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# Commercial Transactions (1975 Annual Survey of Michigan Law)

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# COMMERCIAL TRANSACTIONS

JOHN F. DOLAN†

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## I. REMEDIES

Consequences resulting from the United States Supreme Court's decision in *Fuentes v. Shevin*<sup>1</sup> proceeded apace in Michigan during the Survey period. Both state<sup>2</sup> and federal<sup>3</sup> courts and the Michigan legislature<sup>4</sup> have responded to questions arising in the wake of both that benchmark decision and the same Court's

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1. 407 U.S. 67 (1972).

2. *Hill v. Michigan Nat'l Bank*, 58 Mich. App. 430, 228 N.W.2d 407 (1975); *Detroit & N. Sav. & Loan Ass'n v. Woodworth*, 54 Mich. App. 517, 221 N.W.2d 190 (1974).

3. *Douglas Research & Chem., Inc. v. Solomon*, 388 F. Supp. 433 (E.D. Mich. 1975); *Watson v. Branch County Bank*, 380 F. Supp. 945 (W.D. Mich. 1974).

4. See MICH. COMP. LAWS ANN. §§ 600.4001, .4011 (Supp. 1975-76); cf. MICH. GEN. CT. R. 735, 738.

apparent retrenchment from *Fuentes*' far reaching implications, in *Mitchell v. W. T. Grant Co.*<sup>5</sup>

*Fuentes* held that Florida and Pennsylvania pre-judgment replevin statutes violated the fourteenth amendment because they amounted to state participation in the deprivation of property without benefit of notice and hearing, the indispensable prerequisites of due process. Thus, except in limited situations such as those where the debtor cannot be reached by judicial process, *Fuentes* outlaws ex parte prejudgment replevin. *Fuentes* was presaged by *Sniadach v. Family Finance Corp.*,<sup>6</sup> which held the Wisconsin prejudgment procedure for garnishing wages unconstitutional for the same reasons. Both cases arose out of consumer situations and may have reflected the growing concern that the nation's laws were ignoring what some view as a judicial imbalance against consumers.<sup>7</sup>

In *Mitchell v. W. T. Grant Co.*,<sup>8</sup> a case involving Louisiana's sequestration procedure, the Supreme Court ostensibly distinguished *Fuentes* on several grounds which merit attention. The Court noted that the property sequestered in *Mitchell* was subject to a vendor's lien (which corresponds to the Michigan Uniform Commercial Code purchase money security interest),<sup>9</sup> and concluded, therefore, that with respect to the debtor,

His interest in the property, until the purchase price was paid in full, was no greater than the surplus remaining, if any, after foreclosure and sale of the property in the event of his default and satisfaction of outstanding claims.<sup>10</sup>

Thus the Court differentiated between the property subject to the lien of the creditor and goods which are "exclusively the property of the defendant debtor"<sup>11</sup> as the Court in *Fuentes* found that

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5. 416 U.S. 600 (1974).

6. 395 U.S. 337 (1969).

7. See, e.g., Clark & Landers, *Sniadach, Fuentes and Beyond: The Creditor Meets the Constitution*, 59 VA. L. REV. 355 (1973); Revelos, *Commercial Transactions*, 1974 Ann. Survey of Mich. Law, 21 WAYNE L. REV. 285 (1975); Comment, *Self Help Repossession: Fuentes and Judicial Process*, 46 TEMP. L.Q. 540 (1973).

8. 416 U.S. 600 (1974).

9. MICH. COMP. LAWS ANN. § 440.9107 (1967).

10. 416 U.S. at 604.

11. *Id.*

property to be. In addition, *Mitchell* distinguished the Louisiana statute's procedural features<sup>12</sup> which it held sufficient to meet those requirements of due process which the Florida and Pennsylvania statutes failed to satisfy.

In 1973, in response to *Fuentes*, the Michigan supreme court amended court rule 757,<sup>13</sup> relating to the claim and delivery statute,<sup>14</sup> to provide for notice and a show cause hearing, thereby satisfying the due process requirements of *Fuentes*.

### A. Garnishment

It was in this setting that the Federal District Court for the Eastern District of Michigan, in *Douglas Research & Chemical, Inc. v. Solomon*,<sup>15</sup> held Michigan's prejudgment garnishment statute<sup>16</sup> unconstitutional. The statute, since amended,<sup>17</sup> authorized the issuance of the garnishment writ on the affidavit, supported by facts, of a creditor who had filed suit, that he was justly apprehensive of losing his claim if the writ did not issue. The defendant in *Solomon* urged that *Mitchell* had overturned *Fuentes* and that the Michigan procedure satisfied the requirements of *Mitchell*. The court recognized *Mitchell* as a retreat from *Fuentes* but felt that *Fuentes*' vitality was sufficient to merit a comparison of the factual distinctions on which *Mitchell* ostensibly turned. The court pointed out the distinction,<sup>18</sup> discussed earlier, that the creditor had a property interest, existing quite apart from the sequestration statute, in the goods subject to sequestration in *Mitchell*. In *Fuentes* on the other hand, the creditor had no interest in the property which was subject to replevin apart from those rights afforded him by the offensive statute. Thus the bank deposit, the subject of garnishment in *Solomon*, was closer in character to the goods, the subject of

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12. Namely, that the affidavit of the creditor requires specific facts rather than conclusions and that a judge, not a clerk, issued the writ. *Id.* 616. *But see id.* 631-33 (Stewart, J., dissenting).

13. MICH. GEN. CT. R. 757.

14. MICH. COMP. LAWS ANN. § 600.2920 (1968).

15. 388 F. Supp. 433 (E.D. Mich. 1975).

16. MICH. COMP. LAWS ANN. § 600.4011 (1968).

17. *Id.* § 600.4011 (Supp. 1975-76). See note 21 & accompanying text *infra*.

18. For an application of the distinction to self-help, see text at notes 38-80 *infra*.

replevin in *Fuentes*, than to the household goods, the subject of sequestration in *Mitchell*. *Solomon* pointed out, furthermore, that the Louisiana statute in *Mitchell* required the existence of a vendor's lien before sequestration could apply, *i.e.*, that both the creditor and the debtor have "current real interests in the sequestered property."<sup>19</sup>

*Solomon* distinguished *Mitchell* on two further grounds: first, that the hearing for dissolution contemplated by the Michigan statute, unlike the Louisiana statute, did not reach the merits of the creditor's principal claim but only the allegations of his apprehension that he would lose his claim if the writ did not issue; and second, that the Michigan statute, again unlike the Louisiana sequestration act, failed to require the creditor to post a bond.

While Justice White's use of *Mitchell*'s distinctive facts to justify a departure from *Fuentes* prompted criticism from some,<sup>20</sup> Judge Joiner's use of facts in *Solomon* to justify following *Fuentes* should not. A fair reading of *Mitchell* leaves intact that portion of *Fuentes* which prohibited a creditor, acting *ex parte*, from depriving a debtor of property in which the creditor had no interest when there had been no notice and hearing, the creditor had posted no bond for the protection of the pecuniary loss suffered by the debtor from wrongful deprivation, and there was no procedure for prompt resolution of the underlying claim.

The *Mitchell* holding aside, arguments that *Fuentes* should retain such force are compelling: the decision serves those policies outlined in *Sniadach* and *Fuentes* without challenging assumptions of traditional methods of financing, as the dissenters in *Fuentes* feared that case had done. A creditor who relies on property of the debtor to secure his debt can comply with the provisions of state law to obtain a proper lien, avoiding the necessity of the notice and hearing commanded by *Solomon* and *Mitchell*. It is not too much, moreover, to ask the creditor without such a lien to stand ready to prove his case promptly and to post a bond sufficient to indemnify the debtor in the event that he sustains

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19. *Douglas Research & Chem., Inc. v. Solomon*, 388 F. Supp. 433, 436 (E.D. Mich. 1975).

20. *E.g.*, Revelos, *supra* note 7, at 288.

losses through the wrongful, temporary deprivation of his property. The promptness requirement should be as much in the best interests of the good faith creditor as of the debtor; the fraudulent creditor, using the process in bad faith to harass his commercial or personal adversary, will find these requirements stultifying. The present posture of the Michigan statute makes these requirements unnecessary, however, since its application is limited to instances where the debtor is beyond the jurisdiction of the court or can not be served with process.<sup>21</sup> That statute, which became effective on April 1, 1975, is perhaps more restrictive than the *Mitchell* retreat from *Fuentes* requires.

The final nail in the coffin of ex parte prejudgment garnishment was the Michigan supreme court's decision in *Cochran v. Westwood Wholesale Grocery Co.*,<sup>22</sup> which accepted the *Solomon* reasoning and concluded that *North Georgia Finishing, Inc. v. Di-Chem., Inc.*,<sup>23</sup> which held Georgia's prejudgment garnishment statute unlawful, was dispositive since the Georgia and Michigan procedures were similar. Prejudgment garnishment in Michigan is now limited to those situations when the debtor is outside the jurisdiction of the court or cannot be served, although the legislature could, by a fair reading of *Mitchell*, be less restrictive. Thus, despite fears expressed by some that *Mitchell* had overruled *Fuentes*,<sup>24</sup> *Solomon* and *Cochrane* preserve the primary thrust of the *Fuentes* decision in Michigan.

### B. Claim and Delivery

*Detroit & Northern Savings and Loan Association v. Woodworth*,<sup>25</sup> in which the Michigan Court of Appeals extended the thrust of *Fuentes*, arose under Michigan's post-*Fuentes* claim

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21. MICH. COMP. LAWS ANN. § 600.4011(3) (Supp. 1975-76). Corresponding changes were made in the prejudgment attachment procedure. See *id.* § 600.4001; MICH. GEN. CT. R. 735.

22. 394 Mich. 164, 229 N.W.2d 309 (1975).

23. 419 U.S. 601 (1975).

24. In his dissent, Justice Stewart argued that *Mitchell* overruled *Fuentes*. *Mitchell v. W.T. Grant Co.*, 416 U.S. 600, 634 (1974) (dissenting opinion). Justice Powell, on the other hand, contended that *Mitchell* overruled *Fuentes* only to the extent that it held the temporary deprivation of property without notice and hearing a violation of due process. *Id.* 623-24 (concurring opinion).

25. 54 Mich. App. 517, 221 N.W.2d 190 (1974).

and delivery law,<sup>26</sup> a statutory procedure fashioned to overcome the due process deficiencies that *Fuentes* noted in the Pennsylvania and Florida replevin laws. The revised Michigan procedure provides that, on the filing of a complaint, the court shall issue an order directed to the defendant and requiring him to show cause why the property should not be taken from him and given to the plaintiff.<sup>27</sup>

The issue in *Woodworth* centered on the hearing element of the due process requirement. *Woodworth*, a father of six who appeared *pro se* at the hearing, acknowledged that payments on his mobile home were in arrears, denied that he was letting the home deteriorate, and argued that it was defective when he acquired it. The trial court, refusing to hear evidence on the question of the defect, decided in favor of the plaintiff to which the installment paper and security interest had been assigned by the mobile home dealer. The court of appeals reversed, holding that while *Mitchell* had overruled *Fuentes* (except possibly in the brutal need situation,<sup>28</sup> an exception upon which *Woodworth* did not rely), the debtor's attempts to introduce evidence of defects in the home were proper under section 2-717 of the Uniform Commercial Code.<sup>29</sup> That section provides that a buyer may deduct from the price damages resulting from any breach of the contract, including breach of warranty. The court held that "[t]he trial court mistakenly foreclosed inquiry which the administrative order permits."<sup>30</sup>

The plaintiff argued that the hearing under court rule 757<sup>31</sup> should be confined to the issues of (1) whether there was a contract, (2) whether defendant was in default, and (3) whether there was impairment of the collateral. The court answered that the rule also requires the trial court to determine that the debtor has no meritorious defense to the action.<sup>32</sup>

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26. MICH. COMP. LAWS ANN. § 600.2920 (1968); MICH. GEN. CT. R. 757.

27. MICH. GEN. CT. R. 757.

28. In his concurring opinion, Justice Powell argued that temporary deprivation of property does not necessarily place the debtor in a brutal need situation and implied that if such temporary deprivation did give rise to a brutal need, he would reach a different result. 416 U.S. at 625 (concurring opinion).

29. MICH. COMP. LAWS ANN. § 440.2717 (1967).

30. 54 Mich. App. at 523, 221 N.W.2d at 193.

31. MICH. GEN. CT. R. 757.

32. *Id.* 757.7.

*Woodworth* then, in keeping with the philosophy of *Fuentes*, but relying instead on the Michigan procedure which *Fuentes* spawned, opened the claim and delivery show cause hearing to questions of breach of warranty or other breaches under section 2-717 which can give the buyer the right to refuse payment to the extent he has been damaged. The decision expanded the scope of litigation at the hearing considerably beyond *Mitchell* which specifically rejected, as the *Woodworth* court noted, the notion that the creditor cannot have possession until he establishes through the judicial process that all issues are in his favor. *Woodworth* did not require such a complete determination, but did require an inquiry to determine whether possession should be granted the creditor pending the full trial of those issues, a distinction not without significance to the creditor and the debtor. It is a far simpler task to litigate the question of existence of the contract and the status of payments than questions of breach of warranty and damages. On the other side of the coin, it is far more difficult to defend the simpler allegations than it is to defend against claims of breach of warranty or other breaches which could well involve the necessity of calling expert witnesses and which inevitably relate to factual matters outside the realm of the knowledge and experience of the financing institution assigned or holding the paper in question. These distinctions, which invite introduction of such issues into the proceeding, will not be lost on the debtors' attorneys.

In any event, *Woodworth* set parameters in claim and delivery more protective for the debtor than *Mitchell* seemed to compel, a second instance (the prejudgment garnishment statute being the first)<sup>33</sup> of Michigan procedure which is closer to *Fuentes* than to *Mitchell*.

The *Woodworth* facts raised an additional question that the opinion did not treat in detail. A retail installment sales contract can be a negotiable instrument under sections 3-104 and 3-112 of the Uniform Commercial Code.<sup>34</sup> If the contract in question meets the requirements of negotiability as set forth in those sections and if the financing agency is in fact a holder in due course<sup>35</sup> rather

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33. See text at notes 15-24 *supra*.

34. MICH. COMP. LAWS ANN. §§ 440.3104, .3112 (1967).

35. See *id.* § 440.3302.

than an assignee, the plaintiff creditor in a claim and delivery action would be able to forestall the vexation, expense and delay of litigating questions of the seller's breach of warranty and the buyer's damages by asserting its rights under section 3-305 of the Uniform Commercial Code,<sup>36</sup> which provides that a holder in due course takes the instrument free from the defense of breach of warranty. If the plaintiff in *Woodworth* was a holder in due course, he should have been able, therefore, to overcome the arguments raised by the debtor and to sustain the decision of the trial court refusing to introduce evidence concerning the breach of warranty. Significantly, however, Michigan legislation<sup>37</sup> which became effective after the date of the *Woodworth* transaction prevents a holder in due course from making such an argument if the sale occurred after January 1, 1973. *Woodworth* treated this question with only a passing reference to the fact that the defendant attempted to prove that the plaintiff was not a holder in due course.

### C. *Self-Help*

Sections 9-503<sup>38</sup> and 9-504<sup>39</sup> of the Uniform Commercial Code authorize a procedure of self-help for creditors who hold a valid security interest under other provisions of the Code. Specifically, section 9-503 provides that unless the parties otherwise agree, a secured creditor may take possession of the collateral without judicial process, so long as the retaking can be achieved without breach of the peace. Cases construing the section hold, furthermore, and the section itself implies, that notice need not precede such retaking.<sup>40</sup> Section 9-504 complements section 9-503 by giving the secured party the right to sell or otherwise dispose of the collateral after retaking, but it does require reasonable notification of the sale unless the goods are perishable or threaten to decline speedily in value. In short, the two sections outline a summary procedure, without benefit of judicial process, for de-

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36. *Id.* § 440.3305.

37. *Id.* § 445.865 (Supp. 1975-76).

38. *Id.* § 440.9503 (1967).

39. *Id.* § 440.9504.

40. See cases cited notes 52-73 *infra*.

prising the debtor first of possession and ultimately title to his property.

*Fuentes*, holding that a state statute may not deprive a debtor of property without notice and hearing, has strong implications for the self-help procedures outlined by the Code. The majority opinion in *Fuentes* referred to self-help, noting that creditors may proceed without the use of statutory power through common law distraint.<sup>41</sup> Justice White's dissent, however, expressed fear that the majority opinion called into question aspects of state laws "governing secured transactions."<sup>42</sup> *Mitchell*, of course, distinguished<sup>43</sup> between property which is "exclusively the property of the debtor"<sup>44</sup> and property in which the debtor's interest is "no greater than the surplus remaining, if any, after foreclosure or sale of the property in the event of his default,"<sup>45</sup> *i.e.*, property subject to a vendor's lien or a security interest.

The implications of *Fuentes* in the self-help area, however, were sufficiently strong to yield a plethora of cases on self-help both before and after *Mitchell*; two of these arose in Michigan during the last year. *Watson v. Branch County Bank*,<sup>46</sup> decided by the Federal District Court for the Western District of Michigan, was a class action against several banks. The plaintiff class consisted of natural persons whose automobiles were financed by the defendants under security agreements incorporating the self-help provision of the Code, and who were in arrears on their payments.<sup>47</sup> Clearly, then, in each case the debtor's property interest was not that exclusively of the debtor, as in *Fuentes*, but was no greater than the surplus remaining after sale in the event of the default, as in *Mitchell*. That distinction notwithstanding, *Watson* held that, because the state is extensively involved in regulating both the financing of automobile sales and the repossession scheme itself through the issuance of repossession

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41. 407 U.S. at 79 n.12 (1972).

42. *Id.* 97 (concurring opinion).

43. See notes 10-11 & accompanying text *supra*.

44. *Mitchell v. W.T. Grant Co.*, 416 U.S. 600, 604 (1974).

45. *Id.*

46. 380 F. Supp. 945 (W.D. Mich. 1974).

47. Two of the plaintiffs were not, in fact, in arrears; they were held not to be part of the class, but continued as individual plaintiffs.

titles, the retaking involved sufficient state action to fall within the requirements of the fourteenth amendment; and, since sections 9-503 and 9-504 permit such repossessions without notice and hearing, those sections are unconstitutional insofar as natural persons are concerned.

The *Watson* opinion is lengthy<sup>48</sup> and written in scholarly fashion, with frequent reference to early common law authorities and organic laws;<sup>49</sup> its argument includes what the court saw as current indications of societal dissatisfaction with repossession practices.<sup>50</sup> A fair reading of the opinion clearly indicates it to be an instance of a concerned jurist's applying constitutional principles to meet what he saw to be a felt need.

Redeeming though such features may be, the opinion remains faulty; first, because it does not fairly take into account an important segment of the *Mitchell* opinion, and second, because it ignores a substantial body of law which conflicts with the *Watson* result.

The *Watson* opinion, distinguishing *Mitchell* on the grounds that *Mitchell* required judicial supervision of the repossession process from beginning to end, failed to accord weight to the property interest distinction which *Mitchell* took pains to establish.<sup>51</sup> The Supreme Court of the United States established that distinction; it goes without saying that a district court ought not disregard it, the criticism by authorities<sup>52</sup> and its own strong feelings to the contrary notwithstanding.

More questionable is the *Watson* court's failure to answer, indeed to cite, the substantial body of precedent (admittedly not binding on a district court in Michigan) which had reached a contrary result.

Following *Fuentes* there was a spate of cases in which debtors claimed that *Fuentes* effectively outlawed self-help. Twelve federal district court cases decided prior to *Watson* rejected those

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48. The opinion fills 26 pages in the Federal Supplement Reporter.

49. The opinion cites, among other authorities, Coke, Blackstone, Thomas Aquinas, the Magna Charta, and the Declaration of Independence.

50. The opinion cites three articles from a Detroit newspaper detailing violence arising out of self-help repossessions and subsequent court action. 384 F. Supp. at 967 n.17.

51. See notes 10-11 & accompanying text *supra*.

52. *E.g.*, Revelos, *supra* note 7, at 293-97.

arguments,<sup>53</sup> as did eight cases by federal courts of appeal.<sup>54</sup> In addition, ten state court cases, including the highest court in three states, reached a similar result.<sup>55</sup> One opinion decided after *Watson* expressed the view that *Mitchell* was controlling,<sup>57</sup> but all of the 30 referred to above were decided prior to *Mitchell*,<sup>58</sup> and without the benefit of its property interest distinction. Since *Watson*, this parade of cases has slackened,<sup>59</sup> but, one may presume, that slackening arises in part because the issue now appears to be so well settled.<sup>60</sup> Those post-*Watson* cases, furthermore, continued the trend of upholding the self-help provision.<sup>61</sup>

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53. *McDuffy v. Worthmore Furniture, Inc.*, 380 F. Supp. 257 (E.D. Va. 1974); *Johnson v. Associate Fin., Inc.*, 365 F. Supp. 1380 (S.D. Ill. 1973); *Baker v. Keeble*, 362 F. Supp. 355 (M.D. Ala. 1973); *Nichols v. Tower Grove Bank*, 362 F. Supp. 374 (E.D. Mo. 1973), *aff'd*, 497 F.2d 404 (8th Cir. 1974); *Mayhugh v. Bill Allen Chevrolet*, 371 F. Supp. 1 (W.D. Mo. 1973), *aff'd sub nom.*, *Nowlin v. Professional Auto Sales, Inc.*, 496 F.2d 16 (8th Cir. 1974); *Kinch v. Chrysler Credit Corp.*, 367 F. Supp. 436 (E.D. Tenn. 1973); *Sheldon v. General Elec. Credit Corp.*, 359 F. Supp. 1079 (M.D. Ga. 1973); *Colvin v. Avco Financial Services, Inc.*, 12 UCC REP. SERV. 25 (D. Utah 1973); *Pease v. Havelock Nat'l Bank*, 351 F. Supp. 118 (D. Neb. 1972); *Kirksey v. Theilig*, 11 UCC REP. SERV. 879 (D. Colo. 1972); *Greene v. First Nat'l Exch. Bank*, 348 F. Supp. 672 (W.D. Va. 1972); *Oller v. Bank of America*, 342 F. Supp. 21 (N.D. Cal. 1972).

54. *Gibbs v. Teitelman*, 502 F.2d 1107 (3rd Cir. 1974); *Brantley v. Union Bank & Trust Co.*, 498 F.2d 365 (5th Cir. 1974); *Nichols v. Tower Grove Bank*, 497 F.2d 404 (8th Cir. 1974); *Bowman v. Chrysler Credit Corp.*, 496 F.2d 1322 (5th Cir. 1974); *Chirley v. State Nat'l Bank*, 493 F.2d 739 (2nd Cir. 1974); *Adams v. Southern Cal. First Nat'l Bank*, 492 F.2d 324 (9th Cir. 1973); *Bichel Optical Labs., Inc. v. Marquette Nat'l Bank*, 487 F.2d 906 (8th Cir. 1973).

55. *Kipp v. Cozens*, 40 Cal. App. 3d 709, 115 Cal. Rptr. 423 (1974); *A&S Excavating, Inc. v. International Harvester Credit Corp.*, 31 Conn. Supp. 152, 325 A.2d 535 (Super Ct. 1974); *Giglio v. Bank of Delaware*, 307 A.2d 816 (Del. Ch. 1973); *Northside Motors, Inc. v. Brinkley*, 282 So. 2d 617 (Fla. 1973); *Plante v. Industrial Nat'l Bank*, 12 UCC REP. SERV. 739 (N.J. Super. 1973); *Messenger v. Sandy Motors, Inc.*, 121 N.J. Super. 402, 295 A.2d 402 (1972); *Yankwitt v. Franklin Nat'l Bank*, 12 UCC REP. SERV. 1254 (Dist. Ct. N.Y. 1973); *Brown v. United States Nat'l Bank*, 265 Ore. 234, 509 P.2d 442 (1973); *Sandoval v. American Nat'l Bank*, 517 P.2d 188 (Wyo. 1973).

56. *Northside Motors, Inc. v. Brinkley*, 282 So. 2d 617 (Fla. 1973); *Brown v. United States Nat'l Bank*, 265 Ore. 234, 509 P.2d 442 (1973); *Sandoval v. American Nat'l Bank*, 517 P.2d 188 (Wyo. 1973).

57. *Cook v. Lilly*, 208 S.E.2d 784 (W. Va. 1974).

58. See notes 53-55 *supra*.

59. There have been six. See note 61 *infra*.

60. Three courts have disposed of the cases with short, per curiam decisions: *Brantley v. Union Bank & Trust Co.*, 498 F.2d 365 (5th Cir. 1974); *Bowman v. Chrysler Credit Corp.*, 496 F.2d 1322 (5th Cir. 1974); *Nichols v. Tower Grove Bank*, 497 F.2d 404 (8th Cir. 1974).

61. *Calderon v. United Furniture Co.*, 505 F.2d 950 (5th Cir. 1974); *Teitelbaum v.*

In fact, of the 42 cases which have ever considered the question, only five other than *Watson* found section 2-503 a problem. Four of those cases were federal district court cases<sup>62</sup> of which two were reversed on appeal.<sup>63</sup> Of the remaining two, one involved a mobile home<sup>64</sup> (and arguably falls within the brutal need exception to *Mitchell*);<sup>65</sup> the other, *Boland v. Essex County Bank & Trust Co.*,<sup>66</sup> incorrectly assumed that the authorities were about evenly divided<sup>67</sup> and granted that "the issue is close."<sup>68</sup> The *Boland* court, moreover, simply denied a motion to dismiss without any pronouncement that the Code sections were unconstitutional. The fifth case,<sup>69</sup> which related to the question of deficiency judgments, was a one page opinion that recited without discussion or authority that *Fuentes* had ruled section 9-503 unconstitutional.

In short, had the *Watson* court considered the authorities, it might have concluded that there was a paucity of well reasoned authority for holding self-help provisions unconstitutional and an abundance of authority, including cases decided by appellate and supreme courts, to the contrary. It may be that some of the cases decided during 1974 had not yet appeared in the ad-

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Scranton Nat'l Bank, 384 F. Supp. 1139 (M.D. Pa. 1974); *Rainey v. Ford Motor Credit Co.*, 16 UCC REP. SERV. 1436 (Ala. 1975); *John Deere Co. v. Catalano*, 525 P.2d 1153 (Colo. 1974); *King v. South Jersey Nat'l Bank*, 66 N.J. 161, 330 A.2d 1 (1974); *Cook v. Lilly*, 208 S.E.2d 784 (W. Va. 1974).

62. *Boland v. Essex County Bank & Trust Co.*, 361 F. Supp. 917 (D. Mass. 1973); *Gibbs v. Titelman*, 369 F. Supp. 38 (E.D. Pa. 1973), *rev'd*, 502 F.2d 1107 (3d Cir. 1974); *Adams v. Egley*, 338 F. Supp. 614 (S.D. Cal. 1972), *rev'd sub nom. Adams v. Southern Cal. First Nat'l Bank*, 492 F.2d 324 (9th Cir. 1973); *Michael v. Rex-Noreco, Inc.*, 12 UCC REP. SERV. 543 (D. Vt. 1972).

63. *Gibbs v. Titelman*, 369 F. Supp. 38 (E.D. Pa. 1973), *rev'd*, 502 F.2d 1107 (3d Cir. 1974); *Adams v. Egley*, 338 F. Supp. 614 (S.D. Cal. 1972), *rev'd sub nom. Adams v. Southern Cal. First Nat'l Bank*, 492 F.2d 324 (9th Cir. 1973).

64. *Michael v. Rex-Noreco, Inc.*, 12 UCC REP. SERV. 543 (D. Vt. 1972). The overwhelming majority of the other cases which consider these questions involved the repossession of an automobile.

65. See note 28 *supra*.

66. 361 F. Supp. 917 (D. Mass. 1973).

67. The court relied in part on *Adams* and *Titelman*, both of which were subsequently overruled. See note 63 *supra*.

68. 361 F. Supp. at 919.

69. *Chrysler Credit Corp. v. Dinitz*, 11 UCC REP. SERV. 627 (Kings County Ct. N.Y. 1972).

vance sheets and were not available for the *Watson* court's reference; many of the cases, however, were decided prior to 1974. The length and scholarship of the *Watson* opinion do not make up for its failure to consider such a substantial body of cases which renders it open to the criticism that it is more in the nature of an advocate's brief than a jurist's opinion.

The scope of the *Watson* result appears limited. The plaintiff class was large (all natural persons who finance automobiles), but the order applied only to the defendant banks.<sup>70</sup> *Watson's* value as precedent is also limited by two subsequent decisions by the Sixth Circuit and a decision by the Michigan Court of Appeals all of which reached contrary results.

In *Turner v. Impala Motors*,<sup>71</sup> decided a little over one month after *Watson*, the Sixth Circuit, in a case arising under Tennessee law, rejected the notion that the Code's self-help provisions violate due process. In *Gary v. Darnell*,<sup>72</sup> the court reached the same result with respect to the Kentucky Code.

In *Hill v. Michigan National Bank*,<sup>73</sup> furthermore, the Michigan Court of Appeals followed *Turner* in affirming the trial court's summary judgment for the creditor. Significantly, the court relied, in part, on the fact that the security agreement contained a clause granting the creditor the right to repossess without notice. Such a provision, in the *Hill* court's view, diminished the creditor's reliance on the statute and, correspondingly, diminished state involvement.

In addition, because the debtor had failed to preserve the issue properly, the *Hill* court refused to consider his argument that the contract's repossession clause was unconscionable. Under section 2-302 of the Uniform Commercial Code,<sup>74</sup> the court may find as a matter of law that a clause is unconscionable and may refuse to enforce either the clause or the entire contract or limit its application to avoid an unconscionable result. It can be argued that the incorporation into a contract of rights which correspond to those

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70. *Watson* had both a plaintiff class and a defendant class, but the order expressly applied only to the three banks which were named defendants.

71. 503 F.2d 607 (6th Cir. 1974).

72. 505 F.2d 741 (6th Cir. 1974).

73. 58 Mich. App. 430, 228 N.W.2d 407 (1975).

74. MICH. COMP. LAWS ANN. § 440.2302 (1967).

granted by the Code itself, in sections 9-503 and 9-504, cannot be unconscionable. Yet the language of subsection (2) of 2-302<sup>75</sup> makes it clear that whether a clause is unconscionable depends upon the commercial setting, purpose and effect of the transaction.

In a word, the *Hill* case leaves two questions open: first, the narrow question whether a creditor who retakes in reliance on the Code without a corresponding clause in the contract has sufficiently invoked state assistance to render the retaking a violation of due process; and, second, the broader question whether such a clause is unconscionable, and therefore unenforceable, or limited in its enforcement, say, to situations where the creditor at least gives notice.<sup>76</sup> The narrow issue is one that attorneys for creditors will have little difficulty resolving. They will simply incorporate the language of the Code into a provision of the contract itself. Resolution of the broader issue will have to abide further litigation.<sup>77</sup>

One additional case decided by the United States Supreme Court bears on the state action question and merits brief mention. In *Jackson v. Metropolitan Edison Co.*,<sup>78</sup> the Court consid-

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When it is claimed or appears to the court that the contract or any clause there of may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

MICH. COMP. LAWS ANN. § 440.2302(2) (1967).

76. There is a dearth of discussion in the self-help cases on the relative interests of the parties. What, for example, is the danger or cost of giving notice? Of a hearing? How many debtors would skip? How many would conceal or transfer the property? Such questions do not lend themselves to easy litigation, but their answers may be indispensable to a proper resolution of the unconscionability issue, and evidence relating to them would clearly be admissible under section 2-302(2). In *Gibbs v. Titelman*, 369 F. Supp. 38 (E.D. Pa. 1973), *rev'd*, 502 F.2d 1107 (3d Cir. 1974), one of the few cases in which the parties marshaled evidence of the commercial setting, one expert testified that the cost to the creditor of notice and hearing would be from 475 to 512 dollars in each instance, and that from 75 to 95 percent of the motor vehicle retail installment contracts charge the maximum interest provided by law. In addition, there was testimony that between 70 and 75 percent of all defaults arise because of the inability to pay, 20 to 25 percent because of dissatisfaction with the seller, and 2 per cent because of billing errors.

77. Surprisingly, the section 2-302 unconscionability issue has not arisen in the self-help cases. See authorities cited notes 53-64 *supra*.

78. 419 U.S. 345 (1974).

ered whether there was sufficient state action in state approval of a public utility tariff to bring due process to bear. The tariff contained a provision permitting the utility to terminate service to any customer upon reasonable notice of nonpayment of bills with no opportunity for hearing. The Court refused to extend due process protection to the customer and, finding that the "initiative comes from [the utility] and not from the State,"<sup>79</sup> held that the utility's exercise of a choice "allowed by state law"<sup>80</sup> did not rise to the level of state action. The *Jackson* reasoning could apply to section 9-503 repossession cases which involve the exercise of a choice allowed by state law at the initiative of a private party.

In the area of self-help, then, the cases indicate that sections 9-503 and 9-504 are not unconstitutional if the security agreement contains a clause providing for such self-help, except, perhaps, in the brutal need situation. Where such contractual provisions are absent, there is some room for litigation, though not much. In the consumer setting where the debtor has, for example, paid a substantial portion of the time pay price, the question of unconscionability may still be open. The contrary rule of the *Watson* case appears to be an anomaly.

#### D. Disposition of Collateral

The Michigan Uniform Commercial Code's provision for self-help not only permit the creditor to retake the security<sup>81</sup> and sell it,<sup>82</sup> but also permit him to sue the debtor for any deficiency remaining after the sale.<sup>83</sup> Section 9-505(2)<sup>84</sup> limits the right to sue

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79. 419 U.S. at 357.

80. *Id.*

81. MICH. COMP. LAWS ANN. § 440.9503 (1967).

82. *Id.* § 440.9504.

83. *Id.* § 440.9505(2), which provides:

In any other case involving consumer goods or any other collateral a secured party in possession may, after default, propose to retain the collateral in satisfaction of the obligation. Written notice of such proposal shall be sent to the debtor and except in the case of consumer goods to any other secured party who has a security interest in the collateral and who has duly filed a financing statement indexed in the name of the debtor in this state or is known by the secured party in possession to have a security interest in it. If the debtor or other person entitled to receive

if the creditor does not sell under certain circumstances; in *Jones v. Morgan*,<sup>85</sup> the debtor, a co-maker, argued that section 9-505 should be invoked. Subsection 9-505(2) expressly provides that, upon default, a secured party in possession of the collateral may propose, by written notice to the debtor, to retain the collateral in satisfaction of its claim. The subsection gives the debtor thirty days within which to object to the proposal. In *Jones*, the creditor claimed that he was unable to dispose of the collateral, an automobile, because it was damaged. The debtor argued that section 9-505 gave rights to the debtor as well as the creditor and that the creditor, by retaining the collateral for 20 months, had thereby retained the collateral in satisfaction of the debt. The court of appeals disagreed, seeing section 9-505 as an attempt by the Code to add to the creditor's arsenal of remedies and not as a trap for an unwary creditor:

[W]e think the better interpretation of § 9-505(2) is that it is a provision drafted for the benefit of the secured party by allowing him the option to retain collateral in satisfaction of the debt in certain specified situations and where he manifests that intent.<sup>86</sup>

Debtors' attorneys may ask where the *Jones* decision leaves them in the event the creditor fails to obtain a fair price for the collateral. The *Jones* opinion's answer, section 9-507,<sup>87</sup> which gives the debtor a claim for damages in such event,<sup>88</sup> appears to be a fair reading of section 9-505(2). Section 9-507 does not deprive the debtor of recourse against the creditor who fails to dispose of the collateral promptly, because if such failure causes a diminution in the proceeds of the sale, the creditor has not acted

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notification objects in writing within thirty days from the receipt of the notification or if any other secured party objects in writing thirty days after the secured party obtains possession the secured party must dispose of the collateral under Section 9-504. In the absence of such written objection the secured party may retain the collateral in satisfaction of the debtor's obligation.

84. *Id.*

85. 58 Mich. App. 455, 228 N.W.2d 419 (1975).

86. *Id.* at 461, 228 N.W.2d at 423.

87. MICH. COMP. LAWS ANN. § 440.9507 (1967).

88. See *Wilson Leasing Co. v. Seaway Pharmacal Corp.*, 53 Mich. App. 359, 220 N.W.2d 83 (1974).

in the commercially reasonable manner commanded by section 9-507.<sup>89</sup> The debtor's claim which arises by virtue of such noncompliance, moreover, gives him a right of setoff in the creditor's action to recover the deficiency.<sup>90</sup>

### *E. Collection Practices Act*

Many of the cases discussed above arose out of attempts by litigants to redress what they see as unfair strength of the creditor, who, in the customary situation, enjoys more ample resources than his debtor and can rely on a one-sided adhesion contract.<sup>91</sup> In his dissenting opinion in *Sniadach*,<sup>92</sup> Justice Black decried judicial attempts to redress that imbalance, which attempts he saw as a return to the Supreme Court's due process philosophy of the early years of the Roosevelt presidency. Such an approach, Justice Black argued, permits the Court to substitute its view of what is good law for what the legislature thinks is good law.<sup>93</sup> *Mitchell* may be an indication that the Supreme Court is more inclined to accept the Black approach, leaving to legislatures the challenge of redressing any imbalance. The Collection Practices Act<sup>94</sup> adopted by the Michigan legislature may be evidence of that body's willingness to meet such a challenge. The Act, approved in December of 1974, provides for the licensing of collecting agencies and prohibits certain conduct which smacks of sharp collect-

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89. *Jones* itself so recognized. *Jones v. Morgan*, 58 Mich. App. 455, 228 N.W.2d 419 (1975); cf. *Crosby v. Basin Motor Co.*, 488 P.2d 127 (N.M. App. 1971).

90. "It is not necessary that such damages be affirmatively awarded to the debtor, but they may instead be set off against the amounts owed by the debtor to the creditor." 58 Mich. App. at 460, 228 N.W.2d at 423; cf. *Wilson Leasing Co. v. Seaway Pharmacal Corp.*, 53 Mich. App. 359, 220 N.W.2d 83 (1974).

91. See authorities cited note 7 *supra*.

92. *Sniadach v. Family Fin. Corp.*, 395 U.S. 337 (1969) (Black, J., dissenting).

93. Justice Black would have accepted Holmes' notions, which are not altogether popular during these days of judicial activism, that his "agreement or disagreement has nothing to do with the right of a majority to embody their opinions as law," *Lochner v. New York*, 198 U.S. 45, 75 (1904) (Holmes, J., dissenting), and that "legislatures are ultimate guardians of the liberties and welfare of the people in quite as great a degree as the courts." *Missouri, K.&T. Ry. v. May*, 194 U.S. 267, 270 (1904).

94. MICH. COMP. LAWS ANN. § 445.211 (Supp. 1975-76). Some of the practices outlawed include the making of deceptive statements to the debtor, threatening physical violence, communicating with the debtor directly when he is represented by an attorney, using law enforcement officers to collect debts, publishing lists of debtors, and buying claims with the sole purpose of instituting an action thereon. *Id.* §§ 445.228-.230.

ing practices and which, most persons would agree, are unfair<sup>95</sup> (lawyers should be especially wary of specific provisions relating to the relationship between an agency and an attorney).<sup>96</sup> The Act is a step in the direction of redressing the imbalance, though it is far from a complete answer to the questions the critics have raised.

## II. SALES

### A. *Risk of Loss—Shipment Terms*

*Eberhard Manufacturing Co. v. Brown*<sup>97</sup> raised a primary question of who shall bear the loss when a contract for sale contains no shipment terms and a secondary question of what those terms shall be. In *Eberhard*, goods were lost in transit, and the only shipment term in the contract was a direction to the seller to ship to the buyer's address. Plaintiff seller, suing for the price, argued that the sale was F.O.B. its plant and attempted to introduce evidence that it always shipped goods that way. The court held such evidence of usage could not be used to prove that the parties had agreed on the shipment terms. Relying on section 2-503,<sup>98</sup> the court then held that, absent any shipment terms, the contract is a shipment contract and not a destination contract. Since, under section 2-509,<sup>99</sup> a shipment contract puts risk of loss on the buyer once the seller delivers to the carrier, the buyer must stand the loss.

Clearly the court's reading of 2-503 was correct: comment 5 to that section specifically provides that under Article 2 of the Code "the 'shipment' contract is regarded as the normal one and the 'destination' contract as the variant type."<sup>100</sup> Equally correct was the court's holding that the "shipped to" language on the documents is not sufficient to negate the Code's presumption since a "shipped to" address is included on nearly all such contracts, whether they be shipment or destination contracts, so that the seller can properly instruct the carrier.

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95. *Id.* §§ 445.214-.229.

96. *Id.* § 445.230.

97. 61 Mich. App. 268, 232 N.W.2d 378 (1975).

98. MICH. COMP. LAWS ANN. § 440.2503 (1967).

99. *Id.* § 440.2509.

100. *Id.* § 440.2503, Comment 5.

### B. Warranties

Questions of both warranty disclaimer and warranty limitation arose in *National Cash Register Co. v. Adell Industries, Inc.*,<sup>101</sup> in which the buyer acquired an accounting machine from the seller after specifying the particular use to which it would be put and after showing reliance on the seller's skill and expertise. The factual situation is, thus, a classic instance of a section 2-315<sup>102</sup> implied warranty for particular purpose. The contract disclaimed implied warranties in non-conspicuous language and limited the buyer's remedy for warranty breach to a correction of defects.

The court, properly refusing to give effect to the disclaimer because a section 2-315 warranty can be disclaimed only by conspicuous language,<sup>103</sup> reasoned that since there was a warranty of fitness,<sup>104</sup> and since the equipment was not fit, the warranty limitation (to correction of defects only) failed of its essential purpose.<sup>105</sup> Accordingly, the court held that the buyer could resort to any of the remedies allotted to him by the Code, including the right to revoke acceptance of non-conforming goods.<sup>106</sup>

The goods were delivered on November 26; the target date under the contract for effective performance was January 1, and the buyer revoked acceptance on January 6. It appears that the court gave rather short shrift to the seller, assuming that correction of defects did not encompass modifications or adjustments sufficient to make the equipment serviceable for the buyer's needs. Certainly if such changes could have achieved the desired result, it would be incorrect to hold that the warranty failed of its essential purpose. Perhaps the court concluded that 41 days was sufficient time to make any such modifications or adjustments, but it did not say so.

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101. 57 Mich. App. 413, 225 N.W.2d 785 (1975).

102. MICH. COMP. LAWS ANN. § 440.2315 (1967).

103. *Id.* § 440.2316.

104. *Id.* § 440.2316(3)(c).

105. "Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act." *Id.* § 440.2719.

106. *Id.* § 440.2608.

### C. *Conduct of the Parties*

*R. G. Moeller Co. v. Van Kampen Construction Co.*<sup>107</sup> prompted questions concerning the scope of section 2-204<sup>108</sup> which provides that a contract for the sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract. In *Moeller*, the buyer ordered replacement parts from seller but refused to pay for them. Seller sued; after seller submitted its evidence, the buyer offered none. On appeal, buyer argued that the parts ordered were due it under the seller's warranty, that the statute of frauds applied, and, finally, that the seller failed to prove a contract. The court rejected the warranty argument because, under section 2-607(4),<sup>109</sup> the burden is on the buyer to prove breach of warranty, and this buyer had failed to offer any proof; rejected the statute of frauds defense because the buyer did not plead it; and rejected the contract argument by resorting to authority showing that there was an implied contract under the circumstances.

Unfortunately, in developing the last argument the court neglected to cite section 2-204, which clearly applied under the state of the evidence. Comment 1 to that section provides that "appropriate conduct by the parties may be sufficient to establish an agreement."<sup>110</sup> When the evidence showed that one party ordered parts from another who is in the business of selling such parts, the court should have relied on section 2-204 instead of resorting to implied contract theories.

### III. BAILMENT

*Columbus Jack Corp. v. Swedish Crucible Steel Corp.*<sup>111</sup> is a fresh look at an old bailment rule. The plaintiff-bailor sued to recover the value of its patterns in the possession of the defendant-bailee for use in manufacturing products for the plaintiff. Prior Michigan law<sup>112</sup> held that the presumption of negligence

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107. 57 Mich. App. 308, 225 N.W.2d 742 (1975).

108. MICH. COMP. LAWS ANN. § 440.2204 (1967).

109. *Id.* § 440.2607(4).

110. *Id.* § 440.2204, Comment 1.

111. 393 Mich. 478, 227 N.W.2d 506 (1975).

112. *See Pennsylvania R.R. v. Estate of Dennis*, 231 Mich. 367, 204 N.W. 89 (1925).

established by the bailor's proof that he delivered the goods and that they were destroyed is rebutted when the loss is by fire. In the absence of that presumption, the bailor must prove that the bailee was negligent, a difficult task in a fire situation. Acknowledging that Michigan held to the minority rule, the court overturned the earlier decision and held the presumption is not rebutted by evidence of loss by fire.

The *Columbus Jack* result recognized implicitly that such cases as this are subrogation cases, that good risk bearers (insurance companies) are the real parties in interest, and, tacitly, that there is little that serves the public interest in requiring proof of as potentially difficult an issue as the cause of a fire for recovery. The moral is: bailees must now insure all property in their possession.

#### IV. USURY

Michigan courts turned back attempts by consumers in two cases to expand the scope of the Michigan usury law.<sup>113</sup> Under that statute, any lender who charges more than the statutory maximum interest rate of 7 percent cannot recover any interest or other such charges; but the statute omits any reference to recovery of the money loaned or to a cause of action on behalf of the debtor to recover the excess interest.<sup>114</sup> In *Michigan Mobile Home Owners Association v. Bank of the Commonwealth*,<sup>115</sup> a class action, plaintiffs sought an injunction and damages on the grounds that the contracts required a higher rate of interest than the statute permitted.<sup>116</sup> In *Sienkiewicz v. Leonard Mortgage Co.*,<sup>117</sup> plaintiffs sought to recover interest they paid which allegedly exceeded the 7 percent maximum. In both cases, the courts refused to alter the well established rule that Michigan's usury

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113. MICH. COMP. LAWS ANN. § 438.31 (1967).

114. *Id.* § 438.32.

115. 56 Mich. App. 206, 223 N.W.2d 725 (1974).

116. The suit arose because of the position taken by the Attorney General, Mich. Att'y Gen. Op. No. 4729 (June 21, 1971), that mobile homes were motor vehicles and therefore could not come within the Retail Installment Sales Act's higher interest rate. MICH. COMP. LAWS ANN. §§ 445.851-.872 (1967). The Retail Installment Sales Act was amended in 1972 to make it clear that mobile homes are included within its coverage. *Id.* § 445.852(c) (Supp. 1975-76).

117. 59 Mich. App. 154, 229 N.W.2d 352 (1975).

statute can be used as a shield but not a sword. The rule is consistent with the language of the statute, which provides relief against actions by the lender, and with prior case law, including decisions by the Michigan supreme court.<sup>118</sup> Any change in this rule would be more proper for the legislature than for the courts.

## V. BANKING

Cases in the Survey period relating peculiarly to banking practices involved joint accounts and garnishments. In *Mary v. Louis*,<sup>119</sup> a careless response to a garnishment writ yielded an embarrassing result. The bank answered that it was not liable to the principle debtor when, in fact, it held payables of the debtor which more than secured its loan. The appellate court reversed summary judgment for the bank and held that since the creditors sustained the losses as a result of the bank's failure to disclose the face value of the payables, the bank was liable.

In *Richard v. Richard*,<sup>120</sup> the court gave vigorous support to the presumption which arises out of the execution of a joint account signature card. Under section 703 of the Michigan Financial Institutions Act,<sup>121</sup> the existence of a joint account is prima facie evidence, in the absence of fraud or undue influence, of the intention of the depositor to vest title to the deposit in the survivor. While that presumption, the court held, is rebuttable,<sup>122</sup> evidence that the depositor did not return the permanent signature card with the signature of both depositors did not overcome the presumption created by the "temporary" card she signed when she made the initial deposit.

Both *Richard* and *Louis* are eminently sensible. Surely the garnishment statute's requirement that the garnishee respond includes an obligation of good faith, and it should not surprise a banker, savings and loan officer, or executor to learn that he can rely on the first card the depositor signs even though the second

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118. See, e.g., *Wright v. First Nat'l Bank*, 297 Mich. 315, 297 N.W. 505 (1941); *Union Guardian Trust Co. v. Crawford*, 270 Mich. 207, 258 N.W. 248 (1935).

119. 57 Mich. App. 14, 229 N.W.2d 352 (1975).

120. 58 Mich. App. 660, 228 N.W.2d 512 (1975).

121. MICH. COMP. LAWS ANN. § 487.703 (1967).

122. 58 Mich. App. at 662-63, 228 N.W.2d at 514, citing *Kirilloff v. Glinisty*, 375 Mich. 586, 134 N.W.2d 707 (1965); *Jacques v. Jacques*, 352 Mich. 127, 89 N.W.2d 451 (1958).

card the depositor takes home with him for his joint tenant to sign is never returned.

Of additional significance to the banking community is an opinion issued by the Attorney General relating to automated teller machines and other terminal equipment.<sup>123</sup> The Attorney General confronted the question whether the use of an automated teller machine by a state chartered credit union to disperse on the spot cash advances complies with the requirements of section 10 of the Michigan Credit Union Act.<sup>124</sup> That section permits credit unions to advance loans to members but implies that a loan based on an unsigned advance must be made by a check payable to the order of the buyer.<sup>125</sup> The automated teller machine in question, activated by the use of a personal identification number which the member punches into the machine, distributes the loan in cash.

The Financial Institutions Bureau, concerned that the proceeds of the loan were payable in cash, asked whether a personal identification number can be a signature for the purposes of section 10. Relying on the Uniform Commercial Code definition of "signature" as including any "word or mark used in lieu of a written signature"<sup>126</sup> and the Code Comments which indicate that the signature may be "by mark or even by thumb print,"<sup>127</sup> the opinion concluded that the electronic "mark" effected by the use of the number with the automated teller machine complies with any statutory requirement for a signature.

While the personal identification number does not fall within the class of examples set forth in the Code, which anticipates some mark the eyes can perceive, the Attorney General's conclusion is consistent with the liberal construction the Code requires.<sup>128</sup> The Code Comments and definition are evidence of a disposition clearly favorable to any reasonable identifying symbol and, while not anticipating an electronic mark such as the per-

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123. Mich. Att'y Gen. Op. No. 4864 (April 10, 1975).

124. MICH. COMP. LAWS ANN. § 490.10 (Supp. 1975-76).

125. "Unsigned requests for advances on a pre-approved line of credit or open end revolving credit loan can be honored by check payable to the order of the borrower . . . ." *Id.*

126. *Id.* § 440.3401(2) (1967).

127. *Id.* § 440.3401, Comment 2.

128. *Id.* § 440.1102.

sonal identification number, appear to favor the Attorney General's conclusion. The opinion should serve as a promising starting point for inquiries which will surely arise in the future as the use of automated teller machines increases.

## VI. SECURED TRANSACTIONS

Two significant cases construed Article 9 of the Uniform Commercial Code as adopted in Michigan;<sup>129</sup> both of them related to financing statements and deficiency in the description of the debtor. Section 9-402<sup>130</sup> of the Code provides that the financing statement must include the name of the debtor. It is clear, moreover, from section 9-403(4),<sup>131</sup> that such information is necessary in order to serve the Code's notice filing scheme. A financing statement which incorrectly sets forth the name of the debtor is, therefore, defective because it cannot serve its purpose of putting third persons on notice of the filing period.<sup>132</sup>

*In re Kalamazoo Steel Process, Inc.*<sup>133</sup> involved a financing statement which incorporated the name of the debtor correctly but failed to reflect the fact, which the secured party knew at the time of filing, that the debtor was to change its name shortly thereafter. That fact rendered the filing useless to third persons unaware of the change once it was effected: the secured party had complied with the literal terms of the Code but had not troubled itself with the problem the name change might visit upon innocent third persons.

In fact the problem arose not in the form of such an innocent third person, but in the guise of a trustee in bankruptcy who took the status of such innocent person and sued the secured party which had retaken the collateral. The Sixth Circuit felt that

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129. *Id.* §§ 440.9101-9507.

130. *Id.* § 440.9402.

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Except as provided in subsection (7) a filing officer shall mark each statement with a consecutive file number and with a date and hour of filing and shall hold the statement for public inspection. In addition the filing officer shall index the statement according to the name of the debtor and shall note in the index the file number and the address of the debtor given in the statement.

*Id.* § 440.9403(4).

132. *See In re Thrift Shoe Co.*, 502 F.2d 1211 (9th Cir. 1974).

133. 503 F.2d 1218 (6th Cir. 1974).

meeting literal requirements of section 9-402 was insufficient in light of the Code's ubiquitous requirement of good faith. Under section 1-203,<sup>134</sup> every duty within the Code carries with it "an obligation of good faith in its performance and enforcement."<sup>135</sup> The court concluded that the duty to file a financing statement required a meaningful financing statement and not one which the secured party knew would soon become ineffectual. Accordingly, it held the defendant's security interest unperfected and rendered judgment for the trustee in its preference action.

The result is unsettling because the good faith argument is diluted by two facts: first, the name change did not occur for some eleven months; and second, no one was misled by the incorrect description of the debtor in the statement. The length of the delay indicated not that the secured party was acting in bad faith at the time of the filing but that it was acting in bad faith some eleven months later when the name change occurred. The opinion referred to no evidence that the secured party knew when the change became effective, and the court's suggestion, that the original filing could have contained a request for dual indexing, is no solution because the debtor assumed the secured party's name; dual indexing would have created a cloud on the secured party's property. It is a suggestion, moreover, that is more likely to occur to a court after the fact than to an attorney acting in the first instance; failure of the secured party to follow that suggestion is hard to accept as an example of bad faith.

The court's conclusion, furthermore, overlooks the fact that filings under the Code often become misleading because creditors have no express duty to refile in the event of a name change. Admittedly, the court confined its holding to cases where the secured party knew of the impending change at the time of the original filing; it would not be far removed, however, for a court to hold, on the authority of this case, that any creditor who learns of a name change and does not correct his filing is guilty of bad faith.

Finally, the facts of this case do not cry out for the application of the good faith rule. If the plaintiff had been a party who ad-

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134. MICH. COMP. LAWS ANN. § 440.1203 (1967).

135. *Id.*

vanced funds after a search which did not reveal the filing, or if the secured party were asserting its lien against after acquired property, the equitable imbalances would be more appropriate for application of section 1-203. Significantly, the 1972 Code amendments include the addition of section 9-402(7) which requires a secured party to file after a name change only to perfect his security interest in collateral acquired by the debtor more than four months after that change.<sup>136</sup>

It is not too much to ask potential creditors to check for name changes within preceeding years and run a search under prior names. Nothing in *Kalamazoo* will protect creditors from changes when the creditor does not know about them at the time of the filing, so such inquiry is probably good practice in any event. Indeed, in *Continental Oil Co. v. Citizens Trust and Savings Bank*,<sup>137</sup> in which there was no evidence that the secured party knew of the name change at the time of the original filing, the Michigan Court of Appeals rejected the notion that the secured party must refile after a name change, holding that any filing which is good *ab initio* remains good.

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136. UNIFORM COMMERCIAL CODE § 9-402(7).

137. 57 Mich. App. 1, 225 N.W.2d 209 (1974).