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The Proposed Uniform Commercial Code: A New Bottle for Old and New Wines

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THE PROPOSED UNIFORM COMMERCIAL CODE: A NEW BOTTLE FOR OLD AND NEW WINES

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A nine member committee composed of three state senators, three members of the state House of Representatives, and three members of the Judicial Council has been created by a joint resolution of the General Assembly of South Carolina to study and make recommendations with respect to the Uniform Commercial Code.[1] The committee decided it would be necessary to analyze each section of this code and consider its effect on existing commercial law of South Carolina. To that end the author of this article was appointed reporter of the committee to assist it in the preparation of the study and report. That study is presently proceeding apace and should be available to the 1964 session of the General Assembly.

In the meantime, this discussion is designed to present a general view of this comprehensive statute in order to introduce members of the South Carolina Bar and other interested persons to some of the new concepts and how they would affect commercial practice. To accomplish this in the space allotted, it is necessary to paint with a broad brush and ignore detail except as it may be useful as illustrations. This is said with some apology to those who may have had occasion to explore the code in some depth, and thus may find this treatment too cursory. A more detailed treatment including a comparison with South Carolina law will be more appropriate if and when the code is enacted into law.

BACKGROUND AND INTRODUCTION

The movement toward uniform commercial laws began in the latter part of the last century with the principal impetus coming from the increased volume of interstate commerce as a product of the industrial revolution. The early manifesta-

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1. No. 999, 1962 S.C. ACTS AND JOINT RESOLUTIONS, 2323 (Feb. 9, 1962). Members of the committee are: Senators Charles C. Moore (Chairman), Robert W. Hayes and Earl E. Morris; House members, H. F. Bell, Clyde A. Eltzroth, and Paul M. Moore; Judicial Council appointees, S. Henry Edmunds (Vice-Chairman), William Blackwell and Dean Samuel L. Prince.

tion of the need for uniformity of law in the several states was the creation of the National Conference of Commissioners on Uniform State Laws, whose first major project was the promulgation of the Negotiable Instruments Law in 1896. Thereafter the conference commissioned the drafting of the Uniform Sales Act (1906), Uniform Warehouse Receipts Act (1906), Uniform Stock Transfer Act (1909), Uniform Conditional Sales Act (1918), and the Uniform Trust Receipts Act (1933).

In 1940, when the conference met to consider amendments to the Uniform Sales Act in order to avoid conflict with a proposed Federal Sales Act, a proposal was made to abandon the piecemeal approach to codification of commercial law in favor of a single comprehensive statute. The suggestion was accepted and the Uniform Commercial Code was conceived.[2]

In 1942 the American Law Institute and the conference joined in this undertaking and appointed an editorial board and numerous drafting committees composed of many nationally prominent judges, lawyers, and law teachers. The Section of Corporation, Banking and Business Law of the American Bar Association worked with the editorial board and made numerous suggestions, many of which were incorporated into the code. In 1951 the official text was approved by the two sponsoring organizations and by the House of Delegates of the American Bar Association.[3]

This text, with the drafter's official comments as finally approved, was available in 1952 and the next year the code was enacted in Pennsylvania and became effective on July 1, 1954.[4] The New York Legislature, however, referred it to the New York Law Revision Commission for a comprehensive study and public hearings. After three years of work and the expenditure of over $300,000, the New York commission reported that the Uniform Commercial Code was not satisfactory in its present form.[5] In order to meet a number of the objections raised in this critical analysis the editorial board revised a number of sections. This became the 1957 and

2. HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 58 (1940).
3. HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 126, 148 (1953); 76 A.B.A. ANN. REP. 135 (1951).
4. PA.STAT. ANN. tit. 12A (1954).
5. REPORT OF THE NEW YORK LAW REVISION COMMISSION 57-58 (1956).

finally the 1958 official draft, which has been enacted in twenty-six states as of the date of this writing.[6]

In an attempt to head off the tendency to amend parts of the code as it comes up for enactment in each state and to iron out defects as they appear in application, a permanent editorial board was established to consider "uniform" amendments. This board has published its 1962 official recommendations which will be considered as the most current edition of the proposed code.[7]

The basic premise on which the Uniform Commercial Code is based is that a "commercial transaction" is a single subject of the law, notwithstanding its many facets, involving the sale of and payment for goods. There may be a contract for sale, the giving of a check for part of the purchase price which may be negotiated through the banking system for collection, and the acceptance of some form of security for the balance. The goods may be shipped or stored requiring some form of document of title.

The basic objective of the code is to bring all of these phases under one statute and to simplify, clarify, modernize and make uniform this law.[8] The physical arrangement is to treat these various phases under eight separate articles. These consist of an article on sales, an article on "commercial paper" which would repeal the Negotiable Instruments Law,[9] an article on bank deposits and collections which would repeal the Bank Collection Code,[10] an article on letters of credit, an article on bulk sales which would repeal the Bulk Sales Act,[11] an article on documents of title which would repeal the Uniform Warehouse Receipts Act[12] and the Uniform Bill of Lading Act,[13] an article on investment securities which would repeal the Uniform Stock Transfer Act,[14] and finally, an

6. See 1 UNIFORM LAWS ANN., *Uniform Commercial Code*, Table 1, xxxiii, for statutory citations. The code is presently pending before the legislatures of ten additional states.

7. PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, Rep. No. 1 (1962).

8. UNIFORM COMMERCIAL CODE §1-102. Footnote citations to the Uniform Commercial Code refer to the 1958 official draft as amended by the 1962 report of the Permanent Editorial Board and will hereafter be cited as "U.C.C."

9. S.C. CODE §§8-801 to 8-1108 (1962).

10. S.C. CODE §§8-181 to 8-215 (1962).

11. S.C. CODE §§11-201 to 11-206 (1962).

12. S.C. CODE §§69-151 to 69-246 (1962).

13. S.C. CODE §§58-1701 to 58-1777 (1962).

14. S.C. CODE §§12-301 to 12-324 (1962).

article on all types of personal property security transactions which would repeal a number of South Carolina statutes dealing with chattel mortgages and related matters.[15] Article 1 is a general introductory article and article 10 states the effective date of the code and lists the existing statutes to be repealed. Other uniform commercial acts which the code replaces but which have not been enacted in South Carolina are the Uniform Sales Act, the Uniform Conditional Sales Act, the Uniform Trust Receipts Act, the Uniform Written Obligations Act, and the Uniform Fiduciaries Act.

The several predecessor statutes promulgated by the National Conference of Commissioners on Uniform State Laws were all drafted at different times by different hands. For the first time the code affords the opportunity of integrated coverage whereby the rules are written with regard to the inter-relation between the many aspects of a commercial transaction.

ARTICLE 1: GENERAL PROVISIONS

Article 1 contains several general policy pronouncements as a guide to the construction of sections throughout the code. Consistent with a major objective of flexibility to permit adaptability to change and expansion of commercial practice through custom, usage, and agreement of the parties, section 1-102 expresses a non-controversial preference for freedom of contract. This general language is at once compromised by policy considerations which preclude enforcement of such contract terms which would relieve a party of the obligation of good faith, due care, and such other specific exceptions which will come as no surprise to the lawyer.[16] For example, the invalidity of a clause in a security contract depriving the debtor of certain rights in the collateral upon default is continued.[17]

Another broad policy statement is the preference for liberal administration of remedies.[18] This is, no doubt, a reaction against the tendency of restricting damage for breach found in

15. *E.g.*, S.C. CODE §§45-151 to 45-164 (provisions affecting chattel mortgages); §§45-201 to 45-211 (assignments of accounts receivable); §§45-401 to 45-410 (factors' liens on merchandise); §§60-301 to 60-310 (perfection of chattel mortgages) (1962).
16. U.C.C. §1-102 (3).
17. U.C.C. §9-501 (3).
18. U.C.C. §1-106.

some of the case decisions and is more specifically illustrated in the code by section 2-708, which permits a seller to include lost profits as part of his damages against a breaching party.

While the code is in effect in some states and not in others, difficult conflict of laws problems may arise in interstate commercial transactions. This problem may be partially relieved by the provisions of section 1-105 which authorizes the parties to the transaction to designate in their contract the application of law of a state having some reasonable relation to the contract. In the absence of such agreement, "this act applies to transactions bearing a reasonable relation to this state." A subsection provides an index to other sections of the code which specifies the applicable law governing a specific type of commercial transaction.

Section 1-201 contains a definition of forty-six terms which are used throughout the code. Some of these are in familiar usage in the commercial field; others are new or are defined in a revised or modified way.

ARTICLE 2: SALES

Article 2 is designed to replace the Uniform Sales Act modifying many of the provisions to meet modern commercial needs and to fill gaps of coverage which could not have been anticipated when that Uniform Act was drafted in 1906. While South Carolina is one of about a dozen states which has never enacted the Uniform Sales Act, it was essentially a codification of the common law and thus most of the provisions have been established or have been followed in South Carolina by the case decisions.

A novelty of the sales article of the code is the attempt to stratify sales law by stating different rules where the parties to a sale are merchants. This is more apparent than real, however, since the term "merchant" is defined as "a person who deals in goods of the kind"[19] which would include the great bulk of all sales transactions. (Early drafts of this article contained some complex and interesting distinctions between sales to dealers who buy for re-sale, industrial purchasers who buy for use, and sales to individual consumers.[20]

19. U.C.C. §2-104.
20. Uniform Commercial Code, Text and Comments Official Edition (Proposed Final Draft 1950).

These distinctions have been deleted by subsequent drafts of the code.)

Title-Passing Concept

A much more significant novelty of article 2 is the attempt to state the law without reference to what has been considered the central point in Anglo-American Sales Law for at least a century and a half — the location of title. Many of the controversies between buyer and seller have been answered by early common law decisions and subsequently, as codified in many states by the Uniform Sales Act, by a determination of the location of title to the goods which formed the subject matter of the sales transaction.[21] It has been fictitiously supposed that the parties intended title to pass at some particular time.[22] To compound the fiction, presumptions as to when the parties intended the title to pass were invented which now seem to approach the status of substantive rules of law.[23] Having thus located title in either buyer or seller, it appears to be a simple and certain matter to proceed from that point to the result of such important questions as risk of loss, the right of the seller to maintain an action for the price (as distinguished from an action for damages), the buyer's right to have the goods, as well as matters not directly involved with sales law, such as the tax burden upon the goods and the right of creditors (including a trustee in bankruptcy) of the buyer or seller to reach the goods.

The drafters of article 2 took the position that this "lump concept thinking" has created many uncertain and unfair results, since it is frequently difficult to predict when title passes, and even when established, it may have no logical relationship to the rights and duties in question. The basic approach of "narrow - issue" thinking under the code is generally stated in section 2-401: "Each provision of this article with regard to the rights, obligations and remedies of the seller, the buyer, purchasers or other third parties applies irrespective of title to the goods except where the provisions refer to such title." Having thus de-emphasized title, specific rules are stated to provide solutions to specific problems. Thus, on the recurring risk of loss problem, possession of the goods

21. UNIFORM SALES ACT §22 (risk of loss); §63 (seller's action for the price); §66 (buyers' action for conversion).
22. *Ibid.* §18.
23. *Ibid.* §19.

is the controlling factor which replaces the title-passing test,[24] except where either party is in breach, in which case the loss falls on the breaching party.[25] Where the goods are to be shipped from seller to buyer, possession, and thus risk of loss, passes to the buyer when the goods are delivered to the carrier, except that on a destination contract (*e.g.*, "F.O.B., Columbia, South Carolina," where goods are to be shipped to a buyer in Columbia), possession and risk of loss passes to the buyer when the goods are tendered at their destination.[26]

Furthermore, the seller's rights upon breach by the buyer to recover the contract price (the seller's remedy which is the equivalent of the buyer's action for specific performance) would not turn on the passage of title under the code but on the more functional basis of whether the seller may be able to re-sell the goods.[27]

Where there are no specific provisions dealing with an issue, and title-passing remains relevant, such as in determining the tax incident, or application of other public regulation, section 2-401 prescribes the point in time when title passes. Generally, this is when the seller completes his performance by delivery of documents of title or of the goods, when so required; otherwise at the time of contracting. But in no event will title pass until the goods are identified to the contract, i.e., with respect to future goods, when they are designated by the seller as goods to which the contract refers.

Performance

While the code would seem to continue the standard for a seller's performance of "perfect tender," as distinguished from "substantial performance" where delivery is to be made in single lot (section 2-601 says "if the goods fail in *any* respect to conofrm . . ."), some of the sting has been removed by the rule of section 2-508 which introduces the concept of "cure." A seller is permitted to remedy a defective tender if he can do so within the time set for performance. Furthermore, the seller may cure after the time for performance has passed if the "buyer rejects a non-conforming tender which the seller had reasonable grounds to believe would be ac-

24. U.C.C. §2-509.
25. U.C.C. §2-510.
26. U.C.C. §§2-319, 2-509.
27. U.C.C. §2-709.

cepted." This latter provision is designed to relieve the seller from the "forced breach" advantage enjoyed by the buyer who could wait until the eleventh hour and reject the goods (usually for the real reason that due to a change in market conditions the contract is no longer attractive to him) because of some minor defect.

Section 2-605 shores up another advantage enjoyed by the buyer by requiring him to state the grounds for rejection where a defect in the tender could have been ascertained by reasonable inspection and could have been cured by the seller if stated seasonably. Failure on the part of the buyer to particularize his objection will preclude him from relying on the unstated defect to justify his rejection. With respect to other grounds of rejection (those not readily apparent or not so minor as to be cured) the merchant buyer, upon request from a merchant seller, must make a written final statement of all the defects on which he proposes to rely. Thereafter the buyer is limited to the objections so stated.

Remedies for Breach

Most of the remedy rules upon breach are continued but with some modifications. The code introduces the concept of "cover" where the seller fails to perform by giving the buyer an alternative right to purchase substitute goods and recover from the seller the difference between the contract price and the cost of cover as an absolute measure of damages, provided he purchases in a reasonable manner.[28] In order to be consistent with the right to cover, the buyer's alternative right to sue for damages is measured by the difference between the contract price and the market price at the time he learned of the breach (the time when he could have made a cover purchase), and not the market price at the time when the goods should have been delivered.[29] The buyer's right to specific performance is liberalized by section 2-716, when the goods are "unique (the usual rule) or in other proper circumstances." This last phrase is apparently to permit the buyer to have the specific goods when, for example, in an "output" or "requirements" contract, he is unable to cover, even though the goods are not necessarily unique.

28. U.C.C. §2-712.
29. U.C.C. §2-713.

As in the case of the buyer's remedies, the seller's rights under the code upon breach are also similar to existing law but with some liberalizing modifications. The seller has the absolute right to re-sell the goods wrongfully refused by the buyer and recover the difference in re-sale price and the contract price, provided the re-sale is "commercially reasonable."[30] Section 2-709 expressly permits the seller to recover any loss of profits which he would have received had the buyer performed and which the case law has been reluctant to allow where the market price and contract price are the same.[31]

Public policy restrictions are imposed on freedom of contract under section 2-718 where a liquidated damage clause upon breach is enforceable only where reasonable (not excessive) and in no event will the buyer be made to forfeit an amount in excess of twenty per cent of the price, or $500.00, whichever is smaller. An interesting balance between freedom of contract and policy limitations thereto is found in section 2-725, which prescribes a four-year statute of limitations for actions on a sales contract which by agreement may be reduced to not less than one year but may not be extended.

Formation of the Sales Contract

One area of sales law which is not touched by the Uniform Sales Act nor treated separately from the general common law of contracts is the formation of a sales contract. The application of the usual rules of offer, acceptance and consideration has resulted in some uncommercial and unexpected results — at least results which are not expected by the non-lawyer businessman. The drafters of the code took this opportunity to make sales contract law conform to commercial practice and understanding as to when merchants are bound by their agreements. For example, a written firm offer to buy or to sell goods may not be revoked for a limited time, even though no consideration has passed.[32] An offer to buy goods may be accepted and a contract formed, even though the acceptance contains some additional or minor different terms, and such additional terms will become part of the contract

30. U.C.C. §2-706.
31. See generally, *Lost Profits as Contract Damages: Problems of Proof and Limitations on Recovery*, 65 YALE L. J. 992 (1956).
32. U.C.C. §2-205.

unless objected to within a reasonable time.[33] Section 2-209 permits a good faith modification of an existing sales contract without additional consideration as between merchants. In authorizing the commercially expedient open-price agreements and output and requirement contracts, sections 2-305 and 2-306 deliver the final death blow to the common law objections of uncertainty and lack of mutuality.

Section 2-201 continues the application of the Statute of Frauds to sales contracts with some apparent reluctance, as evidenced by some liberalizing modifications. The amount of the purchase price, which creates the requirements of a writing, is increased to $500.00.[34] The language "some writing sufficient to indicate that a contract of sale has been made . . ." rejects the strict early case law requirement of stating all material terms of the contract in a written memorandum. Where merchants make an oral telephone contract and a confirmation of the conversation is sent by letter, the other party must object to the contents of the writing within ten days. Thereafter, the contract may be proved by oral evidence and is not subject to the Statute of Frauds defense. Partial performance of an oral contract satisfies the Statute of Frauds only to the extent that goods or payment have been actually received.[35]

Warranties

In dealing with the frequently litigated problem of sales warranties, the code makes surprisingly few changes. One minor conflict is resolved by the provision of section 2-314 that the "serving for value of food or drink to be consumed either on the premises or elsewhere is a sale." Disclaimer of warranties is still permitted as a matter of freedom of contract, but with the condition that if such disclaimer is in a written contract it must be "conspicuous." Furthermore, to disclaim the implied warranty of merchantability, the writing must mention the word "merchantability."[36] The code is silent on the question of privity between the seller and buyer as a pre-requisite of a breach of warranty claim. This highly controversial issue is therefore left to the developing case

33. U.C.C. §2-207.
34. S.C. Code §11-103 (1962) requires a writing for the sale of goods for a price of $50.00 or more.
35. See, *e.g.*, Boozer v. Teague, 27 S.C. 348, 359 S.E. 551 (1888).
36. U.C.C. §2-316.

law when a buyer seeks to hold the manufacturer of the goods liable for defects which constitute a breach of the "contractual" warranty obligation.

Rights of Third Parties

An important change with respect to the rights of third parties is the rule of section 2-403 which gives to a buyer from a merchant who deals in goods of that kind a claim to the goods which is superior to that of an owner who had entrusted them with the merchant. Most of the case law, as well as the Uniform Sales Act, has recognized that an owner of goods may be estopped under varying circumstances from asserting his claim of ownership against a bona fide purchaser from the entruster.[37] The code rule would further repudiate the concept that such a transferror can pass no better title than he has, in favor of the policy of greater negotiability of goods and protection to a bona fide purchaser. The law, as it is said to be, would be substantially changed by this code section. The change appears to be more modest, however, when compared with the law as it actually is, which tends to protect the purchaser by working an estoppel against the entrusting-owner. When goods are sold and the seller remains in possession, case decisions have held under varying circumstances that the seller's creditors may treat the sale as fraudulent and thus void as to them.[38] Section 2-402 modifies this rule by stating that "retention of possession in good faith and current course of trade by a merchant-seller for a commercially reasonable time after a sale or indentification is not fraudulent."

37. See, *e.g.*, Budget Plan, Inc. v. Savoy, 336 Mass. 322, 145 N.E.2d 710 (1957), where a bona fide purchaser of a car from a garage prevailed over the owner who had entrusted it with the garage. The court found that the conduct of the owner in creating indicia of title in the transferor precluded the owner from denying the seller's authority to sell under section 23 of the Uniform Sales Act. The South Carolina Supreme Court has recently reached a similar result by estopping a wholesale dealer from converting title to an automobile as against a buyer from a retail dealer who was permitted to have possession. Clanton's Auto Auction Sales, Inc. v. Young, 239 S.C. 250, 122 S.E.2d 640 (1962). See also, Clanton's Auto Auction Sales, Inc. v. Harvin, 238 S.C. 352, 120 S.E.2d 237 (1961), and *Ex Parte* Dort, 238 S.C. 506, 121 S.E.2d 1 (1961).

38. Early South Carolina case law was to the effect that the sale was conclusively fraudulent as to creditors. Kennedy v. Bass, 2 Mill 125 (S.C. 1818). Later decisions have held that retention of possession gives rise to a presumption of fraud which may be rebutted by proof of good faith. *E.g.*, Pregnall v. Miller, 21 S.C. 385 (1884).

ARTICLE 3: COMMERCIAL PAPER

The Uniform Negotiable Instrument Law (NIL) was the first of the uniform laws promulgated by the National Conference of Commissioners on Uniform State Laws and subsequently enacted by all of the states.[39] In repealing the NIL, article 3 of the code represents the first real re-examination and revision of the law of commercial paper in over sixty years. The code drafters apparently found most of the NIL rules as they applied to commercial paper (the code term for bills and notes) adequate, since they confined themselves principally to the tidying up of loose ends by resolving a number of conflicts which have developed over the years.

An important change in the scope of coverage is to divorce commercial paper from long-term investment securities by dealing with the latter in a separate article 8. This would solve the problem of fitting corporate bonds, which necessarily carried collateral provisions, into the rigid mold of the NIL which conceived of all negotiable paper as a "courier without luggage."

Also, the check collection process by banks which has been partially dealt with under the Bank Collection Code and the NIL, is split off and placed under a separate article 4.

Form and Negotiation

The code continues the basic policy that commercial paper, in order to serve its function as a substitute for money, must be a certain promise to pay a definite amount of money at a definite time. A number of conflicting and uncertain rules of case law, which have attempted to balance this policy with contemporary commercial needs, are resolved and settled. For example, negotiability is not affected by any acceleration clause in a time instrument,[40] but such acceleration may be called only upon the good faith belief that the prospect of payment is impaired.[41] Furthermore, a promise to pay is un-

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39. Enacted in South Carolina in 1914 and presently appearing as S.C. CODE §§8-801 to 8-1076 (1962). For subsequently enacted provisions relating to negotiable instruments, see S.C. CODE §§8-1081 to 8-1083 (1962).

40. U.C.C. §3-109(1)(c). This would reverse the rule of the leading South Carolina case of Carroll County Sav. Bank v. Strother, 28 S.C. 504, 6 S.E. 313 (1888), which held that where the holder may declare the note due "whenever he deems himself insecure," the note is not negotiable.

41. U.C.C. §1-208.

conditional, and thus negotiability is not impaired, where a note is executed by a partnership and the promise to pay is only out of partnership assets, or by a governmental agency where the promise is limited to payment out of a particular fund.[42]

Most of the basic rules concerning negotiation are continued under the code. An illustration of a minor change is the complete rejection of the "once bearer, always bearer" common law cliché as partially enacted by section 40 of the NIL, which treats a bearer instrument as remaining bearer even though specially indorsed.[43] Section 3-204 of the code permits any holder, as the owner of commercial paper, to convert bearer paper to order by special indorsement and thus to control the method of future negotiation until it is re-converted to bearer paper by a subsequent holder's blank indorsement.

Section 3-205 includes a conditional indorsement within the definition of restrictive indorsements. A restrictive indorsement (such as the familiar indorsement for collection) does not affect an intermediary bank's taking a check in the collection process, and a restrictive indorsee may be a holder in due course, to the extent that value is applied by him consistent with the indorsement.

Liability of Parties

The construction of several NIL sections by the courts has led to the imposition of liability on parties which the drafters of the code found to be undesirable. This will be illustrated by the following examples of changes which the code would make.

The test of whether a check is bearer or order under NIL section 9 turns on whether the drawer intends for the named payee to receive payment; if he does, it is order paper and thus may be transferred and properly paid only by a valid indorsement of the payee.[44] This conceptual rationale sometimes leads to the result that where a drawer draws a check with the name of a payee supplied by a dishonest employee, who then indorses in that name and receives payment, the paying drawee bank may not debit the account of the drawer,

42. U.C.C. §3-105(1)(g) and (h).
43. S.C. CODE §8-861 (1962).
44. S.C. CODE §8-820(3) (1962), recently applied in Southern Frozen Foods, Inc. v. Hill and Schumpert, 129 S.E.2d 420 (S.C. 1963).

since it paid an order instrument under a forged indorsement.[45] The same result may be reached where an impostor induces the drawer to make a check payable to the person impersonated, in which case the check may be an order instrument, since the drawer intends for the named payee to receive payment.[46] Section 3-405 is aimed at this result, not on the bearer-order theory, but on the basis of allocation of loss, by the provision that the indorsement under the illustrated circumstances is effective. Thus the loss is borne by the drawer and not by the paying drawee.

Section 3-417 contains some elaborate implied warranty provisions in favor of a drawee given by a holder on presentment for acceptance or payment, while under the existing NIL sections 65 and 66 warranties run only to the holder upon transfer.[47] Implied warranties include a warranty of all necessary indorsements and a warranty that the instrument has not been altered. These warranties are also made by prior indorsers so that the drawee or acceptor, who is entitled to recover after payment because of a forgery or alteration, is not restricted to proceeding only against the party receiving payment.

Any existing doubt as to the application of the doctrine of *Price v. Neal*,[48] which places the loss on the drawee bank who pays or accepts a forged check in favor of a holder in due course, is clearly removed by the absence of a warranty of genuineness of the drawer's signature. Section 3-418 confirms this result by making payment or acceptance final as to a holder in due course.[49]

45. *E.g.* Commonwealth v. Farmers Depositors Bank, 264 Ky. 839, 95 S.W.2d 793 (1936). In Bourne v. Maryland Cas. Co., 185 S.C. 1, 192 S.E. 605 (1937), a faithless employee with authority to sign for his employer, made checks payable to other employees, forged their indorsement and received payment from the drawee. The court held this to be bearer paper under S.C. CODE §8-820(3) (1962), since the named payees were not intended by the drawer-fraudulent-employee to receive the payment. Applied in Ellis Weaving Mills v. Citizens & So. Nat'l Bank, 91 F. Supp. 943; *aff'd*, 184 F.2d 43 (4th Cir. 1950).

46. *E.g.*, Milner v. First Nat'l Bank, 38 Ga. App. 668, 145 S.E. 101 (1928).

47. S.C. CODE §§8-896 and 8-897 (1962).

48. 3 Burr 1354 (1762).

49. The application of the Price v. Neal rule in South Carolina has been uncertain in light of the pre-N.I.L. cases of Ford v. Peoples Bank, 74 S.C. 180, 54 S.E. 204 (1906), and Newberry Sav. Bank v. Bank of Columbia, 91 S.C. 294, 74 S.E. 615 (1912), which indicate that a payor may recover the amount paid on a forged check. Subsequently, S.C. CODE §8-893 (1962) enacted the rule of Price v. Neal with respect to an acceptor who accepts a forged check, but the statute is silent as to payment.

NIL section 15 provides that nondelivery of an incompleted instrument is a real defense available against even a holder in due course, although neither nondelivery nor unauthorized completion of a delivered instrument may be asserted against a holder in due course. This is the case of the careless drawer who signs checks but does not fill in all blanks, which checks are stolen, filled in, and negotiated to a holder in due course. Section 3-115 reverses this result by treating this as only a personal defense "when a paper whose contents at the time of signing show that it is intended to become an instrument . . ."

The requirement of timely presentment to parties who are primarily liable (drawees, makers and acceptors) and notice of dishonor in order to hold parties who are secondarily liable (indorsers and drawers) is continued under the code.[50] The requirement of formal protest, however, is practically eliminated as a condition to holding secondary parties liable, by limiting this requirement to a draft drawn in a foreign country upon a drawee located in the United States.[51] The time within which a check must be presented for payment is lengthened to thirty days with respect to the liability of a drawer and to seven days after indorsement with respect to the liability of an indorser, as a matter of presumed reasonable time.[52] The NIL rule of complete discharge of an indorser by a delay in presentment or notice of dishonor is preserved under the code,[53] The discharge to a drawer only to the extent of prejudice by such delay (usually by insolvency of the drawee during the period of delay) applies to all drawers.[54] This *pro tanto* discharge of drawers does not apply under NIL section 70 to the drawer of a bill of exchange other than a check who is fully discharged. Nor does it apply to makers of a note payable "at a bank," or acceptors of a bill where the acceptance is payable "at a bank," who are not discharged at all.[55]

50. S.C. CODE §8-931 (1962), *applied in* Bass v. Rainwater, 133 S.C. 315, 131 S.E. 41 (1925).
51. U.C.C. §3-501(3). *Cf.* S.C. CODE §§8-1021, 8-984 (1962).
52. U.C.C. §3-503(2) *Cf.* S.C. CODE §8-804 (1962).
53. U.C.C. §3-501(1)(b) and (2)(a). S.C. CODE §8-911 (1962).
54. U.C.C. §3-501(1)(c) and (2)(b). *Cf.* S.C. CODE §§8-911 and 8-1073 (1962).
55. S.C. CODE §8-911 (1962).

Discharge

The grounds for discharge under the code are similar to the NIL, except that section 3-601 of the code makes it clear that discharge applies only to the parties to the instrument (and not to the instrument itself) in order to remove the implication that an act which constitutes a discharge may create a defense to a holder in due course. One substantial change relates to discharge by payment which, under NIL section 119, requires payment "in due course."[56] NIL section 88 defines this as payment "without notice that his title was defective," even though the payor had no way of knowing whether the assertion of an adverse claim is valid.[57] Code section 3-603 changes this by permitting discharge by payment to the holder, in spite of knowledge of an adverse claim (thus preserving the payor's credit standing) unless the adverse claimant supplies indemnity. This is further qualified by not including payment to a thief or payment in a manner inconsistent with a restrictive indorsement.

ARTICLE 4: BANK DEPOSITS AND COLLECTIONS

Attempts at codification of the law governing the bank collection process have had a turbulent past. The National Conference of Commissioners on Uniform State Laws made an effort to draft a uniform act, but it met with such opposition from bankers that it was never enacted into law in any jurisdiction. A Bank Collection Code was drafted under the auspices of the American Bankers' Association, and it therefore cannot be called a "Uniform Act" in the usual sense. This "ABA Code" was passed in a number of states shortly after it was drafted, including South Carolina, which enacted it in 1930.[58] The enthusiasm for this legislation was slowed down by criticism that it was unfairly weighed in favor of banks and against their depositors, that it was poorly drafted,[59] and finally by the 1935 decision of the United States Supreme Court in *Jennings v. United States Fid. & Guar. Co.*,[60] that one section was invalid as it applied to national banks.

56. S.C. CODE §8-971 (1962).
57. S.C. CODE §8-929 (1962).
58. S.C. CODE §§8-181 to 8-215 (1962).
59. *E.g.*, TOWNSEND, *The Bank Collection Code of the American Bankers' Association*, (Pts. 1-3) 8 TUL. L. REV. 21, 236, 376 (1933-1934).
60. 294 U.S. 216, 79 L.Ed 865 (1935).

After considerable vacillation, including an initial plan to include the bank collection material under article 3, and a decision, after the traditional cross-fire of controvery surrounding this subject, to drop the subject from the code altogether, the drafters of the code finally decided to include a separate article 4. This decision was based on the need for uniform rules to govern the great volume of checks which continuously flow across state lines in the bank collection process. The scope of this article encompasses practically every item, broadly defined as any instrument for the payment of money which passes through banks for the purpose of presentment, payment or collection.[61]

Final Payment of Checks

One of the most important problems in the bank collection process is the establishment of a precise time when a check is deemed to have been finally paid by the drawee bank. It is at that point that it is no longer possible for the drawer to stop payment, the drawer's account is charged with the amount of the check (so that his creditors may not thereafter attach these funds on deposit), the provisional credit to the account of the depositor of the check becomes irrevocable so that he may draw against that credit, drawers and indorsers of the check are discharged, and the point of no return is reached so that the payor bank is accountable for the amount of the check. Code section 4-213 continues the obvious rule that the final payment occurs when the payor bank pays cash to the holder over the counter. This section further fixes definite rules for time of payment in the more usual case when a check comes to the payor from a depository bank — either directly or through an intermediary bank or through a clearing house in the collection process. The usual practice in such case is for the payor bank to give provisional credit for the item at the time of receipt, reserving the right to revoke that credit if it subsequently decides that the check should not be paid. Since time is of the essence, the payor bank will be deemed to have finally paid if it takes no action to revoke the provisional credit within the period prescribed by clearing house rules (in some instances a matter of hours after receipt). When a check is sent through the mails to the payor bank, the code requires a revocation of the pro-

61. U.C.C. §4-104(2).

visional credit within the "midnight deadline."[62] This term is defined in section 4-104 as "midnight on the next banking day following the banking day on which it receives the item . . . " "Midnight deadline" is also the presumed period of time within which a collecting or intermediary bank receiving a check in the collection process must act in presenting for payment, sending notice of dishonor, etc.[63] For the purpose of computing the commencement of the period, existing banking practice of fixing an afternoon hour no earlier than 2 p.m. as a cut-off time after which items will be considered as received on the next banking day, is recognized by code section 4-107.

An alternative point of final payment after which a check may not be returned, is the "posting" of the check by the payor, i.e., the mechanical act of debiting the drawer's account. The point of time after which a stop-payment order from the drawer or attachment of the account by the drawer's creditors is not effective is established as the time of "sight posting."[64] In the collection process this occurs when a clerk has placed the check in a stack to be sent to another office for final posting and is based on the practical difficulty of preventing the payment by final posting after this time.

Relationship Between Payor Bank and Its Customer

Article 4 contains a number of rules governing the relationship between a payor bank and its customers, some of which would modify or directly change existing law or settle areas of present uncertainty. Section 4-402 recognizes the generally understood rule that a drawee bank has a duty to pay a check which is a proper order to pay,[65] but modifies the damage rule for breach of this duty by limiting recovery to actual damages proved.[66] When two or more checks are presented for payment at the same time and the account is insufficient to pay them all, the bank may pay in any order with impunity until the deposit is no longer sufficient to pay any

62. U.C.C. §4-301. *Cf.* S.C. CODE §8-211 (1962).
63. U.C.C. §4-202(2).
64. U.C.C. §4-303(1)(d).
65. St. Charles Mercantile Co. v. Armour & Co., 156 S.C. 397, 153 S.E. 473 (1930).
66. Present case law in South Carolina permits recovery of substantial damages without proof of special damages where a drawee bank negligently fails to honor a check. *E.g.*, Johnson v. National Bank, 213 S.C. 458, 50 S.E.2d 177 (1948).

one.[67] Present uncertainty as to the effectiveness of stop-payment orders is removed by section 4-403, which makes an oral order binding upon the bank for fourteen days and a written order effective for six months.[68] A bank's duty to its depositor with respect to a stale check presented for payment is clarified by section 4-404, which provides that the bank may, but need not, pay a check which is presented more than six months after its date.[69] When the drawer of a check dies or is incompetent before it is paid, the order to pay is still effective until the bank learns of the death or incompetence and may pay for ten days after such knowledge.[70]

Code section 4-406 continues the common law duty of a depositor to examine his bank statements and paid items and notify the bank with reasonable promptness of a forgery of his signature on a check that has been paid or any alteration, at pain of being precluded from asserting such irregularities.[71] This section gives the drawer 14 days after the return of an item and statement to discover and notify the bank of a forgery or alteration. Thereafter he is estopped to assert any subsequent forgery or alteration by the same wrongdoer. In all other cases, without regard to negligence, the customer has one year from the time the statement and items are made available to him to discover and report to the bank a forgery of his signature or an alteration and three years from such time to report a forged indorsement.

ARTICLE 5: LETTERS OF CREDIT

The commercial letter of credit has been employed principally in international trade where the foreign seller is willing to ship goods only on the credit of a known bank which promises to pay the purchase price upon the receipt of the bill of lading and other necessary documents. Prior to the code, the law concerning letters of credit came from common law decisions, principally of New York, Massachusetts and California, where the bulk of foreign commerce is financed. Thus, article 5 of the code breaks new ground in codifying the legal rules concerning this device. The greater certainty and clari-

67. U.C.C. §4-303(2).
68. *Cf.* S.C. CODE §§8-1082, 8-1083 (1962).
69. *Cf.* S.C. CODE §8-1081 (1962).
70. U.C.C. §4-405. See S.C. CODE §11-302 (1962) as to a note or bill negotiated by an agent after the death of the drawer or indorser.
71. Hair v. Winnsboro Bank, 103 S.C. 543, 88 S.E. 26 (1915).

fication afforded by statutory treatment, may increase its use in domestic trade where a distant seller may have the added protection of substituting the credit of a bank for that of a buyer, who may have already arranged for financing of the purchase price by the bank. The customary documentary sale, whereby the seller sends the bill of lading with a draft drawn on the buyer to a bank in the buyer's town for collection, unlike the letter of credit, does not shift the risk of non-payment from the seller to the bank.

In order to serve this essential risk shifting function, the bank is legally divorced from matters relating to the underlying contract of sale, such as the quantity and quality of the goods. Thus, under the code, the issuing bank's liability to pay and its entitlement to reimbursement from its customer become absolute upon the receipt of the documents called for.[72] If the bank is notified prior to payment that the documents are forged or that there is fraud in the transaction between the buyer and seller, the bank is given an option to honor the draft or demand for payment, unless the customer has obtained a court injunction against the issuer's exercise of its option.

Normally, a bank will issue a straight letter of credit where the language "we engage with you" is used. In such form, the promise does not run to a purchaser of the draft as a holder in due course, on the theory that he sees on the face that the promise runs only to the issuee. A letter of credit may, however, be made negotiable and may be negotiated to a holder in due course, who may enforce it against the issuer regardless of any fraud in the transaction or forgery of the document.[73]

In order to examine the documents and make sure that they comply with the letter of credit, the bank is given until the close of the third banking day following receipt of the documents to honor the draft. Failure to act within this time constitutes dishonor.[74]

Upon wrongful dishonor under an irrevocable credit, the presentor may recover from the issuer the face amount of the draft, plus incidental damages recoverable by a seller under

72. U.C.C. §5-114.
73. U.C.C. §5-114(2)(a).
74. U.C.C. §5-112.

article 2, less any amount realized from re-sale or other use of the subject matter of the transaction.[75]

ARTICLE 6: BULK TRANSFERS

Article 6 is similar to the South Carolina Bulk Sales Act,[76] having the same purpose of protecting creditors of a merchant by voiding a bulk transfer of merchandise out of the ordinary course of trade, unless the transferee gives notice to all known creditors of the contemplated transfer at least ten days before he takes possession.

Coverage is extended under code section 6-102 to include sales of business equipment if it is made in connection with a bulk transfer of inventory.[77] Also, a bulk sale at auction under section 6-108 would expand existing coverage, in which case the auctioneer is charged with the responsibility similar to that of a transferee of other bulk sales where he knows the auction constitutes a bulk transfer. Failure to comply does not affect the rights of the purchasers, but the auctioneeer is personally liable to the creditors of the transferor for uncollected debts, but not exceeding the net proceeds of the auction.[78]

ARTICLE 7: DOCUMENTS OF TITLE

Article 7 would repeal and modernize the half-century-old Uniform Warehouse Receipts Act (UWRA)[79] and the Uniform Bills of Lading Act (UBLA),[80] integrating the statutory treatment of these documents. Some new coverage is included to cover modern shipping and storage practices, which were not contemplated by the original uniform acts, such as bonded storage required by federal or state statute, air bills and problems which arise under modern high-speed or truck transportation. Of course, this state legislation would not affect federal legislation dealing with interstate ship-

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75. U.C.C. §5-115.
76. S.C. CODE §§11-201 to 11-206 (1962).
77. *Contra,* Smith v. Boyer, 119 S.C. 176, 112 S.E. 71 (1921) which held that trade fixtures are not included under the Bulk Sales Act.
78. U.C.C. §6-108(4).
79. S.C. CODE §§69-151 to 69-246 (1962), enacted in South Carolina in 1945.
80. S.C. CODE §§58-1701 to 58-1777 (1962), enacted in South Carolina in 1930.

ments, such as the Federal Bills of Lading Act or the Federal Carriage of Goods by Sea Act.[81]

As under the UWRA, a warehouse receipt, by definition, must be issued by a warehouseman, which does not include a person who stores his own goods.[82] An important exception to this is found in section 7-201, which treats a receipt as a warehouse receipt governed by this article when issued by a non-warehouseman under a statute requiring a bond against withdrawal.

The essential terms of the warehouse receipt are similar to those under existing law,[83] but the code preserves obligations of the issuer even though the document does not comply with the formal requirements.[84] Essential terms of a bill of lading provided by the UBLA are omitted from the code,[85] but federal regulation of the forms used in interstate commerce will continue to control.

An illustration of the code's modernization of documents of title is the newly authorized "destination bill" designed to meet the problem of high speed aid transportation where the goods may arrive at the destination before the documents. This could be inconvenient where the carrier does not have storage facilities, and even more serious where the goods are perishable. To meet this problem, section 7-305 authorizes the carrier, upon receipt of the goods for shipment, to wire or cable its agent at the destination point to issue the bill. (Of course, the carrier may not issue the bill until the goods are received.) Assuming the usual documentary sale, the bill would be issued to the buyer's bank, the seller sale, the bill would be issued to the buyer's bank, the seller would wire the bank a draft on the buyer, and the bank would indorse the bill to the buyer when he honors the draft.

Many of the familiar negotiable instruments rules apply where a document of title is negotiable and is taken by "due negotiation." A new requirement is that negotiation must be in the "regular course of business or financing" in order for the transferee to take free of defenses and claims of owner-

81. U.C.C. §7-103 expressly subjects the provisions of article 7 to state as well as federal regulatory statutes and to tariffs, classifications, or regulations thereunder.
82. U.C.C. §7-201; S.C. CODE §69-161 (1962).
83. U.C.C. §7-202; S.C. CODE §69-162 (1962).
84. U.C.C. §7-401.
85. S.C. CODE §58-1711 (1962).

ship to which his transferor is subject.[86] To qualify under this provision, the person making the transfer must be a person in the trade and the nature of the transaction must be a usual and ordinary transaction in which documents are transferred.

A bona fide purchaser of an altered document of title may enforce it according to its original tenor. The same rule applies to the filling in of blanks in a bill of lading,[87] but a bona fide purchaser may treat as authorized the filling of a blank in a negotiable warehouse receipt.[88] This absolute liability imposed on a warehouseman for the unauthorized filling of blanks is in recognition of the unnecessary danger of executing warehouse receipts in blank. It is often necessary for carriers to execute bills of lading in blank to be filled out by various employees, and thus the consequence of improper completion of bills carries no sanction.

ARTICLE 8: INVESTMENT SECURITIES

The principal statutory law in South Carolina today governing the transfer of certificates of stock as an investment security is the Uniform Stock Transfer Act.[89] As a type of negotiable instrument, the present Uniform Negotiable Instruments Law is also applicable to bearer bonds. The code would repeal the Uniform Stock Transfer Act and replace it with article 8 which also separates the law of investment securities from the short-term negotiable paper of article 3. Article 8 extends new statutory coverage to registered bonds and other types of investment paper not presently covered by any uniform act. The matter of regulation of securities under the federal and state "blue sky laws" is not dealt with by this article.

As the negotiable instruments law of securities, the basic policies of free transferability and protection to a holder are similar to those of article 3, but without the formal prerequisites of negotiability required by the Negotiable Instruments Law and article 3 of the code. Thus a bona fide purchaser of securities is similar to a holder in due course in negotiable instrument law, in that he takes free of defenses and adverse

86. U.C.C. §7-501.
87. U.C.C. §7-306. *Cf.* S.C. CODE §58-1720 (1962).
88. U.C.C. §7-208. *Cf.* S.C. CODE §69-186 (1962).
89. S.C. CODE §§12-301 to 12-324 (1962).

claims of ownership.[90] Similar to the rule of forged commercial paper, no holder has a right against an issuer of a counterfeit security or one on which the validating signature is unauthorized.[91] Under code section 8-205, however, an unauthorized signature is valid in favor of a good faith purchaser for value when it is of a person entrusted by the issuer with signing the security or an employee entrusted with handling the security. Code section 8-206 follows the change in the law of commercial paper under article 3 by protecting a purchaser for value without notice from the defense of improper completion where blanks are left upon the issue of a security.[92]

The purchaser of commercial paper after maturity is automatically subject to all defenses under article 3. His counterpart as a purchaser of security under section 8-203 will be deprived of the bona fide purchaser status only where he purchases more than two years after a call for redemption or exchange, or one year after such call, if the funds or securities are available for delivery when due.

Code section 8-104 prescribes a new formula for adjusting the rights of a holder against the issuer of an over-issue of securities, as where a stock transfer agent issues the new certificate without the surrender of a certificate for a corresponding number of shares thereby creating an excess of the issuer's chartered allowance. The code rule resolves this problem by compelling the issuer to purchase shares on the market to replace the over-issue. If shares are not available from the market, the holder may obtain reimbursement at the price paid or, if not purchased, at the last purchase price.

ARTICLE 9: SECURED TRANSACTIONS

Article 9 is probably the most important article of the code since its scope reaches transactions whose intended effect is to create a security interest in personal property. Furthermore, in order to accomplish its fundamental objective of providing uniform and simplified rules governing chattel security which meet modern commercial needs, it has been necessary to introduce a number of new concepts which would more substantially change existing practice than any other article of the code.

90. U.C.C. §§8-202(4), 8-301(2).
91. U.C.C. §8-202(3).
92. See U.C.C. §3-115(2). *Cf.* S.C. CODE §8-826 (1962).

In limiting the area of coverage to chattel financing, article 9 divorces itself from its ancestor, the real property mortgage.[93] Existing state statutory expressions of local public policy regulating credit (*e.g.*, usury and small loan acts) and creating liens in favor of preferred creditors (*e.g.*, landlords and materialmen) are unaffected by this article.[94] Also, existing federal legislation dealing with the recording of a security interest in certain types of collateral, such as airplanes and ships, and state automobile title laws are made to fit into the scheme of article 9 without change.[95] The remaining aspects of secured financing law, including the creation attachment, and perfection of a security interest, are treated for the first time in an integrated, comprehensive, and uniform way by this article.

In treating a security transaction as a single entity in which there is a conveyance of a security interest in personal property to secure the payment of a debt, article 9 rejects any distinction based on the form or designation of the device employed, such as chattel mortgage, conditional sales agreement, trust receipt, etc.[96] Different results are reached in some instances on functional grounds, depending upon the nature of the collateral and its use. For this purpose, section 9-109 divides all collateral into four classificiations: consumer goods used for personal purposes; equipment used principally in business; farm products in possession of a person engaged in farming operations; and inventory held by a business enterprise for sale, or materials used, consumed, or manufactured.

Consistent with this general functional rather than formal and conceptual approach, article 9 states substantive rules without regard to the ancient controversy over whether the secured party acquires "title" to collateral or a "mere lien."[97]

Creation of the Security Interest

In order to create or convey a security interest which is valid between the parties, a minimum of formalities is prescribed by the code. The pledge type is recognized and requires nothing more than delivery of the collateral or docu-

93. U.C.C. §9-104(j). *But see* U.C.C. §9-313 dealing with fixtures.
94. U.C.C. §9-104(b)(c). *But see* U.C.C. §9-310 dealing with priority of statutory liens.
95. U.C.C. §§9-104(a), 9-302(3)(a) and (b).
96. U.C.C. §9-102.
97. U.C.C. §9-202.

ments of title which represent the goods pledged.[98] For the creation of the more usual type of non-possessory security interest, all that is necessary is a simple security agreement signed by the debtor, containing a general description of the collateral.[99] When there is such an agreement, value is given, and the debtor has rights in the collateral, the security interest attaches in favor of the secured party.[100]

In a modern industrial economy there is frequently an urgent need for even the most successful and solvent business enterprise to acquire working capital in order to finance the acquisition of inventory and meet current operational expenses. A financier may be willing to supply these funds only when he can acquire a valid security interest in the commercial debtor's inventory or equipment which will stand up against claims of third parties. Since inventory is frequently in a state of motion in the resale or manufacturing cycle, what is needed is an effective "floating lien" which automatically feeds the security agreement as it is acquired by the debtor and which relates back to the time of its initial execution and perfection. Where the collateral is business equipment which may be replaced before the loan is repaid, it is also commercially desirable for the replacements to attach automatically to the security interest.

One of the most significant accomplishments of article 9 is that it meets these needs by expressly validating the "after-acquired property" clause in a security agreement whereby a lien on inventory or replacement equipment attaches as it is acquired by the debtor.[101] To complete the commercial objective of a continuing extension of credit secured by new inventory or equipment as acquired, section 9-204 expressly validates the extension of the security interest to future advances.[102]

98. U.C.C. §9-203(1)(a).
99. U.C.C. §9-203(1)(b).
100. U.C.C. §9-204(1).
101. U.C.C. §9-204(3). For an excellent discussion of the historical development of judicial treatment of this subject see, COHEN AND GERBER, *The After-Acquired Property Clause*, 87 U. PA. L. REV. 635 (1939).
South Carolina case law seems generally to assume that the after-acquired property is valid and attaches as soon as the property is acquired by the mortgagor. *E.g.*, Clowney v. Rivers, 129 S.C. 58, 123 S.E. 759 (1924).
102. S.C. CODE §45-55 (1962) also permits future advances to be secured by a mortage previously executed which shall be valid as to third parties as of the time of recording.

The effectiveness of this inventory financing arrangement to withstand the attack of unsecured creditors directly or through their representatives, the trustee in bankruptcy, has been in doubt ever since the 1925 United States Supreme Court decision of *Benedict v. Ratner*[103] held the transaction void as a fraud against creditors where the debtor was given unfettered dominion or control over assigned accounts receivable and inventory collateral. Code section 9-205 removed that doubt by rejecting the principal of *Benedict v. Ratner* as a matter of state law which should be controlling in federal bankruptcy litigation since the trustee's attack under the *Benedict* case is under section 70(e) of the Bankruptcy Act, which gives him the rights of creditors under state law.[104]

The validation of the "after-acquired-property" clause as the key to effective commercial financing does not apply to consumer goods acquired by the debtor more than ten days after the secured party gives value.[105] This is in recognition of the social and economic objection to tying up all of the future acquisitions of an individual by such a continuing blanket lien. A similar policy decision is the basis of the limitation on crop financing to crops which become such within one year after the security agreement is executed.[106]

Perfection

The code continues to recognize that for most types of collateral the perfection of a security interest against third parties — the real test of its effectiveness — may be accomplished alternatively by pledge or by record notice.[107] The

103. 268 U.S. 353.

104. This has not been a serious obstacle to inventory and accounts receivable financing in South Carolina since case law has rejected the majority American view which treats a mortgage as fraudulent per se where the mortgagor is allowed to sell the collateral in the course of trade. *E.g.*, Marshall v. Crawford, 45 S.C. 189, 22 S.E. 792 (1895). Thus, if the mortgagor becomes a bankrupt, the mortgagee's interest is not subject to attach under section 70(e) of the Federal Bankruptcy Act by reason of unfettered dominion by the mortgagor. Bank of Dillon v. Murchison, 213 Fed. 147 (C.C.A. 4th, 1914). With respect to accounts receivable, S. C. CODE §45-207 (1962) provides: "No permission by the assignee to the assignor to exercise dominion and control over a protected assignment or the proceeds thereof shall invalidate the assignment as to third parties."

105. U.C.C. §9-204(4)(b).

106. U.C.C. §9-204(4)(a); S.C. CODE §45-152 (1962) presently limits a mortgage on crops to those to be planted or grown within five years from the execution of the mortgage.

107. U.C.C. §§9-203(1)(a), 9-305, 9-301. A security interest in intangibles (*e.g.*, accounts receivable) may be perfected only by filing. U.C.C.

code adopts what may be generally described as a "lien creditor-race" approach. Only creditors who have obtained a lien without knowledge of the security interest and before it is perfected may defeat the security interest.[108] As between conflicting security interests in the same collateral, priority is accorded to the first to perfect, regardless of notice, and regardless of the order of attachment.[109]

These generalizations are subject to some important exceptions and modifications which need to be outlined in order to present a clearer and more accurate picture of the code's approach to perfection. It should be noted that perfection is a relative term since the security interest may be perfected as to one class of third parties but not as to another.

In the context of inventory financing, its is the usual understanding of the parties that the debtor will sell his inventory in the ordinary course of business and is usually so authorized. Code section 9-307 recognizes this commercial understanding by providing that the buyer out of inventory in the ordinary course of business takes free of the inventory financer's security interest, even though he has knowledge of it. The proceeds received from such sale of inventory are subject to a continuing security interest in favor of the inventory financer, if perfected by express coverage in the instrument filed for record. In the event of insolvency proceedings against the debtor, the perfected security interest in proceeds which are comingled with other funds of the debtor is limited to an amount received within ten days of the institution of such insolvency proceedings.[110] Thus, the inventory financer who properly perfects his security interest will be protected against the honest insolvency of the debtor, to the extent of the value of the collateral. Despite the code's rejection of the *Benedict* Rule, which compelled the security financer to exercise some control over the inventory collateral, some element of the policing and accounting doctrine of that case remains in order to avoid the loss of proceeds received by the debtor more than ten days prior to insolvency proceedings.

§9-305. A security interest in instruments or negotiable documents is perfected against creditors for a period of 21 days without filing or the taking of possession. U.C.C. §9-304(4).

108. U.C.C. §9-301(1)(b). *Cf.* S.C. CODE §60-101 (1962).

109. U.C.C. §9-312(5).

110. U.C.C. §9-306.

Where the secured party does not authorize the sale of the collateral, as where the collateral is business equipment, or in the case of crop financing, a purchaser of the collateral will take subject to the perfected security interest.[111]

No filing is necessary in order to perfect a purchase money security interest in consumer goods and farm equipment having a purchase price not in excess of $2,500.[112] Purchasers from the debtor, however, will take free of the unfiled security interest in such goods.[113] This treatment of consumer goods does not apply to the financing of automobiles for private use where the state's certificate of title law, eliminating the requirement of perfection by filing, would govern.[114]

For the mechanics of perfecting a non-possessory security interest in chattel by filing, the code borrows the concept of "notice filing from the Uniform Trust Receipts Act (enacted in 33 states but not South Carolina) as an alternative to filing the security agreement itself.[115] This is record or constructive notice by the filing of an abbreviated statement which need only contain the signature and address of the debtor and secured party and a general description of the types or items of the collateral.[116] This "financing statement" device is designed principally to facilitate the perfection of a security interest in inventory where there is a continuing change in the collateral and in the amount of indebtedness. The record notice is effective for a period of five years from the time the statement is presented to the filing clerk with the fee, subject to renewal for a like term by filing a "continuation statement."[117]

Since this non-informative notice filing does not reveal the amount of the secured debt at any given time, section 9-208 makes provision for the debtor to obtain a statement from the secured party of record setting out this information, which

111. U.C.C. §9-307.
112. U.C.C. §9-302(1)(c) and (d).
113. U.C.C. §9-307(2).
114. U.C.C. §9-302(3)(b). See S.C. CODE §46-150.41 to 46-150.51 (1962) for perfection of a security interest in motor vehicles.
115. The notice filing concept was introduced in South Carolina in 1938 by the Factor's Lien Act, S.C. CODE §45-403 (1962) and later applied to the assignment of accounts receivable by S.C. CODE §45-204 (1962).
116. U.C.C. §9-402.
117. U.C.C. §9-403. Filing of a chattel mortgage in South Carolina is effective for three years subject to renewal for the same period by refiling. S.C. CODE §§60-305 and 60-306 (1962).

may be then relied on by third parties who deal with the debtor. Whenever there is no longer an outstanding obligation, section 9-404 places the burden on a secured party of record to send a "termination statement" to the filing officer to remove the financing statement from the record.[118] If the secured party fails to send such a termination statement within ten days after demand by the debtor, he is liable for $100 damages plus any loss caused to the debtor by such failure.

Where the collateral remains at rest in the possession of the debtor, the secured party may continue the present practice of filing the security agreement as a "financing statement" rather than execute the separate abbreviated statement which will usually be limited to inventory financing. In that event the code eliminates most of the formal and technical prerequisites to filing such as acknowledgement or witnessing.[119] A new requirement is that the secured party must also sign the agreement as a prerequisite to effective filing in order to establish his responsibility for issuing the termination statement.[120]

Priorities

It has been stated that priority among conflicting security interests in the same collateral is determined by the order of perfection. This is true regardless of the order in which the consideration passes — that is, the time when the secured loan is made — and regardless of actual knowledge. A most important application of this rule and the notice filing concept is the protection it affords to the inventory financer in granting maximum protection against the honest insolvency of his debtor. The financer, having determined that the debtor's property is not subject to a recorded security interest or creditor's lien, may execute and file the abbreviated financing statement containing a general description of the collateral to be covered, an after-acquired property clause, and a claim of proceeds, if appropriate. Thereafter, the security agreement may be executed and the money advanced, at which time the security interest in the collateral attaches, but with the effective date of perfection as of the prior time when

118. *Cf.* S.C. CODE §§45-61 to 45-67 (1962).
119. *Cf.* S.C. CODE §60-51 (1962).
120. Note 116, *supra.*

the financing statement was filed. Even if a creditor of the debtor should acquire a lien or advance money and take a security interest in the same collateral, his interest would be subordinate to the security interest which was filed first, but which attached later. Assuming that the collateral is inventory and the secured party has authorized its sale, he may now look to the proceeds which were expressly claimed in the filed financing statement and any replacement of inventory which was covered by the after-acquired property clause, all of which were perfected as of the time of initial filing. It is apparent that the drafters of article 9 focused their attention on this chattel financing situation and set out to accomplish this result by giving maximum protection to the diligent secured party against losses resulting from the honest insolvency of the debtor. It is also apparent that the policy objective designed to lead to this result was to encourage the supplying of working capital — the vital ingredient of an expanding industrial economy.

The "first-to-perfect" rule, as the basic formula for determining the order of priorities, is subject to an important qualification where one of the competing claimants holds a purchase money security interest to secure the purchase price of newly acquired goods and the other claims the purchased collateral under an after-acquired property clause. In the context of equipment financing, if the purchase money financer perfects his security interest within ten days after the debtor receives protection in the collateral, he will have a priority claim in this collateral over the financer claiming under an after-acquired property clause.[121] This preferred treatment of the purchase money security interest constitutes an exception to the usual rule that after-acquired property feeds a security interest when acquired and is deemed perfected as of the time of the filing of the financing statement containing an after-acquired property clause. Where the collateral is inventory, the purchase money security claimant has priority over a conflicting security interest only when he perfects before the debtor receives possession of the collateral (without benefit of the ten-day grace period for filing) and only if he gives notice of his claim to the inventory financer who has previously filed a financing statement claiming the same in-

121. U.C.C. §9-312(4).

ventory under an after-acquired property clause.[122] The reason for the additional requirement of notice in order for the purchase money financer of inventory to enjoy a priority position, is to save the initial general inventory financer from the risk of continuing to make advances to the debtor under the belief that the subsequently acquired inventory continues to feed his security interest.

Several other special modifications of the first-to-perfect-priority rule should be mentioned. Section 9-312(2) accords priority to a perfected security interest in crops to secure a loan given not more than three months before the crops are planted. Section 9-310 gives priority to statutory liens for services or materials, unless the statute creating the lien provides otherwise.

A security interest in personal property which thereafter becomes a fixture by attachment to real property takes priority over all prior security claims in the realty.[123] Similarly, a security interest in goods which are affixed to other goods (typically a security interest in tires, subsequently installed on cars) takes priority over prior claims to the whole.[124]

Under section 9-315, a perfected security interest in goods, which through processing become so comingled as to lose their identity in the product or mass (*e.g.*, raw materials), continues in the product or mass. This section also covers the case where the collateral consists of components assembled into a machine and which do not lose their identity. In that case, the security interest may be continued in the product if expressly claimed in the filed financing statement; if not so claimed, the identifiable part will be treated as an accession under section 9-314. When more than one security interest attaches to the product or mass, the secured parties share in proportion to their contribution.

Default

Part 5 of article 9 is designed to afford greater flexibility and simplicity in the prescribed manner of liquidating the

122. U.C.C. §9-312(3).
123. See Planter's Bank v. Lummus Cotton Gin Co., 132 S.C. 16, 128 S.E. 876 (1925).
124. U.C.C. §9-314. *Accord*, Goodrich Silvertown, Inc. v. Rogers, 189 S.C. 101, 200 S.E. 91 (1938).

collateral on default in payment of the secured debt. This policy is balanced against the protection of the debtor's interest that the collateral will realize its fair value. This objective is expressed in section 9-504 by the key standard for the liquidation sale that it be "commercially reasonable." Without an attempt at a specific definition of this term, certain guidelines and minimum standards are prescribed for the proper disposition of the collateral by the secured party. It may be by public or private sale; with or without processing; bulk or in parcels. Reasonable notice of the time and place of the disposition must be given to the debtor and other secured parties of record, unless the collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market.[125]

Code section 9-505 authorizes the secured party in the possession of the collateral after default to retain the collateral in satisfaction of the debt if the debtor, or any secured party of record, does not object to such written proposal within 30 days after receipt. Where the collateral is consumer goods and the debtor has paid 60% of the obligation, however, the collateral must be disposed of within 90 days after the secured party takes possession. If the secured party fails to comply with this requirement where the collateral is consumer goods, section 9-507 gives the debtor the right to recover damages in an amount no less than the total credit charge plus 10% of the debt.

CONCLUSION

The Uniform Commercial Code does not represent a revolutionary change in principles and practice of commercial law; it is an evolutionary step in the development of this area of law. In some cases familiar answers to commercial problems are given, sometimes with new terminology. Many gaps in coverage under existing law are filled so that a greater degree of predictability will be possible. When new concepts and rules are introduced by the code, it is with the objective that the law will more closely approximate modern commercial needs and expectations. And, of course, the lawyer would have a single place to look for many solutions to commercial law problems which are presently scattered among a number of different statutes and case decisions.

125. *Cf.* S.C. CODE §45-164 (1962).

The trend toward enactment of the Uniform Commercial Code by the states so that it will truly establish uniform rules governing commercial transacions in the near future has been established. Of the twenty-six states which have passed the code, twenty have done so within the past three years. A further indication of an acceleration of this trend is the fact that most of the states which are national or regional centers of commerce and finance are now included among the list of code states. It is significant that within two years after Massachusetts (with Boston as the financial hub of New England) enacted the code in 1958, the states of Connecticut, New Hampshire and Rhode Island followed suit. It would seem that the same kind of impetus would follow from the enactment of the code in the past two years in the more commercially important hub states of New York, Illinois, Michigan, Ohio, and Georgia; the latter creating an increased interest in the code among the southeastern states because of their important commercial ties with Atlanta.

If it is to be assumed that change is the order of the day in an industrially oriented space age and that law must adapt to and change with the new facts of commercial practice, then the syllogistic conclusion must follow that statutory and case law rules set out yesterday may not always be appropriate to solve problems of today and tomorrow. This leaves the question of whether necessary change should come from statutory law and, if so, whether the Uniform Commercial Code offers the most appropriate collection of commercial law rules for the present and immediate future. The final verdict is, of course, in the hands of the legislature of each state. As an attempt to state the law in terms of contemporary commercial needs, the Uniform Commercial Code deserves the attention and studied consideration of the General Assembly of South Carolina.