoking the doctrine of Moore v. Bay, 284 U.S. 4 (1931). Finally, if the return was made within four months prior to the petition, such return should not be voidable as preferential since return of the goods to a seller under a sale or return arrangement is not a transfer to a creditor for an antecedent debt within the meaning of Section 60 of the Act. The question, however, is quite debatable and Professor Kennedy has come to the opposite conclusion, see Kennedy, Trustee in Bankruptcy Under the U.C.C.: Some Problems Suggested by Articles 2 and 9, in 1 Coogan, Hogan and Vagts, Secured Transactions Under the U.C.C., 1052-1108, especially 1103-1108 (1966).

4. Subsection (3) extends the protection of creditors to arrangements which otherwise would not be strictly speaking "sale or return" arrangements because the person to whom the goods are delivered is technically not a "buyer" and the goods are delivered for "sale" and not for "resale". Nevertheless, this subsection declares that if goods are delivered to a person for sale [not to a buyer for resale!] and such person maintains a place of business at which he deals in goods of the kind involved under a name other than the person making delivery, then the creditors of the person conducting the business may treat the arrangement as "sale or return". This rule is applicable even though the arrangement is qualified as a "consignment" or expressly reserves title to the person making the delivery until payment or resale.

   This subsection, however, does not apply if the person making the delivery:

   (a) complies with a local sign posting statute (not existing in Hawaii), or

   (b) establishes that the consignee is generally known by his creditors to be substantially engaged in selling goods of others, or

   (c) complies with the filing requirements of Article 9.

   The interrelation of Subsections (2) and (3) and the scope of the exemption of compliance with the filing requirements of Article 9 are far from being clear. The considerable revision of Subsections 1-201(37) (definition of security interest) and Section 2-326, made in 1957, has not been an improvement in that respect.

   A true consignment, as contrasted with an agreement reserving title until payment or resale, is not a security agreement, <u>i.e.</u> an agreement creating a security interest as defined in Subsection 1-201(37), and filing does not convert it into one. This filing possibility is therefore "somewhat incongruous", as Professor Kennedy has pointed out, <u>op. cit.</u>, at p. 1105. Compliance with the filing requirements apparently defeats creditors in <u>all</u> transactions classified as "sale or return", whether under Subsection (2) or (3). Although the Code in Subsection (3) merely states that "<u>this</u>" subsection is not applicable if the person files under Article 9, Subsection (2) also limits its applicability with a reference to the exceptions in Subsection (3).

5. A further problem regarding the interpretation of Subsections (2) and (3) relates to their applicability to secured creditors. May a creditor holding a security interest including an after-acquired

property clause invoke it to defeat the rights of a seller under a sale or return agreement or of a consignor? Secured creditors are creditors as defined in Subsection 1-201(12), but on policy grounds there is little reason for their protection in the situation envisaged in Section 2-326, accord Hogan, The Marriage of Sales to Chattel Security in the U.C.C., in 2 Coogan, Hogan and Vagts, Secured Transactions Under the U.C.C., 1872, at 1879 (1966).

6. Subsection (4) clarifies the application of the statute of frauds (Section 2-201) and of the parol evidence rule (Section 2-202) in case of "or return" terms in contracts for sale.

7. Transactions which are "sale or return" transactions within the meaning and for the purposes of Subsection (3) are not necessarily sales within the meaning of the General Excise Tax Law, Revised Laws of Hawaii 1955, Chapter 117, cf. In re Taxes, AIEA Dairy Ltd., 46 Haw. 292 (1963), especially at p. 308: ". . . a transaction may be a consignment for sale up to a certain period of time, and then become a sale by reason of the consignee's duty to pay for the goods then on hand. . . . 'the whole question is whether the ostensible purchaser assumes liability for the purchase price at the time the goods are received. . . .'"

Section 2-327. Special incidents of sale on approval and sale or return.

1. This section governs the interparty aspects of sales on approval and sale or return transactions.

2. A sale on approval leaves the risk of loss and the title with the seller until acceptance. This risk includes the return, but a merchant buyer must follow reasonable instructions. Failure seasonably to notify the seller of an election to return the goods is acceptance, but a mere use for trial purposes is not.

3. Under a sale or return transaction, the return is at the buyer's risk and expense. The option to return must be exercised seasonably and may cover all goods or any commercial unit thereof.

4. The former Uniform Sales Act, Section 19, Rule 3, Revised Laws of Hawaii 1955, Section 202-19, Rule 3, followed substantially the same policy. Similar rules applied at common law. Thus in Fenessey-Wilson v. Benn, 29 Haw. 160 (1926), the Court held that failure to seasonably return a rented car pursuant to a sale or return clause in the lease constituted a waiver of the return option.

Section 2-328. Sale by auction.

1. This section deals with sales by auction, following in the main the principles established by the former Uniform Sales Act, Section 21, Revised Laws of Hawaii 1955, Section 202-21.

2. The Code now adds a rule governing the case where a bid is made while the hammer is falling in acceptance of a prior bid. In such circumstance, the auctioneer has the option to reopen the bidding.

3. As before, an auction "with reserve" is considered the normal procedure. It is otherwise only if the goods are in explicit terms "put up" without reserve. Hence, the putting up of the goods, not the advertising of the auction, is the crucial moment.

4. The section continues the prior policy against bids by or on behalf of the seller unless the other bidders are notified of the reservation of liberty for such bidding. If this prohibition is not observed, the bidder following such spurious bid or bids is entitled to avoid the sale or take the goods at the last bona fide bid. The prohibition does not apply to forced auction sales. Subsection 2-706(4)(d) permits a "seller" to bid at a public auction instituted in exercise of right of resale. Apparently this provision supersedes Subsection 2-328(4).

PART 4

Title, Creditors and Good Faith Purchasers

As has been stressed, the Code rejects the title concept as the hitching post to which all other rights and remedies of the parties to the contract, or third parties, are tied. The approach of the Code is performance-oriented and aims at adjusting the rights and remedies of the parties in a step by step fashion without regard to the location of title. As a by-product of this technique, the Code employs a spectrum of proprietary concepts called, perhaps, in descending order--"title", "security interest", "special property", "insurable interest" and "risk of loss burden" (cf. Subsection 2-722(a)).

Nevertheless, title questions in sales may have a residual importance for various legal relations. Moreover, the protection of creditors and bona fide purchasers in particular settings is traditionally regulated by the law of sales.

In view of this fact the Code devotes a special part--although by far the shortest one--to certain title and apparent ownership aspects. Part 4, however, does not cover the whole field. Related matters are contained in particular in Sections 2-326, 2-502, 2-702(2) and (3) and 2-716(3).

<u>Section 2-401. Passing of title; reservation for security; limited application of this section</u>.

1. This section, after proclaiming the independence of the sales incidents from title questions, except where the Code makes express reference thereto, states the basic rules governing passage of title. Subject to a few limitations spelled out in this section, regulation of the moment of passage is left to the parties. In the absence of a specific agreement on that matter, supplementary rules determining it are set forth.

2. Party autonomy in this area is restricted by two limitations inherent in the structure of the Code as a whole.

   (a) Title to goods cannot pass under a contract for sale prior to their identification to the contract. (Section 2-501).

   (b) A retention or reservation by the seller of title in goods delivered or shipped to the buyer reserves only a security interest in the seller.

3. While the parties may attack the passage of title effect of the identification of goods to the contract, in the absence of such agreement, identification creates only a "special property" of the buyer in the goods (Subsections 2-401(1) and 2-501(1)). While this term conjures up the apparition of the body of common law relating to recovery in detinue, trover, or trespass, actually its modern incidents should be gleaned from the Code. Negatively, it must be noted that special property is not a security interest (Subsection 1-201(37)) and therefore not subject to Article 9 (Section 9-113). Positively, the special property concept entitles the owner:

   (a) to claim the goods against the seller's creditors subject to the limitations of Section 2-402;

   (b) to recover the goods in insolvency proceedings against the seller upon compliance with the conditions specified in Section 2-502;

(c) to assert it by means of suits for specific performance or actions in the nature of replevin (Section 2-716); and

(d) to entertain a tort action against third parties injuring the goods (Section 2-722).

4. In the absence of a contrary agreement, title passes when the seller performs the last step called for by the contract in the physical delivery of the goods. The Code differentiates two basic situations: when delivery requires moving of the goods (Subsection (2)); and when delivery is made without moving the same (Subsection (3)).

   (a) In the case of contracts for sale involving change of the physical location of the goods in the performance of the contract, the difference between destination contracts and shipment contracts becomes material. In shipment contracts title passes at the time and place of the shipment, regardless of the time and place of the delivery of a document of title. In the case of destination contracts, title passes at the time of the tender there.

   (b) If delivery does not require moving of the goods, title passes in the case of contracts calling for delivery by way of documents (as defined in Subsection 1-201(14)) at the time and place of the delivery of the documents (Subsection (3)(a)). In other cases of sales not calling for physical moving of the goods, title passes at the time the contract becomes binding if the goods are already identified at that time (Subsection (3)(b)).

   The rule of Subsection (3)(a) must be considered qualified by a special provision in Subsection 2-503(4)(b) relating to the acquisition of rights by the buyer in a case where goods are in the possession of a bailee and are to be delivered without being moved. In that event, tender to the buyer of a non-negotiable document of title or of a written direction to the bailee to delivery and receipt by the bailee of a notification of the buyer's rights "fixes those rights against the bailee and all third persons" although the risk of loss will still remain on the seller. See the discussion of this clause in Explanatory Note 5 to Section 2-503.

5. Subsection (4) clarifies the result of a rejection or other refusal by the buyer to receive or retain the goods, whether justified or not, and of a justified revocation of acceptance. Such action is declared to "revest" title to the goods in the seller "by operation of law". This subsection covers the return of goods under a "sale or return" transaction pursuant to Section 2-326.

6. The Code does not alter materially the rules as to passage of title prevailing under the former Uniform Sales Act, Sections 17, 18, 19, Rules 1, 2, 4, and 5, and 20(2), Revised Laws of Hawaii 1955, Sections 202-17, 202-18, 202-19, Rules 1, 2, 4, and 5, and 202-20(b), although the methodology of draftsmanship is changed substantially.

Section 2-402. Rights of seller's creditors against sold goods.

1. This section deals with the rights of the seller's creditors with respect to sold or identified goods in the possession of the seller and constitutes the counterpart to Section 2-326. It recognizes the basic right of the seller to recover the goods under these circumstances but subordinates it to the right of the seller's creditors to appropriate them to the payment of their claims under particular circumstances.

2. On principle, the Code, like the former Uniform Sales Act, Section 26, Revised Laws of Hawaii 1955, Section 202-26, recognizes the validity of any local rule, whether based on a separate enactment or the common law, which declares the retention of possession by a seller as fraudulent *vis-a-vis* his creditors and voidable. Since Hawaii does not have a special statute to that effect, a rule of this kind must find its base in the law of fraudulent conveyances, developed under the statute of Elizabeth, 13 Eliz. c. 5 and adopted in Hawaii as part of the common law pursuant to Revised Laws of Hawaii 1955, Section 1-1, *Dee v. Foster*, 21 Haw. 1 (1912); *Metzger v. Lalakea*, 32 Haw. 706 (1933). Whether the courts will consider retention of possession to be fraudulent as a matter of law or merely a badge of fraud, and whether only creditors who have extended credit during the period of retention or also pre-existing creditors who may have withheld enforcement will be protected cannot be anticipated on the basis of prior case law.

3. The Code excludes the applicability of the rules against fraudulent conveyances in cases where the retention of possession is in good faith and current course of trade by a merchant seller for a commercially reasonable time after sale or identification. Where the identification to the contract or delivery is not made in current course of trade but in satisfaction or as security of a pre-existing claim for money or security interest, the rights of creditors under the law against preferences or fraudulent transfers governing in the state where the goods are located remain unimpaired.

4. Of course, a trustee in bankruptcy may invoke the fraudulent character of the possession by the bankrupt if a petition in bankruptcy is filed against the seller while he is still in possession and after the commercially reasonable period has expired. The trustee can base his claim to retention of the goods upon Section 70c or 70e of the Bankruptcy Act. Whether a trustee must part with the goods if the petition has been filed before the expiration of a commercially reasonable period depends on compliance with the conditions stated in Section 2-502 and the validity of this section in Bankruptcy, see Kennedy, Trustee in Bankruptcy Under the U.C.C.: Some Problems Suggested by Articles 2 and 9, 1 Coogan, Hogan, and Vagts, Secured Transactions Under the U.C.C., 1051 at 1099 (1966).

Section 2-403. Power to transfer; good faith purchase of goods; "entrusting".

1. This section has the purpose of consolidating, harmonizing and simplifying the rules on the protection of the good faith purchaser of goods formerly dispersed over various uniform acts, in particular the former Uniform Sales Act, Uniform Trust Receipts Act and Uniform Conditional Sales Act. This section transcends the law of sales since "transactions of purchase" not only denote sales but include any other transactions, whether voluntary or for value, which create interests in property (Subsection 1-201(32)). The section deals only with purchasers. The protection of creditors is left to other sections of Article 2 or to sections in other articles, especially Articles 6, 7 and 9. Even with respect to purchasers of goods, Section 2-403 is not all-inclusive. The protection of bona fide purchasers of goods in particular situations (curiously designated as "other purchasers of goods" in Subsection 2-403(4)) is also left to various sections in Articles 6, 7 and 9.

2. Subsection (1), which obtained its present version in the 1957 revision of the Code, starts in doctrinal fashion with the declaration that a purchaser of goods acquires all title which his transferor has, or has power to transfer, followed by the qualification that the purchase of a limited interest passes merely as an interest as designated. Following these self-evident propositions, the section addresses itself to situations where the transferor's title is subject to defects or where the transferor's title or power to transfer is only ostensible.

3. Subsection (1), sentence 2, lays down the broad proposition that a person with voidable title has power to transfer a good title to a good faith purchaser for value (as defined in Subsections 1-201(19), 2-103(1)(b), and 1-201(44)). Although the Code fails

to say so explicitly, this good faith includes absence of knowledge of the defect. In order to clarify some doubtful cases, the last sentence of Subsection 2-403(1) declares that a bona fide sub-purchaser for value may acquire good title from a purchaser to whom goods have been delivered under a purchase transaction although the remote transferor was deceived as to the identity of the purchaser, or the delivery was in exchange for a check which was later dishonored, or the purchase of the middleman was to be for cash, or the delivery was procured through criminal fraud or trickery.

Unfortunately, Subsection (1) leaves the concept of voidable title undefined. Apparently, it means title by a transfer which is subject to avoidance by the transferor or his creditors and not merely a title which is defeasible by another interest, see the discussion of this problem by Peters, Remedies for Breach of Contracts Relating to the Sale of Goods Under the U.C.C.: A Roadmap for Article Two, 73 Yale L.J. 199, at 236-238 (1963).

4. Subsections (2) and (3) deal with the protection of buyers in the ordinary course of business, as defined in Subsection 1-201(9), who purchase goods to which the merchant seller has neither title nor contractual authority to sell. Such buyers acquire, nevertheless, good title, free from the interest of any third party if the sale entrusted the goods to the merchant seller and the latter is in the business of selling goods of that kind. The term entrusting within the purview of this rule is very broad and includes any delivery and any acquiescence in the retention of possession, regardless of any stipulation between the parties and regardless of whether the entrusting constitutes larceny on the part of the entruster or the recipient.

5. The protection by Subsections (2) and (3) of buyers in the ordinary course of business from a seller who has retained possession parallels that accorded to his creditors by Subsection 2-402(2). Creditors, however, are only protected if local rules, apart from the Code, so provide and only after expiration of a commercially reasonable time. Purchasers other than buyers in the ordinary course of business are not protected in the situations envisaged in Subsections (2) and (3), except in special cases specified in other articles, *e.g.* in Subsection 9-301(1)(c).

PART 5

Performance

This part of Article 2 deals with various aspects of performance, seen as a series of actions taken in chronological order. Since the requisites of performance vary according to the terms of the agreement, frequent references to the meaning of standard terms and clauses in sales agreements given in other parts of Article 2 are necessary.

According to the judgment of the framers of the Code, shipment contracts rather than destination contracts are considered to be the rule.

Section 2-501. Insurable interest in goods; manner of identification of goods.

1. The first step to be taken by a seller in performing his obligation is the identification of goods to the contract. The Code attaches to the identification the effect of giving the buyer an insurable interest and special property in the goods (Subsections 2-501(1) and 2-401(1)). Moreover, title to the goods cannot pass prior to that time (Subsection 2-401(1)). The fixation of the moment and manner of identification therefore is material.

2. Subsection 2-501(1) declares that the identification of goods to the contract is independent of their being in conformity to the contract and that the rules in this section control unless displaced by explicit agreement.

3. The Code distinguishes three types of cases: Identification occurs when the contract is made if it is for goods already existing and identified; it occurs when goods are shipped or designated by the seller as the goods to which the contract refers if the contract is for future goods other than future crops or unborn animals; crops to be harvested within the next twelve months or the next normal harvest season after the making of the contract and animals to be born within twelve months after the contracting are identified when planted or conceived, respectively.

4. Identification when made by the seller alone does not bar substitution of other goods by him except where he is in default, insolvent or has notified the buyer that the identification is final.

5. The insurable interest of the buyer does not preclude an insurable interest in the seller if he retains title to, or a security interest in, the goods.

6. The former Uniform Sales Act, Section 19, Revised Laws of Hawaii 1955, Section 202-19, used the notion of "unconditional appropriation to the contract" for purposes of passing title.

Section 2-502. Buyer's right to goods on seller's insolvency.

1. Upon identification of the goods to the contract, the buyer obtains a special property therein "as limited" by the Code (Subsections 2-401(1), first sentence, and 2-501(1)). The essence of this special property right consists of the buyer's right to recover these goods, either in equity or replevin, if special reasons for such course of action exist (Section 2-716) or to recover them in the seller's insolvency proceedings (Section 2-502). Both rights are made subject to the rights of creditors if retention of possession beyond a reasonable time is fraudulent (Subsections 2-402(1) and (2)) and to the rights of buyers in the ordinary course of business (Subsections 2-403(2) and (3)).

2. This section deals with the assertion of the buyer's right on the seller's insolvency. It enables a buyer who has special property in identified goods in the possession of the seller and who has paid part or all of the price to recover the goods upon tender of the unpaid portion of their price if the seller becomes insolvent (as defined in Subsection 1-201(23)) within ten days after receipt of the first installment.

3. The operation and validity of Section 2-502 in bankruptcy is open to grave doubts. Two types of situations must be distinguished.

   (a) If a commercially reasonable period has expired after identification of the goods to the contract, retention of possession by the seller may be fraudulent against his creditors under applicable law and render the special property right of the buyer voidable by them (Subsection 2-402(2)). Since the right of the buyer under Section 2-502 is made subject to the rights of the seller's creditors under Subsection 2-402(2), by the express mandate of Subsection 2-402(1), the trustee in bankruptcy can defeat the buyer's rights under Section 2-502 by virtue of Sections 70c and 70e of the Bankruptcy Act if the petition in bankruptcy was filed subsequent to the expiration of a commercially reasonable period after identification and if the goods at that time were still in the possession of the bankrupt. Similarly, if the seller yielded to the recovery demands of the buyer after the expiration of the commercially reasonable period for retention of possession and while being insolvent within the meaning of the Bankruptcy Act, the trustee may well be able to defeat the delivery as a preferential transfer if the petition was filed within four months after such delivery, see Kennedy, Trustee in Bankruptcy Under the U.C.C.: Some Problems Suggested by Articles 2 and 9, in 1 Coogan, Hogan, and Vagts, Secured Transactions Under the U.C.C., 1051 at 1099-1102 (1966).

(b) Even where the insolvency and the filing of the petition in bankruptcy occur prior to the expiration of the reasonable commercial period for retention, the buyer's attempt to recover the goods may encounter legal obstacles in the Bankruptcy Act, especially if accompanied by the tender of an unpaid balance. Section 70b of the Bankruptcy Act entitles a trustee to reject executory contracts and leave the other party to a dividend on the resulting damage claim for breach, Bankruptcy Act, Sections 63(a)(9) and (c). It could well be argued that the buyer's right to recovery upon tender of the balance under Section 2-502 defeats this option of the trustee and that the grant of a mere special property right does not suffice to remove the contract from being "executory", especially if it is not fully performed on the part of the buyer. Under the old title doctrine, it was held that a buyer could not reclaim goods prior to passage of title to him even if he had paid for them in full prior to bankruptcy, Ely & Walker Dry Goods Co. v. Adams Mfg. Co., 105 F. 2d. 906 (2d. Cir. 1939). It is not sure that the attribution of a special property right will change this result.

Section 2-503. Manner of seller's tender of delivery.

1. This section is the key section on the manner of the seller's tender of delivery. Its corollary is Section 2-511, regulating the buyer's tender of payment and establishing that, in the absence of any contrary agreement, tender of payment is a condition to the seller's duty to tender and complete delivery. Section 2-503 is supplemented by a number of other sections in Article 2, especially Sections 2-307 (delivery in single lot or several lots), 2-308 (absence of specified place for delivery), 2-309 (absence of provision for time of shipment or delivery), and 2-504 (special condition for tender of delivery in shipment contracts).

2. Subsection (1) contains the general rules governing tender applicable to sales calling for the delivery of goods at the seller's place of business (Subsection 2-308(a)) or at the place of their

location (Subsection 2-308(b)) and to destination sales (Subsection (3)). Subsections (2) and (4) prescribe the manner of tender in cases not calling for delivery of goods to the buyer, viz. shipment sales, sales of goods which are to remain in the possession of a bailee, while Subsection (5) regulates the tender of required documents.

3. In the cases falling under Subsections (1) and (3) tender of delivery requires that the seller put and hold conforming goods at the buyer's disposition and give the buyer notice reasonably necessary to enable him to take delivery, after inspection, except where this right is excluded (Section 2-511), and upon tender of payment. Unless otherwise agreed, the buyer must provide the facilities for the receipt of the goods.

4. Subsection (4) envisages four modes of tender of delivery in the cases of contracts for the sales of goods in the possession of a bailee that are to remain in his possession. Due tender without qualification is made if the seller supplies to the buyer a negotiable document of title covering the goods or an acknowledgment by the bailee that he holds the goods for the buyer. Sufficient tender is also made by delivery to the buyer of a non-negotiable document of title or a written direction to the bailee to release the goods to the buyer, provided the buyer does not seasonably object. But refusal of the buyer to honor the document or to obey the direction, if seasonably presented, defeats the tender. The risk of loss of the goods remains on the seller until the buyer has had a reasonable time for such presentation.

5. Subsection (4)(b) contains a clause prescribing that, where goods are in the possession of a bailee and are to be delivered without being moved and where tender to the buyer is made of a non-negotiable document of title or of a written direction to the bailee to deliver, "receipt by the bailee of the buyer's rights fixes those rights as against the bailee and all other persons."

The actual sequence of events contemplated by Subsection (4)(b) and the precise legal effect attributed thereto is obscure and must be determined in the light of other and seemingly not always consistent sections, especially Sections 2-401(3)(a), 2-509(2)(c), 2-705(2)(b), 7-502(1)(d) and 7-504(2). Professor Braucher has commented on the apparent inconsistency between some but not all of these sections, Braucher and Davenport, The Uniform Commercial Code--Documents of Title in Uniform Commercial Code Handbook (A.B.A., Section of Corporation, Banking and Business Law) 173 at 200 (1964). It would seem that Subsection 2-503(4)(b) applies to the case where the seller delivers to the buyer a non-negotiable document of title or non-negotiable written delivery order, and the bailee subsequent to such delivery receives notification by the seller or apparently also by the buyer of the buyer's entitlement to the goods. At that moment title to the goods passes to the buyer "as against the bailee and all third persons." This construction fits perfectly the wording of Subsection 2-509(2)(c) which specifies that the risk of loss of goods held by a bailee to be delivered without being moved passes to the buyer "<u>after</u> [not upon] his receipt of a non-negotiable document of title or other written direction to deliver, as provided in Subsection (4)(b) of Section 2-503". It also fits squarely with Subsection 7-504(2) which makes the rights of the transferee of a non-negotiable document undefeatable <u>after</u> the bailee receives notification of the transfer. Hence, the other sections mentioned must be considered qualified by these sections. Accordingly, Subsection 2-401(3)(a) must be read as supplemented by Subsection 2-503(4)(b), and Section 7-502(1)(d) must be limited to negotiable delivery orders, as the Official Comment to Section 7-502, Point 3 suggests.

6. Where the contract requires the delivery of documents by the seller, all such documents must be in proper form, except that in overseas shipments one part of a bill of lading issued in parts may suffice (Subsection 2-323(2)). Tender through customary banking channels is sufficient and requires the buyer to honor an accompanying draft.

7. The Code adopts and expands the rules governing tender of delivery contained in the former Uniform Sales Act, Sections 43(3) and (4) and 46, Revised Laws of Hawaii 1955, Sections 202-43(c) and (d) and 202-46. The Code rejects the rule of the former Uniform Sales Act, Section 19, Rule 5, Revised Laws of Hawaii 1955, Section 202-19, Rule 5, which declared that a term calling for payment by the seller of freight or cost of transportation to the buyer converts the contract into a destination sale.

<u>Section 2-504. Shipment by seller</u>.

1. This section details the duties of a seller with reference to delivery in a contract which requires or authorizes shipment of goods but does not call for delivery at a specified destination. The shipment contracts covered by this section include F.O.B. place of shipment contracts (Subsection 2-319(1)(a)), and C.I.F. or C. & F. contracts. Without compliance with the requirements of this section, shipment in the respective cases will not constitute due tender (Subsection 2-503(2)). In such cases title will ordinarily pass at the same time (Subsection 2-401(2)(a)).

2. Delivery under shipment contracts obligates the seller to place the goods in the possession of an appropriate carrier and to conclude a suitable transportation contract. In "F.O.B. vessel" contracts, actual loading of the goods is required (Subsection 2-319(1)(c)). In addition, the seller must obtain and promptly deliver or tender in due form any documents necessary for the buyer to obtain possession of the goods or otherwise required by the agreement or by usage of trade. The proper forms of bills of lading in overseas shipments are governed by Section 2-323. In C.I.F. contracts, policies or certificates of insurance must be in the form prescribed in Subsection 2-320(2)(c). Finally the seller must promptly (a term stricter than seasonably, as defined in Section 1-204) notify the buyer of the shipment.

3. Unless otherwise agreed, the seller has the option to select the carrier and arrange for the terms of the transportation (Subsection 2-311(2)), provided that the contract meets the standards prescribed in Subsection 2-504(a) and complies with the terms of the agreement.

4. Failure to notify the buyer promptly of the shipment or to make a proper transportation arrangement is a ground for rejection (Subsection 2-601(a)) only if material delay or loss ensues.

5. The Code eliminates the requirement of the former Uniform Sales Act, Section 46(2) Revised Laws of Hawaii 1955, Section 202-46(b) that the contract of transportation must be made expressly on behalf of the buyer.

Section 2-505. Seller's shipment under reservation.

1. The shipment of goods which have been previously identified to the contract or which are identified by the shipment (Subsection 2-501(1)) will pass title to the buyer (Subsection 2-401(2)(a)). The buyer will also acquire a special property in the goods by the shipment, unless he has done so prior thereto (Subsections 2-501(1)(a) and (b)). Hence, the seller may have an interest in retaining a non-possessory or, at least, a possessory security interest in the goods. This section gives him the power to do so by selecting a form of the bill of lading which results in the reservation of such security interest. Shipment under a bill of lading in a form which reserves a security interest is styled "shipment under reservation". In contracts which authorize or require the seller to send the goods, authority for shipment under reservation is given unless the shipment terms of the contract exclude this form of shipment (Subsection 2-310(b)). If shipment under reservation is not authorized and therefore improper, the buyer may reject the

delivery but only if material delay or loss ensues (Subsection 2-505(2) in conjunction with Section 2-504). The impropriety of the shipment, however, impairs neither the special property or title of the buyer nor the power of the seller as holder of a negotiable document of title (Subsection 2-505(2)).

2. Procurement of a negotiable bill of lading reserves a non-possessory security interest in the goods to the seller. Even if the bill is drawn to the order of a financing agency or of the buyer, a security interest is reserved to the seller, and the form of the bill indicates merely the expectation on the part of the seller of transferring that interest to the person named.

3. Procurement of a non-negotiable bill of lading to the seller or his nominee reserves possession of the goods as security. Procurement of a non-negotiable bill of lading naming the buyer as consignee reserves no possessory security interest, except in the case of conditional delivery, which can be accomplished in contracts calling for payment against delivery by making an immediate demand for payment (Subsection 2-507(2)). Otherwise, no possessory security interest is retained even though the seller keeps possession of the non-negotiable bill of lading naming the buyer as consignee. Conditional delivery to the buyer, however, saves only a precarious security interest to the seller, see Official Comments to Section 2-505, Point 4 and to Section 2-507, Point 3.

4. This section rephrases and redefines the equivalent rules of the former Uniform Sales Act, Section 20(2), (3) and (4), Revised Laws of Hawaii 1955, Section 202-20(b), (c) and (d).

Section 2-506. Rights of financing agency.

1. This section details the rights of a financing agency, as defined in Subsection 2-104(2), resulting from the payment or purchase for value of a draft relating to a shipment of goods. The section prescribes that, to the extent of such payment or purchase, the financing agency is subrogated to all rights in the goods of the shipper including his right of stoppage and his right to have the draft honored by the buyer. These rights are in addition to the agency's own rights under the draft and any document of title securing it.

2. A financing agency which under commitment to, or authority from the buyer has, in good faith, honored or purchased the draft is entitled to reimbursement; although subsequently it is discovered that relevant documents, though regular on their face, are subject to defects.

Section 2-507. Effect of seller's tender; delivery on condition.

1. This section regulates the effect of the seller's tender of delivery in general and the consequences of conditional delivery in particular. In view of the generality of the subject matter dealt with, the provisions of this section are couched in broad and broadly qualified terms.

2. Tender of delivery is a condition of the buyer's duty to accept the goods and, except in contracts calling for payment in advance, issuance of a letter of credit or similar advance commitments, of his duty to pay for them (Subsection 2-507(1) in conjunction with Section 2-301). Acceptance and payment must be made according to the contract and in accordance with other sections of this article, e.g. Sections 2-310 and 2-511.

3. Subsection (2) provides for conditional delivery in the cases where payment is due and demanded on the delivery to the buyer of goods or documents of title. In such cases the buyer's right "as against the seller" to retain or dispose of the goods is conditional upon his making the payment due. But the seller's right to repossess the goods may be defeated by the buyer's creditors or bona fide purchasers from the buyer or by failure to enforce the condition seasonably. This subsection is applicable to shipment of goods under a non-negotiable bill of lading naming the buyer as consignee (Subsection 2-505(1)(b)).

Section 2-508. Cure by seller of improper tender or delivery; replacement.

1. This section, which has no precedent in the former Uniform Sales Act, Revised Laws of Hawaii 1955, ch. 202, permits a seller under specified conditions to cure an improper tender or delivery by substitution of a proper one.

   If the buyer rejects any tender or delivery because of non-conformance and the time for performance has not yet expired, the seller may make a conforming delivery within the contract time, provided he has seasonably notified the seller of his intention to cure the non-conformity (Subsection (1)).

   If the buyer rejects a non-conforming tender, the seller may substitute a conforming tender even after the contract time has passed if the seller had good reasons to expect that the delivery would be acceptable. In such case he must seasonably notify the buyer of his intention to cure and must make the substituted tender within a reasonable time thereafter (Subsection (2)).

2. Subsection (2) is not applicable if existing trade usages permit variations with price allowances and accordingly exclude a right of rejection based thereon. Reasonable expectation of acceptability may be based on a prior course of dealing or course of performance as well as particular circumstances surrounding the bargain or the delivery. Application of the "reasonable expectation of acceptability" test, however, may lead to practical difficulties in a rapidly falling market, see Peters, Remedies for Breach of Contracts Relating to the Sale of Goods Under the U.C.C.: A Roadmap for Article Two, 73 Yale L.J. 199 at 210 and 215 (1963).

3. The right to cure a defective tender or delivery by substitution of a conforming tender or delivery and the supplementary right of substituted performance (Section 2-614) are important policy innovations of the Code, looking "to preserving the deal whenever possible", Official Comment to Section 2-605, Point 2. The right to cure is safeguarded by other sections of the Code, *e.g.* Subsections 2-605(1)(a) and 2-612(2). The seller's privilege of cure may also include acts short of substitution of an entirely new tender or delivery, such as repair of the goods tendered, partial replacement, removal of improper components in a mixture etc., see Official Comment to Section 2-510, Point 2. Until such cure is completed, the risk of loss remains with the seller (Subsection 2-510(1)) and a buyer who has accepted defective goods on the reasonable assumption that the defects would be cured may revoke the acceptance if the cure is not seasonably forthcoming (Sections 2-607 and 2-608). For a discussion of the seller's privilege of cure, see Peters, *op. cit. supra.*, at 209 (1963).

Section 2-509. Risk of loss in the absence of breach.

1. This section regulates the time when the risk of loss passes from the seller to the buyer. Risk of loss upon the seller signifies that the seller is not entitled to payment if the goods perish after the conclusion of the contract. Risk of loss upon the buyer means that he has to pay for them although they perish either before receipt or, if the risk passes only upon receipt, before he has disposed of them. Special regulation of the time of passage of the risk of loss is necessary in view of the Code's determination to separate the passage of title and the incidents flowing from the progress of performance (Section 2-401).

2. The section divides the subject into three main classes:

   (a) contracts requiring or authorizing the seller to ship the goods by carrier (Subsection (1));

(b) contracts for the sale of goods in the possession of a bailee not calling for a removal thereof (Subsection (2)); and

(c) residual contracts for the sale of goods (Subsection (3)).

3. The first class is subdivided into two types of contracts: "shipment contracts" and "destination contracts". In shipment contracts the risk of loss passes to the buyer upon due delivery of the goods to the carrier, whether or not the shipment is "under reservation" (Section 2-505). This rule, however, is inapplicable unless the goods are identified to the contract before, or by the shipment (cf. Subsection 2-505(1), introductory clause). Otherwise, the risk passes only upon identification. In destination contracts the risk of loss passes when the goods are duly tendered at the place of destination so as to enable the buyer to take delivery.

4. In contracts for the sale of goods in the possession of a bailee which are to remain in his possession, the risk of loss passes to the buyer:

(a) if he receives a negotiable document of title covering the goods, at the time of such receipt (Subsection (2)(a));

(b) if the bailee acknowledges that he holds the goods for the buyer, at the time of such acknowledgment (Subsection (2)(b));

(c) if he receives a non-negotiable document of title or a non-negotiable written instruction to deliver, upon expiration of a reasonable time thereafter, giving the buyer an opportunity for presentment. If the bailee refuses to honor the document or instruction, the risk of loss remains with the seller (Subsection (2)(c) in conjunction with Subsection 2-503(4)(b)).

5. Except where the parties have agreed otherwise, in all other cases including sales on approval (Subsection 2-327(1)), the risk passes to the buyer on tender of delivery unless the seller is a merchant. In that case, the passage of the risk of loss is postponed until receipt of the goods by the buyer. The reason for that rule is the notion that a merchant who is to make delivery at his place of business or at the location of the goods can be expected to carry insurance, while the buyer is not likely to insure goods which are not yet in his control. If delay in taking delivery on the part of the buyer involves a breach, the special rules for risk of loss in cases of breach (Section 2-510) apply.

6. This section changes the prior law as contained in the former Uniform Sales Act, Section 22, Revised Laws of Hawaii 1955, Section 202-22, by separating passage of title and passage of risk of loss and modifying substantially the rules applicable to delivery at the seller's place of business or at the location of the goods.

Section 2-510. Effect of breach on risk of loss.

1. Section 2-509 prescribes rules for the passage of the risk of loss to the buyer at specified stages of the seller's performance in different classes of contracts for the sale of goods. These rules are limited to situations where there is neither a breach on the part of the seller, i.e. where his tender or delivery conforms to the contract, nor a breach on the part of the buyer. Section 2-510 deals with the situation where there is such breach.

2. Where the seller's tender or delivery of goods does not conform to the contract so as to give a right of rejection (Sections 2-601 and 2-504, last sentence), the risk of loss of the goods remains on the seller until cure or acceptance.

   Where the buyer rightfully revokes acceptance (Section 2-608), he may, to the extent of any deficiency in his effective insurance coverage, treat the risk of loss as having rested on the seller from the beginning. In other words, to the extent that the buyer is covered by effective (i.e. fully realizable) insurance, the risk remains on him.

3. Subsection (3) deals with the effect on the risk of loss in the case of a breach by the buyer. Where the buyer, as to conforming goods already identified to the contract for sale, repudiates it or otherwise commits a breach before the risk of loss has passed to him (as, for instance, to seasonably take delivery in a sale calling for delivery at a merchant's place of business, Subsection 2-509(3)), the seller may, to the extent of any deficiency in his effective insurance coverage, treat the loss as resting on the buyer for a commercially reasonable time.

4. These rules, which refer to a limited or temporary passage of the risk of loss, codify new law.

Section 2-511. Tender of payment by buyer; payment by check.

1. This section deals with the general aspects of the tender of payment by the buyer and is, in that respect, the corollary of Section 2-503 (seller's tender of delivery). It is supplemented by the rules of other sections of Article 2, in particular of the section on place and time of payment (Section 2-310) and of the section on the effect of tender of delivery (Section 2-507).

2. In the absence of credit terms, tender of payment is a condition to the seller's duty to tender and complete any delivery. Tender of delivery and tender of payment must be made concurrently, ex-

cept where the sale carries credit terms or calls for advance payment or letter of credit.

3. Tender of payment is sufficient to obligate the seller to tender and complete delivery when made by any means or manner accepted in ordinary commercial practice. The seller may insist on legal tender, but in such case must extend the time for payment reasonably necessary for its procurement.

4. Except in cases of certified bank checks (Section 3-802) payment by check is conditional and is defeated as between the parties by dishonor of the check on due presentment (Subsection 2-511(3)). Until such contingency, the underlying obligation is suspended (Subsection 3-802(1)).

5. Subsection (1) rephrases the rule of the former Uniform Sales Act, Section 42, Revised Laws of Hawaii 1955, Section 202-42.

Section 2-512. Payment by buyer before inspection.

1. Unless the contract stipulates otherwise, a buyer is entitled to inspect the goods before payment is due (see Subsections 2-310(b), 2-321(3), 2-513(1) and 2-606(1)(b)). The contract may, however, by its terms, require payment before inspection (Subsection 2-513 (3)).

2. In the case where the contract requires payment before inspection by calling for payment on delivery, non-conformity of the goods does not excuse the buyer from payment, unless the non-conformity appears without inspection, or the circumstances would justify injunction against honor of a draft or demand for payment against the issuer of a letter of credit despite tender of the required documents pursuant to Subsection 5-114(2)(b).

3. Subsection (2) renders it clear that payment prior to inspection, where required, does not constitute acceptance of the goods or impair the buyer's right to subsequent inspection or any of his remedies. It is, however, not exclusive in that respect, see Explanatory Note 6 to Section 2-513.

4. The section has no direct precedent in the former Uniform Sales Act, Revised Laws of Hawaii 1955, ch. 202.

Section 2-513. Buyer's right to inspection of goods.

1. This section sets forth the general rules governing the buyer's right to inspect the goods prior to payment or acceptance.

2. Subsection (1) declares the principle that, unless a contract for the sale of goods excludes a right of inspection, either by reason of its reference to the existing condition of identified goods or by virtue of standard terms of that import, the buyer is entitled to exercise a right to inspection at any reasonable place and time and in any reasonable manner upon tender, delivery or identification of the goods to the contract with notice to him. In shipment contracts the inspection may be made after arrival of the goods.

3. Subsection (2) allocates the expenses of the inspection to the buyer, subject to a right of reimbursement if the goods are nonconforming or rejected.

4. Except for the qualified right to inspection under contracts including C.I.F. or C. & F. terms and calling for payment on or after arrival of the goods (Section 2-321) Subsection (3) of this section construes the contract to exclude the right to inspection if it:

   (a) includes C.O.D. or equivalent terms, or

   (b) provides for payment against documents of title, without postponement to the time when the goods have become available for inspection.

5. Subsection (4) provides that a place or method of inspection fixed by the parties is deemed to be exclusive. Such an agreement, however, unless it expressly so provides, does not have the effect of postponing the time of identification of the goods to the contract or of shifting the place for delivery or of passing the risk of loss. If inspection on the place or by the method fixed becomes impossible, the supplementary rules of this section are applicable unless compliance with the agreed terms was clearly intended as an indispensable condition, failure of which "avoids" the contract (Subsection (4) last sentence).

6. It should be noted that Subsection (1) gives the right to inspection before payment <u>or acceptance</u>. Hence, receipt of the goods and payment for them does not waive the right to inspection if it is exercised within a reasonable time after delivery, <u>accord</u>, Official Comment to Section 2-513, Point 2. It follows that Subsection 2-512(2), referring to the effect of payment before inspection <u>where the contract so requires</u>, is not meant to be exclusive.

7. This section covers the subject regulated by the former Uniform Sales Act, Section 47, Revised Laws of Hawaii 1955, Section 202-47. While it introduces no major policy changes, the wording and some of the details are new.

Section 2-514. When documents deliverable on acceptance; when on payment.

1. This section specifies the time within which documents, against which a bill of exchange is drawn (Section 3-104) are to be delivered to the drawee. Such delivery must be made on acceptance of the draft if it is payable more than three days after presentment; otherwise, only on payment.

2. The identical rule applies to the presentment of documentary drafts (defined in Subsection 4-104(1)(f)) by collecting banks (Subsection 4-503(a)). The three day period is prescribed in view of Subsection 5-112(1)(a).

3. This section extends the rule of the former Uniform Bills of Lading Act, Section 41, to all documents against which a draft may be drawn. The former Uniform Bills of Lading Act was not adopted in Hawaii.

Section 2-515. Preserving evidence of goods in dispute.

1. This section is designed to promote certainty as to the condition of goods and to facilitate the determination of the quality of the goods in case of a dispute between the parties.

2. Subsection (a) gives either party the right, upon reasonable notification, to inspect, test and sample goods, even if they are in the possession of the other party, for the purpose of collecting and perpetuating evidence.

3. Subsection (b) validates agreements giving inspection rights for that purpose to third parties as well as agreements which attribute binding effect to the findings of a third party as to condition or conformity of the goods.

4. This section is without precedent in the former uniform laws that are superseded by the Code.

PART 6

Breach, Repudiation and Excuse

This part, as its caption indicates, collects the general rules governing the effects of a breach by either party of its contractual duties. In view of the well-known seemless texture of the legal fabric, this part is not self-contained but is supplemented by rules pertinent to breach contained in other sections, as e.g. Sections 2-504 last sentence, 2-505(2), or 2-510 (effect of breach on risk of loss).

Section 2-601. Buyer's rights on improper delivery.

1. This section lists the rights normally given to the buyer if the goods or the tender of delivery fail in any respect to conform to the contract. The buyer has a triple choice: He may reject the whole, or accept the whole, or accept any commercial unit or units (as defined in Subsection 2-105(6)) and reject the rest. Acceptance is final under the condition specified in Subsection 2-607(2). Acceptance of a part of any commercial unit is acceptance of the entire unit (Subsection 2-606(2)).

2. Special rules apply with respect to breaches in installment contracts (Section 2-612).

3. The former Uniform Sales Act, Revised Laws of Hawaii 1955, ch. 202 had no equivalent provision although it dealt in various sections with acceptance or rejection by the buyer because of non-conforming performance, e.g. Sections 11, 44 and 69(1), Revised Laws of Hawaii 1955, Sections 202-11, 202-44 and 202-69(a).

4. Actually the "perfect tender" rule, enshrined in Section 2-601, is limited by qualifications flowing from other sections, especially 2-608, 2-504, 2-614 and 2-508, with the result that the rule is "cut back . . . to a mere shadow of its formerly robust self" Peters, Remedies for Breach of Contracts Relating to the Sale of Goods Under the U.C.C.: A Roadmap for Article Two, 73 Yale L.J. 199 at 206 (1963).

Section 2-602. Manner and effect of rightful rejection.

1. This section deals with the manner and the effects of a rightful rejection (Subsections (1) and (2)). The remedies of a seller in the case of a wrongful rejection are governed by Section 2-703, to which express reference is made in Subsection (3).

2. Rejection, under conditions warranting such action, must be made within a reasonable time after tender or delivery. As the Official Comment, Point 1 observes, rejection requires positive action; mere lack of response to tender does not constitute rejection, nor is the need for rejection obviated by non-conformity of the goods tendered or delivered. Rejection must be notified seasonably to the seller.

3. Rightful rejection leaves certain duties of conservation on merchant buyers and limited powers of salvage to any buyers, as specified in Sections 2-603 and 2-604. Beyond this, any exercise of ownership by the buyer with respect to any commercial unit, except for the purpose of enforcing a security interest for the return of payments or reimbursement of expenditures (Subsection 2-711(3)) constitutes conversion. Conversely, no rejecting buyer may abandon the goods immediately but must hold them with reasonable care at the seller's disposition for a time sufficient to permit their removal by the seller. The buyer is, however, under no active duty to return them.

4. The section continues the policy of the former Uniform Sales Act, Section 50, Revised Laws of Hawaii 1955, Section 202-50.

<u>Section 2-603. Merchant buyer's duties as to rightfully rejected goods</u>.

1. This section imposes some positive duties of cooperation and conservation upon merchant buyers following rightful rejection. If the seller has no agent, in the broadest sense of the word, or place of business at the market of rejection, the buyer must follow any reasonable instructions of the seller with respect to the disposition of the goods and, in the absence of such instructions, make reasonable efforts to sell perishable or quickly depreciating goods for the seller's account. The merchant buyer may condition his compliance with instructions on prompt indemnification for expenses.

2. The buyer is entitled to reimbursement for reasonable expenses incurred in the care for, and the sale of, the goods and to a commission as is usual in the trade or reasonable. He may deduct the respective amounts from the proceeds.

3. The buyer must discharge his duties under this section in good faith (Subsection 2-103(1)(b)), but conduct complying with this standard constitutes neither an acceptance nor a ground for liability for conversion.

4. The section has no statutory precedent and changes prior case law.

Section 2-604. Buyer's options as to salvage of rightfully rejected goods.

1. In contrast to Section 2-603, which imposes affirmative duties on merchant buyers of perishable or quickly depreciating commodities after their rightful rejection, this section is couched strictly in terms of options for any buyer upon rightful rejection of any types of goods.

2. In the absence of instructions by the seller seasonably communicated after the notification of rejection, a buyer has three options with respect to the rejected goods: storage, reshipment, or sale for the seller's account. Exercise of one of these options is neither acceptance nor conversion.

Section 2-605. Waiver of buyer's objections by failure to particularize.

1. This section supplements Subsection 2-602(1), relating to the manner of rightful rejection, and imposes the onus of particularizing defects in certain cases. Subsection (1) deals with particularization of defects of goods in connection with a rejection of goods; Subsection (2) with particularization of defects of documents in connection with payment against their delivery.

2. Subsection (1) bars a buyer from relying on a defect of goods, ascertainable by reasonable inspection, for the purpose of justifying rejection or establishing a breach if he has failed to state such defect in connection with his rejection and either

   (a) the seller could have cured the defect upon a seasonable statement thereof, or

   (b) in a transaction between merchants, the seller requested in writing a full and final written report of all defects on which the buyer proposes to rely.

3. Subsection (1) is aimed at giving the seller a timely chance for curing a defect and at promoting dispatch and certainty in dealings between merchants without laying a trap for the non-mercantile buyer.

4. In the case of payment against documents made without reservation, any defects appearing on the face of the documents cannot subsequently be invoked for recovery of the payment. The acceptance of the documents, however, does not constitute acceptance of the goods or waiver of any right or remedy relating to them (Subsection 2-512(2)).

Section 2-606. What constitutes acceptance of goods.

1. Sections 2-606 to 2-608 codify the rules governing the various aspects of acceptance. Section 2-606 defines the conduct which amounts to an acceptance, while the other two sections deal, respectively, with the effects and the revocability of an acceptance.

2. Since acceptance shifts the risk of loss of defective goods to the buyer (Subsection 2-510(1)), destroys the right of rejection (Subsection 2-607(2)), effects limitations on the exercise of other remedies (Subsection 2-607(3)) and casts the burden of proof of a breach on the buyer (Subsection 2-607(4)), a clear definition of conduct which constitutes acceptance is of considerable importance.

3. Acceptance consists of three types of conduct:

   (a) indication to the seller that the goods are conforming or that the buyer will take or keep them in spite of non-conformity, given after reasonable opportunity for inspection;

   (b) failure to make an effective rejection after a reasonable opportunity for inspection;

   (c) any act inconsistent with the seller's ownership, but if such action is a tort against the seller, only if ratified by him.

4. Acceptance of a part of a commercial unit is acceptance of the whole.

5. The section modifies the law under the former Uniform Sales Act, Section 48, Revised Laws of Hawaii 1955, Section 202-48, by limiting acceptance by tortious conduct and adding the rule stated in Explanatory Note 4.

Section 2-607. Effect of acceptance; notice of breach; burden of establishing breach after acceptance; notice of claim or litigation to person answerable over.

1. This section deals with the effects of an acceptance of defective goods but transcends this topic by regulating certain connected procedural matters. Attention to these matters is needed because, under the Code, as under the former Uniform Sales Act, Sections 49 and 69, Revised Laws of Hawaii 1955, Sections 202-49 and 202-69, acceptance of defective goods affects only the right of rejection (Section 2-601) and, under the Code, also the passage of the risk of loss (Subsection 2-510(1)), but does not impair any other remedy provided for non-conformity (Subsection 2-607(2)).

2. Acceptance entails the duty to pay for the goods at the contract rate and precludes rejection of the goods, except in the special circumstances where the acceptance is revocable and has been effectively revoked. (Subsections (1) and (2)).

3. Since acceptance of itself does not bar any remedy for breach other than rejection, but on the other hand may prompt the seller to believe that no liability on his part is incurred, the Code imposes upon the buyer certain duties of discovery and notification relative to existing defects or litigations (Subsection (3)).

   The buyer loses his remedies for any breach if he fails to discover such breach within an appropriate time or to notify the seller thereof within a reasonable time after discovery. If the breach involves the warranty against infringement suits (Subsection 2-312(3)) the buyer must notify the seller within a reasonable time after he receives notice of the litigation.

4. Acceptance also casts on the buyer the burden of proof with respect to any breach asserted by him (Subsection (4)).

5. Subsection (5) codifies important new rules governing the onus or right of a warrantor to assume responsibility for the conduct of a litigation in which the buyer has become involved as a result of the seller's breach of warranty. a) The buyer's right of "vouching in", given by Subsection (5)(a), is competing with, but different from, his power to interplead in appropriate circumstances, and voucher and interpleader, though both involve liability-over situations, must not be confused, see Note, Does Voucher to Warranty Belong in the U.C.C.?, 18 Stan. L. Rev. 666 at 676 (1966). The chief difference is the voucher's freedom from jurisdictional limitations restricting interpleader actions. Whether voucher is subject to no jurisdictional limits whatsoever, i.e. the warrantor is under the burden of defending in any forum having jurisdiction

over the warrantee, is not settled. Unless the vouchee complies with a seasonable written request to defend the suit, he will be bound by the judgment against the warrantee. b) The Code, in addition, entitles the warrantor against liability for infringement or the like, to conduct the defense of the action against the warrantee, including the negotiation of a settlement, provided he agrees to bear all expenses and to satisfy any adverse judgment.

6. The same rules apply to a buyer who has furnished specifications to the seller and thereby obligated himself to hold the seller harmless against suit for infringement and the like arising out of compliance with the specifications (Subsection (6) in conjunction with Subsection 2-312(3)).

Section 2-608. Revocation of acceptance in whole or in part.

1. This section governs the permissibility and proper manner of revoking an effective acceptance. The methodology of the former Uniform Sales Act, Section 69, Revised Laws of Hawaii 1955, Section 202-69, is changed materially. The remedy against improvident acceptance is not couched in terms of a rescission of the contract but of a revocation of the acceptance. Revocation of an acceptance now operates as a rejection (Subsection (3)).

2. Revocation of an acceptance is authorized only if:

   (a) the non-conformity substantially impairs the value to the buyer of the goods accepted, <u>and</u>

   (b) the acceptance occurred with knowledge of the non-conformity but on the reasonable assumption that its non-conformity would be cured, and no such cure was seasonably forthcoming, <u>or</u>

   (c) the acceptance occurred without discovery of such non-conformity but was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances.

3. The acceptance may be revoked within a reasonable time after the buyer discovers, or should have discovered, the ground for the revocation. Revocation is effective only when the buyer notifies the seller thereof. Any substantial change of the goods not based on their own defects bar the revocability.

4. The revocation of an acceptance may extend to a lot or a particular commercial unit.

5. The requirement that acceptance is not revocable unless the defect substantially impairs the value of the delivery amounts to an important qualification of the impact of the perfect tender rule and has corollaries in other sections of Article 2, e.g. Section 2-504, last sentence (improper shipment contract) and Subsection 2-612(2) (power to reject installment in installment contract).

Section 2-609. Right to adequate assurance of performance.

1. This section establishes an obligation on either party to furnish adequate assurance of due performance upon written demand when reasonable grounds for insecurity arise with respect to the performance of the other party.

2. The Code does not give any definitions for the interpretation of the terms "reasonable grounds for insecurity" or "adequate assurance", but prescribes that "between merchants" (Subsection 2-104 (3)) the propriety of the demand and the sufficiency of the compliance therewith shall be determined according to commercial standards. Otherwise adequacy must be determined according to the circumstances of the particular case (Subsections (2) and (4)).

3. Pending such demand and until satisfaction of it, the affected party may suspend any performance for which the agreed counter-performance has not already been received if such action is commercially reasonable. If upon receipt of a justified demand the other party does not provide adequate assurance of due performance within a reasonable time not exceeding thirty days, the aggrieved party may treat such failure as repudiation of the contract.

4. Acceptance of any improper delivery or payment does not constitute a waiver of the right to demand adequate assurance of future performance.

5. The implied right to adequate assurance may be supplemented by an express option to accelerate payment or performance or to require collateral when the optionee deems himself insecure. Under such stipulation, however, it is not necessary that reasonable grounds for insecurity actually exist, but only that the optionee in good faith believes that the prospects of payment or performance are impaired (Section 1-208).

Section 2-610. Anticipatory repudiation.

1. This section delineates the various courses of action which either party to a contract for the sale of goods may take upon repudia-

tion of the contract by the other party with respect to a performance not yet due, the loss of which will substantially impair the value of the contract to the aggrieved party. Although the Code fails to give a definition of the term "repudiation", it is fairly clear that it signifies an overt act which indicates the intention of the party to default in a future performance without a proper excuse. It is different from a cancellation or termination of the contract with respect to executory obligations (Subsections 2-106(3) and (4)) although an unwarranted cancellation or termination may amount to an anticipatory repudiation.

An anticipatory repudiation which, although referring to a <u>future</u> performance, substantially impairs the <u>present</u> value of the contract (this is apparently the true meaning of the phrasing of the introductory clause in the section), constitutes a present breach of the contractual obligations of the repudiating party (Sections 2-703, 2-711, 2-713 and 2-723).

2. In the case of an anticipatory repudiation which constitutes a present breach the aggrieved party may:

   (a) either await performance by the repudiating party for a reasonable time or resort to any of the remedies for breach available to a seller or buyer, respectively, and concurrently;

   (b) either suspend his own performance or (if a seller) proceed with the provisions on the seller's right to identify goods to the contract or to salvage unfinished goods.

3. By specific statutory permission, granted in the explanatory clause added to the option authorizing <u>any</u> remedy for breach (Subsection 2-610(b)) the aggrieved party may pursue this course although he has informed the repudiating party that he would await the latter's performance and has urged retraction. Although the aggrieved party has transcended the area of mere "silence and inaction" in this respect, the repudiating party is not entitled to hold the other party strictly to the notified course of action. The Official Comment, Point 4, is misleading to that extent, having not been adjusted to the insertion of this clause in the revision of 1957. It can, however, be argued that even now the aggrieved party is not at liberty to pursue a course of action that is totally inconsistent with his notification, see Peters, <u>Remedies for Breach of Contracts Relating to the Sale of Goods Under the U.C.C.: A Roadmap for Article Two</u>, 73 Yale L.J. 199 at 265 (1963).

4. In addition to the effects attributed by Section 2-610 to an anticipatory repudiation that amounts to a breach, an anticipatory repudiation may constitute a reasonable ground for a demand of ade-

quate assurance of performance (Section 2-609). However, these two sections are independent of each other. Neither is it necessary that the anticipatory repudiation amounts to a breach (as is required under Section 2-610) in order to invoke the relief under Section 2-609, nor is it required to proceed under Section 2-609 prior to reliance on Section 2-610.

5. Section 2-610 clarifies and expands the rules of the former Uniform Sales Act, Sections 63(2) and 65, Revised Laws of Hawaii 1955, Sections 202-63(b) and 202-65.

Section 2-611. Retraction of anticipatory repudiation.

1. This section codifies new law relating to retraction of an anticipatory repudiation.

2. Such retraction is permissible until the repudiating party's next performance is due unless the aggrieved party has since the repudiation cancelled the contract or materially changed his position or otherwise indicated that he attributes finality to the repudiation.

3. Retraction reinstates the full operativeness of the contract, but the aggrieved party is excused from liability for the suspension of his performance and entitled to compensation for any delay in his performance occasioned by the repudiation.

4. Retraction may be made by the repudiating party in any matter which clearly indicates this intention to perform. It must include any assurance of due performance justifiably demanded under Section 2-609.

Section 2-612. "Installment Contract"; breach.

1. This section states particular rules for rejection applicable in the special case of installment contracts. The provision of separate rules was deemed to be necessary because in such contracts the individual deliveries are not wholly independent of one another, but defects of one delivery may impair the utility of subsequent or even prior deliveries.

2. Subsection (1) defines "installment contract" as a contract which authorizes or requires delivery in separate lots to be separately accepted and negates any circumvention of the commercial interdependence by a boiler plate separability clause.

3. Subsections (2) and (3) regulate the rejectability of an individual delivery standing by itself and the rejectability of an individual delivery coupled with a cancellation of future deliveries. Unfortunately, the effect of these subsections is obscured, see Peters, Remedies for Breach of Contracts Relating to the Sale of Goods Under the U.C.C.: A Roadmap for Article Two, 73 Yale L.J. 199, at 223-277 (1963).

   (a) The two subsections deal with the permissibility or non-permissibility of a rejection of installments the non-conformity of which substantially impairs the value of the respective installments. Hence by way of a negative inference, it must be concluded that in installment contracts the so-called perfect tender rule is wholly inapplicable, and that a rejection if at all, is only permissible if the defective installment suffers from a non-conformity which substantially impairs its value.

   (b) If an installment suffers from a non-conformity which substantially impairs its value and is incurable, the buyer is entitled to reject it, whether or not its non-conformity also impairs the value of the whole contract. If, however, the value of the whole contract is substantially affected by the non-conformity of the rejected installment, the buyer may, in addition, cancel the whole contract.

   (c) If an installment suffers from a non-conformity which substantially impairs its value but is curable and does not impair substantially the value of the contract as a whole, the buyer may not reject the installment but must accept it, provided the seller gives adequate assurance of its cure.

   (d) Casus omissus is the logical possibility that an installment suffers from a non-conformity which substantially impairs its value and also the value of the whole contract but is curable. In that instance the negative inferences from the two rules stated under (b) and (c) are seemingly irreconcilable. A conceivable solution may be found in the view that a curable defect of a single installment can never by itself impair the contract as a whole and that therefore the rule stated under (c) is applicable. If, however, this suggestion is considered as too rigid and not consonant with the general flexibility of the Code, the buyer should be entitled to rejection of the individual installment and cancellation of the whole contract.

4. The aggrieved party waives his right to cancellation of the whole contract if he accepts a non-conforming installment without seasonable notification to the seller of the cancellation or if he

brings an action with respect only to past installments or demands future deliveries. The Official Comment to Section 2-612, Point 7, suggests that a buyer who accepts a non-conforming installment which substantially impairs the value of the entire contract still may act seasonably if he withholds notification of cancellation pending a response from the seller as to his claim for cure. This implies that the sponsors concede the existence of cases such as suggested in Explanatory Note 3(d), *supra*, *i.e.* that a defect may be curable, but nevertheless substantially impair the contract as a whole.

Section 2-613. Casualty to identified goods.

1. If the goods are destroyed without fault of the seller after the risk of their loss has passed to the buyer, the latter must pay for them, if he has not already done so, and the seller will be free from liability. In the absence of breach, the risk of loss passes to the buyer on tender of delivery or completed delivery and, in some cases after delivery, *i.e.* in sales by a merchant seller calling for delivery at the seller's place of business or at the place of the location of the goods, see Sections 2-509 (risk of loss in the absence of breach); 2-503 (manner of seller's tender of delivery); 2-308 (absence of specified place for delivery); 2-504 (shipment by the seller). Delivery in the case of goods is no unified concept, but its factual incidents vary according to the terms of the contract for sale. Payment is conditioned upon tender of delivery unless the contract calls for advance payment (Subsection 2-507(1)) and is due either at the time of delivery or, in shipment cases other than documentary shipment cases, at the time specified for arrival (Sections 2-511 and 2-310(a)), but in the cases falling under Subsection 2-310(a) the seller is entitled to payment even if the goods do not arrive. If the goods are destroyed without the seller's fault after identification to the contract but before the risk of loss has passed, *i.e.* before delivery or, in the cases falling under Subsection 2-509(3) first clause, after delivery but before receipt, the seller loses his right to payment. It would be unjust, however, to burden the seller in all these cases with the additional liability for non-performance. As a result, Section 2-613 relieves the seller in some of these cases from liability for non-delivery by avoiding the contract.

2. Avoidance of the contract occurs if: a) the contract is for the sale of goods which are identified when the contract is made (Subsections 2-501(1)(a) and 2-105(2)); and b) the goods are totally lost, without the fault of either party, prior to the passage of the risk of loss to the buyer.

3. If the goods are only partially lost or damaged to an extent that they are no longer conforming, the buyer may demand inspection and, at his option, either treat the contract as avoided or accept the goods at an appropriately reduced price.

4. Corresponding rules apply in destination shipment contracts which include a no arrival, no sale term, if the goods suffer casualty without the fault of the seller after proper shipment of conforming goods (Sections 2-613 and 2-324).

5. Section 2-613 is supplemented by Section 2-615 which excuses the seller from performance if the same becomes commercially impracticable as a result of the intervention of events the non-occurrence of which was a basic assumption on which the contract was made. The interrelation between Sections 2-613 and 2-615 is not free from doubt. The legislative history of the two sections is not conducive to resolving the difficulties, see Peters, Remedies for Breach of Contracts Relating to the Sale of Goods Under the U.C.C.: A Roadmap for Article Two, 73 Yale L.J. 199, at 243 ftn. 128 (1963). To be sure, the Official Comment to Section 2-615, Points 5 and 9, suggests separate areas of applicability, although conceding a zone of overlap. Official Comment to Section 2-613, Point 1, however, intimates identity of underlying policy by stating that it covers cases where "continued existence of the goods is presupposed by the agreement". At any rate it is hard to understand why the benefits of Section 2-613 are unavailable where casual destruction of or damage to goods intervenes after identification to the contract and prior to the passage of the risk, but the identification occurred after the making of the contract.

Section 2-614. Substituted performance.

1. This section grants a right to, and imposes a duty of, substituted performance when the agreed manner of delivery becomes commercially impracticable (Subsection (1)) or the agreed means or manner of payment fails because of governmental regulation (Subsection (2)). The provisions of this section constitute an important qualification of the perfect tender rule.

2. Subsection (1) permits insistence on substituted performance by either party if the agreed manner of shipment or delivery becomes unavailable or commercially impracticable but a reasonable commercial substitute is available. The right to substituted performance under this section extends only to the manner of delivery and not to the type or character of the goods sold.

3. Subsection (2) deals with failure of the agreed means or manner of payment because of domestic or foreign governmental regulations. In such case a seller may stop or withhold delivery unless the buyer provides a means or manner of payment which is substantially equivalent by commercial standards. If delivery has already been taken, payment by the means or manner provided by the regulation discharges the buyer's obligation unless the regulation is discriminatory, oppressive or predatory. To the extent that the subject of Subsection (2) is regulated by the Bretton Woods Agreement on the I.M.F. of July 22, 1944, especially Articles VII, VIII and XIV, the provisions of that agreement, of course, override any inconsistent prescriptions of the Code.

Section 2-615. Excuse by failure of presupposed conditions.

1. This section conforms to the modern trend in contract law which does not hold a promisor rigidly to his promise at the penalty of liability for breach in case of non-performance or defective performance, but rather considers failure of complete and timely performance to be excused, if a) it is attributable to the intervention of events, the non-occurrence of which was a basic assumption on which the contract was made, and if b) insistence on complete and timely performance under the sanction of liability for breach would be unduly harsh under the totality of circumstances. The Code adapts this trend of the law to the special case of contracts for the sale of goods and relaxes the rigors of the second branch of the test to commercial impracticability.

2. Section 2-615 a) prescribes the test governing the circumstances under which an excuse for failure of presupposed conditions may be invoked by a seller, b) specifies the conditions under which a stricter liability is in order, c) imposes duties of notification and allocation of resources which must be fulfilled by the seller to be entitled to the excuse, and, finally d) limits its applicability by ordaining substitute performance if a commercially reasonable substitute is available.

3. Delay in delivery or non-delivery in whole or in part by a seller is declared not to be a breach of his contractual obligation if the performance as agreed has been made impracticable either by the occurrence of a contingency, the non-occurrence of which was a basic assumption on which the contract was made, or by compliance in good faith with any unanticipated supervening foreign or domestic regulation or order, whether or not it later proves to be invalid.

4. The excuse may be invoked only if the seller makes a fair and reasonable allocation of his available supplies among his customers, including, at his option, regular customers not then under contract and his own requirements. In addition, the seller must notify the buyer seasonably of the delay or non-delivery and, in apposite cases, of the estimated quota available to the buyer.

5. Where substituted performance is prescribed under the criteria set forth in Section 2-614, the seller must render such performance.

6. The excuse accorded by Section 2-615 is not to be available where the seller, either according to the express terms of the agreement or in view of the circumstances surrounding the bargain, has assumed more extensive obligations.

7. According to the Official Comment, Point 5, this section, rather than Section 2-613, applies to failure of production by an agreed source of supply for causes beyond the seller's control, "since production by an agreed source is without more a basic assumption of the contract". The same is true when a particular source of supply is shown by the circumstances to have been contemplated or assumed by the parties at the time of the contracting. Although Section 2-615 accords the respective excuse only to sellers, the Official Comment, Point 9, suggests its applicability, apparently by analogy, to a buyer in relation to his obligation of acceptance. While ordinarily, continued existence of the buyer's need, except within the limits stated in Section 2-306 on output and requirements contracts, is not a basic assumption on which the contract is based, it may become such an assumption if the buyer's procurement is in reasonable commercial understanding conditioned on a definite and special need.

8. This section codifies new law.

Section 2-616. Procedure on notice claiming excuse.

1. This section provides the options which a buyer has upon the receipt of a notification by the seller that the occurrence of a contingency, the non-occurrence of which was a basic assumption of the bargain, renders a material or indefinite delay in the delivery or a proportionate reduction thereof a commercial necessity.

2. In such case the buyer, by written notification, may either terminate the contract (as defined in Subsection 2-106(3)), or modify the contract by agreeing to take his available quota in substitution. In cases of installment contracts within the meaning of Section 2-612, the buyer may terminate the whole unexecuted por-

tion of the contract if the prospective deficiency substantially impairs the value of the whole contract.

3. The buyer must exercise his option to take his available quota in substitution within a reasonable time, not exceeding thirty days after receipt of the seller's notification; otherwise the contract lapses with respect to any deliveries affected.

4. Termination or lapse of the unexecuted portion of the contract signifies that the contract ceases to be operative as to the excused delivery or deliveries, apparently with the result that the buyer is entitled to the return of an aliquot share of an advance payment allocable to such delivery or deliveries. It cannot be assumed that an advance payment term shifts onto the buyer the risk of non-delivery because of failure of presupposed conditions.

5. Subsection (3) prohibits any agreement negating the options of the buyer. Assumption of greater obligations by the seller is not precluded by this mandate.

6. The section has no statutory precedent in prior uniform legislation.

PART 7

Remedies

This part deals with the remedies available to either the buyer or the seller if the other party, without excuse, fails to perform any of its obligations under the contract (Section 2-301), or if some other contingencies, such as insolvency of the buyer, occur.

Since this part focuses on the availability and scope of remedies, it must be read in the light of the other parts of Article 2.

The part includes two index sections containing a catalogue of remedies at the disposal of the seller (Section 2-703) and of the buyer (Section 2-711).

The remedies part contains two important policy changes: First, the framers of the Code favor resale and recovery of residual damages as the soundest method of liquidating breaches by the buyer prior to acceptance and restrict the resort to an action for the price in the case of non-accepted goods. Secondly, the Code permits a buyer to recover damages also after rejection of defective goods.

Section 2-701. Remedies for breach of collateral contracts not impaired. Contracts for the sale of goods may be accompanied by collateral or ancillary agreements, as, for instance, exclusive dealing clauses, agreements not to compete, etc. This section removes any doubts about the scope of this part by specifying that remedies for breach of such collateral or ancillary contracts are not affected.

Section 2-702. Seller's remedies on discovery of buyer's insolvency.

1. This section delineates the seller's remedies on discovery of the buyer's insolvency. The section differentiates between two types of situations:

   (a) where the goods have not yet come into the actual or constructive possession of the buyer (Subsection (1)), and

   (b) where the goods are in his actual or constructive possession (Subsection (2)). Constructive possession for the purpose of this section signifies possession by means of a bailee who has acknowledged he holds for the buyer (Section 2-705, see Official Comment, Point 1). It should be noted that the Code in its stoppage rules still adheres to the doctrine of attornment while it has rejected that doctrine for many other purposes, (Sections 2-503(4)(b), 7-504(2), 9-304(3), 9-305, see Official Comment to Section 9-305, Point 2).

2. If the goods are not yet in the actual or constructive possession of the buyer, the seller, upon discovery of the buyer's insolvency, as defined by the triple test in Subsection 1-201(23), may

   (a) withhold delivery unless the buyer tenders cash, including payment for all goods theretofore delivered under the contract, and

   (b) stop delivery of goods in transit as specified in Section 2-705, see the Explanatory Notes to that section.

3. Where the seller discovers that the buyer has obtained possession of the goods while insolvent, he may reclaim the goods upon demand made within ten days after such receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery, the ten-day limitation does not apply.

4. Subsection (2), last sentence, suppresses any competing right to reclaim the goods on the ground of the buyer's fraudulent or innocent misrepresentation of solvency or intent to pay. This limitation, accordingly, precludes the possibility of a rescission or

claim for rescission for material mispresentation, which otherwise might have been based upon Sections 2-721 and 1-103, and confines the availability of reclamation to the two sets of conditions specified in Subsection (2). It should be noted that in the first alternative, no misrepresentation of any kind need have occurred. Whether this rule implies that receipt of goods on credit while insolvent is deemed to be "constructive fraud", as suggested in the Official Comment, Point 2, seems to be a moot question. At any rate, the effect of Subsection (2) is a substantial modification of the right of rescission by supplanting it with a more limited but less exacting remedy.

5. Subsection (3) adds specifically that the right of reclamation may be defeated by "the rights of a buyer in ordinary course or other good faith purchaser or lien creditor under this Article (Section 2-403)". As will be explained below, the meaning of this cryptic clause has perplexed the commentators.

6. The seller's right to reclaim goods delivered on credit from an insolvent buyer under Section 2-702 is the counterpart to the buyer's right to claim goods that have been identified to the contract and paid for in whole or in part, on the seller's insolvency under Section 2-502. It should be noted, however, that there are substantial differences in the structure of the two sections. The buyer's right to the undelivered goods is based upon the special property that has passed to him on identification; whereas the seller's right to reclaim the goods has not been clearly defined but left to the agonizing speculation of whether it is a right to revest title by avoidance of the buyer's title on the ground of constructive or actual misrepresentation; a special property retained by the seller, a security interest, or statutory preference <u>sui generis</u>. Moreover, Section 2-502 requires that the seller <u>becomes</u> insolvent within ten days <u>after</u> the receipt of the first installment on the price; whereas Section 2-702 is only applicable if the buyer has received the goods on credit <u>while</u> insolvent.

7. Unfortunately this section has proven to be one of the most obscure and controversial portions of the Code. Troublesome in particular are:

   (a) the computation of the three months limitation on relevant misrepresentation;

   (b) the import of the reference to rights of specified classes of third parties "under this Article (Section 2-403)";

   (c) the possibility of additional limitations resulting from local rules protecting creditors;

(d) the validity on bankruptcy of the "add-on" clause in Subsection (1) and of the right to reclamation under Subsection (2).

8. Despite the narrower definition given to the terms "received" and "receipt" by Subsection 2-103(1)(c), the context of Subsection 2-702(2) clearly seems to require its extension to cases of constructive possession of the buyer as explained in Explanatory Note 1. Otherwise, a no-man's land between the right of stoppage and the right of reclamation would occur. Not so clear, however, is the determination of the start of the backward reckoning of the three months' period within which a misrepresentation of solvency has to have been made so as to remove the ten-day limitation. Subsection (2) uses the phrase "before delivery" which, in apposite cases, such as shipment sales, may designate the parting with possession by the seller rather than the taking of possession by the buyer. There are good policy reasons for the argument that the seller deserves protection if he relinquished possession of goods on credit in reliance on representations made to him within the month preceding his shipment. The early dating of the critical period does not seem to be inconsistent with the policy of limiting the preference under Subsection (2) since the representation of solvency must be <u>false</u> at the time of the making.

9. The cryptic reference to the protection of buyers in ordinary course or other good faith purchasers or lien creditors "under this Article (Section 2-403)" has caused the greatest perplexity among commentators since it is neither clear whether only Section 2-403 and the further references contained therein or also other sections in Article 2 are included, nor certain what protection Section 2-403 affords to the specified classes of third parties in the situation envisaged by Subsection (2). As may be remembered, Subsection 2-403(1) protects bona fide purchasers from buyers with voidable title, Subsections 2-403(2) and (3) protects buyers in the ordinary course of business from merchant sellers to whom goods have been entrusted by <u>any</u> delivery, while Subsection 2-403(4) contains a mystifying reference to additional protection of <u>other</u> purchasers and lien creditors under Article 9. If the interest of the buyer who is subject to the right of reclamation under Section 2-702 is to be classified as "voidable title", then buyers in the ordinary course of business as well as other bona fide purchasers for value are protected under Subsection 2-403(1); otherwise, only buyers in the ordinary course of business would be protected under Subsections 2-402(2) and (3).

10. Even more baffling is the reference to lien creditors in Subsection (3). Lien creditors are not at all directly protected under Subsection 2-403(1) to (3) and have to rely for their rights on the reference made by Subsection 2-403(4) to pertinent sections in Article 9. The principal section thus invoked is Subsection

9-301(1)(b), which subordinates unperfected security interests to lien creditors without knowledge. As a result, lien creditors of the buyer could defeat the seller's right of reclamation under Subsection 2-702(2), if it is in the nature of an unperfected security interest, rather than special property, or power to revest title by avoidance of the buyer's title or a statutory preference. Unfortunately, no persuasive solution is possible and other commentators too have more or less despaired at unravelling this section, see Peters, Remedies for Breach of Contracts Relating to the Sale of Goods Under the U.C.C.: A Roadmap for Article Two, 73 Yale L.J. 199, at 218-222 (1963); Kennedy, Trustee in Bankruptcy Under the U.C.C.: Some Problems Suggested by Articles 2 and 9, in 1 Coogan, Hogan and Vagts, Secured Transactions Under the U.C.C., 1051 at 1093 (1966); Hogan, The Marriage of Sales to Chattel Security, in 2 Coogan, Hogan and Vagts, Secured Transactions Under the U.C.C., 1871 at 1880-1885 (1966).

Closely related to and partly overlapping with the problems delineated in Explanatory Note 9 is the question of the possible defeat of the seller's right of reclamation in the buyer's insolvency under applicable local rules protecting purchasers and creditors. Of course this problem is only practical to the extent that the Code grants no or less extensive protection to these classes of third parties. This issue was faced by the courts in one of the earliest causes celebres arising under the Code, In re Kravitz, 33 J. Nat. Ass'n. Ref. in Bankruptcy, 57 (Ref. E.D. Pa. 1958), aff'd. C.C.H. Banker L. Rep.

59607 (E.D. Pa. 1959), Aff'd. 278 F. 2d 830 (3 Cir. 1960). In that case a trustee in bankruptcy resisted the seller's attempt to exercise his rights of reclamation under Subsection 2-702(2) and was sustained on all three judicial levels. The Court of Appeals dispensed with any discussion of the protection of lien creditor under the two links reference of Subsection 2-702(3) and held that the pre-Code rule of Pennsylvania which permitted lien creditors of the buyer to cut off the seller's right of rescission was still governing by virtue of Section 1-103 and applied to the quasi-rescission under Subsection 2-702(2).

In recognition of the confusing nature of the cross-reference and of the danger that an unqualified recognition of paramount rights of lien creditors under local law would jeopardize the goal of uniformity, the Permanent Editorial Board in 1966 recommended deletion of the words "or lien creditors" from Subsection (3).

11. Of course, the operation and validity of Section 2-702 in bankruptcy is particularly troublesome. To the extent that lien creditors of the buyer are protected against the seller's right

of reclamation (whether under Subsection 9-301(1)(b) or under an applicable local rule) the trust may invoke the same rights under Sections 70c and 70e of the Bankruptcy Act. In that respect, the discussion of the preceding Explanatory Notes apply. Special consideration, however, is needed on the effect of Section 60 of the Bankruptcy Act. Suppose a seller has successfully reclaimed the goods from an insolvent buyer, but within four months after the return of the goods a petition in bankruptcy is filed. May the trustee attack the return as preferential if the buyer was insolvent within the meaning of the Bankruptcy Act at that time? Certainly a negative answer would not be safe, see the discussion by Kennedy, op. cit. supra, at 1097. Similar doubts exist with respect to the validity vis-a-vis the trustee of a pre-bankruptcy exercise of the power under the "add-on" clause in Subsection 2-702(1). It can hardly be denied that the successful exaction, by means of a refusal to deliver, of payment not only for the goods but also for other goods while the buyer is insolvent within the meaning of the Bankruptcy Act seems to be a blatant preference. The recommended deletion of the reference to lien creditors in Subsection (3) would not dispose of all doubts with respect to the validity of Section 2-702 in bankruptcy. While the traditional doctrine of stoppage in transitu has been given effect in bankruptcy, despite its preferential nature, it is by no means clear that state legislation has power to invalidate transfers to the bankrupt by reason of his insolvency at the time of the transfer; but see King, Voidable Preferences and the U.C.C., 52 Cornell L. Qu. 925, at 938 (1967). Of course, if the seller has a valid right to reclaim the goods even after bankruptcy, a pre-bankruptcy reclamation would be unassailable under Section 60 of the Bankruptcy Act.

12. Subsection (3), last sentence, prescribes that successful reclamation of goods excludes all other remedies with respect to them. Exercise of the right under Subsection 2-702(2), therefore, goes beyond the exercise of a power of termination or cancellation (Subsections 2-106(3) and (4)) or a rescission for fraud (Section 2-721).

Section 2-703. Seller's remedies in general.

1. This section is intended as an index section. It lists four categories of breach of contract that a buyer may commit before the contract for sale is fully executed by the seller and enumerates seven remedies which the Code makes available to the seller under these conditions. Its corollary is Section 2-711 which is the index section of the buyer's remedies.

It is in the nature of an index section that the particulars of the remedies cataloguized therein must be found in other sections specifically referred to. Although the remedies are on principle cumulative, not each of the remedies is suitable in each of the situations involving a breach by the buyer. Moreover, one pair of remedies is designed to be mutually exclusive. Clause (e) specifically refers to the recovery of damages for non-acceptance and recovery of the price as alternatives ("or") and prefaces the reference to the recovery of the price with the qualification "in a proper case". It is, however, also in the nature of the other remedies that they may be applicable only in a proper case, as for instance withholding delivery (clause (a)) or stoppage of delivery by a bailee (clause (b)). The reason for the emphasis on a proper case in the instance of the action for recovery of the price is to signal the policy of the Code which aims at making resale and recovery of the residual damages (clause (d)) the standard method of liquidating breaches and restricting recovery of the price where the preferred way is impractical or inapposite (see Official Comment to Section 2-709, Point 2).

2. The introductory paragraph of the section lists four categories of breach of contract by the buyer calling for resort to one or several of the seven listed remedies. These categories are:

   (a) wrongful rejection;

   (b) wrongful revocation of acceptance;

   (c) wrongful failure to make payment due on or before delivery;

   (d) wrongful repudiation.

   The seven remedies available in one or several of these conditions are:

   (a) withholding delivery;

   (b) stoppage of delivery by the bailee;

   (c) identification of goods to the contract, if they are still unidentified at the time of the breach and, if need be, prior completion thereof;

   (d) resale and recovery of damages for non-acceptance;

   (e) recovery of damages for non-acceptance;

   (f) recovery of the price;

(g) cancellation.

3. As has been pointed out, Section 2-703 brackets recovery of damages for non-acceptance and recovery of the price as alternatives ("or") within the same clause (clause (e)) in order to indicate that recovery of the price is normally the appropriate remedy for breaches occurring after acceptance of the goods; whereas recovery of damages for non-acceptance is apposite in the case of wrongful rejection or repudiation.

4. The seller has a completely free choice between resale and recovery of residual damages (Section 2-706) and recovery of damages for non-acceptance (Section 2-708). The original wording of Subsection 2-703(e) which included the qualification "so far as any goods have not been resold" prior to the words "recover damages for non-acceptance" was changed in 1957 by deleting the qualifying clause to clarify the seller's freedom of choice on that point. The seller has this option even where he in fact has resold the goods. See Peters, Remedies for Breach of Contracts Relating to the Sale of Goods Under the U.C.C.: A Roadmap for Article Two, 73 Yale L.J. 199 at 260 (1963). A good illustration is offered by the facts in Grosjean v. Hiyama, 28 Haw. 211 (1925). There the seller shipped rice under an F.O.B. point of shipment contract from San Francisco to Honolulu. The buyer refused to accept the goods, and the seller resold the rice in Honolulu. The seller claimed the balance between the contract price and the proceeds from the resale as damages. Defendant contended that the difference between the contract price and the market price in San Francisco at the time of shipment was the proper measure of damages. The Supreme Court sustained the seller under pre-Code law. Under Section 2-703(d) and (e) the seller has the option. Under the circumstances of the Grosjean case he could have chosen the difference between the contract price and the market price at San Francisco as the measure of damages despite the resale in Honolulu. The buyer, however, had no right to relegate him to this remedy.

5. It should be noted that wrongful failure to pay after delivery is not mentioned under the conditions envisaged as a breach by Section 2-703. The reason for this omission is the fact that in that case an action for recovery of the price will be the sole appropriate remedy, and none of the other choices listed in the catalogue will be apposite.

6. The inclusion of wrongful revocation of acceptance among the types of breach by the buyer which permit resort to the remedies listed in Section 2-703 has produced considerable perplexity, see especially Peters, Remedies for Breach of Contracts Relating to the Sale of Goods Under the U.C.C.: A Roadmap for Article Two, 73 Yale L.J. 199, at 241 (1963). Certainly the Code is not a model

of consistency on that point. On the one hand a wrongful revocation of an acceptance is treated as inoperative, leaving the acceptance intact. Thus Subsection 2-401(4) revests title in the seller either as the result of a rejection or other refusal to receive or retain the goods, whether or not justified, or of a justified revocation of acceptance. Similarly Subsection 2-608(3) declares only that a justified revocation of acceptance operates as a rejection. The consequence of this approach is that in the case of a wrongful revocation of acceptance, the seller may leave the goods with the buyer and recover the price. On the other hand, Sections 2-703 and 2-709(3) seem to permit and expect the seller to treat a wrongful revocation of acceptance as a wrongful rejection and e.g., to proceed by resale and recovery of the residual damages. Professor Peters argues that only the latter course is permitted and that the action for price is unavailable. But her reasons are not wholly convincing. Subsection 2-709(3), in particular, does not necessarily compel this result, in view of Subsection 2-709(1)(a). It seems more consistent with the language of the Code and the practicalities of the situation to give the seller the choice between treating the wrongful revocation of the acceptance as an effective acceptance or as a wrongful rejection. In the latter case he should be able to replevy the goods from the buyer. Despite the restrictive language in Subsection 2-401(4) title to the goods would revest when the seller elects to treat the unjustified revocation of acceptance as a wrongful rejection.

7. The catalogue of remedies is not declared to be exclusive and ought not to be construed that way. Thus, if a buyer who has rejected the goods fails to hold received goods at the seller's disposition, as he is obliged to do pursuant to Subsection 2-602(2)(b), the latter may recover them in a replevin action. The revesting of the title under Subsection 2-401(4) envisages and facilitates resort to this remedy. The same rules should apply if the seller chooses to treat a wrongful revocation of an acceptance as a wrongful rejection, see Explanatory Note 5.

8. The remedies listed in Section 2-703 are available with respect to the lots directly affected and, if the breach is of the whole contract, then also with respect to the whole undelivered balance.

9. The former Uniform Sales Act, Revised Laws of Hawaii 1955, chapter 202 did not include a comparable section.

Section 2-704. Seller's right to identify goods to the contract notwithstanding breach or to salvage unfinished goods.

1. This section is designed to give the seller adequate relief if the buyer breaches the contract for sale prior to the identification of the goods to the contract or prior to their completion,

as e.g. in the case of a wrongful rejection of an installment or of an anticipatory repudiation. In such case, the seller should be able to resort either to resale and recovery of residual damages or, where such resale is not practicable, recovery of the price.

2. Subsection (1) permits the seller to identify conforming goods to the contract even after the breach or to treat unfinished goods which are demonstrably intended for the particular contract as "goods concerned" under the resale section (Section 2-706).

3. In the case of unfinished goods, Subsection (2) gives the seller two options to be exercised on the basis of reasonable commercial judgment for the purpose of effective realization of the best result:

   (a) completion of the manufacture and identification to the contract, or

   (b) discontinuance of the manufacture and resale for scrap or salvage value or any other reasonable disposition.

4. The section broadens the seller's rights existing under the former Uniform Sales Act, Sections 63(3) and 64(4), Revised Laws of Hawaii 1955, Sections 202-63(c) and 202-64(d).

Section 2-705. Seller's stoppage of delivery in transit or otherwise.

1. Since possession of goods by the buyer subjects them to his dispositions and the reach of his creditors, the seller may have a legitimate interest to stop goods in transit in order to forestall this impairment of his rights in, and powers over, the goods. In recognition of the seller's need for protection in a number of situations, the common law has accorded the seller a right to stoppage *in transitu* which is effective against the buyer and his representatives, including a trustee in bankruptcy, receiver or assignee for the benefit of creditors and must be honored by a bailee of the goods during the transit. This section codifies the rules governing the right of stoppage *in transitu* in a variety of settings, thereby coordinating, clarifying, expanding and simplifying pre-Code developments. In particular, the stoppage principle is expressly applied to bailees other than carriers.

2. Subsection (1) grants the seller the right to stop delivery of goods to the buyer, regardless of the size of the shipment, when he discovers the buyer to be insolvent, as defined in Subsection 1-201(23) and, in addition, a right of stoppage of bulk shipments in situations other than insolvency, *viz*. repudiation of the contract, default in payment due before delivery or any other conduct of the buyer or even giving the seller a right to withhold or reclaim the goods.

3. Subsection (2) specifies the events which terminate the seller's right of stoppage. These are events which give the buyer direct or indirect possession of the shipment. The Code identifies four typical factors which place the goods under the possessory umbrella of the buyer and terminate the right of stoppage:

(a) receipt, as defined in Subsection 2-103(1)(c), of the goods by the buyer;

(b) acknowledgment to the buyer by any bailee other than a carrier that the goods are held for him;

(c) acknowledgment to the buyer that the goods are held for him made by a carrier by reshipment or as warehouseman, such reshipment being a new carriage rather than a re-routing of the old voyage; or

(d) negotiation to the buyer of a negotiable document of title covering the goods.

4. Subsection (2)(b) is apparently inconsistent with Subsection 2-503 (4)(b). Subsection (2)(b) provides that (except in the cases of negotiation to the buyer of any negotiable document of title covering the goods under Subsection (2)(d)) the right of stoppage is not cut off until an acknowledgment to the buyer by any bailee of the goods, other than a carrier, that he holds the goods for the buyer. Conversely, Subsection 2-503(4)(b) provides that also apart from such an acknowledgment (which falls within the purview of Subsection (4)(a)), the buyer acquires rights "against the bailee and all third persons" by tender to the buyer of a non-negotiable document or written direction to the bailee to deliver and receipt by the bailee of notification of the buyer's rights. It seems to be inevitable that this provision, which is in consonance with Subsections 2-509(2)(c) and 7-504(2), qualifies Subsection 2-705 (2)(b) and terminates the right of stoppage, at least when rights of third persons, such as garnishing creditors of the buyer, have intervened. Since a trustee in bankruptcy is a hypothetical lien creditor under Section 70c of the Bankruptcy Act, the right of stoppage is defeated if, prior to the filing of the petition, the buyer received a non-negotiable document of title or written delivery order addressed to the bailee, and the bailee received notice of the buyer's rights, see the discussion in Explanatory Note 5 to Section 2-503.

5. Subsection (3) sets forth the conditions which must exist, or be met by, the seller's exercise of right of stoppage vis-a-vis the bailee to render him obliged to obey a stop order and be responsible in damages to the seller in case of disregard thereof. Such order must be communicated in time to permit prevention of the delivery by the exercise of reasonable diligence and must leave

no room for doubt on the legitimation of the author of the order. Therefore, if a negotiable instrument of title has been issued, a surrender of the document must accompany the order or, if a non-negotiable bill of lading was issued, the carrier must be notified by the consignor. If obedience to the stop order entails liability by the carrier to the buyer, for the reason that the order was unjustified under the circumstances, the bailee is entitled to indemnification from the seller.

6. Section 2-705 recodifies and expands the rules on that subject contained in the former Uniform Sales Act, Sections 57 to 59, Revised Laws of Hawaii 1955, Sections 202-57 to 202-59, in the light of provisions contained in other former uniform acts, viz. former Uniform Bills of Lading Act, Sections 12, 14 and 42, not adopted in Hawaii, and former Uniform Warehouse Receipts Act, Sections 9, 11 and 49, Revised Laws of Hawaii 1955, Sections 207-9, 207-11, and 207-49. Except in the situation discussed in Explanatory Note 4, no significant material changes result. Former case law will still be material, e.g. Buss v. Long Island Storage Warehouse, 64 F. 2d. 338 (2. Cir. 1933), noted 18 Minn. L. Rev. 484 (1934). In that case the seller had shipped a parcel of rugs to the buyer, taking out a "straight" bill of lading, delivery to be made by the carrier at its Brooklyn terminal. The buyer did not claim the goods and the carrier delivered them to defendant's warehouse which was accustomed to receive the carrier's unclaimed cargo. Defendant notified both the buyer and seller of his possession of the goods and stated that delivery would be made upon receipt of the bill of lading and payment of accrued charges. The buyer failed to reply, but the seller, having meanwhile learned of the buyer's bankruptcy, transmitted a stoppage order and subsequently, after having recovered the bill of lading from the carrier, obtained redelivery of the rugs upon furnishing an indemnity bond to defendant. Subsequently, the buyer's trustee in bankruptcy secured a turnover order for the goods or the value in summary proceedings against defendant. The District Court affirmed the order, but the Court of Appeals reversed it. It held that defendant had never "acknowledged" that he held the rugs "on behalf of" the buyer. For this reason, the seller, as the consignor, had retained his stoppage right. While the possession of defendant was perhaps equivocal, it certainly was not possession as bailee for the bankrupt. The referee therefore lacked power to issue a summary turnover order.

Section 2-706. Seller's resale including contract for resale.

1. As already mentioned in the prefatory Note to this part and in the Explanatory Notes to Sections 2-703 and 2-704, the framers of the

Code considered the resale of non-accepted marketable articles together with recovery of residual damages to be the most economical and therefore preferable method of liquidating a breach by the buyer with reference to such goods. Accordingly, Subsection (1) authorizes the seller in the cases of breach specified in the index section (Section 2-703) to resell the goods involved in the breach or the undelivered balance thereof. The resale must be made in good faith and in a commercially reasonable manner. If the proceeds from the resale are less than the contract price together with any incidental damages allowable under Article 2 (Section 2-710), the seller may recover the difference but must deduct expenses saved in consequence of the buyer's breach. Conversely, a seller is not accountable to the buyer for any profit made on any resale.

2. Subsection (2) prescribes the general conditions which must be met by the seller in order to conclude an authorized and qualifying resale. The approach of the subsection is mostly permissive and designed to free the remedy of resale from outmoded technical restriction in consonance with the policy to make this method of liquidation of breaches the preferred way.

   In the absence of a special stipulation to the contrary or of the particular conditions where a public sale is not permitted under Subsection (4), the resale may be a sale at public auction or a private sale, including one or more contracts to sell or identification of the goods concerned to another existing contract of the seller. In any event, however, every aspect of the sale, including method, manner, time, place and terms must be commercially reasonable.

   The resale must be reasonably identified as referring to the broken contract, but it is not necessary that the goods be in existence or that any or all of them have been identified to the contract before the breach. The seller's right to identify goods to the contract notwithstanding breach and to complete the manufacture of unfinished goods (Section 2-704) implements the authority of the resale of such goods accorded by the last sentence of Subsection (2).

3. The section contains only one additional obligation with respect to resales at private sale: reasonable notification to the buyer of the seller's intention to resell.

4. Subsection (4) prescribes certain limitations pertaining to the permissibility of resale at public sale and to the modalities of such sale. Apparently the introductory qualification in Subsection (2) envisages these limitations and the reference should be to Subsection (4) rather than Subsection (3).

(a) Public sale is permissible as a resale only for existing identified goods. Future goods can be resold in that fashion only if there is a recognized market for a public sale of futures in goods of the kind.

(b) The public sale must be held at a usual place or market for public sales if one is reasonably available, and the buyer must be seasonably notified of the time and place of the auction, except where the nature of the goods or the market situation requires prompt disposal.

(c) Unless the goods are within the view of the prospective bidders, the notification must state the place where the goods are located and provide for reasonable opportunity of inspection.

(d) The seller may bid. This exception from the ordinary rule (Subsection 2-328(4)) is explained by the fact that usually the buyer is benefited by the seller's purchase at the auction. The exception apparently does not cease to operate when the amount of the last bid exceeds the price of the goods in the broken sale and incidental damages although the seller is not accountable to the buyer for any profit (Subsection (5)). Whether notice of the seller's liberty for such bidding must be given under Subsection 2-328(4) is not clear. See the Explanatory Note to that Subsection.

5. Non-compliance with the requirements of this section for resale-sales does not impair the title of a bona fide purchaser at the resale vis-a-vis the original buyer. The Code modifies the prior law in that respect.

6. While a seller need not account for any profits made on any rightful resale, this dispensation from accounting, by virtue of the express mandate of Subsection (6), does not apply to resales made by financing agencies as person in the position of a seller (Subsection 2-707(1)) under the authority of Subsection 2-707(2) or by buyers who resell upon a rightful rejection or justifiable revocation of an acceptance under the authority of Sections 2-711(3) and 2-604. The duty to account relates to the excess over any security interest in such parties (Section 2-711).

7. This section is an expansion and modification of the rules contained in the former Uniform Sales Act, Section 60, Revised Laws of Hawaii 1955, Section 202-60.

8. The seller's right of resale was the subject of an adjudication by the Supreme Court of Hawaii in the case of Grosjean v. Hiyama, 28 Haw. 211 (1925). According to the findings of the trial court, the parties had concluded a binding contract for the sale of rice. The contract provided that shipment was to be F.O.B. S.S. Dock San Francisco and required, in addition, that this shipment must arrive in Honolulu "within November, 1920". The rice arrived in Honolulu on November 23, 1920, but defendant refused to accept it. Plaintiff sold the rice in Honolulu on December 15, 1920, and claimed the difference between the purchase price and the proceeds from the resale with interest on that sum from the date of the resale as damages. Judgment was rendered in his favor. On writ of error, defendant claimed that the true measure of damage was the difference between the contract price and the market price in San Francisco on the date of shipment. The Supreme Court rejected the contention of defendant and affirmed the decision of the court below. It held that resale in Honolulu was a proper method of procedure: "The contract did provide that the shipment was to be made 'F.O.B. S.S. Dock San Francisco, Calif.' but it also required the forwarding of the rice to Honolulu so as to arrive here in November, 1920. Having complied with these stipulations, the plaintiff could not properly be expected, after breach by the defendants, to return the rice to San Francisco and to sell it there, incurring in this procedure not only added expense but additional risks of deterioration."

In addition, the Court affirmed plaintiff's entitlement to interest on the remaining balance from the date of the resale. In the circumstances of the case, the same result would follow under the Code. Seller would have the choice between proceeding by resale and residual damages (Section 2-706) or recovery of damages for non-acceptance (Section 2-708). See Explanatory Note 4, to Section 2-703. The sale of the rice in Honolulu would be commercially reasonable for the reasons given by the Supreme Court of Hawaii.

Conversely, the seller could select the difference between contract price and market price at the time and place of tender as the measure of damages. In that case, the market price in San Francisco at the time of the shipment rather than the market price in Honolulu at the time of arrival would control, provided the contract is construed as a "shipment" sale rather than a "destination" sale. The facts stated by the Court seem to indicate the first alternative although the contract required arrival in Honolulu during November. The court did not have to pass on that question since the seller chose resale and residual damages for his remedy.

Section 2-706 does not exclude the addition of interest although it is not expressly mentioned as a component of the damages.

Section 2-707. "Person in the position of a seller".

1. This section defines the term "person in the position of a seller" (Subsection (1)) and lists the remedies to which such person is entitled (Subsection (2)).

2. The term "person in the position of a seller" includes a financing agency (as defined in Subsection 2-104(2)) which has paid or become responsible for the price of goods on behalf of its principal and any financing agency which otherwise holds a security interest or other right in goods similar to that of a seller. (cf. Section 2-505(1)(a)).

3. A person in the position of a seller may exercise three of the remedial rights listed in Section 2-703, viz.

   (a) withhold delivery of the goods;

   (b) stop delivery by any bailee (Sections 2-506(1) and 2-705);

   (c) resell and recover incidental damages (Sections 2-706 and 2-710).

   In the latter case, the seller's dispensation from accounting for profit does not apply (Subsection 2-706(6)).

4. The section clarifies and broadens the term "person who is in the position of a seller" employed by the former Uniform Sales Act, Section 52(2), Revised Laws of Hawaii 1955, Section 202-52(b).

Section 2-708. Seller's damages for nonacceptance or repudiation.

1. This section envisages an alternate course of action for liquidating a breach by the buyer which the seller may pursue instead of resale and recovery of residual damages: The seller may retain the goods as his own (the title having revested under Subsection 2-401 (4)) and liquidate additional damages measured either as the difference between the contract price and the market price or as loss of profits and (in either alternative) incidental damages.

2. The recovery of damages under this section is apposite in cases of wrongful "non-acceptance" and repudiation (Section 2-703 in conjunction with Subsection 2-708(1)). Wrongful non-acceptance covers wrongful rejection and, apparently in the seller's option, wrongful revocation of acceptance (Sections 2-703 and 2-709(3)). According to these two provisions, damages for non-acceptance may also be recovered under Section 2-708 if there is no delivery because of the buyer's failure to make a payment due on or before delivery.

3. In measuring the difference between the contract price and the market price, the actual market price at the time and place of tender or the substitute market price, as determined under Section 2-723, controls. In the case of anticipatory repudiation, if the action based thereon comes to trial before the time for performance, the critical time is the time when the seller learned of the breach (Section 2-723). In addition, the seller is entitled to incidental damages computed pursuant to Section 2-710. Due allowance must be made in the total for savings in expenses.

4. The time and place for the tender is the time and place of arrival in destination sales, but the time and place of shipment in shipment cases even though the breach is a wrongful rejection after arrival. The soundness of this rule has been questioned by Peters, <u>Remedies for Breach of Contracts Relating to the Sale of Goods Under the U.C.C.: A Roadmap for Article Two</u>, 73 Yale L.J. 199, at 258 (1963). The distinction between shipment and destination sales is not always easy. In <u>Grosjean v. Hiyama</u>, 28 Haw. 211 (1925) the contract stipulated "F.O.B. S.S. Dock San Francisco, Calif.", the goods to arrive "in Honolulu within November, 1920". It would seem that this contract was a shipment contract and that the place and time for tender was that of shipment in San Francisco. Accordingly, the market price in San Francisco at the time of delivery to the carrier would have been the proper market price had the seller selected to proceed under this section.

5. The formulation of the measure of damages as the difference between the market price and the <u>unpaid portion</u> of the contract price appears to be an inept expression for the difference between contract price (minuend) and market price (subtrahend), provided the latter is lower with proper credit for any payment made or proceeds credited on the contract price. Taken literally, the statutory language would entail the weird result that the damages would increase as the unpaid portion of the contract price decreases which obviously is not intended.

6. If the measure of damages specified above deprives the seller of any profit which he would have made from full performance by the buyer, including reasonable overhead, the seller may compute the damages on that basis. In addition, he may recover incidental damages under Section 2-710 as well as costs reasonably incurred but must give due credit to payments or proceeds from resale.

7. This section continues the rules of the former Uniform Sales Act, Section 64, Revised Laws of Hawaii 1955, Section 202-64, but generalizes the right to measure the damages for non-acceptance as lost profits, including reasonable overhead.

Section 2-709. Action for the price.

1. According to the basic policy of the Code a seller should not be allowed to sue for the price of goods prior to their acceptance except where particular circumstances make restriction to other remedies impracticable or unfair. Accordingly, Subsection (1) limits entitlement to an action for the price to three classes of cases:

   (a) where the goods concerned have been accepted;

   (b) where the risk of loss of conforming goods has passed to the buyer and the goods are lost or damaged within a reasonable time after the passage of the risk;

   (c) where the goods have been identified to the contract, either before or after breach, and no reasonable market can be found for them.

2. Since the buyer must pay at the contract rate for "goods accepted" (Subsection 2-607(1)) it is clear that the seller must have a corresponding remedy for enforcement of this duty. Subsection 2-709(1) makes it clear that the action lies when such payment "becomes" due upon or after acceptance. As the Official Comment, Point 5, points out, goods accepted "include only goods as to which there has been no _justified_ revocation of acceptance". In the case of a _wrongful_ revocation of acceptance, the seller seems to have the option between an action for the price and either "resale and residual damages" or "damages for non-acceptance". Subsection 2-709(3) does not necessarily restrict "goods accepted" to cases where _no_ revocation (justified or unjustified) has been made, especially in view of the seemingly inconsistent wording of Subsections 2-401(4) and 2-608(3) ("a buyer who _so_ revokes"). See the discussion _supra_ in Explanatory Note 6, to Section 2-703.

3. Subsection (1)(a) also authorizes an action for the price of _conforming_ goods which are damaged or lost within a reasonable time after their risk has passed to the buyer. The time of this passage is governed by Sections 2-509 and 2-510, differentiating between passage of title in the absence of a prior breach of either party and cases of breach by either the seller or the buyer.

   The qualification that the damage or loss must have occurred "within a commercially reasonable time" after the passage of the risk must be construed with reference to the various rules governing risk of loss allocation.

(a) If after identification of conforming goods to the contract the buyer either repudiates the contract or otherwise commits a breach (as _e.g._ non-compliance with a duty to cooperate, Subsection 2-311(3)(b)) before the risk of loss has passed to him, the seller may treat the risk of loss as having passed to the buyer for a commercially reasonable time (Subsection 2-510(3)) and if loss or damage occurs during this period, recover the price to the extent of any deficiency in his effective insurance coverage.

(b) If the buyer has not committed any breach causing accelerated passage of the risk of loss, that risk will pass pursuant to the various rules stated in Section 2-509. Accordingly, it will pass at the time of shipment (in the case of shipment sales) or at the time of tender of delivery to the buyer (in destination sales or sales by non-merchant sellers calling for delivery at the seller's place of business or at the location of the goods) or on receipt by the buyer (in cases of sales by merchant buyers calling for delivery at the seller's place of business or at the location of the goods). In any event, there will be an interval between the passage of the risk of loss and an acceptance, in view of the buyer's right to a reasonable opportunity of inspection (Section 2-606). If damage to, or loss of, conforming goods occurs during this interval, the seller may sue for the price as he may upon acceptance. It makes no difference in that respect whether acceptance takes place by signification or by failure to make an effective rejection (Section 2-606). If the buyer wrongfully rejects the goods, as he does of necessity in the case of _conforming_ goods, the seller must have a reasonable time to retake possession of the goods where necessary and to decide upon the course of action he wishes to pursue. If the goods perish or suffer during this period, the seller is still entitled to his action for the price. Accordingly, the length of the commercially reasonable period after the passage of the risk of loss within which loss of or damage to the goods must occur to entitle the seller to the price of non-accepted goods, will vary with the type of delivery envisaged. It will be on considerable duration in shipment sales if the buyer proceeds to a wrongful rejection. _Accord_, Peters, _Remedies for Breach of Contracts Relating to the Sale of Goods Under the U.C.C.: A Roadmap for Article Two_, 73 Yale L.J. 199 at 248 (1963). If in such case the seller, rather than the buyer, is protected by insurance, the purchase price must be reduced by the insurance payments. Although the Code prescribes this subtraction only for the cases of an accelerated passage of risk to the buyer (Subsection 2-510(3)), the same rule should apply _a tortiori_ to the normal passage of risk situations. Professor Peters, in discussing this problem, apparently overlooked Subsection 2-510(3) and its implications (_op.cit._ at p. 248).

4. The third class of cases in which the buyer may resort to the action for the price involves goods identified to the contract, whether before or after breach (Section 2-704) which the seller, despite reasonable efforts, is unable to resell at a reasonable price or which have no reasonable prospect of being so resalable. If the seller sues for the price in such case, he must hold the goods for the buyer. If resale subsequently becomes possible, the seller may resell them at any time before satisfaction of the judgment, but the buyer is entitled to credit on the judgment, in the amount of the net proceeds.

5. If the buyer defaults in making an advance payment, the seller may collect it by means of an action for the price only if the goods nevertheless have been delivered and accepted. Otherwise, only the other remedies enumerated in Section 2-703 are applicable. Since Section 2-703 refers specifically to failure to make payments due before delivery, it is probably unnecessary to classify this default as a breach of "the collateral (through coincident) obligation to finance the seller", as the Official Comment of Section 2-709, Point 4, suggests.

6. Subsection (3) expressly saves to the seller his right to recover damages for non-acceptance in the classes of breach specified in Section 2-703, despite the fact that his action for the price fails. The difficulties flowing from the wording of this subsection for the case of a wrongful revocation of acceptance have been alluded to in Explanatory Note 2, supra.

7. Section 2-709 greatly restricts the scope of the action for the price as it existed under the former Uniform Sales Act, Section 63, Revised Laws of Hawaii 1955, Section 202-63, especially by abolishing the action in case of advance payments or payments due irrespective of delivery or transfer of title.

   A good illustration is offered by the facts in Nichols Ltd. v. Kam, 32 Haw. 84 (1931). Plaintiff brought an action in assumpsit for the unpaid portion of the purchase price of a second-hand motor truck and certain repairs to be made before delivery. Defendant, by way of defense alleged that the seller had breached the contract by failure to deliver the automobile before the due date of the balance claimed. The Supreme Court held that plaintiff was entitled to retain the truck until payment of the repairs and therefore did not commit a breach. Under the Code the seller could no longer sue for the balance of the price under the circumstances of the case.

Section 2-710. Seller's incidental damages.

1. The seller's damages in cases of resale with residual damages (Subsection 2-706(1)) or in recoveries of damages for non-acceptance (Subsections 2-708(1) and (2)) or in an action for the price coupled with damages (Subsection 2-709(1)) include or consist of "incidental damages". This section defines the components of this type of damages.

2. Broadly speaking, these damages consist of all commercially reasonable expenditures, such as storage and transportation charges, commissions, advertising costs, auctioneer fees, etc. incurred as a result of the breach by the buyer.

3. The former Uniform Sales Act, Revised Laws of Hawaii 1955, Chapter 202 contained no specific rules as to "incidental" damages, but permitted their inclusion within its general rules as to the measure of damages, Uniform Sales Act, Sections 64(2) and 70, Revised Laws of Hawaii 1955, Sections 202-64(b) and 202-70.

Section 2-711. Buyer's remedies in general; buyer's security interest in rejected goods.

1. This section is the index section, specifying the buyer's remedies "in general", i.e. his remedies in cases of breach by the seller in regard to non-accepted goods. The buyer's right to damages for breach in regard to accepted goods is regulated separately by Section 2-714.

   The remedial rights granted in Section 2-711 are of a different character and include the right to cancellation and return of payments, alternative methods for the reparation of the damages resulting from the breach, remedies for enforcing performance and security interests in non-conforming goods in the buyer's possession with respect to claims for the return of payments and reimbursement for expenditures.

2. Following the methodology employed in the index section relating to seller's remedies in general (Section 2-703) Section 2-711 enumerates the types of breach by the seller to which it applies and cataloguizes the remedies available in these cases.

   The classes of breach by the seller envisaged by this section are:

(a) wrongful failure to make delivery;

(b) repudiation;

(c) tender of non-conforming goods entailing rightful rejection;

(d) delivery of non-conforming goods entailing justifiable revocation of acceptance.

The remedies available in one or several of these breaches are:

(a) cancellation;

(b) recovery of payments;

(c) cover and residual damages;

(d) damages for non-delivery;

(e) recovery of the goods from an insolvent buyer;

(f) recovery of the goods by means of an action for specific performance or replevin;

(g) enforcement of the security interest for the restitution of payments and expenditures by resale.

3. The details of the remedies enumerated are governed either by special sections following the index section (Sections 2-712, 2-713, 2-715 and 2-716), or by sections in other parts of Article 2 (Sections 2-106 and 2-502), or by sections pertaining also to sellers' remedies (Sections 2-706(6), 2-723 and 2-724).

4. The former Uniform Sales Act had no comparable index section. The possessory security interest in rejected goods accorded by Subsection (3) was also granted by the Uniform Sales Act, Section 69(5), Revised Laws of Hawaii 1955, Section 202-69(e).

Section 2-712. "Cover"; buyer's procurement of substitute goods.

1. This section regulates the buyer's right to cover and residual, incidental or consequential damages. It is the counterpart to the seller's right to resale and incidental damages, governed by Section 2-706. Like the latter remedy in the case of the seller, this remedy is the preferred remedy in the case of the buyer.

Although the right is strictly optional (Subsection (3)) the Code encourages its utilization by barring recovery of consequential damages which reasonably could have been prevented by cover (Section 2-715(2)(a)), limiting the right to replevin to breaches where cover is unavailing (Section 2-716(3)) and freeing it from narrow limitations.

2. The right is granted to merchant buyers and non-merchant buyers alike. It covers any reasonable contract or contracts for the purchase of substitute goods, provided they are made in good faith and without unreasonable delay.

3. The buyer is entitled to recover from the seller as damages the difference between the cost of cover and the contract price and incidental and consequential damages as specified in Section 2-715 but must allow for savings in expenses.

4. The right to cover is a newly codified remedy of the buyer which was not provided by the former Uniform Sales Act, Revised Laws of Hawaii 1955, Chapter 202.

<u>Section 2-713. Buyer's damages for nondelivery or repudiation.</u>

1. In the four situations of breach by the seller listed in Subsection 2-711(1), the buyer may, as an alternate to cover and incidental and consequential damages under Section 2-712, recover damages for non-delivery computed under this section.

2. The measure of damages without cover is the difference between the market price at the time when the buyer learned of the breach and the contract price and, in addition, incidental and such consequential damages as could not have been avoided by cover (Subsection 2-715(2)(a)) with proper allowance for expenses saved in consequence of the breach by the seller.

3. The relevant market is either the place where tender was to be made or, in cases of rejection after arrival or revocation of acceptance, the place of arrival. The determination is made pursuant to Section 2-723.

4. This section is equivalent to the recovery of damages for non-delivery under the former Uniform Sales Act, Section 67(1) and (3), Revised Laws of Hawaii 1955, Section 202-67(a) and (c) with clarification of the relevant market.

5. For a good discussion of policy disparities between the computation of seller's damages for non-acceptance under Subsection 2-708(1) and buyer's damage for non-delivery, see Peters, Remedies for Breach of Contracts Relating to the Sale of Goods Under the U.C.C.: A Roadmap for Article Two, 73 Yale L.J. 199, at 258 (1963).

Section 2-714. Buyer's damages for breach in regard to accepted goods.

1. This section determines the adjustment that must be made to compensate the buyer in the case where he has accepted goods despite any non-conformity of tender and given the notice which is required of the buyer by Subsection 2-607(3)(a) or (b), in order to preserve remedies under Section 2-714 or any other apposite remedy. This section concerns the remedy of the buyer in a situation which is outside the four classes of breach enumerated in the basic index section (Section 2-711). The buyer in the case at hand is not relieved of his duty to pay (Subsection 2-607(1)) but is entitled to an adjustment by way of compensation for damages (cf. also Section 2-717).

2. The remedy is available as compensation for any non-conformity of tender, whether or not it would have entitled the buyer to rightful rejection or justified revocation of acceptance, and regardless of whether the non-conformity constitutes a breach of warranty, or consists in some other defect in the delivery.

3. The computation of damages, however, varies according to whether the non-conformity of the delivery rests on a breach other than a breach of warranty or on a breach of warranty as will be the case in most defects relating to the quality or the title of the goods.

   (a) If the breach is caused by non-conformity other than a breach of warranty, damages are measured by the loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable.

   (b) If the non-conformity consists in a breach of warranty, the measure of damages is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted unless special circumstances show proximate damages of a different amount.

4. The formula used for the normal measure of damages in breach of warranty situations differs in many respects from the method used in the computation of damages for non-delivery. While the relevant market in the case of non-delivery is either the place for tender or the place of arrival, according to the circumstances (Section 2-713), the relevant market in breach of warranty cases is the place of acceptance. The critical time in breach of warranty cases is the time of acceptance, while in the cases of non-delivery the time when the buyer learned of the breach is the determinative moment. The Official Comment, Point 3, suggests that in cases where the buyer decides not to proceed to a justifiable revocation of his acceptance, that moment should be the "time of acceptance" within the meaning of Subsection (2), but such construction seems to do violence to the methodology of Article 2 as a whole.

   The formula measure is fixed as the difference between the value of the defective goods and the value of such goods conforming to the warranty. Value means actual or hypothetical market value, without reference to the specific contract price. This method is pursued to save to the buyer the benefit of his bargain, see Peters, <u>Remedies for Breach of Contracts Relating to the Sale of Goods Under the U.C.C.: A Roadmap for Article Two</u>, 73 Yale L.J. 199, at 270 (1963).

5. In addition to formula-determined damages, the buyer may also claim incidental and consequential damages flowing from the breach (Subsection (3)).

<u>Section 2-715. Buyer's incidental and consequential damages</u>.

1. This section is the corollary to Section 2-710 and defines the components of the buyer's incidental and consequential damages and the conditions for his entitlement thereto.

2. Incidental damages include expenditures incurred in the inspection, receipt, transportation and care of goods rightfully rejected and reasonable charges, expenses or commissions connected with the procurement of cover and other reasonable expense incident to the delay or other breach.

3. Consequential damages flowing from the seller's breach include any loss resulting from the buyer's general or particular needs or circumstances of which the seller had reason to know of at the time of contracting and which could not reasonably be prevented by cover or other measures. The Code liberalizes the rule in some jurisdictions and rejects the "tacit agreement" test. The

inclusion of loss of good will is debated, see Peters, _Remedies for Breach of Contracts Relating to the Sale of Goods Under the U.C.C.: A Roadmap for Article Two_, 73 Yale L.J. 199, at 276 (1963).

4. Consequential damages also include injury to person or property of the buyer proximately resulting from any breach of warranty (Subsection (2)(b)). In the case of breaches of warranty _vis-a-vis_ third parties linked to the buyer, damages are only recoverable if such persons are "injured in person" (Section 2-318). Whether in such contingency property damages are also recoverable under Subsection (2)(b) is not clear. See Explanatory Note 3 to Section 2-318.

5. Section 2-715 both contracts and expands the rule on special damages contained in the former Uniform Sales Act, Section 70, Revised Laws of Hawaii 1955, Section 202-70.

Section 2-716. Buyer's right to specific performance or replevin.

1. Subsection 2-711(2)(b) grants the buyer the right to secure delivery of existing or future goods by means of actions for specific performance or in replevin "where the seller fails to deliver or repudiates" the contract. Section 2-716 implements this section by specifying additional limitations and conditions.

2. The additional qualifications for equitable relief decreeing specific performance are broadly stated and cover cases where the goods are unique or in other proper circumstances (Subsection (1)). The scope of the decree may include such terms and conditions as the court deems just (Subsection (2)). The formulation of Subsection (1) indicates that the Code intends to broaden the buyer's right to compel performance where the other remedies are, by modern standards, inadequate.

3. Subsection (3) implements the declaration of Subsection 2-501(1) which attributes "special property" to a buyer upon the identification of goods to the contract regardless of their conformity or non-conformity. It gives the buyer the right to vindicate his special property by means of replevin if there are no reasonable prospects of cover or if the goods have been shipped under reservation (Section 2-505) and satisfaction of the security interest has been tendered.

4. The right to replevin, must yield to the rights of the seller's creditors under Subsection 2-402(2) if a rule of local law so prescribes, and, if a merchant seller, to the rights of buyers in ordinary course of business if the circumstances of the case war-

rant qualification of the buyer's conduct as "any acquiescence in retention of possession". (Subsections 2-403(2) and (3)). See the Explanatory Notes to Sections 2-402 and 2-403.

5. Subsections (1) and (2) are based on the former Uniform Sales Act, Section 68, Revised Laws of Hawaii 1955, Section 202-68. Subsection (3) is novel.

   The right of a buyer to specific performance by the seller was before the Supreme Court of Hawaii in the case of Paris v. Greig, 12 Haw. 274 (1899). Defendant was the administrator of one Fernandez, deceased. The deceased had agreed to sell all his cattle to plaintiff at a stipulated price per head, said cattle to be driven by deceased. The contract remained unperformed, and plaintiff sued for specific performance. During the litigation the seller died, and the administrator was substituted as respondent. The Supreme Court held that specific performance should not be decreed against the administrator since the contract contemplated the drive by the deceased. In reaching the result, the Court observed: "Perhaps, on the whole, but we do not so decide, if the original defendant were living, he might properly be compelled to make the drive, though it must be confessed that this is not altogether clear from the authorities."

Section 2-717. Deduction of damages from the price.

1. The section permits a buyer to deduct all or any part of his damages for breach of contract from any unpaid part of the price, provided he notifies the seller of his intention to do so.

2. This section adds the notification requirement to the equivalent rule of the former Uniform Sales Act, Section 69(1)(a), Revised Laws of Hawaii 1955, Section 202-69(a)(1).

Section 2-718. Liquidation or limitation of damages; deposits.

1. This section, while permitting contractual liquidation of damages, curbs the validity of stipulations of that type where the amount agreed upon is excessive or where the liquidation clause is not a genuine effort to settle damages but seeks to disguise a forfeiture.

2. Subsection (1) states the general test for the validity of stipulations liquidating damages for breach, requiring that the amount agreed upon must be reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of

loss and the inconvenience or non-feasibility of other relief. A term fixing damages at an excessive amount is void.

3. Subsection (2) denies recognition to "retention of payments" clauses if the seller justifiably withholds delivery because of a breach by the buyer to the extent the amount sought to be retained exceeds either the amount to which the seller is entitled by virtue of a valid liquidation of damages term or, in the absence of such term, an amount equalling 20 per cent of the value of the total performance owed by the buyer or $500, whichever is smaller.

4. Subsection (3) subjects the buyer's right to restitution of all payments that exceed the permissible amounts specified in Subsection (2), to offsets in the amount of damages recoverable apart from a liquidated damages clause and the value of benefits received by the buyer by reason of the contract.

5. Where a seller has received payment in goods, their reasonable value or the proceeds of their resale are treated as payments for the purpose of the buyer's right to restitution. If the seller has notice of the buyer's breach before reselling goods, he must proceed by meeting the same standards and following the same methods as an aggrieved seller under Section 2-706.

6. These rules have no statutory precedent in the former Uniform Sales Act, Revised Laws of Hawaii 1955, Chapter 202.

Section 2-719. Contractual modification or limitation of remedy.

1. This section grants the parties autonomy to fashion their own remedies in addition to, or substitution for, those provided in Article 2 as well as to limit or alter the measure of damages recoverable for breach. By way of example, the Code lists clauses which limit the remedies of a buyer to return of the goods and restitution of the price or to repair and replacement of defective goods. The remedies provided, however, must not constitute penalties or forfeitures.

2. Stipulated remedies are optional, unless other remedies are expressly excluded. If for some reason an exclusive remedy fails of its essential purpose, the statutory remedies are reinstated.

3. Consequential damages may be limited or excluded unless such stipulation violates the prohibition against unconscionable terms (Section 2-302). This is prima facie the case if the limitation applies to injury to the person caused by defective consumer goods but not if it restricts recovery for commercial losses.

4. The Code differentiates sharply between exclusion or modification of warranties and modification or limitation of remedy, including exclusion and limitation of consequential damages (Subsection 2-316(4)). This approach has been criticized as a distinction without a difference by Peters, Remedies for Breach of Contracts Relating to the Sale of Goods Under the U.C.C.: A Roadmap for Article Two, 73 Yale L.J. 199, at 282 (1963). In addition, the Code prohibits the exclusion or limitation of extension of warranties to particular classes of beneficiaries who sustain injury in person (Section 2-318, last sentence).

5. Section 2-719 envisages modification or limitation of remedy before breach. Waiver or renunciation after an alleged breach is governed by Section 1-107.

6. The rules of this section have not been previously codified.

Section 2-720. Effect of "cancellation" or "rescission" on claims for antecedent breach. While the Code employs the term "cancellation" in a carefully defined, strictly technical sense (Subsections 2-106(4), 2-612(3), 2-703(f) and 2-711(1)) and eschews use of the term rescission, except on two occasions (Subsections 2-209(2) and (4) and Section 2-721), the parties may not be as careful in their language. This section prescribes the rule of construction that cancellation or rescission of the contract, when used as contractual expressions or in unilateral declarations, shall not be held to include a renunciation or discharge of any claim in damages for antecedent breach, unless a contrary intention clearly appears.

Section 2-721. Remedies for fraud.

1. The Code does not deal comprehensively with fraud and material misrepresentation but leaves these matters specifically to the general principles of law which remain applicable to supplement the provisions of the Code, unless displaced by particular provisions (Section 1-103). Section 2-721 is the sole section in Article 2 to do so.

2. This section removes certain limitations which traditionally have impaired adequate redress for the victim in these cases. It prescribes that the remedies for material misrepresentation or fraud shall include all remedies accorded by the Code for non-fraudulent breach, i.e. especially non-fraudulent breach of warranty. In particular, neither rescission or a claim for rescission nor rejection or return of the goods shall bar a claim for damages.

3. In connection with Section 2-721, reference must be made to Subsection 2-403(1) which specifies that the voidability of title due to fraud or material representation by the transferee does not deprive him of his power to convey good title to a good faith purchaser for value.

Section 2-722. Who can sue third parties for injury to goods.

1. Under the step-by-step regime of the Code, with its de-emphasis of the title concept and its expansion of fractional property interests of the parties to the sale in the goods depending on the progress of performance, the standing to sue of a third party who has damaged the goods needs uniform regulation. The possible interests of the parties are characterized by the Code as title (Section 2-401), security interest (Subsection 1-201(37)), buyer's special property interest (Subsections 1-201(37), 2-401(1), 2-501(1)), and insurable interest (Subsection 2-501(1)). The Code has no name for the special property interest of the buyer as involuntary bailee upon the rightful or wrongful rejection of the goods (Subsection 2-602(2)(b)) or the justified revocation of acceptance (Subsection 2-608(3)) title having reverted to the seller under Section 2-401(4). Likewise, the Code has refrained from a characterization of the seller's interest in goods upon delivery of them on credit without reservation of a security interest (Sections 2-502 and 2-705).

2. Section 2-722 accords either party to a contract for sale who has one of the "named" interests listed above in the goods the right to sue a third party who deals with goods identified to the contract so as to cause actionable injury to the plaintiff, the other party or both. In addition, where the goods have been destroyed or converted, a right of action is also in the party who bore the risk of loss (Sections 2-509, 2-510) or assumed that risk as against the other since the injury. This catalogue does not exclude additional cases where a party may have a legitimate interest in seeking redress of harm to the goods for the benefit of the other party, as may be the case in the involuntary bailment situations following rightful rejection or justified revocation of acceptance (Subsections 2-510(1), 2-602(2)(b) and 2-608(3)). The case of a wrongful rejection of goods in the buyer's possession falls under the second clause of Section 2-722(a) since the risk of loss will remain on the buyer despite the reversion of title. See also Official Comment to Section 2-722, last sentence, relating to a seller in possession after acceptance.

3. Where the party plaintiff at the time of the injury did not bear the risk of loss vis-a-vis the other party, and absent a subsequent arrangement between the parties, he must conduct the action or the settlement thereof, to the extent that he has no interest of his own, as fiduciary for the other party.

4. The rules of the section represent newly codified law.

   They are in accord with the liberal trend of the case law. In Hawaii it was held in Anduha v. County of Maui, 30 Haw. 44 (1927) that the buyer under a conditional sales contract could bring an action against a third party who had damaged the goods sold under reservation of title.

Section 2-723. Proof of market price; time and place.

1. This section specifies the critical time for the determination of the market price if the breach by the seller or buyer consists in an anticipatory repudiation, and an action based thereon comes to trial before the performance (Subsection (1)). In addition, it provides rules for the determination of a substitute market price if the actual market price at the determinative times and places is not readily ascertainable (Subsection (2)).

2. Subsection (1) which fixes the critical time as the time when the aggrieved party learned of the repudiation, is limited to cases of anticipatory repudiation where the action based thereon comes to trial before time of performance. Hence, if the trial is subsequent to the time of performance, the time for tender controls in the case of a repudiation, buyer's repudiation (Section 2-708) while in the case of a seller's repudiation, this limitation is of no practical significance since Subsection 2-713(1) declares the time when the buyer learned of the breach to be the controlling moment for the determination of the market price in all cases of non-delivery or repudiation.

3. Where the market price cannot be ascertained for the critical date or place, the price prevailing within a reasonable time before or after that date or at any other place which by commercial standards serves as a reasonable substitute may be used, with proper adjustments for effects of transportation costs.

4. Evidence of a substitute market price is not admissible unless the party intending to do so has notified his adversary in time to prevent unfair surprise.

5. The rules of this section are newly codified.

Section 2-724. Admissibility of market quotations.

1. This section governs the admissibility in evidence of reports in official publications, trade journals, newspapers, or periodicals of general circulation, published as the reports of established commodity markets for the purpose of proving the prevailing price or value of any goods regularly traded in such markets. The section affirms the admissibility of such reports and provides that the circumstances of the preparation of such reports may be shown only for the purpose of determining credibility but not admissibility.

2. The policy of this section is in conformity with Subrule 63(30) of the Uniform Rules of Evidence, approved by the National Conference of Commissioners on Uniform State Laws (1953). That subrule excepts from the inadmissibility as hearsay evidence, "Evidence of statements of matters of interest to persons engaged in an occupation contained in a list, register, periodical, or other published compilation to prove the truth of any relevant matter so stated, if the judge finds that the compilation is published for use by persons engaged in that occupation and is generally used and relied upon by them."

3. The section contains newly codified law.

Section 2-725. Statute of limitations in contracts for sale.

1. In view of the advisability of uniformity on the subject, this section contains a special statute of limitations governing actions for breach of contracts for the sale of goods, determining both the length of the period of limitation and its starting date.

2. Subsection (1) fixes the length of the limitation period at four years but permits shortening it to not less than one year in the original agreement. Contractual lengthening is not permitted. Subsection (1) does not apply to waivers while the limitation period is running or has run. To that extent the matter remains governed by local rules (cf. Subsection (4)).

3. The limitation period starts running upon the accrual of the cause of action, which normally is the date when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach. In the case of a breach of warranty, whether statutory, express or implied, the breach occurs when tender of delivery is made. Where, however, a warranty explicitly extends to future performance of the goods and discovery of the breach must await the time of such performance, the cause of action accrues when the breach

is or should have been discovered. The warranty of good title or freedom from claim for infringement does not fall within this exception, see Official Comment to Section 2-312, Point 2.

4. Subsection (3) incorporates the savings provision of many state statutes which gives an additional grace period for bringing a second action if the first action has been terminated without barring a further suit for the same cause of action. The Code permits a grace period of six months for the bringing of another action for the same breach if the first action was timely instituted and terminated without bar against a second action. This rule does not apply where such termination resulted from voluntary discontinuance or failure or neglect to prosecute.

5. Local statutes on tolling of the statute of limitations remain applicable. Unaffected, therefore, are Revised Laws of Hawaii 1955, Sections 241-12 to 241-18.

6. Prior to the enactment of the Code, the limitation period in Hawaii governing actions for breach of contract relating to contracts for the sale of goods and committed in the state was six years after accrual, Revised Laws of Hawaii 1955, Section 241-1 (a). For causes of action arising in sister states, it was four years, Revised Laws of Hawaii 1955, Section 241-6. Hawaii did not have a grace period statute, except for real actions. The changes made by the Code do not affect causes of actions which have accrued prior to January 1, 1967.

ARTICLE 6.

BULK TRANSFERS

Article 6 governing the law regulating Bulk Transfers is the shortest article of the Code, consisting of only eleven sections. It was designed to unify and streamline the existing bulk sales laws of the states. Legislation of this type has been advocated and sponsored by the credit men's associations since the turn of the century. See Billig, Bulk Sales Laws: A Study in Economic Adjustment, 77 U. Pa. L. Rev. 72 (1928). Their efforts had first success in Louisiana where statutes regulating bulk sales were enacted in 1894 and 1896. (La. Acts 1894, p. 205 (No. 166); La. Acts 1896, p. 137 (No. 94)) From there legislation of this type spread to all jurisdictions of the United States. (3 Williston, Sales of Goods 467 (rev. ed. 1948)) Hawaii enacted a statute governing the subject in 1913. (Act 47, Session Laws of Hawaii 1913) The statute was copied from the Pennsylvania Act of 1905 (Pa. Laws 1905, p. 62 (No. 44)) with some minor changes deemed to be necessary. (Journal of the Senate of the Territory of Hawaii 1913, "Report on Senate Bill No. 33", p. 239-241)

The main purpose of this kind of statute is to afford creditors relief against two types of commercial fraud committed by way of bulk transfers. These situations occur, as epitomized in the Official Comments to the Code (Section 6-101, Official Comment, Point 2) where

"(a) The merchant, owing debts, sells out his stock in trade to a friend for less than it is worth, pays his creditors less than he owes them, and hopes to come back into the business through the back door some time in the future.

(b) The merchant, owing debts, who sells out his stock in trade to anyone for any price, pockets the proceeds, and disappears leaving his creditors unpaid."

The first category of transactions, in view of the lack of fair consideration, would be rendered voidable by the general law against fraudulent conveyances, especially in the states which have adopted the Uniform Fraudulent Conveyance Act, but presumably also in Hawaii. See, e.g., Yuen v. French, 29 Haw. 625, 635 (1927). The bulk sales acts mainly add a valuable policing device. The second class of cases, on the other hand, constitutes the major risk that called for legislative intervention and necessitated an extension of the traditional principles governing fraudulent conveyances. That classification has important consequences for the application of this kind of statute.

Historically bulk sales laws fall into two major classes. One, represented by the first Pennsylvania act and the Hawaiian statute, did no more than to require notification of the seller's creditors prior to the consummation of a sale in bulk and to provide that a sale without compliance with the publicity requirement was deemed to be a fraudulent transfer. The other class, which included acts subsequently adopted in Pennsylvania (Pa. Laws 1919, Act 141, p. 262) and a minority of jurisdictions, placed upon the purchaser a responsibility for the application of the proceeds to the payment of the creditors. A number of the acts which required notification of the creditors prescribed direct communication to the creditors (e.g., N.Y. Personal Property Law, sec. 44 (now repealed)) while others were satisfied with recordation of a notice of sale and publication in newspapers. (E.g., Cal. Civ. Code, sec. 3440.1 (now repealed)) In Hawaii an amendment of 1931 (Act 271, Session Laws of Hawaii 1931) required direct notification and recordation of notice.

The Uniform Commercial Code makes provisions for the application of the proceeds from bulk sales in Section 6-106 merely optional, leaving it to the individual states to retain their prior policies on that issue. In states where no such provisions are adopted, creditors who are properly notified of the intended sale must take all steps available under applicable law for the protection of their interests, such as the avoidance of the transfer as a fraudulent conveyance if the circumstances and terms thereof warrant such action or garnishment of the purchaser for the price. Although an amendment of the Bankruptcy Act to that effect has been proposed, at present a bulk transfer as such is not an act of bankruptcy.

The regulation of the Code modifies the prior law of Hawaii in many important details. The changes will be specified under the respective sections.

Section 6-101. Short title. The title chosen by the framers of the Code as suitable for citation is "bulk transfers" rather than bulk sales since the transfers rather than the transactions which give rise thereto are voidable, unless the provisions of this article are complied with.

Section 6-102. "Bulk transfers"; transfers of equipment; enterprises subject to this article; bulk transfers subject to this article.

1. This section enumerates the elements which constitute a bulk transfer within the meaning of this article and render such transfer

subject to the requirements specified in Article 6, unless the transfer is excluded by reason of falling into one of the classes of transfers expressly exempted by Section 6-103.

2. Section 6-102 lists six elements which must concur for the application of Article 6, viz. (a) a transfer "in bulk", (b) not in the ordinary course of the transferor's business, (c) of a major part, (d) of the transferor's inventory (as defined in Section 9-109), whether consisting of materials, supplies, merchandise or other goods, if (e) the transferor is an enterprise whose principal business is the sale of merchandise from stock including manufacturers who sell their products, and (f) the goods so transferred are within the state.

3. The bulk transfers dealt with in Article 6 cover only transfers of goods, not transfers of other property such as money, instruments including investment securities, chattel paper, accounts, contract rights or general intangibles. The goods must constitute inventory within the meaning of Section 9-109. Transfers of equipment are covered if they are made in connection with a bulk transfer of inventory and not otherwise. Even if goods are inventory, bulk sales of a major part thereof are not covered unless the principal business of the transferring enterprise is the sale of merchandise from stock. The reason for this limitation was the desire of the framers of the Code to exclude businesses whose principal lines of activities are the rendition of services such as construction enterprises, hotels, restaurants, barbershops, radio and television repair shops, etc. Unfortunately, the statutory definition also excludes enterprises whose principal business is the leasing of machinery. Although the machines held for leasing are inventory as defined in Subsection 9-109(4), the lessor is not engaged in a sale of merchandise from stock as required by Subsection 6-102(3).

4. The transfer in bulk must include a major part of the enterprise's inventory. The Code contains no standard for the determination of this criterion. It is therefore an open question whether the major part relates to the quantity or value of the goods constituting the inventory. The lack of a definite test for the determination of the major part of the inventory has been criticized by several commentators. See Duesenberg and King, Sales and Bulk Transfers under the U.C.C., 3 Bender's Uniform Commercial Code Service, Sec. 15.02(1) (1967); Rapson, Article 6 of the U.C.C.: Problems and Pitfalls in Conducting Bulk Sales, 68 Com. L.J. 226 (1963). Wisconsin specified that the requisite major part must be determined according to value, but the

Permanent Editorial Board considered addition of the phrase "in value" as being "redundant", Report No. 2 of the Permanent Editorial Board for the Uniform Commercial Code 105 (1964). It would seem that value is the proper standard of measure. In support of this view it may be mentioned that Section 70d(4) of the Bankruptcy Act which denies protection to a bona fide purchaser from a bankrupt where all or "the greater portion" of the bankrupt's non-exempt property are in the possession of a receiver seems to have been interpreted as meaning greater portion in value. See Lake v. New York Life Insurance Co., 218 F. 2d 394 (4 Cir. 1955).

5. Where an enterprise maintains inventory in several states, the major part seems to require measurement with reference to the aggregate inventory and not merely the inventory located in one state. The typical bulk risks are not present if the enterprise is engaged in multi-state activities and merely withdraws from one state by disposing of its inventory there.

6. Transfers in bulk of equipment are subject to the provisions of Article 6 if they extend merely to a "substantial" part thereof. The applicability of Article 6, however, in this case is predicated on the condition that such transfer is made in connection with a bulk transfer of inventory, i.e. a transfer disposing of a major part of the enterprise's inventory.

7. In addition to the criteria based on the quantity and quality of the objects of the transfer and the kind of business of the transferor Section 6-102 requires that the transfer not be in the ordinary course of the transferor's business. A lucky deal by which a business secures an unusually large order of its specialized brand of merchandise is not a bulk sale subject to the curbs of Article 6.

8. Since the drafters of the Code wanted to minimize the delays resulting from the notice requirements of this Article, the loose terms employed should not be subject to a broad and inclusive interpretation.

9. Revised Laws of Hawaii 1955, chapter 200, the former bulk sales law of Hawaii applied to the sale of a "large part" of a stock of merchandise and fixtures, or merchandise or fixtures. The new law, accordingly, is less stringent than the former system. Moreover, the former statute expressly included fixtures. Although fixtures are goods within the definition of goods governing Article 9 (Subsection 9-105(1)(f)) and may be goods within the meaning of that term applicable to Article 2

(Subsection 2-105(1), 2-107(1) and 2-107(2)), it is hard to conceive of fixtures as inventory or stock of merchandise. Accordingly, the sale in bulk of fixtures will ordinarily be a sale of equipment and therefore be covered by Article 6 only if it is made in connection with a bulk transfer of inventory (Subsection 6-102(2)). Hence, again, the new provisions are less extensive in scope in that respect than the former Chapter 200.

Section 6-103. Transfers excepted from this article.

1. Since compliance with the bulk transfer provisions causes delay in the consummation of legitimate business transactions and imposes burdens on purchasers, the framers of the Code have attempted to limit the scope of Article 6 to deals which involve substantial risks for the transferor's creditors. In consonance with this policy, Section 6-103 exempts eight categories of bulk transfers from the notice requirements of Sections 6-104, 6-105 and 6-107, either dispensing with any type of notice or imposing only a duty of giving public notice.

2. In contrast to some of the antecedent state bulk sales laws, the Code excludes from the scope of Article 6 book transfers in bulk for security and transfers in settlement or realization of a lien or other security interest (Subsections (1) and (3)).

3. Similarly excluded are general assignments for the benefit of all the creditors of the transferor and subsequent dispositions by the assignee thereunder as well as sales by executors, administrators, receivers, trustees in bankruptcy or any public officer under judicial process (Subsection (2) and (4)). Likewise exempt are sales made in the course of judicial or administrative proceedings for the dissolution or reorganization of corporations; provided that the creditors are notified thereof pursuant to an order of the court or administrative agency (Subsection (5)).

4. Subsection (6) contains the most important and quite novel exemption from the general notice and liability provisions of Article 6. If the transferee to whom the bulk transfer is made is a person maintaining a known place of business in the State and if such person assumes to pay the debts of the transferor in full, without becoming insolvent (as defined in Subsection 1-201(23)) after such assumption, the giving of public notice of the transaction relieves the parties of compliance with the more cumbersome general provision of Article 6. The satisfaction by merely a simplified notice rests on the reason that assumption of the debts of the seller by a

responsible and easily available buyer obviates the risks for creditors ordinarily inherent in bulk transfers. The public notice requirements are satisfied by publishing once a week for two consecutive weeks in a newspaper of general circulation at the principal place of business of the transferor in the state, an advertisement which lists the names and addresses of the transferor and transferee, gives the effective date of the transfer and states that the transferee has assumed the payment in full of the transferor's debts (Subsection 6-103, last paragraph).

5. For the same reasons, only the giving of public notice as specified in the last paragraph is needed where the transfer is made to a new business enterprise organized to take over and continue the business, if the new enterprise assumes the debts of the transferor and the transferor receives no consideration other than an interest in the new enterprise subordinate to the claims of creditors. In such case the creditors have the same credit base as before.

6. Since secret bulk transfers are considered to be a particular form of fraudulent conveyance and since in general transfers of exempt property do not constitute fraudulent conveyances, Subsection 6-103(8) excludes transfers of exempt property from the provisions regulating bulk transfers.

7. Auction sales, while not subjected to a special regulation by Section 6-103, are nevertheless regulated by a regime of their own set forth in Section 6-108.

8. The former bulk sales law, Revised Laws of Hawaii 1955, Section 200-3, contained exemption similar to those contained in Subsections 6-103(2) and (4). The other exemptions are new.

Section 6-104. Schedule of property, list of creditors.

1. Sections 6-104, 6-105, and 6-107 specify the publicity requirements to be observed in order to render bulk transfers unassailable and thus contain the heart of Article 6. Noncompliance renders the transfers "ineffective" against creditors of the transferor (Sections 6-104(1) and 6-105), as further detailed in Sections 6-109, 6-110 and 6-611. Section 6-106 is omitted in Hawaii. It is reserved by the drafters of the Code for an optional section regarding the application of proceeds, and was not adopted by Hawaii in consonance with the pre-Code policy relating to bulk sales. Hawaii thus is in accord with the position taken by the majority of states.

2. Article 6 imposes two principal sets of burdens upon the transferee in a bulk transaction: (a) the procurement from the transferor of a verified list of his "existing" creditors and the compilation together with the transferor of a schedule of the property transferred, both documents to be either preserved for inspection for six months or filed for record, and to a notification of the creditors shown on the list or known to the transferee prior to the consummation of the transfer. Section 6-104 deals with the first of these two sets of burdens.

3. According to Subsection (1)(a) the transferee must require the transferor to furnish a list of his existing creditors in the form and with the content set forth in Subsection (2). The transferee is not responsible for errors and omissions in the list, unless he has actual knowledge thereof (Subsection (3)). The list must be signed and sworn to or affirmed by the transferor or his agent. It must contain the names and business addresses of all existing creditors of the transferor with the amounts owed when known, including the names of all persons known to the transferor who claim that he is indebted to them. In the case where creditors are represented by an indenture trustee only his name and address need to be listed together with the aggregate principal amount of the outstanding issue of bonds or debentures.

4. The mandate to list "all" "existing" creditors in Subsections (1)(a) and (2) is very broad indeed and has puzzled many commentators, see Duesenberg & King, <u>Sales and Bulk Transfers under the U.C.C.</u>, 3 <u>Bender's Uniform Commercial Code Service</u>, Sec. 15.04 [2][a] (1966); 2 Haukland, <u>A Transactional Guide to the U.C.C</u>. 848 (1964). The Official Comment to Section 6-104 contains cross-references to Sections 1-201 and 6-109. The latter section refers broadly to "claims based on transactions or events occurring before the bulk transfer". Therefore it seems to be clear that the term "creditor" is not qualified by the nature or the origin of the claim and that it includes all claims, whether matured or unmatured, liquidated or unliquidated, fixed or contingent, secured or unsecured, contract or tort. Likewise it seems to be irrelevant whether the claim has a business or a private character. The main problem relates to the time element. Under the Code a bulk transfer must pass through a number of consecutive stages: compilation and transmittal of the creditors' list by the transferor; mailing of the notices to the creditors entitled thereto; elapsing of ten or more days; taking possession of the goods; payment. The last two stages may occur simultaneously or in reverse order. Section 6-109 refers to creditors who become such "before the

bulk transfer", but offers no test for the determination of the time of such transfer, although apparently the taking of possession by the transferee is the critical event. Section 6-109 expressly provides, however, that creditors who become such after notice is given are not entitled to notice. Does this imply that creditors who become such after the creditors' list is compiled and transmitted but before the notices are mailed or delivered must be notified, in other words must the list be kept absolutely current by additions until the notices are actually given? The answer to that question seems to follow from Subsection 6-107(3) which extends the entitlement of notification to creditors shown on the creditors list and to creditors known to the transferee to hold or assert claims. Although the argument is not absolutely cogent, it would seem that the Code does not impose a burden on the transferee to require additions to the list until the notices are given, so long as the delay between the receipt of the list and the giving of the notices is not commercially unreasonable. Failure of the transferee to notify unknown creditors of the transferor who have become such during a commercially reasonable interval between the receipt of the list and the giving of the notice do not vitiate the bulk transfer. As a matter of good business practice, however, a transferee would be well advised to insist on currency of the list at the time of the actual giving of the notice. Other commentators agree with the view here taken, Duesenberg and King, op. cit. supra, sec. 15.04(2)(a)(c).

5. About the position of taxing authorities as creditors, see Explanatory Note 4 to Section 6-105.

6. The transferee in cooperation with the transferor must compile a schedule of the property transferred, describing it in a manner sufficient to identify the same, Subsection 6-104(1)(b).

7. The list of creditors and the schedule of property transferred must be either preserved by the transferee for a period of six months subsequent to the transfer and be open for inspection at all reasonable hours by the creditors of the transferee or be filed by him in the Bureau of Conveyances, Subsection 6-104 (1)(c).

8. Non-compliance with the burdens imposed upon the transferee by this section and Sections 6-105 and 6-107 renders the bulk transfer "ineffective" against "any" creditor of the transferor. The adjective "any" is defined and qualified by Section 6-109, see Explanatory Notes to that section. The lack of effectiveness is asserted in the manner provided for by local law for the avoidance of fraudulent conveyances, see Official Comment, Point 2 to Section 6-104. Since Hawaii has not adopted the Uniform

Fraudulent Conveyance Act, the matter is governed by case law and applicable rules of procedure. Traditionally a creditor had two avenues for assailing a fraudulent conveyance: he could either reduce his claim to judgment and levy the execution on the property fraudulently conveyed or he could have it set aside by means of a creditor's bill available to him after reduction of his claim to judgment and a return nulla bona of an execution issued thereon, Dee v. Foster, 21 Haw. 1 (1912); Lewers & Cooke v. Jones, 23 Haw. 21 (1915); Hoffschlaeger Co. v. Jones, 24 Haw. 74 (1917). In exceptional cases, such as the death of the debtor, the necessity of obtaining judgment and the return nulla bona of an execution issued thereon were dispensed with Estate of Copez, 19 Haw. 620 (1909). Under the Hawaii Rules of Civil Procedure Rule 18(b) reduction of the creditor's claim to judgment and return nulla bona of an execution issued thereon are no longer required as prerequisites to relief against a fraudulent conveyance. The creditor may form his main action with a claim to have the fraudulent conveyance set aside. Likewise it seems to be possible to assail a fraudulent conveyance by attachment or garnishment before judgment, see Chong v. Young, 39 Haw. 527 (1952). The conflict between creditors of the transferor and creditors of the transferee is discussed in the Explanatory Notes to Section 6-110.

Section 6-105. Notice to creditors.

1. Except in the case of bulk transfers by way of auction, the transferee has the burden of notifying the transferor's creditors of the contemplated bulk transfer at least ten days before taking possession of the goods or paying for them, whichever happens first. The purpose of this requirement is to afford the creditors an opportunity for taking the appropriate steps to safeguard their rights. Apparently Section 6-105 requires prior notice even before any down payment can be made with impunity. The wisdom of such rule has been questioned by several commentators, see e.g. Rapson, Article 6 of the U.C.C: Problems and Pitfalls in Conducting Bulk Sales, 68 Com. L.J. 226, 228 (1963). The contents and mode of the notice as well as the persons entitled thereto are detailed in Section 6-107.

2. Although Section 6-105 provides that non-compliance with the notice provision renders the transfer ineffective against "any" creditor, this statement must be read in conjunction with Section 6-109 which limits the assertion of voidability to existing, i.e. pre-transfer creditors, see Explanatory Note 4 to Section 6-104.

3. Article 6 does not require the recordation of bulk transfers with the Bureau of Conveyances as was formerly required by the Revised Laws of Hawaii 1955, Section 200-1. Subsection 6-104 (1)(c) does, however, provide for optional filing of the list of creditors and the schedule of property in lieu of preservation thereof by the transferee.

4. The Code is silent on the necessity of including taxing authorities in the list of creditors and of notifying them of the contemplated transfer. It has been suggested that such action is advisable and that the District Director of Internal Revenue ought to receive advance notice of a contemplated bulk transfer, Duesenberg and King, Sales and Bulk Transfers under the U.C.C. sec. 15.04(4)(c). So far as state taxing authorities are concerned, the matter is regulated by Revised Laws of Hawaii 1955, Section 117-40. This section remains unrepealed by U.C.C., Section 10-103. According to the first paragraph of Section 117-40, the seller or the purchaser in a bulk sale must make a written or verified report of such sale to the Director of Taxation not later than ten days after the possession, or the control, or the title of the property has passed to the purchaser. Since this section is satisfied by a report after consummation of the transfer, failure to give advance notice should not render the transfer defective. It should be noted that under the second paragraph of Section 117-40, the purchaser must withhold payment of the purchase price until the receipt of a certificate from the Director of Taxation that all taxes, penalties and interest levied or accrued under Chapter 117 against the seller, or constituting a lien upon such property have been paid. This provision, accordingly, postpones consummation of the bulk sale on the part of the purchaser until the requisite tax clearance and protects the state taxing authorities to a greater extent than other creditors.

Section 6-106. [Application of the proceeds]. As noted in Explanatory Note 1 to Section 6-104, this section is omitted in Hawaii.

Section 6-107. The notice.

1. Subsections (1) and (2) regulate the content of the notice, while Subsection (3) specifies the manner of giving notice and the persons entitled thereto.

2. Section 6-107 distinguishes between a minimum content (short notice) required in every case and an additional content (long notice) which must be included if the debts of the transferor are not to be paid in full as they fall due or if the transferee is in doubt on that point. According to the Official Comment, Point 2, the short form of notice is provided to facilitate honest and solvent transactions. In view of the broad definition of creditors, however, it is not advisable in practice to rely on the short form since the transferee usually will be in doubt on that point. Moreover, it has been suggested that a positive statement that all debts of the transferor shall be paid as they fall due may be deemed to be a representation by the transferee that this is going to materialize, see e.g. 2 Hawkland, A Transactional Guide to the U.C.C. 852 (1964). Whether the courts will go that far is doubtful. In Ross Industrial Chemical Co. v. Smith, 146 N.W. 2d 816 (Mich. App. 1966) the court held that a notice to a creditor holding a disputed claim did not constitute an undertaking by the transferee to pay the debt without resolution of the dispute.

3. The long notice must include seven items:

(a) that a bulk transfer is to be made;

(b) the names and business addresses of the transferor and the transferee including all other business names and addresses used by the transferor in the three years last past as known to the transferee;

(c) that the debts of the transferor are not to be paid in full as they fall due as a result of the transaction or that the transferee is in doubt on that point;

(d) the location and general description of the property transferred and the estimated total of the transferor's debts;

(e) the address where the schedule of property and list of creditors may be inspected;

(f) whether the transfer is to pay existing debts and if so the amount of such debts and to whom owing;

(g) whether the transfer is for new consideration and if so the amount of such consideration and the time and place of payment.

The items listed under (f) and (g) demonstrate that, outside bankruptcy, a preferential bulk transfer is not fraudulent as such.

4. The notice must be given either by personal delivery or by registered or certified mail.

5. Persons entitled to notice are those who are included in the list of creditors furnished by the transferor and those who are known to the transferee to be or assert to be creditors. The question whether the transferee must insist on an absolutely current list has been discussed before. Explanatory Note 4 to Section 6-104.

Section 6-108. Auction sales; "auctioneer".

1. In order to prevent the possibility of evading the bulk transfer provisions by the device of auction sales, the framers of the Code felt that a comparable regulation should be enacted for bulk sales in the form of auctions. Direct application of the entire body of rules governing normal bulk transfers is not feasible because of the nature of auction sales. The bulk transfer by auction will have this character only on the part of the transferor but not on the side of the bidders, if the inventory or equipment is auctioned off in smaller lots. Moreover, it would be incompatible with the integrity and appropriate conduct of auction sales, if the burdens attendant to bulk transfers were imposed upon the bidders or if non-compliance with the statutory mandates would render the auction purchase subsequently assailable. For that reason the Code imposes the burdens designed to safeguard the transferor's creditor upon the auctioneer and enforces compliance not with voidability of the transfer but with personal liability of the auctioneer. If several persons other than the transferor are in charge of the auction, they are collectively responsible for the performance of the duties imposed upon them by the section. The liability is joint and several.

2. As in other types of bulk transfers the transferor must furnish a list of his creditors and cooperate in the preparation of the property to be sold.

3. According to Subsection (3)(a) the auctioneer must "receive and retain the list of creditors and prepare and retain the schedule of property" as provided in Section 6-104. Despite the wording of this clause, he only needs to cooperate in the preparation of the schedule; on the other hand he must require the transferor to furnish the list of creditors if he knows that the auction constitutes a bulk transfer (Subsection (4)).

4. In addition the auctioneer must notify all creditors so listed or known to him to exist at least ten days prior to the auction in the manner governing regular bulk transfers.

5. Failure to perform these duties despite knowledge that the goods to be auctioned off possess quantitatively and qualitatively the character rendering their transfer in bulk a bulk transfer as defined in Section 6-102, renders the auctioneer liable to the transferor's creditors in an amount not exceeding the net proceeds of the auction. The liability is imposed as a liability to the creditors "as a class". This apparently means that recovery must be had by means of a class action pursuant to Rule 23 of the Hawaii Rules of Civil Procedure. The court must make the necessary order or orders to protect the potential rights of all creditors entitled to share in the recovery. Although Rule 23 does not correspond to the current form of Rule 23 of the Federal Rules of Civil Procedure as amended in 1966, the court should have the power to proceed in a similar fashion as is now expressly provided for in subsection (d) of the corresponding Federal Rule.

6. The burden of proof relating to the actual knowledge of the auctioneer that the sale of the goods to be auctioned off constituted a bulk transfer rests on the creditors. In practice this burden will not be easy to meet, see Duesenberg and King, Sales and Bulk Transfers under the U.C.C., Sec. 15.05[3] (1966).

Section 6-109. What creditors protected.

1. Section 6-109 identifies (a) the creditors who are protected against bulk transfers in violation of the statutory safeguards and (b) the creditors who are entitled to notice. The two groups are not identical, because group (a) in addition, includes creditors who have become such after notice was given but before the bulk transfer.

2. As discussed before, the creditors protected by Article 6 are all pre-transfer creditors, whether business creditors or private creditors, and regardless of whether their claims sound in contract or tort or are liquidated or contingent, matured or non-matured, secured or unsecured. The statutory language "before the bulk transfer" apparently means prior to the taking of possession by the transferee. Although not all creditors are entitled to notice, all of them are entitled to observation of requirements as to the preparation and preservation of the list of creditors and the schedule of property.

3. As discussed before the notice requirement extends only to creditors included in the list or actually known to the transferee at the time notice is given. In other words, creditors who were (a) omitted from the list through the inadvertence or bad faith of the transferor or became such after the compilation of the list and (b) not known to the transferee at the time notice was given, are not entitled to notice. Lack of notification to them will not render the transfer defective.

Section 6-110. Subsequent transfers.

1. This section deals with the protection of bona fide purchasers from a transferee whose title is ineffective against pre-transfer creditors of the transferor by reason of non-compliance with Article 6.

2. Subsection (2) protects a purchaser for value in good faith and without notice of non-compliance with the requirements of Article 6. The terms "good faith", "notice", "value" and "purchaser" have the meaning attributed to them by Subsections 1-201 (19), (25), (33) and (44). A purchaser other than one protected by Subsection 6-110(2) is subject to the remedies of creditors against fraudulent conveyances. Actually Subsection (1) is badly drafted, since it follows from Subsection (2) that purchasers for value without notice but in bad faith are likewise subject to the defects.

3. The term "purchaser" as defined by Subsections 1-201(32) and (33) does not include lien creditors, i.e. creditors who have acquired a judicial lien by the levy of an attachment or execution, garnishment, creditors' bills, or other judicial proceedings. According to the traditional rules governing fraudulent conveyances, such creditors, if bona fide and without notice, are likewise protected, and there is no reason to assume that the draftsmen of the Code meant to deprive such lien creditors of their protection. Section 6-110 deals only with the extent of the protection of purchasers, leaving the protection of lien creditors to the general pre-Code rules (Section 1-103). As a result, bona fide lien creditors of a transferee without notice of non-compliance with the requirements of Article 6 are protected. Similar protection is enjoyed by a trustee in bankruptcy of the transferee pursuant to Section 70(c) of the Bankruptcy Act. If both the transferor and the transferee in a bulk transfer are adjudicated bankrupts, the trustee in bankruptcy of the transferee will prevail over that of the transferor if the petition by or against the transferee antedated the petition by or against the transferor,

In re Dee's, Inc., 311 F. 2d. 619 (3d. Cir. 1962), involving a bulk transfer under the Code in Pennsylvania.

Section 6-111. Limitation of actions and levies.

1. This section limits the remedies available to creditors by reason of violations of Article 6 to six months after the date on which the transferee took possession of the goods, unless the transfer was concealed. In the case of such concealment, the six-month period starts with the discovery of the fraudulent transfer.

2. The limitation period applies to actions "under this Article" and levies. According to the Official Comment, Point 2 "levy" includes the acquisition of a lien by judicial process under local law, whatever the nature of such process. Actions under this article ordinarily will be actions to set aside the fraudulent bulk transfer. Actions for the recovery of money or similar relief, however, where available are also included. Such an action is, for instance, the action against an auctioneer for violation of Section 6-108, given by subsection (4) of that section. A transferee may also be liable to the creditors of the transferor for the proceeds from the sale of goods obtained by means of a defective bulk transfer. This is particularly the case in situations where the original bulk transfer was defective, but a subsequent sale to a bona fide purchaser for value and without notice gave the latter an unimpeachable title. Generally speaking local law will determine what kind of actions are available to the creditors of a transferor against the transferee by reason of a fraudulent bulk transfer. Such actions are recognized by the Code and included in the term "action under this Article". Conversely, the six-month limitation period should not apply to a tort action against the transferor where local law accords such relief to his creditors by reason of an intentional fraudulent conveyance, see James v. Powell, 225 N.E. 2d 741 (1967).

ARTICLE 7.

WAREHOUSE RECEIPTS, BILLS OF LADING AND OTHER DOCUMENTS OF TITLE

Article 7, Documents of Title consolidates, clarifies and modernizes the provisions formerly spread over three uniform acts, *viz*. the Uniform Warehouse Receipts Act, the Uniform Sales Act and the Uniform Bills of Lading Act. The Uniform Sales Act also contained matter now found in Article 2 of the Code, but to the extent that it dealt with negotiation and transfer of documents of title (Uniform Sales Act, Sections 27-39, 76) the corresponding provisions are found in Section 1-201 and Article 7.

Hawaii had adopted the Uniform Warehouse Receipt Act (Revised Laws of Hawaii 1955, chapter 207) and the Uniform Sales Act (Revised Laws of Hawaii 1955, chapter 202). The Uniform Bills of Lading Act was not adopted in this State, but after statehood, Hawaii provided for continuation in force of the Federal Bill of Lading Act (49 U.S.C. secs. 81-124), which itself was based upon and to a large extent identical with the Uniform Bills of Lading Act.

Bills of lading in interstate and foreign commerce by sea or air carriers are governed by a host of federal statutes the interrelation of which is not easy to state. The basic statute is the Federal Bills of Lading Act of 1916 (49 U.S.C. secs. 81-124) which governs "bills of lading issued by any common carrier for the transportation of goods...from a place in a state to a place in a foreign country, or from a place in one state to a place in another state, or from a place in one state to a place in the same state through another state or foreign country". This statute is supplemented or qualified by other federal legislation regulating particular means of transportation. Carriage of goods by sea is governed by the Harter Act (46 U.S.C. secs. 190-196) and the Carriage of Goods by Sea Act, (COGSA) (46 U.S.C. secs. 1300-1315). The Carriage of Goods by Sea Act applies *proprio vigore* only to carriage between American and foreign ports and not carriage between American ports. The Act provides, however, that a bill of lading evidencing a contract of carriage by sea between domestic ports may stipulate that the carriage shall be subject to its provisions (46 U.S.C. sec. 1312). Moreover, since COGSA applies only from tackle to tackle while Harter covers the voyage from pier to pier, there is always a residual area of applicability for the Harter Act, *The Monte Sciar*, 167 F. 2d 334 (3d Cir. 1948). Carriage of goods by air is additionally controlled by the Federal Aviation Act of 1958 (49 U.S.C. secs. 1301 *et seq*.). The provisions of this statute and of the regulations of the Federal Aviation Agency issued thereunder affect the permissible content and the form of "airbills" (see Subsection 1-201(6)) used by air carriers subject to the Act, Twentieth Century Delivery Service, Inc. v. St. Paul Fire & Marine Ins. Co., 242 F. 2d 292 (9 Cir. 1957).

In view of the limited applicability of intra-state carriage without intervening extra-state portions, the importance of the Code's regulation of bills of lading is not of particular significance in Hawaii.

Article 7 consists of six parts. Part 1 deals with general matters concerning scope and construction of the provisions of Article 7 and the test of negotiability. Part 2 deals with special provisions governing warehouse receipts, while Part 3 contains special provisions for bills of lading. The remaining three parts regulate aspects common to warehouse receipts and bills of lading.

Article 7 is not self-contained; it is supplemented by Article 2 (sales) and 9 (secured transactions). In appropriate cases the pertinent sections especially Sections 2-401, 2-503, 9-304, 9-305, and 9-309, must be consulted.

PART 1

General

Section 7-101. Short title.

In conformity with the introductory sections to Article 2 to 9 Section 7-101 specifies a convenient designation for the citation of Article 7.

Section 7-102. Definitions and index of definitions.

1. The larger articles of the Code contain a special section entitled "definitions and index of definitions" (see Sections 2-103, 3-102, 4-104, 5-103, 7-102, 8-102, 9-105) which contains a list of terms and attributes thereto the particular meaning which they have for the purposes of the particular article. As a result the same term may be differently defined in different articles. An example is the term "goods" which has three different definitions, Subsections 2-105(1), 7-102(1)(f) and 9-105(1)(f). In addition, the section cross-references to definitions given in other sections of Article 7, Subsection 7-102(2) or in other articles, Subsections 7-102(3) and (4).

2. The term "bailee" as used in Article 7 means a person who by a document of title acknowledges possession of goods and contracts

to deliver them. It is not necessary that the bailee actually be in possession of the goods. What is required is the acknowledgement of possession and the assumption of an obligation of delivery, Subsection 7-102(1)(a).

3. "Consignor" is a person named in a bill of lading as the person from whom goods have been received for shipment. "Consignee" is a person named in such bill to whom or to whose order delivery is promised by the bill.

4. "Delivery order" is a document of title (Subsection 1-201(15)) which is a written order for the delivery of goods directed to a person, such as a warehouseman or carrier, who in the ordinary course of business issues warehouse receipts or bills of lading. Delivery orders may be negotiable or non-negotiable (Section 7-104). However, until acceptance by the bailee "due negotiation" of such orders (Subsection 7-501(4)) confers upon the "holder" (Subsection 1-201(20)) only limited rights (Subsections 7-502(d), 7-503(2)). The rights of the transferee of a non-negotiable delivery order are restricted to those possessed by the transferor and moreover, defeasible by creditors of the transferor or other person dealing with him, until the bailee is notified of the rights of the transferee (Subsection 7-504(2)). This corresponds to the clause in Subsection 2-503(4)(b) which provides that "notification of the buyer's rights fixes those rights as against the bailee and all third persons. See the Explanatory Notes to Sections 7-502, 7-503 and 7-504 and the discussion by Braucher, <u>Documents of Title</u>, secs. 2, 5.24, 5.32, 6.33 (Joint Committee on Continuing Legal Education of the American Law Institute and the American Bar Ass'n., 1958).

5. "Document" is defined by reference to the definition given by Subsection 1-201(15).

6. "Goods" means movable things capable of storage or transportation. Growing crops and fixtures obviously do not fall under that description in contrast to the term "goods" as used in the articles on sales (Subsection 2-105(1)) and secured transaction (Subsection 9-105(1)(f)).

7. "Issuer" is defined as a bailee who issues a bill of lading or warehouse receipt or who accepts a delivery order. Prior to such acceptance the person who issues a delivery order is the issuer. The term includes a warehouseman or carrier for whom an employee with real or apparent authority purports to act in the issuance of a document of title, notwithstanding that

the issuer did not receive the goods or that the same were misdescribed or that the agent violated his instructions.

8. "Warehouseman" is a person engaged in the business of storage for hire. The former requirements that the warehouseman must be lawfully engaged in the business and that the business must be conducted for profit are deleted as unnecessary limitations, see Official Comment, Point 2. The receipt issued by a warehouseman is a warehouse receipt, (Subsection 1-201(45)).

<u>Section 7-103. Relation of article to treaty, statute, tariff, classification or regulation</u>.

1. This section states the obvious rule that the provisions of the Code must yield to paramount federal law whether in form of a statute or a self-executing treaty, such as the Pomerene Act, Harter Act or COGSA mentioned in the introductory comments to Article 7.

2. In addition the section reserves the power of the states to make overriding rules by regulatory statute or regulations or approval of tariffs or classifications made pursuant thereto, thus leaving room for non-uniformity on the state level.

<u>Section 7-104. Negotiable and non-negotiable warehouse receipt bill of lading or other document of title</u>.

1. The Code differentiates sharply between instruments for the payment of money and securities, (Subsections 3-102(1)(e), 3-805, 4-104(1)(g), 8-105(1) and 9-105(1)(g)) and documents evidencing rights in goods. Book types of paper are objects of commerce and may be negotiable or non-negotiable. Non-negotiable documents of title, however, are not "collateral" within the meaning of the Code and security interests therein can be perfected only as to the goods, (Subsection 9-304(3)).

2. Section 7-104 specifies the formal requirements that must be met in the issuance of a document of title in order to create negotiability with the attendant possibility of protecting the transferee as "holder" (Subsection 1-201(20)). According to this section the document must provide by its terms that the goods must be delivered to bearer or to the order of a named person. A document that does not have this form but runs to a named person or assigns is negotiable only if it is recognized as such in overseas trade.

3. If the requirements are not strictly complied with, the document is non-negotiable. Subsection (2) provides expressly that negotiability is not imparted to a bill of lading running to a named consignee, by providing that delivery should be had only against a written order by the consignee or another named person.

4. The Code omits the provisions of section 5 of the former Uniform Warehouse Receipts Act and section 5 of the former Uniform Bills of Lading Act which stated that the insertion of a provision against negotiability contained in a warehouse receipt or bill of lading running to bearer or the order of a named person was invalid. In view of the peremptory language of Subsection 7-104(1) which predicates negotiability on certain terms of the document, no change of the law in that respect seems to result from that deletion.

5. The Code likewise omits the provisions of section 7 of the former Uniform Warehouse Receipts Act, and section 8 of the Uniform Bills of Lading Act, which prescribed that non-negotiable documents of title falling within the purview of these statutes be plainly marked as non-negotiable. Such requirements, however, still exist under the federal Bills of Lading Act (49 U.S.C. section 86) and federal regulations governing warehouse receipts for particular commodities. The effects of non-compliance will depend primarily on additional provisions in the applicable statutes or regulations and, ultimately on the form of the document.

Section 7-105. Construction against negative implication. Although the bulk of the provisions of Article 7 cover bulk warehouse receipts and bills of lading, Part 2 of the article contains special provisions relating to warehouse receipts, while Part 3 is a set of special provisions relating to bills of lading. This structure could give rise to the negative implication that the absence of a provision from one part although it is present in the other part was a studious omission. Section 7-105 bars such interpretation.

The Official Comment suggests that Subsections 7-209(2) and 7-301(5) are examples of instances where no negative implication should be drawn.

PART 2

Warehouse Receipts: Special Provisions

Section 7-201. Who may issue a warehouse receipt; storage under government bond.

1. Any warehouseman, as defined in Subsection 7-102(1) may issue a warehouse receipt, with the effects regulated by Article 7.

2. A receipt for goods with the effect of a warehouse receipt may be issued by the owner thereof and not by a warehouseman where goods are stored under a statute requiring a bond against withdrawal or a license for the issuance of such receipts.

Section 7-202. Form of warehouse receipt; essential terms; optional terms.

1. This section reiterates the rule of section 2 of the former under the Uniform Warehouse Receipt Act which does not require a warehouse receipt to have any particular form, unless such form is required by an applicable federal or state regulatory statute.

2. Like the former Uniform Warehouse Receipts Act, the Code prescribes nine essential terms for warehouse receipts and permits additional optional terms. Omission of one or more of the essential terms renders the warehouseman liable in damages to a person injured thereby. While section 2 of the Uniform Warehouse Receipts Act provided for such liability only in case of negotiable receipts, the Code now extends it to all receipts.

3. The provisions covering two essential terms (Subsections (2)(e) and (i)) produce certain changes in the law. While formerly only the rate of storage charges needed to be inserted, the duty is now extended also to handling charges. On the other hand the entire requirement is dispensed with in regard to field warehousing arrangements and a statement of that fact declared to be sufficient. The other change concerns the prescribed statement of the amount of advances made and of liabilities incurred for which the warehouseman claims a lien or security interest. The second alternative was added to conform with the new approach to the warehouseman's security for advances and expenditures introduced by Section 7-209 which differentiates between a statutory lien for expenditures and a reserved security interest for advances. According to Subsection 7-202(2)(i) a statement of the precise amounts involved is excused, if they are unknown to the warehouseman or his agent

when the receipt is issued and a statement that advances have been made or that liabilities have been incurred and the purpose thereof is sufficient. The insertion of these statements apparently is needed to avoid liability. Section 7-209 contains an independent regulation of the type of statement needed to create an effective general lien against the bailor or against a person to whom a negotiable warehouse receipt is duly negotiated or to validly reserve as security interests for charges other than those secured by the warehouseman's lien. Certainly harmonization between Sections 7-202(2)(i) and 7-209 is not an easy matter, see Braucher, Documents of Title, sec. 4.12.

4. Under the Code, as under Section 3 of the former Uniform Warehouse Receipts Act, the insertion of optional terms is permitted so long as they do not impair the warehouseman's obligation of delivery or duty of care.

5. Although Subsection (1) dispenses with a requirement of any particular form, Subsection 10-104(1) specifies that Article 7 does not repeal or modify any laws prescribing the form or contents of particular documents of title. Non-compliance, however, is declared not to affect the status of a document of title which otherwise is covered by the definition of the Code (Subsection 1-201(15)). The precise import of this provision is not free from doubt. Although it is consonant with the policy of Subsection 7-401(a) it is more sweeping than the latter provision which only concerns the obligations of an issuer. It has been argued that Subsection 10-104(1) is a position of neutrality and that the effect of non-compliance with special formal requirements on the negotiability or other effects of the document should be left to policy considerations called for by the particular requirements, Boshkoff, The Irregular Issuance of Warehouse Receipts and Article Seven of the U.C.C. 65 Mich. L. Rev. 1361 (1967).

Section 7-203. Liability for non-receipt or misdescriptions.

1. This section renders the issuer (as defined in Subsection 7-102(1)(g)) of a document of title other than a bill of lading liable in damages caused by the non-receipt or misdescription of the goods to a party to, or a purchaser for value in good faith of, the document. This liability is imposed on the principal even where the documents are issued by an employee or agent within the scope of his real or apparent authority (Subsection 7-102(1)(g)). This corresponds to section 20 of the former Uniform Warehouse Receipts Act, Revised Laws of

Hawaii 1955, section 207-20) which changed the common law rules as applied in some jurisdictions in cases of non-receipt by an agent. The Code (in its current version) protects the party to or bona fide purchaser for value of the document of title only if he actually relied on the description and did not have actual notice of the true state of affairs. Contra, as a matter of oversight, Braucher, Documents of Title, Sec. 3.2.

2. The liability may be limited by a conspicuous (see Subsection 1-201(10)) indication on the receipt that the issuer does not know whether in fact any part or all the goods were received or conform to the description. Such indication may be made by the method of description or certain qualifying phrases; but it is effective only if true. According to the Official Comment the principal cannot avoid liability in such fashion if his agent issuing the document knows that the goods were not received or were misdescribed.

Section 7-204. Duty of care; contractual limitation of warehouseman's liability.

1. Subsection (1) defines the standard of care to be exercised by a warehouseman and imposes liability for damages proximately caused by his failure to exercise such care which results in the loss of or injury to the goods.

2. Following the precedent of existing law relating to ocean bills of lading, subsection (2) qualifies the flat prohibition in Subsection 7-202(3) against contractual terms "impairing" the warehouseman's statutory duty of care. It authorizes limitations on the amount of liability by terms in the warehouse receipt setting forth specific amounts per article, item, or unit of weight beyond which the warehouseman shall not be liable. The bailor, within a reasonable time after receipt of the document, may request an increase in the valuation or ceiling subject to a corresponding increase in charges. No such increase may be granted, however, contrary to any lawful limitation in applicable tariffs.

3. The limitation is not effective in the case of a conversion to the warehouseman's own use.

4. Warehouse receipts may validly include terms specifying reasonable conditions as to the time and manner of presenting claims or instituting suits.

Section 7-205. Title under warehouse receipt defeated in certain cases.

1. This section protects buyers in the ordinary course of business of fungible goods (Subsection 1-201(17)) sold and delivered to them by a warehouseman who is also in the business of buying and selling goods of that type. Such buyers are protected against claims by holders of warehouse receipts even though the receipts were negotiable and duly negotiated to the claimant.

2. Section 7-205 constitutes an extension, if not application, of the principle embodied in Subsection 2-403(2) which empowers a merchant who deals in goods of the same kind to transfer good title to buyers in the ordinary course of business of goods which have been entrusted to his possession.

Section 7-206. Termination of storage at warehouseman's option.

1. Storage in a warehouse may be for a fixed or an indefinite period. Ordinarily storage will be for an indefinite term. Termination entitles the warehouseman to removal of the goods and payment of his charges or, in case of a default by the person on whose account the goods are held, to enforcement of his statutory lien or reserved security interest. Normally, termination of the storage will be initiated by the person on whose account the goods are held, but the warehouseman likewise may have reasons for terminating, as, for instance, need of space for other items, etc. Usually his main motive for termination will be the danger that the goods no longer constitute adequate security for his charges either because of mounting unpaid charges on, or diminishing value of, the goods. Unless the term of the storage was fixed in advance, the bailor or his successor in interest needs sufficient notice of the impending termination by the bailee. Section 7-206 regulates the conditions under which a warehouseman may terminate the storage and require removal of the goods and payment of the charges or, in case of non-compliance, enforce his rights thereto.

2. The warehouseman is entitled to removal of the goods and payment of the accrued charges at the date fixed by the warehouse receipt; provided he has notified the person on whose account the goods are held and any other persons known to claim interests in these goods of his intention to liquidate the storage at that time. If the bailment was for an indefinite

term, the warehouseman may fix a period for payment and removal by notifying the persons mentioned above, but such period must be at least thirty days after the notification. Failure of a timely removal of the goods entitles the warehouseman to sell the same in accordance with the requirements for the enforcement of a warehouseman's lien set forth in Section 7-210.

3. Subsections (2) and (3) recognize that in certain circumstances more expeditious action may be required. The Code distinguishes two situations: goods subject to a rapid decline in value and hazardous goods.

4. The case of goods stored for an indefinite period by a person other than a merchant, the time between the notice to pay up and remove and the required auction sale to implement the notice would be at least forty-five days, unless an exception is available. Therefore, the Code permits a warehouseman, who in good faith believes that the goods because of their perishable nature or for other reasons will decline in value to less than the amount of his lien within the time otherwise prescribed for notification, advertisement and sale, to cut the thirty days' period to a reasonable shorter time and to hold an auction sale not less than one week after a single advertisement following the expiration of the final date set for payment and removal. The statute seems to imply that the sale in such case must be always by auction; proper correlation of the governing provisions, however, will permit a private sale of commercially stored goods (Subsection 7-210(1)).

5. If the goods at the time of their storage and without knowledge of the bailee are hazardous to other property or to persons, the warehouseman may sell them at a private sale or auction without advertisement after reasonable notice to persons known to claim an interest therein. If no sale is possible, the warehouseman may dispose of them without liability. This provision seems to apply even where the bailment was for a fixed term.

6. Until sale or other disposition, any person entitled to the goods may demand the goods upon payment of the charges effective against him. The warehouseman may satisfy his lien or security interest from the proceeds of a sale or other disposition under Section 7-206. Any surplus must be held for the benefit of the person or persons who would have been entitled to delivery of the goods.

Section 7-207. Goods must be kept separate; fungible goods.

1. Subsection (1) preserves the prior rule, (Revised Laws of Hawaii 1955, Sections 207-22 and 23) which requires a warehouseman to keep goods covered by each receipt separate, unless either the receipt provides otherwise or the goods are of fungible character. (Subsection 1-201(17))

2. Subsection (2) regulates the effect of comminglement of fungible goods. The goods are owned as tenants in common by the persons entitled thereto and the warehouseman is severally liable to each owner for that owner's share. The Code adds new rules governing overissue of warehouse receipts in case of fungible goods. In such case all holders to whom overissued receipts have been duly negotiated are included in the number of owners in common. The protection applies only to holders to whom such receipts have been duly negotiated, other holders of such receipts are not covered. It has been suggested that the pro rata sharing rule is not applicable to fungible goods which are bailed and added to the mass after the shortage has arisen, Braucher, Documents of Title, sec. 6.31. But since due negotiation and not the issuance of the spurious receipts controls the number of persons entitled to share in the mass it would seem more consistent that the available mass should likewise depend on the time of the allocation of the shares.

Section 7-208. Altered warehouse receipts.

1. Unauthorized alterations of a warehouse receipt are ineffective against the warehouseman, but the receipt remains enforceable according to its original tenor.

2. An exception is made for the case of blanks in a negotiable warehouse receipt filled in without authority. A purchaser for value and without notice of the want of authority may treat the insertion as authorized. This rule clarifies the prior law on that point.

Section 7-209. Lien of warehouseman.

1. This section, somewhat misleadingly entitled "lien of warehouseman", deals with security devices accorded or recognized by the Code to the warehouseman to enable him to safeguard the collection of his charges from the goods in his possession. These devices include the statutory lien granted by subsection

(1) as well as a consensual security interest permitted by subsection (2). The section deals with the scope and priority of each of these security devices and in subsection (3) contains some provisions common to both of them.

2. The statutory lien is regulated in its effect "against the bailor" or "the person on whose account the goods are held" (Subsection (1) sentences 1 and 2) and "against a person to whom a negotiable warehouse receipt is duly negotiated" (Subsection (1) sentence 3). In addition subsection (3) accords and limits the effectiveness of the lien under certain conditions "against any person who...entrusted the bailor with the possession of the goods...."

3. As against the bailor the lien automatically covers charges for storage and transportation, insurance, labor, or charges present or future in relation to the goods, as well as for expenses necessary for the preservation of the goods or reasonably incurred in their sale pursuant to law. It is doubtful whether the lien covers expenses incurred by the bailee in interpleader actions necessary to obtain a judicial determination of the entitlement to the goods of conflicting claimants, cf. National Cold Storage Co. v. Tiya Caviar Co., 276 N.Y.S. 2d 57 (N.Y. Sup. Ct. App. Div. 1966).

4. The scope of the statutory lien may be extended to like charges or expenses in relation to other goods whenever deposited and regardless of whether or not the other goods have been delivered by the warehouseman. The conversion into a general lien requires that the receipt state that the lien is also claimed for charges and expenses in relation to other goods. This enlargement, however, does not change the lien from a statutory lien into a consensual security interest. This distinction is important in several respects, such as the duration of the lien (Subsection (4)) or the status of the lien under Sections 60 and 67c of the Bankruptcy Act.

5. The third sentence of Subsection (1) provides for certain limitations on the scope of the warehouseman's lien against the holder of a negotiable receipt to whom it was "duly negotiated" (Subsection 7-501(4)). Unfortunately the limitations are obscurely drafted as a result of policy changes made in the course of the evolution of Section 7-209. In the 1952 version of the Code, Section 7-209 was couched in inconsistent language, and it was not clear whether the statutory lien was specific or general. In response to elaborate criticism by the New York Law Revision Commission on that score (N.Y. Law

Revision Commission study of the U.C.C., Leg. Doc. (1955) No. 65 H. p. 1798-1800) the text of Subsection 7-209(1) was revised and given its present form. The overall policy was a return to the policy of the Uniform Warehouse Receipts Act, Sections 28-30, but with certain modifications and clarifications. Sentences 1 and 2 differentiated more clearly between a special and a general statutory warehouseman's lien and sentence 3 was cast in its present form. The drafters retained their policy, adopted in 1952, that the limitations on the warehouseman's lien against the holder of a negotiable receipt should operate only for the benefit of a holder to whom the receipt was duly negotiated. There is, however, the question whether the warehouseman's lien can be a general lien against such a holder. The lien is definitely only a special lien if the negotiable receipt is silent as to the charges, and in that case covers only a reasonable charge for storage of the receipted good accruing subsequent to the date of the receipt. But the Code accords a greater scope to the lien if the negotiable receipt specifies the amount or the rate of the charges. It is not clear whether in such cases the lien may be a general one, i.e., cover charges incurred in connection with goods other than those covered by the receipt. If the amount of the charges is fixed, the lien may well be a general one even against a holder to whom the receipt is duly negotiated. This is in accord with the former Uniform Act and the policy behind the limitations, see Braucher, Documents of Title, sec. 4.13. But the situation differs materially if the charges are only specified at a rate without designation of the additional goods causing such charges. Although the language seems to call for a different result, the lien thus recognized against the holder of a duly negotiated receipt should only be a special lien, as was apparently the case under prior law.

6. As mentioned in Explanatory Note 1 Subsection (2) permits the reservation of a security interest for charges other than those specified in Subsection (1), such as for money advanced and interest; provided that the receipt specifies a ceiling. The security interest is stated to be governed by Atticle 9. The exact import of this reference is not self-evident. The theory of the Code seems to be that the security interest is perfected by possession (Subsection 9-302(1)(a)) and that no writing other than the specification of the maximum amount on the receipt is required for its enforcement (Subsection 9-203(1)(a)). The security interest reserved pursuant to Subsection 7-209(2) is designated as security interest "against the bailor". This excludes persons who acquired rights in the goods prior to the

storage, except those subjected thereto by subsection (3), but it includes third parties who derived entitlement to the goods after the storage by either a simple transfer of the receipt, whether negotiable or non-negotiable (Section 7-504) or by due negotiation of a negotiable receipt (Section 7-501). Since the security interest is noted on the receipt, the holder is put on notice of the security interest. Sections 9-304(2), relating to the creation of a security interest in goods while the goods are in the possession of an issuer of a negotiable document therefor and 9-309 relating to the protection of holders of negotiable documents by due negotiation thereof are obviously inapplicable to the situation governed by Subsection 7-209(2).

The reserved security interest provided for by Subsection 7-209(2) is made available for charges "other than those specified in Subsection (1)." The Official Comment, Point 5 suggests that this limitation does not preclude that upon a sale of the stored goods the general lien against the seller may be converted into a reserved security interest against the buyer.

The reserved security interest envisaged by Subsection (2) is predicated upon possession. If the warehouseman wishes to retain an enforceable and perfected security interest in the goods after their release to the owner, separate compliance with all requirements of Article 9, such as a separate written security agreement especially if the receipt is taken up and cancelled upon delivery, and filing of a financing statement would seem to be necessary.

7. Subsection (3) governs the effectiveness of the statutory lien under subsection (1) and of the reserved security interest under subsection (2) with respect to third parties who acquired rights in the goods prior to their bailment to the warehouseman. If such persons so entrusted the depositor with possession of the goods that a pledge of the goods to a good faith purchaser for value would be valid against them under applicable state law, the warehouseman's lien or security interest is likewise effective against them, except when under similar circumstances a document of title would not confer any rights against them by virtue of Section 7-503.

   The hypothetical bona fide pledgee test prescribed by Subsection (3) has been construed to mean that a conflict between a security interest of a third party and the warehouseman's lien must be resolved by resort to Section 9-312 rather than Section 9-310, see Official Comment, Point 3.

8. Report No. 3 of the Permanent Editorial Board includes the official recommendation for an amendment of Subsection 7-209(3) of the Code which would retain the present text of Subsection (3), as (3)(a) and add a new paragraph (3)(b) relating to household goods. The new provision would give the warehouseman a special lien for charges and expenses which is effective against third persons if the depositor was the "legal possessor" of the goods at the time of the storage. The purpose of the amendment is to permit the warehouseman to accept household goods for storage without inquiry into the depositor's authority. The exact meaning of legal possession is obscure.

9. The warehouseman's statutory lien terminates upon voluntary delivery of the goods. Subsection (4) does not apply to a reserved security interest. However, upon release of the goods to the person entitled thereto, the security would become unperfected and possibly, unenforceable, unless a financing statement is filed and, if the receipt is taken up and cancelled, the grant of the security interest is repeated in a separate writing.

Section 7-210. Enforcement of warehouseman's lien.

1. This Section contains detailed provisions for the enforcement of a warehouseman's lien. Except in cases of non-commercial storage, the enforcement may be by public or private sale in any manner and on such terms as is commercially reasonable. In adopting the test of commercial reasonableness as the controlling standard Section 7-210 follows the policy pursued in other provisions of the Code dealing with forced sales, i.e. Sections 2-706, 2-711(3), 7-308, 9-504(3) (enforcement of security interest).

2. The sale for the enforcement of a warehouseman's lien on commercially stored goods must be preceded by a reasonable notice of such sale to all persons known to claim an interest in the goods, including a statement of the amount owed, the nature of the proposed sale and the time and place of any public sale. A sale is commercially reasonable if the warehouseman sells the goods in the usual manner in any recognized market therefore or if he sells at a price current in such market at the time of the sale or if he sells in conformity with reasonable practices among dealers in the type of goods sold. The fact that a better price could have been obtained by a sale at a different time or in a different manner is not sufficient by itself to establish that the manner of the sale

was not commercially reasonable. Identical provisions govern the enforcement of carriers' liens (Subsection 7-308(1)) and the enforcement of security interests after default (Subsection 9-507(2)).

3. The enforcement of a warehouseman's lien on goods other than goods stored by a merchant in the course of his business is subject to much more stringent provisions contained in Subsection (2)(a) to (f). It can only be had by sale at public auction to be held at the nearest suitable place to that where the goods are stored. The auction must be preceded by a notification of all persons known to claim an interest in the goods to the effect that unless the claim is paid within a specified time, not less than ten days after receipt of the notice, the goods will be advertised for auction at a specified time and place. After the expiration of the time given in the notification, an advertisement of the sale must be published once a week for two weeks consecutively in a newspaper of general circulation where the sale is to be held. The sale must take place at least fifteen days after the first publication. If there is no newspaper of general circulation where the sale is to be held, the advertisement must be posted at least ten days prior to the sale in not less than six conspicuous places in the neighborhood. In contrast to the general rule governing auction sales (Subsection 2-328(4)), but in harmony with the provisions governing forced sales by auction (Subsections 2-706(4)(d), 7-308(3) and 9-504(3)), the lienor may bid at the auction.

4. Any person claiming a right in the goods has a right to redeem the goods prior to the sale by paying the amount of the lien and the necessary expenses incurred in the preparation of its enforcement. In case of a redemption, the sale must not be held, and the warehouseman must retain the goods under the terms of the storage.

5. Non-compliance with the requirements of this section does not invalidate the sale aginst a bona fide purchaser. Such purchaser takes the goods free of any rights subordinate to the warehouseman's lien.

6. The warehouseman may satisfy his lien from the proceeds of the enforcement sale but must hold the surplus for the benefit of any person entitled to the delivery of the goods sold.

7. The rights given by Section 7-210 are additional to the rights accorded by law to a creditor against his debtor.

8. Non-compliance with the statutory requirements for a sale to enforce his lien renders the warehouseman liable for the damages caused thereby. Wilful violation constitutes a conversion.

PART 3

Bills of Lading: Special Provisions

<u>Section 7-301. Liability for non-receipt or misdescription; "said to contain"; "shipper's load and count"; improper handling</u>.

1. Section 7-301 defining the liability for non-receipt or misdescription of the issuer of bills of lading is the counterpart to Section 7-203 which deals with the analogous matter pertaining to warehouse receipts. Section 7-301 recodifies and amplifies Section 23 of the former Uniform Bills of Lading Act.

2. Subsection (1) accords protection against non-receipt, misdescription and misdating in a bill of lading to the consignee of a non-negotiable bill who has given value in good faith and to a holder of a negotiable bill to whom the same has been duly negotiated if either of them has relied on the description of the goods or the date shown in such bill. The protection against misdating adopts a rule which was originally inserted in the Federal Bill of Lading Act, sec. 22 (49 U.S.C. 102) by amendment in 1927 (44 Stat. 1450) and was also the prior law of Hawaii. Except as is provided otherwise in subsections (2) and (3) the issuer may relieve himself from such liability by clauses in the document indicating that the issuer does not know whether all or any part of the goods were received or conform to the description. The illustrations for such disclaimer of knowledge by the issuer given by Subsection 7-301(1) correspond to those exemplifying disclaimers by warehouseman listed in Section 7-203, with the addition of shipper's weight, load and count and the like which are not applicable in storage situations. Such disclaimers are effective if true and not in violation of a duty.

3. A common carrier who loads the goods must count the packages if the cargo consists of packages and ascertain the kind and quantity if the cargo is in bulk. In such cases the insertion of the clause "shipper's weight, load and count" is ineffective except as to content of the packages.

4. When bulk cargo is loaded by the shipper, he may in writing request a common carrier to ascertain the kind and quantity of the cargo. If the shipper furnishes adequate facilities for weighing, the carrier must comply with the request within a reasonable time. In such case insertion of a clause like "shipper's weight" in the bill of lading is likewise ineffective.

5. Subsection (4) recodifies a provision contained in Section 23 of the former Uniform Bills of Lading Act and Sec. 21 of the Federal Bills of Lading Act (49 U.S.C. Section 101). The clause "shipper's weight, load and count" inserted in a bill of lading, if true, relieves the carrier of liability for damages caused by improper loading. The Code clarifies the law by adding that omission of such clause does not imply liability of the carrier for damages caused by improper loading, if the shipper was responsible therefore, see Official Comment, Point 2.

6. The carrier is entitled to hold shipper liable for damages, caused to him by inaccuracies of the description, marks, labels, number, kind, quantity, condition and weight furnished by him. The right to such indemnity, however, does not limit the carrier's responsibility vis-a-vis to other parties.

Section 7-302. Through bills of lading and similar documents.

1. Section 7-302 governs the liability of the initial carrier (issuer) and connecting carriers (including the delivering carrier) or connecting bailees under a through bill of lading or similar document. The section is modeled after Section 20(11) and (12) of the Interstate Commerce Act (49 U.S.C. sec. 20(11) and (12)), but with significant modifications: (a) The provisions are extended to documents of title similar to through bills of lading, as for instance combination documents covering carriers and warehousemen, if such documents would be developed in the future. (b) The vicarious liability of the delivering carrier is eliminated and the delivery carrier is treated as other connecting carriers.

2. The issuer bears vicarious liability for the performance of connecting carriers and other persons receiving the goods pursuant to the undertaking embodied in the through bill or assimilated document. The Code, however, permits stipulations to the contrary with respect to transportation overseas or in territory not contiguous to the continental United States or matters other than transportation. The vicarious liability

is measured by the scope of that borne by the connecting carrier or other person covered by the document, see Official Comment, Point 3.

3. Connecting carriers or bailees covered by the document are subject to obligations resulting from the terms of the documents with respect to their performance while the goods are in their possession. The obligation is discharged by delivery of the goods to another person covered by the document pursuant to its terms.

4. The initial carrier, who has incurred vicarious liability because of the breach of the obligation under the document by a connecting carrier or other bailee subject thereto while in possession of the goods, is entitled to indemnity from such person.

Section 7-303. Diversion; reconsignment; change of instructions.

1. When goods are in transit under a bill of lading the carrier may receive instructions from the consignor, the consignee or the holder of the bill of lading covering the goods, ordering him to deliver the goods not as stated in the bill of lading but to a different person or destination. Section 7-303 states the conditions under which the carrier may honor such restrictions without incurring liability. Prior law did not provide for such immunity.

2. Subsection (1) lists various situations in which the carrier is at liberty to obey a diversion or reconsignment. The immunity is unqualified if the instruction emanates from the holder of a negotiable bill or the consignor on a non-negotiable bill. Where reconsignment or diversion is requested by the consignee, the carrier may comply with immunity only if the consignee is entitled against the consignor to dispose of the goods or if the consignor has not issued a conflicting instruction and, either the goods have arrived at the billed destination, or the consignee is in possession of the bill.

3. In case of a negotiable bill of lading, the instruction for reconsignment or diversion must be noted on the bill. Otherwise a holder to whom the bill is duly negotiated may hold the carrier according to the original terms.

Section 7-304. Bills of lading in a set.

1. This section continues the prohibition against the issuance of a bill of lading in a set of parts except in overseas transportation where bills of that type are customary. It imposes liability on the issuer for violation of this prohibition and regulates the legal effects of a bill lawfully issued in a set of parts.

2. Subsection (2) defines the customary form of a bill in a set of parts, i.e. a set of identical documents which are numbered consecutively and contain the clause that upon delivery against one of them, the others are void.

3. The bailee is obliged to deliver the goods against the first part duly presented to him, such delivery discharging the bailee's obligation on the entire bill. Where different parts are negotiated to different persons, the holder by virtue of the senior due negotiation prevails as to both the document and the goods. Negotiation or transfer of any part renders the endorser or transferor liable to the holders of that part in the manner and to the extent prescribed for single bills. The rules of the Code correspond to the rules prevailing for maritime and other overseas bills, see Official Comment.

Section 7-305. Destination bills.

1. Traditionally bills of lading are issued to the consignor by the carrier or his agent at the place of shipment. Ordinarily the bill of lading should arrive at the destination prior to the arrival of the goods so that the necessary arrangements for their delivery can be completed prior to their arrival. In cases of surface transportation of the cargo by rail or vessel the possibility of a timely transmission to the consignee of a bill of lading issued at the place of shipment will usually present no difficulties. In the cases of shipment of air cargo, however, the traditional method of issuing bills of lading is bound to cause unwanted delays. As a result, the framers of the Code devised a method which provides for the issuance of a bill of lading at the place of destination or any other place: the so-called destination bills.

2. Subsection (1) authorizes the issuance of a bill of lading at destination or any other desired place upon the request to that effect by the consignor.

3. Subsection (2) authorizes the carrier to issue a substitute bill at any other place while the goods are in transit upon request to that effect by anyone entitled to control the goods vis-a-vis the carrier and against surrender of any outstanding bill of lading or other receipt covering such goods.

Section 7-306. Altered bills of lading.

1. Section 7-306 relating to the effect of altered bills of lading is the counterpart to Section 7-208 dealing with altered warehouse receipts.

2. Section 7-306 provides that an unauthorized alteration or filling in of blanks leaves the bill enforceable according to its original tenor. This corresponds in simplified form to the rule of Section 16 of the former Uniform Bills of Lading Act, with explicit extension of the rule to unauthorized filling in of blanks.

3. Section 7-306 differs from Section 7-208 with respect to the effect of blanks filled in without authorization. Such insertions are without effect in the case of bills of lading, while in the case of negotiable warehouse receipts, a bona fide purchaser for value is entitled to rely on the document in its new version. The reason for the differentiation may be the ambulatory origin of many bills of lading, see Braucher, Instruments of Title, sec. 26.

Section 7-307. Lien of carrier.

1. At common law a common carrier of goods has a special lien on the goods for the freight and other charges and expenses lawfully incurred in connection with the goods. Section 26 of the Uniform Bill of Lading Act recognized this lien by providing that in cases of negotiable bills of lading the carrier should have no lien except for freight, storage, demurrage and terminal charges and expenses necessary for their preservation or incident to their transportation subsequent to the date of the bill, unless the bill expressly enumerated other charges for which a lien was claimed. Section 7-307 of the Code adopts the rule of the former Uniform Bill of Lading Act, couching it in language modeled after the grant of the special lien accorded to a warehouseman by Section 2-209. The lien covers charges, subsequent to the receipt of goods, for their storage or transportation, including demurrage and terminal charges, and for

their preservation incident to their transportation or reasonably incurred in their sale pursuant to law.

2. Against a purchaser for value of a negotiable bill of lading the carrier's lien is limited to charges stated in the bill or applicable tariffs or in the absence of any stated charges, to a reasonable charge. (Subsection 7-307(1), last sentence) While Subsection 7-209(1) limits the warehouseman's lien against a person to whom the negotiable warehouse receipt is duly negotiated, Section 7-307 establishes the corresponding limitation on the carrier's lien against a purchaser for value of a negotiable bill of lading. This difference in the scope of protection is due to the amendment of Section 7-209 in 1956 without corresponding amendment of the parallel sentence in Subsection 7-307(1). Since a carrier's lien is a special lien, no substantial incongruity is created by this disparity in formulation.

3. In contrast to Section 7-209, Section 7-307 does not expressly recognize either a general lien or a reserved security interest in favor of the carrier. In view of the anti-negative implication provision of Section 7-105, however, it cannot be concluded that the carrier may not reserve a security interest for other charges in consonance with Article 9. It would seem, however, that such broader security interest by agreement is not a statutory general lien either within the meaning of Section 9-310 or Section 1(29a), 60 and 67 of the Bankruptcy Act.

4. Subsection (2) attributes effectiveness of the lien for charges and expenses under subsection (1) on goods which the carrier was bound to receive for transportation against any person entitled to the goods, unless the carrier had notice that the consignor was not authorized to subject the goods to such charges and expenses. A lien on goods which are not subject to mandatory acceptance by the carrier may be asserted against a person other than the consignor only if such person permitted the consignor to have control or possession of the goods and the carrier had no notice of the consignor's lack of authority.

5. The statutory lien of the carrier is a possessory lien which is lost by voluntary delivery or unjustifiable retention of possession.

<u>Section 7-308. Enforcement of carrier's lien</u>. The provisions of Section 7-308 relating to the enforcement of carrier's lien are the exact counterpart to the provisions of Sections 7-210(1)and (3)

to (9) relating to the enforcement of the warehouseman's lien on goods stored by a merchant in the course of his business. Accordingly the Explanatory Notes to Subsections 7-210(1) and (3) to (9) apply mutatis mutandis to this section.

Section 7-309. Duty of care; contractual limitation of carrier's liability.

1. In defining the scope of the carrier's liability for damages to goods entrusted to him for transportation the common law as developed by the federal and most state courts differentiated sharply between private carriage and common carriage. A common carrier was liable for the loss of, or damage to, the goods in his care, unless the loss or damage was due to causes forming a narrow class of exceptions such as an act of God or the public enemy, inherent vice of the goods shipped, fault of the shipper or an order of the public authority. "The rule of the common law did not limit his liability to loss and damage due to his own negligence, or that of his servants. That rule went beyond this and he was liable for any loss or damage which resulted from human agency, or any cause not the act of God or the public enemy", Adams Express Co. v. Croninger, 226 U.S. 491, 509 (1913). Conversely a private carrier was merely an "ordinary" bailee for hire, Commercial Corp. v. N.Y. Barge Corp., 314 U.S. 104, 109 (1941). Having not assumed a common carrier's obligation, he is not an insurer "His undertaking is to exercise due care in the protection of the goods committed to his care and to perform the obligation of his contract including the warranty of seaworthiness when he is a shipowner." Commercial Corp. v. N.Y. Barge Corp., supra at 110. A common carrier, nevertheless was permitted at common law to modify the rigor of his liability "through any fair, reasonable and just agreement with the shipper which did not include exemption against the negligence of the carrier or his servants", Adams Express Co. v. Croninger supra at 509. Some jurisdictions, however, adopted constitutional or statutory provisions which invalidated any modification by a common carrier of his common law liability.

   In the field of interstate transportation by rail or motor truck the subject is now regulated by the Interstate Commerce Act, 49 U.S.C. Section 20(11). That subsection, added by the so-called Carmack Amendment of 1906, provides inter alia "that any common carrier, railroad or transportation company... receiving property for transportation...shall be liable...for any loss, damage or injury to such property caused by it...and no contract, receipt, rule, regulation or other limitation...

shall exempt such common carrier, railroad or transportation company from the liability imposed." In construing the Carmack Amendment, the Supreme Court in the leading case of Adams Express Co. v. Croninger, 226 U.S. 491 (1913) supra, held that it did not impose absolute liability on the initial carrier but that the qualifying words "caused by it" implied only "a liability for some default in its common law duty as a common carrier", id. at p. 507, and that the prohibition against contractual modifications only barred stipulations against liability for damage caused by negligence of the initial or a connecting carrier. (Id. at p. 511) In particular, limitation based on agreed or released valuations were not foreclosed. This rule was later codified by the second Cummins Amendment of Section 20(11) of the Interstate Commerce Act.

In the field of maritime transportation the liability of carriers is now governed by the Harter Act, 46 U.S.C. secs. 190-196, the Carriage of Goods by Sea Act, 46 U.S.C. secs. 1300-1315 and the Fire Statute, 46 U.S.C. sec. 182. The scope of the liability resulting from these statutes for a common carrier by sea is substantially less than that of his terrestrial counterpart.

In the field of carriage by air the Warsaw Convention likewise reduces somewhat the common law liability of common carriers. According to Article 20 of that Convention (which owing to the withdrawal in 1966 of the denunciation by the U.S. filed in 1965 is still in force) a carrier is not liable for damage to cargo if he proves that he and his agents have taken all necessary measures to avoid damage or that it was impossible for him to take such measures. This includes damage from human agencies which may render a carrier liable at common law, Pick v. Lufthansa German Airlines, 265 N.Y.S. 2d 63 (Civ. Ct. City of N. Y. 1965).

2. In the light of the high degree of federal preemption and the sensitivity of the issue by virtue of mandates in state constitutions the drafters of the Code had to walk a tight rope. Subsection 7-309(1) states as a general principle that a carrier who issues a bill of lading, whether negotiable or not, is bound to exercise that degree of care in relation to the goods which a reasonably careful man would exercise under like circumstances. The subsection adds, however, that a stricter liability for common carriers imposed by any applicable statute or rule of law remains unaltered. Subsection (2) codifies the rule which, except in the case of wilful conversion by the carrier, permits a limitation to the value stated in the bill of lading if the rates depend on value and the consignor has opportunity to declare a higher value.

Subsection (3) finally codifies the traditional rule that the bill of lading or a tariff may make reasonable provisions as to the time and manner of presenting claims and instituting actions.

3. In addition to the savings clause relating to common carriers incorporated in the body of Subsection 7-309(1) it must be kept in mind that the whole system of that section is further qualified by the recognition of the overriding effect of a federal or state regulatory statute and the tariffs, classifications or regulations filed or issued pursuant thereto. As a result the regulation of the Code is only subsidiary and outside the federal area subject to local variations.

PART 4

Warehouse Receipts and Bills of Lading: General Obligations

Part 4 supplements the obligations imposed upon carriers or warehousemen in other parts of Article 7, such as Sections 7-203, 7-204, 7-301 and 7-309, and contains general provisions relating to the obligations of issuers of warehouse receipts and bills of lading despite non-compliance with formal requirements established by Article 7 or applicable regulatory laws or non-fulfillment of necessary qualifications.

<u>Section 7-401. Irregularities in issue of receipt or bill or conduct of issuer</u>.

1. This section is designed to render it clear that irregularities in the issue of a warehouse receipt or bill of lading or the lack of qualifications required for issuers do not relieve the person issuing a document from the duty to perform the obligations resulting therefrom.

2. The section enumerates four types of irregularities:

   (a) non-compliance with legal rules pertaining to the form or content of the document or incidents of its issuance;

   (b) violation of rules governing the conduct of the issuer's business;

(c) ownership by the bailee of the goods covered by the document;

(d) issuance of a warehouse receipt by a person other than a warehouseman.

Section 7-402. Duplicate receipt or bill; overissue.

1. This section deals with the effect of and the liability for "overissue". Overissue is the issuance of a document purporting to cover goods already represented by an outstanding document of the same issuer. Where documents covering the same goods are issued by different persons the situation does not constitute overissue. Special cases of overissue are the issuance of duplicates without conspicuous identification of their character as such, of bills in a set (Section 7-304) and of substitutes for lost, stolen and destroyed documents (Section 7-601).

2. Generally speaking a document which is the object of an overissue confers no rights in the goods, but renders the issuer liable for damages resulting from the overissue. Overissued documents may confer rights in the goods in three types of cases, viz. (a) bills in a set, as provided in Section 7-304, (b) in fungible goods, where negotiable receipts have been duly negotiated (Subsection 7-207(2)), and (c) substitute document issued pursuant to Section 7-601.

3. Rights in goods covered by documents issued by different issuers are governed by Section 7-503.

4. The former uniform acts regulated only the issue of duplicate documents (Uniform Warehouse Receipts Act, Section 6, Uniform Bills of Lading Act, Section 7). The remainder of the section is new.

Section 7-403. Obligation of warehouseman or carrier to deliver; excuse.

1. One of the central obligations of the carrier or warehouseman is his delivery of the goods to the person "entitled" to them. The identification of the proper person is not always an easy matter and is the ultimate result of a number of factors, such as the authority of the bailor to entrust the goods to a carrier or warehouseman, the contractual relations between bailor and bailee and dispositions of the goods made subsequent to the bailment. Entitlement in its broadest aspect means the

right to enforce delivery _vis-a-vis_ the bailee and any other person claiming paramount rights in and to the goods. Where the goods are covered by documents of title the possibility of complications is enhanced. Different from the concept of entitlement and the corresponding duty of the bailee to make delivery is the possible immunity of the bailee from liability for delivery to a person not entitled thereto, _i.e_. his privilege of making delivery to a person not entitled thereto with liberating effect _vis-a-vis_ the person or persons entitled thereto.

The framers of the Code have tried to simplify the governing system by establishing a basic duty of delivery and providing for a set of "excuses".

2. According to Subsection 7-403(1) the bailee "must" deliver the goods to "a person entitled under the document," provided that such person satisfies the bailee's lien as provided in subsection (2) and surrenders any outstanding negotiable document covering the goods for cancellation or notation of partial delivery as provided in subsection (3). A "person entitled under the document" is defined as a holder (as construed in Subsection 1-201(20)) of a negotiable document or the person to whom delivery is to be made by the terms of, or pursuant to written instruction "under", a non-negotiable document. Unfortunately the Code does not spell out what is meant by a written instruction "under" a non-negotiable instrument. Section 7-303 is not interpretative of this phrase, since it is drafted in terms of an immunity matter than a duty (see Section 7-303 Official Comment, Point 2 and Subsection 7-403 (e)). Certainly the formulation chosen is quite indefinite and obscure, _accord_, Braucher, _op. cit_. Section 3.42. If the terms of the non-negotiable document are ambiguous and none of the enumerated excuses are available the bailor is liable for misdelivery, if his interpretation turns out to be wrong, Braucher, _Documents of Title_, sec. 3.42. The immunity furnished by the catch-all clause "any other lawful excuse" in Subsection 7-403(1)(g) might alleviate excessive rigor in the bailee's absolute liability for "misdelivery".

3. As mentioned in Explanatory Note 1, Section 7-403 establishes a set of seven excuses from the performance of the duty to deliver. Some of these cases cover instances where the bailee has parted with possession or where the goods for other reasons are no longer intact or in his hands. Others deal with situations where the goods are still in his hands but where supervening transactions or events have created a defense

against the claimant entitled under the document.

4. Subsection (1)(a) provides for an excuse by reason of a delivery of the goods whose receipt was rightful as against the claimant. Obviously a delivery of the goods to a person who has rights to possession paramount to those of the person claiming under the document should excuse any non-delivery to that claimant. The principal examples for the applicability of this excuse are the cases of bailment by a thief or cases where the bailment was otherwise unauthorized and the holder of the document is not protected as a bona fide purchaser. Actually Subsection (1)(a), if taken literally, is couched in too narrow language. Not only should prior delivery to a person with paramount rights constitute a defense, but the bailee should also be excused from delivery of goods still in his hands, if he pleads the existence of a person with paramount rights. This result seems to follow from the interrelation between Sections 7-403, 7-404 and 7-603, and from the recognition of the right to delivery of a person with paramount rights under Subsection 7-403(3). _Accord_, Braucher, _op. cit_. Section 3.42.

5. Subsection 7-403(1) clauses (b), (c), (d) and (e) are no more than cross-references to other sections of the Code which define the bailee's liability for loss of or damage to the goods (Sections 7-204 and 7-309), authorize a sale or other disposition of the goods in cases of non-removal after termination of the bailment or to foreclose a bailee's lien or security interest (Sections 7-206, 7-209, 7-210, 7-307 and 7-308), provide for the seller's right to stop delivery under specified conditions (Section 2-705) and accord an immunity in cases of diversion, reconsignment or other disposition pursuant to Section 7-303.

6. Subsection 7-403(1)(f) recognizes that a release, satisfaction or other transaction or event may afford a valid personal defense against a claimant who otherwise would be entitled to delivery under the document, while Subsection 7-403(1)(g) broadly gives effect to any other lawful excuse. The latter clause may include a delivery of the goods, not otherwise authorized, under the compulsion of legal process. Prior law recognized this excuse only in cases of bills of lading, whether negotiable or not, (Uniform Bills of Lading Act, Section 14) but not in the cases of negotiable warehouse receipts, (see Uniform Warehouse Receipts Act, Section 14, par. 2). The Code thus would abolish the distinction and extend the rule to all documents of title. _Accord_, _semble_, Braucher, _op. cit_. sec. 3.42.

7. Section 7-403(2) provides that the person entitled to the goods, whether under the document or by reason of paramount title, must satisfy the bailee's lien where the bailee so requests or where the bailee is prohibited by law from delivering the goods unless the charges are paid. Of course, the person is subject to this duty only if, and to the extent that, the lien is effective against him (Subsections 7-209(1) to (3), and 7-307(2)). This provision clarifies and modifies the prior law which seemed to require the tender of the charges to accompany the demand of delivery. Unless a rule of law prescribes differently, the bailee must demand the payment of charges, if he wishes to assert an excuse upon the non-payment (Subsection 7-403(1)). See Official Comment, Point 4.

8. A person claiming delivery as a "person entitled under the document" (Subsection 7-403(4)) who is a holder of a negotiable document of title must surrender the same for cancellation or notation of partial deliveries. The bailee must require compliance with this burden, otherwise he is liable in damages to a holder to whom the document subsequently is duly negotiated. (Subsection 7-403(1)). The onus of surrender for cancellation or notation of partial delivery and the corresponding duty of the bailee to take up the negotiable document does not extend to the case where the person demanding delivery is a person possessing rights paramount to the holder of a document of title duly negotiated to him (Subsection 7-503(1) in conjunction with Subsections 7-403(1)(a) and (3)).

   A person acquiring rights paramount to those of the holder of a negotiable document of title is also the purchaser in good faith of goods sold to enforce a warehouseman's or carrier's lien or security interest (Subsections 7-210(5) and 7-308(4)), to the extent that the lien is valid against such holder (Subsections 7-209(1) last sentence, 7-307(1) last sentence). In such case the warehouseman or carrier is not under a duty to take up the document prior to the sale and delivery to the buyer, but only needs to give the requisite notices. The duty to take up the negotiable document exists only if the delivery is made to a person claiming under the document and not by virtue of paramount right. <u>Accord</u>, Braucher, <u>op. cit.</u> sec. 4.3, the contrary statement at p. 35 overlooks the change in Subsection 7-403(3) made in 1956.

   If the outstanding document is claimed to be lost, the bailee may make delivery of the goods subject to and with the effect prescribed in the provisions of Section 7-601.

9. The Code does not impose a statutory duty to take up a non-negotiable document upon the delivery of the goods. Such duty may, however, be provided by the terms of the document. The anti-impairment provision in Subsection 7-202(3) does not exclude the validity of such a clause and it is specifically recognized in the Official Comment, to Section 7-104. Ordinarily, however, such clause will not be inserted in non-negotiable documents, since one of the main reasons for their use is the opportunity for issuance of separate delivery orders by the consignee or depositor. See Braucher, op. cit. sec. 3.43.

10. As pointed out in Explanatory Note 4 the duty of the bailee to deliver the goods in his possession to a person claiming under the document is not as absolute as a literal reading would imply. In case of conflicting claims the bailee may refuse delivery until determination of the conflict by means of an interpleader action (Section 7-603). See also Braucher, op. cit. sec. 3.36.

Section 7-404. No liability for good faith delivery pursuant to receipt or bill.

1. This section modifies the strict common law liability of a bailee for conversion. It relieves a bailee from such liability, if he has acted in good faith including observance of reasonable commercial standards when he received the goods and delivered or otherwise disposed of them in accord with the terms of the document or pursuant to this Article. This rule extends to persons having rights in the goods who suffered loss because the bailor had no authority to procure the document or dispose of the goods or because the recipient of the goods from the bailee had no authority to receive them. In other words Section 7-404, second sentence, is to some extent corollary to Section 7-403(1)(a): delivery to a person with paramount rights excuses non-delivery to the person entitled under the document. Conversely, delivery in good faith and with the exercise of commercially reasonable care to the person entitled under the document excuses non-delivery to the person with paramount rights.

2. Section 7-404 relieves the bailee from his liability only if he acted (a) in good faith, and (b) according to the terms of the document or pursuant to the provisions of the Code, accord, Braucher, Documents of Title, sec. 3.42. If the bailee knows of conflicting claims he may have to resort to interpleader

(Section 7-603). At any rate the bailee is always fully liable for wilful conversion (Subsections 7-204(2), 7-210(9), 7-308(8), and 7-309(2)).

PART 5

Warehouse Receipts and Bills of Lading: Negotiation and Transfer

Part 5 is concerned with various legal aspects of the negotiation or transfer of documents of title. Sections 7-502 to 7-504 and 7-506 deal with the rights in the goods resulting therefrom or affected thereby, while Sections 7-505, 7-507 and 7-508 deal with the warranties implied in such negotiation or transfer. The initial section deals with negotiation and other types of transfer, while the final section ties Part 5 to other articles of the Code.

<u>Section 7-501. Form of negotiation and requirements of "due negotiation."</u>

1. Section 7-501 deals with the constituent elements of due negotiation of negotiable documents of title. Whether or not a document is negotiable is governed by Section 7-104. Negotiable documents of title run either to bearer or to the order of a named person.

2. A negotiable document of title which by its original terms runs to bearer is negotiated by delivery. (Subsection 7-501 (2)(a)). A negotiable document of title which runs to the order of a named person is negotiated by that holder by his indorsement and delivery. The indorsement may have taken one of three possible forms: (a) indorsement in blank, (b) indorsement to bearer and (c) indorsement to a specified person, called a special indorsee. If the indorsement is in blank or to bearer, any person can thereafter negotiate the document by delivery alone. If the indorsement runs to a specified person, the next negotiation must be by indorsement by the special indorsee and delivery, (Subsection (1), 2(a) and (3)). Delivery has the meaning given to it by Subsection 1-201(14).

3. The provisions of the Code relating to negotiation are slightly ambiguous and inconsistent. If an indorsement in blank is followed by a special indorsement, subsection (1) and subsection (3) seem to lead to different results: subsection (1) implies

that after a blank indorsement "any person" regardless by what type of transfer he became a holder, can negotiate the document by delivery alone; conversely subsection (3) implies that after a special indorsement the next negotiation must be by indorsement by the special indorsee and delivery, regardless of the type of indorsement that preceded the special indorsement. It would seem that in the hypothesized case the provision of subsection (3) should override that of subsection (1). This would be in harmony with Section 3-204 (relating to negotiable instruments) which changed the prior law on that point.

Subsection (3) requires an indorsement by the special indorsee as a condition for any further negotiation. This corresponds to the rule of Subsection 3-204(1) second sentence. Since no special form for such indorsement is prescribed, any transfer noted on the instrument should qualify as indorsement and entitle a named transferee to negotiate the document. A special provision to that effect was contained in Section 38, third sentence of the former Negotiable Instruments Law and the same rule should continue to apply under the Code both with respect to negotiable instruments and negotiable documents.

4. According to subsection (1) a negotiable document on which the ultimate indorsement is in blank or to bearer may be further negotiated by delivery by any person. This includes a person who has obtained possession in an illegal way such as a thief. It has been suggested that the qualification as special indorsee likewise does not require that the indorsee obtain possession in a lawful manner, see Braucher, Documents of Title, sec 5.11, relying on Official Comment, Point 2.

5. Subsection (2)(b) provides that delivery (as defined in Subsection 1-201(14)) of a document running to the order of a named person to that person has the effect of negotiation. If the document is issued to the depositor or shipper himself, the recipient will be a "holder" (Subsection 1-201(20)), but he will not be a purchaser within the meaning of Subsection 1-201(32). True, he is taking the document by "issue", but the issuance does not create a property interest in the depositor or shipper. Conversely, if such document is issued to a third person by virtue of an agreement between him and the depositor or shipper, the recipient will take both by negotiation and by purchase, see Official Comment, Point 3.

6. The Code attaches special consequences not to mere negotiation but only to due negotiation. Therefore, the significance of this term is extremely important. While the former uniform laws did not give any definition of this term, the framers of

the Code were careful to fill this gap and to provide the criteria in subsection (4) which underwent a substantial revision in 1956. Due negotiation requires concurrence of six elements: (a) negotiation as specified in subsections (1) to (3), (b) purchase in good faith, (c) without notice of any defense against or claim to the document by any person, (d) for value, (e) in the regular course of business or financing, and (f) not in settlement or payment of a money obligation. Good faith is defined in Subsection 1-201(19), purchase in Subsection 1-201 (32) and value in Subsection 1-201(44). To that extent the elements of due negotiation correspond to prior law. New is the qualification that the negotiation must be in the regular course of business or financing and not in settlement or payment of a money obligation. This qualification was introduced in order to limit the cutting off effects of due negotiation on the rights or defenses of third parties to transactions which genuinely pertain to the flow of commerce.

7. As a result of the definition of "duly negotiated" the limitation of Subsection 7-209(1) last sentence, on the warehouseman's lien would not be available for the benefit of the original bailor. Consequently, the result reached by the Supreme Court of Washington in Klock Produce Co. v. Diamond Ice Co., 90 Wash. 67, 155 Pac. 414(1916) under Section 30 of the Uniform Warehouse Receipts Act would still be precluded even after the amendment of 1956, despite the New York Law Revision Commission's question in that respect. See N.Y. Law Revision Commission, Study of the U.C.C., Leg. Doc. (1955) No. 65(H) p. 1800.

8. The Code contains no provision establishing a presumption of due negotiation. The Official Comment, Point 4 tries to fill the gap by reference to Section 1-202 and the suggestion that this section supports the recognition of a presumption "in favor of any person who has power to make a due negotiation." While Professor Bentel, Interpretation, Construction, and Revision of the Commercial Code: The Presumption of Holding in Due Course, 1966 Wash. U.L.Q. 381, 408, footnote 143 considers the Official Comment obscure, Professor Braucher reads it to mean that the presumption becomes operative after the holder establishes the authenticity of the document and the genuineness of the indorsements. It is dispelled when it is shown that a defense exists. In that case the holder must establish the giving of value and good faith. The burden of proof of the absence of a transaction in the regular course of business rests on the party denying due negotiation. Braucher, op. cit. sec. 5.1.

9. Subsection (5) codifies the generally accepted proposition that an indorsement of a non-negotiable document neither changes the character of the document nor increases the rights of the transferee. Subsection (6) renders it clear that the instruction in a negotiable bill to notify a named person of the arrival neither limits the negotiability nor imparts notice of any interest of such person in the goods. It does not even authorize delivery to such person, Southern Express, Inc. v. T.S.C. Motor Freight Lines, Inc. 200 F. 2d. 797 (5th Cir. 1952).

Section 7-502. Rights acquired by due negotiation.

1. This section brings together and codifies the main effects of a due negotiation of the document to the new holder. Apart from the protection accorded to a buyer in the ordinary course of business of fungible goods from the warehouseman (Section 7-205) and the retention or acquisition of paramount rights in the goods permitted by Section 7-503, the transferee of the document upon due negotiation acquires:

   (a) title to the document;

   (b) title to the goods covered thereby;

   (c) rights accruing under the law of estoppel or agency, including rights delivered to the bailee after issuance of a spurious document;

   (d) the direct obligation of the issuer to hold and deliver the goods according to the terms of the document, free from any defenses and claims except those flowing either from the terms of the document, to the extent permitted by Article 7, (see, *e.g.*, Subsections 7-202(3), 7-209(1) last sentence, 7-307(1) last sentence) or directly from various provisions of that article.

2. Subsection (1)(d) contains a special provision with respect to delivery orders. Negotiable delivery orders do not incorporate any obligation by the bailee until accepted by him. Upon acceptance they have the effect of a document of title issued by the bailee; until acceptance they only entail rights against the issuer and any indorser, including the duty to procure the acceptance of the bailee.

3. Subsection (2) is designed to prevent any uncertainty about the effects of a due negotiation of a negotiable document of title

and to render it clear that unlawfulness of the negotiation on the part of the transferor does not affect the effectiveness of due negotiation and that due negotiation may destroy the rights of innocent third persons.

4. Subsection (2) declares expressly that title and rights to the document and goods acquired by due negotiation are not defeated by any stoppage. It should be borne in mind that due negotiation may be due negotiation to the buyer, either by negotiation of a document issued to the seller or the issuance of a document directly issued to the buyer. According to Subsection 7-502(2) only due negotiation protects the buyer against such stoppage, Subsection 2-705(2)(d) speaks of negotiation generally. The reconciliation of this discrepancy is not free from doubt. It could be argued that Subsection 2-705(2)(a) only deals with the seller's right to stop, rather than with the buyer's rights under the document.

<u>Section 7-503. Document of title to goods defeated in certain cases</u>.

1. Section 7-503 deals with three situations in which due negotiation of a document of title does not confer paramount or indefeasible title.

2. Subsection (1) protects the rights, including a perfected security, in goods of a person who has not actively or by acquiescence placed the goods in a situation where bailment with the attendant issuance of negotiable document of title was not unlikely. The Code enumerates four types of situations of this type:

   (a) where the claimant delivered or entrusted the goods or any document of title covering them to a person with actual or apparent authority to ship, store or sell the goods;

   (b) where the claimant has delivered or entrusted any document of title covering the goods with power to obtain delivery of them (Section 7-403);

   (c) where the claimant has delivered or entrusted the goods to a person with power of disposition under the Code (Sections 2-403, 7-205 and 9-307) or any other applicable statute or rule of law; and

   (d) where the claimant has acquiesced in the procurement by the bailor of any document of title.

In many practical cases the situation may fall under several of these categories.

It should be noted that the defeat of security interest in inventory as collateral will be of particular practical importance. Filing does not prevent due negotiation (Section 9-309).

3. Subsection (2) deals specifically with title to goods based upon an unaccepted delivery order. This subsection was extensively revised in 1956 in response to the criticism of the New York Law Revision Commission of the Code's recognition of delivery orders possessing negotiability prior to their acceptance by the bailee and its dealing with the problem of competing claims of title. Such competing claims of title may exist (a) between the holder of a duly negotiated delivery order and the holder of a duly negotiated warehouse receipt or bill of lading or (b) between holders of two delivery orders covering the same goods, see N.Y. Law Revision Commission, Study of the U.C.C., Leg. Doc. (1955) No. 65(H), p. 1843-1845, 1847-1848.

According to Subsection 7-503(2) title to goods based upon an unaccepted delivery order is subject to the rights of any one to whom a negotiable warehouse receipt or bill of lading has been duly negotiated. The operation of this rule is illustrated by the following sequence of events. S, the owner of goods ships them with C who issues a negotiable bill of lading to S. S then issues a negotiable delivery order to P, who duly negotiates the same to Y. S thereafter duly negotiates the bill of lading to Y. Y prevails over X. Y likewise prevails over X, if S duly negotiated the bill of lading to Y prior to P's due negotiation of the delivery order to X. In addition Subsection 7-503(2) provides that title to goods based upon an unaccepted delivery order may also be defeated to the same extent as the rights of the issuer or a transferee from the issuer pursuant to Section 7-504. This section provides, inter alia, that until notification of the bailee of the transfer, the rights of a transferee under a non-negotiable document may be defeated by a buyer from the transferor in the ordinary course of business, if the bailee has delivered the goods to the buyer or received notification of his rights. The operation of this rule in the case of two conflicting non-accepted negotiable delivery orders to the same goods is illustrated by the following example. O deposits goods with W, a warehouseman. Subsequently he sells the same goods twice to X and Y, issuing a negotiable delivery order to each of them. Title to the goods will depend on the priority of the notification of the bailee of the rights of either X or Y. Section 7-402 (depriving overissued documents of any effect on title) at first blush would seem to call for a different rule, but this section really does not apply, since Y's rights would not flow from the document but from his buying in the ordinary course of business and the first notification, Accord, in the result, Braucher, Documents of Title, sec. 5.24. Section 7-402, however, is applicable if the bailee issues a negotiable document of title and subsequently accepts a negotiable delivery order, without taking up or limiting the negotiable document issued by him. The acceptance constitutes overissue and is governed by Section 7-402, as to the result, accord, Rund, Workhouse Receipts, Bills of Lading and Other Documents of Title: Article VII, the Ark. L. Rev. 81, at 94 (1961-1962).

Some reservation must be registered with respect to the discussion, sec. 5.24, (p. 68) by Professor Braucher of another situation: O, the owner of goods under a non-negotiable warehouse receipt, issues a non-negotiable delivery order to X, who promptly notifies the warehouseman. O then procures a negotiable document in substitution for his non-negotiable document, and negotiates the new document to Y. Professor Braucher suggests that Subsection 7-503(2) could be read as giving superior rights to Y, but that X should prevail by reason of the overissue section. The result seems appropriate, but it would also follow from Subsection 7-503(1) and the fact that Subsection 7-503(2) is inapplicable since it deals with "unaccepted" delivery orders and only negotiable delivery orders are capable of being accepted.

4. Subsection (3) governs a possible conflict between a document of title issued by a freight forwarder and a bill of lading issued by the carrier to the freight forwarder. The Code accords paramount rights to the holder of the freight forwarder's document to whom it was duly negotiated. The rationale is that the carrier's bill shows on its face that it was issued to a freight-forwarder and presumably subject to the latter's certificates. The carrier, however, is liberated by delivery to the holder of its issue.

Section 7-504. Rights acquired in the absence of due negotiation; effect of diversion; seller's stoppage of delivery.

1. Section 7-504 deals with the rights of a transferee who requires a document of title otherwise than by due negotiation. This may be the case because the document is non-negotiable or because the document, although negotiable, is not negotiated at all or not duly negotiated as defined in Subsection 7-501(4). Where negotiation requires indorsement by a special indorsee a document is not negotiated, if the indorsement is missing or forged, (Subsection 7-501(3)).

2. Subsection (1) specifies that a non-negotiable and a negotiable document may be transferred by delivery (as defined in Subsection 1-201(14)) and that such transfer, unless it constitutes due negotiation, conveys the title and rights which are either vested in the transferor or subject to his actual authority to convey.

   There is a conflict of opinion as to the negative implications of this provision. Professor Braucher makes the following statement: "The Comment states that principles of estoppel or agency enable the transferor to convey greater rights than he actually has only when there is due negotiation. Thus a transfer of a document, in the absence of due negotiation, is less effective than a transfer of the goods themselves." (<u>Documents of Title</u>, sec. 5.3). He continues at a later passage: "As in the case of a negotiable document, the transferee [of a non-negotiable document] cannot rely on principles of estoppel or agency to enable the transferor to convey greater rights than he has." <u>Op. cit</u>. sec. 5.32. Actually the Official Comment, Section 7-504, Point 1, refers only to the transfer of a negotiable document without negotiation and specifically states that a consignee who pays against the receipt of a straight bill of lading may be protected as a bona fide purchaser for value of goods, under Subsection 2-403(1) or (2) while payment against an unindorsed order bill would not have this effect. There is nothing in the Code to support this distinction, <u>accord</u>, Braucher, <u>op. cit</u>. <u>supra</u>, sec. 5.32. It seems, however, doubtful that the provision of Subsection (1) requires such far reaching negative implications as Professor Braucher suggests, although Professor William Warren seems to agree with Professor Braucher's reading, Warren, <u>Cutting Off Claims of Ownership Under the U.C.C</u>., 30 U. Ch. L. Rev. 469, 484 (1963).

3. Subsection (2) contains provisions which render the title or other rights acquired by the transferee of a non-negotiable document pursuant to Subsection (1), nevertheless defeasible until the bailee receives notification of the transfer. Such

defeasibility exists in three classes of cases. It should be noted that notification of the bailee is made the critical event which terminates defeasibility. This applies also to non-negotiable delivery orders and is in harmony with the Code's general approach which differentiates between acceptance by the bailee (material in cases of negotiable delivery orders) and notification of the bailee (material in cases of non-negotiable delivery order) see Subsections 2-503(4)(b), 7-503(2) (applicable only to negotiable delivery orders), 7-504(2) and 9-304(3). The inconsistency of the Code, asserted by Dean Rund, Warehouse Receipts, Bills of Lading and Other Documents of Title, 16 Ark. L. Rev. 81, 95 (1961-1962) actually does not exist. On the other hand, inconsistency may be keen in the Code's requirement of an acknowledgement by, rather than of a notification of, the bailee to cut off the right of stoppage, Section 2-705. The theory behind Subsection 7-504(2) is that until notification of the bailee, the transferor is still constructively in possession of the goods.

4. The first class of persons who may defeat the transferee's rights under a non-negotiable document until notification to the bailee of the transfer, are creditors of the transferor. Such defeasibility is possible, if under applicable, local law, retention of possession by a seller of goods is or is presumed to be fraudulent. In Hawaii that question seems to be an open one. In some states, as *e.g.* in California it is governed by statute. The power of creditors to defeat the transferee is limited by the provision of Subsection 2-402(2) that retention of possession in good faith and current course of trade by a merchant-seller for a commercially reasonable time is not fraudulent.

5. The second class of persons who may defeat the rights of the transferee prior to notification of the bailee are buyers from the transferor in ordinary course of business (as defined in Subsection 1-201(a)), if the bailee either has delivered the goods or received notification of their rights. It follows from the definition of buyer in the ordinary course of business that the protection is available only where the transferor is in the business of selling goods of that kind. In that respect, Subsection 7-504(2)(b) is parallel to Subsection 2-403(2). Unlike that section, Subsection 7-504(2)(b) grants protection only if the buyer receives delivery of the goods or the bailee is first notified of the buyer's rights. As mentioned in Explanatory Note 3 to Section 7-503, this rule governs the priority between two non-negotiable or two non-accepted negotiable delivery orders, issued to buyers in the ordinary course of business.

6. The third class permits a defeasance _vis-a-vis_ the bailee by good faith dealings between the latter and the transferor.

7. Subsection (3) deals with the special case of diversion or change of shipping instructions by the consignor in a non-negotiable bill of lading which causes the carrier not to deliver to the consignee. Subsection 7-303(1)(b) accords the bailee an immunity in such case. Subsection 7-504(3) deals with the title aspects of this situation. This is needed because the consignee may have acquired title to the goods either under the law of sales (Subsection 2-401(2)(a)) or by delivery of the document under Subsection 7-504(1). It has been suggested that Subsection 7-504(2)(c) might not apply in the latter situation since the naming of the consignee might be deemed to be the requisite notification, see Braucher, _op. cit_. sec. 5.33. Although this position is quite dubious, at any rate the specific regulation of Subsection (3) renders a discussion of this problem moot since it specifies that the consignee's title, if any, is defeated against the bailee as well as against a buyer to whom the goods have been delivered in the ordinary course of business.

8. Subsection (4) provides that delivery pursuant to a non-negotiable document may be stopped by a seller under Section 2-705 and subject to the requirement of due notification there provided. As mentioned several times before, there seems to be an apparent inconsistency in the provisions of the Code which require careful reconciliation. Subsections 2-705(2)(b) and (c) permit stoppage as against the buyer until "acknowledgement" to the buyer by the bailee that he holds or carries for the buyer. Subsection 2-503(4)(b) on the other hand fixes the buyer's rights against the bailee and all third persons as of the time of the receipt by the bailee of notification of the buyers' rights. It would seem therefore that stoppage cannot defeat the rights of third parties (including his creditors) after notification of the buyer's rights. At any rate a bailee honoring the stop order is entitled to indemnification.

9. A good illustration of the interrelation between Sections 7-502, 7-503 and 7-504 _inter se_ and between these sections and Article 9 is presented by a case discussed by Funk, _Trust Receipt vs. Warehouse Receipt--Which Prevails When They Cover the Same Goods_, 19 Bus. Law. 627, at p. 628 (1964). Mr. Funk states the case as follows: "The case was entitled "The Philadelphia National Bank (Assignee) vs. Irving R. Boody & Co., Inc.," and the facts, briefly summarized, were as

follows: The Bank, as agent for Boody, and South American Wools Company, Inc. ("SAWCO"), had filed a financing statement covering documents of title and wool in SAWCO's hands. The Bank, as agent, thereafter released to SAWCO a delivery order for wool after SAWCO had executed a trust receipt in favor of Boody. SAWCO received delivery of the wool and without authority from either Boody or its agent, placed it in a public warehouse and caused the warehouse to issue a non-negotiable warehouse receipt in the name of N. Wagman & Co., Inc. ("Wagman"). SAWCO then pledged the non-negotiable receipt to Wagman as security for a loan. Neither Wagman nor the warehouseman knew of Boody's earlier security interest in the wool covered by the warehouse receipt. When SAWCO became involved in financial difficulties, however, it became known that this wool was covered by both Boody's trust receipt and Wagman's warehouse receipt, and a conflict arose as to who was entitled to the proceeds of the sale of its wool. Wagman assigned to the Bank as agent for certain creditors of SAWCO all of Wagman's right, title and interest in the wool and its proceeds, and for this reason alone the Bank's name is found in the caption of the case." Mr. Funk acted as arbitrator in the case and held that Boody's security interest had priority over that of Wagman and of the Philadelphia National Bank as Wagman's assignee. Looking at the case on a step-by-step basis it is to be noted that the statement of facts does not indicate whether the delivery order which was released to SAWCO was negotiable or not. If it was negotiable, it was capable of constituting collateral (Subsections 9-304(1) and (2)), whereas if it was not negotiable filing "as to the goods" was required (Subsection 9-304(3)). At any rate, when SAWCO obtained the wool a perfected security interest of Boody attached thereon since the financing statement covered both documents of title and wool in the hands of SAWCO. When the wool was stored in the warehouse and a non-negotiable document issued to Wagman as pledgee the issue as to the effect of that transaction on Boody's security interest arose. Since both Boody's and Wagman's interests were interests in the same collateral, the conflict was to be resolved pursuant to Section 9-312. According to that section the date of perfection controls (Subsection 9-312(5)(b)), unless a different rule is called for by Subsection 9-312(1). One of the rule so invoked is Section 9-309 dealing with conflicts involving security interests in negotiable documents.

Since the receipt issued and delivered to Wagman was non-negotiable, Wagman could not rely on Section 9-309. Mr. Funk suggests that Wagman would have prevailed under that section, if the receipt had been negotiable. Actually this statement oversimplifies the matter. Section 9-309 is primarily concerned with a conflict of rights in the negotiable document and not a conflict between rights (including security interests) in the goods and rights under a document issued after their bailment. This situation is regulated by Subsection 7-503(1) and even as a holder of a duly negotiated warehouse receipt Wagman could have prevailed only if Boody can be said to have entrusted the goods or a document of title covering them to SAWCO with actual or apparent authority to ship, store or sell. This was the case in the situation at hand. However, it does not follow from Subsection 7-503(1) that a purchase for value of <u>any</u> document of title destroys prior security interests who has entrusted the debtor with the goods. The document contemplated by Section 7-503 is a negotiable document of title. That section qualifies Section 7-502 and does not deal with title questions resulting from a non-negotiable document. These questions fall under Section 7-504 and, by way of supplementation under Sections 2-402(2), 9-307 and 9-312(5). Hence, Wagman's interest in the goods as a purchaser by way of a security was subject to Boody's security interest, pursuant to Sections 7-504 and 9-312(5).

<u>Section 7-505. Indorser not a guarantor for other parties</u>.

1. This section provides that the indorsement of a document of title issued by a bailee does not render the indorser liable for any default by the bailee or by a previous indorser. The indorsement has important effects on the rights of the indorsee under the instrument, but in contrast to the law governing the indorsement of negotiable instruments, the indorsement does not entail a guaranty of the performance by other persons.

2. Section 7-505 applies only to indorsements of documents issued by a bailee. An unaccepted negotiable delivery order is not issued by a bailee, and its indorsement guarantees that the indorser will procure the acceptance by the bailee (Subsection 7-502(1)(d)).

3. Section 7-505 is supplemented by Section 7-507 which attaches certain warranties upon the transfer or indorsement of a document of title.

Section 7-506. Delivery without indorsement: right to compel indorsement.

1. In certain cases an indorsement by the transferor is necessary to constitute due negotiation (Subsections 7-501(1) and (3)). In such cases a transferee may compel his transferor to supply the indorsement since the indorsement entails no additional liabilities of the transferor.

2. The indorsement has no relation back effect. Only upon its execution is the document negotiated.

Section 7-507. Warranties on negotiation or transfer of receipt or bill.

1. Transfer or negotiation of a document of title, whether for value or not, to a person other than an intermediary implies three warranties relating to the document:

   (a) that the document is genuine;

   (b) that he has no knowledge of any fact which would impair its validity or worth;

   (c) that the transfer or negotiation is rightful and fully effective with respect to the title to the document and the goods it represents.

2. The warranties extend only to the immediate purchaser and may be excluded by agreement (indorsement without recourse).

3. No warranties as to the goods themselves are implied. Such warranties may flow from an underlying sale.

Section 7-508. Warranties of collecting bank as to documents. This section limits the implied warranties flowing from the delivery of documents by a collecting and or other intermediary known to be entrusted with documents on behalf of another or with collection of a documentary draft or other claim requiring delivery of documents. Such delivery implies only a warranty of good faith and authority. The rule applies even though the intermediary has purchased or made advances against the draft or claim involved.

Section 7-509. Receipt or bill: when adequate compliance with commercial contract. This section is designed to render it clear, that the question whether a document is adequate to fulfill obligations calling for its issuance is governed by the pertinent articles of the Code, viz. Article 2 and Article 5.

PART 6

Warehouse Receipts and Bills of Lading: Miscellaneous Provisions

Section 7-601. Lost and missing documents.

1. Section 7-601 revises the prior law relating to lost, stolen or destroyed documents, by providing for complete immunity, if the bailee makes delivery of the goods or issues a substitute document pursuant to court order. If the bailee delivers the goods in good faith to a person claiming under a document alleged to be missing, he is liable to a person injured thereby; if the delivery is not in good faith, the bailee is liable for conversion. The Code specifies that no liability for conversion is incurred if delivery is made in good faith either in accordance with a filed classification or tariff or, in the absence of such filing, after claimant posts security in an amount at least double the value of the goods to indemnify a person injured by the delivery who files a claim within a year.

2. In proceedings for delivery or the issuance of a substitute document, plaintiff must furnish security approved by the court to indemnify any person injured, if the original document was negotiable. If the document is non-negotiable, the court may require security at its discretion. Exercise of this discretion is indicated, if the negotiability is in doubt, Official Comment, Point 3.

3. The court may order payment of bailee's cost and counsel fees.

Section 7-602. Attachment of goods covered by a negotiable document.

1. Section 7-602 deals with the effect of an outstanding negotiable document of title on the power of creditors to reach the goods

covered by such document themselves. The Code states a triad of rules which appear not completely meshed.

2. The first part of the first sentence provides in effect that with the exception of the creditors of a person whose rights are paramount to those of a person claiming under the negotiable document (Section 7-503) no creditor may obtain a lien by judicial process upon the goods themselves, without prior surrender of the document or an injunction against the holder prohibiting negotiation. The second part of the first sentence states in addition that the bailee shall not be compelled by process, such as replevin, creditors' bill, garnishment, or supplementary proceedings, to deliver the goods until the document is surrendered to the bailee or "impounded" by the court. The last sentence provides further that a purchaser of the document for value and without notice of the process takes free of lien imposed by judicial process.

3. Unfortunately the interrelation of these three precepts is not a model of clarity. The first rule flatly invalidates a lien by judicial process, without restriction of the unqualification to subsequent bona fide purchasers of the document, so long as the document is neither surrendered nor its negotiation enjoined. Obviously, therefore, the third sentence relates only to the case, where an injunction against negotiation of the document was obtained, thus permitting the attachment of a lien, but subsequently disobeyed by the holder. The second rule shields the bailee from compulsory process until the document is surrendered or impounded. Does an injunction against negotiation constitute an impounding? The answer should be in the negative. Impounding means taking into custody by an officer of the court. Since a levy on the goods usually can be made by seizure or garnishment, the second part of the first sentence, which prohibits compulsion to deliver until surrender or impounding of the document, could lead to the result that the lien which is permitted after a mere injunction may only be obtained by garnishment of the bailee and not by seizure of the goods.

4. The Uniform Warehouse Receipts Act, Section 26 and the Uniform Bills of Lading Act, Section 25, vested the courts with power to aid a creditor by injunction or otherwise in obtaining dominion over the document. The Code has not incorporated similar provisions, although it has done so in the analogous case of Section 8-317. No adverse inference should be drawn from this omission.

5. The reservation in the first sentence seems to imply that a person with rights paramount to the holder of the negotiable document may replevy the goods and that his creditors may reach them directly by levy or garnishment.

Section 7-603. Conflicting claims; interpleader. This section supplies a dilatory defense against a claim to delivery. If the bailee is confronted by conflicting claims he may withhold delivery until he has had reasonable time to ascertain the validity of the claims or to have a judicial determination by interpleader proceedings.

ARTICLE 9.

SECURED TRANSACTIONS; SALES OF ACCOUNTS, CONTRACT RIGHTS AND CHATTEL PAPER

Article 9, consolidating and modernizing the law of security transactions and the sale of accounts, contract rights and chattel paper is admittedly the most novel, most important and most intricate portion of the Uniform Commercial Code. Preparation of the final text required more drafts and re-examination of the underlying premises and policies than were necessary for any other Article, see Birnbaum, Article 9--A Restatement and Revision of Chattel Security, 1952 Wis. L. Rev. 348 (1952). 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 the law of security transactions under the Code has been made the subject of two monumental treatises, Coogan, Hogan and Vagts, Secured Transactions Under the U.C.C., 1966, reviewed by Riesenfeld, 52 Calif. L. Rev. 1051 (1964); and Gilmore, Security Interests in Personal Property, 1965, reviewed by Riesenfeld, 54 Calif. L. Rev. 1854 (1966). The complexity and conceptual unorthodoxy of the draftsmanship has produced a vast number of unresolved problems and doctrinal conflicts, and Article 9 has already been the subject of more litigation than any other article of the Code. The consistency of some of its provisions with the Bankruptcy Act has been questioned (see especially Kennedy, Trustee in Bankruptcy Under the U.C.C.: Some Problems Suggested by Articles 2 and 9, in 1 Coogan, Hogan and Vagts, Secured Transactions Under the U.C.C., 1052-1108 (1966), and in fact, denied in a much discussed decision by a Referee in Bankruptcy, (In re Portland Newspaper Publ. Co., 2 CCH Bankr. L. Rep. sec. 61,722 (D. Ore. 1966) noted 44 Tex. L. Rev. 1369 (1966). Conversely, the United States Congress recently has adjusted the tax lien law so as to conform with Article 9, (Federal Tax Lien Act, 35 L. W. 38).

Article 9 sets out a comprehensive and inclusive body of rules providing for the creation, effect, and enforcement of security interests in personal property and fixtures. Its basic aims and policies may be summarized as follows:

(1) Facilitation of secured financing transactions by establishing a simple and unified system instead of the multiplicity of previously existing security devices with the resulting overlaps and gaps that had come into use in the course of time;

(2) Abolition of all distinctions based solely on form and technicality and establishment of distinctions, where apposite, solely along functional lines;

(3) Enhancement of the legal security in credit transactions by permitting flexibility, without impairment of the validity of the transaction, to a greater degree than heretofore possible, but leaving the resulting risk of the debtor's dishonesty upon the creditor;

(4) Simplification of the formalities required for the creation of security interests;

(5) Removal of outmoded restraints on the realization of the security after default by authorizing all commercially reasonable methods of enforcement.

Broadly speaking the system adopted by Article 9 is an extension and improvement of that previously incorporated in the Uniform Trust Receipts Act, Revised Laws of Hawaii 1955, Chapter 206. But while the Uniform Trust Receipts Act applied only to the financing of the <u>acquisition</u> of inventory, Article 9 of the Code covers the creation of consensual security interests in all types of collateral, whether at hand or to be acquired, consisting of personal property or fixtures. Perhaps the most important feature of the new regime of security interests established by the Code is the recognition of a "continuing general lien" or "floating charge" as a proper and effective security device (Section 9-204 in conjunction with Sections 9-108, 9-203(1)(b) and 9-306).

In addition to the regulation of security transactions governing true security interests in all types of personal property and fixtures, Article 9 covers also the outright sale of accounts, contract rights and chattel paper. The reason for their inclusion in this article was the decision of the framers of the Code that, with certain exceptions, all transfers of accounts, contract rights and chattel paper should be governed by identical rules relating to their validity, perfection <u>vis-a-vis</u> third parties, and status under conflict of law rules, whether made outright or for security purposes. As a result rules relating to outright sales of personal property interests are now distributed over at least five different articles of the Code. See especially Article 1, Section 1-206, containing the statute of frauds relating to the sale of general intangibles and to the sale of accounts, contract rights and chattel paper to the extent that it is excluded from the application of Article 9 by Subsection 9-104(f); Article 2, relating to the sale of goods; Article 3, Subsection 3-417(2), relating to statutory warranties of the transferor of negotiable instruments;

Article 4, Subsection 4-207(2), relating to statutory warranties of the transferor of instruments for the payment of money other than money itself; Article 9, covering the sale of accounts, contract rights and chattel paper except in the cases specified in Subsection 9-104(f).

The scope of the coverage of Article 9 has caused the specific repeal (Act 208, Session Laws of Hawaii 1965, Section 10-102; Act 18, Session Laws of Hawaii 1966, Section 5(e)) of a number of statutes formerly operating in its area:

Revised Laws of Hawaii 1955, Ch. 187, Accounts Receivable: Assignment and Notice;
Revised Laws of Hawaii 1955, Ch. 206, Uniform Trust Receipts Act;
Revised Laws of Hawaii 1955, Sections 196-8, 343-51 and 343-52, Chattel Mortgages.

In addition, some common law rules recognized in Hawaiian case law relating to the law of pledges and conditional sales are now either superseded or limited by the Code. Thus, the rule prohibiting the enforcement of a pledge by private sale without a specific agreement to that effect, Okada v. Akahoshi, 29 Haw. 719 (1927), is now abrogated by Subsection 9-504(3). Similarly, the consolidation of the previously existing congeries of different types of security interest into one and the attendant repeal of the array of statutes regulating them on the basis of divergent policies has eliminated the 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 whether it is a sale with a conditional resale or a chattel mortgage, or whether the chattel mortgage has title or only a lien, see e.g., Spreckels v. Macfarlane, 9 Haw. 166 (1893), George Hess v. Sam Paulo, Sr., 38 Haw. 279, 289 (1949) have lost their relevancy.

PART 1

Short Title, Applicability and Definitions

Section 9-101. Short title. Like every other article of the Code, Article 9 is given a short title by which it is to be cited.

The name "secured transactions" indicates the subject although actually the article deals specifically with security agreements rather than the transaction which is secured thereby. The name was chosen in view of the fact that frequently, though not always, the security agreement is part and parcel of a broader transaction covering also other aspects of the deal.

Section 9-102. Policy and scope of article.

1. Subject to qualifications contained in subsequent sections of this article, Subsection 9-102(1) defines the functional and territorial applicability of Article 9. It specifies in Subsection (1)(a) that the article covers any transaction (a term not defined in the Code) designed to create a security interest in personal property. It prescribes in Subsection (1)(b) that, in addition to the transactions covered by Subsection (1)(a), any sale of accounts, contract rights or chattel paper is also included even though such sale is not made for the purpose of securing the payment or performance of an obligation. The reason for that extension is discussed in the Introductory Note to this article.

   The term "security interest" used in Subsection (1)(a) is defined in Subsection 1-201(37), as a general Code definition. It should be noted, however, that the context of Subsection 9-102(1)(a) requires that the term as used therein excludes the interest of an outright buyer of accounts, contract rights and chattel paper as such sale is covered by Subsection (1)(b). In other sections of Article 9 the term "security interest" includes such interest even without specific declaration to that effect.

2. As Subsection (1)(a) indicates, personal property, as covered by Article 9, consists of goods, documents, instruments, money, accounts, contract rights and chattel paper. Each of these terms is defined either by a separate definition contained in Article 9 (Subsection 9-105(1)(f) "goods"; Subsection 9-105(1)(g) "account", "contract rights", "general intangibles") or by a combination of an "index" definition contained in Article 9 and a definition contained in the general definition section of Article 1 (Subsection 9-105(1)(e) "document" in conjunction with Subsection 1-201(15)).

   The only type of personal property to which Article 9 does not apply is money. Although the term money as used in the Code (Subsection 1-201(24)) ordinarily includes foreign money, it could be argued that inventory of foreign money in the hands of a dealer in such commodity may be used as "collateral" (Subsection 9-105(1)(c)) and that in such case it should be treated like a negotiable instrument.

3. Subsection (2) renders it clear that the security interests governed by Article 9 are of a contractual nature and that the Code does not apply to statutory liens or liens obtained by judicial proceedings, except in the context of priorities (Sections 9-301 and 9-310). The contract creating a security interest renders the "secured party" (Subsection 9-105(1)(i)) a "purchaser" (Subsection 1-201(32)). The form of, or label attributed to, the "security agreement" (Subsection 9-105(1)(h)) is immaterial. It may be a pledge, conditional sale, chattel mortgage, chattel trust, equipment trust, trust deed, trust receipt or assignment in the conventional sense. It is important to note that leases or consignment contracts intended as security are within the coverage of Article 9 as security transactions. Subsection 1-201(37) amplifies the provision of Subsection 9-102(2) in that respect by prescribing that the title of the consignor under a consignment which is not intended as security is not a security interest but is subject to the rules for consignment sales (Section 2-326). In addition, Subsection 1-201(37) prescribes the test to be applied in determining whether or not a lease is intended as a security agreement. As a matter of principle, each case has to be decided on the basis of its particular facts. It is, however, specifically stated that the mere inclusion of an option to buy does not in itself attribute to the lease the character of a security agreement. Conversely, if the lease contains a stipulation whereby, upon compliance with the terms of the lease, the lessee shall become, or has the option to become, the owner for no additional consideration or only additional compensation, the contract is to be considered a security agreement. In such case, the rental actually includes the amounts required for the amortization of the capital investment of the lessor and therefore is equivalent to an installment sale, with no or an insubstantial final payment, reserving a security interest in the seller. The test given by the Code is not always easily applied, and a recent case has demonstrated its difficulties, In re Merkel, 25 A.D. 764, 269 N.Y.S. 2d 190 (1966), rev'g. 45 Misc. 2d 753, 258 N.Y.S. 2d 118 (1965).

4. Subsection (3) provides that the application of Article 9 to a security interest in a secured obligation is not affected by the fact that the obligation may be secured by a real estate mortgage or other security interest in real property. Hence, the transfer of an investment, chattel paper, account, contract right or general intangible must comply with provisions of Article 9 governing such transfer even though the right to payment thus transferred is secured by a real estate mortgage. Accordingly, in appropriate cases compliance with the filing requirements of the Code (Section 9-302 in conjunction with 9-104) is needed in addition to

compliance with the recording or registration requirements prescribed for the assignment of land mortgages (Revised Laws of Hawaii 1955, Sections 342-60, 343-21, 343-23, 343-49).

It should be observed that Subsection 9-104(j) does not militate against the interpretation advanced above. That provision specifies that the transfer of a lien on real estate is excluded from the coverage of Article 9. This, however, can only mean the transfer of the lien as such. See the discussion of this point in 1 Gilmore, Security Interests in Personal Property 311 (1965). The transfer of the claim so secured is governed by Subsection 9-102(3). Where such transfer creates a security interest, in the broad sense of Subsection 1-201(37), in the underlying claim for the payment of money or the performance of an obligation, the mandates of Article 9 apply even where the effect necessitates both filing and recordation or registration. This is important in cases where a debt secured by a land mortgage is classified as chattel paper, account, contract right or general intangible. Hence, where a note secured by a land mortgage cannot be classified as a negotiable instrument or a writing which "is of a type which is in ordinary course of business transferred by delivery with any necessary indorsement or assignment" within the purview of Subsection 9-105(g) and therefore is a general intangible, filing plus recordation or registration will be necessary to perfect a security interest in such note. The same result will also follow where the obligation, such as the repayment of a loan, is incorporated in the mortgage deed itself. Doubts on this point are expressed in 1 Gilmore, Security Interests in Personal Property 311 (1965). See the criticism by Riesenfeld, 54 Calif. L. Rev. 1854, 1855 (1966).

5. According to Subsection (1) the Code applies to any personal property and fixtures within the State. Additional conflict of laws rules are provided in Section 9-103.

6. Article 9 applies to transactions regulated by the Retail Installment Sales Act, Revised Laws of Hawaii 1955, Chapter 201A; Disclosure of Finance Costs Act, Revised Laws of Hawaii 1955, Chapter 191A; Industrial Loan Act, Revised Laws of Hawaii 1955, Chapter 194, especially Section 194-18; and Small Loan Act, Revised Laws of Hawaii 1955, Chapter 195. To the extent that these statutes contain provisions in addition to, or different from Article 9, they remain applicable within the limits provided in Sections 9-201 and 9-203, as amended by Act 18, Session Laws of Hawaii 1966, Section (b). Generally speaking, such provisions relate to the validity and enforcement of these transactions. Perfection requirements for, and priorities of, the security aspects of these transactions are governed by the Code.

7. Article 9 applies to security interests in motor vehicles except that the filing requirements of the Code are replaced by the registration requirements of Revised Laws of Hawaii 1955, Chapter 160.

Section 9-103. Accounts, contract rights, general intangibles and equipment relating to another jurisdiction; and incoming goods already subject to a security interest.

1. Section 9-102 specifies that the provisions of Article 9 relating to the validity, perfection, priority and enforcement of security interests apply to personal property and fixtures within the State. However, situs of intangibles is frequently a difficult matter to determine; equipment of a mobile type may be used in several jurisdictions; goods brought into the State may be already subject to a security interest. In order to resolve issues bound to arise, Section 9-103 contains a set of conflict-of-laws rules supplementing the general principle of Section 9-102. For a detailed discussion of the "rickety structure" of Section 9-103, see 1 Gilmore, Security Interests in Personal Property 316-332 (1965).

2. Subsection (1) deals with the proper jurisdiction to determine the validity and perfection of a security interest in accounts and contract rights. If the office where the assignor keeps his records with respect thereto is in Hawaii, the Code provisions as adopted in the State control; otherwise the laws of the state where the assignor keeps such records are applicable in Hawaiian courts.

3. Subsection (2) deals with validity and perfection of security interests in general intangibles and in goods of a type which are normally used in more than one jurisdiction if such goods are classified as equipment or inventory for leasing and not covered by a certificate of title. Note that the rule is couched in terms of the type of chattel and not of the actual use thereof; cf. 1 Gilmore, Security Interests in Personal Property 329 (1965). If the debtor's chief place of business is in Hawaii, the Code as adopted in the State governs. Otherwise the law of the jurisdiction is where the chief place of business of the debtor is located. If the chief place of business is located in a jurisdiction which does not provide for perfection of the security interest by filing or recording in that jurisdiction, the security may be perfected in this State. In view of the nearly universal adoption of the Uniform Commercial Code, this provision should be of minimal practical importance, except for the fact that California does not permit filing as a perfection method for security interests in general intangibles. Security interests in foreign aircraft may

be perfected in the jurisdiction where the office of the agent designated as proper recipient for the service of process is located.

4. Subsection (3) deals with conflict-of-laws rules relating to personal property not already covered by Subsections (1) and (2) i.e., especially consumer goods, non-mobile equipment, and inventory other than mobile machinery used in leasing. Its applicability, however, is reduced by Subsection (4) which provides special rules for goods covered by a certificate of title.

   If collateral of the type envisaged by Subsection (3) is brought into the State after a security interest had already attached thereto, the validity of such security interest is determined by the law of the state where the collateral was located at the time of such attachment; the law of Hawaii applies, however, if the parties at the time of the attachment understand that the property was to be located in Hawaii and it was brought into the State within 30 days.

   If a security interest in such property was perfected prior to the entry in this State, the perfection continues for four months and also thereafter if it is re-perfected within that four-month period. Otherwise, the security interest must be perfected or re-perfected in this State, and such perfection is measured only from its date with the possibility of a period of non-perfection immediately prior thereto.

5. Subsection (4) makes an exception from the conflict-of-laws rules stated in Subsections (2) and (3) with respect to a security interest in personal property which is covered by a certificate of title issued under a statute which requires any security interest to be indicated on the certificate as a condition of its perfection. In such case, the perfection is governed by the law of the jurisdiction which issued the certificate. Apparently such perfection continues so long as the certificate has not expired in the state of issuance and need not be replaced by a new certificate in a jurisdiction where the property is subsequently located.

   The draftsmanship of Subsection (4) has been severely criticized in 1 Gilmore, Security Interests in Personal Property 328 (1965).

6. Subsection (5) deals with the special case where the office in which the assignor of accounts and contract rights keeps the records pertaining thereto is located outside the United States and the transaction creating security interests in such accounts or contract rights has an appropriate relation with this State.

In such case, validity and perfection are governed by Article 9 with the qualification that the perfection is made, and only made, by notification of the account debtors.

7. It is recognized that Section 9-103 is unsatisfactory in all of its five subsections. See 1 Gilmore, Security Interests in Personal Property 320, and the discussion at 316-332 and 624-631 (1965); Vernon, Recorded Chattel Security Interests in the Conflict of Laws, 47 Iowa L. Rev. 346 (1962). One of its chief weaknesses is its perpetual vacillating between validity and perfection with the resulting vast areas of uncertainty and confusion.

Section 9-104. Transactions excluded from article.

1. This section contains a catalogue of eleven categories of liens or transactions which are excluded from the coverage of Article 9 on the ground that subjection to the provisions of Article 9 is for various reasons either inappropriate or, at least, unnecessary.

2. The exclusions range over a great variety of liens or transactions. Subsection (a) exempts security interests, the incidents of which are governed by federal statute, for instance, preferred ship mortgages under the Ship Mortgage Act, 1920. The other subsections refer to liens and transactions regulated by state statute or local common law, among them landlord's liens (Subsection (b)), artisan and material men's liens (Subsection (c)) and equipment trusts covering railway rolling stock (Subsection (e)).

3. As has been mentioned, the coverage of Article 9 includes sales of accounts, contract rights and chattel paper as well as the creation of security interests in general intangibles. The majority of the exclusions limit the coverage in these two respects. Thus Subsection (f) exempts the sale of accounts, contract rights and chattel paper as part of a sale of the business which gave rise to them and the transfer of such items for collection only. In addition, its exclusion applies to the transfer of a contract right which is coupled with a delegation of the performance. Other subsections exclude wage assignments (Subsection (d)), transfers of interests or claims in or under insurance policies (Subsection (g)), transfers of rights under a judgment (Subsection (h)) and transfers of tort claims or deposits or accounts maintained with a bank or similar financial institution (Subsection (k)).

4. Subsection (j) clarifies the border line between personal property interests which are covered by, and real property interests which are outside the scope of, Article 9. Thus, it declares that the

article applies to the creation and transfer of a security interest in fixtures to the extent of the provision of Section 9-313. Otherwise, the creation or transfer of an interest in or lien on real estate, including a lease or rents thereunder, are not within the purview of the article on secured transactions. The reference to the transfer of a lien on real estate refers strictly to the transfer of the lien itself; the creation of security interests in the obligation secured by such lien is within the coverage of Article 9, as is expressly provided in Subsection 9-102(3).

Section 9-105. Definitions and index of definitions.

1. According to the structure of the Code, each article, except Article 10, includes a set of definitions pertaining to the particular branch of the law covered thereby which supplements and in some instances qualifies the definitions contained in Article 1 (Section 1-201) and designed to be applicable throughout the whole Code. Of course, all definitions may be qualified by the context. The definitions contained in Section 9-105 are supplemented by further definitions in Sections 9-106, 9-107 and 9-109. Of special significance are the definitions relating to the various categories of personal property since many of the rules provided by Article 9 depend upon the type of property interests involved. As mentioned in the Introductory Note to this article, the Code classifies personal property as goods, money, documents, instruments, chattel paper, accounts, contract rights and general intangibles. Therefore, the definitions of these concepts deserve particular attention. Chattel paper, goods, documents and instruments are defined in Section 9-105; account, contract right and general intangibles are defined in Section 9-106. Unfortunately the dividing lines are not always clear (see especially 1 Gilmore, <u>Security Interests in Personal Property</u> ch. 12, The Classification of Property, (1965)) and it has been suggested that the system of the Code is unnecessarily refined in that respect (cf. Kripke, <u>Suggestions for Clarifying Article 9: Intangibles, Proceeds and Priorities</u>, 41 N.Y.U. L. Rev. 687 (1966)).

2. "Account debtor" and "debtor" are defined by Subsections (1)(a) and (d). Debtor, as used by the Code, means the person who owes payment or other performance under the obligation secured. Where the debtor is not the owner of the collateral, the term debtor may mean either the obligor or the owner of the collateral according to the subject matter or the context of the particular provision. Debtor and secured party (as defined in Subsection (1)(i)) are corollaries.

Account debtor means the obligor who is indebted to the debtor on an account, chattel paper, contract right or general intangible.

3. Chattel paper is a new concept coined by the Code. According to Subsection (1)(b) it denotes a writing or writings which evidence both a monetary obligation and a security interest in, or a lease of, specific goods. When a transaction is evidenced by a set of writings consisting of a lease or security agreement and one or more instruments, such as promissory notes, the whole package constitutes chattel paper.

The Code treats chattel paper as a unit and separate type of collateral, distinguished from accounts, instruments or general intangibles. Security interests in chattel paper (including negotiable instruments which form part thereof) may be perfected by filing or possession (Sections 9-304 and 9-305) whereas perfection of security interests in accounts or general intangibles is possible only by filing, and of security interests in instruments which are not part of chattel paper, only by possession. Moreover, the Code attributes to chattel paper a character of quasi-negotiability by protecting purchasers for new value who take possession thereof (Section 9-308).

Whether this unity and quasi-negotiability will spill over into branches of the law not directly regulated by the Code remains to be seen and is doubtful Thus, the proper form of a levy on chattel paper by a creditor of the owner thereof may vary, according to whether the chattel paper does or does not include a negotiable instrument. If no negotiable instrument is part of the chattel paper sought to be reached, garnishment of the account debtor seems to be the appropriate procedure (this may be so although chattel paper is pledgeable, cf. 1 Gilmore, Security Interests in Personal Property 379 (1965)) while seizure of the negotiable instrument is necessary, if it is included. In addition, where the chattel paper includes a negotiable instrument, the protection of a holder in due course thereof exceeds that of a purchaser of chattel paper as such (Section 9-309).

4. The term "document" is not separately defined for the purposes of Article 9, but the general definition of document of title given by Subsection 1-201(15) is made applicable by Subsection 9-105(e). The concept of document of title incorporated in the Code broadens the one heretofore employed by including not only documents issued by a bailee but also documents issued by the bailor or a successor in interest addressed to a bailee covering goods in his possession.

Documents of title may be negotiable or non-negotiable (Section 7-104). Hence, negotiable or non-negotiable delivery orders are documents of title within the meaning of the Code, including Article 9. Professor Gilmore suggests that only warehouse receipts and bills of lading will have significance as collateral (1 Gilmore, Security Interests in Personal Property 378 (1965)) but cases involving delivery orders have already arisen. The various sections of Article 9 are explicit as to whether or not the documents within the purview must be negotiable. Actually, all special provisions applicable to documents refer only to negotiable documents (Sections 9-305(1), (2), (4) and (5), 9-305 and 9-309). Security interests in non-negotiable documents are perfected either by filing "as to the goods" or by notification of the bailee of the secured party's interest (Subsection 9-304(3)).

5. Subsection (f) gives a definition of "goods" which varies in several details from that given in Section 2-105 for the purpose of the article on sales. The Article 9 definition includes fixtures as defined in Section 9-313 and excludes expressly "money, documents, instruments, accounts, chattel paper, general intangibles, contract rights and other things in action." Actually the reference to general intangibles and other things in action is redundant and misleading since "general intangibles" covers all things in action, which do not belong in any of the named categories.

6. Subsection (g) supplies an open-ended definition of "instrument" which includes negotiable instruments within the specifications of Section 3-104, securities as defined in Section 8-102, and any other writings which evidence a right to payment of money and are a type which in ordinary course of business are transferred by delivery with any necessary indorsement or assignment. Although it has been suggested that the identification of writings which are and those which are not "transferable by delivery" is without real difficulty, doubts may rise (1 Gilmore, Security Agreements in Personal Property 386 (1965)). Certainly, instruments which technically are not negotiable instruments, but whose terms do not preclude transfer and which are otherwise negotiable within Article 3, are instruments within the meaning of Subsection 9-105(g). But what about promissory notes marked "non-negotiable", as they have to be under (Revised Laws of Hawaii 1955, ch. 201A) the Retail Installment Sales Act? Apparently they, too, fall within the residual clause of the definition of instrument, with the result that all promissory notes are instruments for purposes of Article 9. Of course, non-negotiable promissory notes executed to comply with the Retail Installment Sales Act usually will be part of chattel paper, and no questions as to the proper perfection method will arise in such case.

7. The definition of "collateral" (Subsection (1)(c)), "security agreement" (Subsection (1)(h)) and "secured party" (Subsection (1)(i)) are self-explanatory. They reflect the inclusion of outright sales of accounts, contract rights and chattel paper within the scope of Article 9 and the ensuing artificial scope of the context of security interest contained in Subsection 1-201(37).

<u>Section 9-106. Definitions: "Account"; "contract right"; "general intangibles"</u>.

1. While three of the categories of assets which, apart from goods, may constitute collateral (instruments, documents, chattel paper) are more or less assimilated to tangibles, this "reification" has not been achieved with respect to the three remaining classes, designated as accounts, contract rights and general intangibles. They have remained pure choses in action or, as Professor Gilmore has dubbed them, pure intangibles (1 Gilmore, <u>Security Interests in Personal Property</u> 377 (1965)). It is today recognized that the tripartition is over-refined and an unnecessary source of potential trouble (1 Gilmore, <u>Security Interests in Personal Property</u> 381-383; Kripke, <u>Suggestions for Clarifying Article 9: Intangibles, Proceeds, and Priorities</u>, 41 N.Y.U. L. Rev. 687 (1966)). The residual class "general intangibles" was apparently included as an after-thought of the Editorial Board in 1956 (1956 Recommendations of the Editorial Board for the Uniform Commercial Code Section 9-106). The differentiation between accounts and contract rights on the one hand and general intangibles on the other is material in the choice of law provisions (Subsections 9-103(1) and (2)); in the extension of the perfection provisions to outright sales (Subsection 9-102(b) in conjunction with Sections 1-201(37), 9-301, 9-302); and in the provision invalidating anti-assignment clauses (Subsection 9-318(4)). However, Professor Gilmore suggests that it may nevertheless be extended to the assignment of general intangibles (1 Gilmore, <u>Security Interests in Personal Property</u> 387 (1965)). A distinction between account and contract right occurs only once, in Subsection 9-318(2), relating to the modification of a contract right which "has not already become an account".

2. "Account" is defined as a right to payment for goods sold or leased or services rendered, which is not evidenced by an instrument or chattel paper. "Contract right" is defined as any right not yet earned by performance and not evidenced by an instrument or chattel paper. "General intangibles" is defined as the residual class of personal property which is not goods, accounts, contract rights, chattel paper, documents or instruments. The latter definition adds "including things of action" in a parenthesis following the phrase personal property and omits the reference to

money. Both the parenthetical inclusion and the omission are baffling when compared with the definition of "goods" in Subsection 9-105(f) which lists the residual classes of personal property as money, documents, instruments, chattel paper, contract rights, accounts, general intangibles and (!) other things in action. According to the reading by Professor Gilmore (1 Gilmore, Security Interests in Personal Property 395 (1965)) the parenthesis in Section 9-106 merely explains the term personal property and does not add a sub-category of general intangibles. Obviously, general intangibles are the residual class of things in action which are not accounts or contract rights. The addition of the item in the definition of goods is plainly erroneous. On the other hand, money is not treated as a general intangible. It cannot constitute collateral, except perhaps an inventory of foreign money. In that case, the collateral is instruments.

Contract rights within the meaning of the Code cover any contractual right (not evidenced by an instrument or chattel paper) not yet earned by performance. On performance, it will turn into an account if the performance was a sale or lease of goods or a rendition of services; otherwise, it will turn into a general intangible as in the case of a contract for the assignment of a patent or copyright (cf. 1 Gilmore, Security Interests in Personal Property 382 (1965)).

3. The most important and most difficult problem is produced by the need to differentiate between instruments and general intangibles. This matter has already been discussed in the Explanatory Note 6 to Section 9-105. Instrument, as has been pointed out, is a broad and open-ended concept. It includes many types of writings evidencing rights to a payment of money. Whether it includes all types of non-negotiable notes or mortgage or trust deeds covering real estate is unfortunately far from being clear. Yet the proper method of perfection depends on the answer.

Section 9-107. Definitions: "Purchase money security interest".

1. The Code attributes to purchase money security interests certain preferential treatment (Subsections 9-301(2), 9-302(1)(c) and (d), 9-312(3) and (5)). As a result, the notion of purchase money security interest requires statutory definition which is supplied by Section 9-107.

2. Section 9-107 specifies that purchase money security interest arises in two types of situations:

(a) if a security interest is taken or retained by the seller of the collateral to secure all or part of its price;

(b) if a security interest is taken by a third person who gives value by making advances or incurring an obligation to enable the debtor to acquire rights in or the use of collateral, if such value is in fact so used.

3. The definitions merit brief comments. Branch (a) of the definition applies only to the extent that the acquired property itself is the collateral. To the extent that the purchase price is secured by collateral other than the property bought, the security interest is not purchase money.

4. Branch (b) of the definition covers a third party lender. For instance, value is given in the form of "incurring an obligation" and "in fact so used" where a third party co-signs or indorses a note of the buyer who thereby obtains delivery of merchandise. A security interest given on the merchandise to secure the co-signer's or indorser's right of reimbursement constitutes purchase money security.

   The statement that "purchase money" is given if it enables the debtor to acquire the <u>use</u> of collateral is puzzlesome. Obviously, the drafters contemplated the case of leased collateral, but unless the lessor agrees, such security interest could attach only on the lessee's interest, a right which would be at best of limited value to the secured party (cf. 2 Gilmore, <u>Security Interests in Personal Property</u> 784 (1965)). Moreover, the question arises with respect to the <u>outer limits</u> of this clause. Would a loan for the purpose of defraying warehouse charges and getting the collateral released be value enabling the debtor to acquire the use of the collateral?

5. There may be more than one purchase money security interest in the same collateral. This is the case where several persons finance the acquisition of the collateral, and such financers may include the seller himself. If a fraudulent debtor borrows money from two lenders for the acquisition of property and uses only part of each loan for the stipulated purpose, embezzling the rest, the security interest of each lender constitutes purchase money only to the extent that his loan actually contributed to the purchase. This situation might produce difficult priority questions if the collateral later decreases in value. See 2 Gilmore, <u>Security Interests in Personal Property</u> 784 (1965) and Explanatory Notes to Section 9-312.

Section 9-108. When after-acquired collateral not security for antecedent debt.

1. This section provides that if a secured party gives new value to be secured in whole or in part by after-acquired property, the security interest shall be deemed to be taken for new value if the debtor acquires his rights in such collateral either in the ordinary course of business or under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given.

   This section must be read in conjunction with Subsection 9-204(3) which validates after-acquired property clauses and Subsection 9-204(1) which specifies that a security interest cannot attach until the debtor has rights in the collateral. Section 9-108 is meant to do no more than to clarify that the value which is given prior to such acquisition of collateral is nevertheless to be considered new value with reference to such collateral, provided that the acquisition meets certain tests.

2. Section 9-108 was avowedly inserted in the Code with an eye to Section 60a of the Bankruptcy Act. That provision declares a transfer of any property of the debtor for the benefit of a creditor, made while such debtor is insolvent and within four months before the filing of the petition and resulting in a greater percentage of satisfaction, to be a preference if it was made for or on account of an antecedent consideration.

   The validity of this provision has been the subject of a raging controversy and more ink has been spilled over that provision than any other section in the Code. See e.g., 1 Gilmore, Security Interests in Personal Property 362, 2 id. 1309 (1965); Henson, 9-108 of the Uniform Commercial Code and Sec. 60a of the Bankruptcy Reconciled, 21 Bus. Lawyer 371 (1966); Kennedy, Trustee in Bankruptcy Under the U.C.C.: Some Problems Suggested by Articles 2 and 9, in 1 Coogan, Hogan and Vagts, Secured Transactions Under the U.C.C. 1052, at 1088 (1966); King, Section 9-108 of the U.C.C.: Does It Insulate the Security Interest From Attack by a Trustee in Bankruptcy, 114 U. Pa. L. Rev. 1117 (1966); Riemer, After-Acquired Property Clause Revisited, 70 Comm. L. J. 334 (1965), Keefe, U.C.C. v. Bankruptcy Act, 51 A.B.A.J. 690 (1965) with further references. One Referee's decision has held that the time of the value given rule of Section 9-108 is inconsistent with the declared policy of the Bankruptcy Act (In re Portland Newspaper Publ. Co., 2 CCH Bankr. L. Rep. sec. 61,722 (D. Ore. 1966), noted 44 Tex. L. Rev. 1369 (1966)). Until the issue has been settled by the United States Supreme Court, a satisfactory solution can only be achieved by congressional legislation. It seems doubtful that an amendment of the Code itself would be fruitful. At any rate, even if Section 9-108 does not save such an after-acquired security interest, the other elements of a preferential transfer, especially the result of a higher percentage of recovery, must be present.

3. The controversial relation of security interest in after-acquired property to tax lien has been clarified by the Federal Tax Lien Act of 1966, creating a new section 6323c(1) and (2). The financer may retain priority if the collateral was acquired before the 46th day after the date of tax lien filing. See Senate Report No. 1708, reprinted in U.S. Code Congressional and Administrative News 4946 (1966).

4. Section 9-108 predicates the contemporaneous character of the new value on the concurrence of two alternative conditions: the after-acquired collateral must be purchased either (a) in the ordinary course of business, or (b) under a contract made pursuant to the security agreement within a reasonable time after new value is given.

5. The Code does not define new value but illustrates the concept by statutory illustrations. Value given is defined in Subsection 1-201(44).

<u>Section 9-109. Classification of goods; "consumer goods"; "equipment"; "farm products"; "inventory"</u>.

1. Section 9-109 subdivides goods into four categories according to functional criteria. In the early stages of the Code's development (see, <u>e.g.</u>, Treton, <u>The Proposed Commercial Code: A New Deal in Chattel Security</u>, 43 Ill. L. Rev. 794 (1949)) much greater significance was attached to the distinctions than was retained in the final version. Nevertheless, the Code still differentiates in some of its rules between the four classes defined in Section 9-109. These rules pertain to:

   (a) perfection (Subsections 9-302(1)(c) and (d));

   (b) validity of after-acquired property clauses (Subsections 9-204 (4)(a) and (b));

   (c) waiver of defenses (Section 9-206);

   (d) priorities (Subsections 9-307(1) and (2) and 9-312(2), (3) and (4));

   (e) enforcement (Sections 9-503, 9-505 and 9-507).

2. The central category in the four existing classes is "inventory". It consists of goods held by a person for sale or lease or as supplies to be furnished under a service contract. The goods remain inventory even after they have been placed in the hands of the person who has rented (but not bought) them. Moreover, goods which are materials in the hands of a manufacturer to be used in processing are also inventory. The Code accommodates thus the ever-expanding practice of equipment leasing. It accentuates this policy by expressly stating that "Inventory of a person is not be classified as his equipment."

3. "Equipment" and "consumer goods" are two mutually exclusive categories dove-tailing with inventory. Inventory sold to persons other than dealers in that class of goods will turn into either consumer goods or equipment. Such goods are consumer goods if they are bought by the purchaser for personal, family or household use. They are equipment if they are bought either for non-business purposes other than personal, family or household use, or for business, professional or farm use other than to be held as inventory. The primary use controls. A tractor which is used by a farmer to drive to church is equipment, the family car of the doctor is consumer goods.

4. Farm products include crops, although the Code has some rules applicable only to crops. Farm products are such, even though they are held for sale, so long as they are in the possession of the farmer. If the farmer processes them, they cease to be farm products and become inventory.

5. A subsequent change in the primary use of the goods affect their status and may change a perfected security interest into a non-perfected one. Thus, a security interest in a piano bought for family use need not be filed; filing becomes necessary if the owner transfers it into a bar operated by him.

Section 9-110. Sufficiency of description. Section 9-110 relaxes the standards of specificity required in the description of the collateral, changing decisional requirements developed in older cases involving the recordation of chattel mortgages. Reasonable identification of the collateral is all that is demanded. The policy of Section 9-110 is adopted in order to render advance filing possible. The section continues and extends the approach of the former Uniform Trust Receipts Act, Revised Laws of Hawaii 1955, Section 206-13. But while the latter section applied only to the contents of the financing statement, the instant section relates also to the description required for the security agreement within the meaning of Section 9-203.

Section 9-111. Applicability of bulk transfer laws. The purpose of Section 9-111 is to clarify that the creation of a security interest in a major part of the assets of an enterprise constituting the items listed in Subsection 6-102(1) does not fall under the provisions of Article 6. It reiterates the rule of Subsection 6-103(1). A sale of all outstanding accounts likewise is not a bulk transfer because such sale creates a security interest within the meaning of the Code and does not cover items listed in Section 6-102.

Section 9-112. Where collateral is not owned by debtor.

1. Subsection 9-105(d) defining the term debtor lays down the general proposition that in a situation where the obligor is not the owner of the collateral, the use of the term debtor means the owner in any provision of Article 9 that deals with the obligation. Section 9-112 is designed to implement this rule. It renders it clear that the owner of the collateral as such is not personally liable and is entitled to any excess remaining after the enforcement of the security interest (Subsections 9-502(2) and 9-504(1)).

2. In addition, and by way of clarification, Section 9-112 specifies that the owner is entitled to certain protective remedies, the same as the debtor, in five listed instances:

   (a) statements under Section 9-208;

   (b) notice of, and opportunity to object to, a proposal by the secured party to retain the collateral as satisfaction under Section 9-505;

   (c) redemption under Section 9-506;

   (d) relief against improper disposition of the collateral under Subsection 9-507(1);

   (e) indemnification for losses under Subsection 9-208(2).

3. The Code does not attempt to resolve any possible conflict between the obligor and the owner of the collateral, nor does it aim at an exhaustive regulation of the subject.

4. The secured party is under a duty *vis-a-vis* the owner of the collateral only if he knows that the latter is a person other than the obligor and no different agreement was made.

Section 9-113. Security interest arising under Article on Sales.

1. This section was inserted into the Code as a result of the Recommendations of the Editorial Board made in 1956 in response to certain difficulties felt by the New York Law Revision Commission (1956 Recommendations of the Editorial Board for the Uniform Commercial Code 265 (A.L.I. 1956)). It was accompanied by a set of changes made in Article 2 to conform with Section 9-113. Whether the clarification has succeeded in removing the doubts is subject to debate. See Hogan, The Marriage of Sales to Chattel Security in the U.C.C. in 2 Coogan, Hogan and Vagts, Secured Transactions Under the U.C.C. 1871 (1966).

2. Security interests arising in conjunction with sales transactions are covered by Article 9 with the important exception that a security interest arising solely under Article 2 is privileged in three respects to the extent, and so long as, the debtor does not have or does not lawfully obtain the goods, viz.

   (a) it need not be covered by a security agreement having the formal requisites;

   (b) it is exempt from filing;

   (c) on default the rights of the secured party are governed by Article 2.

3. Actually, the dispensation of Article 9-113 is extremely limited in scope (cf. 1 Gilmore, Security Interests in Personal Property 340, 539 (1965)) and seems to reach only one or two implied security interests of the seller or buyer identified as such by the Code. Section 9-113 does not apply to a security interest of the seller which is created by express reservation, regardless of whether or not the goods subject thereto are in the possession of the debtor (cf. 1 Gilmore, Security Interests in Personal Property 341 (1965)). In addition, the Code is explicit in its theory that the special property interest of a buyer of goods on identification of such goods to a contract of sale as such is not a security interest (Subsections 1-201(37) and 2-401(1)) although the buyer may acquire a security interest in such goods to secure performance if he complies with Article 9. Finally, the Code studiously refrains from designating the in rem remedies of the unpaid seller, such as the right of stoppage, or right to resell, (Sections 2-703 and 2-705) as security interests in goods although they would fall under the exception of Section 9-113 if they are deemed to have that character. The only instances where a seller's implied interest in goods is labeled a security interest are the cases of shipment under reservation (Section 2-505). Conversely,

the buyer's only recognized implied security interest in goods is that in goods in his possession upon rightful rejection or justifiable revocation of the acceptance thereof (Subsection 2-711(3)). Since in that case the goods must be in the buyer's possession, his security interest is perfected even without resort to Subsection 9-113(b). (See 1 Gilmore, Security Interests in Personal Property 539 (1965)).

4. It may be remembered that in one place the Code provides for the filing of an interest in goods which is not necessarily a security interest as defined by the Code (Subsection 2-326(3)(e), discussed *supra* in Explanatory Notes to Section 2-326).

PART 2

Validity of Security Agreement and Rights of Parties Thereto

Part 2 of Article 9, containing eight sections, deals with the substantive and formal requirements which must be met by a transaction in order to operate as a "security agreement" within the meaning of Subsection 9-105(1)(h). To a large extent the thrust of this part is permissive and designed to abolish limitations placed by former case law upon the effectiveness intended, and to create comprehensive and flexible security interests on changing collateral.

Part 2 deals primarily with the "attachment" of security interests rather than their perfection. The difference between these two concepts flows from Sections 9-204 and 9-303 and affects primarily the priorities between a secured party and certain third parties (Section 9-301) and between secured parties _inter se_ (Subsection 9-312(5)). Perfection, however, does not confer absolute priority but may still leave room for the priority of certain privileged purchasers. A security interest which has attached but is not perfected (_i.e._, not yet or no longer perfected) is designated as an "unperfected" security interest.

Part 2 does not contain the whole body of rules governing attachment, but is supplemented by sections in other parts of Article 9, especially Section 9-306.

A security agreement may be "effective" (Section 9-201) although it operates in _futuro_, _i.e._, the security interest "arising" by virtue thereof attaches only at a subsequent time, either because the parties explicitly postponed its effect or because the other conditions for attachment specified in Subsection 9-204(1), _i.e._, acquisition by the debtor of rights in the collateral or the giving of value by the secured party, have not yet been fulfilled. Until a security interest attaches, a security agreement, even though effective, is not said to create an encumbrance of any kind upon the collateral designated by the agreement. It was apparently the intention of the framers (Official Comment, Point 5 to Section 9-203) to do away with the concept and the need for any equitable security interest. Professor Gilmore doubts even the wisdom of this policy, 1 Gilmore, _Security Interests in Personal Property_ 345 (1965). Thus where despite the conclusion of a security agreement and rights of the debtor in the collateral, no security interest attaches either because no value is given as yet or the parties have postponed the attachment until a later date or the fulfillment of a condition, third parties may acquire intervening prior rights in the collateral. Except to the extent that, under appropriate circumstances, the respective filing dates may determine the relative rank of conflicting security interests in the same collateral (Subsection 9-312(5)(a)), the Code does not expressly recognize any pre-attachment effects of security interests vis-a-vis third parties.

A similar approach is pursued with respect to the compliance with the formalities specified by the Code for the conclusion of security agreements (Subsection 9-203(1)). Although the language of the Code is not uniform and vacillates between effectiveness of security agreements (Section 9-201) and enforceability of security interests, it cannot be concluded that the Code recognizes unenforceable security interests. A security interest which attaches is enforceable, otherwise there is no attachment. This, of course, does not exclude that lack of perfection or other priority rules may result in subordination.

Section 9-201. General validity of security agreement.

1. This section accords the parties broad autonomy over the creation of security interests in personal property. Security agreements are declared to be effective according to their terms, not only between the parties thereto but also against purchasers (Subsection 1-201(37)) of the collateral and creditors of the debtor. The section spells out the recognition of comprehensive and flexible security arrangements implicit in the policy section, Section 9-102.

2. The autonomy of the parties, however, is subject to overriding policies embodied in other sections of Article 9 or other parts of the Code, Subsection 1-102(3), invalidating disclaimers of the obligations of good faith, diligence, reasonableness and care. The power of the courts to refuse or forestall the enforcement of unconscionable agreements, although expressly recognized by the Code only with respect to the sale of goods (Section 2-302) may well come to be an important safety valve against the oppressive exaction of security. Article 9 itself contains important limitations on, or qualifications of, the validity of security agreements. Provisions of this kind may be couched in terms of non-enforceability (Sections 9-203 and 9-206), limitations on attachment (Subsection 9-204(4)), subordination (Sections 9-301 and 9-306 to 9-315), non-effectiveness (Subsection 9-318(2)), incapability of being waived or varied (Subsection 9-501(3)) or other expressions of restricted operation.

3. Section 9-201 expressly saves from implied repeal any existing state statute or regulation thereunder governing usury, small loans, retail installment sales or the like and does not validate any charge or practice proscribed thereby. Accordingly the Hawaiian provisions relating to usury (Revised Laws of Hawaii 1955, Chapter 191), disclosure of finance costs (Revised Laws of Hawaii 1955, Chapter 191A), industrial loans (Revised Laws of Hawaii 1955, Chapter 194), small loans (Revised Laws of Hawaii 1955, Chapter 195) and retail installment sales (Revised Laws of Hawaii 1955, Chapter 201A) to the extent that they proscribe certain charges or practices are still applicable. Moreover, the continued validity of these Acts, especially their disclosure and enforcement provisions, is expressly provided for in the next section.

<u>Section 9-202. Title to collateral immaterial</u>.

1. Section 9-202 specifies that the provisions of Article 9 governing the rights, obligations and remedies of the secured party or the debtor apply regardless of the location of title. This section thus is a parallel to the introductory clause of Section 2-401 and is another manifestation of the policy of the Code to de-emphasize the title concept in the realm of commercial transactions.

2. Section 9-202 is supplemented by Subsections 1-201(37) and 2-401 (1) which specify that the retention or reservation of title by a seller notwithstanding shipment or delivery to the buyer is limited, in effect, to a reservation of a security interest, and by Subsection 2-401(2) which provides that the reservation of a security interest by the seller does not postpone the passage of title upon performance of his obligation with respect to delivery.

3. The secured party, however, may have title as a security interest in the case of a lease intended as security (Subsection 1-201(37)); conversely the special property of the buyer on identification of the goods to a contract of sale is not a security interest but may be coupled with such an interest.

4. The extent to which the distinction between title and other types of security interests may still be material under statutory or decisional rules outside the Uniform Commercial Code depends on the import of the respective rule. Generally speaking, however, the designation of a security interest as title, lien, or special property has lost materiality also in other fields of law.

Section 9-203. Enforceability of security interest; proceeds, formal requisites.

1. Subsection (1) specifies that, except in the cases of the statutory security interests arising under Section 4-208 or solely under Article 2, a security interest in collateral not in the possession of the secured party is not enforceable against either the debtor or third parties unless the security agreement creating or providing for it (Subsection 9-105(1)(h)) is reduced to a writing signed (Subsection 1-201(39)) by the debtor and containing a description (Section 9-110) of the collateral. The policy reasons for this provision are primarily evidentiary in character, viz., the prevention of subsequent disputes and fabricated claims.

2. Although Subsection (1) is couched in terms of enforceability of the asserted security interest, its operation really goes to the validity of an entirely oral agreement. Without compliance with the formal requirements specified in the subsection, the agreement has not the "legal consequences" which the parties intended thereby, to employ the language of Subsection 1-201(3), second sentence. According to the Official Comment, Point 5 to Section 9-203, the reduction of the required content of the writing to a minimum of details should eliminate the survival of any doctrine of equitable security interests as recognized prior to the Code or the differentiation between the effects of a security agreement between the parties thereto and vis-a-vis third parties. The wisdom or success of this goal, however, has been questioned by one of the draftsmen of this Article. See 1 Gilmore, Security Interests in Personal Property 345 (1965).

3. The Code differentiates sharply between the "financing statement" giving notice of an existing or contemplated security interest, and the "security agreement" creating or providing for a security interest. Subsection 9-402(1) states specifically that a financing statement may antedate either the making of a security agreement or the attachment of a security interest. However, the distinction between the financing statement and the writing evidencing a security agreement, as required by Section 9-203, must not be carried to extremes. In appropriate cases the execution of the financing statement may constitute the requisite reduction to writing of an existing security agreement. Whether or not such agreement is made depends on the intention and the understanding of the parties in analogy to the principles specified for the formation of contracts of sales by Section 2-204. Although Subsection 9-402(1) provides that a copy of the security agreement may suffice as a financing statement, provided it is signed by the secured party as well as the debtor, it seems to be consistent with the policy of the Code that in appropriate

cases the _original_ of the writing evidencing the security agreement may serve as a financing statement and _vice versa_. This view is shared by Gilmore in 1 Gilmore, _Security Interests in Personal Property_ 347 (1965). The statement in _In re Platt_, (E.D. Pa. 1966, 3 U.C.C. Reporting Service 276, 280) that "a financing statement cannot serve as the security agreement, but a security agreement, if signed by both the debtor and the secured party, may serve as the financing statement" does not militate against this view. It simply means that absent an agreement creating a security interest, the execution of a financing statement does not supplant such agreement. Where such agreement is made in fact, the execution of a writing designated as a financing statement may constitute compliance with the formalities required by Section 9-203.

4. The requisite description of the collateral, except in the cases of crops, or oil, gas or minerals to be extracted or timber to be cut, is governed by Section 9-110. Subsection 9-203(1)(b) adds that in describing the collateral, the mere word "proceeds" is sufficient to cover proceeds of any character. This sentence seems to imply that without specific reference to proceeds in the written security agreement, the security interest does not continue in the proceeds of the original collateral after a disposition thereof. This conclusion, however, seems to be inconsistent with Section 9-306(2) which apparently provides for such continuation without specific agreement to that effect. It has been suggested therefor that the sentence in question is potentially mischievous surplusage. See 1 Gilmore, _Security Interests in Personal Property_ 351 (1965).

5. Subsection (2) provides that the provisions in specified laws relating to security interests securing small loans, retail installment sales and similar credit arrangements involving inexperienced parties remain applicable unless expressly repealed.

Section 9-204. When security interest attaches; after-acquired property; future advances.

1. Section 9-204 is one of the key sections of Article 9, regulating the time and scope of the attachment of a security interest. Attachment (the noun is found in Subsection 9-312(5)(c)) in the sense used in Article 9 means the coming into existence of a security interest in the designated collateral. Prior thereto the secured party may have a _potential right_ but does not have an actual security interest within the meaning of the Code. Unless there is an agreement postponing the attachment, the security interest arises when three prerequisites concur: an agreement

to that effect, value given, and rights of the debtor in the collateral. (Subsection (1)). Whether the debtor's rights are classified as "title" is immaterial. Limited rights may be subjected to a security interest. (Cf. Section 9-311).

2. Attachment must be distinguished from perfection. A security interest may attach either as a perfected or temporarily perfected security interest or as an unperfected security interest. Thus where goods in the possession of a bailee are pledged to the bailee as security for an antecedent debt of the bailor, a perfected security interest attaches upon the conclusion of the agreement to that effect. The agreement may be oral (Section 9-203(1)(a)). No further perfection step is needed. Conversely, where goods in the possession of the debtor are to be subjected to a possessory security interest (*i.e.*, a security interest coupled with possession by the secured party), no security interest arises upon the oral agreement to that effect. If the collateral is subsequently delivered to the secured party, the oral agreement becomes operative, and a perfected security interest attaches at that time, provided that value was given. If the pledge agreement is reduced to writing prior to the stipulated delivery and value is given at that time, the written agreement creates an unperfected security interest at the time of the execution of the writing (unless the parties agree otherwise); the security interest becomes perfected upon the delivery of the collateral. The theory and nomenclature of the Code thus have converted the former "equitable pledge" into an unperfected security interest, to be perfected upon the secured party's taking possession of the collateral (Section 9-305).

   Perfection may accompany or follow attachment (Section 9-303), but, according to the nomenclature of the Code, it may not precede it. The advance filing of a financing statement does not create a security interest of any kind although it may determine the priority of the contemplated security interest once it has attached (Subsection 9-312(5)(a)).

3. Subsection (2) details the date when the debtor acquires rights in the collateral within the meaning of Subsection (1) for a number of instances where, otherwise, the return of the collateral might have created doubts, *viz.*, (a) crops and young of livestock; (b) fish, oil, gas or minerals, and timber; (c) contract rights; and (d) accounts. The provisions of the Code settle the applicable tests.

4. Subsections (3) and (5) recognize the creation of valid security interests in after-acquired property and for future advances. Taken together these provisions constitute the principal statutory execution of the aim of the Code to recognize the permissibility

and possibility of a comprehensive and flexible security interest in the nature of the "floating charge". The character of the Code's floating security interest and its similarities or dissimilarities to the English "floating charge" have been the subject of extensive discussion, especially by Mr. Coogan, see 1 Coogan, Hogan, Vagts, Secured Transactions Under the U.C.C., sec. 7.03; The "Floating Lien" and Article 9 - A Closer Look, sec. 7.12; Operating Under Article 9 of the U.C.C. Without Help or Hindrance of the "Floating Lien", sec. 13.08; The English Floating Charge and the Code's Floating Lien (1966); see also 1 Gilmore, Security Interests in Personal Property, sec. 11.7, The Article 9 Security Interest and the "Floating Lien" (1965). While the framers of Article 9 may have had the image of "a unified security interest in shifting collateral", the extent to which they have succeeded in translating their idea into practical reality is a hotly debated issue. See the bibliography in Comment No. 1 to Section 9-108. The very concept of attachment which is enshrined in Section 9-204 seems to fragmentize the security interest resulting from the basic single or "one deal" agreement and to militate against its integral character, proclaimed by the Official Comment, Point 2 to the section. See the discussion by Prof. King, Section 9-108 of the U.C.C.: Does It Insulate the Security Interest from Attack by a Trustee in Bankruptcy, 114 U. Pa. L. Rev. 1117, especially 1122, 1123 (1966).

The touchstone for the success or failure of the continuous security interest is its fate in bankruptcy, especially under the preference section (Section 60 of the Bankruptcy Act). It has been argued forcefully and plausibly that a transfer within the meaning of that section takes place at the time the debtor obtains rights in the after-acquired collateral, i.e., when the security interest attaches and not before (Gordon, The Security Interest in Inventory Under Article 9 of the U.C.C. and the Preference Problem, 1 Coogan, Hogan, Vagts, Secured Transactions Under the U.C.C., 1162, 1168-1172 (1966); King, Section 9-108 of the U.C.C.: Does It Insulate the Security Interest from Attack by a Trustee in Bankruptcy, 114 U. Pa. L. Rev. 1117, 1123 (1966)). It is also not unlikely that such transfer will be deemed to have preferential effect even though the new collateral may replace former collateral which has been disposed of, at least so long as there has not been a direct substitution of collateral. The simile of inventory as a "stream" of collateral has been conjured up for two purposes: a) to pre-date the time of the transfer, and b) to obviate its possible preferential effect. The latter aspect of the "stream" theory is really a dubious dilution of the substitution concept, accord, King, Section 9-108 of the U.C.C.: Does It Insultate the Security Interest from Attack by a Trustee in Bankruptcy, 114 U.

Pa. L. Rev. 1117, at 1130 ftn. 43; Kripke, Suggestions for clarifying Article 9: Intangibles, Proceeds, and Priorities, 41 N.Y.U. L. Rev. 687, 697 ftn. 14 (1966). The remaining question thus consists in the issue already discussed, of whether the transfer is one for contemporaneous or one for antecedent consideration, a matter which the Code tries to resolve in the former sense (Section 9-108 and the Explanatory Notes to that section).

5. One of the effects of Subsections (1) to (3) is the recognition of the present assignability of future accounts, contract rights and general intangibles. Prior to the Code the possibility and effect of such assignments was quite controversial and unclear. (Cf. 4 Corwin Contracts, 499-509 (1951)) Section 9-205 makes it clear that such assignment is effective although the debtor retains powers of collection.

6. Subsection (4) places two important limitations on the creation of security interests in after-acquired property in the interest of the protection of certain classes of debtors with limited bargaining power.

   a) The first of these restrictions applies to security interests in crops. Subsection (4)(a) limits the validity of security agreements covering crops to such which become crops within one year after the execution of the agreement. The Code defines neither the concept of crops nor the time when they "become such". It seems to be agreed, however, that crops within the meaning of the Code (Subsections 9-105(1)(f), 9-109(3), 9-204 (2)(a) and (4)(a), 9-312(2), 9-402(3) item 2.) include plants which yield only one harvest as well as fruits of trees or vines which supply several harvests. See 2 Gilmore, Security Interests in Personal Property 863 (1965). Crops seem to "become such" within the meaning of Subsection (4)(a) when they "become growing" either by planting or, in the case of fruits of perennials, by the formation of the respective buds (Cf. Subsection 9-312(2)). The one year limitation does not apply to agreements providing for security interests in crops in conjunction with leases or security transactions relating to the purchase or improvement of land. Subsection (4)(a) regulates only the validity of security agreements relating to future crops. The priority of security interests so created is regulated by Subsection 9-312(2).

   b) The second limitation which Subsection (4) places on the validity of security agreements covering after-acquired collateral relates to add-on clauses extending to "consumer goods" as defined in Subsection 9-109(1) other than accessions. Such clauses are declared to be inoperative except with respect to consumer goods in which the debtor acquires rights within ten days after the secured party's giving value. This provision supplements but does not supersede similar and often more stringent prohibitions in local Retail Installment Sales Acts, such as Revised Laws of Hawaii 1955, Section 201A-15. The latter section proscribes any add-on provision in a retail installment contract to secure the time sale price with after-acquired goods except auxiliary parts or substitutes. It should be noted that the definition of retail installment contract in Revised Laws of Hawaii 1955, Section 201A-1 includes the purchase of equipment and that the prohibition against add-on clauses is not limited to after-acquired consumer goods.

7. Security interests may cover future advances or other value, regardless of whether they are given pursuant to an existing commitment or on a purely optional basis. Subsection (5) relates only to the substantive validity of a security agreement to that effect; it does not relate to the formal requirements of such agreement, the contents of a financing statement covering security interests of this kind, or the resulting priorities. Actually the status of security interests for future advances is one of the most uncertain areas of Article 9. For discussion of the problems connected with the recognition of security interests for future advances, see especially Coogan and Gordon, <u>The Effect of the U.C.C. Upon Receivables Financing - Some Answers and Some Unresolved Problems</u>, in 2 Coogan, Hogan, Vagts, <u>Secured Transactions Under the U.C.C.</u>, 1583, at 1606 (1966); Coogan, <u>Intangibles as Collateral Under the U.C.C., With Particular Reference to After-Acquired Property and Legal Liens--Future Advances</u>, in 2 Coogan, Hogan, Vagts, <u>Secured Transactions Under the U.C.C.</u> 2171 at 2198-2216 (1966); 2 Gilmore, <u>Security Interests in Personal Property</u>, 916-946 (1965).

While Subsection 9-204(5) requires agreement between the parties with respect to the giving of mandatory or optional future advances by the secured party and to the creation of a security interest securing the corollary obligation of the debtor, Subsection 9-203(1)(b) does not require a reduction to writing of the details of such agreement, inasmuch as that subsection does not require any identification of the obligation to be secured. The Code's filing provisions likewise do not require that the financing statement disclose whether future advances are covered. (<u>Accord</u>, 2 Gilmore, <u>Security Interests in Personal Property</u>, 933 (1965)). Hence the pre-Code rules of many states which required a stated ceiling for open-ended chattel mortgages have been rejected by the Code. A third party who wishes to inform himself about a possible future advances coverage of an existing security interest must inquire of the secured party, either directly or by means of the mechanics of Section 9-208. See 2 Gilmore, Security Interests in Personal Property 933 (1965).

The main doubt and controversy center around the question as to the relative priorities between a security interest for future advances and other security interests or judicial liens attaching after the execution of the agreement providing for the security interest covering future advances and prior to the actual making of such advances. There seems to be agreement among the commentators that a security interest attaches upon existing collateral at the time of the execution of an agreement to that effect, if the advances stipulated therein are mandatory. According to Subsection 9-204(1) the attachment of a security interest requires that value is given. Subsection 1-201(44) declares that such is the case whenever there is a binding commitment of the secured party to that effect. Conflict, however, exists as to the moment when a perfected or unperfected security interest attaches with respect to optional future advances. Professor Gilmore, who considers the distinction between optional and mandatory advances to be "conceptually nonsensical" (See 2 Gilmore, Security Interests in Personal Property, 933 (1965)) argues that a single but fluctuating security interest attaches whenever the first unit of the envisaged advances is supplied, 2 Gilmore, Security Interests in Personal Property, 936-939 (1965). The opponents contend that the Code has effectuated only fractionated security interests and that each optional advance, when made, results in an additional security interest. In 2 Coogan, Hogan, Vagts, Secured Transactions Under the U.C.C., (1966), Coogan and Gordon, The Effect of the U.C.C. Upon Receivables Financing--Some Answers and Some Unresolved Problems 1583, 1606 and Coogan, Intangibles as Collateral Under the U.C.C. with Particular Reference to After-Acquired Property and Legal Liens--Future Advances, 2171, 2198-2216. Consequently, in the case of optional advances, a sequence of attachments take place entailing priorities which must be determined separately for each installment, according to the general priority rules of Section 9-301 and 9-312. Thus, a judicial lien which is obtained prior to the actual making of a contemplated optional advance will have priority over any subsequent advance, even if a financing statement was on file; an intervening security interest will be prior, unless both security interests are perfected by filing Subsection 9-312(5)(a) and the one for future advances was covered by the older financing statement. The second view seems to be more in consonance with the general structure and approach of Article 9. Of course, this position has important consequences with respect to the effects of Sections 70c and 60 of the Bankruptcy Act.

8. Prior to the adoption of the Code, Revised Laws of Hawaii 1955, Sections 196-1 and 196-2 validated chattel mortgages to secure future advances and chattel mortgages covering after-acquired property including future crops. The statute did not place any limitation on the validity of a mortgage covering future crops. It differentiated between chattel mortgages to secure optional future advances and chattel mortgages where the mortgagee is under a statutory duty to make future advances and the maximum of such future advances is stated in the mortgage. In the latter case, the mortgage was superior to any subsequently recorded mortgage or other lien (except liens for taxes and public improvements), even though such mortgage or lien is recorded prior to the date when the advances are actually made. Conversely, in the case of optional advances or of mandatory advances without stated maximum, the priority of such mortgage was limited to advances made prior to the recordation of another mortgage or lien. Mortgages on after-acquired property, whether securing an existing debt or optional or mandatory future advances, were subject to purchase money mortgages given by the mortgagor on the after-acquired personal property.

   As a result Section 9-204 has made three important changes in the prior law:

   a. Security interests to secure mandatory future advances have priority over subsequent security interests and judicial liens regardless of whether or not a ceiling is stated in writing evidencing the security agreement and the financing statement.

   b. Security interests for optional future advances may be superior to security interests intervening between the execution of the respective security agreement or the filing of the financing statement and the making of the advance, if both are perfected by filing.

   c. Security interests in future crops are now subject to the time limitations of Subsection 9-203(4)(a) and the special priority rules of Subsection 9-312(2).

9. The formerly much debated relative priorities between federal tax liens and security interests for future advances and on after-acquired property are now regulated and classified by the new

Federal Tax Lien Act of 1966, (United States Code Congr. and Adm. News 4572 (1966)) especially Internal Revenue Code, Section 6323(c)(1) and (2), as amended. The tax lien will be prior to a security interest for future advances made after notice of the tax lien has been filed if the advances are optional, but not if they are mandatory and made within 45 days, provided the interpretation of Article 9 as proposed by the partisans of the fractionation theory is adopted; this follows from Internal Revenue Code, Section 6323(c)(1)(B), as amended. The subordination of the tax lien to prior security interests in after-acquired collateral constituting commercial financing security as defined in Internal Revenue Code, Section 6323(c)(2)(C), is subject to a 45-day limitation by Internal Revenue Code, Section 6323(c)(2)(B).

Section 9-205. Use or disposition of collateral without accounting permissible.

1. Prior to the adoption of the Code the law against fraudulent conveyances prevailing in many states had declared security transactions to be subject to attack by creditors or the trustee in bankruptcy if the debtor retained powers of disposition over the collateral despite the transfer. Thus the courts frowned upon chattel mortgages on inventory which reserved to the mortgagor the liberty to sell, especially without immediate transfer of the proceeds, and invalidated assignments of accounts receivable if the assignor was left with the authority to collect. The latter limitation was known as the rule of Benedict v. Ratner, (268 U.S. 353 (1925)) after a famous decision by the United States Supreme Court in which the law of the state of New York had been construed in that fashion. Restrictions of that type have been considered to be commercially unsound, and Section 9-205 rejects them specifically. This section permits the secured party to vest the debtor with power to use, commingle or dispose of the collateral, whether original or proceeds, and to collect or compromise accounts, contract rights or chattel paper. The omission of any reference to general intangibles in that connection should not be construed as a remaining limitation. The secured party need not police the collateral or insist on immediate or full accounting proceeds.

2. As a matter of caution the last sentence of the section specifies that the provision is not meant to relax the requirement of possession by the secured party or his bailee where perfection is predicated on such possession.

3. Since Hawaii passed legislation in 1939 (Revised Laws of Hawaii 1955, Sections 196-1 and 196-2) authorizing chattel mortgages on

revolving stock in trade without artificial safeguards, this section does not seem to entail significant changes in the prior law of the State.

Section 9-206. Agreement not to assert defenses against assignee; modification of sales warranties where security agreement exists.

1. With the exception of sales or leases of consumer goods where the individual jurisdictions may pursue divergent policies, the Code validates stipulations whereby a buyer or lessee agrees not to assert against an assignee any claims or defenses which he may have against the seller or lessor. The binding force of such waiver is restricted to assignees for value, in good faith and without notice of a claim and defense and does not extend to defenses which are not cut off by negotiation of a negotiable instrument to a holder in due course.

   A waiver of the type envisaged by Subsection 9-206(1) is implied if a buyer executes a negotiable instrument in conjunction with a security agreement.

2. Waivers of the type governed by this section are limited by the Retail Installment Sales Act, Revised Laws of Hawaii 1955, Section 201A-17(b) and (d), whereby waivers are effective only if the debtor was duly notified of the assignment and failed to state any facts giving rise to a claim or defense within fifteen days after the mailing of such notice.

3. Subsection (2) makes it clear that sales with the retention of a purchase money security interest are governed by Article 2, including any disclaimer, limitation or modification of the seller's warranties.

Section 9-207. Rights and duties when collateral is in secured party's possession.

1. Section 9-207 codifies the duties, risks and rights of the secured party when the collateral is in his possession either before the default of the debtor or thereafter. The rules stated are in agreement with common law precedents mainly as developed in the law of pledges.

2. Subsection (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 security interest but merely liability in damages.

3. Subsection (4) prescribes the conditions under, and the extent to, which the secured party may use and operate such collateral. Except in the case of consumer goods, the parties may regulate the matter by agreement. A pledgee of consumer goods may not use the same unless such use is for the purpose of preserving the collateral or its value.

<u>Section 9-208. Request for statement of account or list of collateral</u>.

1. 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 to enable the debtor to supply interested third parties, such as purchasers or other parties extending credit, with reliable information regarding the scope of outstanding security interests. Unfortunately the Code fails to extend the procedure to information relative to optional or mandatory future advances. <u>Accord</u>, 2 Gilmore, <u>Security Interests in Personal Property</u> 933 (1965).

2. Failure of the secured party to furnish the requested information renders him liable in damages for the loss caused to the debtor and estops him in appropriate cases, defined in Subsection (2), to assert his security interest against third parties.

3. Section 9-208 contains a number of limitations designed to protect the secured parties against unnecessary or unduly burdensome requests for information.

4. If the original secured party has assigned his rights, he must disclose the name and address of any successor in interest known to him.

PART 3

Rights of Third Parties; Perfected and Unperfected Security Interests; Rules of Priority

Section 9-301. Persons who take priority over unperfected security interests; "lien creditor".

1. Section 9-301 regulates the status of security interests which have attached but are unperfected. While Section 9-201 declares the general principle that security interests upon their attachment are valid and effective against the debtor, purchases of the collateral and creditors of the debtor "except as otherwise provided", Section 9-301 greatly qualifies this rule with respect to the rights of third parties which attach while the security is unperfected. In that case the security interest may be subordinate to the rights of third parties if such rights intervene between attachment (Section 9-204) and perfection (Section 9-303). Section 9-301 specifies various categories of third parties who are so protected and the conditions under which the protection is accorded.

   Attention is called to the system of the Code which classifies third parties into purchasers (Subsection 1-201(32) and (33)) and creditors (Subsection 1-201(12)) and which reserves the designation of security interest within the scope of Article 9 only to consensual security interests (Subsection 9-102(2)) but includes within that term also the assimilated interests of outright buyers of accounts, chattel paper and contract rights to the extent that they are subject to Article 9 (Subsections 1-201(37), 9-102(1)(b) and 9-104(f)).

   Some of the rules of Section 9-301 apply to certain categories of collateral (Subsections (1)(c) and (d)). Moreover special status is accorded to unperfected purchase money security interests (Subsection (2)).

2. Section 9-301 does not contain special rules relating to the priorities between security interests, whether unperfected or perfected, inter se. That matter is regulated by the priority rules of Section 9-312. Section 9-301 makes a cross-reference thereto in Subsection (1)(a). Likewise Section 9-301 does not spell out the cases in which certain third parties prevail over perfected security interests and therefore, a fortiori, over unperfected security interests, such as governed by Sections 9-307, 9-308, 9-309 and 9-310. These cases are indexed in Subsection 9-312(1) and therefore included in the cross-reference to Section 9-312 made in Subsection 9-301(1)(a).

3. Subsection (1)(b) deals with the relative priorities between liens obtained by judicial process or liens assimilated thereto by Subsection (3) and unperfected security interests other than for purchase money. The Code subordinates an unperfected security interest to the lien of a lien creditor subsequently obtained on the collateral without knowledge of the security interest and prior to its perfection. Tangible collateral at such time obviously is not in the possession of the secured party (since such possession would constitute perfection) but in the possession of the debtor or of a third person other than a bailee for the secured party. According to the Code the critical event for the protection of creditors is not the extension of credit but the acquisition of the lien. Prior to the adoption of the Code, state statutes differed widely with respect to the conditions, for and the extent of, the protection accorded to creditors by reason of non-compliance or (untimely) compliance with the recording or filing requirements for security interests in personal property. Frequently the same jurisdiction would pursue different approaches for different security devices. The framers of the Code chose the system adopted not so much by reason of its intrinsic justice, but in order to cut down or eliminate totally the applicability of a much criticized rule of bankruptcy law, known as the rule of Moore v. Bay, 284 U.S. 4 (1931). See Hawkland, The Impact of the Commercial Code on the Doctrine of Moore v. Bay, 67 Comm. L.J. 359, 361 (1962). According to this rule a trustee in bankruptcy may avoid a security interest in toto, if it is fraudulent or voidable for any other reason against a single creditor having a provable debt, however small it may be, see, e.g., In re Plonta, 311 F. 2d 44 (6 Cir. 1966), where a debt of ten dollars served as a wedge for the trustee. Since the framers of the Code concluded that insistence on pre-perfection acquisition of a lien would reduce the cases of such avoidance in bankruptcy, they selected it as the criterion of the creditor's protection under Article 9, inasmuch as that system was also adopted by the former Uniform Trust Receipts Act (Revised Laws of Hawaii 1955, Section 206-8) which served as a general model for Article 9.

A lien creditor who is accorded the protection of Subsection (1)(b) is defined in Subsection (3) as "a creditor who has acquired a lien on the property involved by attachment, levy or the like". In other words he is a creditor who obtains a lien by judicial process under applicable state law. In Hawaii a lien as envisaged by Section 9-301 will be obtained by attaching the personal property under a writ of attachment pursuant to Revised Laws of Hawaii 1955, Section 233-9(b), by levy under a writ of execution pursuant to Revised Laws of Hawaii 1955, Section 233-41 or by service of a summons on a garnishee pursuant to Revised Laws of Hawaii 1955, Sections 237-1(a) and (b). Whether service of a summons on a third party pursuant to Revised Laws of Hawaii 1955, Section 232-5 creates a lien on assets disclosed by the examinee seems to be an open question in this State, but it has been held in many other jurisdictions that proceedings of that type are in the nature of a creditor's bill and create a dragnet lien on all property uncovered thereby, see Riesenfeld, Creditors' Remedies and Debtors' Protection, 226 (1967). While a number of jurisdictions still follow the common law rule that delivery of the writ of execution to the sheriff creates a lien on chattels of the debtor within his bailiwick, Hawaii follows the modern rule and postpones the lien until actual levy, Everett v. Bolles, 6 Haw. 153 (1875). It seems to be settled that the service of a garnishment summons fosters a lien on the goods and effects in the hands of the garnishee and any debt owed by him to the defendant, Nichols v. Mossman, 35 Haw. 772 (1941). Morreira v. Ota, 33 Haw. 337 (1935); Trust Co. v. Furstenburg, 28 Haw. 528 (1925).

Subsection 9-301(3) assimilates an assignee for the benefit of creditors to a judgment lien creditor. The Code thus departs from the traditional common law rule which did not permit an assignee for the benefit of creditors to assail fraudulent conveyances by the assignor, but it follows the trend of state legislation on that point and in particular the former Uniform Trust Receipt Act (Revised Laws of Hawaii 1955, Section 206-8 (c)(2)). Like the former Uniform Trust Receipts Act, the Code provides that knowledge by all creditors of the unperfected security interest bars the priority of the assignee under that section but that personal knowledge by such representative of creditors is immaterial.

Subsection 9-301(3) applies the same rule to a trustee in bankruptcy. This appears to be an unconstitutional invasion of the federal bankruptcy power. Under Section 70c of the Bankruptcy Act, the so-called strong-arm clause, a trustee in bankruptcy has the position of a lien creditor as of the date of the filing of the petition. Whether knowledge by one or all of the creditors destroys his right to claim priority for the benefit of the estate is exclusively a bankruptcy question. Although in In re Komfo Products Corp., 247 F. Supp. 229 (E.D. Pa. 1965) the court inimated that knowledge of all existing creditors defeats the trustee's right under Section 70c, the correctness of this position is quite doubtful and is not in harmony with numerous holdings and dicta in other decisions which consider the trustee under Section 70c as an "ideal" lien creditor without notice, regardless of the knowledge of any or all actual creditors, see In re Kravitz, 278 F. 2d 820 (3d. Cir. 1960), In re Rosenberg Iron & Metal Co., 343 F. 2d. 527 (7 Cir. 1965), see Riesenfeld, op. cit. 500 Explanatory Note 2.

4. Subsection 9-301(1)(c) grants a priority over an unperfected security interest in tangibles (goods, instruments, documents and chattel paper) to a transferee in bulk or other buyer not in the ordinary course of business to the extent that he gives value (Subsection 1-201(44)) and receives delivery of the collateral without knowledge of the security interest and prior to its perfection. This provision does not apply to purchasers by way of security, see supra, Explanatory Note 1.

5. Subsection (1)(d) accords priority over an unperfected security interest in intangibles (accounts, contract rights and general intangibles) to a transferee other than a secured party to the extent that he gives value without knowledge of the security interest and prior to its perfection. This corresponds to analogous provisions in the former statutes providing for the filing of the assignments of accounts receivable, such as Revised Laws of Hawaii 1955, Section 187-3. Note that the subordinated security interest in these cases includes the interests of outright buyers of accounts and contract rights (Sections 1-201(37) and 9-102(1)(b)).

6. Section 9-301(2) enacts a special rule providing a grace period of ten days for the perfection of purchase money security interests (Section 9-107). A holder of an unperfected purchase money security interest in personal property may preserve priority over a transferee in bulk or a lien creditor whose rights arise between the attachment and the perfection of such security interest, if he perfects the same by filing within ten days after the collateral comes into his possession.

   The relation back operates only against bulk transferees and lien creditors, but not against other purchasers within the purview of Subsection 9-301(1)(c), such as donees. Moreover, Subsection (2) applies only to perfection by filing. If S lends money to D for the acquisition of inventory pursuant to a security agreement and C, a creditor of D, attaches the goods two days after receipt by D, S cannot perfect his security interest vis-a-vis C by replevying the goods but must file within ten days before he takes possession.

7. The effect of Section 9-301 in bankruptcy bristles with questions relating to the operation of Sections 70c, 70e and

60 of the Bankruptcy Act, some of which have already been mentioned:

(a) If the security interest is still unperfected at the time of the filing of the petition, the trustee ordinarily gains priority under Section 70c. It is, however, controversial, whether the application of Section 70c requires the existence of at least one creditor with a provable debt who is without knowledge and therefore could have attacked the security interest at the time of the filing of the petition. See supra, Explanatory Note 3.

(b) If the security interest is perfected at the time of the petition, but there is at least one creditor with a provable debt who obtained a judicial lien prior to the perfection, the question arises whether the trustee can invoke Section 70e and the doctrine of Moore v. Bay to avoid the security interest. It has been argued by Professor Kennedy that the Code grants lien creditors priority over unperfected security interests and does not speak of voidability as is required by Section 70e of the Bankruptcy Act (Kennedy, The Trustee in Bankruptcy as a Secured Creditor Under the U.C.C. 65 Mich. L. Rev. 1419 (1967)). Conversely, Riesenfeld argues that the scope of Section 70e is a matter of federal law and that voidability within the meaning of that section means non-effective vis-a-vis creditors under legal principles reaching back to Tuyne's Case (Riesenfeld, Creditors' Remedies and Debtors' Protection, 516 (1957)). Dean Hawkland, finally, suggests that the Trustee may invoke Moore v. Bay, but only if he can avoid the intervening judicial lien under Section 67a (Hawkland, The Impact of the Commercial Code on the Doctrine of Moore v. Bay, 67 Com. L.J. 359 (1962)).

(c) If the security interest was perfected at the time of the filing of the petition in bankruptcy, but less than four months have lapsed since its perfection, the trustee may avoid the security interest under Section 60. The interrelation between the provisions of Section 9-301 and the supplementary allowance of a grace period of twenty-one days in the absence of a shorter period specified by state law by Section 60(a)(7) has disturbed several commentators. See 2 Gilmore, Security Interests in Personal Property, sec. 45.8(1965); Coogan and Vagts, The Secured Creditor and the Bankruptcy Act, in 1 Coogan, Hogan and Vagts, Secured Transactions Under the U.C.C., 971, at 995 (1967); King, Voidable Preferences and the U.C.C., 52 Cornell L. Cir. 925 (1967). Although the result to be reached appears incongruous, it seems unavoidable that a twenty-one day grace period applies to non-purchase money security, while it is cut-down to ten days in case of purchase money security, accord, King, op. cit. supra at p. 931.

Section 9-302. When filing is required to perfect security interest; security interests to which filing provisions of this article do not apply.

1. Section 9-302 is one of the key sections in Article 9. It declares the filing of a financing statement to be the standard method of perfection. This rule, however, is subject to a number of qualifications and exceptions listed in this section. To that extent, the section has the character of an "index section" as several other sections either in Article 9 (e.g. Section 9-312) or in other parts of the Code.

2. Filing is not always the only available method of perfection. In many cases possession of the collateral by the secured party is a permissible alternative (Section 9-305). In addition, the Code dispenses with the necessity of special perfection methods, either permanently or temporarily, in a number of instances (Sections 9-302(1)(c), (d), (e) and (f); 9-304 and 9-306). Special rules also obtain in the case of non-negotiable documents. Finally, in some cases, possession, notification, or registration or filing under a separate statute may be the only available perfection methods (Subsections 9-304(1) and 9-302(2)).

   The solely or alternatively permissible perfection methods depend on the type of collateral involved.

   The system of the Code can be summarized in the following table:

TABLE:

PERFECTION OF SECURITY INTERESTS

Method or Methods of Perfection	Type of Collateral
1. Filing or Possession	goods, negotiable documents, letters of credit, chattel paper;
2. Filing only	contract rights, accounts, general intangibles, fixtures;
3. Possession only	instruments;
4. Filing, notification of bailee or issuance of document in the name of secured party	non-negotiable documents;
5. No specific perfection methods needed	purchase money security interests in consumer goods or farm equipment having a purchase price of $2500 or less;
	isolated accounts or contract rights;
	statutory security interests arising from sales or bank collections;
	temporarily perfected security interests in proceeds or negotiable documents and instruments;
6. Other perfection methods	assignments of accounts and contract rights where records office is abroad;
	property subject to national registration or filing under a federal statute.

3. Subsection (1)(d) dispenses with the need of filing for the perfection of a purchase money security interest in consumer goods, as defined in Subsection 9-109(1). In such case the security interest is vulnerable against a buyer who buys without knowledge of the security interest for value and for his own personal, family or household purposes (Section 9-307). In order to protect the security interest against this type of buyer, filing of a financing statement is required (Section 9-307). Filing, in other words, elevates the security interest of the retailer or purchase money lender from a perfected security interest to a "super-perfected" security interest. Analogous rules apply to a buyer of farm equipment having a purchase price not in excess of $2500 who buys such equipment for his own farming purposes.

   It is conceivable that the goods while in use change their character from consumer goods to equipment. See 1 Gilmore, Security Interests in Personal Property 371 (1965): "Thus if the use changes, the category in which the goods fall may also change." In such case the purchase money security interest would cease to be perfected and become a no longer perfected security interest, subject to the reach of the debtor's creditors (Section 9-301).

   It should be noted that in Hawaii the perfection exemption for purchase money security interests in consumer goods now applies also to registered motor vehicles. In 1967 Section 160-10(e), Revised Laws of Hawaii 1955, was amended so as to make the provisions of the Code governing the attachment and perfection of security interests applicable to registered vehicles. By oversight, corresponding amendments in Subsections 9-302(3)(b) and (4) were omitted.

4. Assignments of perfected security interests need not be filed and do not deprive such security interests of their perfected status vis-a-vis the creditors of, or transferees from, the original debtor (Subsection 9-302(2)). If the assignment creates a security interest in the assignee, filing may be required to perfect the assignment against creditors of, or transferees from, the assignor. Provisions for optional filing of assignments of security interests are contained in Sections 9-404 and 9-405.

5. Subsection (3) exempts certain collateral from the application of the filing provisions of Article 9. In Hawaii this exclusion covers now only property subject to a statute of the United States which provides for a national registration or filing of

all security interests therein. Property of that type is exemplified by aircraft subject to the recording provisions of the Federal Aviation Act of 1958 (49 U.S.C. Secs. 1301-1542, especially Sec. 1403).

As stated in Explanatory Note 3 Revised Laws of Hawaii 1955, Subsection 160-10(e) was amended in 1967 so as to subject the attachment and perfection of security interests in registered motor vehicles to the provisions of the Uniform Commercial Code. No notation on the certificate of ownership is required. Unless the security interest is a purchase money interest in a registered motor vehicle which is consumer goods, filing will be the appropriate perfection method, and in view of Section 9-307, filing will be useful even if the vehicle is consumer goods. Subsection 9-302(3)(b) and the last sentence of Subsection 9-302(4) should have been deleted.

Section 9-303. When security interest is perfected; continuity of perfection.

1. In view of the importance of the rules of perfection for purposes of priority, a statutory rule governing the applicable principles was deemed to be essential.

2. Section 9-303 specifies that a security interest is perfected when (a) it has attached as defined in Section 9-204 and (b) all steps required for perfection are completed. If the steps required for perfection are taken before the security attaches, the date of attachment is the date of perfection. Subsection 9-303 (1) contains a cross-reference to the sections governing perfection, viz. Sections 9-302, 9-304, 9-305 and 9-306.

3. If a security interest is originally perfected in any way permitted by Article 9 and subsequently in some other way without an intervening period of non-perfection, the security interest is deemed to be perfected continously.

4. A no longer perfected security interest may result from the lapse of temporary perfection pursuant to Subsections 9-304(b) and (5) and 9-306(3) or from the lapse of effective filing as specified in Section 9-403.

5. A creditor who obtains a lien which attaches after a security interest has become a no longer perfected security interest and before re-perfection, has gained priority. There is no additional grace period, even if the security interest is one for purchase money.

Section 9-304. Perfection of security interest in instruments, documents, and goods covered by documents; perfection by permissive filing; temporary perfection without filing or transfer of possession.

1. Subsection (1) states that a security interest in chattel paper or negotiable documents may be perfected by filing. Filing, however, is only an alternative method of perfection. The other method is the taking of possession by the secured party (Section 9-305). A security interest in instruments (except where the instrument is part of chattel paper) cannot be permanently perfected by filing, but only by taking possession thereof, although it may be temporarily perfected without filing or possession under the conditions stated in Subsections (4) and (5).

   Subsection (1) applies only to negotiable documents. Non-negotiable documents are not considered separate collateral, different from the goods, except in a very limited sense. See Explanatory Note 3, infra.

   The perfection methods of the Code for negotiable documents differ significantly from those for negotiable instruments. For the former, filing or delivery are permissible alternatives; for the latter, taking possession is the exclusive method. The reason for this differentiation lies in the need for possession of the document by the debtor in appropriate cases. The same holds true in the case of chattel paper where the debtor is frequently left in charge of collection in the interest of the secured party. (Section 9-205)

   The security interest in negotiable documents and chattel paper including a negotiable instrument is precarious. It may be destroyed by the negotiation of the document or instrument. (Section 9-309)

2. Subsection (2) deals with the case where the goods are in the possession of the issuer of a negotiable instrument covering the same. In that situation the negotiable document serves as the principal collateral. A security interest which is perfected in the goods while a negotiable document covering the same is outstanding (without perfection of a security interest in the document) is subordinated to a perfected security interest in the document. The priority rule thus specified in Subsection (2) is supplemented and qualified by other priority rules contained in Section 9-309 and in Article 7, especially Sections 7-102(1)(g), 7-503 and 7-504.

Subsection 9-304(2) envisages only the case where the goods are in the possession of the issuer (Subsection 7-102(1)(g)) of a negotiable document therefor. It does not cover the case where the goods are covered by a negotiable document of title issued by a person other than the possessor, as in the case where the bailor has issued a negotiable delivery order. Delivery orders, defined in Subsection 7-102(1)(d), whether negotiable or not, are documents (Subsection 9-105(e) in conjunction with Subsection 1-201(15)). In such case the priority questions must be solved by resort to Subsections 7-502(2) and 9-312(5) in conjunction with 9-304(2). The difficulties created by the possibility of "two competing claims of title" resulting from the issuance of negotiable delivery orders were noticed with some concern by the New York Law Revision Commission (New York Law Revision Commission, Study of the Uniform Commercial Code, Leg. Doc. (1955) No. 65 (H) p. 1842 and 1847. "Competing claims" on p. 1847 is a misprint; it should read "competing chains". The criticism of the N.Y. Law Revision Commission prompted a far-reaching revision of the 1954 version of the Code, resulting, *inter alia*, in a substantial modification of Subsection 7-102(g), and Sections 7-502 to 7-504 and 9-304, see 1956 Recommendations of the Editorial Board (1957). Unfortunately the amendments left many difficulties unresolved.) and other commentators. (Braucher, Documents of Title 67-69 A.L.I. Uniform Commercial Code Practice Handbook, 1958.)

Subsection 9-304(2) is applicable with respect to negotiable delivery orders which have been accepted by the bailee. In such case the bailee assumes the position of an issuer. (Subsection 7-102(1)(g) excludes a bailee from the status of an issuer only in the case of an unaccepted delivery order; Subsection 7-503(2) likewise applies only to unaccepted delivery orders.)

Section (2) likewise does not cover the case where goods have been subjected to a security interest prior to the issuance of a negotiable document covering the same. That situation is governed by Subsection 7-503(1). According to that provision a security interest in goods is subordinated to a security interest in a negotiable document therefore which is subsequently issued and duly negotiated, unless the prior secured party has neither entrusted the debtor with apparent or actual authority to ship or store the goods nor acquiesced in the subsequent procurement of the negotiable document of title. The result is in conformity with the principle of Section 9-309. That section, however, is not directly applicable, because it concerns conflicting interests in the document itself and not a conflict between an interest in goods and an interest in a negotiable document covering them.

3. Subsection (3) deals with a security interest in goods in the possession of a bailee other than one who has issued a negotiable document therefore. The Code provides for three perfection methods in that situation: (a) filing as to the goods; (b) issuance of a document in the name of the secured party; (c) notification of the secured party's interest. In other words, a security interest in goods stored in a warehouse which are not covered by a negotiable warehouse receipt may be created by filing a financing statement as to such goods or by issuance of a non-negotiable warehouse receipt to the secured party or by notification of the warehouseman that the goods are "pledged". Issuance of a non-negotiable warehouse receipt to the bailor and a pledge of such document to a third party does not create a perfected security interest either in the goods or in the non-negotiable document. Neither does filing "as to" the document. In sum: non-negotiable documents of title cannot constitute collateral. About this "demotion" of non-negotiable documents, see especially 1 Gilmore, Security Interests in Personal Property, Section 12.6 at 383, 385 and Section 12.7 at 389-390(1965).

4. The difficulties resulting from the intertwining of Article 7 and Article 9 are well illustrated by the case of Philadelphia National Bank v. Irving R. Boody Co., decided by an arbitral award of Mr. Funk. (Funk, Trust Receipt v. Warehouse Receipt--Which Prevails When They Cover the Same Goods? 19 Bus. Lawyer 627 (1964). In that case S, a dealer in imported wool, obtained possession of a delivery order for a shipment of wool, after filing a financing statement relating to trust receipt transactions with Boody covering documents of title and wool in the hands of S and executing a trust receipt in favor of Boody. Mr. Funk's statement does not indicate whether the delivery order was negotiable or non-negotiable or whether the trust receipt covered the documents of title and the wool or only one of these items. Subsequently S secured possession of the wool and, without authority by Boody, stored the same in a public warehouse. Thereafter he caused the issuance of a non-negotiable warehouse receipt in the name of W, as security for a loan. W assigned the warehouse receipt to the Philadelphia National Bank. The Bank claimed priority to the wool. It argued that Boody by leaving S in the possession of the delivery order had permitted S to obtain the goods and to place them into the stream of commerce and was thus subordinated

to a security interest in the goods created by a subsequent document of title. It claimed support for its contention in Subsection 7-503(1). The arbitrator rejected this theory. He held that both parties had perfected security interests in the same collateral and that Boody prevailed since he came first in the order of perfection under Subsection 9-312(5)(b). Subsection 7-503(1) did not accord paramount rights to the Bank, since the warehouse receipt was non-negotiable. The award is undoubtedly correct if both security interests existed "in the same collateral", i.e. the wool. Apparently this was the case in the controversy at hand. The trust receipt financing statement covered documents of title and wool in the possession of S, and it can be assumed that the financing agreement did the same. If the original collateral had been only the negotiable delivery order (if it was such), the question might have arisen whether the security interest subsequently shifted to the wool as "proceeds" of the delivery order (Section 9-306). The non-negotiable warehouse receipt issued to W as a secured party created a security interest in goods in the possession of a bailee, within the meaning of Subsection 9-304(3). Hence, the fortuitous circumstance that the filing statement in favor of Boody also covered the goods saved the day for him.

5. Subsection (4) provides a twenty-one day period of temporary perfection, (without filing or possession) starting at the time of their attachment, for security interests in instruments and negotiable documents, to the extent that such interests arise for new value given under a written security agreement. Subsection (4) obviously applies only to the case where instruments or negotiable documents are original collateral and not proceeds.

6. Subsection (5) grants a twenty-one day period of temporarily continued perfection without filing where a secured party having a possessory security interest in instruments or negotiable documents or in goods in the custody of a bailee (whether by means of notification or issuance of a non-negotiable document of title) releases such collateral to the debtor for legitimate commercial purposes such as facilitating the ultimate sale or exchange of the goods so released or represented by the documents so released or for the purpose of facilitating the ultimate sale or collection of such instruments.

7. After expiration of the twenty-one day period, the security interest becomes unperfected unless the requisite steps for perfection or re-perfection are taken.

Section 9-305. When possession by secured party perfects security interest without filing.

1. As pointed out before in Explanatory Note 2 to Section 9-302, the Code makes possession a method of perfection which, when available, is often an alternative to filing, but sometimes the exclusive method. Possession is recognized as a method of perfection of security interests in letters of credit and advices of credit (Subsection 5-116(2)(a)), goods, instruments, negotiable documents and chattel paper. In the case of instruments (other than instruments constituting part of chattel paper) possession is the exclusive method; otherwise it is an alternative method to filing, except in the cases where temporary perfection dispenses with filing or possession.

2. In the case of collateral, other than goods covered by a negotiable document, which is in the possession of a bailee, the secured party is deemed to have possession from the time the bailee receives notification of the secured party's interest. This harmonizes with the rule of Subsections 2-503 (4)(b) and 7-504(2)(b) and rejects the common law rule which required attornment by the bailee.

   In the case of goods covered by a negotiable document, notification of the bailee is immaterial. Possession of the document is all that counts for perfection. In the case of an unaccepted negotiable delivery order, a pledge thereof will have a defeasible security interest, subject to the rules of Subsection 7-503(2). Accordingly, creditors of the pledgor may defeat the pledgee's interest until notification of the bailee, if under applicable state law retention of possession by a seller is considered to be fraudulent and the non-notification of the bailee is not in good faith and current course of trade for a commercially reasonable time.

3. Perfection by possession of the secured party is coterminous with the duration of the possession. It does not relate back to any prior time and does not extend beyond the loss of possession except as otherwise provided in Subsections 9-304(4) and (5). The rule stated is the logical consequence of the Code's sharp distinction between attachment and perfection. The equitable pledge of former days is now a security interest which has attached but is unperfected.

4. The last sentence renders it clear that possession is only an alternative method of perfection where filing is also appropriate.

5. The applicable rules govern also the perfection of security interests in motor vehicles without issuance of a change of the certificate of registration and certificate of ownership (Revised Laws of Hawaii 1955, Section 160-10(e) as amended in 1967).

Section 9-306. "Proceeds"; secured party's rights on disposition of collateral.

1. Section 9-306 deals with the fate of the security interest if the collateral is disposed of. The security interest may survive the disposition and remain an encumbrance of the collateral or it may shift to the proceeds or it may do both. Section 9-306 envisages all three possibilities and determines which of them applies under what circumstances.

2. Subsection (1) furnishes a definition of "proceeds". It specifies that the term "includes whatever is received when collateral or proceeds is sold, exchanged, collected or otherwise disposed of". It extends to the "account" arising when the right to payment is earned under a "contract right", see Section 9-106 for a definition of these terms. Money, checks and other means of payment are called "cash proceeds"; all other proceeds are non-cash proceeds. Since the proceeds must be received in consequence of a disposition of the collateral, it would seem that insurance proceeds in case of destruction of or damage to the collateral are not "proceeds" within the meaning of Section 9-306 and there is judicial authority for this construction, Universal C.I.T. Credit Corp. v. Prudential Invest. Corp., 222 A. 2d 571 (R.I. 1966); see also Michigan Fire & Marine Ins. Co. v. Genie Craft Corp. , 224 F. Supp. 636 (D. Md. 1964).

3. Subsection (2) states the basic rule governing the fate of the security interest in the case of a sale, exchange, collection or other disposition of the collateral: The security interest in the collateral survives the disposition by the debtor, unless the disposition either (a) was authorized by the secured party in the security agreement or otherwise, or (b) involved a transfer to a party who under the applicable rules takes free and clear of the security interest in the particular collateral. Such rules are contained in Sections 9-301, 9-307, 9-308, and 9-309. In addition the security interest continues in any case in identifiable proceeds. Of course, where the security interest continues both in the original collateral and in its proceeds, the secured party may have only one satisfaction, see Official Comment, Point 3.

4. Whether a disposition is authorized by the secured party may depend upon the course of dealing between the parties and any usage of the trade in which they are engaged (Section 1-205). The Official Comment, Point 3 suggests that even a claim to proceeds in the filed financing statement might be considered as authorizing a sale or other disposition.

5. The shift from the collateral to the proceeds as provided in Subsection 2 seems to be automatic and without regard to the terms of the underlying security agreement. If this reading is correct, there would be a curious incongruity between Subsections 9-306(2) and 9-203(1)(b). The latter implies that the security agreement must include a reference to proceeds in order to create an enforceable security interest therein. Perhaps the introductory clause of Subsection 2 "Except where this Article otherwise provides", qualifies not only that part of the sentence which prescribes the continuation of the security interest in the original collateral but also the second part which establishes the continuation in the identifiable proceeds. If the latter interpretation is correct, the shift to the collateral would depend on the terms of the security agreement. At any rate the problem is of reduced practical importance since ten days after receipt of the proceeds the security interest therein would become unperfected, unless the original financing statement or a timely filed new financing statement cover the proceeds (Subsections 9-306(3)(a) and (b) and 9-402(3)(4)) or the secured party takes possession thereof. In the first alternative the financing statement would supply the written security agreement covering the proceeds as collateral; in the second alternative the possession would supersede the need for a written agreement.

6. Subsection (3) provides that the "continuing security" interest in the proceeds is a "continuously perfected" security interest for ten days after receipt of the proceeds if the security interest in the original collateral was a perfected one. Thereafter the security interest in the proceeds becomes an unperfected (i.e. a no longer perfected) security interest, unless either the original filed financing statement covered proceeds as collateral or, prior to the expiration of the ten-day period, the security interest in the proceeds is perfected by the applicable perfection methods. Difficulties arise where a creditor obtains a judicial lien on the proceeds during the period of temporary perfection and the perfection subsequently lapses. Does the lien creditor now gain priority over the no longer perfected security interest? The Official Comment, Point 3 to Section 9-403 states that this is the case. Professor Gilmore makes an elaborate argument against this position,

arguing that priorities once established stay put (1 Gilmore, Security Interests in Personal Property, Section 21.6 (1965)). The matter might be cleared up in the current revision of Article 9. If there are two creditors, one of which gained his lien prior to the lapse, while the other obtained his lien after the gap in perfection, the matter becomes even more complex. The second creditor would be prior to the now unperfected security interest, but junior to the prior lien creditor, who according to Gilmore remains junior to the security interest: the typical circuity of liens problem. Professor Gilmore feels that this is a price that must be paid, op. cit. at p. 589.

7. Subsection (2) and (3) deal with the continuation of the security interest in the original collateral and in the identifiable proceeds from a disposition thereof. The security interest in the original collateral is lost if the disposition was authorized or, although unauthorized, involved a transaction with a purchaser who acquired free and clear of the security interest. The security interest in the identifiable proceeds is lost when the proceeds are no longer identifiable, except in the case of goods (Section 9-315). Subsection (4) provides an exception to the latter rule in the case of insolvency proceedings instituted by or against the debtor. The Code deals with the fate of a security interest in proceeds in the case of insolvency proceedings as a separate matter and not merely as an exception to the rules governing outside insolvency proceedings. Subsection (4) lists four types of situations involving different types of proceeds and events relating to them. If the applicable perfection methods have been followed a secured party, in the event of insolvency proceedings, has a perfected security interest

(a) in identifiable non-cash proceeds, such as an account or trade-in;

(b) in identifiable cash proceeds in the form of money which is neither commingled nor deposited in a bank account prior to the insolvency proceedings;

(c) in identifiable cash proceeds in the form of checks or the like which are not deposited in a bank account prior to the insolvency proceedings;

(d) in all cash and bank accounts of the debtor, if other cash proceeds have been commingled or deposited in a bank account. This trans-substantiated security interest is limited to the difference between (1) the amount of cash proceeds received and commingled or deposited within the ten days prior to the institution of insolvency proceedings and (2) the amount of cash proceeds received by the debtor and paid over to the secured party during that period regardless of whether or not the encumbered funds are identifiable as cash proceeds of the collateral. Furthermore, the security interest under Subsection (4)(d) is subject to the right of set-off.

It seems to be most likely that this recognition of a security interest on collateral not traceable as proceeds will be held to be valid in bankruptcy despite its confinement to the institution of insolvency proceedings. Under Section 10 of the former Uniform Trust Receipts Act, Revised Laws of Hawaii 1955, Section 206-10(b), there was a split of judicial authority on the validity of that provision in bankruptcy. Since the section was drafted in terms of entitlement to proceeds, some of the federal courts held that that section created priorities inconsistent with Section 64 of the Bankruptcy Act, others held that it created liens recognized as valid by Sections 60 and 67c, see the survey of authority in United States v. Haddix & Sons, Inc. 249 F. Supp. 88 (E.D. Mich. 1965). Under the Code there is no doubt that the creation of a full fledged security interest was intended. However, Section 67c(1) of the Bankruptcy Act, as amended in 1966, invalidates statutory liens which first become effective upon the insolvency of the debtor. Nevertheless this provision should not invalidate the lien created by Subsection 9-306(4)(d), since it applies only to statutory lien as defined in Section 1 (29a) of the Bankruptcy Act. This definition excludes liens "dependent upon an agreement to give security, whether or not such lien is also provided by or is also dependent upon statute", such as is constituted by Subsection 9-306(4)(c).

8. Subsection (5) provides for the situation in which goods are returned to or repossessed by the seller after having been sold upon terms which resulted in an account or chattel paper which was transferred by the seller to a secured party. In a situation of this kind it must be determined whether an unsatisfied security interest in the sold collateral reattaches to the returned or repossessed goods and what priorities exist between the holder of the security interest in the original collateral and the transferee of the account or chattel paper. Subsection (5) resolves these issues.

   (a) Subsection (5)(a) renders it clear that an unsatisfied security interest in the original collateral reattaches in in the goods upon their return or repossession. If the original security interest was perfected by filing which is still effective, the reattaching security interest in the repossessed goods will have perfected status and continue in that status without need for further perfection steps. If no effective financing statement is on file, the secured party must either file a financing statement covering these goods or take possession of them. In that situation the question arises whether the secured party has a ten-day grace period during which the reattaching security interest can be considered as a temporarily perfected security interest pursuant to Subsection 9-306(3). Professor Gilmore argues convincingly that this is the case (2 Gilmore, Security Interests in Personal Property, sec. 27.5 at p. 739 (1965)) and the unqualified statement (in sec. 3.06(5)(a)) that the reattaching security interest "continues as a perfected security interest" seems to support this analysis.

(b) According to Subsection (5)(b) an unpaid transferee of chattel paper likewise has a security interest in the goods and has priority over the holder of the security interest in the original collateral, if the transferee was entitled to priority over the original security interst under Section 9-308. Again the question of perfection arises, especially in the absence of any provisions relating thereto which are comparable to those contained in Subsection (5)(a). It would seem that Subsection 9-306(3) accords temporary perfection also to the security interests in the returned or repossessed goods granted to unpaid transferees of a chattel paper or account resulting from the goods. Professor Gilmore suggests that a subsequent lapse of perfection does not deprive the transferee of his priority over the holder of the security interest in the original collateral. A priority once gained is not defeated by a subsequent lapse of perfection of the prior interest. Support of this view is found in Subsection (5)(d) which specifies that reperfection of the security interests accorded by Subsection (b) is needed for protection against creditors and purchasers of the returned goods (2 Gilmore, op. cit. at p. 739).

(c) The priorities are reversed in a conflict between the holder of the security interest in the original collateral and an unpaid transferee of an account resulting from the sale. According to Professor Gilmore the transferee's subordination continues even if the perfection of the security interest in the original collateral subsequently lapses (Gilmore, op. cit. supra, at 741). Again the matter is not free from doubt.

(d) As has been noted in Explanatory Note 8(b), the security interest of an unpaid transferee accorded by Subsections 9-306(5)(b) and (c) must be perfected in order to be protected against creditors of the transferor and purchasers of the returned or repossessed goods. Of course, even a perfected security interest is subject to be defeated by a buyer of the goods pursuant to Section 9-307.

Section 9-307. Protection of buyers of goods.

1. This section deals with the relative priorities between buyers of goods and holders of prior perfected or unperfected security interests in the goods sold.

   Section 9-307 is parallel and supplementary to Section 2-403 which, *inter alia*, deals with the relative rights of buyers of goods and persons having title to these goods which they entrusted to the seller, and to Section 7-205 which deals with the relative rights of buyers of goods from a warehouseman and the person entitled to the same goods under a warehouse receipt.

   Section 9-307 differentiates between buyers of inventory (Subsection (1)), buyers of consumer goods and farm equipment having an original purchase price of not more than $2500 (Subsection (2)), and buyers of other goods, *i.e*. equipment, including farm equipment with an original purchase price of more than $2500, who are not subject to a special regime. For definitions of the terms "inventory", "farm products", "equipment" and "consumer goods", see Section 9-109.

2. A person who buys inventory in ordinary course from a seller other than a pawnbroker takes free and clear of a security interest created by the seller, even though the security is perfected and does not give the debtor the liberty of sale and even though the buyer knows that the security exists, so long as he buys in good faith and without knowledge that the sale to him is in violation of the security interest.

   This proposition flows from the somewhat complex interrelation of the terms used by the subsection in question. Since "buyer in the ordinary course of business" means a buyer of goods from a person in the business of selling goods of that kind other than a pawnbroker (Subsection 1-201(a)) and since Subsection 9-307(1) expressly excludes farm products, it follows that that subsection applies to buyers of inventory from a seller other than a pawnbroker. Moreover, since the definition of "buyer in ordinary course of business" as defined in Subsection 1-201(a) excludes a buyer who has, or in bad faith fails to have, actual knowledge that the sale is violative of an existing security interest, it follows that the rights of a buyer of inventory are subordinate to an existing security interest if he either knows that the security interest exists or knows or should have known that the seller has no liberty of sale from the secured party.

3. A buyer of consumer goods or farm equipment (other than fixtures) having an original purchase price of $2500 or less takes free and clear of an existing security interest if he buys the goods for value and for his own personal, family or household purposes or his own farming operation; provided he has no actual knowledge of the security interest and provided further that no financing statement covering such goods is filed prior to his purchase. The filing of a financing statement thus immunizes the security interest in consumer goods or low cost farm equipment against being defeated by a subsequent sale by the debtor. If the security interest secures a debt other than for purchase money, filing is necessary for perfection. If the debt secured is a purchase money debt (Section 9-107) the security interest is already perfected without filing (Subsection 9-302(1)(c) and (d)). Filing thus converts the perfected security interest into a "super-perfected" security interest, i.e. a security interest which is not only effective against the classes of third parties covered by Subsection 9-301(1)(b) and (c), but also against buyers of the type described in Subsection 9-307(2).

Section 9-308. Purchase of chattel paper and non-negotiable instruments.

1. This section deals with the relative rights of holders of a security interest in chattel paper or a non-negotiable instrument and subsequent purchasers of such chattel paper or non-negotiable instrument. In order to understand the precise scope of the rules laid down by this section, it is necessary to recall the full meaning of the definition of the type of collateral envisaged by this section and the applicable perfection methods. "Chattel paper", as defined in Subsection 9-105(1)(b), means a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods and includes an instrument or instruments given as part of the transaction. "Non-negotiable instruments" means writings which are not negotiable under Section 3-104, but are nevertheless instruments within the meaning of Subsection 9-105(1)(g) because they are writings evidencing a right to the payment of money which

in ordinary course of business are transferred by delivery with any necessary indorsement or assignment. This definition includes but is not restricted to the quasi-negotiable instruments governed by Section 3-805. It excludes a writing which is a security agreement or lease itself. Security interests in chattel paper may be perfected by filing or possession (Sections 9-304(1) and 9-305)). Security interests in instruments (other than instruments which constitute part of chattel paper) can be perfected only by possession except in the cases of temporary perfection specified in Subsections 9-304(4) and (5) where no perfection steps need to be taken. Security interests in instruments cannot be perfected by filing.

2. The basic rule applying to cases where chattel paper and non-negotiable instruments constitute original collateral is contained in the first sentence of Section 9-308. According to this provision, a security interest in chattel paper which is perfected by filing but leaves the debtor in possession thereof, as well as a security interest in a non-negotiable instrument which is temporarily perfected although it is in possession of the debtor, may be defeated by a purchaser who gives new value and takes possession of it in the ordinary course of his business and without knowledge that the specific paper or instrument is subject to that security. Purchases for value include secured lenders, but they are protected only if they take possession of the collateral in the ordinary course of their business. Protection fails if they have knowledge that the particular item is subject to a security interest.

3. The second sentence of Section 9-308 extends the protection of purchases given by the first sentence in cases where the collateral consists of chattel paper, "claimed merely as proceeds of inventory subject to a security interest (Section 9-306)." In that situation a purchaser who gives new value and takes possession of the chattel paper in the ordinary course of his business gains priority over the existing security interest even though he knows that the specific paper is subject to that security interest. Is the priority lost, if the purchaser not only knows that the specific chattel paper is subject to another security interest but knows, in addition, that the disposition is in violation of a prohibition agreed upon between the debtor and the secured party? Professor Gilmore argues that such purchaser is still protected since the Code does not require good faith (2 Gilmore, <u>Security Interests in Personal Property</u>, 1955, Section 27.3, at 731). The matter is at least doubtful. Section 9-308 second sentence applies only to chattel paper. Non-negotiable instruments, even where claimed merely as

proceeds, come under the more restrictive provision of the first sentence.

4. The difference between a security interest in chattel paper and a security interest in chattel paper which is merely claimed as proceeds of inventory is quite elusive. Both the Official Comment, Point 2 and Professor Gilmore, 2 Gilmore, op. cit. Section 27.3 have struggled with the governing criteria. Obviously, where the secured party does not claim a security interest in the inventory at all but only in chattel paper received by the debtor, the security interest in the chattel paper is not claimed as proceeds of inventory. Vice versa, applicability of the second sentence is not circumvented by the fact that the inventory financer spells out the extension of his interest to chattel paper rather than merely describing that part of the collateral as proceeds. The essential criterion seems to be whether a particular advance was made or renewed on the basis of inventory and its proceeds or only on the basis of the proceeds.

Section 9-309. Protection of purchasers of instruments and documents.

1. This section is designed to codify the traditional rule that a holder in due course of a negotiable instrument (Section 3-302), a holder to whom a negotiable document has been duly negotiated (Section 7-501) or a bona fide purchaser of a security (Section 8-301) acquires rights in the instrument or document which have priority over a security interest in such instrument or document, regardless of whether the security interest is perfected or unperfected.

   The perfection envisaged by Section 9-309 is either temporary perfection under Subsections 9-304(4) and (5) or, in the case of documents, perfection by filing. Security interests in instruments, it may be remembered, are not subject to perfection by filing. The last sentence of Section 9-309 renders it clear that filing does not constitute notice to such holders, so as to defeat the possibility of taking as holder in due course, by due negotiation or bona fide purchase as required by the three sections referred to in the first sentence.

2. Section 9-309 covers directly only the case where the existing security interest exists in the document as collateral and does not apply to the case where the conflict arises between a security interest in goods and the rights of a holder by due negotiation

of a document covering them. Technically these rights are not in the same collateral. This matter is governed by Subsection 7-503(1). According to that provision, a document of title confers no rights in the goods against a person who before issuance of the document had a perfected security interest in them and who neither delivered nor entrusted them to the bailor with actual or apparent authority to ship, store or sell or with power of disposition under Sections 2-403 and 9-307 or other statute or rule of law, nor acquiesced in the acquisition by the bailor of any document of title. Normally, the taking of a non-possessory security interest in goods will be considered as entrusting within the meaning of Section 7-503. Consequently subsequent bailment and issuance of a negotiable document covering the goods will give a holder who acquires the instrument by due negotiation superior rights. It follows from Section 7-503 that filing of a financing statement with respect to the goods does not impart notice to a prospective holder of the document.

<u>Section 9-310. Priority of certain liens arising by operation of law</u>. This section subordinates a perfected security interest in goods to a possessory lien upon such goods, accorded by statute or rule of law to a person for materials or services which he has furnished with respect to the goods in the ordinary course of his business. Priority of a lien of this type cannot be claimed if the lien is given by statute and the statute provides expressly to the contrary. Mere silence of the statute, however, does not permit a construction against priority.

<u>Section 9-311. Alienability of debtor's rights: judicial process</u>.

1. A debtor who subjects his rights in personal property to a security interest retains a number of valuable rights. These rights may or may not include the right to possession prior to default, depending upon the terms of the security agreement. Section 9-311 provides that these rights of the debtor are subject to voluntary or involuntary alienation, "notwithstanding a provision in the security agreement prohibiting any transfer or making the transfer constitute a default." The last part of the notwithstanding clause should not be expanded beyond its actual text. The clause does not invalidate a provision which declares a transfer to constitute a default; it merely declares that an alienation despite such a clause is effective. The alienation would still constitute a breach of the security agreement rendering the transferor liable <u>accord</u>, 2 Gilmore,

Security Interests in Personal Property, Section 38.5 at 1018 (1965). The further question, however, remains to be answered whether the breach constitutes a default entitling the secured party to enforce the security interest against the transferee. The literal reading of Section 9-311 seems to permit this result. Professor Gilmore states that "the buyer, transferees and creditors will take free of the prohibitory covenant, even if they have knowledge of it" (Gilmore, op. cit. at 1018) but his comment seems to refer to the first alternative of the notwithstanding clause and not to the second one.

2. Section 9-311 states that the debtor's interest is subject to the reach of creditors by means of attachment, levy, garnishment or other judicial process. The Official Comment, Point 2 adds that the form of the appropriate judicial process is left to the law of each state to determine. Actually most state laws are quite indefinite on that point. If the secured party is in possession of the collateral, garnishment of the secured party to reach any surplus remaining after an enforcement sale seems to be the most feasible collection remedy. Conversely, if the debtor is in possession of the collateral, levy on the property will usually be the appropriate first step. Whether, however, the sheriff is empowered or obligated to sell the property subject to the security interest or whether he must sell free and clear, distributing the proceeds first to the secured party seems to be an open question. Clarification of the law on that point seems to be desirable.

Section 9-312. Priorities among conflicting security interests in the same collateral.

1. This section is designed to assemble in one place all rules governing the priorities among conflicting security interests in the same collateral as well as the priorities among security interests and interests other than security interest claimed in the same property which is subject to the security interests. The caption of the section is too narrow since actually it covers only the broad ground stated. The limited scope of the caption is perhaps explained by the structure of the section. Subsection (1) is no more than an index of other sections likewise dealing with the broad field of priorities involving security interests. The subsequent subsections which contain supplementary rules deal, indeed only with priorities among conflicting security interests in the same collateral. Subsection (2) regulates priorities among security interests in crops. Subsections (3) and (4) relate to conflicts between purchase money security

interests and non-purchase money security interests in the same collateral. Subsections (5) and (6) finally state residual rules for the priorities among security interests in the same collateral which are to govern, if none of the rules collected in Subsection (1) or stated in Subsections (2) to (4) are applicable.

2. Subsection (2) provides that a perfected security interest in crops for new value given to enable the debtor to produce the crops during the production season and given not more than three months before the crops become growing crops by planting outrank an earlier perfected security interest which secures obligations that are due more than six months before the crops become growing crops by planting or otherwise. It is immaterial whether or not the person giving the new value had knowledge of the earlier security interest.

The priority given to current "enabling" security interests in crops is extremely narrow. It subordinates only earlier security interests in crops that are more than six months overdue at the time the crops become growing crops. It advances only security interests for new value given to enable the growing of crops during the current production season, although the Code in difference to true purchase money mortgages, does not require that the value given is in fact so used, compare Subsection 9-107(b). Moreover, the Code fails to state whether the priority given by Subsection 9-312(2) carries over to the proceeds. Probably the answer should be negative, see 2 Gilmore, Security Interests in Personal Property, Section 32.5, 869 (1965). Subsection 9-312(2) does not differentiate as to whether the subordinate earlier overdue security interest was an enabling crop security interest or not. In fact the whole subordination rule, as contemplated by the sponsors, had a comparatively narrow range of application, since Subsection 9-204(4)(a) limited the duration of separate security interests on future crops to crops which become such within a one year period after the execution of the security agreement. The deletion of Subsection 204(4)(a) from the Uniform Commercial Code of Hawaii has, of course, greatly increased the possibility of prior overdue crop security interests, including crop security interests given to enable the growing of prior crops.

Unfortunately, the principal criteria for entitlement to the enabling crop security priority are ill defined. The duration of a production season will vary from crop type to crop type and some crops may not have any well marked production seasons. In addition, there might be a distinct and prolonged period between the planting (or grafting) of the plant and the first harvest, as in the case of fruit trees. Professor Gilmore suggests that security interests in crops securing loans made to enable the establishment of orchard, do not qualify for the Subsection 9-312(2) priority, Gilmore, op. cit. Section 32.5 at 866.

In Hawaii, the retention of an unamended Subsection 9-312(2) after the repeal of Subsection 204(4)(a) may entail difficult questions of interpretation and, what is worse, undesirable results. The reason for the repeal of Subsection 204(4)(a) was the unsuitability of that section to the principal types of commercial crops produced in Hawaii: sugar, pineapple, lilikoi, papaya, macadamia nut and coffee. Some of these crops have no cyclical production seasons and some require several years between the planting and grafting of the trees and the first harvest. A prime example is the macadamia nut. Other crops have a mother crop and one or several ratoon crops with definite production cycles for each crop, e.g., pineapple, sugar. The repeal of Subsection 204(4)(a) eliminated the restriction of crop collateral to only one fruit cycle, but it deprived the grower of his untrammeled opportunity to obtain additional financing for each fruit cycle, unless the prior crop security interest is six months overdue.

It would seem that Subsection 9-312(2) in its present form will not give the borrower the desirable freedom of obtaining crop financing for successive crops from different lenders if a prior enabling security interest is not paid off although not overdue for more than six months:

(a) Enabling crop security interests for different growing cycles (each ratoon crop should be a growing cycle) should rank in inverse order of attachment whether the earlier interest is overdue or not.

(b) Where the crop of a plant after reaching the first harvest has no natural growing cycle, a "growing year" should be established and enabling crop security interests for each growing year should rank in inverse order of the respective growing year.

(c) Enabling crop security interests should have the priority only if the value given was in fact so used.

(d) The enabling crop security interest should outrank all non-enabling crop security interests, whether the latter are perfected or unperfected, due or not due.

(e) Security interests on future crops for value given to establish the planting of trees, etc., should be entitled to crop security interest priorities.

3. Subsection (3) establishes a special regime for purchase money security interests on inventory collateral. The purchase money lender is entitled to priority for his purchase money security interest over other security interests in the same collateral, if the purchase money security interest is perfected at the time the debtor receives possession of the collateral and if he, prior to that time, notifies potential rivals of the fact that he expects to acquire a purchase money interest in inventory of the debtor as described by item and type.

   The potential rivals who are entitled to notification as condition for subordination are (a) secured parties who have filed a financing statement covering the same types or type of inventory as that serving as collateral for the holder of the purchase money security interest and (b) secured parties who are known to the purchase money financer to have security interests in the same collateral. The cut-off date with respect to other filers is the date of the filing made by the purchase money lender. He need not make further checks therefor. Parties who are known to have conflicting security interests are entitled to notification although their interests are created subsequent to the purchase money lender's filing and prior to the date when the debtor receives possession of the collateral. In most of these cases, however, the purchase money security would have priority under the residual rules of Subsection (5).

4. The scope of the priority under Subsection (3) has been the subject of a vast amount of discussion and conflicting views. One of the principal battle issues is the question of whether or not the priority under Subsection (3) carries over to the proceeds, see e.g. the lengthy discussion in 2 Gilmore, op. cit. Section 29.4 at 791. At the outset it is necessary to define the posture of that problem. If S_1 is an account receivable financer and S_2 is an inventory and proceeds purchase money financer, S_1 and S_2 initially do not claim conflicting security interests in the same collateral. S_1 is not one of the parties to be notified by S_2, if his financing statement is filed when S_2 files. Subsection 9-312(3)(b) is quite specific that the potential rivals must claim security interests in the same items or type of "inventory". Hence, the case posed falls under the residual rules of Subsection (5) and not at all under Subsection (3). The controversial

problem does arise, however, if S_1 gives general operating credit on the strength of D's inventory and proceeds, and S_2 is an inventory and proceeds purchase money financer. Does notification of S_1 by S_2 assure the latter of his priority in the proceeds? Subsection (3) accords priority to S_2's security interest only in the inventory stage. Is the priority lost and does S_1 prevail once the proceeds stage is reached? Until the forthcoming revision of Article 9, no safe answer can be given. Subsection 9-312(6) does not help since perfection and priority are not necessarily identical.

Another famous brain-teaser is the priority between two conflicting purchase money financers. S_1 and S_2 both contemplate financing of D's inventory acquisitions. S_1 files first, S_2 second. Both make cash advances to D for the purpose of inventory. D acquires inventory with a part of the advance made by S_1 and a part of the advance made by S_2, using the other money for extraneous purposes. S_1 and S_2 have purchase money security interests in the inventory only in the amount that the loans were actually used for the acquisition; with respect to the embezzled part of his advance, each has only a non-purchase money security interest in the inventory. Is it necessary that S_1 and S_2 each notify the other to make sure that his purchase money security interest is prior to any non-purchase money security interest of the other? The answer probably has to be yes. Initially in our example, the two purchase money security interests would be fully covered by the inventory acquired with part of the advances by S_1 and S_2, and no question as to the relative priorities of the purchase money security interests <u>inter se</u> would arise. But what if the collateral diminishes in value? Do S_1 and S_2 share pro rata or is the filing date controlling pursuant to Subsection 9-312(5)(a)? Again the correct solution is a matter of unresolved policy. See 2 Gilmore <u>op. cit</u>. Section 29.2 at 784 and Section 29.3 at 787. Of course questions of this type arise even, if D is honest and S_1 and S_2 are joint financers of D's inventory acquisitions. In such case the security agreement should stipulate for equal rank pursuant to Section 9-316. Otherwise Subsection 9-312(5)(a) ought to govern.

5. Subsection (4) deals with the rank of a purchase money security interest in collateral other than inventory. A purchase money security interest of that type has priority over a conflicting security interest in the same collateral if it is perfected at the time the debtor receives possession of the collateral or within ten days thereafter.

From the reference to the possession of the debtor it must be concluded that Subsection 9-312(4) is applicable only to collateral that is capable of possession, primarily goods other than inventory. Moreover, the security interest must be in collateral which was acquired by means of the advance. Hence, Subsection (4) does not apply to proceeds, and certainly not to proceeds in the form of accounts. Accord, 2 Gilmore, op. cit. Section 29.4 at 792, 793. The main area of application for Subsection 9-312(4) is equipment other than fixtures, and within a limited range, consumer goods.

Subsection (4), does not predicate the priority of the purchase money security interest on any notification. It is absolute; provided that the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within a grace period of ten days commencing at the time of reception of the possession of the collateral.

Note that Subsection (3) does not grant a corresponding grace period.

6. Subsections (5) and (6) establish a set of residual rules which govern when none of the rules listed in Subsection (1) or stated in Subsections (2) to (4) apply. These rules are strictly confined to conflicts between security interests in the same collateral and include conflicts involving purchase money security interests which do not qualify for the special priorities accorded by Subsections (3) and (4). The supplementary rules are stated in the form of an hierarchical triad:

   (a) if there are two conflicting security interests in the same collateral which are both perfected by filing their rank is determined by the date of the filing regardless of the dates of attachment;

   (b) if there are two conflicting security interests in the same collateral and one or both of them are perfected otherwise than by filing, their rank is determined by the order of perfection regardless of the order of attachment;

   (c) if there are two conflicting security interests in the same collateral neither of which is perfected, their rank is determined by the order of attachment.

   It should be noted that under the residual rules the filing date is material only in the case of two security interests which are both perfected by filing. Thus a security interest which is filed first, but attaches only after an intervening security interest has both been filed and attached, will nevertheless have priority. Of course, its priority does not operate until it actually attaches, but when it attaches, its priority will relate back to a date prior to the date of perfection.

7. Subsection (6) specifies that for the purpose of the residual priority rules, a continously perfected security interest shall be treated at all times as perfected in the manner in which it was originally perfected, i.e., by filing only if that was the original mode of perfection.

Section 9-313. Priority of security interests in fixtures.

1. Section 9-313 is one of the most troublesome provisions of the Code. It necessitated a major revision of the Code in 1956, and it is still the object of much criticism with calls for change. Some of the major commentaries on that section are Coogan, Security Interests in Fixtures Under the U.C.C., and Coogan and Clovis, The U.C.C. and Real Estate Law: Problems for Both the Real Estate Lawyer and the Chattel Security Lawyer, in 2 Coogan, Hogan and Vagts, Secured Transactions Under the U.C.C., chapters 16A and 17A (1967); 2 Gilmore, Security Interests in Personal Property, chapter 30 (1965); Kripke, Fixtures Under the U.C.C., 64 Colum. L. Rev. 44 (1964); Shanker, An Integrated Financing System for Purchase Money Collateral: A Proposed Solution to the Fixture Problem Under Section 9-313 of the U.C.C., 73 Yale L.J. 788 (1964); Shanker, Further Critique of the Fixture Section of the U.C.C., 6 B.C. Ind. & Com. L. Rev. 61 (1964).

2. The principal objective of Section 9-313 is to recognize, and to allocate the priorities relating to, security interests in goods even after they have become fixtures. An inescapable by-product of this approach is the need of a regulation of the conditions of removal on default (Subsection 9-303(5)). From an economic point of view, the reimbursement required as a condition of removal actually is the key to the true significance of the section although it comes into operation only after it is established that the security interest in fixtures has priority over all other interests in the real estate.

3. Section 9-313 applies only to collateral consisting of fixtures. If the items forming the collateral are not fixtures, other provisions of the Code, notably Subsection 9-312(4), will control. This is important since Section 9-313 established different conditions for priority than Subsection 9-312(4). Accordingly,

the fixture or non-fixture issue may gain renewed importance, accord, 2 Gilmore, op. cit. supra, Section 30.6 at 822. Generally speaking, the determination of whether or not goods have become fixtures is made according to the applicable rules of state law. The Code, however, specifies expressly that Section 9-313 does not apply to goods incorporated into a structure in the manner of lumber, brick, tile, cement, glass, metal work and the like. Such incorporated items cannot be collateral of a security interest governed by Article 9 unless the whole structure remains personal property under applicable law. Accessions, i.e. goods installed in or affixed to other goods, are not fixtures and are governed by Section 9-314.

4. The Code differentiates between priorities accorded to pre-affixation security interests in fixtures (Subsection 9-313(2)) and priorities accorded to post-affixation security interests in that type of collateral (Subsection 9-313(3)). Subsection (4) establishes a set of principles protecting subsequent purchasers, lien creditors and prior lienors, who make subsequent advances against both pre-affixation and post-affixation security interests in fixtures.

5. Subsection (2) grants the holder of a pre-affixation security interest in fixtures priority over all claims based on anterior interests in the realty and also over all claims based on subsequently created interests in the realty except with respect to such subsequent claims as are protected under Subsection (4). The pre-affixation security interest in fixtures prevails over prior interests in the realty regardless of whether or not it is perfected. An unperfected security interest of that type, however, may be subordinated to subsequent claims by reason of Subsection (4).

6. A post-affixation security interest in fixtures is invalid against interests in the real estate existing at the time such interest in fixtures attaches. It may become effective against a person with an existing interest in the realty only if the latter in writing consents to the security interest or disclaims an interest in the goods. Conversely, a post-affixation security interest is valid against all persons subsequently acquiring interests in the real estate except those who are protected under Subsection (4).

7. Subsection (4) protects three classes of persons against unperfected security interests in fixtures of which they have no knowledge:

(a) subsequent purchasers for value of any interest in the real estate;

(b) creditors with a lien on the real estate subsequently obtained by judicial proceedings; and

(c) creditors with a prior mortgage or trust deed of record on the real estate to the extent that they make or contract for subsequent advances.

In order to settle a pre-Code controversy Subsection 9-313(4) provides expressly that a purchaser at a foreclosure sale other than an encumbrancer purchasing at his own foreclosure sale is a subsequent purchaser for purposes of Subsection (4). Although the Code does not include a similar rule with respect to purchasers at an execution sale, the same principle should apply by analogy. It cannot be said that Subsection (4) is a model of consistency. Bona fide purchasers of interests are protected whether they record or not; conversely, a prior encumbrancer who makes or contracts for a future advance is protected only if his interest was recorded.

As Professor Gilmore points out there is an ambiguity in the term "subsequent" as used in connection with pre-affixation fixture security interests. Does "subsequent" relate to the time of the attachment of the security interest or to that of affixation? Professor Gilmore suggests that in the case of lien creditors, "subsequent" means after affixation but that in the case of bona fide purchasers and mortgages giving or committing further advances, it may include post-attachment situations where the purchase or further advance was made in the expectation of the affixation of unencumbered fixtures, 2 Gilmore, op. cit. Section 30.6 at 825, 827, and 828.

Two cases cause particular difficulties: (a) mortgages for construction loans and (b) installations of fixtures by construction companies, i.e. debtors who are not owners of the real estate, see Gilmore op. cit. Section 30.6 at 830, 832, Shanker, Further Critique of the Fixture Section of the U.C.C., 6 B.C. Ind. & Com. L. Rev. 61 (1964).

In the case of construction mortgages, the difficulty stems from the "contracted for" provision in the "if"-clause of Subsection (4). This could be read to mean that construction mortgages always have priority over fixtures because the advance was contracted for prior to the perfection of the fixture security interest and without knowledge thereof. As

Professor Shanker correctly states, such reading would not only do violence to the policy of the Code which protects fixture security interest but also to a sensible reading of the whole "if"-clause, op. cit. at 66. The Code fails to give special rules for the case of a landowner who is not the debtor of the fixture secured party. If he makes payments to the construction company in ignorance of an unperfected security interest in installed fixtures, he deserves the same protection as a mortgagee who makes further advances. As a result, analogous application of Subsection 9-313(4)(c) might be in order, accord, 2 Gilmore, op. cit. Section 30.6 at 834.

8. The consequence of the creation or preservation of a security interest in fixtures is the right to removal upon default. Subsection 9-313(5) surrounds this right with important qualifications: (a) It exists only if the secured party has priority over the claims of all persons having interests in the real estate. (b) It may be exercised without qualifications only if it can be done without physical injury though not without diminution in value of the real estate caused by the absence of the goods removed or the necessity of replacing them. Otherwise the secured party is under a duty to reimburse any encumbrancer or owner who is not the debtor and who has not otherwise agreed to the removal for the repair of the physical injury. A person entitled to reimbursement may prohibit removal until the posting of adequate security.

   The dividing line between physical injury and mere diminution in value because of missing fixtures cannot be easily drawn and will call for difficult judgments. The exclusion of construction materials from fixtures made by Subsection (1) is a first approximation to a solution, but there will be other borderline cases.

9. The fixture section involves perplexing filing problems. They are treated under Section 9-401.

10. Subsection 9-313(1), last sentence, provides that the Code does not prevent creation of an encumbrance upon fixtures or real estate pursuant to the law applicable to real estate. The applicable sections in Hawaii are Sections 196 to 196-1, Revised Laws of Hawaii 1955. Unfortunately, in their present form these sections are in need of clarification and revision.

Section 9-314. Accessions.

1. This section deals with security interests in accessions, i.e. goods installed in or affixed to other goods. Although there may be great difficulties in the practical application, the theoretical line separating the respective areas of applicability of Section 9-313 (fixtures) and Section 9-314 is easily drawn. The criterion is the character of the property to which the affixation is made, as real or personal property. The differentiation, however, of the cases falling under Section 9-314 and those falling under Section 9-315 (Comminglement or Processing) is extemely problematic even as a conceptual matter. There is a large area of overlap between these two sections which results in bothersome problems of construction. This will be discussed in the Explanatory Notes to Section 9-315. Certainly Section 9-314 applies only where component goods have not lost their identity.

2. The theory and structure of Section 9-314 follows completely that of the fixture section. Like the preceding section, Section 9-315 distinguishes between pre-affixation and post-affixation security interests in accessions, recognizing the validity of the latter type. Pre-affixation security interests in accessions prevail over the claims of all persons to the whole except certain classes of persons who acquire subsequent interests in the whole at a time when the security interest in the accession is neither perfected nor known to them. Post-affixation security interests in accessions are invalid against existing interests in the whole unless the holder of such interest, in writing, consents to the security interest or disclaims an interest in the accessions as part of the whole. Post-affixation security interests are valid against subsequently acquired interests in the whole, again subject to the protection of certain classes of persons who acquire certain types of interests prior to the perfection of the security interest and without knowledge thereof.

   The classes of the protected claimants and the conditions for their protection correspond verbatim to the fixture section.

3. The removal and reimbursement provisions in Subsection (4) are likewise identical with those relating to fixtures. The Explanatory Notes to Subsection 9-313(5) are equally applicable to Subsection 9-314(4).

Section 9-315. Priority when goods are commingled or processed.

1. This section pertaining to cases of commingling or processing, is closely and unhappily related, to Section 9-314 on accessions. The difficulties do not so much relate to the case of commingling or processing where the identity of the components of the mass or product is lost, but to the cases of processing where the final product permits identification of the goods which have been manufactured, processed or assembled into it (Subsection 9-315 (1)(b)). Section 9-315 deals with the fate of a pre-commingling or pre-processing perfected security interest of the goods which have been incorporated into a mass or product.

2. Subsection (1)(a) provides that where goods are so manufactured, processed, assembled or commingled that their identity is lost in the mass or product, a previously existing perfected security interest in the goods continues in the product or mass. This rule applies also where only part of the collateral has been so manufactured, processed, assembled or commingled.

3. Subsection (1)(b) provides for the continuation in the product of a pre-existing perfected security interest in goods which have been manufactured, processed or assembled into the product without losing their identity. The continuation in that case depends on the condition that the original financing statement includes the product as collateral. Where such continuing security in the product is accorded, no separate security interest in the goods which have been manufactured, processed or assembled into the product may be claimed as security interest in accessions.

   In the cases of the overlap between Sections 9-314 and 9-315, the secured party thus has a choice between a security interest in the product and a security interest in the goods. The choice will depend on the extent of the depreciation of the component parts which formed the original collateral, the extent of the duty of reimbursement under Subsection 9-314(4) and the extent of competing security interests in the product. The choice must be made at the time the original financing statement is made. By including the product in the identification of the collateral a secured party waives his rights under Section 9-314 in the cases where installation or affixation within the meaning of Section 9-314 is done in the process of manufacturing, processing or assembling a product. Where this is not the case, Section 9-314 remains unaffected. See 2 Gilmore, <u>Security Interests in Personal Property</u>, Section 31.4 at 848-849 (1965).

4. Subsection (2) regulates the relative rights among several security interests in the mass or product attaching pursuant to Subsection (1). In that situation all the continued security

interests have equal rank and share in the proceeds according to the ratio which the cost of the goods to which their security interest originally attached bears to the cost of the total product or mass.

The operation of the equality of rank rule and of the distribution formula may lead to unfortunate and unintended results (a) where the proceeds of the product fail to cover its costs, (b) where the security interest is only for part of the cost of the particular component, and (c) where some of the continued security interests are for purchase money while others are not; see 2 Gilmore, op. cit. Section 31.5 at 852-856. Although Professor Gilmore exaggerates some of the possible consequences of his formula, its indiscriminate equal rank proposition may be a serious danger to the preferred status of purchase money security in cases of manufacturing.

Section 9-316. Priority subject to subordination.

1. Section 9-316 states broadly that a person entitled to priority may, by agreement, subordinate his right to other parties. The import of this section is quite nebulous. Subordination agreements may affect the relative rights

    (a) of secured creditors *inter se*, or

    (b) of unsecured creditors *inter se*, or

    (c) between a secured creditor and one or more unsecured creditors.

Apparently all three types of agreements are effective and violate neither Sections 64 and 65(a) nor Section 60 of the Bankruptcy Act, when the common debtor is the bankrupt. If both parties to the agreement are unsecured creditors, subordination means no more than that the dividends to which the subordinator is entitled are payable to the contractual senior. If both parties are secured creditors, the subordination agreement has the result that the proceeds allocable to the subordinator's security interest go to the senior until he is satisfied. If the subordinator is secured and the contractual senior is unsecured, subordination denotes that the proceeds allocable to the subordinator's security interest are payable to the unsecured senior. Such an arrangement has no preferential effect within the meaning of Section 60 and therefore is unassailable by the trustee in bankruptcy of the common debtor. See Riesenfeld, *Creditors' Remedies and Debtors' Protection*, 592 (1967).

2. The main questions which are left unanswered by Section 9-316 relate to the formal and perfection requirements applicable to subordination agreements, especially in relation to creditors of the subordinator. A proposed optional new Section 1-209 (Report No. 3 of the Permanent Editorial Board for the U.C.C. (1967)) provides that a creditor may subordinate obligations owed to him by agreement with either the obligor or another creditor of the obligor and that such a subordination shall not create a security interest as against either the common debtor or the subordinated creditor. According to the Official Comment appended to the proposal, it relates only to subordination agreement by an unsecured creditor with or for the benefit of another unsecured creditor, leaving the question of subordination agreement of a creditor holding a security interest with another secured creditor or with or for the benefit of another unsecured creditor unanswered. It would seem that in these two classes of cases the rules governing the formal and perfection requirements for the assignment of security interest should govern. For a discussion of the problem antedating the proposals of the Permanent Editorial Board, see 2 Gilmore, <u>Security Interests in Personal Property</u>, Section 37.3 at 997, 998 (1965).

<u>Section 9-317. Secured party not obligated on contract of debtor</u>. This section is designed to render it clear that the mere existence of security interest imposes no vicarious liability on the secured party for the acts or omissions of the debtor. Such liability likewise is not incurred by the fact that the secured party has authorized the debtor to dispose of or use the collateral.

<u>Section 9-318. Defenses against assignee; modification of contract after notification of assignment; term prohibiting assignment ineffective; identification and proof of assignment</u>.

1. Broadly speaking, Section 9-318 attempts to codify the law of assignments. <u>Dramatis personae</u> are the assignor, the assignee and the account debtor. If the assignment is for the purpose of security or an outright sale of accounts, contract rights and chattel paper, the assignor is called a debtor (Subsection 9-105(1)(d)); if the assignment relates to the sale of a general intangible, the assignor has no other technical designation. An "account debtor" means a person who is indebted on an account, chattel paper, contract right or general intangible (Subsection 9-105(1)(a)). The four types of indebtedness of an account debtor are defined in Subsection 9-105(1)(b) and Section 9-106.

2. Except in the cases of an enforceable agreement between the account debtor and the assignor whereby the former agrees not to assert defenses, the assignee stands in the shoes of the assignor. Accordingly, his rights are subject (a) to all terms of the contract between the account debtor and the assignor and to any defense or claim arising therefrom as well as (b) to any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives notice (Subsection 1-201(26) second sentence) of the assignment. This is improved traditional common law.

The rules governing the position of the assignee are conditioned on the absence of an agreement by the account debtor not to assert defenses, as validated by the Code, subject to certain qualifications. This validation is in terms restricted to "defenses or claims arising out of a sale" and in addition limited by the conditions stated Section 9-206: i.e., it does not apply to account debtors who are buyers or lessors of consumer goods, if a local retail installment sale act provides otherwise; it only protects assignees who take the assignment for value in good faith and without notice of a claim and defense; and it does not apply to defenses which may be asserted in due course against the holder of a negotiable instrument.

It has been argued that the restriction in Subsection 9-318(1) of the validation of agreements not to assert defenses to sales is senseless, since even the reference Section 9-206 applies to both sales and leases, and it has been proposed that it should be "send in a cheerful spirit", 2 Gilmore, Security Interests in Personal Property, Section 41.5 at 1095 (1965). Whether the courts will accept this broad quasi-negotiability of all business contracts remains to be seen.

3. Subsection (2) tackles the thorny problem of the power of the original parties to modify or replace a contract despite a prior assignment that has been properly notified to the account debtor. The Code validates such modification of or substitution for the contract if made in good faith and in accordance with reasonable commercial standards, but terminates the power of the original parties vis-a-vis the assignee to modify or substitute after the assigned contract right has become an account. The rationale for this change in traditional common law principles is the need for workable rules permitting the financing of long term procurement contracts with the contract rights as the principal collateral. While the assignee should have a commercially sound basis of security, the original parties should retain the necessary freedom of movement. This

freedom, however, is no longer apposite after the right to payment has been earned by performance. At that point the assignor should no longer have the power to bargain his right away to the detriment of the assignee. The term "modification of or substitution for the contract" apparently includes outright terminations and recisions, at least this is the implication of the Official Comment, Point 2.

The right to modify or substitute for the contract may be stipulated away by agreement between the account debtor and the assignee. In the absence of an agreement to that effect, the assignee acquires, at any rate, the corresponding rights under the modified or substituted contract.

The last sentence of Subsection (2) provides that an assignment may stipulate that a modification or substitution, though effective against the assignee, is nevertheless a breach by the assignor. In the absence of such a term in the assignment, an effective modification or substitution would not constitute a breach.

4. Subsection (3) is concerned with the question of the authority of the account debtor to make payments to the assignor with liberating effect <u>vis-a-vis</u> the assignee despite the assignment. Subsection (3) extends this authority to the account debtor until he receives notification of the assignment and that payments are to be made to the assignee. The notification must reasonably identify the rights assigned; otherwise it is ineffective. If requested, the assignee must seasonably (as defined in Subsection 1-204(3)) furnish proof of the assignment. Until and unless he does so, the account debtor may pay the assignor.

5. Subsection (4) invalidates any stipulation between an account debtor and an assignor which prohibits the assignment of an account or contract right to which they are parties. As the Official Comment, Point 4 states, the rule codified in this subsection is the culmination of a long development which gradually has invalidated attempted restraints on the alienation of contractual rights. It should be noted that the invalidation in terms is limited to prohibitions against assignments of accounts or contract rights and not of general intangibles. According to Professor Gilmore, this limitation is due to inadvertence. Moreover, there is an apparent inconsistency between Sections 2-210 and 9-318(4) which, according to the Official Comment, Point 3 to Section 2-210 must be resolved in favor of Subsection 9-318(4); see 1 Gilmore, <u>op. cit</u>. Section 12.8 at 392 ftn. 4.

PART 4

Filing (Recording)

1. Part 4 regulates the formal and administrative aspects of filing. Whether filing is a necessary or permissive method of perfection for a particular type of collateral, as well as the effects of non-perfection, are regulated in other parts of Article 9, especially Part 1 and Part 3.

   It should be remembered that filing is a necessary method of perfection, except where:

   (a) An alternative method is available and has been resorted to (Subsections 9-302(1)(a) and 9-304(3) and Section 9-305);

   (b) A different method of perfection is the sole sanctioned method (Subsection 9-304(1), second sentence);

   (c) No special step is needed for perfection (Subsection 9-302(1)(c) to (f)) or temporary perfection (Subsections 9-302(1)(b), 9-304(4) and (5), 9-306(3)),

   In some instances, filing is only necessary for "superperfection" (Subsection 9-307(2)).

   It must be further remembered that the filing provisions of the Code do not apply to property subject to a statute of the United States which provides for national registration or filing of all security interests in such property and that security interests in such property may be perfected only by filing or registration under such statute (Subsection 9-302(3)(a) and (4), as amended in 1966).

   Security interests in motor vehicles may be perfected by filing. For motor vehicles which are not required to be registered under chapter 160 of the Revised Laws of Hawaii 1955, or which though required to be registered under that chapter, constitute inventory, the application of the filing provisions follows from Subsection 9-302(3)(b) as amended in 1966. For motor vehicles which are required to be registered under chapter 160 but which do not constitute inventory but equipment or consumer goods, the applicability follows from Section 160-10(e) as amended in 1967. The legislature failed to amend Subsection 9-302(4) at the same time, but under applicable canons of statutory construction, the amendment of 1967 controls.

2. Generally speaking, the filing provisions as applicable in Hawaii create few problems by reason of the fact that the State has only one central office in charge of all records: the Bureau of Conveyances. As a result, problems of filing in a wrong office, so bothersome in other states cannot arise. All filings for the perfection of security interests governed by the Code are filed in the Bureau of Conveyances. Actually, the word "filing" is a misnomer. All papers submitted to the Bureau of Conveyances for processing are not filed, i.e., kept in the original, but are recorded, i.e., kept in the form of a literal copy produced by electrostatic process and micro-film. The original is returned. The propriety of this system of record keeping under the Code is indicated by the insertion in 1966 of Subsection 9-105(1)(ee), which specifies "filing" means recording.

3. Article 9 applies only to security interests in personal property. There are, however, two or three places where there is a perplexing spill-over into real property law, including the recordation or registration of transactions relating to interests in land. These trouble-spots are:

   (a) Subsection 9-102(3) relating to the creation of a security interest in a secured obligation although the obligation is secured by an interest in real property;

   (b) Sections 9-312 and 9-402 relating to security interest in crops; and

   (c) Sections 9-313 and 9-402 relating to fixtures.

   Actually, the real or imaginary difficulties stem less from the overlap of real and personal property law than from the faulty lack of clarity in the amendments of chapter 196 of the Revised Laws of Hawaii 1955. True, the "pledge" of a real estate mortgage (not securing a negotiable instrument) requires compliance with both the recording or registration provisions relating to the assignment of mortgages (Revised Laws of Hawaii 1955, Sections 196-5, 342-60 and 343-23) and the filing provisions of the Code relating to the perfection of a security interest in intangibles (Subsection 9-102(1)(a), but see 1 Gilmore, Section 10.6 at 311, 312 (1965)); but once this is understood, it is readily accomplished.

   Similarly it is easy enough to draft and record a writing which creates both a land mortgage covering fixtures subsequently affixed to the land and a separate fixture security interest therein and to have it recorded pursuant to Section 9-408, as amended in 1967. It is only necessary to realize that it is good practice to draft the writing so as to separately state both effects.

Section 9-401. Place of filing; erroneous filing; removal of collateral.

1. This section is of utmost simplicity in Hawaii. The only proper place to file is the registrar of conveyances, Bureau of Conveyances. This rule applies even in the case of goods which are or are to become fixtures on registered land. Fixture security of this kind is no longer noted on the Land Court Certificate. Although the point has been made that a practice of this kind "defeat[s] a basic policy of the Torreus Statutes, i.e., that all heirs and encumbrances affecting land should be noted directly on the certificate and that the Code yields to this policy by giving way to certificate of title acts", (Shanker, A Further Critique of the Fixture Section of the U.C.C., 6 B.C. Ind. & Com. L. Rev., 61, 64 (1964)); Hawaii's abandonment of this approach in 1967 should not cause serious troubles after this limitation on the completeness of the Land Court Certificate is known.

2. Subsection (4) is a reference provision stating that if collateral is brought into this State from another jurisdiction, the necessity of filing in this State is to be determined according to the rules stated in Section 9-103, especially Subsection (3).

Section 9-402. Formal requisites of financing statements; amendment.

1. Section 9-402 sets forth the extremely simple formal requirements of the "financing statement", and gives rules governing the possibility and effect of amendments and the consequences of minor errors.

   The method of filing employed by the Code 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 or subsequent thereto. The Code does not require a filing of the security agreement, but declares that a copy of the security agreement constitutes a sufficient financing statement if it contains the requisite information and is signed by both parties.

2. The requisite content and formalities are kept to a minimum. What is needed are: (1) signatures of both parties, (2) addresses of both parties, (3) description of the types or items of the collateral. When the collateral includes crops growing or to be grown or goods which are or are to become fixtures, the financing statement must also contain a description of the real estate concerned and the name of the record owner or lessee. The inclusion of the name of the record-owner or record lessee of the real estate concerned, if fixtures or crops are the collateral, is not prescribed in the official version of the Code but has been indorsed by eminent authority, (2 Gilmore, Security Interests in Personal Property, Section 30.6 at 832 (1965)) and is inserted in Section 9-402 by a dozen states, among them Massachusetts, New Jersey, New York, Ohio and Wisconsin. Professor Shanker has argued that this requirement places too great a burden of search on the secured party (Shanker, A Further Critique of the Fixture Section of the U.C.C., 6 B.C. Ind. & Com. L. Rev. 61, 63 (1964)).

   It would seem to be advisable to insert a clause to the effect that it suffices if the secured party includes the name of a person who he in good faith believes to be the record owner.

   In two 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 interest was perfected.

   If the original financing statement also claims proceeds, no additional financing statement is needed (Subsection 9-306(3)). In one case only the signature of the debtor is required, viz., in the case of the combined real estate mortgage and fixture security interest (Section 9-408).

3. Subsection (4) authorizes amendments of the original financing statement and explains that the term "financing statement" when used in Article 9 means the original statement and subsequent amendments. Where an amendment makes additions to the collateral, the filing date as to the addition is the filing date of the amendment. Minor errors which are not seriously misleading do not impair the effectiveness of the financing statement.

Section 9-403. What constitutes filing; duration of filing; effect of lapsed filing; duties of filing officer.

1. This section deals with the computation of the perfection period resulting from filing, the possibility and effect of renewals, the mechanics of indexing and the filing fee. Because of the integrated recording system of the Bureau of Conveyances, Subsection (4) of the Official Version of the Code has been replaced with a reference to the Revised Laws of Hawaii 1955, chapter 343 and a specific rule relating to indexing in cases of crops and fixtures.

2. The perfection period resulting from filing begins when the financing statement is filed. This crucial moment is fixed by Subsection (1) as the time when the financing statement is presented for filing together with a tender of the filing fee or when the filing officer accepts the statement. Indexing is immaterial for the purposes of perfection. The duration of the perfection resulting from filing varies according to whether the financing statement indicates a maturity date of the obligation secured of five years or less, or whether no maturity date or a more remote maturity date is shown. In the first alternative the effectiveness of the filed statement lasts until sixty days after the stated maturity date; in the second alternative it is good for a period of five years. Thereafter the effectiveness lapses unless a continuation statement is properly and timely filed prior to the expiration of the original filing. A statement that the obligation is payable on demand sets the flat five-year period in motion.

3. Upon the lapse of the effectiveness of the filing, "the security interest becomes unperfected", i.e., turns into a "no longer perfected" security interest, comparable to the status of a security interest, the temporary perfection of which has lapsed (Subsections 9-304(4) and (5) and 9-306(3)).

   The effect of the occurrence of a lapse of perfection, whether in form of a filing gap or without subsequent re-perfection, has precipitated a lively discussion among commentators and the registration of a sharp dissent from the Official Comment by Professor Gilmore (1 Gilmore, Section 21.6 at 588-592 (1965)). The problem has two aspects: (a) the effect of the lapse on subordinate interests, the subordination of which depended on the existing perfection when the subordinate interest was acquired; and (b) the effect of the lapse on creditors who extended credit during the period of perfection but who acquired a lien (or security interest) during the gap. According to the

Official Comment, occurrence of a perfection gap causes a reversal of existing priorities based on filing dates, see Official Comment, Point 3. Professor Gilmore rejects this result. While he is quite convincing on that aspect, he seems to be in error on the second aspect. If S, security interest lapses and thereafter C, a creditor of the common debtor D, takes a security interest for a pre-lapse debt and perfects it by filing, he is clearly protected under Subsection 9-312(5). Why should a pre-lapse creditor who levies after the gap be less protected? Gilmore's argument that absence of knowledge means absence of prior though now lapsed constructive notice seems to be unduly far fetched. A trustee in bankruptcy appointed on a petition filed after lapse would prevail over the no longer perfected security interest, In re Cohen, 4 U.C.C. Reporting Service 22 (E. D. Pa. 1967) In re Ralph Fider, 4 U.C.C. Reporting Service 114 (E. D. Pa. 1967).

4. A continuation statement to effectuate continuous perfection must be filed by the secured party (a) within six months before and sixty days after a stated maturity date of five years or less, or (b) within six months prior to the end of the five-year period in cases where the fixed perfection period is applicable.

   The continuation period needs only the signature of the secured party and must identify the original statement by book and page number and state that the statement is still effective.

   Upon timely filing of the continuation statement, the effectiveness of the original statement is continued for five years from the date at which the effectiveness of the prior statement would have terminated otherwise. Lapse occurs at the end of that period unless another continuation statement is filed within six months prior to the arrival of that event.

   Records of lapsed statements may be removed from the records and destroyed.

   A "continuation" statement apparently may not be filed after a lapse. If a lapse occurs, a new statement must be recorded. Such re-filing needs a financing statement signed by the debtor and the secured party.

5. Subsection (4) prescribes double grantor indexing in the cases of fixtures and crops. If that type of collateral is involved, the record owner and the record lessee must be indexed as grantors in addition to the debtor. Such double indexing is

not prescribed where the owner of the collateral and the obligor of the secured obligation are different persons. In that case, the owner of the collateral is indexed as grantor.

6. The filing fee for filing, indexing and furnishing filing data for an original or continuation statement is $2 per page.

Section 9-404. Termination statement.

1. The existence of an effective financing statement in the records, if no security interest covered thereby is outstanding and the creation of a security interest covered thereby is no longer contemplated, may seriously impair the ability of the debtor to obtain credit from another lender, since Section 9-312 settles the relative priority between two security interests perfected by filing according to the respective filing dates. As a result, a device had to be created to terminate the effectiveness of a filed financing statement prior to the expiration of the five-year period. This device is the termination statement.

2. A secured party, i.e., a person appearing on a recorded financing statement as a secured party, must send the debtor a statement that he no longer claims a security interest under a recorded financing statement, identifying it by book and page number, if the debtor demands such statement in writing and if at that time there is no outstanding secured obligation and no commitment to make advances, incur obligations or otherwise give value.

   A termination statement may be presented for recordation and is to be recorded and indexed in the manner prescribed by Revised Laws of Hawaii 1955, chapter 343. The fee for filing and indexing is $2 per page.

3. Assignments of perfected security interest need not be filed in order to continue the perfected status of the security interest against creditors of and transferees from the original debtor. Filing may be required, however, to protect the assignee against creditors of and purchasers from the assignor. It is therefore possible that the secured party transferred the security interest to an assignee (without filing the assignment) and that subsequently the secured debt was satisfied. In that case, the assignee may be the proper author of the termination statement. In order to take care of this situation, Section 9-404 provides that a person other than the secured party of record may be the signatory of the termination

statement, but that in such case, the termination statement must include or be accompanied by the assignment or a statement by the secured party that he has assigned the security interest to the signatory of the termination statement. The assignment or statement of assignment may be filed and indexed. The filing fee is $2 per page except in the case of a combined real estate mortgage and fixture security interest (Section 9-408).

4. The Code imposes a duty upon "the affected secured party" to send a termination statement within ten days after proper demand. Non-compliance renders the affected secured party liable in damages and subject to a penalty of $100. The identification of the "affected" secured party may create difficulties where the financing statement covers a series of loans or advances and the assignment covers an outstanding loan which has been assigned and paid off. In such case, both the secured party of record and the assignee may be under a duty to furnish requested termination statements if the assignment is likewise of record.

5. An inherent danger of the system is the possibility of forged termination statements. Of course, the recordation of a forged termination statement would not terminate the effectiveness of the genuine financing statement. To guard against forgery the Code provides that upon filing of a termination statement the original financing statement and the statement of assignment should be delivered to the secured party (Subsection 9-404(2)). This salutary provision was deleted in toto in Hawaii. True, the Bureau does not keep an original of the financing statement and therefore cannot return it upon termination of its effectiveness. But under the Hawaii system of recording, the originals of the statement of asssignment and termination statement should be sent to the secured party, even if they are presented for filing by the debtor.

Section 9-405. Assignment of security interest; duties of filing officer; fees.

1. An assignment may take place even prior to the filing of the original financing statement. This permits adjustment of the financing statement to the situation at hand. The financing statement may disclose an assignment of a security interest in the collateral described, by indicating the name and address of the assignee or by an assignment itself or a copy thereof on the face or back of the financing statement. Either the

assignee or the secured party may sign the statement as secured party.

Apparently, where the financing statement itself indicates an assignment, the assignee is to be indexed as the secured party. Since the Code provides only for debtor-indexing (Subsection 9-403(4)), this question is not resolved.

2. In addition, Subsection 9-405(2) provides for the total or partial assignment by a secured party of record "of his rights under a financing statement" by means of a statement of assignment. Actually, this power seems to include the possibility of an assignment of only potential priorities in the described collateral. Although neither the Official Comment nor other commentators have discussed this point, the reading of the subsection seems to support this possibility.

   The statement of assignment must be signed by the secured party of record and must contain specified information. A copy of the assignment may serve as a statement of assignment if it contains the requisite data. The statement of assignment is recorded and indexed as other assignments.

3. Upon the filing of a financing statement disclosing an assignment or the filing of an assignment, the assignee is the secured party of record to the extent of the assignment.

Section 9-406. Release of collateral; duties of filing officer; fees. A secured party of record may, by a signed statement, grant a recordable release of all or a part of any collateral described in a filed financing statement.

The statement of release must be signed by the secured party of record and contain certain information. Such recordation is not necessary to make the release effective. The recordation is purely optional and designed to reduce unnecessary inquiries.

Section 9-407. Information from filing officer.

1. A person filing any financing statement, termination statement, statement of assignment or statement of release may request that the date and hour of filing and the book and page of its record be noted upon a copy of these statements furnished to the filing officer and that the copy with such notation be sent back to him.

2. In addition, any person is entitled to a certificate from the filing officer, showing whether on the date and hour stated therein there is on file any presently effective financing statement naming a particular debtor and any statement of assignment thereof, and, if there is, giving the date and hour of filing of each such statement and the names and addresses of each secured party therein.

   The fee for such certificate is $1.50 for each statement reported.

<u>Section 9-408. Special provisions for processing of filings as to fixtures; fees; combined real estate and fixture mortgage</u>.

1. Following the model of Section 9-409 of the U.C.C. of Massachusetts, Hawaii, in Section 9-408, provides for a combined land mortgage and fixture security agreement. The caption "combined real estate and fixture mortgage" is a misnomer. What such writing really provides for is a combination of a land mortgage and a separate fixture security interest. A land mortgage automatically applies to all existing and subsequently affixed fixtures "as part of the real estate". This coverage by a land mortgage does not exclude fixtures also as collateral for a separate chattel security interest, with the relative priorities of the latter being determined by Section 9-313. One and the same creditor may take both a land mortgage and a fixture security concerning the same land. A combination instrument, properly identified as such, may be recorded as an instrument affecting real estate, in the manner and subject to the filing fee provided by Revised Laws of Hawaii 1955, chapter 343, and if it includes the requisite content of a financing statement, as specified in Section 9-402, such recording shall be effective filing under Part 4 without the necessity of a separate filing or payment of a separate filing fee.

   In such a case, the requirement of a signature of the secured party is dispensed with.

PART 5

Default

Part 5 contains 7 lengthy sections governing the rights of the secured party and of the debtor upon a default. The primary objectives of Part 5 are twofold: (a) to rid the enforcement provisions of cumbersome and useless technicalities and formalities or obsolete doctrines and (b) to accord the debtor substantial rights, not subject to be contracted away, in order to protect him against uneconomical or oppressive enforcement steps. The Code incorporates certain minimum protective measures in the case where the collateral consists of consumer goods. These provisions may be supplemented by state consumers' protection laws, such as the Retail Installments Sales Act (Revised Laws of Hawaii 1955, chapter 201A), see Subsection 9-203(2).

The term "default" is not defined by the Code. The principal case of default is non-payment or other non-performance at the time specified by the agreement. What does or does not constitute default is mainly a matter of agreement between the parties. The Code itself recognizes the validity of a clause which declares that modification or substitution of a contract right which is subject to a security interest shall constitute a default (Subsection 9-318 (2)). Section 9-311 likewise does not seem to deny validity to a clause which provides that transfer of collateral shall constitute a default by the transferor.

Of course, a default provision which is so unreasonable that it is unconscionable will not be enforced (Section 2-302). A particular application of this principle exists in the case where the secured party has reserved to himself the right to demand immediate payment whenever he deems himself insecure. Insecurity clauses not predicated upon the occurrence of specified events had been repudiated by some courts prior to the Code. Section 1-208 provides specifically that reliance on insecurity clauses requires that the creditor in good faith believes that the prospect of payment or performance is impaired.

In some instances, dealt with in Part 5, the action of the secured party might not technically aim at an immediate liquidation of the security agreement, but merely at the strengthening of his position. This is the case where a secured party takes over the collection of receivables (Subsection 9-502(1)) or takes possession of the collateral (Section 9-503). These rights may be predicated on certain occurrences which do not necessarily constitute a default. See also 2 Gilmore, Sections 43.3 and 43.4 (1965).

Section 9-501. Default; procedure when security agreement covers both real and personal property.

1. Section 9-501, like certain other key sections in the Code, combines the functions of an index section with the enactment of clarifying, qualifying and other supplemental rules. In

particular, it correlates the provisions contained in the next six sections with other remedies which a secured creditor may resort to.

2. Subsection (1) defines the range of cumulative remedies which a creditor who is a secured party may have at his disposal upon default by the debtor. These remedies are:

   (a) the remedies provided for in Sections 9-502 to 9-507 and remedies otherwise provided for the judicial foreclosure of security interests;

   (b) remedies provided for in the security agreement to the extent that they are not prohibited by Subsection 9-501(3);

   (c) remedies available to a secured creditor as further defined in Subsection 9-501(5);

   (d) rights and remedies given to a secured party in possession by Section 9-207.

3. Subsection (2) is the counterpart of Subsection (1) and lists the rights and remedies of a debtor after default. The statute catalogues three classes:

   (a) those given by the following six sections;

   (b) those provided for in the security agreement;

   (c) those given to a debtor by Section 9-207 when the secured party has possession of the collateral either by the original terms of the agreement or by reason of re-possesion, see Official Comment, Point 3.

4. Subsection (3) is a most important provision. It collects those rules contained in the following sections which are enacted in the interest of the debtor and may not be either waived or modified at all or only within certain limits and under particular conditions. The following table is a synoptic presentation of the result:

Number of Subsection	Subject Matter	Whether Subject to No or Limited Qualification
9-502(2)	Accounting for surplus	None
9-504(2)	Accounting for surplus	None
9-504(3)	Disposition of collateral	None
9-505(1)	Compulsory disposition of collateral	Limited
9-505(2)	Acceptance of collateral as discharge	None
9-506	Redemption of collateral	Limited
9-507(1)	Liability for non-compliance	None

Subsection (3) permits, however, the parties by agreement to determine the standards to be observed in the fulfillment of these rights and duties, so long as such standards are not manifestly unreasonable.

5. Where a security agreement covers both real and personal property, Subsection (4) gives the secured party the option of either enforcing his security interest solely according to the provisions of the Code or proceeding as to both the real and personal property in accordance with the rules governing the foreclosure of real property security. In that case, the provisions of Part 5 are not applicable.

6. Subsection (5) deals with the situation where a creditor with a security interest does not enforce his security interest under the special enforcement remedies available for security interests but levies on the collateral as an execution creditor. The Code abolishes the pre-Code rules formerly applicable in a number of jurisdictions, which deemed such levy to be a waiver of the security interest and declares that the levy shall relate back to the date of perfection of such interest. The last sentence adds that an execution sale pursuant to such levy is a foreclosure of the security interest within the meaning of this section and that the secured party may purchase at the sale and thereafter hold the collateral free of any other requirements of Article 9.

Subsection (5) which, together with certain changes in Subsection (1), became part of the Code in 1958 in response to an unfortunate decision by the U.S. District Court In the Matter of Adrian Research and Chemical Co., Inc., 169 F. Supp. 357, rev'd. 269 F. 2d. 734 (3d Cir. (1959)). Unfortunately its draftsmanship is not impeccable. In the first place, it is not clear why the relation back effect is restricted to lien by levy of an execution and not accorded to any other type of judicial lien, such as resulting from a levy under a writ of attachment, garnishment or creditors' bill, accord, 2 Gilmore, Security Interests in Personal Property, Section 43.7 at 1209 ftn. 6 (1965). In the second place, it is not patent why the security interest must be perfected. Certainly, so long as no other party has gained priority under Section 9-301, the date of the attachment of an unperfected security interest should determine the rank of the judicial lien obtained by the secured party on his collateral. Thirdly, it is regrettable that execution sales are called judicial sales, which, in most jurisdictions, they are not. The gist of this subsection is that foreclosure sales and execution sales should have identical effects and that the acquisition of a judicial lien of whatever kind should not impair the position of the secured party.

Section 9-502. Collection rights of secured party.

1. Subsection (1) relates to the effect of default on non-notification financing of receivables and analogous transactions. It states, what Professor Gilmore has called "obvious propositions", 2 Gilmore, Section 44.4 at 1231 (1965), and authorizes the secured party to notify an account debtor (i.e., a person obligated on an account, chattel paper, contract right or general intangible) or the obligor on an instrument to make payment to him, whether or not the debtor (unhappily here called "assignor") was heretofore making the collections. It also authorizes the secured party to take control of any proceeds to which he is entitled under Section 9-306. The proceeds to which this clause of Section 9-502 refers should be restricted to receivables, whether accounts, chattel paper or instruments, and should not be applied to goods, such as trade-ins, which may be repossessed under Section 9-503, see Gilmore op. cit. supra.

The rationale given for the rule of Subsection 9-502(1) is that the assumption of the collection of receivables by the secured party is a less drastic interference with the business of the debtor than withdrawal of inventory or equipment, Official

Comment, Point 1. Actually, however, the right to repossession upon default under Section 9-503 is not subject to more qualifications than the right to the assumption of collections. What is restricted is the use of the collateral upon repossession (Section 9-207). The point is important for the assumption of the collection on instruments. The obligor may refuse payment unless there is presentment of the instrument (Section 3-505). Hence, the secured party must take possession under Section 9-503 in order to exercise effectively his right under Subsection 9-502(1).

2. Subsection (2) imposes certain duties on, and grants certain rights to, a secured party who undertakes to collect from account debtors or obligors on instruments and who by agreement is entitled to charge back uncollected collateral or otherwise to full or limited recourse against the debtor. He must proceed in a commercially reasonable manner and may deduct his reasonable expenses of realization. Moreover, if the agreement is an assignment for the purpose of securing an indebtedness, the secured party must account to the debtor for any surplus, (without possibility of contracting against such duty) although no corresponding duty exists when the underlying transaction is an outright sale of accounts, contract rights or chattel paper, except where the sales agreement expressly provides for such accounting. Conversely, a debtor is liable for any deficiency if the assignment is for the purpose of security unless the security agreement provides otherwise, moreover, the debtor is liable for any deficiency in the case of an outright sale only if he has assumed this type of a warranty.

The Subsection 9-502(2) appears to be confusing because of the double-barrelled meaning of the term "security agreement" in the case of accounts, contract rights and chattel paper, (Subsections 9-105(h) and 1-201(37)) and the notion that there can be a true sale of such items although the agreement imposes liability for deficiency or entitlement to surplus on the seller, see Official Comment, Point 4. Professor Gilmore's criticism of the wording of Subsection 9-502(2), op. cit. Section 44.4 at 1230, seems to overshoot the mark. There is no reason why an outright seller may not subject himself to full or limited recourse in case of non-collectibility.

Section 9-503. Secured party's right to take possession after default.

1. Section 503, first sentence, permitting the secured party to take possession of the collateral upon default, parallels his right to take over the collection of receivables upon such event.

The fact that Subsection 502(1) is prefaced by the clause "When so agreed" while Section 9-503 begins with "Unless otherwise agreed" does not indicate a difference in the scope of these rights in the absence of default. Subject to the condition of good faith, the secured party may reserve to himself either right before default, accord, 2 Gilmore, Section 43.3 at 1192, 1193 (1965).

2. The repossession may be accomplished without judicial process if this can be done "without breach of the peace". This authorization is far from being a carte blanche. The courts have come to be quite solicitous of consumer debtors and consider removal over the protest of debtors to be breach of peace. Revised Laws of Hawaii 1955, Section 201A-13, regulates repossession by the seller or holder of a retail installment contract.

3. The security agreement may impose further reaching cooperation on the debtor, such as the duty to assemble the collateral and to make it available at a place to be designated by the secured party which is reasonably convenient to both parties.

4. A secured party may render equipment unusable without removal, if such action is commercially reasonable. Similarly, the secured party may dispose of collateral on the debtor's premises without removal, again provided that such method is commercially reasonable.

5. Upon taking possession, the right and duties of the parties are governed by Section 9-207. This section applies also after default (Subsection 9-501(2)). See Official Comment, Point 4 to Section 9-207, and Official Comment, Point 3 to Section 9-501.

Section 9-504. Secured party's right to dispose of collateral after default; effect of disposition.

1. This section regulates the realization of the security interest out of the collateral upon default of the debtor. Section 9-504 applies primarily to a realization of the security interest by methods other than the collection of receivables. The latter case is governed by Section 9-502. The secured party may, however, at his option sell the receivables if that type of disposition is commercially reasonable, accord, 2 Gilmore, Section 44.5 at 1232 (1965).

2. Subsection (1) liberalizes the pre-Code law and offers the secured party a wide range of methods of disposition of any or all the collateral, so long as the method chosen is commercially reasonable. Disposition may take the form of a sale, lease or other appropriate transaction either in its ken condition or following any commercially reasonable preparation or processing. Any sale of goods is governed by Article 2. The rationale for this liberalization of available methods of disposition is the experience that restriction to auction sales caused unnecessary economic losses. Unlike Section 2-706 (Seller's resale to cover), Section 9-504 offers choices for realization other than sales.

3. Subsection (1) and Subsection (2), first sentence, establish a hierarchy of canons governing the distribution of proceeds. Proceeds are to be applied as follows:

   (a) First priority is given to the reasonable expenses incurred in taking the steps needed to effectuate the disposition, including reasonable attorneys' fees and legal expenses if there is a lawful agreement to that effect.

   (b) Next ranks the secured indebtedness owed to the secured party who undertakes the disposition.

   (c) Proceeds available 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 Subsection 1-201 (26)) prior to the completion of the distribution. Knowledge alone, whether constructive or actual of the existence of a junior security interest, apparently does not entail a duty of the secured party to make such payments in its satisfaction. It should be noted, however, that holders of security interests in the collateral who either have filed a financing statement or are known to the debtor are normally entitled to reasonable notification of the sale (Subsection 9-504(3)). If requested by the foreclosing secured party, the holder of a subordinate security interest must reasonably furnish reasonable proof of his entitlement. The prescribed distribution to junior secured parties is necessary in view of the fact that the foreclosure of the senior interest discharges all junior interests (Section 9-504(4)).

   (d) Any remaining surplus must be accounted for to the debtor or if the debtor and the owner of the collateral are different persons, to the latter (Subsection 9-501(2) in conjunction with Section 9-112). This duty is mandatory and not subject to waiver or variation (Subsection 9-501(3)).

4. Subsection (2) declares further that the debtor is liable for any deficiency unless otherwise agreed. By way of caution Subsection (2) adds that if the underlying transaction was a sale of accounts, contract rights, or chattel paper, the debtor is entitled to any surplus or is liable for any deficiency if the security agreement so provides. It should be noted that Subsection 9-502(2) sentences 2 and 3 and Subsection 9-504(2) are essentially identical. The reason for this apparent duplication is the fact that Section 9-502 applies only to the collection of collectible types of collateral while Section 9-504 governs the disposition (primarily other than by collection) of all kinds of collateral, whether collectible or not. Although Professor Gilmore seems to think that the provisions relating to an accounting for surplus and liability for deficiency in the case of an outright sale of accounts, contract rights or chattel paper, makes little sense, (2 Gilmore, op. cit. Section 44.4 at 1229, 1230) agreements are at least conceivable whereby an outright seller reserves for himself a share in profits or assumes liability for losses, resulting from a resale or collection of the sold collectibles.

5. Subsection (3) deals with the modalities of the disposition. It places public and private "proceedings" for the disposition of the collateral on equal footing. Such disposition may be made as a unit or in parcels, seriatim or simultaneously. The cardinal principle is that every aspect of the disposition including method, manner, time, place and terms must be commercially reasonable, as illustrated and exemplified in Subsection 9-507(2).

   Except where notification is inapposite, because the collateral possesses perishable character or speedily sliding value, or is superfluous, because the collateral has a regular market price, reasonable advance notice of the intended disposition must be sent out by the secured party. In the case of a public sale, the notification must be "of the time and place" thereof. In the case of a private sale or other intended disposition, the notification must indicate "the time after which" it is to be made. The reason for this seemingly curious distinction rests in the different nature and function of a public and a private sale. Notice of the public sale affords the notified persons an opportunity to bid, while notice of the private sale is primarily designed to enable the notified parties to redeem (Section 9-506) or to file written claims to proceeds cf. 2 Gilmore, op. cit. Section 44.6 at 1241.

   The notification must be sent to the debtor and, except in the case of consumer goods, to any other person who has a security interest in the collateral, if he has either filed a financing statement in this State or his security interest is known to the party making the disposition.

The secured party may buy at any public sale, and (in destruction to sales under Sections 2-706, 7-210 and 7-308) at private sale, if the collateral has a regular market price or is covered by widely distributed standard price quotation.

6. Subsection (4) governs the effects of disposition upon default. Disposition by sale transfers to a purchaser for value all of the debtor's rights in the collateral free and clear of the security interest under which it is made any junior security interest or lien. The Code goes a long way to assure the stability of foreclosure sales, whether judicial or extra-judicial, public or private. A purchaser acquires title free of the security interests mentioned even though the secured party fails to comply with the requirements specified in Article 9, Part 5 or in any other statute governing the judicial proceedings culminating in the sale; provided that

   (a) in the case of public sale, the purchaser had no knowledge of any defects in the sale and was not guilty of collusive practices and

   (b) in any other case, the purchaser acted in good faith as defined in Section 1-201(19).

   For the difference between these requirements see Official Coment, Point 4.

7. Subsection (5) governs the case where a person receives a transfer of the collateral from the secured party or becomes subrogated to the secured party's rights therein pursuant to payment under a guaranty, indorsement, repurchase agreement or similar indemnity contract. Such a transfer is not a disposition upon default which extingushes the security interest of that secured party and all junior security interests and liens, but has merely the effect putting the transferee in the place of the secured party, cf. 2 Gilmore, op. cit. Section 45.4 at 1232 ftn. 1 and Section 44.7 at 1247 ftn. 2.

Section 9-505. Compulsory disposition of collateral; acceptance of the collateral as discharge of obligation.

1. Section 9-505 deals with two separate matters:

(a) compulsory and prompt disposition of consumer goods, where sixty per cent of the cash price, in the case of a purchase money security therein, or sixty per cent of the loan, in the case of another security interest therein, has been paid (Subsection (1)), and

(b) an option to accept the collateral in satisfaction of the indebtedness in all other cases (Subsection (2)).

2. As stated above, Subsection (1) relates only to the disposition of consumer goods collateral where, in the case of purchase money security, sixty per cent of the cash price or, in the case of a non-purchase money security sixty per cent of the loan has been paid off. In such case the secured party who has repossessed the collateral must dispose of it by sale or lease or other commercially reasonable arrangement within ninety days after he takes possession. If the secured party fails to do so, the debtor, at his option, may either recover in conversion or in an amount not less than the credit service charge plus ten per cent of the principal amount of the debt or the time price differential and ten per cent of the cash price. The debtor may not renounce or modify his rights under this subsection, except by a statement signed after default.

   Section 9-504 and 9-505 may not detract from, but may only add to, any protection relating to the mode or effect of a foreclosure of a security interest given by the Retail Installment Sales Act, Revised Laws of Hawaii 1955, chapter 201A. Thus, Sections 201A-23, 201A-24 and 201A-25 grant the consumer a protection which in many respects is broader than that given by Subsection 9-505(1). On the other hand, the Code adds to that protection by entitling a consumer buyer who has paid sixty per cent of the cash price which may be less than fifty per cent of the purchase (time sale price) to disposition, as contrasted with retention, without a written demand to that effect.

3. Subsection (2) authorizes a secured party who has possession of the goods, whether pursuant to the original agreement or by means of repossession, to retain the collateral in satisfaction of the obligation upon compliance with a number of conditions. This retention in lien of disposition is one of the great innovations of the Code. It is available in all cases where the collateral is not consumer goods and in cases of consumer goods where the conditions of Subsection (1) are not fulfilled and where an applicable retail installment sales act or other consumer protection act does not prohibit such method of enforcement.

   Retention is authorized only if the secured party in possession makes the proposal for retention in satisfaction of the obligation after default. He must send notice of the proposal to the debtor and, except in the case of consumer goods, to any other holder of a security interest in the collateral who either has filed a financing statement in this State or whose interest is known to the proponent. If the debtor or other person entitled to receive notice of such proposal within thirty days from the receipt of such notice, or if any other secured party within thirty days after the repossession, objects in writing to that method of liquidation of the indebtedness, the secured party must proceed by disposition pursuant to Section 9-504. Otherwise he is free to retain the collateral in satisfaction of the debt.

Section 9-506. Debtor's right to redeem collateral.

1. Section 9-506 incorporates and expands the principle, developed by the common law of pledges and recognized in the Uniform Conditional Sales Act and Uniform Trust Receipts Act, which entitled the pledgor, conditional buyer or entruster to redeem from the secured party after default so long as no disposition of the collateral by way of foreclosure had been made. While pre-Code law apparently did not extend the redemption privilege to creditors holding a security interest in the collateral, Section 9-506 provides for such enlargement. Section 9-506 addresses itself to the following issues:

   (a) Who is entitled to redeem;

   (b) What must be included in the redemption price;

   (c) What events terminate the right to redeem;

   (d) To what extent and under what conditions may the right to redeem be modified?

   Unfortunately, the Code fails to spell out the effects of a redemption.

2. Section 9-506 grants the right to redeem to the debtor or any other secured party. The debtor is at any rate the owner of the collateral and may include the obligor (Subsection 9-105 (a)). It is puzzling that Section 9-506 accords the right to redeem to "any" secured party, instead of reserving it to junior secured parties. Since a senior party is not affected by the foreclosure (Subsection 9-504(4)) and is not entitled to proceeds (Subsection 9-504(1)(c)) the grant of redemption rights to seniors seems to be due to an oversight. A senior secured party would not have the remotest incentive to redeem.

His security interest survives the foreclosure, and that is all he wants or needs. Whether the reservation of the right to redeem to "secured parties" rather than to all junior lienors must also be charged to "drafting inadvertence" is hard to tell. Plausible arguments could be made that such post-default rights should not be given to any junior encumbrances, contra, 2 Gilmore op. cit. Section 44.2 at 1218.

3. Section 9-506 lists the items which must be included in the redemption price. They correspond to the items which have first and second priority in the order of distribution under Subsection 9-504(1). If the debt is accelerated, the whole debt must be paid off, see Official Comment.

4. The right to redeem is cut-off by a disposition of the collateral or contract for its disposition under Section 9-504, or by the final retention and discharge under Subsection 9-505(2). This diversification of cut-off events was necessary to conform to the scheme of Part 5, see Official Comment.

5. The Code is silent on the effect of a redemption. If the debtor redeems, the debt of the foreclosing secured party is paid off. The debtor cannot claim any subrogation rights if he is both the owner and the obligor. The junior encumbrancers move up. If the owner is not the obligor, the situation is more complex, and the subrogation rights of the redeeming owner depend on the equities between him and the juniors. If a secured party redeems, he is subrogated to the security interest from which he redeems. The transfer to him is not a disposition, see Subsection 9-504(5). The relative priorities among the secured parties and lienors remain as before. Let us assume three security interests, A, B and C, entitled to priority in alphabetical order, each securing a $10,000 debt. A repossesses and C redeems from A. C has first priority for the redemption price, followed by B, with C on the bottom with respect to his original $10,000 debt. Professor Gilmore. op. cit. Section 44.2 at 1218 agrees with this analysis. Unfortunately, he contrasts this example with a case where C forecloses and A redeems. He contends that in such a case, A is ahead of B with respect to $20,000, analogizing the case to a future advance by A. This seems to be erroneous on two scores: Seniors should not be permitted to redeem although the statute does not say so explicitly, see supra Explanatory Note 2. Moreover, there is no priority for optional further advances over intervening secured parties, a point of disagreement between Professor Gilmore and this commentator.

Section 9-507. Secured party's liability for failure to comply with this Part.

1. Section 9-507 deals with two different topics. Subsection (1) deals with the effects of a non-observance of the provisions of Article 9, Part 5 regulating realization of indebtedness out of collateral. Subsection (2) states some tests for the commercial reasonableness of certain dispositions or other realization acts by the secured party.

2. Subsection (1), sentence 1, makes it clear that observance of the rules prescribed in Part 5 may be enforced by court order. If disposition has already occurred, "the debtor or any person entitled to notification or whose security interest has been made known to the secured party prior to the disposition" has a right to recover from the secured party any loss caused by his non-compliance with Part 5 (Subsection 1, sentence 2). The persons entitled to notification are identified in Subsections 9-504(3) and 9-505(2). They include persons who are known by the secured party to have a security interest in the collateral. The special inclusion of persons whose security interest has been made known to the secured party prior to the disposition is baffling, see 2 Gilmore, Section 44.9.2 at 1259 (1965). Perhaps it is supposed to catch the cases of security interests attaching in the interval after the notifications are sent and prior to the actual disposition.

3. Subsection (1), last sentence, grants a special right of recovery as sanction for violations to owners of consumer goods. Debtor of that class, in lieu of actual damages, may recover an amount not less than the credit service charge plus ten per cent of the principal amount of the debt or the time price differential plus ten per cent of the cash price. This recovery is in the nature of a penalty.

4. Subsection (2) states criteria for determining whether a particular method or time of disposition is or is not "commercially reasonable". The first two sentences of that subsection are essentially identical with provisions found in Sections 7-210(1) and 7-308(1) relating to the enforcement of warehousemen's and carriers' liens. According to the second sentence, the secured party is in the clear if he sells the collateral in one of the three ways enumerated therein. Sales which have been approved or confirmed in judicial proceedings or by any bona fide creditors' committee or creditors' representative are conclusively deemed to be commercially reasonable. But this provision carries no negative implications. Nor is it sufficient

to establish lack of commercial reasonableness by showing that a better price could have been obtained by a sale at a different time or in a different method from that selected by the secured party.