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# Commercial Transactions (1980 Annual Survey of Michigan Law)

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# COMMERCIAL TRANSACTIONS

JOHN DOLAN†

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### INTRODUCTION

As they do each year, Michigan courts decided a number of commercial law cases during the survey period. Several of the cases are significant opinions which either raise questions or carry significant implications for Michigan's commercial lawyers. This survey selects those significant cases, attempts to answer the questions raised, and probes the implications of the decisions.

#### I. PERFECTING THE SECURITY INTEREST

Perfection of a creditor's security interest is a critical step in the process of achieving protection against third parties. Although a security interest may attach without perfection,<sup>1</sup> and even though a security agreement generally is binding on third parties,<sup>2</sup> specific provisions of Article 9 render the unperfected security interest subordinate to the rights of lien creditors,<sup>3</sup> the trustee in bankruptcy,<sup>4</sup> and

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1. U.C.C. § 9-203(1)-(2) sets forth the requirements for attachment, *i.e.*, for creation of the security interest. (Unless otherwise stated, all references to the Uniform Commercial Code are to the Code as adopted in Michigan at MICH. COMP. LAWS ANN. §§ 440.1101-.1110 (1967 & Supp. 1980-81)).

2. U.C.C. § 9-201 stipulates that unless the Code provides otherwise, "a security agreement is effective . . . against purchasers of the collateral and against creditors."

3. See U.C.C. § 9-301(1)(b).

4. The Code gives the trustee the rights of a lien creditor. See U.C.C. §

other perfected secured parties.<sup>5</sup> Perfection, then, is a matter commercial lawyers watch closely.

In *International Harvester Credit Corp. v. Vos*<sup>6</sup> the court of appeals confronted the difficult task of determining the point in time at which the creditor must determine the action necessary to perfect his security interest properly. The problem stems from the fact that the Code provisions assume a static situation.<sup>7</sup> While most secured transactions fit the assumed model, frequently the situation is fluid.

The difficulty begins at the very heart of Article 9 in the provisions that define the time at which a security interest attaches and the time a security interest becomes perfected. Under section 9-203(1) there are three elements a secured party must satisfy before his security interest comes into being, *i.e.*, attaches: first, the statute of frauds rule which requires either a written security agreement describing the collateral and signed by the debtor or the secured party's possession of the collateral pursuant to agreement; second, the requirement that value be given; and third, the requirement that the debtor have rights in the collateral. For purposes of this analysis the critical provision is section 9-203(2), which stipulates that unless the parties agree otherwise, as they rarely do, attachment occurs at the time when the last of the three elements is satisfied.<sup>8</sup>

The Code follows a similar pattern in defining the time when a security interest becomes perfected. The Code first establishes various methods of perfection.<sup>9</sup> It then provides that a security interest is perfected when it has attached and when the steps for perfection have been satisfied.<sup>10</sup> If the perfection step occurs before attachment, furthermore, perfection itself occurs at the time of attachment.<sup>11</sup> When we put the attachment and perfection provisions together, it becomes clear that perfection will not occur until all of the events necessary for attachment have occurred.

Three examples illustrate the problem. In a purchase money loan, the lender customarily will ask the debtor to sign a security agreement

9-301(3). More importantly, the strong arm clause of the Bankruptcy Code, a federal statute, gives the trustee such rights. See Bankruptcy Code, 11 U.S.C. § 544(a)(1) (Supp. III 1979).

5. See U.C.C. § 9-312(5).

6. 95 Mich. App. 45, 290 N.W.2d 401 (1980).

7. The Code, however, does provide for the multiple state transaction. See U.C.C. § 9-103.

8. The parties may agree to postpone attachment only until some time after all of the elements are satisfied. To permit the parties to agree that attachment occurs before the three requirements are satisfied would violate the obvious reason of § 9-203. See U.C.C. § 1-102, Comment 1, which indicates that proper construction of the Code requires courts to read the sections according to their reason.

9. See U.C.C. §§ 9-302, -304, -305, -306.

10. See U.C.C. § 9-303(1).

11. "If such steps are taken before the security interest attaches, it is perfected at the time when it attaches." *Id.*

and a financing statement before the debtor buys the equipment. Code priority rules commend this procedure by giving the lender its purchase money priority only if the lender files within certain prescribed time limits.<sup>12</sup> The careful lender will often not advance funds, then, unless he has already taken steps to insure compliance with those limits so that his security interest attaches, is perfected, and enjoys priority as soon as those funds are disbursed.<sup>13</sup>

In this example it is important to note that the perfection and attachment occur simultaneously either at the time the debtor acquires rights in the collateral<sup>14</sup> or at the time the lender disburses the funds, whichever is later. That point is the first time at which all three elements of the attachment provision have been satisfied.

The purchase money situation is not the only one in which lenders might file a financing statement before the security interest attaches. Frequently a borrower will ask for credit on existing assets. Again, the lender is concerned about its priority. If the debtor has the collateral in its possession, the rules of Article 9 grant priority to the creditor who files first.<sup>15</sup> The lender, then, will want to take steps to insure that its filing is first. The most efficient procedure is to file a financing statement, take a signed security agreement, and search for filings. If the search discloses that the lender's filing is the earliest, the lender may then disburse loan proceeds confident that it enjoys a first priori-

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12. If the collateral is inventory, the lender must file before the debtor receives possession of the inventory. U.C.C. § 9-312(3)(a). If the collateral is not inventory, the creditor must file within ten days after the debtor receives possession. U.C.C. § 9-312(4). Cf. U.C.C. § 9-301(2) (which gives the purchase money lender priority over lien creditors and buyers in bulk if he files no later than ten days after the debtor receives possession). Of course, if the collateral is consumer goods, no filing is necessary. U.C.C. § 9-302(1)(d).

13. The purchase money lender may insist on paying for the goods directly or on putting the seller's name on the loan proceeds check all in order to satisfy the purchase money security interest definition. See U.C.C. § 9-107.

14. Courts have had some trouble determining when such rights arise. Section 2-501(1) suggests strongly that such rights arise as soon as the goods are identified to the debtor's contract. Cf. *Goldberg Co. v. County Green Ltd. Partnership* (*In re County Green Ltd. Partnership*), 438 F. Supp. 693, 696 (W.D. Va. 1977); *Rex Financial Corp. v. Mobile America Corp.*, 119 Ariz. 176, 177-78, 580 P.2d 8, 9-10 (1978); *International Harvester Credit Corp. v. Associates Fin. Serv. Co.*, 133 Ga. App. 488, 493-94, 211 S.E.2d 430, 433-34 (1974); *Herman v. First Farmers State Bank*, 73 Ill. App. 3d 475, 392 N.E.2d 344 (1979); *Chrysler Credit Corp. v. Sharp*, 56 Misc. 2d 261, 270, 288 N.Y.S.2d 525, 533-34 (1968); *Holstein v. Greenwich Yacht Sales, Inc.*, 404 A.2d 842, 844 (R.I. 1979) (buyer's rights arise on identification). *But see United States v. Wyoming Nat'l Bank*, 505 F.2d 1064, 1067 (10th Cir. 1974); *General Elec. Credit Corp. v. Tidwell Indus., Inc.*, 115 Ariz. 362, 364, 565 P.2d 868, 870 (1977); *First Nat'l Bank v. Smoker*, 153 Ind. App. 71, 80-81, 86 N.E.2d 203, 209 (1972) (debtor first acquires rights in the goods upon delivery). See also *Mechanics Nat'l Bank v. Gaucher*, 79 Mass. App. Ct. Adv. Sh. 314, 386 N.E.2d 1052 (1979) (court ignores buyer's special property on identification; no disposition of mobile home until delivery).

15. See U.C.C. § 9-312(5)(a).

ty. Again we see that filing may occur early in the transaction. Attachment and perfection arise in this illustration when the lender gives value by disbursing the loan proceeds, that disbursement being the last of the three elements of attachment to take place.

The third illustration involves after-acquired property. It is most common for lenders (especially inventory lenders) to take a security agreement which includes after-acquired property. In such a situation, the security interest in the after-acquired property attaches and becomes perfected at the time the debtor acquires an interest in that property.

All three of these examples are common in the commercial setting, and it may very well be that secured lenders file early more often than they file late. These rules and practices, however, can cause confusion. The problem stems from the fact that the perfection and filing rules of Article 9 turn on the nature of the collateral and the nature of the debtor. The Code provides one perfection rule for inventory and another for equipment.<sup>16</sup> It provides different perfection rules when the collateral is consumer goods,<sup>17</sup> a class of goods determined in part by the status of the debtor.<sup>18</sup> It also provides for the filing of a financing statement in one place if the goods are farm products, a characterization which depends in part on the status of the debtor,<sup>19</sup> and another if they are inventory;<sup>20</sup> one place if they are equipment used in farming operations, another if they are used in manufacture.<sup>21</sup>

These rules reflect a number of policies, some of them questionable,<sup>22</sup> but practicing lawyers must deal with the rules, often at their peril. There is no serious problem if at the time of filing, at the time of attachment, and at all times in between the nature of the collateral and the debtor do not change. The problem arises when something does change.

In all three of these illustrations, the secured party will file at a time before the security interest can be perfected. Since a filing is good for five years,<sup>23</sup> therefore, the period between the time of filing and the time of perfection may run from one day to five years. It thus

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16. Compare U.C.C. § 9-312(3) with U.C.C. § 9-312(4).

17. Compare U.C.C. §§ 9-312(3) & (4) with U.C.C. § 9-302(1)(d).

18. Only a consumer may own consumer goods. See U.C.C. § 9-109(1).

19. Farm products are such only if they are in the possession of "a debtor engaged in raising, fattening, grazing or other farming operations." U.C.C. § 9-109(3).

20. See U.C.C. § 9-401(1) (Second Alternative Subsection), No. 53, [1980] Mich. Pub. Acts.

21. *Id.*

22. Most commentators would prefer to see central filing and thereby avoid the confusion. It is difficult to justify the dual filing system in an age of rapid and cheap communication. The Michigan Legislature recently amended § 9-401 but did not alter its dual filing scheme. See No. 53, [1980], Mich. Pub. Acts.

23. See U.C.C. § 9-403(2), No. 53, [1980] Mich. Pub. Acts.

becomes critical for the courts to decide which date to use in determining the effectiveness of the filing.

The leading case is *In re Pelletier*.<sup>24</sup> There a secured party filed a financing statement in VanBuren, Maine after the debtor had moved from the town<sup>25</sup> but before he had taken up permanent residence elsewhere. When the goods were delivered, however, the court seemed to assume that the debtor's permanent residence was Benton, Maine. The court also assumed that perfection and attachment occurred upon delivery and saw the issue as one of deciding whether the date of filing or the date of attachment should serve as the time for determining whether the filing was good. The court opted for the date of attachment, reasoning that subsequent parties would face undue search burdens if they had to search in all places where the debtor had lived during the preceding five years.

*In re Knapp*<sup>26</sup> adopted the same attachment rule but implicitly raised questions about the *Pelletier* rationale. In *Knapp* the debtor moved from Fulton County to Herkimer County after the security interest attached whereas in *Pelletier* the debtor moved before it attached. The *Knapp* creditor filed in Fulton County, and the attachment rule imposed the very search burdens the *Pelletier* court sought to avoid. The *Knapp* court accepted the *Pelletier* rule by using the time of attachment as the time for determining the efficacy of the filing but implicitly rejected the *Pelletier* rationale by imposing the burdensome search requirement.

Thus the *Knapp* case illustrates the weakness of the *Pelletier* analysis. The fact is that the attachment rule is neutral: sometimes it imposes burdens on the secured party by requiring him to refile or to withhold filing until he knows where the debtor will live at the time of attachment, and sometimes it requires the subsequent party to search in the debtor's prior place of residence.

Both the *Pelletier* and *Knapp* courts looked to other Code provisions for some clue to the proper rule. Ironically the *Pelletier* court found Code support for its rule *against* the secured party, and the *Knapp* court found Code support for its rule *in favor of* the secured party. The signals do indeed conflict. Generally, the Code does not impose a burden on the secured party to monitor the activity of the debtor for changes, after filing, in residence or in the use of the col-

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24. 5 U.C.C. REP. SERV. 327 (D. Me. 1968). Then Referee in Bankruptcy and now Bankruptcy Judge Conrad Cyr authored the *Pelletier* opinion.

25. Maine's version of § 9-401 required filing with the town clerk in the town where the debtor resided. See ME. REV. STAT. ANN., tit. 11, § 9-401(1) (repealed 1969). Maine has since adopted the first alternative subsection to § 9-401 and thereby avoided a repeat of the problem in *Pelletier*. The first alternative subsection generally requires central filing with the secretary of state. See ME. REV. STAT. ANN., tit. 11, § 9-401(1) [1979].

26. 575 F.2d 341 (2d Cir. 1978).

lateral.<sup>27</sup> At the same time the Code does impose a duty on a secured party to refile if the debtor makes a name change that would cause confusion and if the security agreement covers property acquired more than four months after the name change.<sup>28</sup> The Code hints, furthermore, that the character of the property *at the time of attachment*, not filing, determines the proper place to file.<sup>29</sup> Finally, Comment 3 to section 9-401 says that the courts should use the last event test of section 9-103(1)(b) in determining *whether* local filing is required and suggests, therefore, that the last event (attachment in our three illustrations) might also control the *place* of local filing.<sup>30</sup>

In light of these conflicting signals, courts should adopt a rule which best satisfies the realities of secured lending. Such a test would favor a result in *Vos* different from the attachment rule the majority fashioned. In *Vos* the residence of Blaser, the buyer of a farm tractor, changed. At the time he entered into the contract and security agreement, Blaser lived in Ionia County but planned to farm in Barry County. The company that financed the purchase filed a financing statement in Barry County. Blaser, however, took delivery of the tractor while he was living in Ionia County and then moved to Barry County.

The Michigan version of the Code provides that a financing statement covering equipment used in farming operations must be filed in the office of the Register of Deeds in the county of the debtor's residence.<sup>31</sup> The *Vos* security interest attached at the time the buyer acquired an interest in the collateral,<sup>32</sup> that being the last of the three elements necessary for attachment. At that point the debtor resided in Ionia County, and the court of appeals held that at that point the finance company should have filed in Ionia County. Since it filed in Barry County, the filing was no good, the security interest was unperfected, and purchasers from Blaser would defeat the finance company.<sup>33</sup>

27. See U.C.C. § 9-401(3), No. 53, [1980] Mich. Pub. Acts. *But cf.* § 9-103(1)(d) (requires refile if the debtor moves the goods into another state).

28. See U.C.C. § 9-402(7), No. 53, [1980] Mich. Pub. Acts.

29. The hint is a weak one. Section 9-105(1)(h) defines "goods" as "things which are movable at the time the security interest attaches."

30. One court, in fact, rejected both the time of filing rule and the time of perfection rule in favor of a last event rule. See *Borg-Warner Acceptance Corp. v. Fedders Financial Corp.* (*In re Hammons*), 614 F.2d 399 (5th Cir. 1980).

31. § 9-401(1) (Second Alternative Subsection (1)), No. 53, [1980] Mich. Pub. Acts.

32. The majority opinion in *Vos* assumed that the buyer's interest arose upon delivery. In fact, under § 2-501, it may have arisen earlier. See note 14 *supra*. The distinction, however, is of no moment here. The buyer apparently lived in Ionia County from the time he entered into the purchase contract until after he took delivery. Thus he lived in Ionia County when his interest arose, whether it arose on identification or on delivery.

33. The purchasers included buyers, the *Voses*, and the bank to which they granted a security interest. The *Vos* opinion suggests that the *Voses* won under

The question is a close one. The Code itself provides no specific answer; it is proper, therefore, that the courts fashion a rule consistent with the general policies of the Code.<sup>34</sup> The majority in *Vos* felt that the filing scheme of the Code should provide certainty and that by picking attachment, an event whose time is fixed by the Code, the court gave subsequent parties more certainty in searching for filings and filing parties more certainty on where to file.

The majority placed considerable reliance on *In re Pelletier* and ignored the analytical weakness of *Pelletier* even though the dissent in *Vos* decried that analysis. *Vos*, moreover, provided an opportunity to resolve the policy inconsistency of *Knapp* and *Pelletier*. In *Vos* the secured party had anticipated the debtor's move and ostensibly tried to facilitate a search which always begins with the farmer's home county.<sup>35</sup> That conduct seems reasonably designed not to mislead. In fact, the Code mandates such anticipation when a debtor buys goods and promptly moves them to a state different from their situs at the time of attachment.<sup>36</sup>

Finally, *Vos* gave the court a way to distinguish *Pelletier* and *Knapp*, in which the secured party filed at the debtor's old residence. In *Vos* the secured party filed at his new one. The *Vos* trial court and the dissent argued that a filing is good so long as there is at one time a unity of the requirements for perfection. We must concede that under *Pelletier* and *Knapp* the Barry County filing was not good to perfect the security interest so long as the debtor had not moved to Barry County; but once he moved there, the filing should suffice. Such a rule does not impose any heavier burden on a searching party, who must search in Barry County to determine whether the debtor created any security interests after he moved there. Certainly it is fair to hold the secured party unperfected during the period prior to the debtor's move, but it seems unfair to hold him unperfected after the move.

This analysis does not disregard the legislature's expressed policy in favor of national uniformity in construing the Code.<sup>37</sup> *Pelletier* and *Knapp* come from authoritative sources, but the cases are split, with

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§ 9-301(1)(b) because they were lien creditors. In fact they were not lien creditors. See U.C.C. § 9-301(3). Presumably, however, they were buyers who gave value and took possession without knowledge of the security interest. In such event they would defeat the finance company under § 9-301(1)(c). Their bank, of course, a perfected secured party, would defeat the finance company under §§ 9-301(1)(a) and 9-312(5)(a).

34. The Code's general policies are set forth in § 1-102.

35. Any careful lender must search the home county even if he knows that the debtor obtained the goods while residing in another county. The debtor could have granted a second security interest after the move, in which event both *Pelletier* and *Knapp* mandate filing in the new county.

36. See U.C.C. § 9-103(1)(c).

37. The legislature has designated such uniformity one of the underlying purposes and policies of the Code. See U.C.C. § 1-102(2)(c).



some rejecting the *Pelletier/Knapp* approach.<sup>38</sup> Those who support *Pelletier* and *Knapp* must do so not because they make searching any easier but because they provide certainty for all parties. That certainty is not disturbed, however, by making an exception to their attachment oriented rule in the *Vos* situation. A creditor who anticipates a move and files in the county where the debtor is going to live takes the risk of being unperfected before the move. After the move, however, the unity rule rejected by the majority in *Vos* would mislead no one and would reward the creditor who tries to make searching easier.

The certainty rationale of *Pelletier* and *Knapp* is suspect anyway. As the discussion of attachment above suggests, the time of attachment is not easy to determine, and a careful lender will find it far easier to investigate the history of his debtor's residence and search for filings than to determine the dates (and residences on these dates) when security interests attached to the various goods against which the debtor seeks to borrow. The lender must make the former inquiry in any event to guard against interstate moves.<sup>39</sup>

Central filing would obviate most of the problems. The state of Maine has avoided the *Pelletier* rule by altering section 9-401.<sup>40</sup> Unless the Michigan legislature makes a similar change, commercial lawyers in Michigan will have to contend with the *Pelletier-Vos* line of authority, and careful farm lenders will have to search in all counties where the debtor resided during the preceding five years.

## II. FRAUDULENT CONVEYANCES

It is a well-settled principle of commercial law that a failing enterprise may borrow against its assets. In fact, through its purchase money priority rules,<sup>41</sup> the Code facilitates such borrowing, at times to

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38. Compare *In re Knapp*, 575 F.2d 341 (2d Cir. 1978); *In re O'Donnell*, 7 U.C.C. REP. SERV. 888 (D. Me. 1970); *In re Pelletier*, 5 U.C.C. REP. SERV. 327 (D. Me. 1968); *In re Kane*, 1 U.C.C. REP. SERV. 582 (E.D. Pa. 1962), with *Borg-Warner Acceptance Corp. v. Fedders Financial Corp.* (*In re Hammons*), 614 F.2d 399 (5th Cir. 1980); *John Deere Co. v. Castonguay* (*In re Castonguay*), [1979] 4 SECURED TRANS. GUIDE ¶ 53,415 (D. Me. 1979); *Schoel v. Oak Cliff Sav. & Loan Ass'n* (*In re Roy*), 21 U.C.C. REP. SERV. 325 (N.D. Ala. 1977); *In re Page*, 6 U.C.C. REP. SERV. 250 (W.D. Ky. 1968); *In re Golden Kernel, Inc.*, 5 U.C.C. REP. SERV. 43 (E.D. Pa. 1968).

39. Section 9-103 contains provisions that require lenders to search in states from which the debtor moved.

40. ME. REV. STAT. ANN. tit. 11, § 9-401 (Supp. 1979-80). See also *John Deere Co. v. Castonguay* (*In re Castonguay*), [1979] 4 SECURED TRANS. GUIDE ¶ 53,415 (D. Me. 1979) (in which Judge Johnson implicitly rejects Judge Cyr's attachment rule in favor of a unity rule such as that urged by the dissent in *Vos*); see note 25 *supra*.

41. Sections 9-312(3) & (4) grant security interest priority to creditors who provide the credit that enables the debtor to acquire the secured assets. See U.C.C. § 9-107 (which defines "purchase money security interest").

the detriment of some of the debtor's creditors.<sup>42</sup> In the classic setting, a business facing angry creditors will raise cash by borrowing against existing assets. Sometimes, however, the debtor will keep his hounding creditors at bay by granting them a security interest in return for their promise to refrain from collection measures. The Code recognizes this latter practice and accepts the creditor's promise of restraint as value adequate to support a security agreement.<sup>43</sup>

In rare cases a debtor may use these rules in a fashion that reflects an intent to "hinder" his creditors, thereby obtaining more leverage than the law is willing to give. In *A.M. McCarthy & Sons Co. v. Cooney Engineering Co.*,<sup>44</sup> the circuit court for Oakland County confronted such a situation. In *McCarthy* the debtor, a failing company, granted a security interest in all of its assets, including after-acquired property, to those creditors who would agree to stay and subordinate their claims. Eventually eighty-four of the debtor's ninety-five creditors entered into the arrangement. These creditors then sought a permanent injunction to restrain one of the dissenting creditors from enforcing its claim against property subject to the alleged security interest.<sup>45</sup>

The court's opinion recites that the arrangement creditors took their security interest on June 25, 1978 but did not file a financing statement until June 28, 1979, more than one year later. The dissenting creditor obtained its judgment on August 10, 1978. On that date, then, the dissenting creditor could become a lien creditor under the Code;<sup>46</sup> on the same date, the arrangement creditors were unperfected secured parties.<sup>47</sup> Given these characterizations of the parties, the Code would grant priority to the dissenting lien creditor.<sup>48</sup>

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42. The purchase money priority rules disappoint the revolving lender who takes a security interest in after-acquired property and then finds that the later, purchase money lender enjoys priority. See U.C.C. §§ 9-312(3) & (4).

43. No security interest may attach until the creditor gives value. U.C.C. § 9-203(1)(b). The Code stipulates that a secured party gives value when he acquires his interest "as security for . . . a pre-existing claim." U.C.C. § 1-201(44)(b). Thus the Code's definition of value departs from the more rigorous contract standard which would not permit the taking of security for a pre-existing claim to constitute consideration. A debtor may approach a single creditor, negotiate an extension and grant the creditor a security interest which is valid. See *A. M. McCarthy & Sons Co. v. Cooney Eng'r Co.*, No. 79-184-842 CZ (Oakland County Cir. Ct. 1980); notes 44-45 & accompanying text *infra*. See also *In re United Fuel & Supply Co.*, 250 Mich. 325, 230 N.W. 164 (1930).

44. No. 79-184-842 CZ (Oakland County Cir. Ct. 1980).

45. By virtue of the fact that the security interest here was not for the benefit of all creditors and thereby preferred some creditors, the assignment did not fall within the scope of the statute regulating assignments for the benefit of creditors, and the *McCarthy* court so held. See MICH. COMP. LAWS ANN. § 600.5201 (1968).

46. See U.C.C. § 9-301(3) (definition of "lien creditor").

47. The arrangement creditors' security interest was unperfected until the filing in June of 1979. See U.C.C. §§ 9-302(1), -303(1).

48. See U.C.C. § 9-301(1)(b).

For reasons not discussed in the opinion the court did not pursue this Article 9 analysis, but it reached the same result by invoking a statutory provision relating to fraudulent conveyances. That statute provides that "[e]very conveyance . . . made with the intent to hinder, delay or defraud creditors . . . shall be void."<sup>49</sup> The *McCarthy* court concluded that this debtor did in fact act with such intent.

The opinion is sound. It draws on cases from Michigan and elsewhere, all of which support it, and it achieves a commercially desirable result. The key to the analysis is the court's characterization as coercive the debtor-imposed condition that only those creditors who agreed to stay and subordinate their claims would benefit from the security interest. Such a condition does delay and hinder, thus satisfying the elements of the statute, the court ruled.

The leading Michigan case is an old one. In *Wood v. Eldredge*<sup>50</sup> the debtor granted a chattel mortgage only to those creditors who agreed to extend the time for paying debts. Such a condition, the court held, hindered and delayed those creditors who did not agree to the extension by preventing them from proceeding against the mortgaged property.

At first blush the rule appears to be a curious one. We know that, absent an intent to defraud, a debtor may prefer one creditor over another.<sup>51</sup> Plainly, however, the debtor who makes that preference<sup>52</sup> after exacting a creditor's promise to extend the time for payment or to forgive a portion of the debt has hindered and delayed that creditor. Yet it is not that creditor whom the rule of the *McCarthy* case protects,<sup>53</sup> but the creditor who refused to accept the condition and who is hindered as well. Thus the dissenting creditor upsets the conveyance under the *McCarthy* rule when the debtor exacts the condition from the consenting creditors but may not upset the conveyance when the debtor prefers creditors without exacting the concessions. In short, the dissenting creditor wins or loses not on his merits but on the elements of the debtor's "fraudulent" conduct.

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49. MICH. COMP. LAWS ANN. § 566.221 (1967). Cf. UNIFORM FRAUDULENT CONVEYANCE ACT § 7; MICH. COMP. LAWS ANN. § 566.17 (1967) (appears to impose the same sanction against similar conduct).

50. 147 Mich. 554, 111 N.W. 168 (1907).

51. See, e.g., *Geisert v. Corriveau*, 140 F. Supp. 29, 32 (E.D. Mich. 1956); *Warner v. Longwell*, 261 Mich. 468, 472, 246 N.W. 188, 189 (1933); *In re United Fuel & Supply Co.*, 250 Mich. 325, 331, 230 N.W. 164, 166 (1930); *Ferris v. McQueen*, 94 Mich. 367, 373, 54 N.W. 164, 166-67 (1892).

52. Bankruptcy rules may, of course, bear on the success of any such attempt by the debtor. See Bankruptcy Code, 11 U.S.C. § 547 (Supp. III 1979). Those considerations, however, do not bear on the fraudulent conveyance aspects of the *McCarthy* case where there was apparently no bankruptcy, nor in the many cases in which such a preference does not fall within the ambit of § 547 and, therefore, is not voidable under that section of the federal statute.

53. Arguably, however, either a dissenting or accepting creditor should be able to upset the conveyance. See generally 1 G. GLENN, FRAUDULENT CONVEYANCES & PREFERENCES §§ 111-117 (rev. ed. 1940).

In its early days, commercial law fashioned rules against the fraudulent assignment.<sup>54</sup> Those rules recognized fraud costs. In order to minimize those costs, the courts and legislatures<sup>55</sup> penalized<sup>56</sup> parties who engage in activity of questionable commercial value. The law, then, uses the dissenting creditor as an enforcer in order to inhibit the practice of extorting favorable treatment from some creditors. The failing company will often have the economic strength to exact such favor. The legislature, however, interdicts the use of that strength. Such strength arises out of the threat of bankruptcy with its attendant delay and expense. To permit a debtor to profit from the threat of bankruptcy thereby hindering some of his creditors is a course the law has wisely eschewed. Certainly all creditors may agree to delay and forgive payment, but some creditors and the debtor may not through this mutual arrangement prevent the dissenting creditor from pursuing the debtor's property.<sup>57</sup>

The *McCarthy* case, then, demonstrates the continued vitality of legislation that predates the Uniform Commercial Code by many years.<sup>58</sup> In section 1-103<sup>59</sup> the Code anticipates this type of concert between Code and non-Code legislation. The *McCarthy* case illustrates that concert well and serves as a timely reminder that statutes relating to fraudulent conveyances play a significant role in supplementing the Code.

The distinction that *McCarthy* makes is worth noting. Nothing in the Code or the anti-fraud statutes prohibits a failing company from using assets to stave off insolvency,<sup>60</sup> but when the debtor uses his assets with the intent to hinder or delay some creditors, he runs afoul

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54. The classic legislative response is the Statute of 13 Elizabeth (13 Eliz. c. 5 (1570)), but the statute was a codification of what had been the common law. See *Sturtevant v. Ballard*, 9 Johns. 337, 339 (N.Y. 1812).

55. The UNIFORM FRAUDULENT CONVEYANCES ACT or similar statutes have been enacted in most jurisdictions. See generally 1 G. GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES § 62 (rev. ed. 1940).

56. Cf. *Twyne's Case*, 76 Eng. Rep. 809 (Star Ch. 1601) (Twyne, the grantor of a fraudulent conveyance, was convicted of the crime of fraud and his friends, who resisted the sheriff, of riot).

57. In theory the *McCarthy* rule permits creditor *A* to withhold his consent and force the other creditors into agreeing with the debtor to give *A* favorable treatment. Such conduct reflects market forces as most commercial agreements do. The commercial evil to which the *McCarthy* rule addresses itself is the evil of affecting a party's right without his agreement. When the parties agree, the legislature leaves them alone.

58. The earliest Michigan predecessor of § 566.221 was enacted in 1846. See MICH. COMP. LAWS ANN. § 566.221 (1967).

59. "Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions." U.C.C. § 1-103.

60. Clearly, then, nothing in *McCarthy* prevents a debtor from granting a security interest to one creditor and not to others, so long as the debtor's conduct does not reflect the forbidden intent. See note 51 *supra*.

of the anti-fraud rules. A debtor who invites his creditors to make concessions and then conveys assets to those who do, moreover, has evidenced such unlawful intent.

### III. SUBROGATION RIGHTS

The doctrine of subrogation, a creature of equity, also supplements the rules of the Code by virtue of the legislative command in section 1-103. Two problems tend to recur, however, as the policy of this equitable notion intersects with the policies of the Code itself, for the Code emanates from equity's stricter cousin, the common law. The first problem is one of distinguishing subrogation rights from rights arising out of the Code, particularly Article 9. The second problem is one of fashioning priority rules when legal rights and equitable rights confront each other. Two cases during the survey period reflect these recurring questions.

There is a tendency among commercial lawyers to mischaracterize interests which are in fact security interests but which the parties have wittingly or unwittingly disguised. Thus some courts fail to distinguish between a true lease and a lease-purchase<sup>61</sup> or between retention of title<sup>62</sup> and retention of a security interest.<sup>63</sup> The Code treats all security devices as security interests and renders all of them subject to the rules of Article 9.<sup>64</sup>

In *American Oil Co. v. L.A. Davidson, Inc.*<sup>65</sup> the court of appeals confronted the claim of a lien creditor that it defeated a contractor's surety which, the lien creditor argued, was an unperfected secured party. In fact, the surety had taken a security interest in the accounts of the contractor and had perfected its security interest by filing. When the filing lapsed,<sup>66</sup> however, the surety failed to refile and its

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61. See, e.g., *United Road Machinery Co. v. Jasper*, 568 S.W.2d 242 (Ky. App. 1978). But see *Wilson Leasing Co. v. Seaway Pharmacal Corp.*, 53 Mich. App. 359, 220 N.W.2d 83 (1974); *John Deere Co. v. Wonderland Realty Corp.*, 38 Mich. App. 88, 195 N.W.2d 871 (1972); *Nickell v. Lambrecht*, 29 Mich. App. 191, 185 N.W.2d 155 (1970) (Michigan appellate courts were quick to look through the lease and find a security agreement). See generally U.C.C. § 1-201(37) (distinguishes true leases from security interests).

62. It is misleading, of course, to use the term "retention of title" in the sale context, since the Code specifies that such retention operates as a security interest. See U.C.C. § 2-401(1).

63. See, e.g., *International Harvester Credit Corp. v. American Nat'l Bank*, 296 So.2d 32 (Fla. 1974); *Zions First Nat'l Bank v. First Security Bank*, 534 P.2d 900 (Utah 1975).

64. "Except as otherwise provided in section 9-104 on excluded transactions, this Article applies . . . to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper or accounts . . ." U.C.C. § 9-102(1)(a).

65. 95 Mich. App. 358, 290 N.W.2d 144 (1980).

66. A filing is good for only five years. U.C.C. § 9-403(2) (No. 53, [1980] Mich. Pub. Acts).

security interest then became unperfected<sup>67</sup> and subordinate to the interest of the lien creditor.<sup>68</sup> The surety countered that in addition to its rights under Article 9, it also enjoyed the benefits of equitable subrogation. Thus the court confronted the question of whether the equitable right of subrogation is a security interest subject to the priority rules of Article 9. The court correctly answered the question in the negative, refused to apply Article 9, and utilized rules of equity to hold in favor of the surety.

The *American Oil* case is consistent with prevailing authority. The leading case is *National Shawmut Bank v. New Amsterdam Casualty Co.*<sup>69</sup> in which the surety for a defaulting contractor used a subrogation theory to claim proceeds from the contract. The contractor's bank, which had taken a perfected security interest in the contract proceeds, contended that both parties were in fact secured parties and that the bank prevailed because it was perfected and the surety was not. If the court had accepted the bank's characterization of the surety's claim, the bank would have prevailed under the priority rules of Article 9.<sup>70</sup> The *Shawmut* court, however, specifically rejected that argument and refused to apply Article 9 rules. It looked instead to the law of equitable subrogation and concluded that under that doctrine, the surety which completes the work of the defaulting contractor is entitled not only to sums due for work completed by the surety after default but also to unpaid sums earned by the contractor before default. These latter funds should go to the surety, the court reasoned, because equity subrogates the surety not only to the rights of the defaulting contractor but also to the rights of the owner.<sup>71</sup>

The *Shawmut* court reasoned that an owner need not pay to a defaulting contractor sums already earned if those funds are needed to complete the contract. Thus, when the surety steps into the shoes of the owner via subrogation, the surety need not pay those funds to the defaulting contractor or to the defaulting contractor's bank. It is important to note that prior to default the bank had a perfected security interest in those earned funds. The surety's right to the funds does not arise until after default, yet the surety prevailed in the *Shawmut* case.

The second leading case, the one on which the Michigan court relied, is *Canter v. Schlager*,<sup>72</sup> a Massachusetts case. That opinion held squarely that the right of subrogation is not a security interest and not subject to the priority rules of Article 9.

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67. "Upon lapse the security interest becomes unperfected . . ." *Id.*

68. *Id.* See also U.C.C. § 9-301(1)(b) (implies the same rule).

69. 411 F.2d 843 (1st Cir. 1969).

70. See U.C.C. §§ 9-301(1)(a), -312(5)(a).

71. In fact, the court held that the surety is also subrogated to the rights of subcontractors and suppliers it paid under the surety bond. Thus broad, then, is the surety's right of subrogation. See *National Shawmut Bank v. New Amsterdam Cas. Co.*, 411 F.2d 843, 845 (1st Cir. 1969).

72. 358 Mass. 789, 267 N.E.2d 492 (1971).

In the *American Oil* case, the Michigan court expressly adopted the holding common to *Canter* and *National Shawmut* that subrogation rights are governed by equitable rules and not Code rules.<sup>73</sup> In doing so it followed the weight of authority.<sup>74</sup>

In the second subrogation case the court of appeals had somewhat less success. *Earl Dubey & Sons, Inc. v. Macomb Contracting Corp.*<sup>75</sup> involved a surety and a secured party (whose interests were aligned by virtue of an indemnification arrangement) on the one hand and a garnishing creditor on the other. The subject of the dispute was sums earned by the contractor but unpaid by the owner. The court considered the following dates to be critical: the bank filed its financing statement on March 13, 1978; the judgment creditor served its garnishment writ on July 31, 1978; and the contractor defaulted on August 18, 1978. The court adopted a "first-in-time, first-in-right" approach and held first that the garnishment rights of the creditor defeated the subrogation rights of the surety (these subrogation rights having arisen no earlier than the date of default) and second that the security interest of the bank defeated the garnishment, the writ having been served after the bank filed its financing statement.

Although the facts of *Earl Dubey* are unique, the holding implicitly rejects the *American Oil* decision and flies in the face of the *National Shawmut* line of authority. The *Earl Dubey* court's first-in-time, first-in-right approach stems from contract and property law, not equity; by positing the dates of filing as the critical dates for determining the bank's rights, furthermore, the court invoked an Article 9 priority rule.<sup>76</sup> Under the first rule of contract conveyancing law, a grantor cannot give what he does not have.<sup>77</sup> Thus under contract law the garnishing creditor cannot in July obtain from the debtor what the debtor gave to the bank the previous March. By the same brand of contract-conveyancing analysis, the surety whose rights arise in August cannot defeat the earlier conveyances.<sup>78</sup> This analysis, however, derives strictly from "law," not equity, and by employing it, the court

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73. 95 Mich. App. 358, 361, 290 N.W.2d 144, 145 (1980). The surety retained its equitable right of subrogation even though it had at one time filed a financing statement under the Code and had later failed to renew it.

74. For a collection of the cases, see J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE 889 n.93 (2d ed. 1980).

75. 97 Mich. App. 553, 296 N.W.2d 582 (1980).

76. Article 9 employs the first-in-time rule in U.C.C. § 9-312(5)(a), its omnibus priority provision, and, moreover, uses the date of filing to determine priority for most non-possessory security interests.

77. "[N]emo plus juris in alium transferre potest quam ipse habet" (No one may transfer more rights than he enjoys himself). Wheelwright v. Depeyster, 1 Johns. 471, 479 (N.Y. 1806).

78. For a more complete discussion of these contract conveyancing rules, see Dolan, *The U.C.C. Framework: Conveyancing Principles and Property Interests*, 59 B.U.L. REV. 811 (1979).

ignored the Code's stipulation that rules of equity supplement Code rules.<sup>79</sup>

Clearly neither the *National Shawmut* case nor the *Canter* case adopt contract principles. In the *National Shawmut* case, moreover, the surety succeeded in its claim to proceeds earned before the right of subrogation arose and earned at a time when the surety's antagonist, the secured party, had a perfected security interest in those contract proceeds. A first-in-time approach in *Shawmut* would have yielded a rule for the bank, but the *Shawmut* court held for the surety.

In addition, the rule of the *Earl Dubey* case conflicts with the general line of authority that holds that the contractor's surety defeats the contractor's bank.<sup>80</sup> That line of cases, properly rejecting Article 9 analysis as the Michigan court did in *American Oil*, uses subrogation theory to elevate the surety's interest above the earlier filed security interest of the bank. *Earl Dubey*, of course, does not address the secured party/surety dispute directly, but the implication is manifest. *Earl Dubey* holds that the secured party bank defeats the garnishment creditor, who defeats the surety. It follows from that holding that the secured party bank defeats the surety—a result opposite to that of *National Shawmut*.

It may be argued, of course, that *National Shawmut* is wrong. Yet the *Earl Dubey* case is not persuasive on that point. The opinion does not address the question and does not reflect a conscious decision to reverse the *National Shawmut* rule, and it would be a distinct disservice to the cause of legal certainty for future Michigan courts to read *Earl Dubey* as breaking with a significant body of precedent.<sup>81</sup> We cannot deny, however, that *Earl Dubey* carries such an implication.

#### IV. PRODUCTS LIABILITY

This final section considers the gentle suggestion by a federal court that Michigan put its products liability house in order and offers a proposed resolution of the current confusion.

In *Roundhouse v. Owens-Illinois, Inc.*,<sup>82</sup> a diversity action, the Court of Appeals for the Sixth Circuit confronted a claim by fish farmers that their supplier sold infected fish and contaminated the plaintiffs' entire stock. The plaintiffs took four deliveries, three of

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79. See U.C.C. § 1-103.

80. See note 74 *supra*.

81. The issue is not an easy one. Should courts burden banks, as *National Shawmut* does, and increase the cost of construction financing? Or should courts burden sureties and increase the cost of construction bonds? Given these claims of the banking and the insurance industries, courts are well-advised above all to fashion a rule that yields certainty so that only the industry so burdened will incur the cost. Without certainty the price of both financing and bonding will reflect the uncertainty.

82. 604 F.2d 990 (6th Cir. 1979).



which occurred more than four years prior to the time the plaintiffs filed their complaint, and expert testimony established that the diseased fish could have been included in any or all of the deliveries.

The defendant asserted a statute of limitations defense under section 2-725, which limits recovery to claims brought within four years of delivery.<sup>83</sup> The defendant argued that it was incumbent on the plaintiffs to show that the contaminated delivery occurred within the four year period. The court rejected this defense, however, on the grounds that the burden was on the defendant to establish the statutory bar and that by failing to show that the fourth delivery was untainted the defendant failed to satisfy the burden of the affirmative defense.<sup>84</sup>

The opinion accords with Michigan case law on the burden question<sup>85</sup> and is unremarkable but for the opinion's reference to an unresolved problem with Michigan's statutes of limitations. The court noted that in addition to the Code's four year statute of limitations for breach of contract actions Michigan has an earlier statute that deals with "actions for damages based on breach of a warranty of quality or fitness . . . ."<sup>86</sup> The four year provision of the Code stipulates that the cause of action for "breach of warranty" occurs when the seller tenders delivery.<sup>87</sup> The latter provision stipulates that the claim for "breach of a warranty" occurs when the breach is or reasonably should be discovered.<sup>88</sup>

Although the Sixth Circuit was relieved at not having had "to grapple with" the issue,<sup>89</sup> Michigan courts and lawyers must. The problem stems from the fact that Michigan courts, perhaps deliberately, have confused two causes of action, both of which they call "breach of warranty."

It is not necessary to recite here the long effort to wrench contract

83. (1) An action for breach of any contract for sale must be commenced within four years after the cause of action has accrued. By the original agreement the parties may reduce the period of limitation to not less than one year but may not extend it.

(2) A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach. A breach of warranty occurs when tender of delivery is made, except that where 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.

U.C.C. § 2-725(1) & (2).

84. 604 F.2d at 993.

85. See, e.g., *Locke v. City of Detroit*, 335 Mich. 29, 33, 55 N.W.2d 161, 163 (1952); *Tumey v. City of Detroit*, 316 Mich. 400, 410, 25 N.W.2d 571, 575 (1947).

86. MICH. COMP. LAWS ANN. § 600.5833 (1968).

87. U.C.C. § 2-725(2).

88. MICH. COMP. LAWS ANN. § 600.5833 (1968).

89. *Roundhouse v. Owens-Illinois, Inc.*, 604 F.2d 990, 992 (6th Cir. 1979).

The court's opinion also refers to an earlier "valiant attempt to devine Michigan law in this area . . . ." *Id.* 992 n.4.

law from its position of *caveat emptor* to one more commercially realistic. We all know that the "citadel" has fallen with the nearly universal demise of the privity and notice requirements that prohibited claims by remote buyers. In the haste to achieve this desirable result, however, courts and legislatures may have tripped over each other. Michigan is the prime example.

At common law a party injured by a defective product may sue in tort for damages caused by the negligent conduct of the manufacturer or seller.<sup>90</sup> This traditional cause of action, however, arguably poses significant burdens on the plaintiff, not the least of which is the requirement of showing that the seller or manufacturer was negligent. Courts responded to plaintiffs' claims that this burden was too heavy by fashioning a new tort which, among other things, did not require the injured party to show any such negligence, but rather to show only that the product was dangerously defective and that the defect caused the injury.<sup>91</sup>

In most jurisdictions this new, judicially-created tort came to be known as strict liability in tort.<sup>92</sup> Unfortunately, the Michigan supreme court dubbed it "breach of . . . warranty,"<sup>93</sup> and the era of confusion had begun.

While courts were fashioning this new tort to relieve the burdens of injured buyers, the legislatures were also responding, but in contract, not in tort. The contract action was known by its historic name: "breach of warranty."<sup>94</sup> Manufacturers and sellers had attempted to avoid such contract liability by arguing that they made no warranties. The legislatures responded by inferring a warranty if the contract was silent<sup>95</sup> and by imposing serious limitations on the seller's attempts to disclaim any such implied warranty.<sup>96</sup> It is clear, furthermore, that the Michigan legislature intended to extend the contract breach of warranty claim to those who might sustain personal injury as a result of the sale of defective products. The Code stipulates that any contract which limits consequential damages<sup>97</sup> for injury to the person in the case of consumer goods is *prima facie* an unconscionable and,

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90. The leading case is still *MacPherson v. Buick Motor Co.*, 217 N.Y. 382, 111 N.E. 1050 (1916).

91. Prosser, however, takes the position that the proof required in a negligence case is really no different from that required in a strict liability case or a breach of warranty case. W. PROSSER, *HANDBOOK OF THE LAW OF TORTS*, 671-72 (4th ed. 1971).

92. The Restatement refers to it as "strict liability." *RESTATEMENT (SECOND) OF TORTS* § 402A (1965).

93. See, e.g., *Piercefield v. Remington Arms Co.*, 375 Mich. 85, 95, 133 N.W.2d 129, 133 (1965).

94. See *UNIFORM SALES ACT* §§ 14-16; F. POLLOCK, G. WALD & S. WILLISTON, *PRINCIPLES OF CONTRACT AT LAW AND IN EQUITY* 655 (3d ed. 1906).

95. See U.C.C. §§ 2-314, -315.

96. See U.C.C. § 2-316.

97. The Code defines consequential damages to include "injury to person or property proximately resulting from any breach of warranty." U.C.C. § 2-715(2)(b).

therefore, unenforceable<sup>98</sup> provision.<sup>99</sup> The Code also lists those persons to whom the protection of those rules extends.<sup>100</sup>

One final legislative refinement completed the cause of action picture. Injured plaintiffs complained that the two year statute of limitations for personal injuries yielded unfair results in situations where a manufacturer or seller delivered defective goods but the defect was latent. Similar arguments had been raised in service cases, and some courts had held that the cause of action accrues at the time the service is performed even though the injury does not occur until a later time, when the statute may have run.<sup>101</sup> Other courts rejected this view and held that the statute of limitations does not begin to run until the plaintiff discovers the defective service or reasonably should have discovered it.<sup>102</sup> These latter decisions in effect held that the cause of action accrues at the time of the injury, since it was at that time that the defect usually became apparent for the first time. Michigan adopted a broad version of the latter rule by statute extending it to actions for "breach of a warranty . . . ."<sup>103</sup>

There were two effects of this legislative and judicial reform. First, we have three causes of action: ordinary negligence, strict liability in tort, and breach of warranty. Second, we have in Michigan a triad of limitations statutes: a three-year statute for "actions to recover damages for injuries to persons and property;"<sup>104</sup> a four-year statute for actions for "breach of warranty,"<sup>105</sup> which runs from the time of delivery; and a statute which stipulates that the limitations period in a "breach of warranty" claim begins to run at the time the breach is or reasonably should be discovered.<sup>106</sup>

It is important to note that this state of affairs reversed the caveat emptor rule and rendered sellers and manufacturers virtual insurers of their customers, both those in privity and those remote. Defendants in products liability cases had to win three cases. They had to win the ordinary negligence claim, the strict tort claim, and the breach of warranty claim. The plaintiff, on the other hand, would recover his damages<sup>107</sup> if successful at only one of the three opportunities the courts and legislature had given him.

98. See U.C.C. § 2-302 (renders an unconscionable provision unenforceable or enforceable only as the court directs in order to avoid an unconscionable result).

99. See U.C.C. § 2-719(3).

100. See U.C.C. § 2-318 (extends recovery to persons other than the buyer).

101. See, e.g., *Essex Wire Corp. v. M.H. Hilt Co.*, 263 F.2d 599 (7th Cir. 1959); *Pasquale v. Chandler*, 350 Mass. 450, 215 N.E.2d 319 (1966).

102. See, e.g., *Flanagan v. Mount Eden Gen. Hosp.*, 24 N.Y.2d 427, 248 N.E.2d 871, 301 N.Y.S.2d 23 (1969).

103. MICH. COMP. LAWS ANN. § 600.5833 (1968).

104. MICH. COMP. LAWS ANN. § 600.5805(8) (Supp. 1980-81).

105. U.C.C. § 2-725.

106. MICH. COMP. LAWS ANN. § 600.5833 (1968).

107. It is beyond the scope of this article to consider the question of damages

The Michigan supreme court evidently thought three tries was one too many. In *Parish v. B.F. Goodrich Co.*<sup>108</sup> the plaintiff asserted causes of action for ordinary negligence and for "breach of warranty," the name Michigan gives to both the judicially created tort of strict liability in tort and the legislatively created contract cause of action for breach of implied warranty. The *Parish* court held, in effect, that the plaintiff had only two causes of action: ordinary negligence and breach of warranty, and that the Code's four-year statute of limitations did not apply to either. "[I]t was not intended that the time for commencement of a product-liability action against a manufacturer depend on whether plaintiff's theory of liability is grounded in tort or contract."<sup>109</sup> In short, *Parish* held that the remote products liability plaintiff has a cause of action only for ordinary negligence and for the judicially created strict liability tort cause of action, which Michigan courts call "breach of warranty."

This analysis clarifies the statute of limitations problem. It removes entirely the conflict the Sixth Circuit perceived between the Code statute, which begins to run at the time of delivery, and the statute which stipulates that the action accrues when the defect is or should be discovered. The former applies to contract actions under the Code and the latter to tort actions in negligence or strict liability.

There remains, of course, the question of whether the court has not destroyed the contract cause of action for personal injuries and property damage the legislature intended to create when it adopted the Code.<sup>110</sup> Certainly the court may in the common law tradition create causes of action, but it is also certain that the court may not prefer its judicially created cause of action to that created by the legislature, unless the legislature has authorized it to do so. In this instance, the legislature has so authorized it. The *Parish* case involved the "product liability of a manufacturer, not in direct dealing with the" plaintiff.<sup>111</sup> The buyer in *Parish*, then, was a remote buyer, not a direct buyer. The legislature has left it to the courts to decide whether such a buyer should benefit from Code warranties. The Code itself extends the warranties only to the buyer, his family, household and guests.<sup>112</sup> It leaves to the courts to decide whether to extend the warranties to remote buyers.<sup>113</sup>

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and the effect of Michigan's comparative negligence rule in these cases. See MICH. COMP. LAWS ANN. §§ 600.2945 & .2949 (Supp. 1980-81).

108. 395 Mich. 271, 235 N.W.2d 570 (1975).

109. *Id.* at 278, 235 N.W.2d at 572.

110. See text at notes 97-100 *supra*.

111. 395 Mich. at 279, 235 N.W.2d at 573.

112. See U.C.C. § 2-318 (Alternative A).

113. The first alternative expressly includes as beneficiaries within its provisions the family, household and guests of the purchaser. Beyond this, the section in this form is neutral and is not intended to enlarge or restrict the

The pattern, then, is clear. In Michigan the remote buyer has only two causes of action against the manufacturer: ordinary negligence and strict liability in tort, called "breach of warranty" by Michigan courts. The Code statute of limitations has nothing to do with either of those causes, which are governed by the three-year statute that commences to run at the time the product defect is or should be discovered.

In those cases where the plaintiff is in privity with the manufacturer or otherwise satisfies the rather narrow scope of section 2-318, he will enjoy three causes of action: ordinary negligence, strict liability in tort (called breach of warranty), and breach of warranty under the Code. The three-year statute applies to the first two and commences to run at the time the defect is or should be discovered. The Code's four-year statute applies to the third but commences to run at the time the goods are delivered.

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developing case law on whether the seller's warranties, given to his buyer who resells, extend to other persons in the distributive chain.  
*Id.* Comment 3.