Business Law

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I. Equitable Exception to Signature Warranty Provision Recognized

In Bankers Trust v. South Carolina National Bank the South Carolina Court of Appeals recognized an equitable exception to the presentment warranty provision of section 36-4-207 of the South Carolina Code. This case provides a background for an analysis of the applicability of equitable principles in cases governed by the Uniform Commercial Code (UCC).

The problem arose when Bankers Trust loaned $21,500 to three individuals for the purchase of a houseboat. The individuals misrepresented the purchase price of the boat as $28,900 when it was actually $13,500. Bankers Trust issued a check payable to the three men and the seller of the boat and received a promissory note due in 180 days.

The three individuals forged the seller's signature, opened a checking account with South Carolina National Bank (SCN), and deposited the $21,500 check. They promptly obtained a cashier's check for $13,500 and paid the seller his full purchase price. In the meantime, SCN forwarded the check containing the forged endorsement to Bankers Trust. After the note matured and was not paid, Bankers Trust repossessed the houseboat and received $14,000 in proceeds. Bankers Trust applied $7500 of this to the men's account after paying collection and attorney's fees. Deficiency judgments were also entered against the three men on other unpaid notes.

Bankers Trust discovered the forgery of the seller's signature and obtained an affidavit from him. Upon receiving the affidavit and forged check, SCN paid the full amount pursuant to

2. This section provides a warranty in which a collecting bank (e.g., SCN) guarantees to a payor bank (e.g., Bankers Trust) that all signatures are genuine. S.C. Code Ann. § 36-4-207 (1976).
3. 284 S.C. at 241, 325 S.E.2d at 83.
4. Id.
section 36-4-207. \(^5\) SCN later obtained the seller’s endorsement of the check\(^6\) and requested the return of the $21,500 it had previously paid. Bankers Trust declined to return the money and instead brought a declaratory judgment action to determine the status of the proceeds from the boat sale regarding the other debts of the three men. SCN counterclaimed for the return of the $21,500, but made no claim for the proceeds. The trial court allowed Bankers Trust to retain the proceeds, but determined that equity required Bankers Trust to return the $21,500 and bear the loss from the three men’s fraud.\(^7\)

On appeal Bankers Trust initially contended that the issue should be resolved by the clear language of the UCC. Bankers Trust argued that when SCN cured the forgery, SCN was merely presenting the check for repayment, and that since SCN was not a holder in due course, it stood in the same position as the three men.\(^8\) The court summarily dismissed this reasoning, pointing out that once Bankers Trust paid the check, neither party could assert a right to recover losses under the check.\(^9\)

The court concluded, however, that SCN could cure its breach of the presentment warranty by ratifying the forged signature of the seller.\(^10\) More importantly, the court recognized an equitable exception to the warranty provision of section 36-4-207 by stating that when the payee of a forged check (the seller of the boat in Bankers Trust) receives the proceeds, no cause of action may be brought on the endorsement since the funds have reached the intended party.\(^11\) In this case, Bankers Trust could not keep the $21,500 because the loss was determined to be from its dealings with the three men and not from the forgery.

This case raises the question of the applicability of principles of equity in South Carolina cases falling within the UCC. Although section 36-1-103\(^12\) outlines the general application of

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5. Id.
6. S.C. Code Ann. § 36-3-404 (1976) provides that an unauthorized signature may be ratified by the person whose name was forged.
7. 284 S.C. at 241, 325 S.E.2d at 83.
8. Id. at 242, 325 S.E.2d at 84.
9. Id.
10. Although not recognized by the court, S.C. Code Ann. § 36-3-404 official comment 3 (1976) explicitly states that this ratification is to be retroactive.
equity under the UCC, the section was not cited by the court. SCN argued that the principles of equity supplemented the language of the UCC.\textsuperscript{13} Conversely, Bankers Trust argued that section 36-1-103 applies only when the Code itself does not come into play.\textsuperscript{14} Even though the court did not acknowledge consideration of section 36-1-103, it clearly stated that Bankers Trust had a right to recover under the presentment warranty when it discovered the fraud.\textsuperscript{15}

The key phrase of section 36-1-103 is the “displaced” provision at the beginning of the statute which allows judges to utilize the section and reach equitable results without creating judicial exceptions.\textsuperscript{16} A broad reading of the section suggests that the provision applies if the particular code provision does not displace equity.\textsuperscript{17} The section can also be interpreted to dictate that courts resort to equity only in instances when a code provision on point does not exist. Bankers Trust urged this latter, “gap filler” interpretation.\textsuperscript{18}

In explaining its conclusion, the Bankers Trust court emphasized that “the courts have developed an equitable exception . . . .”\textsuperscript{19} This language seems to suggest a judicially created exception and possibly indicates why the court did not seek the assistance of section 36-1-103 in its decision. This result is unfortunate because an interpretation of section 36-1-103 would tend to promote stability in questions concerning the application of equitable theories in cases under the Uniform Commercial Code. Through the utilization of a court-created exception, the

\textsuperscript{13} Brief of Respondent at 11. SCN asserted that the claim was one of unjust enrichment. 284 S.C. at 242, 325 S.E.2d at 83.
\textsuperscript{14} Reply Brief of Appellant at 3.
\textsuperscript{15} 284 S.C. at 243, 325 S.E.2d at 84.
\textsuperscript{16} See supra note 12.
\textsuperscript{17} This interpretation advances the theory that “supplement,” as used in section 36-1-103, is not to be construed narrowly. Support for this rationale is found in the use of the term “invalidating” in the section, for the precise meaning of the word points to an exception rather than a mere “gap filler.” The additional equitable principles outlined in the section also refer to doctrines which are exceptions rather than supplemental terms.
\textsuperscript{18} Reply Brief of Appellant at 3.
\textsuperscript{19} 284 S.C. at 244, 325 S.E.2d at 85.
application of equity is probably limited to the unique fact situation presented in this case.

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II. "No Notice" Provision of Acceleration Clause Enforced

A number of states have enforced acceleration clauses in instruments of indebtedness unless those provisions are clearly inequitable. In Allendale Furniture Co. v. Carolina Commercial Bank the South Carolina Supreme Court reaffirmed its position within this group by holding that when a note contains a provision for accelerating the maturity of the debt upon default without further notice, the creditor's rejection of an untimely payment is sufficient to notify the debtor of the election to accelerate. The court also eliminated the application of the "equitable tender" rule to this contractual provision.

Allendale involved a $75,000 note and real estate mortgage given by Allendale Furniture Company (Allendale) to Carolina Commercial Bank (the bank), payable in monthly installments on the first of each month. The note contained a provision allowing acceleration of the entire debt upon default at the option of the holder and "without further notice" to the mortgagor. Although the initial payments by Allendale were timely, the payments became increasingly sporadic after September 1976. The bank notified Allendale on numerous occasions of the need for compliance with the note but it continued accepting late payments. When Allendale tendered its February payment on February 22, 1980, the bank advised the company in writing that the bank's attorney would contact it regarding the account. The bank had given the note and mortgage to its attorney for fore-

22. Id. at 80, 325 S.E.2d at 532.
23. Id. at 79, 325 S.E.2d at 531.
closure on February 14, 1980.25

The circuit court affirmed the master's recommendation of foreclosure but the court of appeals reversed in a divided decision.26 The court of appeals refused to apply Allendale's theory of equitable estoppel and found that Allendale had cured its default by tendering its late payment before it was notified of the bank's election to accelerate.27 The court disregarded the wording of the acceleration clause and stated that the bank did not give an "affirmative, unequivocal act" that would appraise the debtor of its election to accelerate.28 The supreme court reversed, citing Dargan v. Metropolitan Properties, Inc.29 in support of its view that the election to accelerate need not be communicated to the debtor after default when the acceleration clause contained the language "without further notice."30

The supreme court's insistence on following the language in the note has been echoed by other courts and follows well-established case law.31 In Collins v. Collins Estate, Inc.32 the court stated that "[a]n acceleration clause of the nature stipulated in appellant's note is not uncommon in instruments of indebtedness and generally will be enforced as written."33 South Carolina's strict enforcement of these clauses is not unique and is

25. Record at 6-11.
27. Id. at 253, 312 S.E.2d at 572.
28. Id. at 251-52, 312 S.E.2d at 571-72.
29. 243 S.C. 324, 133 S.E.2d 821 (1963). Dargan is an example of the supreme court's unwillingness to grant equitable relief. In Dargan the corporate mortgagor had made payments of $11,000 in excess of the annual payment required, but was one day late on a payment after a sixty-day grace period had expired and had failed to include interest on accrued interest in its late payment. In addition, the corporation's president had been hospitalized. Despite these facts, the court denied equitable relief. Id. at 330, 133 S.E.2d at 824; see also Shirley v. Parris, 121 S.C. 260, 113 S.E. 788 (1922).
30. 284 S.C. at 78, 325 S.E.2d at 531. The court distinguished a Georgia case on the ground that the note in that case did not involve the type of acceleration clause in Allendale. See Lee v. O'Quinn, 184 Ga. 44, 190 S.E. 564 (1937). Lee involved a note and purchase contract for a parcel of land. Although the contract recited that the note contained a waiver of notice provision, the actual note did not. The Georgia Supreme Court concluded that the note should prevail over the recital in the contract; thus, the acceleration clause contained no waiver of notice provision. Id. at 45, 190 S.E.2d at 565.
32. 207 S.C. 452, 36 S.E.2d 584 (1946).
33. Id. at 458, 36 S.E.2d at 586.
based on the need for commercial stability. Because commercial banks frequently engage in financing transactions, the form of their agreement should be upheld unless it is inequitable.\textsuperscript{34} If the provision in a note was ignored, the court might be inadvertently encouraging debtor delinquency and increasing litigation.\textsuperscript{35} The need for stability in commercial transactions overrides the need for protection from hardship in all but the most inequitable situations. Other courts have reached similar conclusions based on the same factors.\textsuperscript{36}

Nevertheless, the supreme court’s statement in \textit{Allendale} that “tender of anything less than the full accelerated amount will not cure the default”\textsuperscript{37} represents a substantial variation from the general rule that tender of the payment in arrears, if made before the creditor’s election to accelerate, will prevent foreclosure.\textsuperscript{38} The theory behind this rule is that after tender there is no longer any default, which is the prerequisite of the right to accelerate.\textsuperscript{39} Prior to \textit{Allendale}, the rule in South Carolina was that, once the creditor had the right to commence foreclosure, this right could not be removed by partial tender.\textsuperscript{40} Rather than reading “partial tender” as partial tender of the payment in arrears, the court in \textit{Allendale} interpreted this language to mean partial tender of the entire accelerated amount.\textsuperscript{41} Thus, nothing less than the “full accelerated amount” will cure default.

Although the rule in most jurisdictions allows tender of the payment in arrears to cure default,\textsuperscript{42} the court in \textit{Allendale} effectively eliminates this approach. In \textit{Allendale} the election to accelerate occurs automatically upon default because of specific language in the acceleration clause.\textsuperscript{43} If this language does not exist or if the clause requires notice, the election to accelerate

\textsuperscript{37} 284 S.C. at 79, 325 S.E.2d at 531.
\textsuperscript{38} 59 C.J.S. Mortgages § 495(6)(b) (1955).
\textsuperscript{39} 280 S.C. at 251, 312 S.E.2d at 571.
\textsuperscript{40} \textit{Dargan}, 243 S.C. at 329, 133 S.E.2d at 823 (1963).
\textsuperscript{41} 284 S.C. at 79, 325 S.E.2d at 531.
\textsuperscript{42} See supra note 38.
\textsuperscript{43} 284 S.C. at 77, 325 S.E.2d at 530-31.
may need to be communicated to the debtor in order to be effective. In this situation, tender of the arrearage can be made before the creditor has exercised his option, rather than after the election, which was the case in Allendale. If tender is made before this election, South Carolina courts may apply the general rule rather than the rule used in Allendale, and the default would be cured.

The supreme court’s decision in Allendale is exceedingly harsh for debtors, primarily because it gives the creditor unbridled discretion to accelerate, even in minor cases of default. Equitable relief is also not readily available. The decision, however, may be limited to its facts, especially in light of the court’s emphasis on the language in the note. The practitioner should look to the form of the financing agreement in order to protect his client. South Carolina courts may favor the common-law approach if the acceleration clause does not contain the type of provision described in Allendale.

Douglas Manning Muller

III. PROCEDURAL ERRORS RESULT IN ENFORCEMENT OF “DUE-ON-SALE” CLAUSE

In Security Federal Savings and Loan Association v. Coleman the South Carolina Supreme Court held that a lending institution could enforce a “due-on-sale” clause in a mortgage against a subsequent purchaser of the mortgaged property.

Security Federal brought the action seeking the foreclosure of a mortgage which it originally entered into with the Colemans. Although the Colemans were the named defendants, they made no appearance in the case. The defendants who contested the action, the Howells, purchased the home from the Colemans by paying them $10,000 and assumed the mortgage. The agreement entered into by the Colemans and Howells contained a “whereas” provision which stated that the sellers, the Colemans, believed paragraph seventeen of the mortgage was violated by the agreement. Paragraph seventeen contained a stan-

44. See supra note 29.
46. Id. at 396, 325 S.E.2d at 547.
standard "due-on-sale" clause that the lender, Security Federal, could exercise at its option if the borrower transferred the property without the lender’s written consent.

One month after the defendants entered into the sale agreement, Security Federal received the Howell's insurance policy along with a cover letter explaining that the Howells had assumed the Colemans' loan. For the next fifteen months, the Howells made payments on a timely basis and also made improvements to the property worth approximately $10,000. Nevertheless, Security Federal notified the Howells that it was exercising the "due-on-sale" provision to accelerate the balance due.47

The master determined that, although the agreement notified the Howells of the "due-on-sale" clause at all relevant times,48 Security Federal was estopped from enforcing the clause because its acceptance of the monthly payments constituted waiver of the option to accelerate.49

The circuit court disagreed, finding estoppel inapplicable because no false representation or concealment was shown. Moreover, the court noted that the Howells had possessed knowledge of the "due-on-sale" clause.50 The trial judge also noted that no implied waiver was established because the Howells failed to illustrate an intention on the part of Security Federal to waive its rights under the option provision.51 Finally, he rejected the defense of laches,52 a ground upon which the master had ruled favorably.53 The circuit court, however, held that since the foreclosure was an action in equity, the Howells would, in fairness, be allowed to refinance the house at the interest rate in effect at the time of the agreement.54

47. There apparently was no dispute over the fact that Security Federal utilized the "due-on-sale" clause in order to receive a higher rate of interest. The supreme court characterized the reason as an "earnings crunch." See id.

48. About one year after the agreement, Security Federal sent letters to attorneys and realtors in the area advising them not to enter into mortgage-assuming transactions. Record at 15.

49. Id. at 20-21.

50. Id. at 7.

51. Id. at 8.

52. Id.

53. Id. at 23-24.

54. Id. at 9. The original mortgage to the Colemans was a fixed nine percent rate of interest for 30 years. Id. at 11. At the time of the agreement, Security Federal's rate was
Security Federal then appealed to the supreme court, challenging the circuit court's decision to refinance the house. A key mistake made by the Howells was their failure to appeal any findings of the trial judge. The brief of the defendant reflects that the Howells then attempted to adopt the findings of the master. \(^{55}\) This maneuver was rejected by the supreme court in a stern footnote \(^{56}\) and was a significant factor in the court's holding that Security Federal did not have to refinance the mortgage.

In rendering his decision, Justice Gregory also emphasized Security Federal's second argument based on a party's right to contract with one of his own choosing. The supreme court did not directly express an opinion regarding the enforceability of "due-on-sale" clauses in general; this issue, however, would not appear to be as debatable as it was in the past. \(^{57}\)

Although the "due-on-sale" clause appears to be a lawful provision and has survived arguments that it constitutes a restraint on alienation, \(^{58}\) Security Federal Savings and Loan highlights the difficulties that arise when a party makes procedural errors. Since the court's footnote appears to suggest that the master's arguments were valid, \(^{59}\) attorneys facing similar situations would be well advised to pursue vigorously the defenses of equitable estoppel, implied waiver, and laches when faced with similar litigation. If the defendants in Security Federal Savings

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12%. *Id.* at 9.


56. The court stated:

In their brief, respondents purport to adopt the findings of the master; however, there has been no exception taken from the trial judge's express rejection of the master's report. While we agree that appellant's conduct ignores good business ethics, the absence of a proper exception by respondents leaves nothing before this Court for decision.

284 S.C. at 396 n.1, 325 S.E.2d at 547 n.1 (citations omitted).


58. *See* Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta, 458 U.S. 141 (1982), in which the Supreme Court held that the "Wellenkamp doctrine" does not apply to federal savings and loan associations. In Wellenkamp v. Bank of Am., 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978), the California Supreme Court held that a "due-on-sale" clause was an unreasonable restraint on alienation.

59. *See supra* note 56.
and Loan had properly presented these arguments, a contrary result may have been reached.

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