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I. EFFECT OF THE UCC ON COMMON-LAW NEGLIGENCE CLAIMS AGAINST A DEPOSITARY BANK

In *Flavor-Inn, Inc. v. NCNB National Bank*[1] the South Carolina Court of Appeals clarified the effects of sections 36-1-103[2] and 36-3-419[3] of the South Carolina Commercial Code on common-law negligence claims against a depositary bank. The court faced the issue of "whether, within the meaning of [section] 36-1-103, an action under [section] 36-3-419 of the UCC for the conversion of an instrument supplants an action for negligence arising from a depositary bank's payment or acceptance for deposit of a check on an unauthorized indorsement."[4] The court also addressed whether an award for consequential compensatory and punitive damages under section 36-3-419 is appropriate.[5] Addressing the primary issue, the court held "that the conversion action permitted by [section] 36-3-419 is a 'particular provision' of the UCC that [pursuant to section 36-1-103] displaces the common law action for the negligent acceptance for deposit of a check with an unauthorized indorsement."[6] On the issue of damages, the court held that section 36-3-419(2) entitled the appellant to receive compensatory damages equal to the face amount of the instrument, but the section did not allow for recovery of consequential damages.[7] However, section 36-3-419 authorized recovery of punitive damages.[8]

Flavor-Inn involved an embezzlement scheme conducted by two employees of Flavor-Inn, Inc. ("Flavor-Inn"). The employees fraudulently indorsed checks made payable to Flavor-Inn with the company's rubber stamp. Then they presented the checks for deposit into their personal accounts at NCNB National Bank of South Carolina ("NCNB").[9]

Flavor-Inn made several claims against NCNB based on both the common law and the South Carolina Code. The claims included a claim for conversion under section 36-3-419 and two negligence claims: one for common-law negligence and one alleging NCNB's negligence in conducting its duties as a

1. ___ S.C. ___, 424 S.E.2d 534 (Ct. App. 1992).
2. S.C. CODE ANN. § 36-1-103 (Law. Co-op. 1976).
3. *Id.* § 36-3-419.
4. *Flavor-Inn*, ___ S.C. at ___, 424 S.E.2d at 535 (footnote omitted).
5. *Id.* at ___, 424 S.E.2d at 535.
6. *Id.* at ___, 424 S.E.2d at 536 (citing Equitable Life Assurance Soc'y of the United States v. Okey, 812 F.2d 906, 909-10 (4th Cir. 1987)).
7. *Id.* at ___, 424 S.E.2d at 537.
8. *Id.* at ___, 424 S.E.2d at 537.
9. *Id.* at ___, 424 S.E.2d at 535.

collecting bank under section 36-4-202.[10] In conjunction with these causes of action Flavor-Inn sought consequential, compensatory, and punitive damages. The trial court struck both negligence claims, focusing on the section 36-3-419 conversion claim, and it struck the consequential and punitive damage claims.[11]

On appeal the court upheld the trial court's conclusion that section 36-3-419 subsumes a common-law claim for negligent acceptance of a check with an unauthorized indorsement for payment or deposit.[12] The court also upheld the striking of the claim for consequential damages, but reversed the denial of punitive damages.[13]

The court of appeals began its analysis of Flavor-Inn's appeal by construing the relationship of sections 36-1-103 and 36-3-419.[14] The *Flavor-Inn* court followed the reasoning set forth by the Fourth Circuit Court of Appeals in *Equitable Life Assurance Society of the United States v. Okey*.[15]

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10. S.C. CODE ANN. § 36-4-202 (Law. Co-op. 1976). Section 36-4-202 outlines the basic responsibilities of a collecting bank. The court did not address the negligence claim based upon this section because Flavor-Inn failed to preserve the issue for appeal. *Flavor-Inn*, ___ S.C. at ___, 424 S.E.2d at 536.

11. *Flavor-Inn*, ___ S.C. at ___, 424 S.E.2d at 535.

12. *Id.* at ___, 424 S.E.2d at 536. The court refused to address the § 36-4-202 negligence claim because when the circuit court does not explicitly rule on a particular argument and the party fails to make a S.C. R. Civ. P. 59(e) motion to amend or alter judgment for failure to address the issue, then the appellate court cannot properly address the issue. *Id.* at ___, 424 S.E.2d at 536 (citing Noisette v. Ismail, 304 S.C. 56, 58, 403 S.E.2d 122, 124 (1991)).

13. *Id.* at ___, 424 S.E.2d at 537.

14. Section 36-1-103 provides: "Unless displaced by the particular provisions of this act, the principals of law and equity . . . shall supplement its provisions." S.C. CODE ANN. § 36-3-103 (Law. Co-op. 1976). Likewise, § 36-3-419 provides:

> (1) An instrument is converted when
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> . . . .
>
> (c) it is paid on a forged indorsement.
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> . . . .
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> (3) Subject to the provisions of this act concerning restrictive indorsements a representative, including a depositary or collecting bank, who has in good faith and in accordance with the reasonable commercial standards applicable to the business of such representative dealt with an instrument or its proceeds on behalf of one who was not the true owner is not liable in conversion or otherwise to the true owner beyond the amount of any proceeds remaining in his hands.

Id. § 36-3-419.

15. 812 F.2d 906 (4th Cir. 1987) (applying South Carolina's version of the UCC). Charles Okey III, an insurance agent for Equitable Life, personally indorsed customer checks made payable to Equitable Life and deposited them in his personal account at First National Bank of South Carolina. Okey then remitted part of each check to Equitable Life and embezzled the remainder which approximated $1.4 million. *Id.* at 907. The factual similarities between *Okey* and *Flavor-Inn* place *Okey* directly on point.

The *Flavor-Inn* court reasoned that section 36-3-419(1)(c) fell within the auspices of section 36-1-103, thereby displacing Flavor-Inn's common-law negligence claim.[16] Following *Okey*, the court justified this rationale by recognizing that the "reasonable commercial standards" language in section 36-3-419(3) encompasses the due care element of a negligence claim in an unauthorized indorsement deposit situation.[17] Therefore, the action for conversion under section 36-3-419 effectively subsumed the common-law negligence claim.[18]

The court next turned to the damages available as a consequence of its dismissing the negligence claim. First upholding the trial court's conclusion that section 36-3-419 disallowed consequential damages,[19] the court discussed damages actually recoverable in the section 36-3-419 conversion action.[20] Section 36-3-419(2) provides that in a conversion action the measure of liability other than a drawee's liability "is presumed to be the face amount of the instrument."[21] The plain language of this provision indicates that a conversion action permits recovery of compensatory, not consequential, damages.[19] Because the suit was against NCNB as a depositary bank, the court presumed that compensatory damages equalled the face amount of the instrument.[20]

The court recognized, however, Flavor-Inn's right to seek punitive damages as a matter of law, and consequently, reversed the trial court's decision on that issue.[21] According to section 36-1-106(1), "penal damages may [not] be had except as specifically provided in this act or by other rule of law."[22] Applying section 36-1-103, the court reasoned that no "particular provision" of South Carolina's common code displaced the "principal of law" entitling Flavor-Inn to recover punitive damages.[23] Instead, the "other rule of law" regarding punitive damages, the common law, applies and supplements the UCC.[24] The supplemental principal of law recognized and applied by the

16. *Flavor-Inn*, ___ S.C. at ___, 424 S.E.2d at 536.

17. *Id.* at ___, 424 S.E.2d at 536 (citing *Okey*, 812 F.2d at 908).

18. *Id.* at ___, 424 S.E.2d at 536 (citing *Okey*, 812 F.2d at 908).

19. *Id.* at ___, 424 S.E.2d at 537.

20. *Id.* at ___, 424 S.E.2d at 536-37.

21. S.C. CODE ANN. § 36-3-419(2) (Law. Co-op. 1976).

19. *Flavor-Inn*, ___ S.C. at ___, 424 S.E.2d at 537 (citing Patterson v. I.H. Servs., Inc., 295 S.C. 300, 310, 368 S.E.2d 215, 221 (Ct. App. 1988)).

20. *Id.* at ___, 424 S.E.2d at 536-37. The presumption that damages equal the face amount of the instrument arises only when a party sues the bank in a capacity other than as drawee. Section 36-3-419(2) expressly provides that the face amount of the instrument is the measure of a *drawee's* liability, but in "any other action" under this section, the measure of liability is only *presumed* to be that amount. S.C. CODE ANN. § 36-3-419(2) (Law. Co-op. 1976).

21. *Flavor-Inn*, ___ S.C. at ___, 424 S.E.2d at 537.

22. S.C. CODE ANN. § 36-1-106(1) (Law. Co-op. 1976).

23. *Flavor-Inn*, ___ S.C. at ___, 424 S.E.2d at 537.

24. *Id.* at ___, 424 S.E.2d at 537 (citing S.C. CODE ANN. § 36-1-106(1) (Law. Co-op.

court in awarding punitive damages was the rule that "[p]unitive damages may be recovered in South Carolina for a conversion, provided the defendant's conduct has been malicious, wilful, reckless, or committed with a conscious indifference to the rights of others."[25]

The *Flavor-Inn* conclusion that section 36-3-419 displaces common-law negligence claims for payment on a forged instrument is a widely recognized interpretation of section 1-103's relationship with section 3-419.[26] However, the opinion presents only a "bare-bones" analysis of why Flavor-Inn's negligence claim cannot co-exist with a section 36-3-419(1)(c) conversion claim. Other decisions reaching the same conclusion set forth a more in-depth analysis.[27]

The analytical backbone of whether a section 36-3-419(1)(c) claim subsumes a negligence claim lies in the interpretation of section 36-1-103, which provides the standard for determining if a UCC provision displaces a common-law cause of action. The conclusion in this decision arises from the concept that common-law negligence and UCC conversion claims conflict in three basic ways: (1) the overlapping nature of the two claims, (2) their notions of due care, and (3) their defenses.[28]

The ruling that Code conversion displaces a common-law negligence claim for payment on a forged instrument is supported by an analysis and comparison of the nature of each individual theory. "[B]oth negligence and conversion require a consideration whether there was payment over an unauthorized indorsement and evaluation of the reasonableness of the defendant's action."[29] Therefore, courts espousing the rationale followed by *Flavor-Inn* conclude that because the claims are so similar, the Code subsumes the common-law theory.[30]

1976)).

25. *Id.* at ___, 424 S.E.2d at 537 (citing Oxford Fin. Cos. v. Burgess, 303 S.C. 534, 402 S.E.2d 480 (1991); Cox v. Coleman, 189 S.C. 218, 200 S.E. 762 (1939)).

26. *See* Equitable Life Assurance Soc'y of the United States v. Okey, 812 F.2d 906 (4th Cir. 1987); Berthot v. Security Pac. Bank, 823 P.2d 1326 (Ariz. Ct. App. 1991) (adopting *Okey*'s reasoning); Florida Nat'l Bank v. Isaac Indus., Inc., 560 So. 2d 1203 (Fla. Dist. Ct. App. 1990) (per curiam) (finding Florida's conversion statute replaced the common-law action for negligence), *aff'd per curiam*, 617 So. 2d 472 (Fla. Dist. Ct. App. 1993); Husker News Co. v. South Ottumwa Savs. Bank, 482 N.W.2d 404 (Iowa 1992) (recognizing the argument that the UCC supplanted and annulled common-law negligence claims).

27. *E.g.*, *Okey*, 812 F.2d at 908-11.

28. *Id.*, at 909-10.

29. *Id.* at 909.

30. *Cf.* Robert A. Hillman, *Construction of the Uniform Commercial Code: UCC Section 1-103 and "Code" Methodology*, 18 B.C. INDUS. & COMM. L. REV. 655, 660-65 (1976) (analyzing cases which resist abandoning "outside law" for the more direct Code laws), *cited in Okey*, 812 F.2d at 909. Hillman believes that the underlying purposes of the UCC justify the conclusion that section 3-419(1)(c) subsumes common-law negligence claims. Hillman, *supra*, at 678-85.

The conflict in the claims' treatment of the concept of due care also supports *Flavor-Inn's* conclusion. A common-law negligence claim requires proving a lack of due care as a basic element of the cause of action, and the plaintiff bears the burden of proof.[31] Conversely, in a Code conversion claim, section 3-419 makes due care an element of the defendant's affirmative defense; and therefore, the defendant bears the burden of proving due care.[32] In affirmatively defending that they acted in a reasonable manner, the defendants must prove that they handled the instrument "in good faith and in accordance with the reasonable commercial standards applicable to the business of such [defendant]."[33] Courts often equate "reasonable commercial standards" with due care.[34] Consequently, the Code creates absolute liability for a 3-419(1)(c) claim unless the defendant establishes due care and good faith.[35] Therefore, as recognized in *Okey*, the plaintiff in a common-law negligence claim would carry a greater burden of proof than the Code intends.[36]

Conflict between the two causes of action because of their differing standards of proof also appears in the inconsistent result obtained if both causes are alleged and only one cause prevails. For example, if the common-law negligence claim prevailed, it would establish the defendant's failure to use due care; with the 3-419(1)(c) conversion claim, the defendant would establish that it acted with due care.[37] This inconsistency occurs because although virtually identical, the claims allocate the burden of proving due care differently.

The common-law negligence and Code claims also conflict regarding the available defenses. Section 3-419(1)(c) creates absolute liability in the defendant unless the defendant establishes the section 3-419(3) affirmative

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He recognizes that because the UCC seeks to establish uniformity in commercial transactions, the Code should displace the common law when both offer a method of recovery because the common law may vary among states. *Id.*

31. *Okey*, 812 F.2d at 908.

32. *Id.* (citing Nat'l Bank v. Refrigerated Transp. Co., 248 S.E.2d 496 (Ga. Ct. App. 1978)).

33. S.C. CODE ANN. § 36-3-419(3) (Law. Co-op. 1976).

34. *Okey*, 812 F.2d at 908 (citing 6 RONALD A. ANDERSON, UNIFORM COMMERCIAL CODE § 3-419:35 (3d ed. 1981)); *see also* Berthot v. Security Pac. Bank, 823 P.2d 1326, 1329 (Ariz. Ct. App. 1991) (interpreting "reasonable commercial standards" to mean due care).

35. *Okey*, 812 F.2d at 909; *see also Berthot*, 823 P.2d at 1331 (imposing absolute liability unless the bank can prove its own due care); Cartwood Constr. Co. v. Wachovia Bank & Trust Co., 352 S.E.2d 241, 244 (N.C. Ct. App.) (imposing absolute liability for conversion), *aff'd*, 357 S.E.2d 373 (N.C. 1987).

36. *Okey*, 812 F.2d at 909.

37. *Id.* (discussing the confusion caused by two differing burdens of proof, which caused the jury to reach inconsistent results). The court concluded that elimination of the common-law negligence clause remedied the confusion. *Id.*

defense of due care and good faith.[38] Furthermore, because the comments to the Code indicate that section 3-419 codifies common-law conversion,[39] defendants cannot avail themselves of common-law defenses such as contributory or comparative negligence because these defenses were not recognized at common law.[40] Conversely, in a common-law negligence action defendants routinely assert either contributory or comparative negligence as a defense.[41]

The *Okey* court best summed up the reasoning of this conflict-based analysis: "The cumbersomeness of dealing simultaneously with two causes of action that incorporate the same elements under varying proof burdens, when the only conceptual reason for considering both still viable is their somewhat different measures of damages, convinces us that . . . courts would find displacement . . . ."[42]

Although section 36-3-419 still exists in South Carolina and many other states,[43] in 1990 the model version of the UCC modified section 3-419. The remainder of section 3-419's provisions now appear in section 3-420 which provides:

> (a) The law applicable to conversion of personal property applies to instruments. An instrument is also converted if it is taken by transfer, other than a negotiation, from a person not entitled to enforce the instrument or a bank makes or obtains payment with respect to the instrument for a person not entitled to enforce the instrument or receive payment. An action for conversion of an instrument may not be brought by (i) the issuer or acceptor of the instrument or (ii) a payee or indorsee who did not receive delivery of the instrument either directly or through delivery to an agent or co-payee.
>
> (b) In an action under subsection (a), the measure of liability is presumed to be the amount payable on the instrument, but recovery may not exceed the amount of the plaintiff's interest in the instrument.

38. *See* S.C. CODE ANN. § 36-3-419 (Law. Co-op. 1976).

39. *Id.* (South Carolina Reporter's Comments).

40. *Okey*, 812 F.2d at 910.

41. *See id.*

42. *Id.* at 911.

43. As of October 26, 1992, the following nineteen states had adopted the Revised Model Code which contains § 3-420 (formerly § 3-419): Arkansas, California, Connecticut, Florida, Hawaii, Illinois, Kansas, Louisiana, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Mexico, North Dakota, Oklahoma, Pennsylvania, Virginia, and Wyoming. John J. A. Burke, *Loss Allocation Rules of the Check Payment System With Respect to Forged Drawer Signatures and Forged Indorsements: An Explanation of the Present and Revised UCC Articles 3 and 4*, 25 UCC L.J. 318, 324 n.25 (1993). Presumably, most states will adopt the revision. *Id.* at 324.

> (c) A representative, other than a depositary bank, who has in good faith dealt with an instrument or its proceeds on behalf of one who was not the person entitled to enforce the instrument is not liable in conversion to that person beyond the amount of any proceeds that it has not paid out.[44]

Subsection (a) of the new section 3-420 expands prior section 3-419(1)'s definition of conversion. As the comments to the 1990 revisions indicate, section 3-419(1) did not include all possible situations when conversion of an instrument can occur, and section 3-420 corrects this problem by adopting the personal property law of conversion for instruments.[45] The new section 3-420 also clarifies prior section 3-419 regarding conversion of unindorsed instruments, conversion by multiple payees, causes of action by payees who never received instruments against depositary or drawee banks, damages available from drawees and other converters, and defenses available to depositary banks.[46]

The clarifications that section 3-420 imposes on former section 3-419 probably would not dictate a different result from the one reached by the *Flavor-Inn* court in a similar case. Section 3-420 appears to cover the primary issue in *Flavor-Inn*—whether a depositary bank which paid on or accepted for deposit a check with an unauthorized endorsement is liable for negligence. The UCC's definition of conversion still covers the acceptance of a forged check for payment or deposit by a bank in section 3-420(a).[47] Therefore, because section 1-103 of the Model Code remains unchanged, section 3-420 presumably subsumes common-law negligence claims as did its predecessor.

A provision of section 3-420 which might change the result in a *Flavor-Inn* scenario appears in subsection (a)(ii) which expressly prohibits a payee or indorsee who did not receive delivery of an instrument from bringing an action for conversion of the instrument.[48] However, this prohibition is limited because the payee or indorsee may receive delivery indirectly through its agent.[49] Therefore, in a *Flavor-Inn* scenario the employees converting the checks would be considered agents of the payee authorized to receive customer checks. This indirect delivery would allow a section 3-420 conversion action.

44. U.C.C. § 3-420 (1993).

45. *Id.* cmt. 1.

46. *Id.* cmts. 1-3.

47. *Id.* cmt. 1. Subsections (a) and (b) of § 3-419(1) were deleted from the Model UCC; however, the second sentence of § 3-420(a) encompasses subsection (c). *Id.* "Section 3-420(a) . . . covers cases in which a depositary or payor bank takes an instrument bearing a forged indorsement." *Id.*

48. *Id.* § 3-420(a)(ii). "An action for conversion of an instrument may not be brought by . . . (ii) a payee or indorsee who did not receive delivery of the instrument either directly or through delivery to an agent or a co-payee." *Id.*

49. U.C.C. § 3-420 cmt. 1.

Although the above application of agency theory answers the question of delivery, the Revised Model Code section 3-405 sets forth a special provision dictating an employer's responsibility for fraudulent indorsements made by employees which adds a twist to the above analysis. Section 3-405 separates employees into two groups: those who have responsibility with respect to instruments and those who do not.[50] If the employee has responsibility with respect to instruments, then section 3-405 imposes strict liability on an employer for a fraudulent indorsement made by the employee.[51] Section 3-405 identifies six groups of employees who have responsibility with respect to instruments and lists them as those employees with authority

> (i) to sign or indorse instruments on behalf of the employer, (ii) to process instruments received by the employer for bookkeeping purposes, for deposit to an account, or for other disposition, (iii) to prepare or process instruments for issue in the name of the employer, (iv) to supply information determining the names or addresses of payees of instruments to be issued in the name of the employer, (v) to control the disposition of instruments to be issued in the name of the employer, or (vi) to act otherwise with respect to instruments in a reasonable capacity.[52]

Although this section imposes strict liability on the employer, subsection (b) allows an employer to split the loss with the depositary bank if the bank failed to exercise ordinary care in paying on the instrument, and this lack of care contributed substantially to the loss by the employer.[53]

If the employee is not entrusted with the described responsibility then section 3-405 does not apply.[54] If section 3-405 does not apply then the issue becomes whether or not the employer negligently retained the check.[55] If the employer was not negligent, then the employer may claim forgery by the employee and bring an action for conversion under section 3-420. Therefore, in a *Flavor-Inn* situation the court must determine whether the employee who forged the indorsements on the checks falls into one of the section 3-405 categories. If so, then the employer incurs strict liability for the amount lost, or at least part of it, and the result will differ from that reached in *Flavor-Inn.*

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50. *See id.* § 3-405(a)(3); *see also* Burke, *supra* note 43, at 372 (discussing the impact of the revisions).

51. *Id.*

52. U.C.C. § 3-405(a)(3); *see also* Burke, *supra* note 43, at 372-73 (discussing § 3-405(a)(3)).

53. U.C.C. § 3-405(b); *see also* Burke, *supra* note 43, at 373-74 (discussing an employer sharing the loss with a negligent bank).

54. Section 3-405(a)(3) gives specific examples of when it does not apply. "'Responsibility' does not include authority that merely allows an employee to have access to instruments or blank or incomplete instrument forms that are being stored or transported or are part of incoming or outgoing mail, or similar access." U.C.C. § 3-405(a)(3).

55. *See* ANDERSON, *supra* note 34, § 3-405:1 cmt. 1.

However, if the employee does not fall in one of the section 3-405 categories, then the result will likely approximate that in *Flavor-Inn*, unless the employer negligently retained the check.

Section 3-420(b) changes the standard for calculating the amount of damages. In former section 3-419 the measure of liability was presumably the face amount of the instrument, while in section 3-420 "the measure of liability is presumed to be the amount payable on the instrument."[56] This change in language will not likely affect a *Flavor-Inn* type case because no difference exists in the application of the two standards when the instrument is a check. The change was made to clarify situations in which the instrument converted was interest bearing or declared other amounts due.[57] Because a *Flavor-Inn* scenario deals only with converted checks, which usually do not involve interest, "the amount payable on the instrument" will likely remain "the face value of the instrument."

The South Carolina Court of Appeals in *Flavor-Inn*, following the Fourth Circuit's lead in *Okey*, reinforced the logical reasoning behind the denial of a plaintiff's common-law negligence claim when a section 3-419 conversion claim is simultaneously made. Although section 3-419 of the South Carolina Commercial Code no longer reflects the Model Uniform Commercial Code's provision on conversion, many states still follow the pre-revised version of Article 3. However, nineteen states have adopted the Revised Model Code with more expected to follow. If South Carolina adopts the Revised Model Code provision on conversion, courts will likely still reach the same result that the Court of Appeals reached in *Flavor-Inn* unless section 3-405 applies, in which case the employer would incur strict liability for at least part of the loss depending upon the level of care of the depositary bank.

Elizabeth Anne Holley

II. COURT ADDRESSES THE REGULATION OF MANUFACTURERS, DISTRIBUTORS, AND DEALERS ACT

In *Taylor v. Nix*[1] the South Carolina Supreme Court held: (1) the Regulation of Manufacturers, Distributors, and Dealers Act ("the Act")[2] is constitutional; (2) the lessees of an automobile were entitled to double and treble damages as provided under the Act; and (3) the Act allowed recovery

56. U.C.C. § 3-420(b).
57. *Id.* cmt. 2.

1. 307 S.C. 551, 416 S.E.2d 619 (1992).
2. S.C. CODE ANN. § 56-15-10 to -360 (Law. Co-op. 1991).

of attorney's fees, although the attorney did not itemize the bill into the relative time spent on the statutory cause of action.[3] In *Taylor* the lessees of an automobile sued the lessor and the manufacturer, claiming breach of warranty, strict liability in tort, and violation of the Act.[4] The decision proves significant because it is one of the few South Carolina decisions interpreting the Act, and the court takes an expansive view of the Act's applicability and amount of damages recoverable.

The plaintiffs, Kathy and Glenn Taylor, leased with an option to buy a Porsche 928S from the defendants. Shortly thereafter, the Taylors discovered numerous problems and defects with the automobile, including the following: a water leak in the hatchback; the presence of exhaust fumes in the passenger compartment; heat radiating from the console between the two front seats; a leaky sun roof; a faulty alarm system; defective speakers; and the failure of the rear wipers, interior lights, and rear hatch release.[5] The uncontested testimony of Ms. Taylor revealed that she took the car to the dealer approximately fourteen times in the twenty-six months the Taylors possessed the automobile, and the dealership never fully corrected the defects. The Taylors then met with two Porsche representatives who also failed to remedy the problems. Further, the Taylors complained of the unprofessional conduct of the service personnel and representatives.[6] In the original lawsuit, the Taylors named Nix V.W., Inc. ("Nix"), Porsche Cars North America, Inc. ("Porsche"), and various other defendants, seeking damages stemming primarily from a failure to repair the automobile in a proper, timely, and professional manner.[7]

The trial court submitted the case to the jury on theories of breach of warranty, strict liability in tort, and violation of the Act. After finding a malicious violation of the Act, the jury returned a plaintiffs' verdict awarding both actual damages and treble damages—the maximum punitive damages allowed under the Act.[8] The total verdict amounted to $80,500.00 to which the court added $15,903.50 in attorney's fees and $2,563.10 in costs.[9] Nix and Porsche appealed.[10]

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3. *Taylor*, 307 S.C. at 555-57, 416 S.E.2d at 621-22.

4. *Id.* at 553, 416 S.E.2d at 620.

5. *Id.* at 553 & n.1, 416 S.E.2d at 670 & n.1.

6. The Taylors complained of being joked about, laughed at, and avoided by the service personnel and the Porsche representatives. *Id.* at 554, 416 S.E.2d at 621.

7. *Id.* at 551-55, 416 S.E.2d at 619-21. The other named defendants included Marine Midland Automotive Corporation, Auto Recovery Bureau, Inc., and Sam Price. *Id.* at 551, 416 S.E.2d at 619. These defendants settled before the verdict on various claims unrelated to the issues on appeal. *See* Brief of Respondent at 1 n.1.

8. *Taylor*, 307 S.C. at 555, 416 S.E.2d at 621.

9. Brief of Respondent at 2.

10. *Taylor*, 307 S.C. at 553, 416 S.E.2d at 620.

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First, the appellants challenged the Act as being unconstitutionally vague because it failed to define the term "arbitrary."[11] In finding the Act constitutional, the court recognized that although not defined in the Act, "arbitrary" is readily definable, and thus not unconstitutionally vague.[12]

The South Carolina Supreme Court has previously upheld the South Carolina Unfair Trade Practices Act ("UTPA") as not unconstitutionally vague.[13] However, at least one commentator argues otherwise and points out that the UTPA allows treble damages with no prior judicial order for violation of a facially broad statute.[14] The combination of these factors raises the possibility that a person or business may act in good faith and still receive a punitive fine.[15] Although the Act differs from the UTPA, the concerns that Mr. Norton expresses with the UTPA are applicable to the Act because the Act encompasses a wide range of conduct and allows both treble damages and double actual damages with no prior judicial order.[16]

Before assessing the constitutionality of the Act, it would appear that the court should have discussed whether the Taylors could properly avail themselves of remedies provided by the Act. The court neglected to specifically address two issues: (1) whether the Act provides a remedy to consumers, and (2) whether the lease with an option to purchase falls within the purview of the Act.

The Act appears to be based on the Federal Automobile Dealers Day in Court Act ("Automobile Dealers Act").[17] Although the Automobile Dealers Act seeks to balance the playing field between automobile dealers and manufacturers,[18] it does not contemplate consumer recovery.[19] The early

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11. *Id.* at 555, 416 S.E.2d at 621.

12. *Id.* ("Arbitrary conduct is readily definable and includes acts which are unreasonable, capricious or nonrational; not done according to reason or judgment; depending on will alone." (citing BLACK'S LAW DICTIONARY 104 (6th ed. 1990))). The court found the lower court's definition of "arbitrary" ("not governed by any fixed rules or standards") too narrow to apply to the conduct of motor vehicle dealers. The lower court took its definition from Deese v. South Carolina State Board of Dentistry, 286 S.C. 182, 332 S.E.2d 539 (Ct. App. 1985). Although the supreme court recognized the usefulness of this definition in reviewing administrative agency decisions, the court determined that it was not appropriate for motor vehicle dealers, noting that "[m]otor vehicle dealers are not required to deal with their customer guided solely by fixed rules and standards." *Taylor*, 307 S.C. at 556, 416 S.E.2d at 621.

13. Inman v. Ken Hyatt Chrysler Plymouth, Inc., 294 S.C. 240, 363 S.E.2d 691 (1988).

14. *See* Albert L. Norton, Jr., *The South Carolina Unfair Trade Practices Act and the Void-For-Vagueness Doctrine*, 40 S.C. L. REV. 641, 666 (1989).

15. *Id.*

16. S.C. CODE ANN. § 56-15-110 (Law. Co-op. 1991).

17. *See* 15 U.S.C. §§ 1221-1225 (1988).

18. *See* DeCantis v. Mid-Atlantic Toyota Distribs., Inc., 371 F. Supp. 1238, 1241 (E.D. Va. 1974) ("[T]he [Automobile Dealers] Act's ultimate purpose is to curtail the effects of any coercion and intimidation which automobile manufacturers may be able to impose on their retail dealers by virtue of the manufacturers' superior economic position." (citing Barney Motor Sales

case of *Superior Motors, Inc. v. Winnebago Industries, Inc.*[20] refers to the Act's original version as a "South Carolina franchise law,"[21] thereby supporting the contention that the statutory scheme initially expressed no intention to provide consumers with a cause of action. The *Superior Motors* court stated: "Although the title suggests a broader scope, the act purports to regulate only motor vehicle sales and business dealings."[22] The appellants in *Taylor* argued that *Superior Motors* suggested that the legislature merely intended for the Act to apply to dealings between automobile dealers and manufacturers.[23] In *Adams v. Grant*[24] and *Riddle v. Pitts*,[25] South Carolina courts have affirmed jury awards for consumers under the Act; however, neither appeal directly raised the issue of the Act's applicability to consumers.

Section 56-15-80 of the Act lists the agreements to which the Act applies. The section applies to "agreements between a manufacturer, wholesaler or distributor with a motor vehicle dealer,"[26] but it does not mention the applicability of the Act to consumer agreements. However, consumer recovery under the Act seems predicated on the language of sections 56-15-40 and 56-15-110. Section 56-15-40(1) makes it a violation for a "motor vehicle dealer to engage in any action which is arbitrary, in bad faith, or unconscionable and which causes damage to any of the parties or to the public."[27] Further, section 56-15-110(1) provides that "any person who shall be injured in his business or property by reason of anything forbidden in this chapter may sue therefor in the court of common pleas."[28]

The *Taylor* court further expanded the Act to apply to a lease with an option to purchase. This decision conforms with the ruling in *Southern National Leasing Corp. v. Hall*[29] which held that South Carolina's UTPA did in fact cover automobile leases.[30] The *Hall* court noted that although section 56-15-10(l) lacks a specific reference to leases, the definition of "sale"[31] is

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v. Cal Sales, Inc., 178 F. Supp. 172, 175 (S.D. Cal. 1959))).

19. *See generally* 15 U.S.C. §§ 1221-1225 (1988).

20. 359 F. Supp. 773 (D.S.C. 1973).

21. *Id.* at 776.

22. *Id.*

23. Brief of Appellant at 10.

24. 292 S.C. 581, 358 S.E.2d 142 (Ct. App. 1986).

25. 283 S.C. 387, 324 S.E.2d 59 (1984).

26. S.C. CODE ANN. § 56-15-80 (Law. Co-op. 1991).

27. *Id.* § 56-15-40(1).

28. *Id.* § 56-15-110(1).

29. 306 S.C. 92, 410 S.E.2d 577 (Ct. App. 1991).

30. *Id.* at 93-94, 410 S.E.2d at 578; *see also supra* text accompanying notes 13-16.

31. "Sale," shall include the issuance, transfer, agreement for transfer, exchange, pledge, hypothecation, mortgage in any form, whether by transfer in trust or otherwise, of any motor vehicle or interest therein or of any franchise related thereto; and any option, subscription or other contract, or

expressed in broad terms.[32] By reading this section together with sections 56-15-20[33] and 56-15-40(5),[34] the court found that the definition of sale encompasses a lease.[35]

To recover under the Act, the plaintiff must establish arbitrary, bad faith, or unconscionable conduct by the defendant.[36] The Taylors' suit stemmed primarily from the repeated failure to repair the vehicle and the insensitive and unprofessional conduct of the service personnel and representatives. The application of the Act under these circumstances deserves a degree of scrutiny.

Two recent South Carolina cases reject the contention that conduct arguably similar to that complained of in *Taylor* violated South Carolina's UTPA. In *Key Co. v. Fameco Distributors, Inc.*[37] the court held that a mere breach of contract, even if intentional, fails to constitute an unfair trade practice.[38] Additionally, in *Clarkson v. Orkin Exterminating Co.*[39] the Fourth Circuit Court of Appeals ruled that mere failure to repair is not unfair trade practice.[40] The court stated:

> solicitation, looking to a sale, or offer or attempt to sell in any form, whether spoken or written. A gift or delivery of any motor vehicle or franchise with respect thereto with, or as, a bonus on account of the sale of anything shall be deemed a sale of such motor vehicle or franchise.

S.C. CODE ANN. § 56-15-10(l) (Law. Co-op. 1991).

32. *Hall*, 306 S.C. at 93, 410 S.E.2d at 578.

33. Section 56-15-20 provides:

> Any person who engages directly or indirectly in purposeful contacts within this State in connection with the offering or advertising for sale or has business dealings with respect to a motor vehicle within this State shall be subject to the provisions of this chapter and shall be subject to the jurisdiction of the courts of this State upon service of process in accordance with the provisions of Chapter 9 of Title 15.

S.C. CODE ANN. § 56-15-20 (Law. Co-op. 1991).

34. Section 56-15-40(5) provides:

> There is hereby created the Office of Administrator, within the Attorney General's office, and he shall appoint such personnel within his office for the purpose of regulating this chapter. The Administrator shall have the power to investigate, issue cease and desist orders and injunctive relief on any valid abuse connected with the sale, rental or leasing of a new or used motor vehicle; *provided, however*, this power shall only apply after reasonable attempts by the consumer have been made with the seller, dealer, manufacturer or lessor of the motor vehicle to alleviate the complaint.

Id. § 56-15-40(5).

35. *Hall*, 306 S.C. at 94, 410 S.E.2d at 578.

36. S.C. CODE ANN. § 56-15-40 (Law. Co-op. 1991).

37. 292 S.C. 524, 357 S.E.2d 476 (Ct. App. 1987).

38. *Id.* at 526-27, 357 S.E.2d at 478 (citing Atlantic Purchasers, Inc. v. Aircraft Sales, Inc., 705 F.2d 712 (4th Cir. 1983) and Chancellors Racquet Club v. Schwarz, 661 S.W.2d 194 (Tex. Ct. App. 1983)).

39. 761 F.2d 189 (4th Cir. 1985).

40. *Id.* at 191.

> There is no support in South Carolina law for the proposition that a service person violates the unfair trade practice statute if he performs his job poorly or overlooks something which should have attracted his attention. An explicit or implicit representation that he performed his job properly, if the fault is negligence or inattention, is simply not the kind of deceptive practice the statute was intended to reach.[41]

Although the UTPA differs from the statutory scheme in the Regulation of Manufacturers, Distributors, and Dealers Act,[42] the underlying reasoning of the above two decisions remains relevant to the Act. That is, to benefit from favorable damages provisions under the statutory schemes, the plaintiff must establish something more than a mere breach of warranty or failure to repair.

However, in *Taylor* the trial court seemingly relied on the express language of the Act and found the defendants guilty of arbitrary and malicious conduct. *Taylor* gives no indication of when unfriendly service and failure to properly repair warrant a finding of arbitrary conduct. In fact, the ability of a court to sufficiently define "arbitrary" conduct for the jury seems questionable. For example, in ERISA cases courts have observed that juries cannot adequately apply an "arbitrary" conduct standard.[43]

The *Taylor* court's ruling regarding the damages allowable under the Act also merits attention. In addition to violations of the Act, the Taylor's alleged breach of warranty and strict liability in tort. The court noted that "only damages incurred as a result of the conduct in violation of [the Act] are recoverable and subject to doubling and punitive damages."[44] The trial court failed to instruct the jury to determine what damage resulted from the defendants' violation of the statute.[45] The court ruled this charge erroneous, but concluded that the defendants suffered no prejudice.[46] Therefore, the court's decision indicates that it determined that all of the damages resulted from conduct in violation of the statute.

Next, the court found sufficient evidence to support a finding of malice, thus triggering the punitive damages provision and authorizing treble actual

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41. *Id.*

42. *See supra* text accompanying notes 13-16. In Columbia (SC) Teachers Fed. Credit Union v. Newsome Chevrolet-Buick, Inc., 303 S.C. 162, 399 S.E.2d 444 (Ct. App. 1990), the court referred to the Act as the "Motor Vehicle Dealers Unfair Trade Practices Act." *Id.* at 163, 399 S.E.2d at 445.

43. *See, e.g.*, Berry v. Ciba-Geigy Corp., 761 F.2d 1003 (4th Cir. 1985). The *Berry* court stated that "[t]he significance of the [arbitrary and capricious] standard, while second-nature to a judge, is not readily communicated to jurors." *Id.* at 1006-07.

44. Taylor v. Nix, 307 S.C. at 556, 416 S.E.2d at 622 (citing S.C. CODE ANN. § 56-15-110 (Law. Co-op. 1991)).

45. *Id.*

46. *Id.*

damages.[47] The court found that the 95 m.p.h. test drive and the acts by the servicemen of ignoring, avoiding, joking about and laughing at the Taylors when they took the car in for service supported a finding of malice.[48] Apparently, the trial court deemed these identical acts "arbitrary," thus rendering the Act applicable in this case. Unfortunately, the court's interpretation makes it difficult to distinguish between a finding of malice and a finding of no malice in a breach of warranty action. Arguably, any breach of warranty action will trigger the malice provision of the Act.

Finally, the court affirmed the award of attorney's fees under section 56-15-110(1) of the Act.[49] However, fees related to the nonstatutory causes of action were excluded. Therefore, the trial court correctly deducted an amount that represented time spent on actions against other defendants who settled prior to the trial. The dispute regarding allowable attorney's fees arose because the breach of warranty, strict liability, and statutory claims all related to the same transaction and conduct. The court held that "no allocation of attorney's services need be made except to the extent counsel admits that a portion of the services was totally unrelated to the statutory claim or it is shown that the services related to issues which were clearly beyond the scope of the statutory proceeding."[50]

The South Carolina Supreme Court's decision in *Taylor* allows consumer recovery under the Regulation of Manufacturers, Distributors, and Dealers Act for a failure to properly and professionally repair a leased automobile in a timely manner. The Act proves very attractive to plaintiffs by allowing an award of double actual damages, treble actual damages as punitive damages, and attorney's fees. However, the Act proves troubling to defendants because of the potential for broad application. Finally, because this decision is one of the few South Carolina cases interpreting the Act, no clear guidelines exist regarding when application of the Act is appropriate.

Mark L. Richardson

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47. *Id.* at 556-57, 416 S.E.2d at 621-22. "In an action for money damages, if the jury finds that the defendant acted maliciously, the jury may award punitive damages not to exceed three times the actual damages." S.C. CODE ANN. § 56-15-110(3) (Law. Co-op. 1991).

48. *Taylor*, 307 S.C. at 556-57, 416 S.E.2d at 622.

49. *Id.* at 557, 416 S.E.2d at 622.

50. *Id.* (citing Heindel v. Southside Chrysler-Plymouth, Inc., 476 So. 2d 266 (Fla. Dist. Ct. App. 1985)).

III. LENDER LIABILITY: EXPRESS TERMS OF A CONTRACT VERSUS THE IMPLIED OBLIGATION OF GOOD FAITH

In *First Federal Savings & Loan Ass'n v. Dangerfield*[1] the South Carolina Court of Appeals held that a commercial lender does not breach implied obligations of good faith and fair dealing simply because it does not take discretionary action that would lessen the liability of a guarantor in default of a loan. Although this decision departs from the holding of the landmark federal case, *K.M.C. Co. v. Irving Trust Co.*,[2] it does not significantly depart from the historical practice of South Carolina courts. In addition, the *Dangerfield* decision conforms to the growing national trend not to find a breach of an implied obligation of good faith when the parties follow the express terms of a commercial contract.[3]

In *Dangerfield*, First Federal Savings and Loan Association filed an action against Clyde Dangerfield, John Watkins, and Margaret Bivens, seeking to

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1. 307 S.C. 260, 414 S.E.2d 590 (Ct. App. 1992).

2. 757 F.2d 752 (6th Cir. 1985). "The most significant decision in the field of lender liability is the 1985 decision of the Sixth Circuit in *K.M.C. Co. v. Irving Trust Co.* . . . [which] first gave the lending community the message that lenders have an underlying obligation to deal in good faith with their borrowers, regardless of the strict terms of the loan agreements their lawyers drafted." HELEN D. CHAITMAN, THE LAW OF LENDER LIABILITY ¶ 4.01 (1990).

In *K.M.C.*, Irving Trust Company refused to advance $800,000 to K.M.C. even though the advance would not have overdrawn K.M.C.'s $3.5 million line of credit. Being a wholesale retail and grocery business, K.M.C. contended that Irving's refusal without notice to advance the requested funds caused the collapse of K.M.C. "as a viable business entity." 757 F.2d at 754.

The Sixth Circuit Court of Appeals upheld the lower court's finding that "there is implied in every contract an obligation of good faith" which may impose upon the lender a duty to give notice before refusing to advance funds under a loan agreement. *Id.* at 759. (citing U.C.C. § 2-309 cmt. 8 (1989) ("[T]he application of principles of good faith and sound commercial practice normally call for such notification of the termination of a going contract relationship as will give the other party reasonable time to seek a substitute arrangement.")).

For a discussion of the implied obligation of good faith which denounces the *K.M.C.* decision, see Mark Snyderman, Comment, *What's So Good About Good Faith? The Good Faith Performance Obligation In Commercial Lending*, 55 U. CHI. L. REV. 1335 (1988) (calling *K.M.C.* "a prototypical example of a hard case making bad law").

3. "In the recent boom of lender liability litigation, borrowers have attempted to impose on lenders obligations that are contrary to explicit contractual provisions." David M. Schiffman, *Lender Liability Claims Die in Circuits*, NAT'L L.J., Sept. 28, 1992, at 23. However, a number of courts have estopped borrowers from denying lenders the right to enforce the terms of their contracts. *Id.* Claims against lenders which courts have recently rejected include alleged lender duties to "negotiate in good faith over a borrower's proposal to repay only a portion of a loan . . . release collateral or subordinate liens if its loan would still be adequately secured . . . exercise reasonable forbearance following a default . . . continue extending credit while its borrower is in default, if it has done so in the past . . . provide a loan even if a borrower has not satisfied minor conditions precedent set forth in the loan commitment . . . [and] act reasonably when deciding whether to make additional advances under a discretionary line of credit, or when deciding whether to renew an expiring loan." *Id.*

collect on the guaranty agreements executed by each as shareholders of the borrower, a company named "A Professional Moving and Storage of Charleston, Inc." ("the Company"). Dangerfield, Watkins, and Bivens's husband, Joseph, were the principal incorporators of the Company. While both Dangerfield and Bivens leased equipment to the Company, only Dangerfield contributed capital to the business.[4]

After incorporating the Company, Dangerfield and Watkins, as officers of the Company, met with the vice president of First Federal to obtain a loan. First Federal granted the Company two loans based on personal guaranties from the stockholders as well as a security interest in the leased equipment. The Company was the primary obligor on all of the personal guaranties, and the terms of the guaranties continued until either the obligation was retired or the guarantors provided written notice of termination to First Federal.[5]

Less than one month after the issuance of the loan, Joseph Bivens informed First Federal of improprieties by the Company's officers involving the loan funds. He reported that the Company improperly disbursed loan funds to an unrelated business in Greenville, and also made several large payments to Dangerfield and Watkins. Joseph also requested First Federal to discontinue additional loan payments to the Company to prevent further loss. Despite this request, First Federal continued to make loan disbursements to the Company and even granted an extension of the loan payment to the Company after Dangerfield and Watkins announced their intentions to either sell or discontinue the Company. Eight months after the issuance of the loan and two days after the extension, the Company filed for bankruptcy, and the legal action ensued.[6]

The trial court granted summary judgment in favor of First Federal, and Bivens appealed. Addressing three issues in *Dangerfield*, the South Carolina Court of Appeals affirmed. The issue with the greatest impact on lender liability law was whether First Federal, once informed of improprieties with the loan funds, breached the implied covenants of good faith and fair dealing by failing to exercise its contractually authorized discretion to locate and safeguard the loan collateral. Such safeguarding would have reduced Bivens's share of liability after the loan default.[7]

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4. 307 S.C. at 261-62, 414 S.E.2d at 591.

5. *Id.* at 262, 414 S.E.2d at 592.

6. *Id.* at 263-64, 414 S.E.2d at 592-93.

7. *Id.* at 266, 414 S.E.2d at 594. The other two issues the court addressed were: (1) whether Bivens was liable on her guaranty even though the loan documents incorrectly listed the Greenville company as the borrower instead of the Charleston company; and (2) whether the Bivenses' oral communications to First Federal served as a sufficient revocation of the guaranty agreement prior to the final disbursal of the loan funds when the agreement expressly called for a written revocation. *Id.* at 264-65, 414 S.E.2d at 593-94.

In a short explanation, the court of appeals held that First Federal did not breach any implied covenants of good faith and fair dealing by not locating and safeguarding the Company's collateral after learning of the alleged improprieties by the corporate officers.[8] The court relied on Bivens's guaranty, which stated:

> First Federal shall retain the right from time to time, without further notice to or consent of the undersigned, to deal with all or any of the Obligations, and any collateral or security thereof, as First Federal may deem advisable in its sole discretion . . . . The rights granted to First Federal hereunder shall be cumulative with all other rights of First Federal and First Federal may select and assert its remedies against the undersigned, or any other maker, endorser or guarantor of the Obligations or against any security or collateral therefor.[9]

The court found that the guaranty gave First Federal the power to obtain payment from the guarantors without first pursuing collection against the Company's collateral. Although Bivens maintained that First Federal breached an implied duty, the court stated that First Federal merely did "what the contract expressly permitted it to do."[10] Citing only to a 1979 Georgia case that neither party briefed or argued, the court of appeals ruled that "[t]here is no breach of an implied covenant of good faith where a party to a contract has done what the provisions of the contract expressly gave him the right to do."[11]

A survey of South Carolina case law reveals that its courts have encountered little opportunity to address the issue of an implied good faith

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8. 307 S.C. at 267, 414 S.E.2d at 594.

9. *Id.*

10. *Id.*

11. *Id.* (citing Automatic Sprinkler Corp. of Am. v. Anderson, 257 S.E.2d 283 (Ga. 1979)).

In *Automatic Sprinkler*, the court addressed the issue of "whether good faith is a prerequisite in the exercise of an absolute discretion to withhold incentive compensation" in an employment contract. 257 S.E.2d at 284. The Georgia Supreme Court stated:

> [T]he [court of appeals] recognized "the time honored rule that where a decision is left to the discretion of a designated entity, the question is not whether it was in fact erroneous, but whether it was in bad faith, arbitrary or capricious so as to amount to an abuse of that discretion." The decision continues, however, by citing one of the most basic rules of contract construction. "What the intent of the parties was in making the contract must control; it is possible to so draw a contract as to leave decisions absolutely to the uncontrolled discretion of one of the parties and in such a case the issue of good faith is irrelevant." There can be no breach of an implied covenant of good faith where a party to a contract has done what the provisions of the contract expressly give him the right to do.

Id. (quoting MacDougald Constr. Co. v. State Highway Dep't, 188 S.E.2d 405, 406 (Ga. Ct. App. 1972) (citations omitted)).

obligation in commercial contracts. With the exception of *Commercial Credit Corp. v. Nelson Motors, Inc.*,[12] South Carolina courts have declined to find an implied good faith obligation and instead have chosen to uphold the express terms of the contract.

In *Commercial Credit* the South Carolina Supreme Court recognized an implied obligation of good faith in a commercial contract even though the contract did not provide specific terms describing the duties of the parties. The court estopped the finance corporation, Commercial Credit Corp. ("Commercial Credit") from recovering its loss on certain contracts and mortgages securing the credit portion of the purchase price of cars sold by Nelson Motors, Inc. ("Nelson Motors"). Furthermore, the court found that the finance corporation did not act in good faith in carrying out its discretionary contractual powers.

Under the contract, Nelson Motors would assign security instruments to Commercial Credit upon the sale of cars from its dealership. During the first ten years of the contract, the parties agreed that in the event of default by a buyer, Commercial Credit could recover its loss after repossession by sale back to the dealership. The dealership would purchase the repossessed automobiles from funds held in a reserve account, but held no obligation to Commercial Credit for losses beyond the funds available in the account.[13] An affidavit of Commercial Credit's Columbia office manager also alleged the following: "From the course of dealings between Nelson Motors, Inc. and Commercial Credit Corporation over these years, any security instrument that was sold to, and purchased by, Commercial Credit was with the understanding that Commercial Credit Corporation would look after the collection of the installments due on these instruments."[14]

Three years before Commercial Credit filed suit against Nelson Motors, the parties supplanted their contract with a new agreement obligating Nelson Motors to pay out-of-pocket any net loss Commercial Credit suffered after depletion of the Nelson Motors reserve fund.[15] Based upon the terms of this new contract, Commercial Credit sued Nelson Motors for a deficiency payment. Nelson Motors denied liability for Commercial Credit's deficiencies claiming that Commercial Credit failed to collect the balances of the security instruments with the same care and diligence it previously employed.[16]

Although the court found that the contract did not expressly impose upon Commercial Credit an obligation to service and collect the assigned accounts,

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12. 247 S.C. 360, 147 S.E.2d 481 (1966).

13. *Id.* at 364, 147 S.E.2d at 482.

14. *Id.* at 365, 147 S.E.2d at 483.

15. *Id.*

16. *Id.* at 363, 147 S.E.2d at 482. Nelson Motors' answer "allege[d] that the losses sustained by Commercial were caused by its failure to perform its obligations in these respects." *Id.*

the court found that an implied covenant of good faith exists in every contract.[17] Consequently, the court ruled:

> Without going into further detail, we are satisfied that under the terms of the contract in the light of surrounding circumstances, including the relationship of the parties and their past dealings, it is, to say the least, fairly arguable that Commercial was impliedly obligated to pursue the collection of the accounts with reasonable and customary diligence.[18]

In *Rock Hill National Bank v. Honeycutt*,[19] the South Carolina Court of Appeals declined to find a breach of an implied obligation of good faith when a lender exercised its discretion under the Bankruptcy Act and Rules and voted against a plan of reorganization, despite the guarantor's contention that if the bank had not voted against the proposed plan, all creditor debts would have been satisfied. Honeycutt, the guarantor of a note, filed for Chapter Eleven bankruptcy on behalf of the borrower, Mac-Fab. During the bankruptcy proceeding, Honeycutt proposed a "plan of arrangement" for Mac-Fab whereby he would sell the corporation to a ready and willing buyer.[20] Honeycutt alleged that the majority of the relevant unsecured corporate creditors approved the plan until the bank voted against it. The bank's negative vote forced Mac-Fab into involuntary liquidation which provided for only a portion of the company's outstanding debt.[21]

As a defense in the ensuing foreclosure action, Honeycutt asserted that the bank should be precluded from enforcing its guaranty because it voted against the proposed plan and thereby prevented Mac-Fab from realizing funds that would have enabled it to pay all of its creditors in full.[22] Moreover, Honeycutt also argued that the plan would have eradicated the need to enforce

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17. *Commercial Credit Corp.*, 247 S.C. at 366-368, 147 S.E.2d at 483-84. The court found that the contract conferred "unlimited authority on Commercial to deal with the obligors, without releasing Nelson, and provide[d] no opportunity for Nelson to protect its own interest by stimulating payments." *Id.* at 369, 147 S.E. at 483.

18. *Id.* at 369, 147 S.E.2d at 485.

19. 289 S.C. 98, 344 S.E.2d 875 (Ct. App. 1986). Although the court's opinion does not indicate that the defendant alleged breach of an implied obligation of good faith, this issue arises when the lender is given discretion to act pursuant to the terms of a commercial contract. "If a lender has discretion over a particular issue relating to a contract, the lender's good faith in determining that issue may be questioned. When the lender's discretion is such that the reasonable expectations of the borrower may be frustrated, the good faith of the lender will undoubtedly be questioned." CHAITMAN, *supra* note 2, ¶ 4.03[1]. While *Honeycutt* does not present a good faith issue under a loan instrument, a court might find the discretion given a bank in a foreclosure proceeding analogous, thereby creating an implied obligation of good faith.

20. *Honeycutt*, 289 S.C. at 100, 344 S.E.2d at 876.

21. *Id.*

22. *Id.* at 105, 344 S.E.2d at 879.

the bank's guaranty against the company. However, the court of appeals rejected Honeycutt's argument by stating: "As we see it, the bank simply exercised the discretion granted it under the Bankruptcy Act and Bankruptcy Rules in voting against the plan. Moreover, it defies logic that the bank would vote against a 'sure plan' which would have paid in full all of its indebtedness."[23]

In another South Carolina Court of Appeals case, *PPG Industries, Inc. v. Orangeburg Paint & Decorating Center, Inc.*,[24] the South Carolina Court of Appeals declined to find an implied obligation of good faith to give notice when a written continuing guaranty agreement was silent as to whether the creditor must "notify the guarantor of each additional extension of credit to the guarantor's principal."[25] The court held that the plaintiff-creditor was under no obligation to notify the defendant-guarantor of the additional extension of credit to the debtor because there was no specific provision in the guaranty requiring such notice.[26]

In *PPG Industries*, Leonard Sanford ("Sanford") incorporated Orangeburg Paint & Decorating Center, Inc. ("Orangeburg Paint") and personally signed a guaranty for extensions of credit by a supplier, PPG.[27] The guaranty extended to all sales and deliveries of PPG products, but it did not provide for notice to Sanford of orders made by Orangeburg Paint.[28] PPG sued to enforce the guaranty agreement against Sanford. Sanford denied liability for credit extensions beyond the initial shipment of goods to the store because PPG did not notify him of the additional credit extensions.[29]

The court relied upon *American Jurisprudence* to find that a notice provision must be bargained for in a guaranty agreement between a creditor

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23. *Id.* The court also noted that the record was completely devoid of any evidence about the feasibility of the proposed plan. *Id.*

24. 297 S.C. 176, 375 S.E.2d 331 (Ct. App. 1988).

25. *Id.* at 182, 375 S.E.2d at 334 (finding this issue to be a question of law). Again, there is no indication in the opinion that an implied obligation was alleged by the defendant. However, courts have found an implied obligation of good faith to give notice even when the express terms of the contract do not so provide. *See K.M.C. Co. v. Irving Trust Co.*, 757 F.2d 752, 759 (6th Cir. 1985) (finding an obligation to give notice although the lender argues "that an implied requirement that the bank provide a period of notice before discontinuing financing up to the maximum credit limit would be inconsistent with the provisions in the agreement that all monies loaned are repayable on demand").

26. *PPG Indus., Inc.*, 297 S.C. at 183, 375 S.E.2d at 334.

27. *Id.* at 178, 375 S.E.2d at 332.

28. *Id.*

29. *Id.* at 183, 375 S.E.2d at 334. The guaranty agreement signed by Sanford contained a box filled in with an "X," indicating that the guaranty provided for all sales and deliveries of products to Orangeburg Paint. Sanford claimed that the box was not filled in with an "X" when he signed the contract; however, he further admitted that he did not read the agreement prior to signing it. *Id.* at 178, 375 S.E.2d at 332.

and debtor.[30] Finding this to be the majority view, the court adopted it "as the law of South Carolina."[31] Accordingly, the court held that PPG was not obligated to notify Sanford of the continued credit extensions because the contract did not require notice to the guarantor as a prerequisite to the extensions.[32]

Finally, in *Nantahala Village, Inc. v. NCNB National Bank*,[33] a case decided after *Dangerfield*, the Fourth Circuit refused to find a breach of the common-law duty of good faith implicit in promissory agreements executed between a lender and borrower. Instead, the court upheld the lower court's determination that the bank's conduct was not unconscionable because the loan documents expressly permitted its conduct.[34]

In *Nantahala Village*, Robert Riedel, the president and principal shareholder of Nantahala Village, Inc. ("Nantahala"), obtained a loan from NCNB National Bank of Florida ("NCNB") on behalf of the resort. Nantahala provided NCNB with "a deed of trust on the resort and a security interest in certain personal property located at the resort."[35] Both prior to and subsequent to the resort loan agreement, Riedel obtained several other short-term loans from NCNB in order to make loans to Nantahala for its operating expenses,[36] thereby establishing a course of dealing between the two.[37] In addition, NCNB allowed modification of the loan agreement when Nantahala had difficulty meeting its obligations.[38]

NCNB instituted a foreclosure action against Nantahala when Nantahala defaulted on the loan. In addition, NCNB sold Riedel's NCNB stock to satisfy his current line-of-credit obligations and to obtain additional security on

30. *Id.* at 182, 375 S.E.2d at 334. "'[R]ecent cases have concluded that in a continuing guaranty, notice of the transactions occurring between the debtor and creditor is purely one [sic] of express contract, and—in the absence of a specific provision requiring notice—the creditor has no obligation to advise or to notify the guarantor.'" *Id.* (quoting 38 AM. JUR. 2D *Guaranty* § 99 (1968)).

31. *PPG Indus., Inc.*, 297 S.C. at 183, 375 S.E.2d at 334.

32. *Id.*

33. *(In re* Nantahala Village, Inc.), 976 F.2d 876 (4th Cir. 1992).

34. The plaintiff alleged that the defendant breached both a common-law and statutory duty of good faith. *Id.* at 877; *see also* N.C. GEN. STAT. § 25-1-203 (1986) (imposing an obligation of good faith on contract performance covered by the code).

35. *Nantahala Village, Inc.*, 976 F.2d at 878. In addition, the president and his wife personally guaranteed payment of the Nantahala debt to NCNB. *Id.*

36. *Id.* Riedel secured a personal line of credit from NCNB to provide for Nantahala's off-season needs with 9,000 shares of his NCNB stock, worth $468,000. *Id.*

37. A good faith notice issue can arise when a lender participates in a course of dealing with the borrower inconsistent with the express terms of the loan agreement. Courts differ as to whether to require that the lender notify the borrower when it disregards the course of dealing and begins to strictly adhere to the express terms of the agreement. *See* CHAITMAN, *supra* note 2, at ¶ 4.03[3][b].

38. *Nantahala Village, Inc.*, 976 F.2d. at 878.

Nantahala's loan.[39] Subsequently, Nantahala instituted an action against NCNB alleging breach of the duty of good faith under both the common law and the Uniform Commercial Code.[40] The Fourth Circuit upheld the district court's finding that NCNB's "conduct of which Nantahala complain[ed] flowed from valid and binding loan documents executed by both parties . . . [and] that a party does not breach section 203 of the U.C.C. when it merely exercises its contractual rights."[41]

In conclusion, the *Dangerfield* rule, that a lender does not breach an implied covenant of good faith by acting in accordance with express contractual rights,[42] does not significantly depart from previous South Carolina case law. Although South Carolina courts have not addressed the precise issue of a lender's implied obligation of good faith to guarantors on a note, the *Dangerfield* ruling is consistent with the courts' trend to uphold a lending contract's express terms even though an implied good faith obligation could arguably exist.

Dangerfield is also consistent with the apparent trend in South Carolina to abate the number of suits charging lenders with unconscionable dealings in carrying out commercial contracts. This trend is exemplified by the General Assembly's enactment in 1991 of a statute prohibiting a borrower of greater than $50,000 from bringing an action against its lender *unless* the borrower has received a writing from the lender containing the material terms and conditions of the loan.[43]

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39. *Id.* at 878.

40. *Id.* at 881-82. Nantahala also alleged NCNB breached its contractual duty to lend money, and engaged in unfair and deceptive business practices and fraud. *Id.* To support its claim of a common-law breach of good faith, Nantahala "argued that NCNB misused its superior bargaining position and engaged in unfair dealing during the loan negotiations, and held Riedel's stock in bad faith as excess collateral." *Id.* at 881. *See generally* SNYDERMAN, *supra* note 2 (discussing the Uniform Commercial Code's influence on commercial instruments).

41. *Nantahala Village, Inc.*, 976 F.2d at 882.

42. *See supra*, note 11 and accompanying text.

43. S.C. CODE ANN. § 37-10-107 (Law. Co-op. Supp. 1992). Section 107 provides:

> No person may maintain an action for legal or equitable relief or a defense based upon a failure to perform an alleged promise, undertaking, accepted offer, commitment, or agreement: (a) to lend or borrow money; (b) to defer or forbear in the repayment of money; or (c) to renew, modify, amend, or cancel a loan of money or any provision with respect to a loan of money, involving in any such case a principal amount in excess of fifty thousand dollars, unless the party seeking to maintain the action or defense has received a writing from the party to be charged containing the material terms and conditions of the promise, undertaking, accepted offer, commitment, or agreement and the party to be charged, or its duly authorized agent, has signed the writing.

Id. § 37-10-107(1). The statute further mandates that failure to obtain a signed writing precludes any action or defense based on: "(a) an implied agreement based on course of dealing or performance or on a fiduciary relationship; (b) promissory or equitable estoppel; (c) part

The legislature enacted the 1991 amendments to the South Carolina Consumer Protection Code,[44] including section 37-10-107, "[t]o give the Department of Consumer Affairs additional administrative and judicial remedies to curb unconscionable and overreaching conduct by unscrupulous creditors operating in South Carolina."[45] To the consumer's detriment, however, this statute may provide otherwise because both on its face and in light of the *Dangerfield* ruling, the statute has the potential to bar causes of action against unscrupulous lenders.

The writing requirement itself potentially bars suits because lenders typically do not sign a borrower's guaranty note along with the borrower. Furthering this effect is the lack of a provision requiring lenders to inform borrowers that a writing is required in order to later bring a cause of action against the lender. However, section 107(3) counters this effect by limiting the application of the law and excluding several transactions from the writing requirement such as: personal loans, "promissory notes, real estate mortgages, security agreements, guaranty and surety agreements, and letters of credit."[46]

The statute further provides that if the statutory terms of the writing requirement conflict with any other alternate provisions of state law requiring a signed writing, the alternate provision of state law shall control.[47] One such controlling provision is the South Carolina Commercial Code, and it requires an implied obligation of good faith in all contracts covered by the Code.[48] However, the *Dangerfield* rule ultimately nullifies any beneficial effect provided by this section to a borrower facing a breach of an implied obligation of good faith.

As a result of the *Dangerfield* rule and the enactment of the aforementioned statute, it appears that the judiciary and state regulatory bodies will pay great deference to commercial lending activities. It is fair to presume that this proposition is one most lenders would enthusiastically accept.

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performance, except to the extent that the part performance may be explained only by reference to the alleged promise, undertaking, accepted offer, commitment, or agreement; or (d) negligent misrepresentation." *Id.* § 37-10-107(2).

44. S.C. CODE ANN. §§ 37-1-301 to 10-107 (Law. Co-op. 1976 & Supp. 1992).

45. Harry J. Haynsworth, Summary of Proposed 1991 Amendments to the South Carolina Consumer Protection Code 1 (Feb. 11, 1911) (unpublished summary, on file with the South Carolina House of Representative's Labor, Commerce and Industry Committee).

46. § 37-10-107(3)(a), (d).

47. *Id.* § 37-10-107(4).

48. S.C. CODE ANN. § 36-1-203 (Law. Co-op. 1976).