TIME TO ADOPT THE UNIFORM COMMERCIAL CODE

REPORT OF THE
VIRGINIA ADVISORY LEGISLATIVE COUNCIL
to
THE GOVERNOR
and
THE GENERAL ASSEMBLY OF VIRGINIA

COMMONWEALTH OF VIRGINIA
Department of Purchases and Supply
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TIME TO ADOPT THE UNIFORM COMMERCIAL CODE

REPORT OF
THE VIRGINIA ADVISORY LEGISLATIVE COUNCIL

Richmond, Virginia, October 31, 1963.

To:

HONORABLE A. S. HARRISON, JR., *Governor of Virginia*

and

THE GENERAL ASSEMBLY OF VIRGINIA

The Uniform Commercial Code, a unified and inclusive codification of the statutes covering most of the major fields of commercial law, is rapidly gaining acceptance throughout the United States; it has been adopted by more than half of the states, including four out of the five states adjoining Virginia. While adoption of the Code by Virginia was deemed premature in 1956, the General Assembly at its 1962 Session recognized the trend toward universal adoption of the Code and directed the Virginia Advisory Legislative Council to make a study of the desirability of adopting, in whole or in part, the Uniform Commercial Code. Text of the Resolution directing this study follows:

HOUSE JOINT RESOLUTION NO. 16

Directing the Virginia Advisory Legislative Council to make a study and report upon the desirability of adopting, in whole or in part, the Uniform Commercial Code.

Whereas, the laws governing commercial transactions of the several states are varied; and

Whereas, the growth of interstate commercial transactions has created a confusion in this segment of the law thereby creating a great need for a uniform commercial code; now, therefore, be it

Resolved by the House of Delegates, the Senate concurring, That the Virginia Advisory Legislative Council is hereby directed to make a study of the desirability of adopting, in whole or in part, the Uniform Commercial Code.

The Council shall conclude its study and make its report to the Governor and the General Assembly by October one, nineteen hundred sixty-three.

The Council selected J. C. Hutcheson, Member of the State Senate and Member of the Council, Lawrenceville, as Chairman of a Committee to make the initial study and report to the Council. Selected to serve with Senator Hutcheson as members of the Committee were the following: Fred R. Edney, Attorney, Reynolds Metals Company, Richmond; Edward F. Gee, President, State-Planters Bank of Commerce and Trusts, Richmond;

Clem D. Johnston, representing Virginia warehousemen, Roanoke; John W. Landis, Babcock and Wilcox Company, Lynchburg; Charles R. McDowell, Professor of Law, Washington and Lee University, Lexington; Garnett S. Moore, Attorney and Member of the House of Delegates, Pulaski; Joseph J. Muldowney, Scott and Stringfellow, Richmond; Fred G. Pollard, Attorney and Member of the House of Delegates, Richmond; Edgar A. Prichard, Attorney, Fairfax; Hunter R. Rawlings, Jr., representing wholesale merchants, Norfolk; James S. Ritchie, Jr., representing retail merchants, Petersburg; Ronald H. Smith, Attorney, Arlington; Harry L. Snead, Jr., Professor of Law, T. C. Williams Law School, University of Richmond; Richard E. Speidel, Professor of Law, University of Virginia, Charlottesville; Charles K. Woltz, Professor of Law, University of Virginia, Charlottesville; and D. W. Woodbridge, Dean, Marshall-Wythe School of Law, College of William and Mary, Williamsburg.

The Committee organized by electing Mr. Pollard as Vice-Chairman. John B. Boatwright, Jr. and G. M. Lapsley served as Secretary and Recording Secretary, respectively to the Committee.

The Council retained Wilfred J. Ritz, Professor of Law, Washington and Lee University, as Consultant for the purpose of reviewing the Uniform Commercial Code, comparing it with Virginia law, and preparing annotations reflecting his findings.

In addition, the consultant and members of the Committee prepared analyses of Articles of the Uniform Commercial Code dealing with the fields of their special competence and portions of memoranda prepared by them are embodied in this Report. Particular acknowledgment is made to Mr. Speidel with reference to Articles 2 and 6, Mr. Woltz with reference to Article 3 and Mr. Snead with reference to Article 9. The Committee was also assisted materially by the specialized knowledge of some of its members as to other Articles, particularly Mr. Gee as to Articles 3, 4 and 5, Mr. Ritchie as to Article 6, Mr. Johnston as to Article 7 and Mr. Muldowney as to Article 8.

I. RECOMMENDATION AND REASONS THEREFOR

We recommend that the 1964 Session of the General Assembly enact the Uniform Commercial Code for Virginia, in the form set out in Appendix II to this Report, with a deferred effective date sufficiently long to enable complete distribution of the text and to permit Virginia attorneys and businessmen to become familiar with its provisions prior to their becoming effective.

We make this recommendation for the following reasons:

1. The Uniform Commercial Code has been adopted in twenty-eight of the fifty states, including Maryland and West Virginia, Kentucky and Tennessee and further including most of the states on the Eastern Seaboard and the Midwest with which Virginia has strong and increasingly close commercial ties. Thus, residents of Virginia need the Code in order to "speak" the same business language as the majority of those with whom they deal in interstate transactions.

2. Virginia is making strong and successful efforts to attract new industry into the State. As more business and industrial firms locate or establish branches in Virginia, a modern law embodying universally accepted commercial practices will become of ever increasing importance

and will of itself serve as an attraction to business firms considering relocation or expansion within the Commonwealth.

3. Adoption of the Code will have a fourfold effect on Virginia law:

(a) It will give Virginia a law which is modern in all respects and which will replace some statutes which have become outmoded and at variance with present business practices. For instance, the Uniform Negotiable Instruments Law was adopted in Virginia in 1897 and has been basically unchanged since that date; in many respects it has proved to be not in accord with present day conditions.

(b) Such adoption will make Virginia law relating to the manufacture, sale, transportation, delivery and financing of goods more certain, it will improve the remedies available to businessmen in enforcing business contracts, and it will, as to interstate transactions, clarify many points of law which are now obscure. Again using the Negotiable Instruments Law as an example, a majority of its sections have been variously interpreted by courts of different jurisdictions. The UCC brings order out of the relative chaos into which the case law on some of these sections has fallen.

(c) Particularly as to the financing of commercial transactions at every level, the Uniform Commercial Code greatly simplifies the present law of Virginia, placing its emphasis on substance rather than form, and will accordingly be most advantageous in stimulating such transactions and financing them in Virginia.

(d) The Uniform Commercial Code expands considerably the means available for the provision of credit to businessmen and will in this respect also exert a stimulating effect on the Virginia economy.

II. HISTORY OF UNIFORM COMMERCIAL CODE

At the 1940 meeting of the National Conference of Commissioners on Uniform State Laws, William A. Schnader of Philadelphia, then President of the Conference, suggested that the Conference prepare a comprehensive Code to embrace the whole field of commercial law. The proposal was adopted and in 1942 was concurred in by the American Law Institute. Financial support of the project was obtained and the project was officially begun in January, 1945, by a group headed by Professor Karl N. Llewellyn, of Columbia Law School. The final draft was completed in 1952 and was approved by the sponsoring organizations as well as by the American Bar Association.

The 1952 text was adopted immediately only by the State of Pennsylvania. However, the New York Law Revision Commission began a study of the Code in 1953. Following the report of that Commission in 1956, a revision of the Code was undertaken, which resulted in the Official Text of 1958. Furthermore, a Permanent Editorial Board was created which took under advisement criticisms and suggested amendments which were made of or offered to the 1958 text, with the result that there was promulgated the 1962 Official Text, which is the version under consideration in this study.

Interest in the Uniform Commercial Code in Virginia has been considerable since its inception. In the biennium 1954-56 a study was made of the Code by the Virginia Code Commission, but in 1956 the Virginia Code Commission concluded that adoption by Virginia was premature and so recommended. Subsequently, however, the list of adopting states has

steadily grown and with the adoption of the Code by New York in 1962 the trend toward universality of adoption became sure.

A list of the states which have adopted the Code, together with the date of adoption and the effective dates of the adopting acts, is attached as Appendix III to this Report.

III. BASIC PURPOSE OF UNIFORM COMMERCIAL CODE

The 1962 Official Text of the Uniform Commercial Code is contained in a volume which, with official comments to the Code, contains 731 pages. Of this, probably one-third is the text of the bill which is proposed for enactment. With its voluminous comments, its detailed notes and cross references, it appears at first glance to be a document of frightening bulk and complexity.

In operation, however, it will be found that the Code simplifies rather than complicates the law. Its provisions in most instances merely spell out and put into readily accessible form the better business practices generally in use throughout the country. This is true particularly in Article 4, which incorporates into law the practices of commercial banks in handling the many thousands of transactions which daily are encountered by their staffs. Similarly, Article 5, which deals with letters of credit, fills a void in Virginia, which has relatively few of such transactions, and provides, for the attorney or the businessman who needs to use such a device, a source to which he can turn for information and guidance. Insofar as the Code replaces commercial acts now on the statute books such as the NIL, the Uniform Trust Receipts Act, the Uniform Warehouse Receipts Act, and others, the Code, generally speaking, embodies the substance of present law and attempts to eliminate certain complexities which have arisen in connection with application of such statutes to business transactions.

This is particularly true of Article 9 of the Code, which represents the most considerable departure from current law in the adopting states, but the overall effect of which is to substitute simple procedures, minimum reliance upon forms, and uniform security devices for the many intricate and formal instruments by which it has been necessary to protect creditors' interests in the past.

In Appendix I of this Report we set forth in summary form the basic principles and provisions of each Article of the Code. In Appendix II we publish, together with the text of the Code as we recommend it, the comments prepared by the staffs of the American Law Institute and the National Conference of Commissioners on Uniform State Laws together with detailed annotations, prepared by the Committee and its Staff, showing the effect of each UCC provision on present Virginia law.

IV. "UNIFORMITY" AND RECOMMENDED VIRGINIA VARIATIONS

The national sponsors of the Uniform Commercial Code almost unanimously argue that for it to accomplish its purposes it should be completely uniform except as to the variations which they themselves have suggested in the Official Text. We concur, up to a point, in this position. However, we do not feel that Virginia should sacrifice its own law where, in our judgment, it is definitely superior to the proposed language, nor do we feel that, where Virginia practice has long been accepted and a certain procedure has proved satisfactory and is recognized by those concerned as proper, we should slavishly conform to the language of the Code.

Furthermore, some of the adopting states have varied from the proposed Official Text in a manner which has the endorsement both of Virginia specialists in the affected matters and of influential national groups.

Specifically, as to the first category, we have reference to the matter of the defense of lack of privity which the Virginia legislature, in 1962, substantially abolished. The sponsors of the Code did not feel that they could go that far although, we are advised, they felt that this would be desirable. In this instance, accordingly, we recommend adoption of the Virginia law as a part of the Code.

Similarly, there appears to be some ambiguity in the language of the Code dealing with recording a security interest where the collateral is a motor vehicle. Virginia law is clear and effective on this point and while the Code apparently would permit such a law to control, there is a possibility of misinterpretation in the Code as it stands in the Official Text. We feel that this should be eliminated.

Our views as to one major variation which we recommend is supported by action taken by the State of New York. This relates to the "good faith" concept of the Negotiable Instruments Law which provides that the holder of an instrument is not denied the rights of a holder in due course because of mere negligence in his purchase. In our view, the Official Text of the proposed Commercial Code departs from this principle and would forbid holder in due course status to a purchaser if he acts negligently. We recommend following the New York version in this instance, thus retaining, in effect, the present Virginia law.

The foregoing examples will indicate the reasons why we have in some instances departed from uniform language. With the possible exception of the cited examples, we do not feel that our variations are of crucial importance or that they seriously undermine the general purpose expressed in the UCC "to make uniform the law among the various jurisdictions."

V. OTHER MATTERS INCIDENT TO ADOPTION OF THE CODE

1. Repeal and Amendments to Existing Law.

As noted in the Virginia Annotations to the Commercial Code and in Appendix I, certain provisions of the Code will replace existing law entirely. In other cases, they will replace portions of certain sections of Virginia law, and, in still other cases, certain sections of Virginia law will have to be amended by insertion of cross references.

The reason for the repeals is obvious. Two different statutes on the same subject can only lead to confusion.

The amendment of certain sections is necessary to insure the deletion of a paragraph or portion of an existing section of present law which is rendered superfluous or is in conflict with some provision of the Commercial Code. The reason set forth in the preceding paragraph applies here also.

Cross references should be inserted, in appropriate cases, in certain sections of the present law to make it clear that, in specific situations, the provisions of the Commercial Code apply while, under other types of situations, the present Virginia law will continue to apply.

It is proposed to include the amendments and repeals as a part of the bill embracing the Commercial Code. They are all related to the same

subject and are thus in compliance with Section 52 of the Constitution. Also, it will facilitate the consideration by the General Assembly of the subject. When a reprint is made, it will be most helpful to the bar and general public to have all of the related matters included in the reprint.

2. Printing of the Act When Adopted.

§ 2-232 of the Code of Virginia requires the Acts of Assembly to be printed and bound by the Director of the Department of Purchases and Supply. The most recent volume of the Acts contains 1,575 pages. If the several hundred pages of the Cemmercial Code and consequential changes were bound in the Acts, a bulky and unwieldy volume would result.

Appendix IV contains an amendment to § 2-232 so as to provide for the printing and binding of the Commercial Code and related laws in a separate volume from the other Acts of the General Assembly of 1964; it would probably be printed as Volume 2. Not only will this reduce the size of the volume of the usual laws, but it also will enable everyone who desires to do so, to obtain the Commercial Code with its attendant changes in a separate volume at a much lower cost than if he had to purchase the entire volume of the Acts of Assembly of 1964. The convenience and saving commend this approach to us.

3. Effective date.

A number of effective dates for the application of the Code and consequential changes were considered. Some states adopted it to become effective in due course. This in Virginia would be normally about June 29 or 30, 1964. Sufficient distribution of the text cannot be obtained in that time.

Some states adopted the Code to become effective two years after adoption. In Virginia this would be about the first of July, 1966. It is a human failing to put off the necessity of becoming familiar with a subject until the need therefor is at hand. If "bugs" were to develop, they might be found as late as May or June of 1966 and no session would be at hand to correct them. We do not believe this course should be followed.

Some proposed that the Code become effective January 1, 1965. It is anticipated that a publication of the Code will be made, probably as Volume 2A of the Virginia Code, with the customary annotations. It is possible that printing and distribution could not be completed by this time; and further, this date would be subject to the immediately preceding objection.

Making the Code effective January 1, 1966 will coincide with a calendar year and in many cases with a business fiscal year; it will also have several other beneficial results: Everyone will have had opportunity to become familiar with the Code through perusal of the Act itself, and by reference to the annotations mentioned in the preceding paragraph. Attorneys and others who will use the Code will be forced to an examination of it in November and December of 1965. If imperfections are found, the General Assembly of 1966 will be at hand to correct them. For these reasons we propose an effective date of January 1, 1966 and the bill is so prepared.

VI. CONCLUSION

In conclusion, we should like to reiterate that we believe that the time is ripe for Virginia to bring its commercial law up to date; that the adoption of the recommended bill will prove of great value to business interests in this State as well as to persons outside of Virginia who desire to deal with

Virginia businessmen, that the modernization of our commercial law will have a direct benefit on the over-all economy of the State and that, in the last analysis, we are firmly convinced that Virginia cannot afford to fail to adopt this measure.

We again express our sincere appreciation for the tremendous contribution made by all those who assisted in the completion of this study.

Respectfully submitted,

CHARLES K. HUTCHENS, Chairman
EDWARD E. WILLEY, Vice-Chairman
C. W. CLEATON
JOHN WARREN COOKE
JOHN H. DANIEL
CHARLES R. FENWICK
TOM FROST
J. D. HAGOOD
EDWARD M. HUDGINS
J. C. HUTCHESON
BALDWIN G. LOCHER
LEWIS A. McMURRAN, JR.
ARTHUR H. RICHARDSON

MOSBY G. PERROW, JR., was unable to participate in the Council's final consideration of this report due to illness.

APPENDIX I

ARTICLE 1

GENERAL PROVISIONS

Article 1 contains general provisions applicable to the entire Code. § 1-101 provides that it is to be cited as the Uniform Commercial Code. It is to be liberally construed and applied so as to promote its underlying purposes and policies, which are set forth in § 1-102(2) as follows:

"(2) Underlying purposes and policies of this Act are

(a) to simplify, clarify and modernize the law governing commercial transactions;

(b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties;

(c) to make uniform the law among the various jurisdictions.

The Code gives the parties to commercial transactions large freedom of contract, providing that the effect of its provisions may be varied by agreement between the parties, except as otherwise provided in the Code, and except that obligations of good faith, diligence, reasonableness, and care may not be disclaimed by agreement, although the parties may by agreement determine the standards, not manifestly unreasonable, by which these obligations are to be measured.

The Code is intended to be an exclusive codification of commercial law, providing within its framework the principles and analogies by which problems not precisely covered by its provisions may be resolved. To the extent, though, that particular provisions of the Code do not displace principles of law and equity, those principles continue to supplement the Code.

§ 1-105 establishes the territorial application of the Code, but with nationwide adoption this becomes of small significance. The section provides that when a transaction bears a reasonable relation to a state adopting the Code and to another jurisdiction, the parties may agree as to which jurisdiction's law shall govern their rights and duties. In the absence of such an agreement, the Code applies to transactions bearing an appropriate relation to the state adopting it.

Forty-six general definitions applicable throughout the Code are set forth in § 1-201. The term "buyer in ordinary course of business," as distinguished from buyer, is used to refer to a person who in good faith and without knowledge that a sale may be wrongful buys in ordinary course from a person, other than a pawnbroker, in the business of selling goods of that kind. "Creditor" is defined so as to include an assignee for the benefit of creditors or a trustee in a deed of trust to secure creditors. "Good faith" is defined as "honesty in fact in the conduct or transaction concerned." Both notice and value are fully defined. "Security interest" is defined as "an interest in personal property or fixtures which secures payment or performance of an obligation," and replaces the traditional names of security arrangements, such as chattel mortgage, deed of trust, and conditional sale.

§ 1-203 imposes an obligation of good faith in the performance and enforcement of every contract or duty within the Code.

The Code provides a statute of frauds for commercial transactions involving substantial sums of money and for secured transactions. Except in contracts for the sale of goods and securities and in secured transactions, all of which are covered by specific provisions, the Code requires a signed writing in order to maintain an action or establish a defense where the amount or value of the remedy exceeds $5,000.

ARTICLE 2

SALES

PART I.

Since Virginia has never adopted the Uniform Sales Act its sales law is found primarily in some 200 decisions of the Supreme Court of Appeals. Approximately 70% of these cases were decided before 1930. Many of the decisions are concentrated in particular areas, e.g., products liability. Further, many of the cases involve relatively narrow points of law. As a result, the "law" of these decisions is piecemeal and the precedent value of many of the generalizations made by the court is dubious. Finally, even though five decisions in the 1920's may exist on a particular point it is extremely difficult to predict what the Supreme Court of Appeals would do if the same type of controversy arose in 1963. This difficulty is compounded if there are no decisions on point and the attorney is compelled to advise his client with the hope that the court will follow the generally prevailing view under the Uniform Sales Act. The value, then, of a comprehensive, systematized sales article cannot be over-estimated.

Part 1.

Part 1 delineates the scope of Article 2 and deals with definitions rather than substantive law. Since Article 2 covers transactions in goods, i.e., contracts for the sale of goods, the definition of goods is important. Thus, distinctions between the sale of goods and, say, investment securities or choses in action must be made in Virginia if the UCC is adopted where previously they were relatively unimportant. In the main, the new definitions amplify and vary emphasis rather than change existing Virginia law. In most cases they are undoubtedly consistent with commercial practice and understanding. In one area, however, a change has been made. Under existing Virginia law, oral contracts for the sale of standing timber to be severed by either the buyer or the seller are within the statute of frauds relating to interests in land if the severance is not to occur within a reasonable time. Under § 2-107(1), standing timber sold to be severed by the seller at any time is classified as goods rather than an interest in land. However, the change is minimized since the transaction is now within the scope of Article 2 and thus subject to the statute of frauds provision relating to the sale of goods.

Part 2.

In treating the form, formation and readjustment of contracts for the sale of goods, Article 2 makes the greatest changes in Virginia law.

(a) Form

§ 2-201 provides, for the first time in Virginia, a statute of frauds for the sale of goods. Consistent with modern trends and the basic philoso-

phy of the UCC, however, the statute sanctions a liberal use of parol evidence to supplement writings which, while inaccurate or incomplete, indicate that a contract for sale has been made. The parol evidence rule of § 2-202 permits the introduction of a wide range of extrinsic evidence to explain or supplement written agreements unless the parties intended the writing to be a final and complete expression of the deal. This liberalizes the approach taken by many Virginia cases.

§ 2-203 changes Virginia law by abolishing the effect of the seal where transactions in goods are involved.

(b) Formation

The UCC appears to be consistent with Virginia law except in the following respects: (1) A firm offer must have consideration to be enforceable in Virginia; (2) Virginia is more restrictive in the manner and medium available for the acceptance of offers and probably would deny the existence of a contract where the offer objectively requested performance as an acceptance and the offeree gave a promise to perform; (3) Virginia decisions reject the basic philosophy of § 2-207 and make no differentiation between sellers and buyers who are "merchants" and those who are not. It should be noted, however, that Virginia and the UCC both espouse a liberal attitude toward the resolution of indefiniteness in agreements by resort to external, objective standards, i.e., what would be reasonable in the business context, and the use of prior dealings and trade usage to achieve a practical construction of ambiguous terms.

(c) Readjustment

§ 2-209 conflicts with Virginia law in two respects. First, the Code abolishes the need for consideration in modifying agreements. Second, the UCC modifies Virginia law by stating that a signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded. Virginia permits an oral rescission of the written stipulation.

§ 2-210 appears to be consistent with existing Virginia law where the transfer of contracts is involved, although the UCC amplifies and more clearly defines the standards to be applied.

Part 3.

Part 3 concerns the general obligation and construction of contracts. In 6 of the 11 Sections from § 2-301 through § 2-311 there are no Virginia decisions or statutes on point. Of these, § 2-302, dealing with unconscionable contracts or clauses, and § 2-305, dealing with open price terms, probably make the greatest changes in the traditional approach to contracts while the other four are generally consistent with the Uniform Sales Act. The Virginia decisions are generally consistent with the remaining five Sections.

(a) Warranties

The UCC warranty Sections are § 2-312 through § 2-318. Virginia decisions have recognized and granted relief for breaches of express warranties and implied warranties of merchantability and fitness for a particular purpose. These decisions are consistent with UCC §§ 2-313 through 2-315, although the Code is more detailed and comprehensive in its treatment of the problem. Since Virginia has never had an implied warranty of title case, § 2-311 provides new rules for this problem. Virginia cases

are generally in accord with the UCC on the problems of contractual exclusion or modification of statutory warranties, § 2-316, and the cumulation and conflict of several warranties express or implied contained in the same contract, § 2-317. However, the UCC is more precise in both of these areas and contains express safeguards to insure that a limitation or exclusion of implied warranties be in writing, conspicuous and contain specific language of disclaimer. In summary, the UCC works a general improvement in the statutory treatment of express and implied warranties yet is consistent with the basic warranty policy reflected in Virginia cases.

§ 2-318 effects a limited abolition of the privity defense in breach of warranty actions by specified users of goods against remote manufacturers or sellers. Virginia, however, has recently enacted legislation which virtually abolishes the defense of privity. The Virginia statute reflects the increasing tendency of modern decisions and we recommend its substitution for this section.

(b) Delivery Terms

§§ 2-319 through 2-325 prescribe and define certain terms commonly used in domestic and international sales transactions. § 2-319 states that "F.O.B." is a delivery term and seems to change some Virginia decisions which suggested that "F.O.B." is a price term when used in connection with the price of goods. Virginia has no decisions or statutes which are affected by §§ 2-320 through 2-325. These sections contain provisions relating to and consistent with general practice in international sales transactions.

(c) Special Sales Situations

§§ 2-326 through 2-328 cover sales by consignment, approval, sale or return and auction. The UCC carefully defines the incidents and legal effects of these transactions, giving special emphasis to the rights of the buyer's creditors to goods of the seller in the buyer's possession. Virginia has no case law in this area except those decisions which seem consistent with the UCC's position on when a buyer on approval has accepted goods in his possession. The effect of the UCC on the Virginia Trader's Act, Code, § 55-152, is discussed in the Virginia annotations to § 2-326. Except for one anomaly upon which there is no Virginia rule, the sale by auction provisions of the UCC are consistent with Virginia law.

Part 4.

This part contains three important Sections on title, creditors and good faith purchasers. § 2-401 is generally consistent with Virginia decisions and the Uniform Sales Act as to when title to goods passes from seller to buyer. As under previous law, the parties are free to agree when title passes but if the contract is silent a series of statutory rules govern the issue. These, in turn, depend upon whether the contract authorizes the seller to ship the goods or whether the goods are to be delivered without being moved. Unlike previous Virginia and Uniform Sales Act law, however, the importance of title under the UCC is minimized. Passage of title is immaterial to such questions as risk of loss, the buyer's right to seek specific performance and the seller's ability to sue the buyer for the price of goods. Title will still be important in the determination of problems outside the scope of the Code, such as public regulation and creditors rights.

The rights of the seller's unsecured creditors and the buyer to goods still in the seller's possession are set forth in § 2-402. If the buyer has obtained a special property interest in the goods by identification (see

§ 2-501), the creditor who seeks to attach the goods is subject to the buyer's right to the specific goods as defined by § 2-503 (seller's insolvency) and § 2-716 (specific performance and replevin under specified circumstances). There is little or no Virginia law on this problem. If the buyer has no rights to specific goods by identification, the creditor may treat the sale or identification and retention of possession by the seller as void under any applicable rule of law in Virginia unless the seller is a merchant who retained possession in good faith and in the current course of trade for a commercially reasonable time. To the extent that the seller has not properly retained possession, the existing Virginia law on fraudulent transfers would prevail. But if the seller has properly retained possession, a more difficult problem is presented. Would this prevail over Virginia Code §§ 11-1, 55-95 and 55-96, which require the public recordation of bills of sale when possession is retained? We believe that it would, and to eliminate possible ambiguity, recommend that §§ 11-1, 55-95 and 55-96 be amended to exclude from their coverage retentions of possession by sellers which are otherwise proper under § 2-402.

§ 2-403 both clarifies and expands the rights of good faith purchasers for value of goods in which third persons other than the seller have legitimate interests. The clarification occurs in the statement of the general rule that a seller with voidable title may pass good title to a third person and a listing of four controversial situations which the Code classifies as voidable rather than void transactions. The expansion comes in the power of a merchant to transfer good title in goods entrusted to him to a buyer in the ordinary course of business even though the merchant has no title whatever. This latter expansion clearly changes Virginia law.

Part 5.

Part 5 concerns performance of the contract of sale. § 2-501 covers identification of goods to the contract, the effect of which is to create in the buyer both an insurable and a special property interest in the goods. Under Virginia cases, identification is usually called appropriation and coupled with a conclusion that the parties intended title to pass. Since the UCC separates the special property interest created by identification from the passage of title, this effects a change in theory under Virginia law. But whether the buyer obtains title to goods by appropriation in Virginia or a special property interest by identification under the UCC, the validity of his claim to specific goods in the seller's possession would seem to be substantially the same. Although title will give the buyer greater protection than a "special" property interest against the seller's unsecured creditors, the parties are free to agree that title shall pass upon identification of goods to the contract of sale.

The UCC carefully defines the manner of the seller's tender of delivery, § 2-503, and his duties when the contract requires a shipment of goods to the buyer, § 2-504. These sections, though more detailed, are generally consistent with the few Virginia cases on point. While the buyer's duty to pay for the goods is conditioned upon a tender of delivery by the seller, § 2-507, the seller is given a limited power to cure a defective tender under § 2-508. This latter Section expands the "cure" rights provided by Virginia case law. On the other hand, while the buyer's tender of payment is a condition to the seller's duty to tender and complete any delivery, unless the contract otherwise provides the buyer may inspect the goods at the place of delivery before making a tender of payment. §§ 2-511 and 2-513. These rules appear to be consistent with Virginia law. Of course, the tender of payment is excused in a credit transaction and the right to inspect before payment does not exist if the contract, for example, requires payment

against documents of title. §§ 2-514 and 2-515 provide new rules for the delivery of documents of title upon acceptance of a draft and the preserving of evidence of goods in dispute.

The risk of loss provisions of Part 5 represent another area of theoretical change made by the UCC. Under Virginia law and the Uniform Sales Act, risk of loss followed passage of title. While in many cases title did not pass until the goods had been delivered to the buyer it was not uncommon for title to pass either by express agreement or "appropriation" while the goods were still in the seller's possession. Thus, risk of loss would be on the buyer even though the seller was in possession. § 2-509 divorces risk of loss from passage of title. In essence, risk of loss follows the transfer of possession by the seller to the buyer or a carrier if the sale is F.O.B. Delivery of possession may often coincide with the passage of title, thus preserving similar results if not reasoning. However, in cases where title has passed before delivery of possession, the risk of loss remains with the seller unless he is a non-merchant who is not obligated to ship the goods by carrier and tenders delivery to the buyer. § 2-509(b)(3). Different rules apply when the goods sold are in the possession of a bailee and these are generally consistent with Virginia law.

A basic reason for this change is the judgment that a merchant seller will or should have insurance to cover the risk of loss to goods in his possession. As long as he retains possession it is commercially feasible to place the risk on him. In fact, the risk of loss remains with the seller who ships F.O.B. destination until the carrier tenders delivery of conforming goods to the buyer, or where the buyer accepts non-conforming goods and later properly revokes his acceptance. However, if the seller identifies conforming goods to the contract and the buyer then breaches his contract before the risk passes to him the seller may treat the risk of loss as resting on the buyer to the extent of any deficiency in insurance coverage. § 2-510. This is a new concept which has no counterpart in existing Virginia sales law.

Part 6.

Part 6 deals with the general problems of breach, repudiation and excuse. Upon tender of goods by the seller, the buyer, under traditional sales law, has a right to inspect the goods. If they fail to conform in any respect § 2-601 gives the buyer an option to accept or reject the whole or accept any commercial unit or units and reject the rest. A decision to reject all or part is closely regulated by §§ 2-602 through 2-605 and their basic requirements of particularized notice to the seller. While the remedy of rejection is recognized in Virginia, the UCC Sections defining procedures are new. It is not clear whether Virginia would permit rejection for any failure to conform and there appears to be some limitation upon the buyer's ability to accept part of the non-conforming goods without waiving objections to the rest.

If a buyer knowingly accepts non-conforming goods under the UCC, his rejection remedy is ended. Under both § 2-607 and the law of Virginia, however, acceptance does not necessarily preclude other remedies for breach of warranty, provided prompt notice is given the seller. The UCC imposes stricter notice requirements on the buyer than are seemingly required by Virginia decisions. It appears that under both the UCC and Virginia law a buyer who accepts without discovery of defects after a reasonable inspection may later "revoke" his acceptance and reject the goods. § 2-608. The UCC provides additional grounds for revocation of acceptance, specifies the time in which the revocation must occur and requires prompt notice to the seller.

A buyer's power to reject tendered deliveries or rescind in an installment contract is limited to cases where the non-conformity substantially impairs the value of the installment or the entire contract. § 2-612. This is consistent with the theory of material breach in general contract law. If the buyer may rescind the entire contract, however, there is a risk that he will reinstate it by certain conduct specified in § 2-612(3). This "waiver" idea is generally consistent with Virginia law, although a few of the cases raise interesting factual variations.

§ 2-609 gives either the seller or the buyer a right to demand adequate assurance of performance when reasonable grounds for insecurity arise with regard to performance of the other. There is no comparable Virginia rule. The UCC also has provisions on anticipatory repudiation and the retraction of repudiations which are consistent with existing Virginia case law. §§ 2-613 through 2-616 have no counterpart in existing Virginia law. § 2-615, by defining situations where a performance failure is excused by the failure of conditions, apparently liberalizes the excuses available for non-performance under Virginia law.

Part 7.

This part carefully organizes and details the various remedies possessed by sellers and buyers of goods upon breach of contract. For the most part, these basic remedies are recognized in Virginia sales law. The UCC, however, makes changes in the following important respects: (1) under the Code, a seller delivering goods on credit to an insolvent buyer may reclaim the goods within 10 days of their receipt, § 2-702(2); (2) a seller under the UCC may recover the price of goods sold only when the buyer has accepted them and in two other specified circumstances, § 2-709, while in Virginia an action for the price depends upon the passage of title; (3) the UCC, in a limited context, permits the buyer to replevin goods in the seller's possession although Virginia has abolished replevin as a form of action; (4) the UCC, in providing a four-year statute of limitations subject to a reduction to one year by agreement, § 2-725, reduces the Virginia limitation from 10 years and introduces some confusion as to whether, under Virginia law, an agreement to reduce the statute of limitations is enforceable.

ARTICLE 3

COMMERCIAL PAPER

I

General Matters

It must be said at the start that Article 3 will not apply to some common and commercially important instruments covered by the present statute. § 3-103 says explicitly that the Article does not apply to investment securities. These are defined in Article 8, § 8-101, to include any instrument issued in bearer form, of a type commonly dealt in on securities markets or commonly recognized as a medium for investment, which is one of a class or series, and evidences an obligation of the issuer. So under the Code most corporate bonds and many mortgage bonds would be controlled by Article 8 and not by the rules relating to negotiable paper. The purpose is to free such instruments from the arbitrary rules as to form specified for negotiable paper and the result is to make applicable to them the same rules as are applicable to stock certificates.

On the other hand Article 3 is made applicable by § 3-805 to the anomalous instruments which meet all tests of negotiability except that they are not payable to order or bearer. All the rules applicable to negotiable paper will apply to these instruments except that no holder can occupy the position of a holder in due course. Anyone signing such an instrument assumes all the liabilities of maker, drawer, acceptor or indorser as the case may be, and not common law obligations. And the rules applicable to transfer of such instruments will be the rules of negotiation rather than those of common law assignment.

II

Requirements of Form

With respect to the form an instrument must take to be negotiable, Article 3 liberalizes the present law in some respects and settles some open questions. For instance, it allows provision for acceleration on *any* ground, including the holder's insecurity, and specifically recognizes the validity of certain extension provisions (§ 3-109); it clarifies the negotiable status of instruments antedated or postdated (§ 3-114); it makes clear the effect of outside agreements (§ 3-119); it allows an exclusion of individual liability in the case of partnerships, unincorporated associations, trusts or estates, provided the entire assets are available for payment (§ 3-105). But in one important respect Article 3 is more restrictive than present law. Virginia Code, § 6-357, prohibits the inclusion in a negotiable instrument of promises to do an act in addition to the payment of money, with stated exceptions; but allows an option in the holder to take something in lieu of money. Article 3 eliminates the possibility of such option and prohibits (§ 3-104) not only "promises" for acts in addition to the payment of money but "obligations and powers" given by maker or drawer. The list of exceptions stated in § 3-112 is reasonably broad, particularly the allowance of a promise to maintain or protect collateral. However, doubt is cast on the possibility of inserting in negotiable paper rights to inspect the maker's books, obligations by maker to refrain from certain business practices, and so on.

III

Holder in Due Course

A. Definition

Under Article 3 as under existing law the fundamental requirement for holder in due course status is good faith purchase for value, so at a glance the definition seems not materially altered. Yet there are substantial changes. For example, "value" is no longer defined as any consideration sufficient to support a simple contract; under § 3-303 one takes an instrument for value to the *extent that the agreed consideration has been performed.* This is more a change of language than change in result, for NIL § 54 and Virginia Code, § 6-406, now limit one's holder in due course status to the extent value has been paid before notice of some defect or infirmity.

Other changes, however, will produce a difference in legal result. A purchaser will no longer be denied holder in due course status merely by purchasing after maturity, unless he has notice of the fact. This will clear up some troublesome questions in the case of paper whose maturity has

been accelerated, or on which demand has been made. Similarly, an honest purchaser will not be condemned because he buys an instrument incomplete or irregular on its face, provided it is not so obviously so as to call in question its validity or terms.

In these two respects the definition is altered in ways making it easier for a holder to become a holder in due course. Yet in another and extremely crucial respect Article 3 may have altered present law to the disadvantage of the honest purchaser. Nothing is clearer under the present law than the rule that a holder is not denied holder in due course rights because of mere negligence in his purchase. He falls from grace only if he acts in bad faith, buys when he is suspicious. Article 3, § 3-302 defines a holder in due course as one who has bought "without notice . . . of any defense against or claim to . . ." the instrument. Under § 3-304 he has such notice if he has notice that the obligation of any party is voidable in whole or part. And under Article 1, § 1-201 (25), he has notice of such fact when "from all the facts and circumstances known to him at the time in question (the time of purchase) he has reason to know that it exists." It seems clear that the test under the Code is not whether one buys with suspicion, but with reason to know—that is, negligently. This is a most unfortunate, and perhaps unintentional, return to the position held by the English courts for a very brief time and now repudiated by them and by the Negotiable Instruments Law. New York has amended the UCC to return to the concept of the NIL, and we recommend a similar amendment.

§ 3-302 incorporates into the statute itself the preferred case law rule that the payee may be a holder in due course if he meets the usual tests. § 3-201 continues the rule that a person who may not himself qualify as a holder in due course may enjoy the status vicariously by purchase from one. Present law denies this right only to a person who has been party to some fraud or illegality affecting the instrument. § 3-201 denies the privilege also to a person who, while holding the instrument, knew of some defense or claim against it and sells and later reacquires it.

B. Proof

As under present law one suing on negotiable paper will have an initial burden of showing he owns the instrument. This often involves the proof of signatures, a point as to which plaintiff will have the burden of proof. But he will no longer (as under Virginia Code § 8-114) have to allege their genuineness in his pleading. Under Article 3, § 3-307, they are admitted unless denied in defendant's pleading. And even though so challenged, signatures will be presumed genuine.

Under present law, once plaintiff has by proof of signatures or otherwise proved himself a holder he is by statute declared to be presumptively a holder in due course, which presumption the defendant can rebut only by showing those particular defenses defined by the statutes as "defects of title." Plaintiff does not have to sustain the burden of proof on the issue of his being a holder in due course until such technical defense is shown; rather defendant is under the burden of proof. Article 3 makes a significant change here. There is no stated presumption that plaintiff holder is a holder in due course. But plaintiff is required to prove himself such whenever *any* defense is proved by defendant. In other words, the unstated presumption is defeated by proof of any defense, not as at present by some technical defenses only. Hence under the Code the plaintiff will have the burden of proving himself a holder in due course much more frequently than he now does.

C. Rights and Defenses

These are in general the same as under existing law. But in § 3-305 it is flatly stated that a holder in due course takes the instrument free from "all claims to it on the part of any person." This would include claim made by an infant, and changes Virginia law.

As under existing law even a holder in due course will be subject to defenses of infancy, incapacity or illegality resulting in voidness, fraud in the factum and discharge (§ 3-305); will be able to enforce completed instruments as filled up regardless of breach of authority, and altered instruments according to their original tenor (§ 3-407). But it will no longer be a defense against a holder in due course that the instrument was incomplete and not delivered.

IV

Negotiation

As under present law, negotiation under the Code will be effected by delivery alone in some cases or by indorsement plus delivery in others. And the result of negotiation will be to constitute the transferee a holder (§ 3-202). To be effective an indorsement must be on the instrument or on a paper so firmly attached as to become a part of it. This probably changes Virginia law.

But contrary to the present rule, paper made to bearer on its face will not remain such and therefore always negotiable by delivery alone. Under Article 3 whenever *any* negotiable instrument receives a special indorsement it can be further negotiated only by the signature of the special indorsee (§ 3-204).

Furthermore, under Article 3 a restrictive indorsement no longer destroys the negotiability of the instrument. It remains negotiable and a future taker may become a holder in due course of it if he pays value consistently with the indorsement. If the restrictive indorsement is of the type which creates a trust rather than an agency even this requirement of payment of value consistently with the indorsement applies only to the first taker under the indorsement, i.e., the trustee. Purchasers from the trustee and later holders are in no way affected by a restrictive indorsement of this type.

In the case of restrictive indorsements of the agency type, calling for collection or deposit, the situation is normally one where the instrument is put into bank collection channels. If that happens, the provisions of Article 4 on Bank Collections come into operation and by explicit provision control the provisions of Article 3.

V

Liability of Parties

A. In General

Article 3, § 3-802, is a new provision which makes it clear (a) that while a negotiable instrument is outstanding but not due parties to it are not liable on any underlying obligation for which it was given, (b) that when the instrument is due the holder may sue on it or on the underlying obligation, and (c) that discharge of a party on an instrument discharges him also on the underlying obligation.

Article 3, § 3-803, gives a party sued on an instrument a right to notify any party liable to him on the instrument, and if the notice states that that party may come in and defend and he does not do so he is bound by factual determinations.

The Code makes a change in the law as to liability of parties who sign incomplete instruments. They are now liable to holders in due course on the instrument as completed, but not liable to a non-holder in due course. Under § 3-407, they will be liable to non-holders in due course according to the authority to complete originally given unless the filling in is done with fraudulent purpose.

This same section also effects a substantial change in the law applicable where the instrument is altered by means other than unauthorized completion. Under it the only alteration that may avoid an instrument is one made by the holder, and not as now by a holder or a stranger. Again, unless the alteration is made with fraudulent purpose, even a non-holder in due course may recover, according to the original tenor of the instrument; whereas under present law he recovers nothing.

As pointed out above, against a holder in due course a defendant may no longer successfully defend on the ground the instrument was both incomplete and not delivered.

Nor may one any longer defend on the ground that a necessary signature has been forged, in cases where an imposter has used the mails to effect his scheme rather than dealing face to face. § 3-405 treats the two cases alike. It does not treat such instruments as bearer paper, but provides that an indorsement *by any person* in the name of the named payee is effective. This approach is also taken in the Section as to paper dishonestly made or drawn to a payee who is fictitious, or not intended to have any interest in the instrument, whereas present law treats these as cases of bearer paper needing no indorsement.

Under § 3-306, a defendant may not defend on the ground that some party other than the plaintiff has a claim to the instrument unless such third party claim is based on a situation of theft or rights under a restrictive indorsement. This settles a point where the Virginia law has been undecided and there has been conflict in other jurisdictions. On the other hand, contrary to present law, a party notified of a third party claim may nevertheless safely pay the presenting holder, unless the third party claim is based on theft or rights under a restrictive indorsement (§ 3-603).

B. Liability of Agent or Representative

In accord with present law a person signing as agent or in some representative capacity is personally liable unless authorized in fact to sign; and is furthermore liable to anyone other than the party immediately dealt with unless the instrument both names the person represented and shows the signature was in a representative capacity. However, when sued by his immediate party the agent may defend against personal liability if the instrument shows either of these facts, being allowed to prove the other by parol (§ 3-403). As to this last point the Section settles a matter as to which Virginia law had not been clear.

C. Indorsers and Drawers

Article 3 makes no change in the basic rule that, absent waiver, the promise to pay of indorser and drawer is conditioned on proper presentment, notice of dishonor, and in some cases protest. However, contrary to

present law, one who indorses after maturity is not entitled to these steps (§ 3-501 (4)). Furthermore, whereas the present statute states that the drawer of a check is discharged only to the extent of his loss if notice is not given, § 3-502 (1)(b) provides that if either proper presentment is not made or notice given and the bank becomes insolvent, such drawer may discharge his liability by assigning to the holder his rights against the bank, but is not otherwise discharged.

Protest is no longer required of instruments drawn in one state and payable in another, but only of instruments drawn or payable outside the United States and its territories (§ 3-501).

Presentment for payment of a check, to hold an indorser, must be within seven days after his indorsement, rather than within, roughly, the one day accorded under present case law. With respect to the liability of the drawer presentment must be within thirty days of date or issue (§ 3-503). Presentment by mail or through a clearing house is expressly sanctioned. And if presentment is at a proper place and neither the party to accept or pay nor his agent is present, presentment is excused (§ 3-504). This represents a considerable relaxation in favor of the holder, who will now not have to prove grounds of excuse otherwise.

Notice of dishonor is no longer required within one day. Three days are allowed for this purpose (§ 3-508). And whereas at present effective notice can be given only by the holder of a dishonored instrument or some one who has received notice from him or through him, this same section provides that notice may be given by the holder, a party who has received notice, or any other party who can be compelled to pay the instrument—a considerable liberalization.

Under § 3-510 not only a certificate of protest but a bank stamp or ledger entry indicating dishonor are admissible as evidence and create a presumption of dishonor and proper notice.

The liability of indorsers on warranty are rephrased but apparently not changed.

D. Banks and other Drawees

The rule of *Price* v. *Neal* is codified in §§ 3-417 (1) and 3-418; but the method of handling the problems is new. The approach taken is, under § 3-418, that payment or acceptance by drawee is final, unless it has a right of recovery (§ 3-417(a)). This latter Section provides that anyone who obtains payment or acceptance (and any prior transferor) warrants to the person accepting or paying (a) title; (b) lack of knowledge of forgery of the drawer's signature in some circumstances, and (c) absence of material alteration in some cases. The rules are stated in complicated fashion, but the results under them should be in accord with existing law. For instance a bank paying on a forged indorsement is liable to the true owner under the provision of § 3-419 that it is by this action a converter; but it can recover from the person paid, even a holder in due course, because of the breach of the warranty of title. Where a bank is involved reference should also be made, of course, to Article 4, in particular to § 4-207.

E. Discharge

The changes here are minor. There is a change in method of approach; the present law focusing on discharge of the instrument and the consequent results thereof, whereas the Code focuses on discharge of the parties. But the results will be about the same under the Code as under present law.

ARTICLE 4

BANK DEPOSITS AND COLLECTIONS

Article 4 codifies and develops present law relating to bank deposits and collections as found in the following: Negotiable Instruments Law, adopted in all the states; the American Bankers Association's Bank Collection Code, adopted in eighteen states but not in Virginia; deferred posting statutes, adopted in most states; and miscellaneous statutes relating to stop payment orders, limitations on liability for payment of forged and altered checks, and similar matters. The case law developing rules of contract, agency, and trusts as applied to bank deposits and collections is codified in the Article.

While the entire Code seeks to retain flexibility in the development of commercial law, this is particularly true of Article 4. The specific provision of § 4-103(1) expressly embodies this concept of flexibility. It authorizes, subject to concepts of good faith and ordinary care, variation by agreement of the provisions of the Article.

Some knowledge of banking practices is necessary to a full understanding of this Article, which is relatively complex. The rules laid down are sufficiently broad to take account of different operating procedures as between different banks, as well as the different procedures a particular bank applies to different types of items, while retaining the opportunity for future changes in internal operating procedures.

Part 1: General Provisions and Definitions

Under § 4-102 the law of the place where the bank is located governs its liability for action or nonaction as to any item handled by it for purposes of presentment, payment, or collection. A branch or separate office of a bank, under § 4-106, is considered a separate bank for most purposes.

§ 4-107 authorizes a bank to fix two P. M. or later as a cut-off hour for the handling of money and items and the making of entries in its books. The time limits set forth in the Code may be extended, unless otherwise instructed, by a collecting bank in a good faith effort to secure payment, for a period of not in excess of an additional banking day. Delay may also be excused if caused by circumstances beyond the control of the bank.

Part 2: Collection of Items: Depository and Collecting Banks

The considerably litigated question of whether a bank takes an item as purchaser or as agent for collection is settled under the Code in § 4-201 in favor of the view that the bank always takes "for collection," unless a contrary intent clearly appears. The Virginia cases have considered the form of the indorsement, and the entry made on a deposit slip by the original owner of a draft, to be of large significance in determining whether a bank was a purchaser of the draft or only an agent for collection. Under the Code the form of the indorsement is immaterial on this question. However, Virginia is consistent with the Code approach in that no particular significance is placed on the form of indorsement placed on the draft by the depository bank itself, or to a right of recourse by the depository bank against the drawer of the draft.

§ 4-204 authorizes direct forwarding to a payor bank for collection; § 4-202 requires the collecting bank to use due diligence in other respects in the collection of the item. Under § 4-205 a depository bank may supply a missing indorsement, and § 4-206 authorizes transfers between banks by any agreed method that identifies the transferor bank.

The problem of payment and acceptance of forged and altered items is dealt with in § 4-207, as in Article 3, in terms of warranties made by the customer of the bank and by the collecting bank on transfer and presentment of items.

§ 4-208 gives a collecting bank a security interest in items, the accompanying documents, and the proceeds. It recognizes that a bank has a security interest in an item or its proceeds to the extent that bank credit given on the basis of the item has been withdrawn. This section of the Code recognizes that a bank may have a security interest in an item, and so have given value, if the credit is available for withdrawal as of right, whether or not drawn upon.

The Code sets forth in detail the media of remittance that may be used in bank collections, expressly recognizes rights of charge-back, and undertakes to define when an item is finally paid.

§ 4-214 set forth preference rules to be applied in case a bank in the course of collection becomes insolvent.

Part 3: Collection of Items: Payor Banks

The deferred posting provisions of the Code, set forth in § 4-301, carry out the same basic purposes as the Virginia statutes on the subject. While the Code uses different terminology, there are no apparent significant differences.

§ 4-303 contains provisions setting forth when items are subject to stop payment orders, legal process, or setoff, and also provides the order in which items are to be charged or certified.

Part 4: Relationship Between Payor Bank and its Customer

The Code in § 4-401 allows a bank to charge a customer's account according to the original tenor of an altered item.

The Code recognizes the right of a customer to stop payment on any item payable from his account, if the order is received by the bank at such time and in such manner as to afford the bank a reasonable opportunity to act upon it. Oral orders are binding only for fourteen calendar days, unless confirmed in writing within that period. Written orders are effective only for six months, unless renewed in writing.

§ 4-405 provides that until a bank has knowledge of the death or an adjudication of incompetency of a customer and a reasonable opportunity to act on it, the authority of the bank to accept, pay, or collect his items is not revoked. Even with knowledge of death, the bank for ten days after the date of death may pay or certify checks drawn on or prior to the date of death, although it is not intended to prevent the personal representative from recovering the payment. A person claiming an interest in the account may, however, order the bank to stop payment.

§ 4-406 of the Code recognizes that a depositor owes a bank the duty of examining statements of account and cancelled checks and to report unauthorized withdrawals from his account. It draws distinctions between the customer's duty as regards his own forged signature and altered items, and his duty as regards forged endorsements, where he cannot be expected to know the signatures of the indorsers. The Code is somewhat broader in its coverage, as regards items, signatures, and types of alterations, than the Virginia statutes. The statutes of limitations in the Code are longer than those presently in effect in Virginia.

§ 4-407 expressly recognizes that a payor bank has a right of subrogation when it has made an improper payment.

Part 5: Collection of Documentary Drafts

This subject has not generally been covered by statute, and there is no relevant law in Virginia.

ARTICLE 5

LETTERS OF CREDIT

Article 5 undertakes a partial codification of the law relating to letters of credit. The letter of credit business has a strong international flavor, and has generally been carried out in accordance with the Uniform Customs and Practice for Commercial Documentary Credits, adopted in 1951 by the 13th Congress of the International Chamber of Commerce. So far as the United States is concerned, the letter of credit business has been concentrated in New York. As a result, the only consistent and, anywhere near, comprehensive body of American law relating to letters of credit has been developed in the decisions of the New York courts and the Federal Court of Appeals for the Second Circuit.

Virginia has no statute law and only one case arising out of a transaction that the Supreme Court of Appeals of Virginia said involved a letter of credit. One of the greatest services Article 5 provides for Virginia is to establish guideposts on this matter of identity.

Article 5 gives everyone ready access to some of the open secrets regarding letters of credit, already available in publications of the International Chamber of Commerce, the New York decisions, and other sources.

ARTICLE 6

BULK SALES

To understand this Article, one must know the general purpose of bulk sales legislation. Assume that a merchant has a stock of inventory which he holds for sale in the ordinary course of business. Assume further that a creditor, relying on that stock of inventory and the income that it will generate, extends *unsecured* credit to the merchant. So long as the merchant sells inventory in the ordinary course of business the unsecured creditor has a good chance of being paid. But if the merchant sells all or substantially all of that inventory for value to a third person not in the ordinary course of business, the risk of nonpayment is materially increased. In one deal the creditor loses a large part of the merchant's assets upon which a levy might be made. Further, even if the conveyance amounts to a fraud on creditors, most states protect the third party purchaser unless he had notice of his seller's fraudulent intent. Thus, while a creditor might set aside a proposed conveyance by the merchant which is in fraud of creditors, he cannot levy on the inventory once it has been delivered to a purchaser for value without notice. The creditor's best security, therefore, is the proceeds of the sale which have been received by the merchant seller. But if those proceeds are inadequate or have been dissipated before the creditor is informed of the transaction, his rights are seriously impaired.

The Virginia Bulk Sales Act, Virginia Code §§ 55-83 to 86, and Article 6 of the UCC approach these problems in substantially the same way.

Under both statutes, specified bulk transfers of certain quantities of inventory or equipment not in the transferor's usual or ordinary course of business are ineffective against creditors unless three basic conditions are met: (1) the parties prepare a schedule of the property involved which is held by the transferee for six months after the transfer and made available for inspection by the transferor's creditors; (2) the transferor prepares at the transferee's demand a sworn list of creditors which, again, is held by the transferee for six months, subject to inspection; (3) the transferee gives notice of the proposed transfer to the transferor's creditors at least 10 days before taking possession of the goods. Since the creditor has notice *before* the transfer occurs, he may utilize available state remedies to protect his interest, i.e., prevent the transfer as a fraud on creditors, impound the proceeds when received by the transferor or negotiate a consensual payment arrangement with the transferor.

There are differences of a relatively minor nature between the Virginia Bulk Sales Act and Article 6 of the UCC. For example, the Virginia statute applies to bulk transfers of "any part" of specified goods while Article 6 applies to bulk transfers of a "major part" of the seller's inventory. Similarly, the Virginia Act is more readily applied to bulk transfers of fixtures or equipment "pertaining" to a stock inventory than is Article 6.

On the other hand, Article 6 is more precise than the Virginia Bulk Sales Act in defining what property is subject to the act and in listing eight specific exceptions to the act's literal coverage. Further, Article 6 requires more information to be contained on the schedule of property, list of creditors and notice to creditors than does Virginia. Additional precision is obtained in Article 6 by prescribing which creditors can object to defective transfers, which creditors are entitled to notice, the legal effect of defects in the list of creditors prepared by the transferor and the rights of third persons who, without notice, purchase inventory from the immediate transferee in a defective bulk sales transfer. These questions have been left to the courts in Virginia. Article 6 also adopts a six month statute of limitations for all bulk transfers. Finally, Article 6 contains a special provision for bulk sales by auction which is not found in Virginia.

In summary, the purpose of Article 6 is to simplify and make uniform the law of bulk sales. The differences between Article 6 and the Virginia Bulk Sales Act are insubstantial.

Article 6 provides an optional "Application of Proceeds" section which may be adopted or rejected without serious damage to the principle of uniformity. This section imposes upon the transferee a duty to "assure that such consideration (i.e., the sale price) is applied so far as necessary to pay those debts of the transferor which are either shown on the list furnished by the transferor . . . or filed in writing in the place stated in the notice . . . within thirty days after the mailing of such notice."

Only five of the first seventeen states to adopt the Uniform Commercial Code have enacted the Application of Proceeds section. These states are Alaska, Kentucky, New Jersey, Pennsylvania and Oklahoma. In general, the reasons for rejection of the optional provisions reflect a feeling that notice coupled with independent creditor remedies in particular states is adequate protection for the unsecured creditor. We concur in this view and recommend that the optional provisions be omitted.

ARTICLE 7

WAREHOUSE RECEIPTS, BILLS OF LADING, AND OTHER DOCUMENTS OF TITLE

Article 7 is a consolidation and revision of the Uniform Warehouse Receipts Act, the Uniform Bills of Lading Act, and the provisions of the Uniform Sales Act relating to the negotiation of documents of title. The criminal provisions of the Warehouse Receipts Act and the Bills of Lading Act are omitted as being inappropriate to a Commercial Code. The Article does not undertake to define the tort liability of bailees, except to hold certain classes of bailees to a minimum standard of reasonable care.

The Uniform Warehouse Receipts Act was promulgated in 1906 and adopted by Virginia in 1908. Neither the Uniform Bills of Lading Act nor the Uniform Sales Act has been adopted by Virginia.

Article 7 makes as few innovations in existing law as any of the articles of the Code.

Part 1: General

This part contains general definitions and statements regarding the difference between a negotiable and nonnegotiable document of title, which are consistent with present law, to the extent that these subjects are now defined.

Part 2: Warehouse Receipts: Special Provisions

The formal requirements of the Uniform Warehouse Receipts Act are continued in § 7-202.

§ 7-204 defines the warehouseman's duty of care and provides how his liability can be limited by contract. The warehouseman's lien is spelled out in detail in § 7-209, and the method of enforcement in § 7-210. Under the UCC the warehouseman converts the goods only if he wilfully fails to comply with the requirements set forth.

Part 3: Bills of Lading: Special Provisions

The provisions of this part provide new statutory law in Virginia consistent with the Uniform and the Federal Bills of Lading Acts.

§ 7-309 provides that a carrier "must exercise the degree of care in relation to the goods which a reasonably careful man would exercise under like circumstances." This section expressly provides that the Code does not repeal any law or rule of law which imposes liability upon a common carrier for damages not caused by its negligence. As a result, Code 1950, § 56-119, which invalidates contractual provisions purporting to exempt transportation companies from their liability as common carriers, is continued in effect. This section permits the carrier to limit the amount of damages on the basis of declared values. The section authorizes the carriers to make reasonable provisions as to the time and manner of presenting claims and instituting actions.

Part 4: Warehouse Receipts and Bill of Lading: General Obligations

This part continues and expands the provisions of the earlier uniform acts. § 7-404 is in accord with Virginia law.

Omission of the optional language in § 7-403(1)(b) will leave unchanged the Virginia rule as regards the burden of proof in fixing the liability of a warehouseman, and this is recommended.

Part 5: Warehouse Receipts and Bills of Lading: Negotiation and Transfer

Under §§ 40 and 47 of the Uniform Warehouse Receipts Act, as now in effect in Virginia, a warehouse receipt can only be negotiated by the owner or by a person to whom the possession or custody of the receipt has been entrusted by the owner, so that a person who obtained the receipt by trespass or by finding could not negotiate the document. The UCC follows the 1922 amendments proposed by the National Conference of Commissioners on Uniform State Laws under which a person within the tenor of the document and in possession, "however such possession may have been acquired," could negotiate the document. This changes Virginia law.

In other respects this part continues and develops the prior law of the uniform acts.

Part 6: Warehouse Receipts and Bills of Lading: Miscellaneous Provisions

§ 7-603 excuses a bailee from delivery when conflicting claims are made upon him until he has had a reasonable time to ascertain the validity of the adverse claims or to bring an action to compel the claimants to interplead.

ARTICLE 8

INVESTMENT SECURITIES

This Article replaces the Uniform Negotiable Instruments Law, adopted in Virginia in 1897, to the extent that act covered bonds used as investment securities. It replaces the Uniform Stock Transfer Act, promulgated in 1909, adopted in Virginia in 1924, and eventually by all the states. This Article does not replace, but by § 10-104 is made subject, in case of inconsistency, to the Uniform Act for the Simplification of Fiduciary Security Transfers, promulgated in 1958 and adopted in Virginia in 1960.

The Article uses a functional rather than a formal definition of a security. § 8-102 defines a security as an instrument in bearer or registered form which is of a type "commonly dealt in upon securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium of investment." In general, then, the Article covers bearer bonds, previously covered by the Negotiable Instruments Law; certificates of stock, previously covered by the Stock Transfer Act; and registered bonds and additional types of investment paper, not covered by any statutes.

The Article is not a Corporation Code nor a Blue Sky Law, statutes covering these subjects being unaffected.

Part 1: General Matters

This part provides definitions, establishes rules for governing the effect of an over-issue, declares that securities are negotiable, and outlines the rights and duties of the parties in a sale of securities. § 8-103 provides that a lien in favor of an issuer is valid against a purchaser only if the right of the issuer to such a lien is noted conspicuously on the security.

Part 2: Issue—Issuer

The term "issuer" is comprehensively defined in § 8-201 for the purpose of this Article only. § 8-202 set forth the issuer's responsibilities and defenses and the effect of notice of a defense or defect. In general, it extends the provisions of the Negotiable Instruments Law to all securities. The section gives validity to a security in the hands of a purchaser for value and without notice of a particular defect, even though the defect is so serious that it is said to go to the validity of the security. A security in the hands of a bona fide purchaser is voided only if so declared in a Constitution or statute, either expressly or by unavoidable implication.

§ 8-203 deals with matured or called securities, and makes an extensive modification in the policy that a holder in due course must take before maturity of the instrument. The defense of lack of notice is limited to one and two years depending upon the circumstances. It permits the issuer to determine definitely its liability with reference to invalid or improper issue, and this point is fixed at two years maximum after the default. The section does not, however, extend beyond the redemption date, the life of preferred stock called for redemption.

§ 8-204 provides that unless noted conspicuously on the security, a restriction on transfer imposed by the issuer, even though otherwise lawful, is ineffective, except against a person with actual knowledge of it. The Code does not undertake to deal with restrictions on transfer imposed by private agreement or restrictions on transfer imposed by other statutes.

Under § 8-205 a forged security is made valid in the hands of a purchaser for value without notice, if the signing was done by one entrusted by the issuer with the signing, or by an employee entrusted with responsible handling of the security. § 8-206 continues prior law on the effect of completion or alteration of an instrument.

§ 8-207 covers the rights of the issuer with respect to registered owners and § 8-208 states the warranties made by an authenticating trustee, registrar, or transfer agent in signing a security.

Part 3: Purchase

In general, this part extends the doctrine of negotiability to all investment securities. § 8-302 defines a bona fide purchaser as a purchaser for value in good faith and without notice of any adverse claim who takes delivery of a security in bearer form or of one in registered form issued to him or indorsed to him or in blank. § 8-304 defines when a purchaser has notice of an adverse claim. § 8-305 sets time limits when staleness, or the purchase of a security after it has been called for redemption or payment, gives notice of adverse claims. § 8-306 sets forth the warranties a person makes when he presents a security for registration of transfer, payment or exchange.

§§ 8-307 through 8-311 deal with indorsements: the effect of delivery without indorsement, the right to compel indorsement, how an indorsement is made, the effect of an indorsement, and the effect of an unauthorized indorsement.

§§ 8-312 through 8-316 deal with various aspects of guaranteeing signatures, delivery of securities, the reclamation of securities wrongfully transferred, and a purchaser's right to requisites for registration of transfer.

§ 8-317 continues the basic provision of the Uniform Stock Transfer Act that an attachment or levy on a security can only be made by actually

seizing or possessing the security so it can no longer be transferred. In *Iron City Savings Bank* v. *Isaacsen,* 158 Va. 609, 632, 164 S.E. 520 (1932), the Stock Transfer Act was interpreted to mean that the holder of the stock must be before the court. This section of the Code provides that a creditor whose debtor is the owner of a security is entitled to the aid of courts in reaching it to satisfy his claim.

§ 8-319 establishes a statute of frauds for the sale of securities, and since Virginia has not had such a statute covering securities, this changes Virginia law.

Part 4: Registration

An issuer is required to register the transfer of a security in registered form when the requirements set forth in § 8-401 have been met. § 8-402 provides that the issuer may require assurances that each necessary endorsement is genuine and effective, including a guarantee of the signature of the person indorsing.

The other sections of this part deal with the issuer's duty of inquiry when a security is presented for registration, the issuer's liability as a result of registration, circumstances under which an issuer must issue a new security when a security has been lost, destroyed, or wrongfully taken, and the duties of an authenticating trustee, transfer agent, or registrar.

ARTICLE 9

SECURED TRANSACTIONS

I. GENERAL COMMENTS

Prior to detailed consideration of some provisions of Article 9 and their application to conventional Virginia business transactions it may be well to respond to two general objections frequently made to this Article.

These two objections are:

1. "Article 9 is completely novel." Implied in this objection is the further objection that lawyers would find Article 9 "foreign" and would have to learn "security law" all over again; this, in turn, might lead to a fear that Virginia security law would suffer from uncertainty until a lengthy and extensive training period had expired.

2. The unsecured seller selling goods to merchants will suffer under the Code because Article 9 permits a lender to obtain a valid lien on a shifting stock of merchandise and permits a floating lien for future advances and on after-acquired property.

After attempting a refutation of these two objections, a brief examination will be made of some of the problem areas of Article 9, this followed by a summary of some of the advantages of Article 9 over current Virginia law.

A. *General*

Peter Coogan (an eminent practicing attorney and lecturer at Harvard) states there are two ways of approaching Article 9: We can look for and employ our knowledge of what's familiar or we can look for and accent what's different. Employing the first approach, Coogan demonstrates that the fundamentals of Article 9 are easily and quickly grasped

by "security lawyers." (Coogan, *A Lazy Lawyers' Guide to Secured Transactions Under the Code*, 60 MICH. L. REV. 685.)

Coogan suggests that lawyers continue to think in terms of traditional security devices when employing Article 9 with respect to secured transactions.

We will attempt to show below how the more common traditional (Virginia) secured transactions would come into existence and be handled under Article 9.

Let us stipulate, however, that the oversimplifications which follow will inevitably conceal some difficult problems which could arise under Article 9 (the problems concealed are equally or more difficult under present law).

B. *General Observations and Essential Definitions.*

No amount of magic or oversimplification can conceal the fact that Article 9 is complex (but so is present security law), so some minimum of definition and background is essential to even a simplified illustrated exploration of Article 9.

1. The concepts of "title" and lien are not employed in the determination of rights, duties, and priorities in Article 9.

2. Only the *conceptual* dividing lines between traditional security devices have been abandoned; the approach is functional, that is, rights, duties, priorities turn on what purpose the security was intended to serve rather than the conceptual *form* of the security, *e. g.*, having the controversy turn upon whether a particular instrument was a chattel mortgage or a conditional sale does not happen under Article 9.

3. The traditional terminology surrounding secured transactions has been largely abandoned—this to escape the existing judicial and legislative meanings given the old terminology.

4. "Filing" (recording) under Article 9 does *not necessarily* "perfect" the security interest.

5. A "perfected" security interest under Article 9 will *not always* have priority over another security interest. However, a "perfected" (and otherwise valid) security interest (in the original security) *will always* withstand attack by lien creditors and a trustee in bankruptcy (to the fullest extent to which state law can afford the latter protection).

6. Article 9 contains three distinct methods of "perfecting" security interests: (1) taking possession (2) filing (3) doing nothing ("automatic perfection") BUT: The method or methods of "perfecting" permitted under Article 9 turn upon the nature of the security, and/or the use to which the security is to be put, *e. g.*, is the security a television set being purchased by retailer, or by a consumer?—or is it a warehouse receipt?

7. No secured creditor should be content with the security interest he has created until he has thoroughly studied the sections of Article 9 dealing with priorities. These sections control his right to ultimate realization as much, or more so, than the sections dealing with creation and "perfection" of the security interest.

8. Article 9 enables a secured creditor to claim a security interest in the "proceeds" of the original security, *e. g.*, the conditional sales contract obtained by an automobile dealer when selling to a consumer would be "proceeds" as regards a secured party whose original security interest

was obtained by "floor-planning" the autos for the dealer. (Extending the security interest to "proceeds" is not entirely novel; the Uniform Trust Receipts Act, already Virginia law, extends the security interest to "proceeds." Incidentally, any lawyer familiar with the Trust Receipts Act will have a relatively easier task of understanding Article 9). Article 9 extends the "proceeds" concept to all security interests; in so doing, entirely new (and difficult) priority problems have been created.

9. The "security agreement" and a "financing statement" are not the same; they have different purposes. But a "security agreement" may be used as a "financing statement."

Thus alerted to the more obvious quirks of Article 9, we proceed to the minimum of definitions essential to basic understanding of the Article. For brevity and simplicity, the definitions will be by way of factual illustration and/or in terms of present law, when practicable:

"Goods"—tangible personal property.

There are *four types* of "goods" in Article 9—

"Consumer goods"—a television set, auto, furniture, etc., being held for *personal use.*

"Farm products"—things grown or produced by and held by a farmer—wheat, eggs, etc., *in the hands of the farmer.*

"Equipment"—machinery in a plant, furniture in an office, an auto used primarily for business, etc.

"Inventory"—the things being manufactured by a manufacturer, also cars, televisions, hardware, clothing or other merchandise being offered for sale to consumers by retailers.

"Instruments"—a negotiable instrument or a security (Article 8) other than a document of title, *e. g.*, a demand negotiable note.

"Document"—a document of title such as a bill of lading or a warehouse receipt.

"Chattel paper"—a conditional sale contract or a chattel mortgage.

"Account"—an unsecured *unconditional* right to receive money arising from a sale of goods or services—the traditional "accounts receivable."

"Contract right"—an unsecured *conditional* right to receive money—a builder's contract right to payment when, and if, he completes the building.

"General intangibles"—any form of intangible personal property not previously mentioned above—copyrights, trademarks, patents, and the like.

THE METHOD, OR METHODS, OF PERFECTION, PLACE OF FILING, AND PRIORITY *ALL* TURN ON THE ABOVE CLASSIFICATIONS OF PROPERTY—HENCE, IT COULD WELL BE SAID THAT THESE CLASSIFICATIONS (ALONG WITH THE PURCHASE MONEY CONCEPT BELOW) ARE ARTICLE 9's SUBSTITUTE FOR THE PRESENT LAW'S CONCEPTUAL METHOD OF DISTINGUISHING AMONG THE VARIOUS SECURITY DEVICES.

"Purchaser money security interest"—A security interest taken or retained by a seller to secure the price or a security interest taken by a lender of money whose loan has enabled a person to acquire personal property—

a bank loan made directly to a consumer and used by the consumer to purchase an automobile, the bank taking a chattel mortgage as security for its loan.

C. *A Brief Analysis of How Some Common Virginia Secured Transactions Would Be Classified and Treated Under Article 9.*

1. *Conditional Sale* (a) (at retail level—other than automobile)—A consumer buys a refrigerator from a dealer and secures the price with a conditional sale. Under Article 9 this would be classified as *a purchase-money security interest in consumer goods.* The security agreement must be in writing to be valid even between the dealer and the consumer (a change in Virginia law) but *any writing* which evidences an intent to secure the transaction, describes the collateral, and is signed by the consumer—debtor is sufficient (§ 9-203). Thus, existing forms may be used. The dealer does not have to file anything—his security interest is perfected without filing (automatic perfection) (§ 9-302). The only risk the dealer runs by not filing is that he could lose his security interest if the consumer sold the refrigerator to a person *without actual knowledge* of the security interest and that person used the refrigerator for his *personal* use (not a second hand dealer, for example); even this slight risk is eliminated if the dealer wishes to, and does in fact, file. (§ 9-307 (2)).

The consumer runs no risk of buying subject to an existing security interest against the dealer's stock in trade; even if he knows of such interest he cuts it off. (§ 9-307 (1)).

In the event of default the dealer may peaceably repossess, sue for the balance, repossess by legal action, etc. (§§ 9-503, 9-504, 9-505, 9-506). He may sell at public sale and in certain instances (and this is one of them) he may sell at private sale (§ 9-504 (3)). The dealer's expenses of repossession, storing, selling, and reasonable attorneys' fees may be added to the debt (§ 9-504 (1)(a)). However, if the consumer has paid 60% or more of the purchase price, or the loan, the consumer may request a public sale (§ 9-505(1)). Unless the dealer and consumer agree that the dealer will accept the collateral in satisfaction of the debt, the dealer has a right to a deficiency judgment (§§ 9-504 (2), 9-505 (2)). (These are changes in present Virginia law—giving clearer and better rights to *both* dealer and consumer).

(b) Conditional sale—at retail level—automobile—Same as (a) above *except* the existence of the security interest *must be noted on the title certificate* to become perfected. (§ 9-302 (3)(b)). Remedies of dealer and consumer are the same as in (a) above.

(c) Conditional sale contract or purchase—money chattel mortgage or deed of trust—assigned or sold to bank or other lending institution by dealer. Illustration—appliance dealer sells or assigns his conditional sales contract to bank.

Under Article 9 this transaction would be classified as *a security interest in chattel paper.* The bank need *not* examine for prior filings by other lenders; the bank will take the contracts free of any existing security interest *unless* it had *actual knowledge* of a prior security interest (first sentence, § 9-308). The bank steps into the shoes of its assignor insofar as method of filing, perfection priority and method of realizing upon the security, as against creditors of and purchasers from the consumer who purchased from the dealer. However, as against creditors of, or purchasers from, the *dealer* (the bank's assignor), the bank needs to perfect its security interest in the chattel paper. This perfection may be accomplished in either of two ways: if the bank retains *possession* of the conditional sales con-

tracts its security interest is perfected by possession (§ 9-305); if the bank chooses to give possession of the conditional sale contracts to the dealer (for collection or other purposes) it may do so without the risk of having the transaction declared void for failure to "police" the collections (repeal of *Benedict* v. *Ratner*, § 9-205) *but* now the bank must *file* a financing statement to perfect its security interest and even after filing the bank runs a risk that a purchaser without notice of the contracts left in the dealer's hands will cut off the bank's security interest (§ 9-308). The bank can eliminate this risk by stamping the conditional sales contracts (the "chattel paper") in such a way as to indicate its security interest. The bank is given a limited security interest in the money collected by the dealer from the consumer—as "proceeds" of the original security (§ 9-306).

All of the above observations also apply to a conditional sale contract which is in the form of a lease.

2. *Chattel Mortgage or Chattel Deed of Trust*—

(a)—As security for *purchase* money at *retail* level—other than automobiles—

Under Article 9 this would be classified as *a purchase money security interest in consumer goods.* Hence, all the observations and rules stated in part 1 (a) above relative to conditional sales would be applicable. The difference in the conceptual *form* of the security would make no difference in operation and result.

(b) As security for *purchase money* at *retail level—automobiles*—

Under Article 9, same rule and results as under 1 (b) above or conditional sales.

(c) Chattel mortgage *other than purchase money.* This is the orthodox use of the chattel mortgage. Under Article 9 rights, duties, priorities will turn upon the further question of the *type of goods* which the chattel mortgage secures. That is, are the goods "consumer goods", "equipment" or "farm products" (under present Virginia law no lender in his right mind would use a *chattel mortgage* against *inventory*—it would be a fraudulent conveyance).

Illustration—An owner of a fully paid-for pleasure boat borrows and uses the boat as security. Under Article 9 this would be classified as a *"security interest in consumer goods"* (not purchase money). (§ 9-109(1)). The lender should check for prior filings (§ 9-312). The significant difference in the handling of this secured transaction from those previously discussed is caused by its not being a purchase money security interest; thus, even though "consumer goods" are involved the lender's security interest requires a *filing* to become "perfected" (§ 9-302(1)) unless the lender takes possession of the boat (§ 9-305). A *filing* would also be required to perfect "chattel mortgage" security interest in "equipment" and "farm products". The lender's priority in the original security (boat) would, we believe, be almost unassailable if prompt filing had been made by the lender and the lender had checked and found no prior filing (see § 9-312). (Perhaps the security interest would lose effect if the borrower were a boat dealer and placed this, his personal boat, in his inventory.)

(d) Assignment or sale of chattel mortgage to a buyer or lender—

Under Article 9 the chattel mortgage would be "chattel paper". Thus as regards the rights, duties, priorities of the buyer or assignee of the chattel mortgages, as against creditors of and purchasers from the lender's seller or assignor, the discussion in 1 (c) above on conditional sales would be applicable in its entirety.

3. *Trust Receipt Financing*—

This form of financing is used in Virginia to finance *acquisition* of inventory by retailers, particularly acquisition of large items such as autos, refrigerators, etc. It is often referred to as "floor planning". It may also be used to finance the acquisition of new material for manufacturers.

Probably its most typical use is to finance the purchase by an auto dealer of his stock of new cars. We select this as our illustration.

Under Article 9 the "floor planning" of autos would be described as *a purchase-money security interest in inventory*. The lender should first check for prior filings. Dealer and lender must have a written security agreement. The lender's security interest cannot become perfected until *a financing statement is filed* (§ 9-302) unless the lender takes possession of the autos (§ 9-305). Filing can ante-date the advance of money. *The financing statement is the same for all secured transactions under Article 9* (except "farm products" and fixtures); it must contain the address of the secured party, give the mailing address of the debtor, state the type of collateral, and be signed by the debtor (§ 9-402). This illustration affords a most appropriate instance for the financing statement to claim a security interest in "proceeds" from the sale of the automobile. (§§ 9-402(3) (4), 9-306; but see § 9-308).

After this type of security transaction is "perfected" the lender has excellent priority as to the original security (§ 9-312) but one who lends against inventory will always lose to purchasers in the ordinary course of business (§ 9-307(1)). This latter is not a change in the present law.

If in checking the records our lender had found that another lender's financing statement covered the same type collateral, he could still have financed the purchase of new cars for this dealer and obtained a valid security interest by giving the notice set forth in § 9-312 (3). Thus, Article 9 quite effectively prevents one financier from obtaining a monopoly in the financing of a customer's inventory.

All that has been stated in this portion of the memorandum would be equally applicable to "floor-planning" refrigerators, stoves, television sets, etc.

4. *Accounts Receivable financing*—

(a) Factoring type arrangement—retailer or manufacturer procures money by a "sale" or assignment of amounts due him by his customer.

This lender should first check for prior filings. Lender and borrower must enter into a written security agreement (§ 9-203). A security interest in accounts can be *perfected only by filing* unless the total of the assignments transfers only an "insignificant part of the outstanding accounts of the assignor" (§ 9-302(1)(d)). The best rule to follow is—*file!*

A security interest in accounts is not rendered legally invalid because of failure of the lender to "police" collections and returned merchandise; Article 9 abolishes the rule of *Benedict* v. *Ratner* (§ 9-205).

An assignment of an account is legally effective even though no notice is given the account debtor but the account debtor may pay the assignor of the account and be discharged unless he, the account debtor, has been notified of the assignment. (§ 9-318(3)).

Quite frequently a large customer of the borrower will use a purchase order which prohibits assignments of that customer's account. Article 9 expressly invalidates a clause prohibiting assignments (§ 9-318(4)) and

thus the existing practice of some lending institutions to make loans on such accounts is no longer clouded by legal uncertainty.

(b) Bank "charge plans"—

In essence, these plans are true sales of accounts, or non-recourse assignments of accounts; however they would be treated as a security interest under Article 9—*a security interest in accounts* (§ 9-102(1)(b)). Thus, the discussion in 4(a) immediately above would be fully applicable to such charge plans, or any other true sale of accounts.

5. *Agricultural Deeds of Trust and Crop Liens*—

Under Article 9 these would be classified as *a security interest in farm products* (§§ 9-105(1)(f), 9-109(3)). Unborn animals and growing crops can be subjects of such security interests (§ 9-105(1)(f)). An after-acquired property clause is limited in its effect to crops which become such within one year after the execution of the security interest except where the security agreement containing the after-acquired property clause was a purchase money or improvement deed of trust on the land itself (§ 9-204(4)(a)).

The lender should check for prior filings. A security agreement in writing must be executed (§ 9-203). A financing statement must be filed for "perfection", but here the financing statement must contain one additional piece of information: it must describe the land on which the crops are growing or are to be grown (§§ 9-402(1), 9-402(3) 2). The place of filing a financing statement for "farm products" includes the county in which the crops are growing or are to be grown (§ 9-401-optional).

The lender who makes loans on crops, etc. ("farm products") is given a preferred position insofar as protection against purchasers is concerned: a purchaser in ordinary course of business does *not* buy free of a perfected security interest when he buys directly from the farmer (§ 9-307(1)).

A lender making an enabling advance against crops not more than three months before planting is given a very limited priority over lenders whose security interest in the crop did not result from an enabling advance (§ 9-312(2)). However, if this priority is not satisfactory to a lender making an enabling advance, Article 9 recognizes the validity of a subordination agreement, and thus the enabling lender (with the consent of the lender having a higher priority) could advance his priority (§ 9-316).

6. Pledges—

(a) Tangible personal property—"goods"—Illustration—Pledge of diamond ring.

Under Article 9 this would be classified simply as *a security interest in goods perfected by possession.* The lender should checks for prior filings. The security agreement is effective even though *not* in writing (§ 9-203(a)). No filing is required; the security interest is perfected by possession; however the lender may also perfect by filing (§§ 9-305, 9-302).

The rights, duties and remedies on default are clearly spelled out in Article 9 (§§ 9-504, 9-506, 9-507, 9-207).

If our lender found no prior filing his security interest would, it seems, have top priority (§ 9-312(5)(6)).

(b) Bills of lading and warehouse receipts—"Documents".

Under Article 9 these pledges would be classified as *security interests in documents perfected by possession.*

If the documents are negotiable, and have been "duly negotiated" to our lender, then our lender need not check for a prior filing (§§ 9-309, 9-304(1)).

Again, no *written* security agreement is legally required (§ 9-205(1)) but the lender would be wise to reduce the transaction to writing because these documents will ultimately leave the lender's possession and the lender might desire a perfected security interest for a period longer than his period of possession plus twenty-one days, and our lender might wish to claim "proceeds" and perfect his interest in proceeds for a period longer than thirty-one days. (See §§ 9-304(5) and (6) and 9-306(3)).

Again, the security interest is perfected by possession, and, in addition, it is perfected for twenty-one days after a release of possession *if* the release of possession was for the usual business purposes (§ 9-304(5)). This latter is "automatic perfection".

During the period of time the documents are out of the lender's possession he runs the risk of losing his security interest by due negotiation to a holder, that is, transfers to one who is a "holder in due course" (§ 9-309). This is not a change in the law. The lender may protect himself by notation on the document or by seeing to it that the borrower has no opportunity to negotiate the document.

Filing, although not necessary, is advisable because of the limited duration of perfection as to the document and its proceeds (§§ 9-304(5) and (6) and 9-306(3)). The filing can precede the advances.

Priority is excellent so long as possession is retained and for twenty-one days thereafter (with the exception noted above (§ 9-312(5)(a)).

(c) Negotiable paper—"Instruments"—Illustration—pledge of a negotiable note.

Under Article 9 a pledge of negotiable paper would be described as *a security interest in instruments perfected by possession.* The bank need not check for prior filings (§ 9-309).

No *written* security agreement is legally necessary (§ 9-203(1)(a)). The security interest is perfected by taking possession (§ 9-305). There is no advantage gained by filing; possession and "automatic perfection" are the *only* ways of perfecting a security interest in negotiable paper (§ 9-304(1)(4)(5)). The lender's rights will turn largely upon Article 3 on Commercial Paper.

Some rights and duties of the lender are set out in §§ 9-207 and 9-504.

Again, top priority seems likely so long as possession has not terminated, twenty-one days thereafter has not elapsed, and a holder in due course has not acquired rights (§§ 9-312(5)(b) and 9-309).

(d) "Field warehousing"

This is essentially a pledge of the goods. If the field warehouse is "bona-fide" there would be no need of filing under the Code. However, a lender may wish to have a *written* security agreement *and* file a financing statement as insurance against a creditor successfully proving that the field warehouse was not bona-fide, in which event, the lender's security interest would be defeated unless he could show that under the Code he had "an existing security interest in inventory—perfected by filing." To the extent that field warehousing involves the issuance and pledge of documents of title the previous discussion on pledges is applicable.

7. "Lay-away" plans—

Illustration—consumer buys a dress from a merchant and the merchant retains possession of the dress until all installments have been paid.

There is at present no satisfactory law in Virginia covering this security device. Unfairness and harsh forfeitures are too frequent.

Under the Code, this "seller's lien" in a "lay-away" (which arises under § 2-703(a) of Article 2) is a "security interest" under Article 9 (§ 9-112). Clear, and ostensibly fair, rules are laid down in Article 9 for the adjustment of a controversy between a "lay-away" merchant and his customer (§§ 9-504 through 9-507).

8. Fixtures—Illustration—furnace in a home.

Article 9 provides for a security interest in fixtures but does not define the term.

There can be no security interest under Article 9 as regards lumber, brick, tile, and the like which are incorporated into a building (§ 9-313).

The security interest in fixtures must be evidenced by a written security agreement (§ 9-203(1)(b)). Perfection is achieved by filing a financing statement (§ 9-302(1)). The financing statement must also contain a description of the land on which the fixture is located (§ 9-402(1)). The financing statement is filed and indexed with mortgages and deeds of trust on land (§ 9-401).

A *perfected* security interest in fixtures has priority over:

(a) a purchaser for value of the realty

(b) a *prior* encumbrance on the realty *but only* to the extent of advances made by the realty lender *after* perfection of the security interest in fixtures.

(c) a lien creditor subsequent to perfection of the security interest in fixtures.

BUT—When a holder of a security interest in fixtures exercises his priority over persons having an interest in the realty he must reimburse any (non-consenting) holders of an interest in the realty for the cost of any repair of any physical injury caused the realty by the removal of the fixtures (§ 9-313(1-5)).

II. UNSECURED SELLERS AND ARTICLE 9

The belief that under present law unsecured sellers have a residuum of unencumbered assets for realization of their claims is probably illusory to a large degree.

Under *present* law all the stock-in-trade, equipment, and accounts of a retailer *can* be encumbered: Trust Receipts, Conditional Sales of equipment, Consignments, Factoring, and assignment of accounts receivable, when combined, can, even today, encumber all the assets of a retailer.

The only change made by Article 9, in this regard, is that it's *easier* to encumber all the assets, and if the lender is "piggish" he can now legally claim a "floating" lien which covers after-acquired property.

Will lenders be "piggish" if the Code is adopted? The experience in Pennsylvania has shown they will not. In addition, if the lender attempts to make full use of his legally permissable right to "tie up his borrower" the

lender is likely to find his security up-set, in bankruptcy. See Coogan, *The Effect of the Uniform Commercial Code Upon Receivables Financing—Some Answers and Some Unresolved Problems*, 76 HARV. L. REV. 1529 (1936). This could help explain why lenders operating under the Code have not proved "piggish".

One further point should be made. Under the Code a security interest is so easily and cheaply created and perfected that any seller who has doubts as to unsecured credit could become a secured creditor. The manufacturer supplying the small retailer could himself achieve secured priority over a "floating lien" by (1) giving notice, (2) obtaining a written security agreement from his retailer (the seller's order blank would suffice, with the addition of one sentence), and (3) filing *once* (which would cover a chain of transactions). (See § 9-312(3)).

III. A PROBLEM AREA OF ARTICLE 9

The priorities sections of Article 9 have been shown by some writers to (1) not answer all priority problems, and (2) not always protect the interest which is more vital to the business community.

Suffice it to say that generally the criticisms are directed to results reached in hypothetically possible, but rare situations created by the critics. And, generally speaking, until the priorities sections are amended after extensive study, lenders can avoid the deficiencies of Article 9's priority sections by exercising diligence.

Additionally, it can be stated that it is conflicting claims to "proceeds" which most loudly is said to demand further consideration and amendment. These are problems the existing law does not pretend to answer.

IV. SUGGESTED AMENDMENTS

We do not recommend any significant departure from the language of this Article. However, we suggest two minor amendments as follows:

§ *9-104.* This section exempts certain transactions from the Article on Secured Transactions, which, among other provisions, prevents enforcement of a contract clause prohibiting assignment of a debtor's rights in collateral. Among the exemptions is "a transfer of an interest or claim in or under any policy of insurance". We propose to add the following language: "or contract for an annuity, including a variable annuity".

This will prevent an unfortunate or improvident person from losing or dissipating rights in an annuity contract which he may have spent years in accumulating against the needs of his old age.

§ *9-302.* Paragraphs (1) (c) and (1) (d) of this section require that a financing statement be filed to protect a purchase money security interest in a motor vehicle. This is inconsistent with another provision of the same section, and we propose the deletion of this requirement.

Virginia law requires a notice of lien to be placed on the certificate of title of a motor vehicle and gives adequate protection to creditors.

ARTICLE 10

EFFECTIVE DATE—TRANSITIONAL PROVISIONS

This Article fixes the effective date of the Uniform Commercial Code, provides for repeal of prior uniform acts and inconsistent statutes, and sets forth certain laws not to be affected or repealed by adoption of the Code.

APPENDIX II

UNIFORM COMMERCIAL CODE

A BILL to be known as the Uniform Commercial Code, relating to certain commercial transactions in or regarding personal property and contracts and other documents concerning them, including Sales, Commercial Paper, Bank Deposits and Collections, Letters of Credit, Bulk Transfers, Warehouse Receipts, Bills of Lading, other Documents of Title, Investment Securities, and Secured Transactions, including certain sales of accounts, chattel paper, and contract rights; providing for public notice to third parties in certain circumstances; regulating procedure, evidence and damages in certain court actions involving such transactions, contracts or documents; to make uniform the law with respect thereto; and to amend and reenact §§ 6-341, 8-13, 8-94, 8-114 as amended, 8-223, 8-517 as amended and 8-593 of the Code of Virginia, and to repeal §§ 6-63, 6-71 through 6-75; 6-353 through 6-421; 6-423 through 6-426; 6-426.1; 6-427 through 6-543; 6-543.1 through 6-543.3; 6-544 through 6-549; 6-550 through 6-558; 8-654.3, 11-5 through 11-7; 13.1-401 through 13.1-423; 43-27, 43-28, 43-44 through 43-61; 55-83 through 55-86; 55-88 through 55-94; 55-98, 55-99, 55-143 through 55-151; 56-120, 56-121, 56-126, 56-127, 61-1 through 61-52, and all amendments thereof, the sections amended and repealed relating generally to the same matters.

COMMENT

This comment and those which follow are the Comments of the National Conference of Commissioners on Uniform State Laws and the American Law Institute. Uniformity throughout American jurisdictions is one of the main objectives of this Code; and that objective cannot be obtained without substantial uniformity of construction. To aid in uniform construction these Comments set forth the purpose of various provisions of this Act to promote uniformity, to aid in viewing the Act as an integrated whole, and to safeguard against misconstruction.

This Act is a revision of the original Uniform Commercial Code promulgated in 1951 and enacted in Pennsylvania in 1953, effective July 1, 1954; and these Comments are a revision of the original comments, which were before the Pennsylvania legislature at the time of its adoption of the Code. Changes from the text enacted in Pennsylvania in 1953 are clearly legitimate legislative history, but without explanation such changes may be misleading, since frequently matters have been omitted as being implicit without statement and language has been changed or added solely for clarity. Accordingly, the changes from the original text were published, under the title "1956 Recommendations of the Editorial Board for the Uniform Commercial Code," early in 1957, with reasons, and these revised Comments were then prepared to restate the statutory purpose in the light of the revision of text.

The subsequent history leading to the 1962 Official Text with Comments is set out in detail in Report No. 1 of the Permanent Editorial Board for the Uniform Commercial Code. That Report follows the Foreword to this Edition. *(This material not included in this publication—VALC.)*

Hitherto most commercial transactions have been regulated by a number of uniform laws prepared and promulgated by the National Conference of Commissioners on Uniform State Laws. These acts, with the dates of their promulgation by the Conference, are:

Uniform Negotiable Instruments Law	1896
Uniform Warehouse Receipts Act	1906
Uniform Sales Act	1906
Uniform Bills of Lading Act	1909
Uniform Stock Transfer Act	1909
Uniform Conditional Sales Act	1918
Uniform Trust Receipts Act	1933

Two of these acts were adopted in every American State and the remaining acts have had wide acceptance. Each of them has become a segment of the statutory law relating to commercial transactions. It had been recognized for some years that these acts needed substantial revision to keep them in step with modern commercial practices and to integrate each of them with the others.

The concept of the present Act is that "commercial transactions" is a single subject of the law, notwithstanding its many facets.

A single transaction may very well involve a contract for sale, followed by a sale, the giving of a check or draft for a part of the purchase price, and the acceptance of some form of security for the balance.

The check or draft may be negotiated and will ultimately pass through one or more banks for collection.

If the goods are shipped or stored the subject matter of the sale may be covered by a bill of lading or warehouse receipt or both.

Or it may be that the entire transaction was made pursuant to a letter of credit either domestic or foreign.

Obviously, every phase of commerce involved is but a part of one transaction, namely, the sale of and payment for goods.

If, instead of goods in the ordinary sense, the transaction involved stocks or bonds, some of the phases of the transaction would obviously be different. Others would be the same. In addition, there are certain additional formalities incident to the transfer of stocks and bonds from one owner to another.

This Act purports to deal with all the phases which may ordinarily arise in the handling of a commercial transaction, from start to finish.

Because of the close relationship of each phase of a complete transaction to every other phase, it is believed that each Article of this Act is cognate to the single broad subject "Commercial Transactions", and that this Act is valid under any constitutional provision requiring an act to deal with only one subject. See, for excellent discussions of the meaning of "single subject": House v. Creveling, 147 Tenn. 589, 250 S.W. 357 (1923) and Commonwealth v. Snyder, 279 Pa. 234, 123 A. 792 (1924).

The preparation of the Act (which § 1-101 denominates the "Uniform Commercial Code") was begun as a joint project of The American Law Institute and the National Conference of Commissioners on Uniform State Laws in 1942. Various drafts were considered by joint committees of both bodies and debated by the full membership of each organization at annual meetings.

In the main, the project was made possible, financially, through a large grant by The Maurice and Laura Falk Foundation of Pittsburgh, Pennsylvania, supplemented by contributions from the Beaumont Foundation of Cleveland, Ohio, and from 98 business and financial concerns and law firms. Additional funds for final revisions and study were received from the Falk Foundation and others.

The original drafting and editorial work which led to the 1952 edition of the Code was in charge of an Editorial Board of which United States Circuit Judge Herbert F. Goodrich of Philadelphia was Chairman. The other members at various times were Professor Karl N. Llewellyn of the University of Chicago Law School, Walter D. Malcolm, Esquire, of Boston, John C. Pryor, Esquire, of Burlington, Iowa, Wm. A. Schnader, Esquire, of Philadelphia, and Harrison Tweed, Esquire, of New York City. In the final stages of work on the Code, certain questions of policy were submitted for consideration to an Enlarged Editorial Board consisting at various times of the foregoing members and Howard L. Barkdull, Esquire, of Cleveland, Joe C. Barrett, Esquire, of Jonesboro, Arkansas, Robert K. Bell, Esquire, of Ocean City, N. J., Robert P. Goldman, Esquire, of Cincinnati, Dean Albert J. Harno of the University of Illinois Law School, Ben W. Heineman, Esquire, of Chicago, Carlos Israels, Esquire, of New York City, Albert E. Jenner, Esquire, of Chicago, Arthur Littleton, Esquire, of Philadelphia, Willard B. Luther, Esquire, of Boston, Kurt F. Pantzer, Esquire, of Indianapolis, Indiana, George Richter, Jr., Esquire, of Los Angeles, R. Jasper Smith, Esquire, of Springfield, Missouri, United States Circuit Judge Sterry Waterman of St. Johnsbury, Vermont, and Charles H. Willard, Esquire, of New York City.

The Chief Reporter of the Code was Professor Llewellyn, and the Associate Chief Reporter was Professor Soia Mentschikoff. Final editorial preparation of the 1952 edition was in the hands of Professor Charles Bunn of the University of Wisconsin Law School. The Coordinators for the revisions leading to this edition were Professors Robert Braucher and A. E. Sutherland of the Law School of Harvard University, Professor Braucher doing the final editorial preparation for this edition.

The actual drafting was done in some cases by practicing lawyers and in others by teachers of various law schools. The customary procedure required that before a draft was submitted for discussion to the general memberships of The American Law Institute and of the National Conference of Commissioners, it was successively approved by three groups.

The first group were the so-called "advisers", consisting of specially selected judges, practicing lawyers and law teachers. The advisers met with the draftsmen on frequent occasions to debate and iron out, not only the substance but the form and phraseology of the proposed draft.

After the draft was cleared by the advisers, it was meticulously examined by the next two groups—the Council of The American Law Institute and either the Commercial Acts Section or the Property Acts Section of the Conference of Commissioners.

When these bodies had given their approval to the draft, it came before the general membership both of the Institute and of the Conference for consideration.

In addition in the final stages leading to this Edition each article was reviewed and discussed by a special Subcommittee for that article. Recommendations of the Subcommittee were reviewed and acted upon by the Enlarged Editorial Board, pursuant to authority from the sponsoring bodies.

The judges, practicing lawyers and law teachers who originally acted either as advisers or as draftsmen were:

Judges: John T. Loughran, of the New York Court of Appeals; Thomas W. Swan, United States Circuit Judge for the Second Circuit; and the late John D. Wickhem, of the Supreme Court of Wisconsin.

Practicing lawyers: Dana C. Backus, of New York, N. Y.; Howard L. Barkdull, of Cleveland, Ohio; Lawrence G. Bennett, of New York, N. Y.; Harold F. Birnbaum, of Los Angeles, California; William L. Eagleton, of Washington, D. C.; H. Vernon Eney, of Baltimore, Maryland; Fairfax Leary, Jr., of Philadelphia, Pennsylvania; Willard B. Luther, of Boston, Massachusetts; Walter D. Malcolm, of Boston, Massachusetts; Frederic M. Miller, of Des Moines, Iowa; Hiram Thomas, of New York, N. Y.; Sterry R. Waterman, of St. Johnsbury, Vermont; and Cornelius W. Wickersham, of New York, N. Y.

The law teachers were: Ralph J. Baker, of the Harvard Law School; William E. Britton, of the University of Illinois Law School; Charles Bunn, of the University of Wisconsin Law School; Arthur L. Corbin, of Yale University Law School; Allison Dunham, of Columbia University Law School; Grant Gilmore, of Yale University Law School; Albert J. Harno, of the University of Illinois Law School; Friedrich Kessler, of the Yale University Law School; Maurice H. Merrill, of the University of Oklahoma Law School; William L. Prosser, of the University of California School of Law; Louis B. Schwartz, of the University of Pennsylvania Law School; and Bruce Townsend, of the University of Indiana Law School.

The members of the Council of the Institute during the period when the Commercial Code was under consideration were: Dillon Anderson, of Houston, Texas; Fletcher R. Andrews, of Cleveland Heights, Ohio; the late Walter P. Armstrong of Memphis, Tennessee; Francis M. Bird, of Atlanta, Georgia; John G. Buchanan, of Pittsburgh, Pennsylvania; Charles Bunn, of Madison, Wisconsin; Howard F. Burns, of Cleveland, Ohio; Herbert W. Clark, of San Francisco, California; R. Ammi Cutter, of Boston, Massachusetts; Norris Darrell, of New York, N. Y.; the late John W. Davis, of New York, N. Y.; Edwin D. Dickinson, of Berkeley, California; Edward J. Dimock, of New York, N. Y.; Arthur Dixon, of Chicago, Illinois; Robert G. Dodge, of Boston, Massachusetts; the late George Donworth, of Seattle, Washington; Charles E. Dunbar, Jr., of New Orleans, Louisiana; William Dean Embree, of New York, N. Y.; Frederick F. Faville, of Des Moines, Iowa; James Alger Fee, of Portland, Oregon; Gerald F. Flood, of Philadelphia, Pennsylvania; H. Eastman Hackney, of Pittsburgh, Pennsylvania; the late Augustus N. Hand, of New York, N. Y.; Learned Hand, of New York, N. Y.; Albert J. Harno, of Urbana, Illinois; the late Earl G. Harrison, of Philadelphia, Pennsylvania; William V. Hodges, of New York, N. Y.; Joseph C. Hutcheson, Jr., of Houston, Texas; Laurence M. Hyde, of Jefferson City, Missouri; William J. Jameson, of Billings, Montana; Joseph F. Johnston, of Birmingham, Alabama; the late William H. Keller, of Lancaster, Pennsylvania; the late Daniel N. Kirby, of St. Louis, Missouri; Monte M. Lemann, of New Orleans, Louisiana; the late William Draper Lewis, of Philadelphia, Pennsylvania; the late Henry T. Lummus, of Swampscott, Massachusetts; William L. Marbury, of Baltimore, Maryland; Robert N. Miller, of Washington, D. C.; the late William D. Mitchell, of New York, N. Y.; John J. Parker, of Charlotte, North Carolina; Thomas I. Parkinson, of New York, N. Y.; George Wharton Pepper, of Philadelphia, Pennsylvania; Timothy N. Pfeiffer, of New York, N. Y.; Orie L. Phillips, of Denver, Colorado; Frederick D. G. Ribble, of Charlottesville, Virginia; William A. Schnader, of Philadelphia, Pennsylvania; Bernard G. Segal, of

Philadelphia, Pennsylvania; Austin W. Scott, of Cambridge, Massachusetts; the late Harry Shulman, of New Haven, Connecticut; Henry Upson Sims, of Birmingham, Alabama; the late Sydney Smith, of Jackson, Mississippi; Eugene B. Strassburger, of Pittsburgh, Pennsylvania; Thomas W. Swan, of Guilford, Connecticut; the late Thomas Day Thacher, of New York, N. Y.; Floyd E. Thompson, of Chicago, Illinois; the late Edgar Bronson Tolman, of Chicago, Illinois; the late Robert B. Tunstall, of Norfolk, Virginia; the late Arthur J. Tuttle, of Detroit, Michigan; Harrison Tweed, of New York, N. Y.; Cornelius W. Wickersham, of New York, N. Y.; the late John D. Wickhem, of Madison, Wisconsin; Raymond S. Wilkins, of Boston, Massachusetts; Charles H. Willard, of New York, N. Y.; Laurens Williams, of Washington, D. C.; Edward L. Wright, of Little Rock, Arkansas; and Charles E. Wyzanski, Jr., of Boston, Massachusetts.

The members of the Conference's Commercial Acts Section during the same period were: Howard L. Barkdull, of Cleveland, Ohio; the late William L. Beers, of New Haven, Connecticut; Charles R. Hardin, of Newark, New Jersey; Frank E. Horack, Jr., of Bloomington, Indiana; L. Barrett Jones, of Jackson, Mississippi; Karl N. Llewellyn, now of Chicago, Illinois; Willard B. Luther, of Boston, Massachusetts; William G. McLaren, of Seattle, Washington; Frederic M. Miller, of Des Moines, Iowa; William L. Prosser, of Berkeley, California; Arthur E. Sutherland, Jr., now of Cambridge, Massachusetts; O. H. Thormodsgard, of University. North Dakota; Sterry R. Waterman, of St. Johnsbury, Vermont; and Edward L. Wright, of Little Rock, Arkansas.

The members of the Conference's Property Acts Section during the period when it cooperated in the consideration of the Code were: Joe C. Barrett, of Jonesboro, Arkansas; the late William L. Beers, of New Haven, Connecticut; Boyd M. Benson, of Huron, South Dakota; George G. Bogert, now of San Francisco, California; C. Walter Cole, of Towson, Maryland; John A. Daly, of Boston, Massachusetts; William L. Eagleton, of Washington, D. C.; H. Vernon Eney, of Baltimore, Maryland; Spencer A. Gard, of Iola, Kansas; Homer B. Harris, of Lincoln, Illinois; W. J. Jameson, of Billings, Montana; the late Sherman R. Moulton, of Burlington, Vermont; J. C. Pryor, of Burlington, Iowa; the late C. M. A. Rogers, of Mobile, Alabama; Murray M. Shoemaker, of Cincinnati, Ohio; and Greenberry Simmons, of Louisville, Kentucky.

The members of the Subcommittees which considered the various articles of the Code in the work leading to the 1958 Edition were:

Article 1: Charles H. Willard, Esquire, Chairman, of New York, New York; Professor Charles Bunn of the University of Wisconsin Law School, Madison, Wisconsin; Mahlon E. Lewis, Esquire, of Pittsburgh, Pennsylvania.

Article 2: Professor Robert Braucher, Chairman, of the Law School of Harvard University, Cambridge, Massachusetts; Professor Karl N. Llewellyn, of the Law School of the University of Chicago, Chicago, Illinois; Bernard D. Broeker, Esquire, of Bethlehem, Pennsylvania; Frank T. Dierson, Esquire, of New York, New York.

Article 3: Professor A. E. Sutherland, Chairman, of the Law School of Harvard University, Cambridge, Massachusetts; William R. Emblidge, Esquire, of Buffalo, New York; John J. Clarke, Esquire, of the Federal Reserve Bank of New York, New York; James V. Vergari, Esquire, of Federal Reserve Bank of Philadelphia, Philadelphia, Pennsylvania.

Article 4: Walter D. Malcolm, Esquire, Chairman, of Boston, Massachusetts; James V. Vergari, Esquire; John J. Clarke, Esquire; Henry J. Bailey, III, Esquire, of the Federal Reserve Bank of New York, New York; Rollin C. Huggins, Esquire, Chicago, Illinois; Carl W. Funk, Esquire, of Philadelphia, Pennsylvania.

Article 5: Arthur Littleton, Esquire, Chairman, Philadelphia, Pennsylvania; Mr. Horace M. Chadsey, Vice-President of the First National Bank of Boston; Arthur F. McCarthy, Esquire, of Philadelphia, Pennsylvania; Professor Soia Mentschikoff, of the University of Chicago Law School, Chicago, Illinois. In addition, the following acted as an Advisory Committee to the Article 5 Subcommittee: Ernest A. Carlson, of the Continental Illinois National Bank and Trust Company, Chicago, Illinois; John E. Corrigan, Jr., of the First National Bank of Chicago; Guy A. Crum, of the First National Bank of Chicago; Louis F. Dempsey, of the Northern Trust Company, Chicago, Illinois; Gerard E. Keidel, of the American National Bank and Trust Company of Chicago; Robert W. Maynard, of the Harris Trust and Savings Bank, Chicago, Illinois.

Article 6: Professor Charles Bunn, Chairman; Eugene B. Strassburger, Esquire, of Pittsburgh, Pennsylvania.

Article 7: Professor Robert Braucher, Chairman; John C. Pryor, Esquire, of Burlington, Iowa.

Article 8: Carlos Israels, Esquire, Chairman, of New York, New York; Professor Soia Mentschikoff; Eliot B. Thomas, Esquire, of Philadelphia, Pennsylvania; Fred B. Lund, Esquire, of Boston, Massachusetts.

Article 9: J. Francis Ireton, Esquire, Chairman, of Baltimore, Maryland; Homer L. Kripke, Esquire, of New York, New York; Anthony G. Felix, Jr., Esquire, of Philadelphia, Pennsylvania; Peter F. Coogan, Esquire, of Boston, Massachusetts; Professor Grant Gilmore, of Yale University Law School, New Haven, Connecticut; Harold F. Birnbaum, Esquire, of Los Angeles, California; Richard R. Winters, Esquire, of Pittsburgh, Pennsylvania; Professor John Hanna, of the Law School of Columbia University, New York, New York.

In addition there were informal consultants much too numerous to mention who frequently advised those working on the Code to insure a workable set of laws. In this latter class were included practicing lawyers, hard-headed businessmen and operating bankers, who contributed generously of their time and knowledge so that, not only current business practice, but foreseeable future developments would be covered.

Committees of several Bar Associations, and in particular a committee of the Section of Corporation, Banking and Business Law of the American Bar Association, of which Mr. Walter D. Malcolm of Boston was chairman, considered the various drafts of the Code and made valuable suggestions. After final approval of the Code by the Institute and the Conference, and in accordance with the practice of the Conference, the completed Code was submitted to the American Bar Association and was approved by the House of Delegates of that Association.

ARTICLE 1

GENERAL PROVISIONS

PART 1

SHORT TITLE, CONSTRUCTION, APPLICATION AND SUBJECT MATTER OF THE ACT

§ 1-101. Short Title. This Act shall be known and may be cited as Uniform Commercial Code.

COMMENT: Each Article of the Code (except this Article and Article 10) may also be cited by its own short title. See §§ 2-101, 3-101, 4-101, 5-101, 6-101, 7-101, 8-101 and 9-101.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 1-102. Purposes; Rules of Construction; Variation by Agreement.

(1) This Act shall be liberally construed and applied to promote its underlying purposes and policies.

(2) Underlying purposes and policies of this Act are

(a) to simplify, clarify and modernize the law governing commercial transactions;

(b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties;

(c) to make uniform the law among the various jurisdictions.

(3) The effect of provisions of this Act may be varied by agreement, except as otherwise provided in this Act and except that the obligations of good faith, diligence, reasonableness and care prescribed by this Act may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.

(4) The presence in certain provisions of this Act of the words "unless otherwise agreed" or words of similar import does not imply that the effect of other provisions may not be varied by agreement under subsection (3).

(5) In this Act unless the context otherwise requires

(a) words in the singular number include the plural, and in the plural include the singular;

(b) words of the masculine gender include the feminine and the neuter, and when the sense so indicates words of the neuter gender may refer to any gender.

COMMENT: **Prior Uniform Statutory Provision:** § 74, Uniform Sales Act; § 57, Uniform Warehouse Receipts Act; § 52, Uniform Bills of Lading Act; § 19, Uniform Stock Transfer Act.

Changes: Rephrased and new material added.

Purposes of Changes: 1. Subsections (1) and (2) are intended to make it clear that:

This Act is drawn to provide flexibility so that, since it is intended to be a semi-permanent piece of legislation, it will provide its own machinery for expansion

of commercial practices. It is intended to make it possible for the law embodied in this Act to be developed by the courts in the light of unforeseen and new circumstances and practices. However, the proper construction of the Act requires that its interpretation and application be limited to its reason.

Courts have been careful to keep broad acts from being hampered in their effects by later acts of limited scope. Pacific Wool Growers v. Draper & Co., 158 Or. 1, 73 P.2d 1391 (1937), and compare § 1-104. They have recognized the policies embodied in an act as applicable in reason to subject-matter which was not expressly included in the language of the act, Commercial Nat. Bank of New Orleans v. Canal-Louisiana Bank & Trust Co., 239 U.S. 520, 36 S.Ct. 194, 60 L.Ed. 417 (1916) (bona fide purchase policy of Uniform Warehouse Receipts Act extended to case not covered but of equivalent nature). They have done the same where reason and policy so required, even where the subject-matter had been intentionally excluded from the act in general. Agar v. Orda, 264 N.Y. 248, 190 N.E. 479 (1934) (Uniform Sales Act change in seller's remedies applied to contract for sale of choses in action even though the general coverage of that Act was intentionally limited to goods "other than things in action.") They have implemented a statutory policy with liberal and useful remedies not provided in the statutory text. They have disregarded a statutory limitation of remedy where the reason of the limitation did not apply. Fiterman v. J. N. Johnson & Co., 156 Minn. 201, 194 N.W. 399 (1923) (requirement of return of the goods as a condition to rescission for breach of warranty; also, partial rescission allowed). Nothing in this Act stands in the way of the continuance of such action by the courts.

The Act should be construed in accordance with its underlying purposes and policies. The text of each section should be read in the light of the purpose and policy of the rule or principle in question, as also of the Act as a whole, and the application of the language should be construed narrowly or broadly, as the case may be, in conformity with the purposes and policies involved.

2. Subsection (3) states affirmatively at the outset that freedom of contract is a principle of the Code: "the effect" of its provisions may be varied by "agreement." The meaning of the statute itself must be found in its text, including its definitions, and in appropriate extrinsic aids; it cannot be varied by agreement. But the Code seeks to avoid the type of interference with evolutionary growth found in Manhattan Co. v. Morgan, 242 N.Y. 38, 150 N.E. 594 (1926). Thus private parties cannot make an instrument negotiable within the meaning of Article 3 except as provided in § 3-104; nor can they change the meaning of such terms as "bona fide purchaser," "holder in due course," or "due negotiation," as used in this Act. But an agreement can change the legal consequences which would otherwise flow from the provisions of the Act. "Agreement" here includes the effect given to course of dealing, usage of trade and course of performance by §§ 1-201, 1-205 and 2-208; the effect of an agreement on the rights of third parties is left to specific provisions of this Act and to supplementary principles applicable under the next section. The rights of third parties under § 9-301 when a security interest is unperfected, for example, cannot be destroyed by a clause in the security agreement.

This principle of freedom of contract is subject to specific exceptions found elsewhere in the Act and to the general exception stated here. The specific exceptions vary in explicitness: the statute of frauds found in § 2-201, for example, does not explicitly preclude oral waiver of the requirement of a writing, but a fair reading denies enforcement to such a waiver as part of the "contract" made unenforceable; § 9-501(3), on the other hand, is quite explicit. Under the exception for "the obligations of good faith, diligence, reasonableness and care prescribed by this Act," provisions of the Act prescribing such obligations are not to be disclaimed. However, the section also recognizes the prevailing practice of having agreements set forth standards by which due diligence is measured and explicitly provides that, in the absence of a showing that the standards manifestly are unreasonable, the agreement controls. In this connection, § 1-205 incorporating into the agreement prior course of dealing and usages of trade is of particular importance.

3. Subsection (4) is intended to make it clear that, as a matter of drafting, words such as "unless otherwise agreed" have been used to avoid controversy as to whether the subject matter of a particular section does or does not fall within the exceptions to subsection (3), but absence of such words contains no negative implication since under subsection (3) the general and residual rule is that the effect of all provisions of the Act may be varied by agreement.

4. Subsection (5) is modelled on 1 U.S.C. § 1 and New York General Construction Law §§ 22 and 35.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 61-3 (warehouse receipts); 13.1-420 (stock transfers); 1-13(15) and (7).

Comment: The rules of construction contained in subsection 1-102(5) relating to number and gender are consistent with the rules set forth in Code 1950, § 1-13(15) and (7).

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

COMMENT: Prior Uniform Statutory Provision: §§ 2 and 73, Uniform Sales Act; § 196, Uniform Negotiable Instruments Act; § 56, Uniform Warehouse Receipts Act; § 51, Uniform Bills of Lading Act; § 18, Uniform Stock Transfer Act.

Changes: Rephrased, the reference to "estoppel" and "validating" being new.

Purposes of Changes: 1. While this section indicates the continued applicability to commercial contracts of all supplemental bodies of law except insofar as they are explicitly displaced by this Act, the principle has been stated in more detail and the phrasing enlarged to make it clear that the "validating", as well as the "invalidating" causes referred to in the prior uniform statutory provisions, are included here. "Validating" as used here in conjunction with "invalidating" is not intended as a narrow word confined to original validation, but extends to cover any factor which at any time or in any manner renders or helps to render valid any right or transaction.

2. The general law of capacity is continued by express mention to make clear that § 2 of the old Uniform Sales Act (omitted in this Act as stating no matter not contained in the general law) is also consolidated in the present section. Hence, where a statute limits the capacity of a non-complying corporation to sue, this is equally applicable to contracts of sale to which such corporation is a party.

3. The listing given in this section is merely illustrative; no listing could be exhaustive. Nor is the fact that in some sections particular circumstances have led to express reference to other fields of law intended at any time to suggest the negation of the general application of the principles of this section.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-549 (negotiable instruments); 61-2 (warehouse receipts); 13.1-418 (stock transfers).

§ 1-104. Construction Against Implicit Repeal. This Act being a general act intended as a unified coverage of its subject matter, no part of it shall be deemed to be impliedly repealed by subsequent legislation if such construction can reasonably be avoided.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: To express the policy that no Act, which bears evidence of carefully considered permanent regulative intention should lightly be regarded as impliedly repealed by subsequent legislation. This Act, carefully integrated and intended as a uniform codification of permanent character covering an entire "field" of law, is to be regarded as particularly resistant to implied repeal. See Pacific Wool Growers v. Draper & Co., 158 Or. 1, 73 P.2d 1391 (1937).

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 1-105. Territorial Application of the Act; Parties' Power to Choose Applicable Law. (1) Except as provided hereafter in this section, when a transaction bears a reasonable relation to this State and also to another

state or nation the parties may agree that the law either of this State or of such other state or nation shall govern their rights and duties. Failing such agreement this Act applies to transactions bearing an appropriate relation to this State.

(2) Where one of the following provisions of this Act specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law (including the conflict of laws rules) so specified:

Rights of creditors against sold goods. § 2-402.

Applicability of the Article on Bank Deposits and Collections. § 4-102.

Bulk transfers subject to the Article on Bulk Transfers. § 6-102.

Applicability of the Article on Investment Securities. § 8-106.

Policy and scope of the Article on Secured Transactions. §§ 9-102 and 9-103.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. Subsection (1) states affirmatively the right of the parties to a multi-state transaction or a transaction involving foreign trade to choose their own law. That right is subject to the firm rules stated in the six sections listed in subsection (2), and is limited to jurisdictions to which the transaction bears a "reasonable relation." In general, the test of "reasonable relation" is similar to that laid down by the Supreme Court in Seeman v. Philadelphia Warehouse Co., 274 U.S. 403, 47 S.Ct. 626, 71 L. Ed. 1123 (1927). Ordinarily the law chosen must be that of a jurisdiction where a significant enough portion of the making or performance of the contract is to occur or occurs. But an agreement as to choice of law may sometimes take effect as a shorthand expression of the intent of the parties as to matters governed by their agreement, even though the transaction has no significant contact with the jurisdiction chosen.

2. Where there is no agreement as to the governing law, the Act is applicable to any transaction having an "appropriate" relation to any state which enacts it. Of course the Act applies to any transaction which takes place in its entirety in a state which has enacted the Act. But the mere fact that suit is brought in a state does not make it appropriate to apply the substantive law of that state. Cases where a relation to the enacting state is not "appropriate" include, for example, those where the parties have clearly contracted on the basis of some other law, as where the law of the place of contracting and the law of the place of contemplated performance are the same and are contrary to the law under the Code.

3. Where a transaction has significant contacts with a state which has enacted the Act and also with other jurisdictions, the question what relation is "appropriate" is left to judicial decision. In deciding that question, the court is not strictly bound by precedents established in other contexts. Thus a conflict-of-laws decision refusing to apply a purely local statute or rule of law to a particular multi-state transaction may not be valid precedent for refusal to apply the Code in an analogous situation. Application of the Code in such circumstances may be justified by its comprehensiveness, by the policy of uniformity, and by the fact that it is in large part a reformulation and restatement of the law merchant and of the understanding of a business community which transcends state and even national boundaries. Compare Global Commerce Corp. v. Clark-Babbitt Industries, Inc., 239 F.2d 716, 719 (2d Cir.1956). In particular, where a transaction is governed in large part by the Code, application of another law to some detail of performance because of an accident of geography may violate the commercial understanding of the parties.

4. The Act does not attempt to prescribe choice-of-law rules for states which do not enact it, but this section does not prevent application of the Act in a court of such a state. Common-law choice of law often rests on policies of giving effect to agreements and of uniformity of result regardless of where suit is brought. To the extent that such policies prevail, the relevant considerations are similar in such a court to those outlined above.

5. Subsection (2) spells out essential limitations on the parties' right to choose

the applicable law. Especially in Article 9 parties taking a security interest or asked to extend credit which may be subject to a security interest must have sure ways to find out whether and where to file and where to look for possible existing filings.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: The approach of the UCC is consistent with the principles expressed in Poole v. Perkins, 126 Va. 331, 101 S.E. 240, 18 A.L.R. 1509 (1919), in which effect was given to the intentions of the parties. The case was followed in In the Matter of Lincoln Industries, Inc., 166 F. Supp. 240, 243 (W.D. Va. 1958). Similarly, the UCC is consistent with R. S. Oglesby Co. v. Bank of New York, 114 Va. 663, 77 S.E. 468 (1913), holding a New York instrument, which called for payment of reasonable attorney fees, to be enforceable in Virginia according to its terms, even if such a term would not be valid in Virginia. The section is also consistent with Fourth Nat'l Bank of Montgomery, Alabama v. Bragg, 127 Va. 47, 102 S.E. 452 (1920), which applied the law of the place wbere the bank took an instrument from its customer for collection to determine whether the bank was a purchaser or an agent.

§ 1-106. Remedies to Be Liberally Administered. (1) The remedies provided by this Act shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special nor penal damages may be had except as specifically provided in this Act or by other rule of law.

(2) Any right or obligation declared by this Act is enforceable by action unless the provision declaring it specifies a different and limited effect.

COMMENT: Prior Uniform Statutory Provision: Subsection (1)—none; Subsection (2)—§ 72, Uniform Sales Act.

Changes: Reworded.

Purposes of Changes and New Matter: Subsection (1) is intended to effect three things:

1. First, to negate the unduly narrow or technical interpretation of some remedial provisions of prior legislation by providing that the remedies in this Act are to be liberally administered to the end stated in the section. Second, to make it clear that compensatory damages are limited to compensation. They do not include consequential or special damages, or penal damages; and the Act elsewhere makes it clear that damages must be minimized. Cf. §§ 1-203, 2-706(1), and 2-712(2). The third purpose of subsection (1) is to reject any doctrine that damages must be calculable with mathematical accuracy. Compensatory damages are often at best approximate: they have to be proved with whatever definiteness and accuracy the facts permit, but no more. Cf. § 2-204(3).

2. Under subsection (2) any right or obligation described in this Act is enforceable by court action, even though no remedy may be expressly provided, unless a particular provision specifies a different and limited effect. Whether specific performance or other equitable relief is available is determined not by this section but by specific provisions and by supplementary principles. Cf. §§ 1-103, 2-716.

3. "Consequential" or "special" damages and "penal" damages are not defined in terms in the Code, but are used in the sense given them by the leading cases on the subject.

Cross References:

§§ 1-103, 1-203, 2-204(3), 2-701, 2-706(1), 2-712(2) and 2-716.

Definitional Cross References:

"Action". § 1-201.
"Aggrieved party". § 1-201.
"Party". § 1-201.
"Remedy". § 1-201.
"Rights". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 1-107. **Waiver or Renunciation of Claim or Right After Breach.** Any claim or right arising out of an alleged breach can be discharged in whole or in part without consideration by a written waiver or renunciation signed and delivered by the aggrieved party.

COMMENT: Prior Uniform Statutory Provision: Compare § 1, Uniform Written Obligations Act; §§ 119(3), 120(2) and 122, Uniform Negotiable Instruments Law.

Purposes: This section makes consideration unnecessary to the effective renunciation or waiver of rights or claims arising out of an alleged breach of a commercial contract where such renunciation is in writing and signed and delivered by the aggrieved party. Its provisions, however, must be read in conjunction with the section imposing an obligation of good faith. (§ 1-203). There may, of course, also be an oral renunciation or waiver sustained by consideration but subject to Statute of Frauds provisions and to the section of Article 2 on Sales dealing with the modification of signed writings (§ 2-209). As is made express in the latter section this Act fully recognizes the effectiveness of waiver and estoppel.

Cross References:

§§ 1-203, 2-201 and 2-209. And see § 2-719.

Definitional Cross References:

"Aggrieved party". § 1-201.
"Rights". § 1-201.
"Signed". § 1-201.
"Written". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Compare Code 1950, §§ 6-472, 6-473, and 6-475.

§ 1-108. **Severability.** If any provision or clause of this Act or application thereof to any person or circumstances is held invalid, such invalidity shall not affect other provisions or applications of the Act which can be given effect without the invalid provision or application, and to this end the provisions of this Act are declared to be severable.

COMMENT: This is the model severability section recommended by the National Conference of Commissioners on Uniform State Laws for inclusion in all acts of extensive scope.

Definitional Cross Reference:

"Person". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 1-109. **Section Captions.** Section captions are parts of this Act.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: To make explicit in all jurisdictions that section captions are a part of the text of this Act and not mere surplusage.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 1-13(9).

Comment: Under Code 1950, § 1-13(9), headlines of sections in the Code of Virginia are not titles, unless expressly so provided. Since this section of the UCC does so expressly provide, the section captions of the UCC are parts of the Act.

PART 2

GENERAL DEFINITIONS AND PRINCIPLES OF INTERPRETATION

§ 1-201. **General Definitions.** Subject to additional definitions contained in the subsequent Articles of this Act which are applicable to specific Articles or Parts thereof, and unless the context otherwise requires, in this Act:

(1) "Action" in the sense of a judicial proceeding includes recoupment, counterclaim, set-off, suit in equity and any other proceedings in which rights are determined.

(2) "Aggrieved party" means a party entitled to resort to a remedy.

(3) "Agreement" means the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usuage of trade or course of performance as provided in this Act (§§ 1-205 and 2-208). Whether an agreement has legal consequences is determined by the provisions of this Act, if applicable; otherwise by the law of contracts (§ 1-103). (Compare "Contract".)

(4) "Bank" means any person engaged in the business of banking.

(5) "Bearer" means the person in possession of an instrument, document of title, or security payable to bearer or indorsed in blank.

(6) "Bill of lading" means a document evidencing the receipt of goods for shipment issued by a person engaged in the business of transporting or forwarding goods, and includes an airbill. "Airbill" means a document serving for air transportation as a bill of lading does for marine or rail transportation, and includes an air consignment note or air waybill.

(7) "Branch" includes a separately incorporated foreign branch of a bank.

(8) "Burden of establishing" a fact means the burden of persuading the triers of fact that the existence of the fact is more probable than its non-existence.

(9) "Buyer in ordinary course of business" means a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. "Buying" may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

(10) "Conspicuous": A term or clause is conspicuous when it is so written that a reasonable person against whom it is to operate ought to have noticed it. A printed heading in capitals (as: NON-NEGOTIABLE BILL OF LADING) is conspicuous. Language in the body of a form is "conspicuous" if it is in larger or other contrasting type or color. But in a telegram any stated term is "conspicuous". Whether a term or clause is "conspicuous" or not is for decision by the court.

(11) "Contract" means the total legal obligation which results from the parties' agreement as affected by this Act and any other applicable rules of law. (Compare "Agreement".)

(12) "Creditor" includes a general creditor, a secured creditor, a lien creditor and any representative of creditors, including an assignee for the benefit of creditors, a trustee in bankruptcy, a receiver in equity and an executor or administrator of an insolvent debtor's or assignor's estate.

(13) "Defendant" includes a person in the position of defendant in a cross-action or counterclaim.

(14) "Delivery" with respect to instruments, documents of title, chattel paper or securities means voluntary transfer of possession.

(15) "Document of title" includes bill of lading, dock warrant, dock receipt, warehouse receipt or order for the delivery of goods, and also any other document which in the regular course of business or financing is treated as adequately evidencing that the person in possession of it is entitled to receive, hold and dispose of the document and the goods it covers. To be a document of title a document must purport to be issued by or addressed to a bailee and purport to cover goods in the bailee's possession which are either identified or are fungible portions of an identified mass.

(16) "Fault" means wrongful act, omission or breach.

(17) "Fungible" with respect to goods or securities means goods or securities of which any unit is, by nature or usage of trade, the equivalent of any other like unit. Goods which are not fungible shall be deemed fungible for the purposes of this Act to the extent that under a particular agreement or document unlike units are treated as equivalents.

(18) "Genuine" means free of forgery or counterfeiting.

(19) "Good faith" means honesty in fact in the conduct or transaction concerned.

(20) "Holder" means a person who is in possession of a document of title or an instrument or an investment security drawn, issued or indorsed to him or to his order or to bearer or in blank.

(21) To "honor" is to pay or to accept and pay, or where a credit so engages to purchase or discount a draft complying with the terms of the credit.

(22) "Insolvency proceedings" includes any assignment for the benefit of creditors or other proceedings intended to liquidate or rehabilitate the estate of the person involved.

(23) A person is "insolvent" who either has ceased to pay his debts in the ordinary course of business or cannot pay his debts as they become due or is insolvent within the meaning of the federal bankruptcy law.

(24) "Money" means a medium of exchange authorized or adopted by a domestic or foreign government as a part of its currency.

(25) A person has "notice" of a fact when

(a) he has actual knowledge of it; or

(b) he has received a notice or notification of it; or

(c) from all the facts and circumstances known to him at the time in question he has reason to know that it exists.

A person "knows" or has "knowledge" of a fact when he has actual knowledge of it. "Discover" or "learn" or a word or phrase of similar import refers to knowledge rather than to reason to know. The time and circumstances under which a notice or notification may cease to be effective are not determined by this Act.

(26) A person "notifies" or "gives" a notice or notification to another by taking such steps as may be reasonably required to inform the other in ordinary course whether or not such other actually comes to know of it. A person "receives" a notice or notification when

(a) it comes to his attention; or

(b) it is duly delivered at the place of business through which the contract was made or at any other place held out by him as the place for receipt of such communications.

(27) Notice, knowledge or a notice or notification received by an organization is effective for a particular transaction from the time when it is brought to the attention of the individual conducting that transaction, and in any event from the time when it would have been brought to his attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information.

(28) "Organization" includes a corporation, government or governmental subdivision or agency, business trust, estate, trust, partnership or association, two or more persons having a joint or common interest, or any other legal or commercial entity.

(29) "Party", as distinct from "third party", means a person who has engaged in a transaction or made an agreement within this Act.

(30) "Person" includes an individual or an organization (See § 1-102).

(31) "Presumption" or "presumed" means that the trier of fact must find the existence of the fact presumed unless and until evidence is introduced which would support a finding of its non-existence.

(32) "Purchase" includes taking by sale, discount, negotiation, mortgage, pledge, lien, issue or re-issue, gift or any other voluntary transaction creating an interest in property.

(33) "Purchaser" means a person who takes by purchase.

(34) "Remedy" means any remedial right to which an aggrieved party is entitled with or without resort to a tribunal.

(35) "Representative" includes an agent, an officer of a corporation or association, and a trustee, executor or administrator of an estate, or any other person empowered to act for another.

(36) "Rights" includes remedies.

(37) "Security interest" means an interest in personal property or fixtures which secures payment or performance of an obligation. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (§ 2-401) is limited in effect to a reservation of a "security interest". The term also includes any interest of a buyer of accounts, chattel paper, or contract rights which is subject to Article 9. The special property interest of a buyer of goods on identification of such goods to a contract for sale under § 2-401 is not a "security interest", but a buyer may also acquire a "security interest" by complying with Article 9. Unless a lease or consignment is intended as security, reservation of title thereunder is not a "security interest" but a consignment is in any event sub-

ject to the provisions on consignment sales (§ 2-326). Whether a lease is intended as security is to be determined by the facts of each case; however, (a) the inclusion of an option to purchase does not of itself make the lease one intended for security, and (b) an agreement that upon compliance with the terms of the lease the lessee shall become or has the option to become the owner of the property for no additional consideration or for a nominal consideration does make the lease one intended for security.

(38) "Send" in connection with any writing or notice means to deposit in the mail or deliver for transmission by any other usual means of communication with postage or cost of transmission provided for and properly addressed and in the case of an instrument to an address specified thereon or otherwise agreed, or if there be none to any address reasonable under the circumstances. The receipt of any writing or notice within the time at which it would have arrived if properly sent has the effect of a proper sending.

(39) "Signed" includes any symbol executed or adopted by a party with present intention to authenticate a writing.

(40) "Surety" includes guarantor.

(41) "Telegram" includes a message transmitted by radio, teletype, cable, any mechanical method of transmission, or the like.

(42) "Term" means that portion of an agreement which relates to a particular matter.

(43) "Unauthorized" signature or indorsement means one made without actual, implied or apparent authority and includes a forgery.

(44) "Value". Except as otherwise provided with respect to negotiable instruments and bank collections (§§ 3-303, 4-208 and 4-209) a person gives "value" for rights if he acquires them

(a) in return for a binding commitment to extend credit or for the extension of immediately available credit whether or not drawn upon and whether or not a charge-back is provided for in the event of difficulties in collection; or

(b) as security for or in total or partial satisfaction of a pre-existing claim; or

(c) by accepting delivery pursuant to a pre-existing contract for purchase; or

(d) generally, in return for any consideration sufficient to support a simple contract.

(45) "Warehouse receipt" means a receipt issued by a person engaged in the business of storing goods for hire.

(46) "Written" or "writing" includes printing, typewriting or any other intentional reduction to tangible form.

COMMENT: Prior Uniform Statutory Provision, Changes and New Matter:
1. "Action". See similar definitions in § 191, Uniform Negotiable Instruments Law; § 76, Uniform Sales Act; § 58, Uniform Warehouse Receipts Act; § 53, Uniform Bills of Lading Act. The definition has been rephrased and enlarged.

2. "Aggrieved party". New.

3. "Agreement". New. As used in this Act the word is intended to include full recognition of usage of trade, course of dealing, course of performance and the surrounding circumstances as effective parts thereof, and of any agreement permitted under the provisions of this Act to displace a stated rule of law.

4. "Bank". See § 191, Uniform Negotiable Instruments Law.

5. "Bearer". From § 191, Uniform Negotiable Instruments Law. The prior definition has been broadened.

6. "Bill of Lading". See similar definitions in § 1, Uniform Bills of Lading Act. The definition has been enlarged to include freight forwarders' bills and bills issued by contract carriers as well as those issued by common carriers. The definition of airbill is new.

7. "Branch". New.

8. "Burden of establishing a fact". New.

9. "Buyer in ordinary course of business". From § 1, Uniform Trusts Receipts Act. The definition has been expanded to make clear the type of person protected. Its major significance lies in § 2-403 and in the Article on Secured Transactions (Article 9).

10. "Conspicuous". New. This is intended to indicate some of the methods of making a term attention-calling. But the test is whether attention can reasonably be expected to be called to it.

11. "Contract". New. But see §§ 3 and 71, Uniform Sales Act.

12. "Creditor". New.

13. "Defendant". From § 76, Uniform Sales Act. Rephrased.

14. "Delivery". § 76, Uniform Sales Act, § 191, Uniform Negotiable Instruments Law, § 58, Uniform Warehouse Receipts Act and § 53, Uniform Bills of Lading Act.

15. "Document of title". From § 76, Uniform Sales Act, but rephrased to eliminate certain ambiguities. Thus, by making it explicit that the obligation or designation of a third party as "bailee" is essential to a document of title, this definition clearly rejects any such result as obtained in Hixson v. Ward, 254 Ill. App. 505 (1929), which treated a conditional sales contract as a document of title. Also the definition is left open so that new types of documents may be included. It is unforeseeable what documents may one day serve the essential purpose now filled by warehouse receipts and bills of lading. Truck transport has already opened up problems which do not fit the patterns of practice resting upon the assumption that a draft can move through banking channels faster than the goods themselves can reach their destination. There lie ahead air transport and such probabilities as teletype transmission of what may some day be regarded commercially as "Documents of Title". The definition is stated in terms of the function of the documents with the intention that any document which gains commercial recognition as accomplishing the desired result shall be included within its scope. Fungible goods are adequately identified within the language of the definition by identification of the mass of which they are a part.

Dock warrants were within the Sales Act definition of document of title apparently for the purpose of recognizing a valid tender by means of such paper. In current commercial practice a dock warrant or receipt is a kind of interim certificate issued by steamship companies upon delivery of the goods at the dock, entitling a designated person to have issued to him at the company's office a bill of lading. The receipt itself is invariably nonnegotiable in form although it may indicate that a negotiable bill is to be forthcoming. Such a document is not within the general compass of the definition, although trade usage may in some cases entitle such paper to be treated as a document of title. If the dock receipt actually represents a storage obligation undertaken by the shipping company, then it is a warehouse receipt within this Section regardless of the name given to the instrument.

The goods must be "described", but the description may be by marks or labels and may be qualified in such a way as to disclaim personal knowledge of the issuer regarding contents or condition. However, baggage and parcel checks and similar "tokens" of storage which identify stored goods only as those received in exchange for the token are not covered by this Article.

The definition is broad enough to include an airway bill.

16. "Fault". From § 76, Uniform Sales Act.

17. "Fungible". See §§ 5, 6 and 76, Uniform Sales Act; § 58, Uniform Warehouse Receipts Act. Fungibility of goods "by agreement" has been added for clarity and accuracy. As to securities, see § 8-107 and Comment.

18. "Genuine". New.

19. "Good faith". See § 76(2), Uniform Sales Act; § 58(2), Uniform Warehouse Receipts Act; § 53(2), Uniform Bills of Lading Act; § 22(2), Uniform Stock Transfer Act. "Good faith" whenever it is used in the Code, means at least what is here stated. In certain Articles, by specific provision, additional requirements are made applicable. See, e. g., §§ 2-103(1)(b), 7-404. To illustrate, in the Article on Sales, § 2-103, good faith is expressly defined as including in the case of a merchant observance of reasonable commercial standards of fair dealing in the trade, so that throughout that Article wherever a merchant appears in the case an inquiry into his observance of such standards is necessary to determine his good faith.

20. "Holder". See similar definitions in § 191, Uniform Negotiable Instruments Law; § 58, Uniform Warehouse Receipts Act; § 53, Uniform Bills of Lading Act.

21. "Honor". New.

22. "Insolvency proceedings". New.

23. "Insolvent". § 76(3), Uniform Sales Act. The three tests of insolvency—"ceased to pay his debts in the ordinary course of business," "cannot pay his debts as they become due," and "insolvent within the meaning of the federal bankruptcy law"—are expressly set up as alternative tests and must be approached from a commercial standpoint.

24. "Money". § 6(5), Uniform Negotiable Instruments Law. The test adopted is that of sanction of government, whether by authorization before issue or adoption afterward, which recognizes the circulating medium as a part of the official currency of that government. The narrow view that money is limited to legal tender is rejected.

25. "Notice". New. Compare N.I.L. § 56. Under the definition a person has notice when he has received a notification of the fact in question. But by the last sentence the act leaves open the time and circumstances under which notice or notification may cease to be effective. Therefore such cases as Graham v. White-Phillips Co., 296 U.S. 27, 56 S.Ct. 21, 80 L.Ed. 20 (1935), are not overruled.

26. "Notifies". New. This is the word used when the essential fact is the proper dispatch of the notice, not its receipt. Compare "Send". When the essential fact is the other party's receipt of the notice, that is stated. The second sentence states when a notification is received.

27. New. This makes clear that reason to know, knowledge, or a notification, although "received" for instance by a clerk in Department A of an organization, is effective for a transaction conducted in Department B only from the time when it was or should have been communicated to the individual conducting that transaction.

28. "Organization". This is the definition of every type of entity or association, excluding an individual, acting as such. Definitions of "person" were included in § 191, Uniform Negotiable Instruments Law; § 76, Uniform Sales Act; § 58, Uniform Warehouse Receipts Act; § 53, Uniform Bills of Lading Act; § 22, Uniform Stock Transfer Act; § 1, Uniform Trust Receipts Act. The definition of "organization" given here includes a number of entities or associations not specifically mentioned in prior definition of "person", namely, government, governmental subdivision or agency, business trust, trust and estate.

29. "Party". New. Mention of a party includes, of course, a person acting through an agent. However, where an agent comes into opposition or contrast to his principal, particular account is taken of that situation.

30. "Person". See Comment to definition of "Organization". The reference to § 1-102 is to subsection (5) of that section.

31. "Presumption". New.

32. "Purchase". § 58, Uniform Warehouse Receipts Act; § 76, Uniform Sales Act; § 53, Uniform Bills of Lading Act; § 22, Uniform Stock Transfer Act; § 1, Uniform Trust Receipts Act. Rephrased.

33. "Purchaser". § 58, Uniform Warehouse Receipts Act; § 76, Uniform Sales Act; § 53, Uniform Bills of Lading Act; § 22, Uniform Stock Transfer Act; § 1, Uniform Trust Receipts Act. Rephrased.

34. "Remedy". New. The purpose is to make it clear that both remedy and rights (as defined) include those remedial rights of "self help" which are among the most important bodies of rights under this Act, remedial rights being those to which an aggrieved party can resort on his own motion.

35. "Representative". New.

36. "Rights". New. See Comment to "Remedy".

37. "Security Interest". See § 1, Uniform Trust Receipts Act. The present definition is elaborated, in view especially of the complete coverage of the subject in Article 9. Notice that in view of the Article the term includes the interest of certain outright buyers of certain kinds of property. The last two sentences give guidance on the question whether reservation of title under a particular lease of personal property is or is not a security interest.

38. "Send". New. Compare "notifies".

39. "Signed". New. The inclusion of authentication in the definition of "signed" is to make clear that as the term is used in this Act a complete signature is not necessary. Authentication may be printed, stamped or written; it may be by initials or by thumbprint. It may be on any part of the document and in appropriate cases may be found in a billhead or letterhead. No catalog of possible authentications can be complete and the court must use common sense and commercial experience in passing upon these matters. The question always is whether the symbol was executed or adopted by the party with present intention to authenticate the writing.

40. "Surety". New.

41. "Telegram". New.

42. "Term". New.

43. "Unauthorized". New.

44. "Value". See §§ 25, 26, 27, 191, Uniform Negotiable Instruments Law; § 76, Uniform Sales Act; § 53, Uniform Bills of Lading Act; § 58, Uniform Warehouse Receipts Act; § 22(1), Uniform Stock Transfer Act; § 1, Uniform Trust Receipts Act. All the Uniform Acts in the commercial law field (except the Uniform Condition Sales Act) have carried definitions of "value". All those definitions provided that value was any consideration sufficient to support a simple contract, including the taking of property in satisfaction of or as security for a pre-existing claim. Subsections (a), (b) and (d) in substance continue the definitions of "value" in the earlier acts. Subsection (c) makes explicit that "value" is also given in a third situation: where a buyer by taking delivery under a pre-existing contract converts a contingent into a fixed obligation.

This definition is not applicable to Articles 3 and 4, but the express inclusion of immediately available credit as value follows the separate definitions in those Articles. See §§ 4-208, 4-209, 3-303. A bank or other financing agency which in good faith makes advances against property held as collateral becomes a bona fide purchaser of that property even though provision may be made for charge-back in case of trouble. Checking credit is "immediately available" within the meaning of this section if the bank would be subject to an action for slander of credit in case checks drawn against the credit were dishonored, and when a charge-back is not discretionary with the bank, but may only be made when difficulties in collection arise in connection with the specific transaction involved.

45. "Warehouse receipt". See § 76(1), Uniform Sales Act; § 1, Uniform Warehouse Receipts Act. Receipts issued by a field warehouse are included, provided the warehouseman and the depositor of the goods are different persons.

46. "Written" or "writing". This is a broadening of the definition contained in § 191 of the Uniform Negotiable Instruments Law.

VIRGINIA ANNOTATIONS

Prior Statutes and Comment:

Action. See Code 1950, §§ 6-544 (negotiable instruments); 61-1 (warehouse receipts).

Bank. See Code 1950, § 6-544 (negotiable instruments). The definition of "bank" in Code 1950, § 6-6, is limited to Chapter 2.

Bearer. See Code 1950, § 6-544 (negotiable instruments).

Buyer. See Code 1950, § 6-550 (trust receipts).

Creditor. See Code 1950, § 55-103, providing how the word "creditor" is to be construed. Under Virginia law an assignee for the benefit of creditors has been considered a purchaser. National Cash Register Co. v. Burrow, 110 Va. 785, 786, 67 S.E. 370 (1910); Corbett v. Riddle, 209 Fed. 811, 815 (4th Cir. 1913). Under Virginia law a trustee in a deed of trust to secure creditors has been considered a purchaser. Arbuckle v. Gates, 95 Va. 802, 812, 30 S.E. 496 (1898); Janney v. Bell, 111 F.2d 103, 105 (4th Cir. 1940). The UCC changes Virginia law by defining such parties as creditors.

Delivery. See Code 1950, §§ 6-544 (negotiable instruments); 61-1 (warehouse receipts).

Fungible. See Code 1950, § 61-1 (warehouse receipts).

Good Faith. See Code 1950, §§ 61-1 (warehouse receipts); 13.1-422 (stock transfers). The test of good faith is discussed in Stevens v. Clintwood Drug Co., 155 Va. 353, 154 S.E. 515 (1930), which found that a makeshift arrangement entered into between the payee and the holder for the purpose of overriding the defenses of the maker did not satisfy the test of a good faith purchase for value of a negotiable instrument, especially where the arrangement provided that the payee would reimburse the holder for any losses incurred in endeavors to collect the notes. See also discussion in VIRGINIA ANNOTATIONS to UCC 3-304.

Holder. See Code 1950, §§ 6-544 (negotiable instruments); 61-1 (warehouse receipts).

Money. See Code 1950, § 6-358 (negotiable instruments). See also Code 1950, § 6-339, for definition of money of account.

Notice. See Code 1950, § 6-408 (negotiable instruments).

Party. For a comment on the definition of "party" as applied to Wilson v. Stowers, 161 Va. 418, 170 S.E. 745 (1933), see VIRGINIA ANNOTATIONS to UCC 3-415.

Person. See Code 1950, §§ 6-544 (negotiable instruments); 61-1 (warehouse receipts); 13.1-422 (stock transfers); 6-550 (trust receipts). See also Code 1950, § 1-13(19) for a rule of construction.

Presumption. For a comment on the presumption of nonpayment see discussion of Schmitt v. Redd, 151 Va. 333, 338-44, 143 S.E. 884 (1928), in VIRGINIA ANNOTATIONS to UCC 3-602 and 3-307.

Purchase. See Code 1950, §§ 61-1 (warehouse receipts); 13.1-422 (stock transfers); 6-550 (trust receipts). It is doubtful if the transaction in Philip Greenberg, Inc. v. Dunville, 166 Va. 398, 402-03, 185 S.E. 892 (1936), would constitute a purchase under this definition. See discussion in VIRGINIA ANNOTATIONS to UCC 2-403.

Purchaser. See Code 1950, §§ 61-1 (warehouse receipts); 13.1-422 (stock transfers); 6-550 (trust receipts). Code 1950, § 55-103, contains a statement as to how the word "purchaser" is to be construed. Under Virginia law assignees for the benefit of creditors have been defined as purchasers. National Cash Register Co. v. Burrow, 110 Va. 785, 786, 67 S.E. 370 (1910); Corbett v. Riddle, 209 Fed. 811, 815 (4th Cir. 1913). Under Virginia law trustees in deeds of trust to secure creditors have been defined as purchasers. Arbuckle v. Gates, 95 Va. 802, 812, 30 S.E. 496 (1898); Janney v. Bell, 111 F.2d 103, 105 (4th Cir. 1940). The UCC changes Virginia law by defining these parties as creditors.

Security Interest. See Code 1950, § 6-550 (trust receipts). This definition is in accord with Southern Dairies, Inc. v. Cooper, 35 F.2d 439, 440 (4th Cir. 1929), in taking the view that whether a lease is intended as a security is to be determined by the facts of each case. This case found that the lease was not intended to create a security interest.

Value. See Code 1950, §§ 6-337 - 379, 6-544 (negotiable instruments); 61-1 (warehouse receipts); 13.1-422 (stock transfers); 6-550 (trust receipts).

Warehouse Receipt. See Code 1950, § 6-550 (warehouse receipts).

Written or Writing. See Code 1950, § 6-544 (negotiable instruments).

§ 1-202. **Prima Facie Evidence by Third Party Documents.** A document in due form purporting to a bill of lading, policy or certificate of insurance, official weigher's or inspector's certificate, consular invoice, or any other document authorized or required by the contract to be issued by a third party shall be prima facie evidence of its own authenticity and genuineness and of the facts stated in the document by the third party.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. This section is designed to supply judicial recognition for documents which have traditionally been relied upon as trustworthy by commercial men.

2. This section is concerned only with documents which have been given a preferred status by the parties themselves who have required their procurement in the agreement and for this reason the applicability of the section is limited to actions arising out of the contract which authorized or required the document. The documents listed are intended to be illustrative and not all inclusive.

3. The provisions of this section go no further than establishing the documents in question as prima facie evidence and leave to the court the ultimate determination of the facts where the accuracy or authenticity of the documents is questioned. In this connection the section calls for a commercially reasonable interpretation.

Definitional Cross References:

"Bill of lading". § 1-201.
"Contract". § 1-201.
"Genuine". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 1-203. **Obligation of Good Faith.** Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: This section sets forth a basic principle running throughout this Act. The principle involved is that in commercial transactions good faith is required in the performance and enforcement of all agreements or duties. Particular applications of this general principle appear in specific provisions of the Act such as the option to accelerate at will (§ 1-208), the right to cure a defective delivery of goods (§ 2-508), the duty of a merchant buyer who has rejected goods to effect salvage operations (§ 2-603), substituted performance (§ 2-614), and failure of presupposed conditions (§ 2-615). This concept, however, is broader than any of these illustrations and applies generally, as stated in this section, to the performance or enforcement of every contract or duty within this Act. It is further implemented by § 1-205 on course of dealing and usage of trade.

It is to be noted that under the Sales Article definition of good faith (§ 2-103), contracts made by a merchant have incorporated in them the explicit standard not only of honesty in fact (§ 1-201), but also of observance by the merchant of reasonable commercial standards of fair dealing in the trade.

Cross References:

§§ 1-201; 1-205; 1-208; 2-103; 2-508; 2-603; 2-614; 2-615.

Definitional Cross References:

"Contract". § 1-201.
"Good faith". §§ 1-201; 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Under Virginia law the buyer under a contract on approval must act in good faith in determining whether he approves or disapproves of the goods. Virginia-Carolina Chemical Co. v. Carpenter & Co., 99 Va. 292, 38 S.E. 143

(1901); Carpenter & Co. v. Virginia-Carolina Chemical Co., 98 Va. 117, 35 S.E. 358 (1900). This section may continue the rule of these cases, which is not otherwise expressly covered in the UCC. See VIRGINIA ANNOTATIONS to UCC 2-327.

Under Virginia law the buyer must act in good faith in order to obtain a good title to goods. Peshine v. Shepperson, 58 Va. (17 Gratt.) 472 (1867). See VIRGINIA ANNOTATIONS to UCC 2-103 and 2-403.

§ 1-204. **Time; Reasonable Time; "Seasonably".** (1) Whenever this Act requires any action to be taken within a reasonable time, any time which is not manifestly unreasonable may be fixed by agreement.

(2) What is a reasonable time for taking any action depends on the nature, purpose and circumstances of such action.

(3) An action is taken "seasonably" when it is taken at or within the time agreed or if no time is agreed at or within a reasonable time.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. Subsection (1) recognizes that nothing is stronger evidence of a reasonable time than the fixing of such time by a fair agreement between the parties. However, provision is made for disregarding a clause which whether by inadvertence or overreaching fixes a time so unreasonable that it amounts to eliminating all remedy under the contract. The parties are not required to fix the most reasonable time but may fix any time which is not obviously unfair as judged by the time of contracting.

2. Under the section, the agreement which fixes the time need not be part of the main agreement, but may occur separately. Notice also that under the definition of "agreement" (§ 1-201) the circumstances of the transaction, including course of dealing or usages of trade or course of performance may be material. On the question what is a reasonable time these matters will often be important.

Definitional Cross Reference:

"Agreement". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 1-205. **Course of Dealing and Usage of Trade.** (1) A course of dealing is a sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct.

(2) A usage of trade is any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such a usage are to be proved as facts. If it is established that such a usage is embodied in a written trade code or similar writing the interpretation of the writing is for the court.

(3) A course of dealing between parties and any usage of trade in the vocation or trade in which they are engaged or of which they are or should be aware give particular meaning to and supplement or qualify terms of an agreement.

(4) The express terms of an agreement and an applicable course of dealing or usage of trade shall be construed wherever reasonable as consistent with each other; but when such construction is unreasonable express terms control both course of dealing and usage of trade and course of dealing controls usage of trade.

(5) An applicable usage of trade in the place where any part of per-

formance is to occur shall be used in interpreting the agreement as to that part of the performance.

(6) Evidence of a relevant usage of trade offered by one party is not admissible unless and until he has given the other party such notice as the court finds sufficient to prevent unfair surprise to the latter.

COMMENT: **Prior Uniform Statutory Provision:** No such general provision but see §§ 9(1), 15(5), 18(2), and 71, Uniform Sales Act.

Purposes: This section makes it clear that:

This Act rejects both the "lay-dictionary" and the "conveyancer's" reading of a commercial agreement. Instead the meaning of the agreement of the parties is to be determined by the language used by them and by their action, read and interpreted in the light of commercial practices and other surrounding circumstances. The measure and background for interpretation are set by the commercial context which may explain and supplement even the language of a formal or final writing.

2. Course of dealing under subsection (1) is restricted, literally, to a sequence of conduct between the parties previous to the agreement. However, the provisions of the Act on course of performance make it clear that a sequence of conduct after or under the agreement may have equivalent meaning. (§ 2-208.)

3. "Course of dealing" may enter the agreement either by explicit provisions of the agreement or by tacit recognition.

4. This Act deals with "usage of trade" as a factor in reaching the commercial meaning of the agreement which the parties have made. The language used is to be interpreted as meaning what it may fairly be expected to mean to parties involved in the particular commercial transaction in a given locality or in a given vocation or trade. By adopting in this context the term "usage of trade" this Act expresses its intent to reject those cases which see evidence of "custom" as representing an effort to displace or negate "established rules of law". A distinction is to be drawn between mandatory rules of law such as the Statute of Frauds provisions of Article 2 on Sales whose very office is to control and restrict the actions of the parties, and which cannot be abrogated by agreement, or by a usage of trade, and those rules of law (such as those in Part 3 of Article 2 on Sales) which fill in points which the parties have not considered and in fact agreed upon. The latter rules hold "unless otherwise agreed" but yield to the contrary agreement of the parties. Part of the agreement of the parties to which such rules yield is to be sought for in the usages of trade which furnish the background and give particular meaning to the language used, and are the framework of common understanding controlling any general rules of law which hold only when there is no such understanding.

5. A usage of trade under subsection (2) must have the "regularity of observance" specified. The ancient English tests for "custom" are abandoned in this connection. Therefore, it is not required that a usage of trade be "ancient or immemorial", "universal" or the like. Under the requirement of subsection (2) full recognition is thus available for new usages and for usages currently observed by the great majority of decent dealers, even though dissidents ready to cut corners do not agree. There is room also for proper recognition of usage agreed upon by merchants in trade codes.

6. The policy of this Act controlling explicit unconscionable contracts and clauses (§§ 1-203, 2-302) applies to implicit clauses which rest on usage of trade and carries forward the policy underlying the ancient requirement that a custom or usage must be "reasonable". However, the emphasis is shifted. The very fact of commercial acceptance makes out a prima facie case that the usage is reasonable, and the burden is no longer on the usage to establish itself as being reasonable. But the anciently established policing of usage by the courts is continued to the extent necessary to cope with the situation arising if an unconscionable or dishonest practice should become standard.

7. Subsection (3), giving the prescribed effect to usages of which the parties "are or should be aware", reinforces the provision of subsection (2) requiring not universality but only the described "regularity of observance" of the practice or method. This subsection also reinforces the point of subsection (2) that such usages may be either general to trade or particular to a special branch of trade.

8. Although the terms in which this Act defines "agreement" include the elements of course of dealing and usage of trade, the fact that express reference is made in some sections to those elements is not to be construed as carrying a contrary intent or implication elsewhere. Compare § 1-102(4).

9. In cases of a well established line of usage varying from the general rules of this Act where the precise amount of the variation has not been worked out into a single standard, the party relying on the usage is entitled, in any event, to the minimum variation demonstrated. The whole is not to be disregarded because no particular line of detail has been established. In case a dominant pattern has been fairly evidenced, the party relying on the usage is entitled under this section to go to the trier of fact on the question of whether such dominant pattern has been incorporated into the agreement.

10. Subsection (6) is intended to insure that this Act's liberal recognition of the needs of commerce in regard to usage of trade shall not be made into an instrument of abuse.

Cross References:

Point 1: §§ 1-203, 2-104 and 2-202.
Point 2: § 2-208.
Point 4: § 2-201 and Part 3 of Article 2.
Point 6: §§ 1-203 and 2-302.
Point 8: §§ 1-102 and 1-201.
Point 9: § 2-204(3).

Definitional Cross References:

"Agreement". § 1-201.
"Contract". § 1-201.
"Party". § 1-201.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: This section is in accord with Virginia law as to what constitutes a course of dealing binding on the parties. Arkla Lumber and Manufacturing Co. v. West Virginia Timber Co., 146 Va. 641, 649-52, 132 S.E. 840 (1926); Walker v. Gateway Milling Co., 121 Va. 217, 221-25, 92 S.E. 826 (1917); Ragland & Co. v. Butler, 59 Va. (18 Gratt.) 323, 335-36 (1868). See also VIRGINIA ANNOTATIONS to UCC 2-208.

§ 1-206. Statute of Frauds for Kinds of Personal Property Not Otherwise Covered. (1) Except in the cases described in subsection (2) of this section a contract for the sale of personal property is not enforceable by way of action or defense beyond five thousand dollars in amount or value of remedy unless there is some writing which indicates that a contract for sale has been made between the parties at a defined or stated price, reasonably identifies the subject matter, and is signed by the party against whom enforcement is sought or by his authorized agent.

(2) Subsection (1) of this section does not apply to contracts for the sale of goods (§ 2-201) nor of securities (§ 8-319) nor to security agreements (§ 9-203).

COMMENT: **Prior Uniform Statutory Provision:** § 4, Uniform Sales Act (which was based on § 17 of the Statute of 29 Charles II).

Changes: Completely rewritten by this and other sections.

Purposes: To fill the gap left by the Statute of Frauds provisions for goods (§ 2-201), securities (§ 8-319), and security interests (§ 9-203). The Uniform Sales Act covered the sale of "choses in action"; the principal gap relates to sale of the "general intangibles" defined in Article 9 (§ 9-106) and to transactions excluded from Article 9 by § 9-104. Typical are the sale of bilateral contracts, royalty

rights or the like. The informality normal to such transactions is recognized by lifting the limit for oral transactions to $5,000. In such transactions there is often no standard of practice by which to judge, and values can rise or drop without warning; troubling abuses are avoided when the dollar limit is exceeded by requiring that the subject-matter be reasonably identified in a signed writing which indicates that a contract for sale has been made at a defined or stated price.

Definitional Cross References:

"Action". § 1-201.
"Agreement". § 1-201.
"Contract". § 1-201.
"Contract for sale". § 2-106.
"Goods". § 2-105.
"Party". § 1-201.
"Sale". § 2-106.
"Signed". § 1-201.
"Writing". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: This section changes Virginia law by imposing a statute of frauds on contracts for the sale of personal property.

§ 1-207. **Performance or Acceptance Under Reservation of Rights.** A party who with explicit reservation of rights performs or promises performance or assents to performance in a manner demanded or offered by the other party does not thereby prejudice the rights reserved. Such words as "without prejudice", "under protest" or the like are sufficient.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. This section provides machinery for the continuation of performance along the lines contemplated by the contract despite a pending dispute, by adopting the mercantile device of going ahead with delivery, acceptance, or payment "without prejudice," "under protest," "under reserve," "with reservation of all our rights," and the like. All of these phrases completely reserve all rights within the meaning of this section. The section therefore contemplates that limited as well as general reservations and acceptance by a party may be made "subject to satisfaction of our purchaser," "subject to acceptance by our customers," or the like.

2. This section does not add any new requirement of language of reservation where not already required by law, but merely provides a specific measure on which a party can rely as he makes or concurs in any interim adjustment in the course of performance. It does not affect or impair the provisions of this Act such as those under which the buyer's remedies for defect survive acceptance without being expressly claimed if notice of the defects is given within a reasonable time. Nor does it disturb the policy of those cases which restrict the effect of a waiver of a defect to reasonable limits under the circumstances, even though no such reservation is expressed.

The section is not addressed to the creation or loss of remedies in the ordinary course of performance but rather to a method of procedure where one party is claiming as of right something which the other feels to be unwarranted.

Cross Reference:

§ 2-607.

Definitional Cross References:

"Party". § 1-201.
"Rights". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 1-208. Option to Accelerate at Will. A term providing that one party or his successor in interest may accelerate payment or performance or require collateral or additional collateral "at will" or "when he deems himself insecure" or in words of similar import shall be construed to mean that he shall have power to do so only if he in good faith believes that the prospect of payment or performance is impaired. The burden of establishing lack of good faith is on the party against whom the power has been exercised.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: The increased use of acceleration clauses either in the case of sales on credit or in time paper or in security transactions has led to some confusion in the cases as to the effect to be given to a clause which seemingly grants the power of an acceleration at the whim and caprice of one party. This Section is intended to make clear that despite language which can be so construed and which further might be held to make the agreement void as against public policy or to make the contract illusory or too indefinite for enforcement, the clause means that the option is to be exercised only in the good faith belief that the prospect of payment or performance is impaired.

Obviously this section has no application to demand instruments or obligations whose very nature permits call at any time with or without reason. This section applies only to an agreement or to paper which in the first instance is payable at a future date.

Definitional Cross References:

"Burden of establishing". § 1-201.
"Good faith". § 1-201.
"Party". § 1-201.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

SALES

PART 1

SHORT TITLE, GENERAL CONSTRUCTION AND SUBJECT MATTER

§ 2-101. Short Title. This Article shall be known and may be cited as Uniform Commercial Code—Sales.

COMMENT: This Article is a complete revision and modernization of the Uniform Sales Act which was promulgated by the National Conference of Commissioners on Uniform State Laws in 1906 and has been adopted in 34 states and Alaska, the District of Columbia and Hawaii.

The coverage of the present Article is much more extensive than that of the old Sales Act and extends to the various bodies of case law which have been developed both outside of and under the latter.

The arrangement of the present Article is in terms of contract for sale and the various steps of its performance. The legal consequences are stated as following directly from the contract and action taken under it without resorting to the idea of when property or title passed or was to pass as being the determining factor. The purpose is to avoid making practical issues between practical men turn upon the location of an intangible something, the passing of which no man can prove by evidence and to substitute for such abstractions proof of words and actions of a tangible character.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Since Virginia never adopted the Uniform Sales Act, there is no comprehensive statutory treatment of the law of sales, which would be replaced by this Article. At the most, there are about ten statutory sections and rules of court in Virginia that are related to this Article.

Virginia sales law is to be found in some 214 sales cases decided by the Supreme Court of Appeals between 1799 and the present. Article 2 provides systematization of this case law. The UCC makes only a few changes in sales law as it has been generally understood in Virginia.

§ 2-102. Scope; Certain Security and Other Transactions Excluded From This Article. Unless the context otherwise requires, this Article applies to transactions in goods; it does not apply to any transaction which although in the form of an unconditional contract to sell or present sale is intended to operate only as a security transaction nor does this Article impair or repeal any statute regulating sales to consumers, farmers or other specified classes of buyers.

COMMENT: **Prior Uniform Statutory Provision:** § 75, Uniform Sales Act.

Changes: § 75 has been rephrased.

Purposes of Changes and New Matter: To make it clear that:

The Article leaves substantially unaffected the law relating to purchase money security such as conditional sale or chattel mortgage though it regulates the general sales aspects of such transactions. "Security transaction" is used in the same sense as in the Article on Secured Transactions (Article 9).

Cross Reference:

Article 9.

Definitional Cross References:

"Contract". § 1-201.
"Contract for sale". § 2-106.
"Present sale". § 2-106.
"Sale". § 2-106.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-103. Definitions and Index of Definitions. (1) In this Article unless the context otherwise requires

(a) "Buyer" means a person who buys or contracts to buy goods.

(b) "Good faith" in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.

(c) "Receipt" of goods means taking physical possession of them.

(d) "Seller" means a person who sells or contracts to sell goods.

(2) Other definitions applying to this Article or to specified Parts thereof, and the sections in which they appear are:

"Acceptance". § 2-606.
"Banker's credit". § 2-325.
"Between merchants". § 2-104.
"Cancellation". § 2-106(4).
"Commercial unit". § 2-105.
"Confirmed credit". § 2-325.
"Conforming to contract". § 2-106.
"Contract for sale". § 2-106.
"Cover". § 2-712.
"Entrusting". § 2-403.
"Financing agency". § 2-104.
"Future goods". § 2-105.
"Goods". § 2-105.
"Identification". § 2-501.
"Installment contract". § 2-612.
"Letter of credit". § 2-325.
"Lot". § 2-105.
"Merchant". § 2-104.
"Overseas". § 2-323.
"Person in position of seller". § 2-707.
"Present sale". § 2-106.
"Sale". § 2-106.
"Sale on approval". § 2-326.
"Sale or return". § 2-326.
"Termination". § 2-106.

(3) The following definitions in other Articles apply to this Article:

"Check". § 3-104.
"Consignee". § 7-102.
"Consignor". § 7-102.
"Consumer goods". § 9-109.
"Dishonor". § 3-507.
"Draft". § 3-104.

(4) In addition Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

COMMENT: **Prior Uniform Statutory Provision:** Subsection (1): § 76, Uniform Sales Act.

Changes: The definition of "buyer" and "seller" have been slightly rephrased, the reference in § 76 of the prior Act to "any legal successor in interest of such person" being omitted. The definition of "receipt" is new.

Purposes of Changes and New Matter: 1. The phrase "any legal successor in interest of such person" has been eliminated since § 2-210 of this Article, which limits some types of delegation of performance on assignment of a sales contract, makes it clear that not every such successor can be safely included in the definition. In every ordinary case, however, such successors are as of course included.

2. "Receipt" must be distinguished from delivery particularly in regard to the problems arising out of shipment of goods, whether or not the contract calls for making delivery by way of documents of title, since the seller may frequently fulfill his obligations to "deliver" even though the buyer may never "receive" the goods. Delivery with respect to documents of title is defined in Article 1 and requires transfer of physical delivery. Otherwise the many divergent incidents of delivery are handled incident by incident.

Cross References:

Point 1: See § 2-210 and Comment thereon.
Point 2: § 1-201.

Definitional Cross Reference:

"Person". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-104. Definitions: "Merchant"; "Between Merchants"; "Financing Agency". (1) "Merchant" means a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.

(2) "Financing agency" means a bank, finance company or other person who in the ordinary course of business makes advances against goods or documents of title or who by arrangement with either the seller or the buyer intervenes in ordinary course to make or collect payment due or claimed under the contract for sale, as by purchasing or paying the seller's draft or making advances against it or by merely taking it for collection whether or not documents of title accompany the draft. "Financing agency" includes also a bank or other person who similarly intervenes between persons who are in the position of seller and buyer in respect to the goods (§ 2-707).

(3) "Between merchants" means in any transaction with respect to which both parties are chargeable with the knowledge or skill of merchants.

COMMENT: **Prior Uniform Statutory Provision:** None. But see §§ 15 (2), (5), 16(c), 45 (2) and 71, Uniform Sales Act, and §§ 35 and 37, Uniform Bills of Lading Act for examples of the policy expressly provided for in this Article.

Purposes: 1. This Article assumes that transactions between professionals in a given field require special and clear rules which may not apply to a casual or inexperienced seller or buyer. It thus adopts a policy of expressly stating rules applicable "between merchants" and "as against a merchant", wherever they are needed instead of making them depend upon the circumstances of each case as in the statutes cited above. This section lays the foundation of this policy by defining those who are to be regarded as professionals or "merchants" and by stating when a transaction is deemed to be "between merchants".

2. The term "merchant" as defined here roots in the "law merchant" concept of a professional in business. The professional status under the definition may be based upon specialized knowledge as to the goods, specialized knowledge as to business practices, or specialized knowledge as to both and which kind of specialized knowledge may be sufficient to establish the merchant status is indicated by the nature of the provisions.

The special provisions as to merchants appear only in this Article and they are of three kinds. §§ 2-201(2), 2-205, 2-207 and 2-209 dealing with the statute of frauds, firm offers, confirmatory memoranda and modification rest on normal business practices which are or ought to be typical of and familiar to any person in business. For purposes of these sections almost every person in business would, therefore, be deemed to be a "merchant" under the language "who . . . by his occupation holds himself out as having knowledge or skill peculiar to the practices . . . involved in the transaction . ." since the practices involved in the transaction are non-specialized business practices such as answering mail. In this type of provision, banks or even universities, for example, well may be "merchants." But even these sections only apply to a merchant in his mercantile capacity; a lawyer or bank president buying fishing tackle for his own use is not a merchant.

On the other hand, in § 2-314 on the warranty of merchantability, such warranty is implied only "if the seller is a merchant with respect to goods of that kind." Obviously this qualification restricts the implied warranty to a much smaller group than everyone who is engaged in business and requires a professional status as to particular kinds of goods. The exception in § 2-402(2) for retention of possession by a merchant-seller falls in the same class; as does § 2-403(2) on entrusting of possession to a merchant "who deals in goods of that kind".

A third group of sections includes 2-103(1)(b), which provides that in the case of a merchant "good faith" includes observance of reasonable commercial standards of fair dealing in the trade; 2-327(1)(c), 2-603 and 2-605, dealing with responsibilities of merchant buyers to follow seller's instructions, etc.; 2-509 on risk of loss, and 2-609 on adequate assurance of performance. This group of sections applies to persons who are merchants under either the "practices" or the "goods" aspect of the definition of merchant.

3. The "or to whom such knowledge or skill may be attributed by his employment of an agent or broker . . . " clause of the definition of **merchant** means that even persons such as universities, for example, can come within the definition of merchant if they have regular purchasing departments or business personnel who are familiar with business practices and who are equipped to take any action required.

Cross References:

Point 1: See §§ 1-102 and 1-203.
Point 2: See §§ 2-314, 2-315 and 2-320 to 2-325, of this Article, and Article 9.

Definitional Cross References:

"Bank". § 1-201.
"Buyer". § 2-103.
"Contract for sale". § 2-106.
"Document of title". § 1-201.
"Draft". § 3-104.
"Goods". § 2-105.
"Person". § 1-201.
"Purchase". § 1-201.
"Seller". § 2-103.

Prior Statutes: None.

Comment: By imposing different standards upon merchants than upon casual buyers or sellers in specified situations, the UCC changes the law of Virginia.

§ 2-105. Definitions: Transferability; "Goods"; "Future" Goods; "Lot"; "Commercial Unit". (1) "Goods" means all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities (Article 8) and things in action. "Goods" also includes the unborn young of animals and growing crops and other identified things attached to realty as described in the section on goods to be severed from realty (§ 2-107).

(2) Goods must be both existing and identified before any interest in them can pass. Goods which are not both existing and identified are "future" goods. A purported present sale of future goods or of any interest therein operates as a contract to sell.

(3) There may be a sale of a part interest in existing identified goods.

(4) An undivided share in an identified bulk of fungible goods is sufficiently identified to be sold although the quantity of the bulk is not determined. Any agreed proportion of such a bulk or any quantity thereof agreed upon by number, weight or other measure may to the extent of the seller's interest in the bulk be sold to the buyer who then becomes an owner in common.

(5) "Lot" means a parcel or a single article which is the subject matter of a separate sale or delivery, whether or not it is sufficient to perform the contract.

(6) "Commercial unit" means such a unit of goods as by commercial usage is a single whole for purposes of sale and division of which materially impairs its character or value on the market or in use. A commercial unit may be a single article (as a machine) or a set of articles (as a suite of furniture or an assortment of sizes) or a quantity (as a bale, gross, or carload) or any other unit treated in use or in the relevant market as a single whole.

COMMENT: Prior Uniform Statutory Provision: Subsections (1), (2), (3) and (4) —§§ 5, 6 and 76, Uniform Sales Act; Subsections (5) and (6)—none.

Changes: Rewritten.

Purposes of Changes and New Matter: 1. Subsection (1) on "goods": The phraseology of the prior uniform statutory provision has been changed so that:

The definition of goods is based on the concept of movability and the term "chattels personal" is not used. It is not intended to deal with things which are not fairly identifiable as movables before the contract is performed.

Growing crops are included within the definition of goods since they are frequently intended for sale. The concept of "industrial" growing crops has been abandoned, for under modern practices fruit, perennial hay, nursery stock and the like must be brought within the scope of this Article. The young of animals are also included expressly in this definition since they, too, are frequently intended for sale and may be contracted for before birth. The period of gestation of domestic animals is such that the provisions of the section on identification can apply as in the case of crops to be planted. The reason of this definition also leads to the inclusion of a wool crop or the like as "goods" subject to identification under this Article.

The exclusion of "money in which the price is to be paid" from the definition of goods does not mean that foreign currency which is included in the definition of money may not be the subject matter of a sales transaction. Goods is intended to cover the sale of money when money is being treated as a commodity but not to include it when money is the medium of payment.

As to contracts to sell timber, minerals, or structures to be removed from the land § 2-107(1) (Goods to be severed from Realty: recording) controls.

The use of the word "fixtures" is avoided in view of the diversity of definitions of that term. This Article in including within its scope "things attached to realty" adds the further test that they must be capable of severance without material harm thereto. As between the parties any identified things which fall within that definition become "goods" upon the making of the contract for sale. "Investment securities" are expressly excluded from the coverage of this Article.

It is not intended by this exclusion, however, to prevent the application of a particular section of this Article by analogy to securities (as was done with the Original Sales Act in Agar v. Orda, 264 N.Y. 248, 190 N.E. 479, 99 A.L.R. 269 (1934)) when the reason of that section makes such application sensible and the situation involved is not covered by the Article of this Act dealing specifically with such securities (Article 8).

2. References to the fact that a contract for sale can extend to future or contingent goods and that ownership in common follows the sale of a part interest have been omitted here as obvious without need for expression; hence no inference to negate these principles should be drawn from their omission.

3. Subsection (4) does not touch the question of how far an appropriation of a bulk of fungible goods may or may not satisfy the contract for sale.

4. Subsections (5) and (6) on "lot" and "commercial unit" are introduced to aid in the phrasing of later sections.

5. The question of when an identification of goods takes place is determined by the provisions of § 2-501 and all that this section says is what kinds of goods may be the subject of a sale.

Cross References:

Point 1: §§ 2-107, 2-201, 2-501 and Article 8.
Point 5: § 2-501.
See also § 1-201.

Definitional Cross References:

"Buyer". § 2-103.
"Contract". § 1-201.
"Contract for sale". § 2-106.
"Fungible". § 1-201.
"Money". § 1-201.
"Present sale". § 2-106.
"Sale". § 2-106.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Since Virginia never adopted the Uniform Sales Act, there has been little reason to decide whether a particular sale constitutes a sale of goods or a sale of something else. This decision is important under the UCC. For example, the narrow definition of goods in 2-105(1) excludes actions by buyers or sellers for breach of contract to sell investment securities, Lynch v. Highfield, 146 Va. 488, 499-500, 131 S.E. 810 (1926), choses in action, Hughes v. Burwell, 113 Va. 598, 75 S.E. 230 (1912) or a business, Pinsky v. Kleinman, 198 Va. 360, 94 S.E. 2d 267 (1956), from the remedies provided by Article 2.

§ 2-106. Definitions: "Contract"; "Agreement"; "Contract for Sale"; "Sale"; "Present Sale"; "Conforming" to Contract; "Termination"; "Cancellation". (1) In this Article unless the context otherwise requires "contract" and "agreement" are limited to those relating to the present or future sale of goods. "Contract for sale" includes both a present sale of goods

and a contract to sell goods at a future time. A "sale" consists in the passing of title from the seller to the buyer for a price (§ 2-401). A "present sale" means a sale which is accomplished by the making of the contract.

(2) Goods or conduct including any part of a performance are "conforming" or conform to the contract when they are in accordance with the obligations under the contract.

(3) "Termination" occurs when either party pursuant to a power created by agreement or law puts an end to the contract otherwise than for its breach. On "termination" all obligations which are still executory on both sides are discharged but any right based on prior breach or performance survives.

(4) "Cancellation" occurs when either party puts an end to the contract for breach by the other and its effect is the same as that of "termination" except that the cancelling party also retains any remedy for breach of the whole contract or any unperformed balance.

COMMENT: **Prior Uniform Statutory Provision:** Subsection (1)—§ 1 (1) and (2), Uniform Sales Act; Subsection (2)—none, but subsection generally continues policy of §§ 11, 44 and 69, Uniform Sales Act; Subsections (3) and (4)—none.

Changes: Completely rewritten.

Purposes of Changes and New Matter: 1. Subsection (1): "Contract for sale" is used as a general concept throughout this Article, but the rights of the parties do not vary according to whether the transaction is a present sale or a contract to sell unless the Article expressly so provides.

2. Subsection (2): It is in general intended to continue the policy of requiring exact performance by the seller of his obligations as a condition to his right to require acceptance. However, the seller is in part safeguarded against surprise as a result of sudden technicality on the buyer's part by the provisions of § 2-508 on seller's cure of improper tender or delivery. Moreover usage of trade frequently permits commercial leeways in performance and the language of the agreement itself must be read in the light of such custom or usage and also, prior course of dealing, and in a long term contract, the course of performance.

3. Subsections (3) and (4): These subsections are intended to make clear the distinction carried forward throughout this Article between termination and cancellation.

Cross References:

Point 2: §§ 1-203, 1-205, 2-208 and 2-508.

Definitional Cross References:

"Agreement". § 1-201.
"Buyer". § 2-103.
"Contract". § 1-201.
"Goods". § 2-105.
"Party". § 1-201.
"Remedy". § 1-201.
"Rights". § 1-201.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-107. Goods to Be Severed From Realty: Recording. (1) A contract for the sale of timber, minerals or the like or a structure or its materials to be removed from realty is a contract for the sale of goods within this Article if they are to be severed by the seller but until severance a

purported present sale thereof which is not effective as a transfer of an interest in land is effective only as a contract to sell.

(2) A contract for the sale apart from the land of growing crops or other things attached to realty and capable of severance without material harm thereto but not described in subsection (1) is a contract for the sale of goods within this Article whether the subject matter is to be severed by the buyer or by the seller even though it forms part of the realty at the time of contracting, and the parties can by identification effect a present sale before severance.

(3) The provisions of this section are subject to any third party rights provided by the law relating to realty records, and the contract for sale may be executed and recorded as a document transferring an interest in land and shall then constitute notice to third parties of the buyer's rights under the contract for sale.

COMMENT: **Prior Uniform Statutory Provision:** See § 76, Uniform Sales Act on prior policy; § 7, Uniform Conditional Sales Act.

Purposes: 1. Subsection (1). Notice that this subsection applies only if the timber, minerals or structures "are to be severed by the seller". If the buyer is to sever, such transactions are considered contracts affecting land and all problems of the Statute of Frauds and of the recording of land rights apply to them. Therefore, the Statute of Frauds section of this Article does not apply to such contracts though they must conform to the Statute of Frauds affecting the transfer of interests in land.

2. Subsection (2). "Things attached" to the realty which can be severed without material harm are goods within this Article regardless of who is to effect the severance. The word "fixtures" has been avoided because of the diverse definitions of this term, the test of "severance without material harm" being substituted.

The provision in subsection (3) for recording such contracts is within the purview of this Article since it is a means of preserving the buyer's rights under the contract of sale.

3. The security phases of things attached to or to become attached to realty are dealt with in the Article on Secured Transactions (Article 9) and it is to be noted that the definition of goods in that Article differs from the definition of goods in this Article.

Cross References:

Point 1: § 2-201.
Point 2: § 2-105.
Point 3: Articles 9 and 9-105.

Definitional Cross References:

"Buyer". § 2-103.
"Contract". § 1-201.
"Contract for sale". § 2-106.
"Goods". § 2-105.
"Party". § 1-201.
"Present sale". § 2-106.
"Rights". § 1-201.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 11-2 (Statute of Frauds) and Code 1950, §§ 59-200 through 59-213 (Timber Brands).

Comment: Under Virginia law, when standing timber sold is to be severed within a reasonable time by either the buyer or seller the transaction is not within the statute of frauds provision relating to transfers of interests in land. Va. Code

11-2(6), as interpreted by Hurricane Lumber Co. v. Lowe, 110 Va. 380, 383, 66 S.E. 66 (1909). Since Virginia has no statute of frauds provision relating to the sale of goods, the transaction need not be reduced to writing. But see Stuart v. Pennis, 91 Va. 688, 689-91, 22 S.E. 509 (1895) (buyer had right to let timber stand for 3 years). The UCC provides that if the seller is to sever at any time, a sale of standing timber is within the scope of Article 2 and thus subject to the statute of frauds provision relating to the sale of goods. 2-201. The net effect of this is to reduce the scope of the statute of frauds provision relating to interests in land when the seller is to sever but to increase the requirement of a writing by bringing these transactions within the scope of Article 2.

In Stuart v. Pennis, 91 Va. 688, 691, 22 S.E. 509 (1895), it was said that land includes everything "attached to it," a statement that would include growing crops, but this broad definition seems to have been limited by Hurricane Lumber Co. v. Lowe, 110 Va. 380, 383, 66 S.E. 66 (1909). Under UCC 2-107(2) growing crops are defined as goods. See also, Note, Crops—Personalty or Realty in Virginia, 39 Va. L. Rev. 1115 (1953).

The UCC makes no provision for legislation such as Virginia's Timber Branding statute, Code 1950, §§ 59-200 through 59-213, and there appears to be no necessary conflict between the UCC and this legislation, under § 59-210 of which the branding of marketable timber is deemed to be a change of ownership and possession. The statute was applied in Hurley v. Hurley, 110 Va. 31, 65 S.E. 472 (1909). Subsection 2-107(3) authorizes the recordation of contracts for sale under this section as though they involved transfers of interests in land, so as thereby to give third parties notice. This provision would change the result in Braxton v. Bell, 92 Va. 229, 235, 23 S.E. 289 (1895), holding that the recordation of a contract in regard to personal property, not required by statute to be recorded, as a nullity and not notice to any person.

PART 2

FORM, FORMATION AND READJUSTMENT OF CONTRACT

§ 2-201. Formal Requirements; Statute of Frauds. (1) Except as otherwise provided in this section a contract for the sale of goods for the price of $500 or more is not enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his authorized agent or broker. A writing is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable under this paragraph beyond the quantity of goods shown in such writing.

(2) Between merchants if within a reasonable time a writing in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, it satisfies the requirements of subsection (1) against such party unless written notice of objection to its contents is given within ten days after it is received.

(3) A contract which does not satisfy the requirements of subsection (1) but which is valid in other respects is enforceable

(a) if the goods are to be specially manufactured for the buyer and are not suitable for sale to others in the ordinary course of the seller's business and the seller, before notice of repudiation is received and under circumstances which reasonably indicate that the goods are for the buyer, has made either a substantial beginning of their manufacture or commitments for their procurement; or

(b) if the party against whom enforcement is sought admits in his pleading, testimony or otherwise in court that a contract for sale was made, but the contract is not enforceable under this provision beyond the quantity of goods admitted; or

(c) with respect to goods for which payment has been made and accepted or which have been received and accepted (§ 2-606).

COMMENT: **Prior Uniform Statutory Provision:** § 4, Uniform Sales Act (which was based on § 17 of the Statute of 29 Charles II).

Changes: Completely re-phrased; restricted to sale of goods. See also §§ 1-206, 8-319 and 9-203.

Purposes of Changes: The changed phraseology of this section is intended to make it clear that:

1. The required writing need not contain all the material terms of the contract and such material terms as are stated need not he precisely stated. All that is required is that the writing afford a basis for believing that the offered oral evidence rests on a real transaction. It may be written in lead pencil on a scratch pad. It need not indicate which party is the buyer and which the seller. The only term which must appear is the quantity term which need not be accurately stated but recovery is limited to the amount stated. The price, time and place of payment or delivery, the general quality of the goods, or any particular warranties may all be omitted.

Special emphasis must be placed on the permissibility of omitting the price term in view of the insistence of some courts on the express inclusion of this term even where the parties have contracted on the basis of a published price list. In many valid contracts for sale the parties do not mention the price in express terms, the buyer being bound to pay and the seller to accept a reasonable price which the trier of the fact may well be trusted to determine. Again, frequently the price is not mentioned since the parties have based their agreement on a price list or catalogue known to both of them and this list serves as an efficient safeguard against perjury. Finally, "market" prices and valuations that are current in the vicinity constitute a similar check. Thus if the price is not stated in the memorandum it can normally be supplied without danger of fraud. Of course if the "price" consists of goods rather than money the quantity of goods must be stated.

Only three definite and invariable requirements as to the memorandum are made by this subsection. First, it must evidence a contract for the sale of goods; second, it must be "signed", a word which includes any authentication which identifies the party to be charged; and third, it must specify a quantity.

2. "Partial performance" as a substitute for the required memorandum can validate the contract only for the goods which have been accepted or for which payment has been made and accepted.

Receipt and acceptance either of goods or of the price constitutes an unambiguous overt admission by both parties that a contract actually exists. If the court can make a just apportionment, therefore, the agreed price of any goods actually delivered can be recovered without a writing or, if the price has been paid, the seller can be forced to deliver an apportionable part of the goods. The overt actions of the parties make admissible evidence of the other terms of the contract necessary to a just apportionment. This is true even though the actions of the parties are not in themselves inconsistent with a different transaction such as a consignment for resale or a mere loan of money.

Part performance by the buyer requires the delivery of something by him that is accepted by the seller as such performance. Thus, part payment may be made by money or check, accepted by the seller. If the agreed price consists of goods or services, then they must also have been delivered and accepted.

3. Between merchants, failure to answer a written confirmation of a contract within ten days of receipt is tantamount to a writing under subsection (2) and is sufficient against both parties under subsection (1). The only effect, however, is to take away from the party who fails to answer the defense of the Statute of Frauds; the burden of persuading the trier of fact that a contract was in fact made orally prior to the written confirmation is unaffected. Compare the effect of a failure to reply under § 2-207.

4. Failure to satisfy the requirements of this section does not render the contract void for all purposes, but merely prevents it from being judicially enforced in favor of a party to the contract. For example, a buyer who takes possession of

goods as provided in an oral contract which the seller has not meanwhile repudiated, is not a trespasser. Nor would the Statute of Frauds provisions of this section be a defense to a third person who wrongfully induces a party to refuse to perform an oral contract, even though the injured party cannot maintain an action for damages against the party so refusing to perform.

5. The requirement of "signing" is discussed in the comment to § 1-201.

6. It is not necessary that the writing be delivered to anybody. It need not be signed or authenticated by both parties but it is, of course, not sufficient against one who has not signed it. Prior to a dispute no one can determine which party's signing of the memorandum may be necessary but from the time of contracting each party should be aware that to him it is signing by the other which is important.

7. If the making of a contract is admitted in court, either in a written pleading, by stipulation or by oral statement before the court, no additional writing is necessary for protection against fraud. Under this section it is no longer possible to admit the contract in court and still treat the Statute as a defense. However, the contract is not thus conclusively established. The admission so made by a party is itself evidential against him or the truth of the facts so admitted and of nothing more; as against the other party, it is not evidential at all.

Cross References:

See §§ 1-201, 2-202, 2-207, 2-209 and 2-304.

Definitional Cross References:

"Action". § 1-201.
"Between merchants". § 2-104.
"Buyer". § 2-103.
"Contract". § 1-201.
"Contract of sale". § 2-106.
"Goods". § 2-105.
"Notice". § 1-201.
"Party". § 1-201.
"Reasonable time". § 1-204.
"Sale". § 2-106.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: This section provides Virginia with a statute of frauds for the sale of goods where none existed before. Virginia decisions under existing provisions of the statute of frauds have required essential terms but not the whole of contracts within the statute to be in writing. See e.g., Browder v. Mitchell, 187 Va. 781, 785, 48 S.E. 2d 221 (1948); Reynolds v. Dixon, 187 Va. 101, 106, 46 S.E. 2d 6 (1948). The UCC requires only that there be "some writing sufficient to indicate that a contract for sale has been made." Further, since a writing is not insufficient because it omits or incorrectly states a term agreed upon, this section will lead to greater liberality in the introduction of parol evidence in Virginia where unintegrated writings within the statute of frauds are involved. Matthews v. LaPrade, 130 Va. 408, 420, 107 S.E. 795 (1921).

§ 2-202. Final Written Expression: Parol or Extrinsic Evidence. Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented

(a) by course of dealing or usage of trade (§ 1-205) or by course of performance (§ 2-208); and

(b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. This section definitely rejects:

(a) Any assumption that because a writing has been worked out which is final on some matters, it is to be taken as including all the matters agreed upon;

(b) The premise that the language used has the meaning attributable to such language by rules of construction existing in the law rather than the meaning which arises out of the commercial context in which it was used; and

(c) The requirement that a condition precedent to the admissibility of the type of evidence specified in paragraph (a) is an original determination by the court that the language used is ambiguous.

2. Paragraph (a) makes admissible evidence of course of dealing, usage of trade and course of performance to explain or supplement the terms of any writing stating the agreement of the parties in order that the true understanding of the parties as to the agreement may be reached. Such writings are to be read on the assumption that the course of prior dealings between the parties and the usages of trade were taken for granted when the document was phrased. Unless carefully negated they have become an element of the meaning of the words used. Similarly, the course of actual performance by the parties is considered the best indication of what they intended the writing to mean.

3. Under paragraph (b) consistent additional terms, not reduced to writing, may be proved unless the court finds that the writing was intended by both parties as a complete and exclusive statement of all the terms. If the additional terms are such that, if agreed upon, they would certainly have been included in the document in the view of the court, then evidence of their alleged making must be kept from the trier of fact.

Cross References:

Point 3: §§ 1-205, 2-207, 2-302 and 2-316.

Definitional Cross References:

"Agreed" and "agreement". § 1-201.
"Course of dealing". § 1-205.
"Parties". § 1-201.
"Term". § 1-201.
"Usage of trade". § 1-205.
"Written" and "writing". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: This section reflects a more liberal approach to the introduction of parol evidence to explain or supplement written contracts for the sale of goods than has been followed in Virginia. The Supreme Court of Appeals has said that "no rule is better settled in this State than that extrinsic evidence is not admissible to determine the sense in which language is used unless the contract is ambiguous." Mathieson Alkali Works v. Virginia Banner Coal Corp., 147 Va. 125, 136, 136 S.E. 673 (1927). This case held that parol evidence was inadmissible to show the "quantity" contracted for in a requirements contract. Hopkins v. LeCato, 142 Va. 769, 779-83, 128 S.E. 55 (1925), held parol evidence inadmissible to show the time at which a deposit to guarantee performance was to be made. Sutherland & Co. v. Gibson, 117 Va. 840, 842-44, 86 S.E. 108 (1915), held parol evidence inadmissible to show a custom of weighing livestock between daylight and nine o'clock. Scott v. Norfolk & Western Railroad Co., 90 Va. 241, 243, 17 S.E. 882 (1893), held parol evidence inadmissible to show that a buyer was to haul a part of a purchase of railroad ties. Under this section of the UCC, it would appear that parol evidence would be admissible in these situations.

In Richlands Flint Glass Co. v. Hiltebeitel, 92 Va. 91, 94-97, 22 S.E. 806 (1895), Virginia permitted the introduction of parol evidence to show custom and usage and a prior course of dealing where a contract for doing brick work did not contain any term stating how the quantity of brick was to be ascertained. See also Hansbrough v. Neal, Featherston and Co., 94 Va. 722, 724-26, 27 S.E. 593 (1897). Virginia also permits the introduction of parol evidence to show that a buyer

was induced by false and fraudulent representations of the seller's agents to enter into the contract, even though the written contract purports to embody all the agreements between the parties. White Sewing Machine Co. v. Gilmore Furniure Co., 128 Va. 630, 637-44, 105 S.E. 134 (1920). And Virginia has construed a term of a conditional sale contract providing that all conditions and agreements between the parties are stated therein as referring to that contract only and not to a prior sales contract. Transit Corp. of Norfolk v. Four Wheel Drive Auto Co., 151 Va. 865, 873, 145 S.E. 331 (1928). A federal court, in Victor Products Corp. v. Yates-American Mach. Co., 54 F.2d 1062, 1063-64 (4th Cir. 1932), held that the parol evidence rule, as applied in Virginia, bars proof of an oral warranty that contradicts the terms of a conditional sale contract. These holdings are not changed by the UCC.

§ 2-203. **Seals Inoperative.** The affixing of a seal to a writing evidencing a contract for sale or an offer to buy or sell goods does not constitute the writing a sealed instrument and the law with respect to sealed instruments does not apply to such a contract or offer.

COMMENT: **Prior Uniform Statutory Provision:** § 3, Uniform Sales Act.

Changes: Portion pertaining to "seals" rewritten.

Purposes of Changes: 1. This section makes it clear that every effect of the seal which relates to "sealed instruments" as such is wiped out insofar as contracts for sale are concerned. However, the substantial effects of a seal, except extension of the period of limitations, may be had by appropriate drafting as in the case of firm offers (see § 2-205).

2. This section leaves untouched any aspects of a seal which relate merely to signatures or to authentication of execution and the like. Thus, a statute providing that a purported signature gives prima facie evidence of its own authenticity or that a signature gives prima facie evidence of consideration is still applicable to sales transactions even though a seal may be held to be a signature within the meaning of such a statute. Similarly, the authorized affixing of a corporate seal bearing the corporate name to a contractual writing purporting to be made by the corporation may have effect as a signature without any reference to the law of sealed instruments.

Cross Reference:

Point 1: § 2-205.

Definitional Cross References:

"Contract for sale". § 2-106.
"Goods". § 2-105.
"Writing". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 11-3.

Comment: Although seals are still recognized in Virginia, there have been no cases involving contracts for the sale of goods, where a question involving a seal has arisen. At least in equity, the seal no longer prevents inquiry as to whether a sealed instrument is supported by consideration. Norris v. Barbour, 188 Va. 723, 737, 51 S.E. 2d 334 (1949); Cooper v. Gregory, 191 Va. 24, 31, 60 S.E. 2d 50 (1950). The principal change is in the length of the statute of limitations, for which see VIRGINIA ANNOTATIONS to UCC 2-725.

§ 2-204. **Formation in General.** (1) A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract.

(2) An agreement sufficient to constitute a contract for sale may be found even though the moment of its making is undetermined.

(3) Even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a con-

tract and there is a reasonably certain basis for giving an appropriate remedy.

COMMENT: Prior Uniform Statutory Provision: §§ 1 and 3, Uniform Sales Act.

Changes: Completely rewritten by this and other sections of this Article.

Purposes of Changes: Subsection (1) continues without change the basic policy of recognizing any manner of expression of agreement, oral, written or otherwise. The legal effect of such an agreement is, of course, qualified by other provisions of this Article.

Under subsection (1) appropriate conduct by the parties may be sufficient to establish an agreement. Subsection (2) is directed primarily to the situation where the interchanged correspondence does not disclose the exact point at which the deal was closed, but the actions of the parties indicate that a binding obligation has been undertaken.

Subsection (3) states the principle as to "open terms" underlying later sections of the Article. If the parties intend to enter into a binding agreement, this subsection recognizes that agreement as valid in law, despite missing terms, if there is any reasonably certain basis for granting a remedy. The test is not certainty as to what the parties were to do nor as to the exact amount of damages due the plaintiff. Nor is the fact that one or more terms are left to be agreed upon enough of itself to defeat an otherwise adequate agreement. Rather, commercial standards on the point of "indefiniteness" are intended to be applied, this Act making provision elsewhere for missing terms needed for performance, open price, remedies and the like.

The more terms the parties leave open, the less likely it is that they have intended to conclude a binding agreement, but their actions may be frequently conclusive on the matter despite the omissions.

Cross References:

Subsection (1): §§ 1-103, 2-201 and 2-302.
Subsection (2): §§ 2-205 through 2-209.
Subsection (3): See Part 3.

Definitional Cross References:

"Agreement". § 1-201.
"Contract". § 1-201.
"Contract for sale". § 2-106.
"Goods". § 2-105.
"Party". § 1-201.
"Remedy". § 1-201.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: The UCC is consistant with the Virginia policy of enforcing apparently indefinite agreements whenever possible by resort to external, objective standards of reasonableness. Turpin v. Branaman, 190 Va. 818, 828, 58 S.E.2d 63 (1950), held an agreement to be sufficiently definite where one of its terms provided the means and formula by which the quantity could be determined. Cocoa Products Co. of America, Inc. v. Duche, 156 Va. 86, 90, 158 S.E. 719 (1931), held an agreement for the sale of three to five cars of cocoa butter to be sufficiently definite. Smokeless Fuel Co. v. Seaton & Sons, 105 Va. 170, 172-74, 52 S.E. 829 (1906), held a contract for 1,000 to 1,500 tons of coal to be sufficiently definite. The section is consistent with Chandler v. Kelley, 149 Va. 221, 227-32, 141 S.E. 389 (1928), holding that a contract for sale had been made, an intermediary being an agent for the buyer.

§ 2-205. Firm Offers. An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

COMMENT: **Prior Uniform Statutory Provision:** §§ 1 and 3, Uniform Sales Act.

Changes: Completely rewritten by this and other sections of this Article.

Purposes of Changes: 1. This section is intended to modify the former rule which required that "firm offers" be sustained by consideration in order to bind, and to require instead that they must merely be characterized as such and expressed in signed writings.

2. The primary purpose of this section is to give effect to the deliberate intention of a merchant to make a current firm offer binding. The deliberation is shown in the case of an individualized document by the merchant's signature to the offer, and in the case of an offer included on a form supplied by the other party to the transaction by the separate signing of the particular clause which contains the offer. "Signed" here also includes authentication but the reasonableness of the authentication herein allowed must be determined in the light of the purpose of the section. The circumstances surrounding the signing may justify something less than a formal signature or initialing but typically the kind of authentication involved here would consist of a minimum of initialing of the clause involved. A handwritten memorandum on the writer's letterhead purporting in its terms to "confirm" a firm offer already made would be enough to satisfy this section, although not subscribed, since under the circumstances it could not be considered a memorandum of mere negotiation and it would adequately show its own authenticity. Similarly, an authorized telegram will suffice, and this is true even though the original draft contained only a typewritten signature. However, despite settled courses of dealing or usages of the trade whereby firm offers are made by oral communication and relied upon without more evidence, such offers remain revocable under this Article since authentication by a writing is the essence of this section.

3. This section is intended to apply to current "firm" offers and not to long term options, and an outside time limit of three months during which such offers remain irrevocable has been set. The three month period during which firm offers remain irrevocable under this section need not be stated by days or by date. If the offer states that it is "guaranteed" or "firm" until the happening of a contingency which will occur within the three month period, it will remain irrevocable until that event. A promise made for a longer period will operate under this section to bind the offeror only for the first three months of the period but may of course be renewed. If supported by consideration it may continue for as long as the parties specify. This section deals only with the offer which is not supported by consideration.

4. Protection is afforded against the inadvertent signing of a firm offer when contained in a form prepared by the offeree by requiring that such a clause be separately authenticated. If the offer clause is called to the offeror's attention and he separately authenticates it, he will be bound; § 2-302 may operate, however, to prevent an unconscionable result which otherwise would flow from other terms appearing in the form.

5. Safeguards are provided to offer relief in the case of material mistake by virtue of the requirement of good faith and the general law of mistake.

Cross References:

Point 1: § 1-102.
Point 2: § 1-102.
Point 3: § 2-201.
Point 5: § 2-302.

Definitional Cross References:

"Goods". § 2-105.
"Merchant". § 2-104.
"Signed". § 1-201.
"Writing". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: This section changes prior law by making firm offers by merchants irrevocable, even without consideration. Virginia cases, following traditional contract law, have held that such offers are revocable. Weade v. Weade, 153 Va. 540, 545, 150 S.E. 238 (1929); Saunders v. Bank of Mecklenburg, 112 Va. 443, 451, 71 S.E. 714 (1911).

§ 2-206. Offer and Acceptance in Formation of Contract. (1) Unless otherwise unambiguously indicated by the language or circumstances

(a) an offer to make a contract shall be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances;

(b) an order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or non-conforming goods, but such a shipment of non-conforming goods does not constitute an acceptance if the seller seasonably notifies the buyer that the shipment is offered only as an accommodation to the buyer.

(2) Where the beginning of a requested performance is a reasonable mode of acceptance an offeror who is not notified of acceptance within a reasonable time may treat the offer as having lapsed before acceptance.

COMMENT: **Prior Uniform Statutory Provision:** §§ 1 and 3, Uniform Sales Act.

Changes: Completely rewritten in this and other sections of this Article.

Purposes of Changes: To make it clear that:

1. Any reasonable manner of acceptance is intended to be regarded as available unless the offeror has made quite clear that it will not be acceptable. Former technical rules as to acceptance, such as requiring that telegraphic offers be accepted by telegraphed acceptance, etc., are rejected and a criterion that the acceptance be "in any manner and by any medium reasonable under the circumstances," is substituted. This section is intended to remain flexible and its applicability to be enlarged as new media of communication develop or as the more time-saving present day media come into general use.

2. Either shipment or a prompt promise to ship is made a proper means of acceptance of an offer looking to current shipment. In accordance with ordinary commercial understanding the section interprets an order looking to current shipment as allowing acceptance either by actual shipment or by a prompt promise to ship and rejects the artificial theory that only a single mode of acceptance is normally envisaged by an offer. This is true even though the language of the offer happens to be "ship at once" or the like. "Shipment" is here used in the same sense as in § 2-504; it does not include the beginning of delivery by the seller's own truck or by messenger. But loading on the seller's own truck might be a beginning of performance under subsection (2).

3. The beginning of performance by an offeree can be effective as acceptance so as to bind the offeror only if followed within a reasonable time by notice to the offeror. Such a beginning of performance must unambiguously express the offeree's intention to engage himself. For the protection of both parties it is essential that notice follow in due course to constitute acceptance. Nothing in this section however bars the possibility that under the common law performance begun may have an intermediate effect of temporarily barring revocation of the offer, or at the offeror's option, final effect in constituting acceptance.

4. Subsection(1)(b) deals with the situation where a shipment made following an order is shown by a notification of shipment to be referable to that order but has a defect. Such a non-conforming shipment is normally to be understood as intended to close the bargain, even though it proves to have been at the same time a breach. However, the seller by stating that the shipment is non-conforming and is offered only as an accommodation to the buyer keeps the shipment or notification from operating as an acceptance.

Definitional Cross References:

"Buyer". § 2-103.
"Conforming". § 2-106.
"Contract". § 1-201.
"Goods". § 2-105.
"Notifies". § 1-201.
"Reasonable time". § 1-204.

Prior Statutes: None.

Comment: The Supreme Court of Appeals has said that the acid test of the formation of a contract for the sale of goods is "A meeting of the minds of the parties." Palmer v. Charles E. Frosst & Co., 139 Va. 239, 244, 123 S.E. 357 (1924). See also Rownd v. Bell, 156 Va. 811, 813-14, 158 S.E. 890 (1931); Old Dominion Coal Corp. v. Snipes, 142 Va. 331, 339-40, 128 S.E. 518 (1925); Insurance Company of North America v. Gamble & Co., 94 Va. 622, 625, 27 S.E. 463 (1897). The UCC generally follows this approach, with, perhaps, some relaxation of what constitutes a meeting of the minds. Without expressly so providing, the UCC continues the general proposition of contract law that an offer can be revoked at any time before it is accepted. J. B. Colt Co. v. Elam, 138 Va. 124, 127, 120 S.E. 857 (1924); Virginia Hardwood Lumber Co. v. Hughes, 140 Va. 249, 257-58, 124 S.E. 283 (1924).

The UCC rejects technical rules of acceptance, providing that an offer shall be construed as inviting acceptance in any manner and by any medium reasonable under the circumstances, thus relaxing the requirement of Virginia Hardwood Lumber Co. v. Hughes, 140 Va. 249, 258, 124 S.E. 283 (1924), that an offer made by mail must generally be accepted by an answer sent by return mail.

Under this section an order or other offer for prompt or current shipment can be accepted either by prompt shipment or a "prompt promise to ship." In Virginia Hardwood Lumber Co. v. Hughes, 140 Va. 249, 258, 124 S.E. 283 (1924), the buyer asked the seller to "ship at once." The court said that under the principles of law governing the acceptance of an offer, the seller, "in order to effectuate a binding contract, had to notify the defendant of his acceptance of its order and ship promptly." However, since the seller neither shipped to nor notified the buyer before the offer was revoked, the case is doubtful precedent for the view that Virginia permits an offer for an "unilateral" contract to be accepted by a promise to perform. Both the UCC and Virginia appear to agree that if an offer is properly accepted by starting or completing a bargained for performance, the offeree, as a condition to the creation of a contract, must notify the offeror within a reasonable time.

An offer for a shipment "at once" under Virginia Hardwood Lumber Co. v. Hughes, 140 Va. 249, 257, 124 S.E. 283 (1924), means a "prompt and an immediate shipment" although, of course, not a shipment made simultaneously with the receipt of the order. The UCC leaves this construction of the term unchanged.

The UCC does not expressly cover fraud in the factum as a defense to an alleged sale of goods. Consequently, the holding in Amos v. Franklin, 159 Va. 19, 22-23, 165 S.E. 510 (1932), that this is a good defense remains unchanged. In this case the buyer thought he was signing a permit for a demonstration of a truck, whereas he actually was signing a contract to buy the truck.

The section is consistent with Lynch v. Commonwealth, 131 Va. 769, 772, 109 S.E. 418 (1921), which distinguishes between a sale and an offer to sell. It is also consistent with Montague Manufacturing Co. v. Aycock-Holly Lumber Co., 139 Va. 742, 747, 124 S.E. 208 (1924), in which it was found that no contract had arisen between the parties.

§ 2-207. Additional Terms in Acceptance or Confirmation. (1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.

(2) The additional terms are to he construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:

(a) the offer expressly limits acceptance to the terms of the offer;

(b) they materially alter it; or

(c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.

(3) Conduct by both parties which recognizes the existence of a con-

tract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this Act.

COMMENT: Prior Uniform Statutory Provision: §§ 1 and 3, Uniform Sales Act.

Changes: Completely rewritten by this and other sections of this Article.

Purposes of Changes: 1. This section is intended to deal with two typical situations. The one is where an agreement has been reached either orally or by informal correspondence between the parties and is followed by one or both of the parties sending formal acknowledgments or memoranda embodying the terms so far as agreed upon and adding terms not discussed. The other situation is one in which a wire or letter expressed and intended as the closing or confirmation of an agreement adds further minor suggestions or proposals such as "ship by Tuesday," "rush," "ship draft against bill of lading inspection allowed," or the like.

2. Under this Article a proposed deal which in commercial understanding has in fact been closed is recognized as a contract. Therefore, any additional matter contained either in the writing intended to close the deal or in a later confirmation falls within subsection (2) and must be regarded as a proposal for an added term unless the acceptance is made conditional on the acceptance of the additional terms.

3. Whether or not additional or different terms will become part of the agreement depends upon the provisions of subsection (2). If they are such as materially to alter the original bargain, they will not be included unless expressly agreed to by the other party. If, however, they are terms which would not so change the bargain they will be incorporated unless notice of objection to them has already been given or is given within a reasonable time.

4. Examples of typical clauses which would normally "materially alter" the contract and so result in surprise or hardship if incorporated without express awareness by the other party are: a clause negating such standard warranties as that of merchantability or fitness for a particular purpose in circumstances in which either warranty normally attaches; a clause requiring a guaranty of 90% or 100% deliveries in a case such as a contract by cannery, where the usage of the trade allows greater quantity leeways; a clause reserving to the seller the power to cancel upon the buyer's failure to meet any invoice when due; a clause requiring that complaints be made in a time materially shorter than customary or reasonable.

5. Examples of clauses which involve no element of unreasonable surprise and which therefore are to be incorporated in the contract unless notice of objection is seasonably given are: a clause setting forth and perhaps enlarging slightly upon the seller's exemption due to supervening causes beyond his control, similar to those covered by the provision of this Article on merchant's excuse by failure of presupposed conditions or a clause fixing in advance any reasonable formula of proration under such circumstances; a clause fixing a reasonable time for complaints within customary limits, or in the case of a purchase for sub-sale, providing for inspection by the sub-purchaser; a clause providing for interest on overdue invoices or fixing the seller's standard credit terms where they are within the range of trade practice and do not limit any credit bargained for; a clause limiting the right of rejection for defects which fall within the customary trade tolerances for acceptance "with adjustment" or otherwise limiting remedy in a reasonable manner (see §§ 2-718 and 2-719).

6. If no answer is received within a reasonable time after additional terms are proposed, it is both fair and commercially sound to assume that their inclusion has been assented to. Where clauses on confirming forms sent by both parties conflict each party must be assumed to object to a clause of the other conflicting with one on the confirmation sent by himself. As a result the requirement that there be notice of objection which is found in subsection (2) is satisfied and the conflicting terms do not become a part of the contract. The contract then consists of the terms originally expressly agreed to, terms on which the confirmations agree, and terms supplied by this Act, including subsection (2).

Cross References:

See generally § 2-302.
Point 5: §§ 2-513, 2-602, 2-607, 2-609, 2-612, 2-614, 2-615, 2-616, 2-718 and 2-719.
Point 6: §§ 1-102 and 2-104.

Definitional Cross References:

"Between merchants". § 2-104.
"Contract". § 1-201.
"Notification". § 1-201.
"Reasonable time". § 1-204.
"Seasonably". § 1-204.
"Send". § 1-201.
"Term". § 1-201.
"Written". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Virginia law has been that an expression of an acceptance to be effectual must be identical with the offer. Since the UCC provides that additional terms are to be construed as proposals for additions to the contract, this section changes Virginia law. In W. S. Hoge & Bro. v. Prince William Co-operative Exchange, Inc., 141 Va. 676, 682-84, 126 S.E. 687 (1925), it was held that there was no contract where the offer provided for goods to be shipped when ordered and the acceptance called for shipment before October 1, and the acceptance also varied the offer by providing for nonliability for failure to deliver when due because of causes beyond the control of the seller. See also Virginia Hardwood Lumber Co. v. Hughes, 140 Va. 249, 257-58, 124 S.E. 283 (1924); Gibney & Co. v. Arlington Brewing Co., 112 Va. 117, 120-21, 70 S.E. 487 (1917) (no contract where acceptance contained three material alterations in the terms of the offer); Lynchburg Hosiery Mills v. Chesterfield Manufacturing Co., 107 Va. 73, 77-78, 57 S.E. 606 (1907) (acceptance varied grades of yarn to be supplied and time of delivery).

The UCC provides that between merchants under specified conditions a failure to respond to proposed additional, nonmaterial terms resnlts in their incorporation into the contract. By thus specifying additional circumstances from which an acceptance by silence may reasonably be implied, the UCC changes Virginia law. See Boone v. Standard Acc. Ins. Co. of Detroit, 192 Va. 672, 66 S.E. 2d 530 (1951) (insurance case).

§ 2-208. **Course of Performance or Practical Construction.** (1) Where the contract for sale involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement.

(2) The express terms of the agreement and any such course of performance, as well as any course of dealing and usage of trade, shall be construed whenever reasonable as consistent with each other; but when such construction is unreasonable, express terms shall control course of performance and course of performance shall control both course of dealing and usage of trade (§ 1-205).

(3) Subject to the provisions of the next section on modification and waiver, such course of performance shall be relevant to show a waiver or modification of any term inconsistent with such course of performance.

COMMENT: **Prior Uniform Statutory Provision:** No such general provision but concept of this section recognized by terms such as "course of dealing", "the circumstances of the case," "the conduct of the parties," etc., in Uniform Sales Act.

Purposes: 1. The parties themselves know best what they have meant by their words of agreement and their action under that agreement is the best indication of what that meaning was. This section thus rounds out the set of factors which

determines the meaning of the "agreement" and therefore also of the "unless otherwise agreed" qualification to various provisions of this Article.

2. Under this section a course of performance is always relevant to determine the meaning of the agreement. Express mention of course of performance elsewhere in this Article carries no contrary implication when there is a failure to refer to it in other sections.

3. Where it is difficult to determine whether a particular act merely sheds light on the meaning of the agreement or represents a waiver of a term of the agreement, the preference is in favor of "waiver" whenever such construction, plus the application of the provisions on the reinstatement of rights waived (see § 2-209), is needed to preserve the flexible character of commercial contracts and to prevent surprise or other hardship.

4. A single occasion of conduct does not fall within the language of this section but other sections such as the ones on silence after acceptance and failure to specify particular defects can affect the parties' rights on a single occasion (see §§ 2-605 and 2-607).

Cross References:

Point 1: § 1-201.
Point 2: § 2-202.
Point 3: §§ 2-209, 2-601 and 2-607.
Point 4: §§ 2-605 and 2-607.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: This section is in accord with Virginia law under which parties engaged in a particular vocation or trade are bound by its usages. Arkla Lumber and Manufacturing Co. v. West Virginia Timber Co., 146 Va. 641, 649-52, 132 S.E. 840 (1926); Walker v. Gateway Milling Co., 121 Va. 217, 221-25, 92 S.E. 826 (1917); Ragland & Co. v. Butler, 59 Va. (18 Gratt.) 323, 335-36 (1868).

§ 2-209. Modification, Rescission and Waiver. (1) An agreement modifying a contract within this Article needs no consideration to be binding.

(2) A signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded, but except as between merchants such a requirement on a form supplied by the merchant must be separately signed by the other party.

(3) The requirements of the statute of frauds section of this Article (§ 2-201) must be satisfied if the contract as modified is within its provisions.

(4) Although an attempt at modification or rescission does not satisfy the requirements of subsection (2) or (3) it can operate as a waiver.

(5) A party who has made a waiver affecting an executory portion of the contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver.

COMMENT: Prior Uniform Statutory Provision: Subsection (1)—Compare § 1, Uniform Written Obligations Act; Subsections (2) to (5)—none.

Purposes of Changes and New Matter: 1. This section seeks to protect and make effective all necessary and desirable modifications of sales contracts without regard to the technicalities which at present hamper such adjustments.

2. Subsection (1) provides that an agreement modifying a sales contract needs no consideration to be binding.

However, modifications made thereunder must meet the test of good faith imposed by this Act. The effective use of bad faith to escape performance on the original contract terms is barred, and the extortion of a "modification" without legitimate commercial reason is ineffective as a violation of the duty of good faith. Nor can a mere technical consideration support a modification made in bad faith.

The test of "good faith" between merchants or as against merchants includes "observance of reasonable commercial standards of fair dealing in the trade" (§ 2-103), and may in some situations require an objectively demonstrable reason for seeking a modification. But such matters as a market shift which makes performance come to involve a loss may provide such a reason even though there is no such unforeseen difficulty as would make out a legal excuse from performance under §§ 2-615 and 2-616.

3. Subsections (2) and (3) are intended to protect against false allegations of oral modifications. "Modification or rescission" includes abandonment or other change by mutual consent, contrary to the decision in Green v. Doniger, 300 N.Y. 238, 90 N.E.2d 56 (1949); it does not include unilateral "termination" or "cancellation" as defined in § 2-106.

The Statute of Frauds provisions of this Article are expressly applied to modifications by subsection (3). Under those provisions the "delivery and acceptance" test is limited to the goods which have been accepted, that is, to the past. "Modification" for the future cannot therefore be conjured up by oral testimony if the price involved is $500.00 or more since such modification must be shown at least by an authenticated memo. And since a memo is limited in its effect to the quantity of goods set forth in it there is safeguard against oral evidence.

Subsection (2) permits the parties in effect to make their own Statute of Frauds as regards any future modification of the contract by giving effect to a clause in a signed agreement which expressly requires any modification to be by signed writing. But note that if a consumer is to be held to such a clause on a form supplied by a merchant it must be separately signed.

4. Subsection (4) is intended, despite the provisions of subsections (2) and (3), to prevent contractual provisions excluding modification except by a signed writing from limiting in other respects the legal effect of the parties' actual later conduct. The effect of such conduct as a waiver is further regulated in subsection (5).

Cross References:

Point 1: § 1-203.
Point 2: §§ 1-201, 1-203, 2-615 and 2-616.
Point 3: §§ 2-106, 2-201 and 2-202.
Point 4: §§ 2-202 and 2-208.

Definitional Cross References:

"Agreement". § 1-201.
"Between merchants". § 2-104.
"Contract". § 1-201.
"Notification". § 1-201.
"Signed". § 1-201.
"Term". § 1-201.
"Writing". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Subsection 2-209(1), providing that an agreement modifying a contract within this Article is binding without consideration, probably changes Virginia law as stated in Georgetown v. Reynolds, 161 Va. 164, 173, 170 S.E. 741 (1933), citing Richmond Leather Manufacturing Co. v. Fawcett, 130 Va. 484, 107 S.E. 800 (1921), for the proposition that a purchaser, who told the seller that if he continued to ship there would be no lawsuit, was held not to be bound by his promise not to sue.

Virginia law has recognized that a stipulation in a written contract that it can only be modified by a writing can be rescinded by an oral agreement. Zurich General Accident and Liability Insurance Co., Ltd. v. Baum, 159 Va. 404, 409, 165 S.E. 518 (1932). Subsection 2-209(2) modifies this rule.

Virginia law is in accord with subsection 2-209(5) in recognizing that the waiver of an executory portion of a contract may be retracted by giving reasonable notification that strict performance is to be required. Cocoa Products Co. of America, Inc. v. Duche, 156 Va. 86, 97, 158 S.E. 719 (1931); Richmond Leather Manufacturing Co. v. Fawcett, 130 Va. 484, 506, 107 S.E. 800 (1921).

The UCC does not say whether causes of action for breaches survive termination of contracts by mutual agreement. Under Virginia law such causes of action do not survive, unless expressly reserved. Plant Lipford, Inc. v. E. W. Gates & Son Co., 141 Va. 325, 335, 127 S.E. 183 (1925); Juniper Lumber Co. v. John M. Nelson, Jr., Inc., 133 Va. 146, 156-57, 112 S.E. 564, 24 A.L.R. 247 (1922).

§ 2-210. **Delegation of Performance; Assignment of Rights.** (1) A party may perform his duty through a delegate unless otherwise agreed or unless the other party has a substantial interest in having his original promisor perform or control the acts required by the contract. No delegation of performance relieves the party delegating of any duty to perform or any liability for breach.

(2) Unless otherwise agreed all rights of either seller or buyer can be assigned except where the assignment would materially change the duty of the other party, or increase materially the burden or risk imposed on him by his contract, or impair materially his chance of obtaining return performance. A right to damages for breach of the whole contract or a right arising out of the assignor's due performance of his entire obligation can be assigned despite agreement otherwise.

(3) Unless the circumstances indicate the contrary a prohibition of assignment of "the contract" is to be construed as barring only the delegation to the assignee of the assignor's performance.

(4) An assignment of "the contract" or of "all my rights under the contract" or an assignment in similar general terms is an assignment of rights and unless the language or the circumstances (as in an assignment for security) indicate the contrary, it is a delegation of performance of the duties of the assignor and its acceptance by the assignee constitutes a promise by him to perform those duties. This promise is enforceable by either the assignor or the other party to the original contract.

(5) The other party may treat any assignment which delegates performance as creating reasonable grounds for insecurity and may without prejudice to his rights against the assignor demand assurances from the assignee (§ 2-609).

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. Generally, this section recognizes both delegation of performance and assignability as normal and permissible incidents of a contract for the sale of goods.

2. Delegation of performance, either in conjunction with an assignment or otherwise, is provided for by subsection (1) where no substantial reason can be shown as to why the delegated performance will not be as satisfactory as personal performance.

3. Under subsection (2) rights which are no longer executory such as a right to damages for breach or a right to payment of an "account" as defined in the Article on Secured Transactions (Article 9) may be assigned although the agreement prohibits assignment. In such cases no question of delegation of any performance is involved. The assignment of a "contract right" as defined in the Article on Secured Transactions (Article 9) is not covered by this subsection.

4. The nature of the contract or the circumstances of the case, however, may bar assignment of the contract even where delegation of performance is not involved.

This Article and this section are intended to clarify this problem, particularly in cases dealing with output, requirement and exclusive dealing contracts. In the first place the section on requirements and exclusive dealing removes from the construction of the original contract most of the "personal discretion" element by substituting the reasonably objective standard of good faith operation of the plant or business to be supplied. Secondly, the section on insecurity and assurances, which is specifically referred to in subsection (5) of this section, frees the other party from the doubts and uncertainty which may afflict him under an assignment of the character in question by permitting him to demand adequate assurance of due performance without which he may suspend his own performance. Subsection (5) is not in any way intended to limit the effect of the section on insecurity and assurances and the word "performance" includes the giving of orders under a requirements contract. Of course, in any case where a material personal discretion is sought to be transferred, effective assignment is harred by subsection (2).

5. Subsection (4) lays down a general rule of construction distinguishing between a normal commercial assignment, which substitutes the assignee for the assignor both as to rights and duties, and a financing assignment in which only the assignor's rights are transferred.

This Article takes no position on the possibility of extending some recognition or power to the original parties to work out normal commercial readjustments of the contract in the case of financing assignments even after the original obligor has been notified of the assignment. This question is dealt with in the Article on Secured Transactions (Article 9).

6. Subsection (5) recognizes that the non-assigning original party has a stake in the reliability of the person with whom he has closed the original contract, and is, therefore, entitled to due assurance that any delegated performance will be properly forthcoming.

7. This section is not intended as a complete statement of the law of delegation and assignment but is limited to clarifying a few points doubtful under the case law. Particularly, neither this section nor this Article touches directly on such questions as the need or effect of notice of the assignment, the rights of successive assignees, or any question of the form of an assignment, either as between the parties or as against any third parties. Some of these questions are dealt with in Article 9.

Cross References:

Point 3: Articles 5 and 9.
Point 4: §§ 2-306 and 2-609.
Point 5: Article 9, §§ 9-317 and 9-318.
Point 7: Article 9.

Definitional Cross References:

"Agreement". § 1-201.
"Buyer". § 2-103.
"Contract". § 1-201.
"Party". § 1-201.
"Rights". § 1-201.
"Seller". § 2-103.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: This section takes a more liberal view as to the assignment of a sales contract than was expressed in J. Maury Dove Co. v. New River Coal Co., 150 Va. 796, 827, 143 S.E. 317 (1928), which held that a contract for the purchase of coal, subject to cancellation if the seller found that the buyer's credit had been impaired, could not be assigned without the consent of the seller. See also Eastern Coal and Export Corp. v. Beasley & Blandford, 121 Va. 4, 10-11, 92 S.E. 824 (1917).

PART 3

GENERAL OBLIGATION AND CONSTRUCTION OF CONTRACT

§ 2-301. General Obligations of Parties. The obligation of the seller is to transfer and deliver and that of the buyer is to accept and pay in accordance with the contract.

COMMENT: **Prior Uniform Statutory Provision:** §§ 11 and 41, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: This section uses the term "obligation" in contrast to the term "duty" in order to provide for the "condition" aspects of delivery and payment insofar as they are not modified by other sections of this Article such as those on cure of tender. It thus replaces not only the general provisions of the Uniform Sales Act on the parties' duties, but also the general provisions of that Act on the effect of conditions. In order to determine what is "in accordance with the contract" under this Article usage of trade, course of dealing and performance, and the general background of circumstances must be given due consideration in conjunction with the lay meaning of the words used to define the scope of the conditions and duties.

Cross References:

§ 1-106. See also §§ 1-205, 2-208, 2-209, 2-508 and 2-612.

Definitional Cross References:

"Buyer". § 2-103.
"Contract". § 1-201.
"Party". § 1-201.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-302. Unconscionable Contract or Clause. (1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

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

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. This section is intended to make it possible for the courts to police explicitly against the contracts or clauses which they find to be unconscionable. In the past such policing has been accomplished by adverse construction of language, by manipulation of the rules of offer and acceptance or by determinations that the clause is contrary to public policy or to the dominant purpose of the contract. This section is intended to allow the court to pass directly on the unconscionability of the contract or particular clause therein and to make a conclusion of law as to its unconscionability. The basic test is whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract. Subsection (2) makes it clear that it is proper for the court to hear evidence upon

these questions. The principle is one of the prevention of oppression and unfair surprise (Cf. Campbell Soup Co. v. Wentz, 172 F.2d 80, 3d Cir. 1948) and not of disturbance of allocation of risks because of superior bargaining power. The underlying basis of this section is illustrated by the results in cases such as the following:

Kansas City Wholesale Grocery Co. v. Weber Packing Corporation, 93 Utah 414, 73 P.2d 1272 (1937), where a clause limiting time for complaints was held inapplicable to latent defects in a shipment of catsup which could be discovered only by microscopic analysis; Hardy v. General Motors Acceptance Corporation, 38 Ga.App. 463, 144 S.E. 327 (1928), holding that a disclaimer of warranty clause applied only to express warranties, thus letting in a fair implied warranty; Andrews Bros. v. Singer & Co. (1934 CA) 1 K.B. 17, holding that where a car with substantial mileage was delivered instead of a "new" car, a disclaimer of warranties, including those "implied," left unaffected an "express obligation" on the description, even though the Sale of Goods Act called such an implied warranty; New Prague Flouring Mill Co. v. G. A. Spears, 194 Iowa 417, 189 N.W. 815 (1922), holding that a clause permitting the seller, upon the buyer's failure to supply shipping instructions, to cancel, ship, or allow delivery date to be indefinitely postponed 30 days at a time by the inaction, does not indefinitely postpone the date of measuring damages for the buyer's breach, to the seller's advantage; and Kansas Flour Mills Co. v. Dirks, 100 Kan. 376, 164 P. 273 (1917), where under a similar clause in a rising market the court permitted the buyer to measure his damages for non-delivery at the end of only one 30 day postponement; Green v. Arcos, Ltd. (1931 CA) 47 T.L.R. 336, where a blanket clause prohibiting rejection of shipments by the buyer was restricted to apply to shipments where discrepancies represented merely mercantile variations; Meyer v. Packard Cleveland Motor Co., 106 Ohio St. 328, 140 N.E. 118 (1922), in which the court held that a "waiver" of all agreements not specified did not preclude implied warranty of fitness of a rebuilt dump truck for ordinary use as a dump truck; Austin Co. v. J. H. Tillman Co., 104 Or. 541, 209 P. 131 (1922), where a clause limiting the buyer's remedy to return was held to be applicable only if the seller had delivered a machine needed for a construction job which reasonably met the contract description; Bekkevold v. Potts, 173 Minn. 87, 216 N.W. 790, 59 A.L.R. 1164 (1927), refusing to allow warranty of fitness for purpose imposed by law to be negated by clause excluding all warranties "made" by the seller; Robert A. Munroe & Co. v. Meyer (1930) 2 K.B. 312, holding that the warranty of description overrides a clause reading "with all faults and defects" where adulterated meat not up to the contract description was delivered.

2. Under this section the court, in its discretion, may refuse to enforce the contract as a whole if it is permeated by the unconscionability, or it may strike any single clause or group of clauses which are so tainted or which are contrary to the essential purpose of the agreement, or it may simply limit unconscionable clauses so as to avoid unconscionable results.

3. The present section is addressed to the court, and the decision is to be made by it. The commercial evidence referred to in subsection (2) is for the court's consideration, not the jury's. Only the agreement which results from the court's action on these matters is to be submitted to the general triers of the facts.

Definitional Cross References:

"Contract". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-303. Allocation or Division of Risks. Where this Article allocates a risk or a burden as between the parties "unless otherwise agreed", the agreement may not only shift the allocation but may also divide the risk or burden.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. This section is intended to make it clear that the parties may modify or allocate "unless otherwise agreed" risks or burdens imposed by this Article as they desire, always subject, of course, to the provisions on unconscionability.

Compare § 1-102(4).

2. The risk or burden may be divided by the express terms of the agreement or by the attending circumstances, since under the definition of "agreement" in this Act the circumstances surrounding the transaction as well as the express language used by the parties enter into the meaning and substance of the agreement.

Cross References:

Point 1: §§ 1-102, 2-302.
Point 2: § 1-201.

Definitional Cross References:

"Party". § 1-201.
"Agreement". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-304. Price Payable in Money, Goods, Realty, or Otherwise. (1) The price can be made payable in money or otherwise. If it is payable in whole or in part in goods each party is a seller of the goods which he is to transfer.

(2) Even though all or part of the price is payable in an interest in realty the transfer of the goods and the seller's obligations with reference to them are subject to this Article, but not the transfer of the interest in realty or the transferor's obligations in connection therewith.

COMMENT: Prior Uniform Statutory Provision: Subsections (2) and (3) of § 9, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: 1. This section corrects the phrasing of the Uniform Sales Act so as to avoid misconstruction and produce greater accuracy in commercial result. While it continues the essential intent and purpose of the Uniform Sales Act it rejects any purely verbalistic construction in disregard of the underlying reason of the provisions.

2. Under subsection (1) the provisions of this Article are applicable to transactions where the "price" of goods is payable in something other than money. This does not mean, however, that this whole Article applies automatically and in its entirety simply because an agreed transfer of title to goods is not a gift. The basic purposes and reasons of the Article must always be considered in determining the applicability of any of its provisions.

3. Subsection (2) lays down the general principle that when goods are to be exchanged for realty, the provisions of this Article apply only to those aspects of the transaction which concern the transfer of title to goods but do not affect the transfer of the realty since the detailed regulation of various particular contracts which fall outside the scope of this Article is left to the courts and other legislation. However, the complexities of these situations may be such that each must be analyzed in the light of the underlying reasons in order to determine the applicable principles. Local statutes dealing with realty are not to be lightly disregarded or altered by language of this Article. In contrast, this Article declares definite policies in regard to certain matters legitimately within its scope though concerned with real property situations, and in those instances the provisions of this Article control.

Cross References:

Point 1: § 1-102.
Point 3: §§ 1-102, 1-103, 1-104 and 2-107.

Definitional Cross References:

"Goods". § 2-105.
"Money". § 1-201.
"Party". § 1-201.
"Seller". § 2-103.

Prior Statutes: None.

Comment: The possibility of treating an exchange of chattels as involving two sales was not discussed in Philip Greenberg, Inc. v. Dunville, 166 Va. 398, 185 S.E. 892 (1936).

§ 2-305. **Open Price Term.** (1) The parties if they so intend can conclude a contract for sale even though the price is not settled. In such a case the price is a reasonable price at the time for delivery if

(a) nothing is said as to price; or

(b) the price is left to be agreed by the parties and they fail to agree; or

(c) the price is to be fixed in terms of some agreed market or other standard as set or recorded by a third person or agency and it is not so set or recorded.

(2) A price to be fixed by the seller or by the buyer means a price for him to fix in good faith.

(3) When a price left to be fixed otherwise than by agreement of the parties fails to be fixed through fault of one party the other may at his option treat the contract as cancelled or himself fix a reasonable price.

(4) Where, however, the parties intend not to be bound unless the price be fixed or agreed and it is not fixed or agreed there is no contract. In such a case the buyer must return any goods already received or if unable so to do must pay their reasonable value at the time of delivery and the seller must return any portion of the price paid on account.

COMMENT: **Prior Uniform Statutory Provision:** §§ 9 and 10, Uniform Sales Act.

Changes: Completely rewritten.

Purposes of Changes: 1. This section applies when the price term is left open on the making of an agreement which is nevertheless intended by the parties to be a binding agreement. This Article rejects in these instances the formula that "an agreement to agree is unenforceable" if the case falls within subsection (1) of this section, and rejects also defeating such agreements on the ground of "indefiniteness". Instead this Article recognizes the dominant intention of the parties to have the deal continue to be binding upon both. As to future performance, since this Article recognizes remedies such as cover (§ 2-712), resale (§ 2-706) and specific performance (§ 2-716) which go beyond any mere arithmetic as between contract price and market price, there is usually a "reasonably certain basis for granting an appropriate remedy for breach" so that the contract need not fail for indefiniteness.

2. Under some circumstances the postponement of agreement on price will mean that no deal has really been concluded, and this is made express in the preamble of subsection (1) ("The parties *if they so intend*") and in subsection (4). Whether or not this is so is, in most cases, a question to be determined by the trier of fact.

3. Subsection (2), dealing with the situation where the price is to be fixed by one party rejects the uncommercial idea that an agreement that the seller may fix the price means that he may fix any price he may wish by the express qualification that the price so fixed must be fixed in good faith. Good faith includes observance of reasonable commercial standards of fair dealing in the trade if the party is a merchant. (§ 2-103). But in the normal case a "posted price" or a future seller's or buyer's "given price," "price in effect," "market price," or the like satisfies the good faith requirement.

4. The section recognizes that there may be cases in which a particular person's judgment is not chosen merely as a barometer or index of a fair price but is an essential condition to the parties' intent to make any contract at all. For

example, the case where a known and trusted expert is to "value" a particular painting for which there is no market standard differs sharply from the situation where a named expert is to determine the grade of cotton, and the difference would support a finding that in the one the parties did not intend to make a binding agreement if that expert were unavailable whereas in the other they did so intend. Other circumstances would of course affect the validity of such a finding.

5. Under subsection (3), wrongful interference by one party with any agreed machinery for price fixing in the contract may be treated by the other party as a repudiation justifying cancellation, or merely as a failure to take cooperative action thus shifting to the aggrieved party the reasonable leeway in fixing the price.

6. Throughout the entire section, the purpose is to give effect to the agreement which has been made. That effect, however, is always conditioned by the requirement of good faith action which is made an inherent part of all contracts within this Act. (§ 1-203).

Cross References:

Point 1: §§ 2-204(3), 2-706, 2-712 and 2-716.
Point 3: § 2-103.
Point 5: §§ 2-311 and 2-610.
Point 6: § 1-203.

Definitional Cross References:

"Agreement". § 1-201.
"Burden of establishing". § 1-201.
"Buyer". § 2-103.
"Cancellation". § 2-106.
"Contract". § 1-201.
"Contract for sale". § 2-106.
"Fault". § 1-201.
"Goods". § 2-105.
"Party". § 1-201.
"Receipt of goods". § 2-103.
"Seller". § 2-103.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: C. G. Blake Co., Inc. v. W. R. Smith and Son, Ltd., 147 Va. 960, 973-81, 133 S.E. 685 (1926), discusses the interpretation of a clause providing that the "price inserted is based upon the government fixed price and subject to any revision."

§ 2-306. Output, Requirements and Exclusive Dealings. (1) A term which measures the quantity by the output of the seller or the requirements of the buyer means such actual output or requirements as may occur in good faith, except that no quantity unreasonably disproportionate to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded.

(2) A lawful agreement by either the seller or the buyer for exclusive dealing in the kind of goods concerned imposes unless otherwise agreed an obligation by the seller to use best efforts to supply the goods and by the buyer to use best efforts to promote their sale.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. Subsection (1) of this section, in regard to output and requirements, applies to this specific problem the general approach of this Act which requires the reading of commercial background and intent into the language of any agreement and demands good faith in the performance of that agreement. It applies to such contracts of nonproducing establishments such as dealers or distributors as well as to manufacturing concerns.

2. Under this Article, a contract for output or requirements is not too indefinite since it is held to mean the actual good faith output or requirements of the particular party. Nor does such a contract lack mutuality of obligation since, under this section, the party who will determine quantity is required to operate his plant or conduct his business in good faith and according to commercial standards of fair dealing in the trade so that his output or requirements will approximate a reasonably foreseeable figure. Reasonable elasticity in the requirements is expressly envisaged by this section and good faith variations from prior requirements are permitted even when the variation may be such as to result in discontinuance. A shut-down by a requirements buyer for lack of orders might be permissible when a shut-down merely to curtail losses would not. The essential test is whether the party is acting in good faith. Similarly, a sudden expansion of the plant by which requirements are to be measured would not be included within the scope of the contract as made but normal expansion undertaken in good faith would be within the scope of this section. One of the factors in an expansion situation would be whether the market price had risen greatly in a case in which the requirements contract contained a fixed price. Reasonable variation of an extreme sort is exemplified in Southwest Natural Gas Co. v. Oklahoma Portland Cement Co., 102 F.2d 630 (C.C.A. 10, 1939). This Article takes no position as to whether a requirements contract is a provable claim in bankruptcy.

3. If an estimate of output or requirements is included in the agreement, no quantity unreasonably disproportionate to it may be tendered or demanded. Any minimum or maximum set by the agreement shows a clear limit on the intended elasticity. In similar fashion, the agreed estimate is to be regarded as a center around which the parties intend the variation to occur.

4. When an enterprise is sold, the question may arise whether the buyer is bound by an existing output or requirements contract. That question is outside the scope of this Article, and is to be determined on other principles of law. Assuming that the contract continues, the output or requirements in the hands of the new owner continue to be measured by the actual good faith output or requirements under the normal operation of the enterprise prior to sale. The sale itself is not grounds for sudden expansion or decrease.

5. Subsection (2), on exclusive dealing, makes explicit the commercial rule embodied in this Act under which the parties to such contracts are held to have impliedly, even when not expressly, bound themselves to use reasonable diligence as well as good faith in their performance of the contract. Under such contracts the exclusive agent is required, although no express commitment has been made, to use reasonable effort and due diligence in the expansion of the market or the promotion of the product, as the case may be. The principal is expected under such a contract to refrain from supplying any other dealer or agent within the exclusive territory. An exclusive dealing agreement brings into play all of the good faith aspects of the output and requirement problems of subsection (1). It also raises questions of insecurity and right to adequate assurance under this Article.

Cross References:

Point 4: § 2-210.
Point 5: §§ 1-203 and 2-609.

Definitional Cross References:

"Agreement". § 1-201.
"Buyer". § 2-103.
"Contract for sale". § 2-106.
"Good faith". § 1-201.
"Goods". § 2-105.
"Party". § 1-201.
"Term". § 1-201.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Virginia law has recognized that "requirements" contracts are sufficiently definite so as to be enforceable. C. G. Blake, Inc. v. W. R. Smith and Son, Ltd., 147 Va. 960, 973, 133 S.E. 685 (1926); Mathieson Alkali Works v. Virginia Banner Coal Corp., 147 Va. 125, 135-36, 143-49, 136 S.E. 673 (1927); New Idea

Spreader Co. v. R. M. Rogers & Sons, 122 Va. 54, 64-65, 94 S.E. 351 (1917); Smokeless Fuel Co. v. W. E. Seaton & Sons, 105 Va. 170, 174, 52 S.E. 829 (1906). A requirements contract is not one for such quantity as the purchaser may see fit to order, but a contract for a reasonable quantity by a good faith buyer, and a buyer whose requirements do not equal a stated estimate is not required to take the estimated figure. Mathieson Alkali Works v. Virginia Banner Coal Corp., 147 Va. 125, 141-50, 136 S.E. 673 (1927). See Standard Ice Co. v. Lynchburg Diamond Ice Factory, 129 Va. 521, 527-32, 106 S.E. 390 (1921), for construction of "the full making capacity of the plant." See also Potts v. Mathieson Alkali Works, 165 Va. 196, 215-18, 181 S.E. 521 (1935).

The Comment, Point 4, indicates that the UCC does not cover the situation presented in Wiseman v. Dennis, 156 Va. 431, 435, 157 S.E. 716 (1931), in which it was held that a buyer could not avoid a requirements contract by selling his business.

§ 2-307. Delivery in Single Lot or Several Lots. Unless otherwise agreed all goods called for by a contract for sale must be tendered in a single delivery and payment is due only on such tender but where the circumstances give either party the right to make or demand delivery in lots the price if it can be apportioned may be demanded for each lot.

COMMENT: **Prior Uniform Statutory Provision:** § 45(1), Uniform Sales Act.

Changes: Rewritten and expanded.

Purposes of Changes: 1. This section applies where the parties have not specifically agreed whether delivery and payment are to be by lots and generally continues the essential intent of original Act, § 45(1) by assuming that the parties intended delivery to be in a single lot.

2. Where the actual agreement or the circumstances do not indicate otherwise, delivery in lots is not permitted under this section and the buyer is properly entitled to reject for a deficiency in the tender, subject to any privilege in the seller to cure the tender.

3. The "but" clause of this section goes to the case in which it is not commercially feasible to deliver or to receive the goods in a single lot as for example, where a contract calls for the shipment of ten carloads of coal and only three cars are available at a given time. Similarly, in a contract involving brick necessary to build a building the buyer's storage space may be limited so that it would be impossible to receive the entire amount of brick at once, or it may be necessary to assemble the goods as in the case of cattle on the range, or to mine them.

In such cases, a partial delivery is not subject to rejection for the defect in quantity alone, if the circumstances do not indicate a repudiation or default by the seller as to the expected balance or do not give the buyer ground for suspending his performance because of insecurity under the provisions of § 2-609. However, in such cases the undelivered balance of goods under the contract must be forthcoming within a reasonable time and in a reasonable manner according to the policy of § 2-503 on manner of tender of delivery. This is reinforced by the express provisions of § 2-608 that if a lot has been accepted on the reasonable assumption that its nonconformity will be cured, the acceptance may be revoked if the cure does not seasonably occur. The section rejects the rule of Kelly Construction Co. v. Hackensack Brick Co., 91 N.J.L. 585, 103 A. 417, 2 A.L.R. 685 (1918) and approves the result in Lynn M. Ranger, Inc. v. Gildersleeve, 106 Conn. 372, 138 A. 142 (1927) in which a contract was made for six carloads of coal then rolling from the mines and consigned to the seller but the seller agreed to divert the carloads to the buyer as soon as the car numbers became known to him. He arranged a diversion of two cars and then notified the buyer who then repudiated the contract. The seller was held to be entitled to his full remedy for the two cars diverted because simultaneous delivery of all of the cars was not contemplated by either party.

4. Where the circumstances indicate that a party has a right to delivery in lots, the price may be demanded for each lot if it is apportionable.

Cross References:

Point 1: § 1-201.
Point 2: §§ 2-508 and 2-601.
Point 3: §§ 2-503, 2-608 and 2-609.

Definitional Cross References:

"Contract for sale". § 2-106.
"Goods". § 2-105.
"Lot". § 2-105.
"Party". § 1-201.
"Rights". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-308. Absence of Specified Place for Delivery. Unless otherwise agreed

(a) the place for delivery of goods is the seller's place of business or if he has none his residence; but

(b) in a contract for sale of identified goods which to the knowledge of the parties at the time of contracting are in some other place, that place is the place for their delivery; and

(c) documents of title may be delivered through customary banking channels.

COMMENT: Prior Uniform Statutory Provision: Paragraphs (a) and (b)—§ 43(1), Uniform Sales Act; Paragraph (c)—none.

Changes: Slight modification in language.

Purposes of Changes and New Matter: 1. Paragraphs (a) and (b) provide for those noncommercial sales and for those occasional commercial sales where no place or means of delivery has been agreed upon by the parties. Where delivery by carrier is "required or authorized by the agreement", the seller's duties as to delivery of the goods are governed not by this section but by § 2-504.

2. Under paragraph (b) when the identified goods contracted for are known to both parties to be in some location other than the seller's place of business or residence, the parties are presumed to have intended that place to be the place of delivery. This paragraph also applies (unless, as would be normal, the circumstances show that delivery by way of documents is intended) to a bulk of goods in the possession of a bailee. In such a case, however, the seller has the additional obligation to procure the acknowledgment by the bailee of the buyer's right to possession.

3. Where "customary banking channels" call only for due notification by the banker that the documents are on hand, leaving the buyer himself to see to the physical receipt of the goods, tender at the buyer's address is not required under paragraph (c). But that paragraph merely eliminates the possibility of a default by the seller if "customary banking channels" have been properly used in giving notice to the buyer. Where the bank has purchased a draft accompanied by documents or has undertaken its collection on behalf of the seller, Part 5 of Article 4 spells out its duties and relations to its customer. Where the documents move forward under a letter of credit the Article on Letters of Credit spells out the duties and relations between the bank, the seller and the buyer.

4. The rules of this section apply only "unless otherwise agreed." The surrounding circumstances, usage of trade, course of dealing and course of performance, as well as the express language of the parties, may constitute an "otherwise agreement".

Cross References:

Point 1: §§ 2-504 and 2-505.
Point 2: § 2-503.
Point 3: § 2-512, Articles 4, Part 5, and 5.

Definitional Cross References:

"Contract for sale". § 2-106.
"Delivery". § 1-201.
"Document of title". § 1-201.
"Goods". § 2-105.
"Party". § 1-201.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Virginia has also indicated, in accord with this section, that the place of delivery, unless otherwise agreed, is at the seller's place of business, or if he has none, at his residence. Geoghegan Sons & Co. v. Arbuckle Bros., 139 Va. 92, 105, 123 S.E. 387, 36 A.L.R. 399 (1924); Blenner v. Vim Motor Truck Co., 136 Va. 189, 204-05, 117 S.E. 834 (1923).

§ 2-309. **Absence of Specific Time Provisions; Notice of Termination.** (1) The time for shipment or delivery or any other action under a contract if not provided in this Article or agreed upon shall be a reasonable time.

(2) Where the contract provides for successive performances but is indefinite in duration it is valid for a reasonable time but unless otherwise agreed may be terminated at any time by either party.

(3) Termination of a contract by one party except on the happening of an agreed event requires that reasonable notification be received by the other party and an agreement dispensing with notification is invalid if its operation would be unconscionable.

COMMENT: **Prior Uniform Statutory Provision:** Subsection (1)—see §§ 43(2), 45(2), 47(1) and 48, Uniform Sales Act, for policy continued under this Article; Subsection (2)—none; Subsection (3)—none.

Changes: Completely different in scope.

Purposes of Changes and New Matter: 1. Subsection (1) requires that all actions taken under a sales contract must be taken within a reasonable time where no time has been agreed upon. The reasonable time under this provision turns on the criteria as to "reasonable time" and on good faith and commercial standards set forth in §§ 1-203, 1-204 and 2-103. It thus depends upon what constitutes acceptable commercial conduct in view of the nature, purpose and circumstances of the action to be taken. Agreement as to a definite time, however, may be found in a term implied from the contractual circumstances, usage of trade or course of dealing or performance as well as in an express term. Such cases fall outside of this subsection since in them the time for action is "agreed" by usage.

2. The time for payment, where not agreed upon, is related to the time for delivery; the particular problems which arise in connection with determining the appropriate time of payment and the time for any inspection before payment which is both allowed by law and demanded by the buyer are covered in § 2-513.

3. The facts in regard to shipment and delivery differ so widely as to make detailed provision for them in the text of this Article impracticable. The applicable principles, however, make it clear that surprise is to be avoided, good faith judgment is to be protected, and notice or negotiation to reduce the uncertainty to certainty is to be favored.

4. When the time for delivery is left open, unreasonably early offers of or demands for delivery are intended to be read under this Article as expressions of desire or intention, requesting the assent or acquiescence of the other party, not as final positions which may amount without more to breach or to create breach by the other side. See §§ 2-207 and 2-609.

5. The obligation of good faith under this Act requires reasonable notification before a contract may be treated as breached because a reasonable time for

delivery or demand has expired. This operates both in the case of a contract originally indefinite as to time and of one subsequently made indefinite by waiver. When both parties let an originally reasonable time go by in silence, the course of conduct under the contract may be viewed as enlarging the reasonable time for tender or demand of performance. The contract may be terminated by abandonment.

6. Parties to a contract are not required in giving reasonable notification to fix, at peril of breach, a time which is in fact reasonable in the unforeseeable judgment of a later trier of fact. Effective communication of a proposed time limit calls for a response, so that failure to reply will make out acquiescence. Where objection is made, however, or if the demand is merely for information as to when goods will be delivered or will be ordered out, demand for assurances on the ground of insecurity may be made under this Article pending further negotiations. Only when a party insists on undue delay or on rejection of the other party's reasonable proposal is there a question of flat breach under the present section.

7. Subsection (2) applies a commercially reasonable view to resolve the conflict which has arisen in the cases as to contracts of indefinite duration. The "reasonable time" of duration appropriate to a given arrangement is limited by the circumstances. When the arrangement has been carried on by the parties over the years, the "reasonable time" can continue indefinitely and the contract will not terminate until notice.

8. Subsection (3) recognizes that the 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. An agreement dispensing with notification or limiting the time for the seeking of a substitute arrangement is, of course, valid under this subsection unless the results of putting it into operation would be the creation of an unconscionable state of affairs.

9. Justifiable cancellation for breach is a remedy for breach and is not the kind of termination covered by the present subsection.

10. The requirement of notification is dispensed with where the contract provides for termination on the happening of an "agreed event." "Event" is a term chosen here to contrast with "option" or the like.

Cross References:

Point 1: §§ 1-203, 1-204 and 2-103.
Point 2: §§ 2-320, 2-321, 2-504, and 2-511 through 2-514.
Point 5: § 1-203.
Point 6: § 2-609.
Point 7: § 2-204.
Point 9: §§ 2-106, 2-318, 2-610 and 2-703.

Definitional Cross References:

"Agreement". § 1-201.
"Contract". § 1-201.
"Notification". § 1-201.
"Party". § 1-201.
"Reasonable time". § 1-204.
"Termination". § 2-106.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: This section is in accord with Virginia law, under which action must be taken within a reasonable time, when there is no specific provision relating to time. Norfolk & Western Railway Co. v. Duke & Rudacille, 107 Va. 764, 768, 60 S.E. 96 (1908); Duke v. Norfolk & Western Railway Co., 106 Va. 152, 155, 55 S.E. 548 (1906); Carpenter Co. v. Virginia-Carolina Chemical Co., 98 Va. 177, 181-82, 35 S.E. 358 (1900). See also Fulton v. Henrico Lumber Co., 152 Va. 666, 676, 148 S.E. 576 (1929), involving conflicting evidence as to the contractual provision relating to the time of delivery. By implication the section recognizes that a failure to make delivery at an agreed time constitutes a breach of a sales contract, a result that is in accord with W. S. Forbes & Co. v. Southern Cotton Oil Co., 130 Va. 245, 252, 108 S.E. 15 (1921).

§ 2-310. Open Time for Payment or Running of Credit; Authority to Ship Under Reservation. Unless otherwise agreed

(a) payment is due at the time and place at which the buyer is to receive the goods even though the place of shipment is the place of delivery; and

(b) if the seller is authorized to send the goods he may ship them under reservation, and may tender the documents of title, but the buyer may inspect the goods after their arrival before payment is due unless such inspection is inconsistent with the terms of the contract (§ 2-513); and

(c) if delivery is authorized and made by way of documents of title otherwise than by subsection (b) then payment is due at the time and place at which the buyer is to receive the documents regardless of where the goods are to be received; and

(d) where the seller is required or authorized to ship the goods on credit the credit period runs from the time of shipment but post-dating the invoice or delaying its dispatch will correspondingly delay the starting of the credit period.

COMMENT: **Prior Uniform Statutory Provision:** §§ 42 and 47(2), Uniform Sales Act.

Changes: Completely rewritten in this and other sections.

Purposes of Changes: This section is drawn to reflect modern business methods of dealing at a distance rather than face to face. Thus:

1. Paragraph (a) provides that payment is due at the time and place "the buyer is to receive the goods" rather than at the point of delivery except in documentary shipment cases (paragraph (c)). This grants an opportunity for the exercise by the buyer of his preliminary right to inspection before paying even though under the delivery term the risk of loss may have previously passed to him or the running of the credit period has already started.

2. Paragraph (b) while providing for inspection by the buyer before he pays, protects the seller. He is not required to give up possession of the goods until he has received payment, where no credit has been contemplated by the parties. The seller may collect through a bank by a sight draft against an order bill of lading "hold until arrival; inspection allowed." The obligations of the bank under such a provision are set forth in Part 5 of Article 4. In the absence of a credit term, the seller is permitted to ship under reservation and if he does payment is then due where and when the buyer is to receive the documents.

3. Unless otherwise agreed, the place for the receipt of the documents and payment is the buyer's city but the time for payment is only after arrival of the goods, since under paragraph (b), and §§ 2-512 and 2-513 the buyer is under no duty to pay prior to inspection.

4. Where the mode of shipment is such that goods must be unloaded immediately upon arrival, too rapidly to permit adequate inspection before receipt, the seller must be guided by the provisions of this Article on inspection which provide that if the seller wishes to demand payment before inspection, he must put an appropriate term into the contract. Even requiring payment against documents will not of itself have this desired result if the documents are to be held until the arrival of the goods. But under (b) and (c) if the terms are C.I.F., C.O.D., or cash against documents payment may be due before inspection.

5. Paragraph (d) states the common commercial understanding that an agreed credit period runs from the time of shipment or from that dating of the invoice which is commonly recognized as a representation of the time of shipment. The provision concerning any delay in sending forth the invoice is included because such conduct results in depriving the buyer of his full notice and warning as to when he must be prepared to pay.

Cross References:

Generally: Part 5.
Point 1: § 2-509.
Point 2: §§ 2-505, 2-511, 2-512, 2-513 and Article 4.
Point 3: §§ 2-308(b), 2-512 and 2-513.
Point 4: § 2-513(3)(b).

Definitional Cross References:

"Buyer". § 2-103.
"Delivery". § 1-201.
"Document of title". § 1-201.
"Goods". § 2-105.
"Receipt of goods". § 2-103.
"Seller". § 2-103.
"Send". § 1-201.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-311. Options and Cooperation Respecting Performance. (1) An agreement for sale which is otherwise sufficiently definite (subsection (3) of § 2-204) to be a contract is not made invalid by the fact that it leaves particulars of performance to be specified by one of the parties. Any such specification must be made in good faith and within limits set by commercial reasonableness.

(2) Unless otherwise agreed specifications relating to assortment of the goods are at the buyer's option and except as otherwise provided in subsections (1)(c) and (3) of § 2-319 specifications or arrangements relating to shipment are at the seller's option.

(3) Where such specification would materially affect the other party's performance but is not seasonably made or where one party's cooperation is necessary to the agreed performance of the other but is not seasonably forthcoming, the other party in addition to all other remedies

(a) is excused for any resulting delay in his own performance; and

(b) may also either proceed to perform in any reasonable manner or after the time for a material part of his own performance treat the failure to specify or to cooperate as a breach by failure to deliver or accept the goods.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. Subsection (1) permits the parties to leave certain detailed particulars of performance to be filled in by either of them without running the risk of having the contract invalidated for indefiniteness. The party to whom the agreement gives power to specify the missing details is required to exercise good faith and to act in accordance with commercial standards so that there is no surprise and the range of permissible variation is limited by what is commercially reasonable. The "agreement" which permits one party so to specify may be found as well in a course of dealing, usage of trade, or implication from circumstances as in explicit language used by the parties.

2. Options as to assortment of goods or shipping arrangements are specifically reserved to the buyer and seller respectively under subsection (2) where no other arrangement has been made. This section rejects the test which mechanically and without regard to usage or the purpose of the option gave the option to the party "first under a duty to move" and applies instead a standard commercial interpretation to these circumstances. The "unless otherwise agreed" provision of this subsection covers not only express terms but the background and circumstances which enter into the agreement.

3. Subsection (3) applies when the exercise of an option or cooperation by one party is necessary to or materially affects the other party's performance, but it is not seasonably forthcoming; the subsection relieves the other party from the necessity for performance or excuses his delay in performance as the case may be. The contract-keeping party may at his option under this subsection proceed to perform in any commercially reasonable manner rather than wait. In addition to the special remedies provided, this subsection also reserves "all other remedies". The remedy of particular importance in this connection is that provided for insecurity. Request may also be made pursuant to the obligation of good faith for a reasonable indication of the time and manner of performance for which a party is to hold himself ready.

4. The remedy provided in subsection (3) is one which does not operate in the situation which falls within the scope of § 2-614 on substituted performance. Where the failure to cooperate results from circumstances set forth in that Section, the other party is under a duty to proffer or demand (as the case may be) substitute performance as a condition to claiming rights against the non-cooperating party.

Cross References:

Point 1: §§ 1-201, 2-204 and 1-208.
Point 3: §§ 1-203 and 2-609.
Point 4: § 2-614.

Definitional Cross References:

"Agreement". § 1-201.
"Buyer". § 2-103.
"Contract for sale". § 2-106.
"Goods". § 2-105.
"Party". § 1-201.
"Remedy". § 1-201.
"Seasonably". § 1-204.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Virginia has reached the same result as provided for in subsection 2-311(3), excusing a party who fails to receive seasonable cooperation from the other party for any resulting delay in his own performance. James River Lumber Co., Inc. v. Smith Bros., 135 Va. 406, 416-18, 116 S.E. 241 (1923); Lewis v. Weldon, 24 Va. (3 Rand.) 71, 79-80 (1824).

Virginia is in accord with subsection 2-311(3), having given similar effect to an express contractual clause providing that "failure to give prompt shipping instruction may, at seller's option, be deemed refusal to take nitrate." Wessel, Duval & Co. v. Crozet Cooperage Co., 143 Va. 469, 473-76, 130 S.E. 393 (1925).

§ 2-312. Warranty of Title and Against Infringement; Buyer's Obligation Against Infringement. (1) Subject to subsection (2) there is in a contract for sale a warranty by the seller that

(a) the title conveyed shall be good, and its transfer rightful; and

(b) the goods shall be delivered free from any security interest or other lien or encumbrance of which the buyer at the time of contracting has no knowledge.

(2) A warranty under subsection (1) will be excluded or modified only by specific language or by circumstances which give the buyer reason to know that the person selling does not claim title in himself or that he is purporting to sell only such right or title as he or a third person may have.

(3) Unless otherwise agreed a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or

the like but a buyer who furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications.

COMMENT: Prior Uniform Statutory Provision: § 13, Uniform Sales Act.

Changes: Completely rewritten, the provisions concerning infringement being new.

Purposes of Changes: 1. Subsection (1) makes provision for a buyer's basic needs in respect to a title which he in good faith expects to acquire by his purchase, namely, that he receive a good, clean title transferred to him also in a rightful manner so that he will not be exposed to a lawsuit in order to protect it.

The warranty extends to a buyer whether or not the seller was in possession of the goods at the time the sale or contract to sell was made.

The warranty of quiet possession is abolished. Disturbance of quiet possession, although not mentioned specifically, is one way, among many, in which the breach of the warranty of title may be established.

The "knowledge" referred to in subsection 1(b) is actual knowledge as distinct from notice.

2. The provisions of this Article requiring notification to the seller within a reasonable time after the buyer's discovery of a breach apply to notice of a breach of the warranty of title, where the seller's breach was innocent. However, if the seller's breach was in bad faith he cannot be permitted to claim that he has been misled or prejudiced by the delay in giving notice. In such case the "reasonable" time for notice should receive a very liberal interpretation. Whether the breach by the seller is in good or bad faith § 2-725 provides that the cause of action accrues when the breach occurs. Under the provisions of that section the breach of the warranty of good title occurs when tender of delivery is made since the warranty is not one which extends to "future performance of the goods."

3. When the goods are part of the seller's normal stock and are sold in his normal course of business, it is his duty to see that no claim of infringement of a patent or trademark by a third party will mar the buyer's title. A sale by a person other than a dealer, however, raises no implication in its circumstances of such a warranty. Nor is there such an implication when the buyer orders goods to be assembled, prepared or manufactured on his own specifications. If, in such a case, the resulting product infringes a patent or trademark, the liability will run from buyer to seller. There is, under such circumstances, a tacit representation on the part of the buyer that the seller will be safe in manufacturing according to the specifications, and the buyer is under an obligation in good faith to indemnify him for any loss suffered.

4. This section rejects the cases which recognize the principle that infringements violate the warranty of title but deny the buyer a remedy unless he has been expressly prevented from using the goods. Under this Article "eviction" is not a necessary condition to the buyer's remedy since the buyer's remedy arises immediately upon receipt of notice of infringement; it is merely one way of establishing the fact of breach.

5. Subsection (2) recognizes that sales by sheriffs, executors, foreclosing lienors and persons similarly situated are so out of the ordinary commercial course that their peculiar character is immediately apparent to the buyer and therefore no personal obligation is imposed upon the seller who is purporting to sell only an unknown or limited right. This subsection does not touch upon and leaves open all questions of restitution arising in such cases, when a unique article so sold is reclaimed by a third party as the rightful owner.

6. The warranty of subsection (1) is not designated as an "implied" warranty, and hence is not subject to § 2-316 (3). Disclaimer of the warranty of title is governed instead by subsection (2), which requires either specific language or the described circumstances.

Cross References:

Point 1: § 2-403.
Point 2: §§ 2-607 and 2-725.
Point 3: § 1-203.
Point 4: §§ 2-609 and 2-725.
Point 6: § 2-316.

Definitional Cross References:

"Buyer". § 2-103.
"Contract for sale". § 2-106.
"Goods". § 2-105.
"Person". § 1-201.
"Right". § 1-201.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: An express warranty of clear title in the sale of an automobile was involved in Silvey v. Johnston, 193 Va. 677, 679, 70 S.E.2d 280 (1952), but Virginia has not had a case involving an implied warranty of title.

§ 2-313. Express Warranties by Affirmation, Promise, Description, Sample. (1) Express warranties by the seller are created as follows:

(a) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.

(b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.

(c) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.

(2) It is not necessary to the creation of an express warranty that the seller use formal words such as "warrant" or "guarantee" or that he have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods does not create a warranty.

COMMENT: **Prior Uniform Statutory Provision:** §§ 12, 14 and 16, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To consolidate and systematize basic principles with the result that:

1. "Express" warranties rest on "dickered" aspects of the individual bargain, and go so clearly to the essence of that bargain that words of disclaimer in a form are repugnant to the basic dickered terms. "Implied" warranties rest so clearly on a common factual situation or set of conditions that no particular language or action is necessary to evidence them and they will arise in such a situation unless unmistakably negated.

This section reverts to the older case law insofar as the warranties of description and sample are designated "express" rather than "implied".

2. Although this section is limited in its scope and direct purpose to warranties made by the seller to the buyer as part of a contract for sale, the warranty sections of this Article are not designed in any way to disturb those lines of case law growth which have recognized that warranties need not be confined either to sales contracts or to the direct parties to such a contract. They may arise in other appropriate circumstances such as in the case of bailments for hire, whether such bailment is itself the main contract or is merely a supplying of containers under a contract for the sale of their contents. The provisions of § 2-318 on third party beneficiaries expressly recognize this case law development within one particular area. Beyond that, the matter is left to the case law with the intention that the policies of this Act may offer useful guidance in dealing with further cases as they arise.

3. The present section deals with affirmations of fact by the seller, descriptions of the goods or exhibitions of samples, exactly as any other part of a negotiation which ends in a contract is dealt with. No specific intention to make a warranty is necessary if any of these factors is made part of the basis of the bargain. In actual practice affirmations of fact made by the seller about the goods during a bargain are regarded as part of the description of those goods; hence no particular reliance on such statements need be shown in order to weave them into the fabric of the agreement. Rather, any fact which is to take such affirmations, once made, out of the agreement requires clear affirmative proof. The issue normally is one of fact.

4. In view of the principle that the whole purpose of the law of warranty is to determine what it is that the seller has in essence agreed to sell, the policy is adopted of those cases which refuse except in unusual circumstances to recognize a material deletion of the seller's obligation. Thus, a contract is normally a contract for a sale of something describable and described. A clause generally disclaiming "all warranties, express or implied" cannot reduce the seller's obligation with respect to such description and therefore cannot be given literal effect under § 2-316.

This is not intended to mean that the parties, if they consciously desire, cannot make their own bargain as they wish. But in determining what they have agreed upon good faith is a factor and consideration should be given to the fact that the probability is small that a real price is intended to be exchanged for a pseudo-obligation.

5. Paragraph (1)(b) makes specific some of the principles set forth above when a description of the goods is given by the seller.

A description need not be by words. Technical specifications, blueprints and the like can afford more exact description than mere language and if made part of the basis of the bargain goods must conform with them. Past deliveries may set the description of quality, either expressly or impliedly by course of dealing. Of course, all descriptions by merchants must be read against the applicable trade usages with the general rules as to merchantability resolving any doubts.

6. The basic situation as to statements affecting the true essence of the bargain is no different when a sample or model is involved in the transaction. This section includes both a "sample" actually drawn from the bulk of goods which is the subject matter of the sale, and a "model" which is offered for inspection when the subject matter is not at hand and which has not been drawn from the bulk of the goods.

Although the underlying principles are unchanged, the facts are often ambiguous when something is shown as illustrative, rather than as a straight sample. In general, the presumption is that any sample or model just as any affirmation of fact is intended to become a basis of the bargain. But there is no escape from the question of fact. When the seller exhibits a sample purporting to be drawn from an existing bulk, good faith of course requires that the sample be fairly drawn. But in mercantile experience the mere exhibition of a "sample" does not of itself show whether it is merely intended to "suggest" or to "be" the character of the subject-matter of the contract. The question is whether the seller has so acted with reference to the sample as to make him responsible that the whole shall have at least the values shown by it. The circumstances aid in answering this question. If the sample has been drawn from an existing bulk, it must be regarded as describing values of the goods contracted for unless it is accompanied hy an unmistakable denial of such responsibility. If, on the other hand, a model of merchandise not on hand is offered, the mercantile presumption that it has become a literal description of the subject matter is not so strong, and particularly so if modification on the buyer's initiative impairs any feature of the model.

7. The precise time when words of description or affirmation are made or samples are shown is not material. The sole question is whether the language or samples or models are fairly to be regarded as part of the contract. If language is used after the closing of the deal (as when the buyer when taking delivery asks and receives an additional assurance), the warranty becomes a modification, and need not be supported by consideration if it is otherwise reasonable and in order (§ 2-209).

8. Concerning affirmations of value or a seller's opinion or commendation under subsection (2), the basic question remains the same: What statements of the seller have in the circumstances and in objective judgment become part of the

basis of the bargain? As indicated above, all of the statements of the seller do so unless good reason is shown to the contrary. The provisions of subsection (2) are included, however, since common experience discloses that some statements or predictions cannot fairly be viewed as entering into the bargain. Even as to false statements of value, however, the possibility is left open that a remedy may be provided by the law relating to fraud or misrepresentation.

Cross References:

Point 1: § 2-316.
Point 2: §§ 1-102(3) and 2-318.
Point 3: § 2-316(2)(h).
Point 4: § 2-316.
Point 5: §§ 1-205(4) and 2-314.
Point 6: § 2-316.
Point 7: § 2-209.
Point 8: § 1-103.

Definitional Cross References:

"Buyer". § 2-103.
"Conforming". § 2-106.
"Goods". § 2-105.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Virginia law relating to express warranties is generally in accord with this section. C. E. Wright & Co., Inc. v. Shackleford, 152 Va. 635, 648, 148 S.E. 807 (1929) (ninety day warranty of new car); Newbern v. Joseph Baker & Co., Inc., 147 Va. 996, 998, 133 S.E. 500 (1926) (cabbage warranted to be in good merchantable condition); Ford Motor Co. v. Switzer, 140 Va. 383, 393-94, 125 S.E. 209 (1924) (new car warranted for ninety days to be free from defects in material and workmanship); Monroe & Monroe, Inc. v. Cowne, 133 Va. 181, 203, 112 S.E. 848 (1922) (warranty of a machine); Ney v. Wrenn, 117 Va. 85, 93, 84 S.E. 1 (1915) (machine warranted to be strictly up-to-date in every respect and in first-class working condition); Reese & Co. v. Bates, 94 Va. 321, 324, 26 S.E. 865 (1897) (fertilizer warranted to be as good for potatoes as any other in the market); Milburn Wagon Co. v. Nisewarner, 90 Va. 714, 715, 19 S.E. 846 (1894) (seller expressly warranted in catalogue that wagons were well made of good, thoroughly seasoned material, and of sufficient strength to carry the weights mentioned); Herron & Holland v. Dibrell Bros., 87 Va. 289, 292, 12 S.E. 674 (1891) (tobacco warranted to be sound); Eastern Ice Co. v. King, 86 Va. 97, 98, 9 S.E. 506 (1889) (warranted best quality ice); Trice v. Cockran, 49 Va. (8 Gratt.) 442, 450 (1852) (slave warranted sound). The only apparent discrepancy between the UCC and prior Virginia law is that under UCC subsection 2-313(2) it is not necessary for the seller to have any specific intention to make a warranty, while the Supreme Court of Appeals in Mason v. Chappell, 56 Va. (15 Gratt.) 572, 583 (1860), said that "no affirmation, however strong, will constitute a warranty, unless it is so intended." See also Herron & Holland v. Dibrell Bros., 87 Va. 289, 296, 12 S.E. 674 (1891).

Since under the UCC both a warranty by affirmation and one by description are express warranties, it is unnecessary to determine which the warranty is. See Latham v. Powell, 127 Va. 382, 398-400, 103 S.E. 638 (1920). Depending somewhat on the view taken of the facts, subsection 2-313(1)(b) might change the result in Gillette v. Kelling Nut Co., 185 F.2d 294, 297-98 (4th Cir. 1950), in which there was a sale by description, but the buyer relied on his own inspection rather than the seller's description. If the description was "made part of the basis of the bargain" there would be an express warranty under the UCC, but not otherwise.

Virginia law is in accord with subsection 2-313(1)(c) that a sample made a part of the bargain creates an express warranty. Van Duyn v. Matthews, 181 Va. 256, 259-61, 24 S.E.2d 442 (1943); Jacot v. Grossman Seed and Supply Co., Inc., 115 Va. 90, 105, 78 S.E. 646 (1913); Note, 1 Va. L. Rev. 151 (1913). Although a sample is exhibited, it is not necessarily a part of the bargain. Proctor v. Spratley, 78 Va. 254, 265-66 (1884).

§ 2-314. Implied Warranty: Merchantability; Usage of Trade. (1) Unless excluded or modified (§ 2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a mer-

chant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.

(2) Goods to be merchantable must be at least such as

(a) pass without objection in the trade under the contract description; and

(b) in the case of fungible goods, are of fair average quality within the description; and

(c) are fit for the ordinary purposes for which such goods are used; and

(d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and

(e) are adequately contained, packaged, and labeled as the agreement may require; and

(f) conform to the promises or affirmations of fact made on the container or label if any.

(3) Unless excluded or modified (§ 2-316) other implied warranties may arise from course of dealing or usage of trade.

COMMENT: Prior Uniform Statutory Provision: § 15(2), Uniform Sales Act.

Changes: Completely rewritten.

Purposes of Changes: This section, drawn in view of the steadily developing case law on the subject, is intended to make it clear that:

1. The seller's obligation applies to present sales as well as to contracts to sell subject to the effects of any examination of specific goods. (Subsection (2) of § 2-316). Also, the warranty of merchantability applies to sales for use as well as to sales for resale.

2. The question when the warranty is imposed turns basically on the meaning of the terms of the agreement as recognized in the trade. Goods delivered under an agreement made by a merchant in a given line of trade must be of a quality comparable to that generally acceptable in that line of trade under the description or other designation of the goods used in the agreement. The responsibility imposed rests on any merchant-seller, and the absence of the words "grower or manufacturer or not" which appeared in § 15(2) of the Uniform Sales Act does not restrict the applicability of this section.

3. A specific designation of goods by the buyer does not exclude the seller's obligation that they be fit for the general purposes appropriate to such goods. A contract for the sale of second-hand goods, however, involves only such obligation as is appropriate to such goods for that is their contract description. A person making an isolated sale of goods is not a "merchant" within the meaning of the full scope of this section and, thus, no warranty of merchantability would apply. His knowledge of any defects not apparent on inspection would, however, without need for express agreement and in keeping with the underlying reason of the present section and the provisions on good faith, impose an obligation that known material but hidden defects be fully disclosed.

4. Although a seller may not be a "merchant" as to the goods in question, if he states generally that they are "guaranteed" the provisions of this section may furnish a guide to the content of the resulting express warranty. This has particular significance in the case of second-hand sales, and has further significance in limiting the effect of fine-print disclaimer clauses where their effect would be inconsistent with large-print assertions of "guarantee".

5. The second sentence of subsection (1) covers the warranty with respect to food and drink. Serving food or drink for value is a sale, whether to be con-

sumed on the premises or elsewhere. Cases to the contrary are rejected. The principal warranty is that stated in subsections (1) and (2)(c) of this section.

6. Subsection (2) does not purport to exhaust the meaning of "merchantable" nor to negate any of its attributes not specifically mentioned in the text of the statute, but arising by usage of trade or through case law. The language used is "must be at least such as . . . ," and the intention is to leave open other possible attributes of merchantability.

7. Paragraphs (a) and (b) of subsection (2) are to be read together. Both refer, as indicated above, to the standards of that line of the trade which fits the transaction and the seller's business. "Fair average" is a term directly appropriate to agricultural bulk products and means goods centering around the middle belt of quality, not the least or the worst that can be understood in the particular trade by the designation, but such as can pass "without objection." Of course a fair percentage of the least is permissible but the goods are not "fair average" if they are all of the least or worst quality possible under the description. In cases of doubt as to what quality is intended, the price at which a merchant closes a contract is an excellent index of the nature and scope of his obligation under the present section.

8. Fitness for the ordinary purposes for which goods of the type are used is a fundamental concept of the present section and is covered in paragraph (c). As stated above, merchantability is also a part of the obligation owing to the purchaser for use. Correspondingly, protection, under this aspect of the warranty, of the person buying for resale to the ultimate consumer is equally necessary, and merchantable goods must therefore be "honestly" resalable in the normal course of business because they are what they purport to be.

9. Paragraph (d) on evenness of kind, quality and quantity follows case law. But precautionary language has been added as a reminder of the frequent usages of trade which permit substantial variations both with and without an allowance or an obligation to replace the varying units.

10. Paragraph (e) applies only where the nature of the goods and of the transaction require a certain type of container, package or label. Paragraph (f) applies, on the other hand, wherever there is a label or container on which representations are made, even though the original contract, either by express terms or usage of trade, may not have required either the labelling or the representation. This follows from the general obligation of good faith which requires that a buyer should not be placed in the position of reselling or using goods delivered under false representations appearing on the package or container. No problem of extra consideration arises in this connection since, under this Article, an obligation is imposed by the original contract not to deliver mislabeled articles, and the obligation is imposed where mercantile good faith so requires and without reference to the doctrine of consideration.

11. Exclusion or modification of the warranty of merchantability, or of any part of it, is dealt with in the section to which the text of the present section makes explicit precautionary references. That section must be read with particular reference to its subsection (4) on limitation of remedies. The warranty of merchantability, wherever it is normal, is so commonly taken for granted that its exclusion from the contract is a matter threatening surprise and therefore requiring special precaution.

12. Subsection (3) is to make explicit that usage of trade and course of dealing can create warranties and that they are implied rather than express warranties and thus subject to exclusion or modification under § 2-316. A typical instance would be the obligation to provide pedigree papers to evidence conformity of the animal to the contract in the case of a pedigreed dog or blooded bull.

13. In an action based on breach of warranty, it is of course necessary to show not only the existence of the warranty but the fact that the warranty was broken and that the breach of the warranty was the proximate cause of the loss sustained. In such an action an affirmative showing by the seller that the loss resulted from some action or event following his own delivery of the goods can operate as a defense. Equally, evidence indicating that the seller exercised care in the manufacture, processing or selection of the goods is relevant to the issue of whether the warranty was in fact broken. Action by the buyer following an examination of the goods which ought to have indicated the defect complained of can be shown as matter bearing on whether the breach itself was the cause of the injury.

Cross References:

Point 1: § 2-316.
Point 3: §§ 1-203 and 2-104.
Point 5: § 2-315.
Point 11: § 2-316.
Point 12: §§ 1-201, 1-205 and 2-316.

Definitional Cross References:

"Agreement". § 1-201.
"Contract". § 1-201.
"Contract for sale". § 2-106.
"Goods". § 2-105.
"Merchant". § 2-104.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: This section is in accord with the Virginia decision in Smith v. Hensley, 202 Va. 700, 703-04, 119 S.E.2d 332 (1961), in recognizing an implied warranty of merchantability in the sale of all kinds of goods. This case involved the sale of a roof coating by its trade name and the court said that "there was an implied warranty of merchantability or fitness of the product for the ordinary or general purposes for which it was sold." The case is commented upon in Comment, The Implied Warranty of Merchantability—Smith v. Hensley, 48 Va. L. Rev. 152 (1962). The general subject is also discussed in Note, The Implied Warranty of Fitness in Virginia, 43 Va. L. Rev. 273 (1957).

Virginia had previously recognized something akin to this warranty insofar as sales of food and drink not in sealed packages was involved. In such sales the Virginia court has recognized that there is a warranty that the food is sound and fit for human consumption. Kroger Grocery and Baking Co. v. Dunn, 181 Va. 390, 393-94, 25 S.E.2d 254 (1943) (sale by seller to buyer-plaintiff of ham from which plaintiff got ptomaine poisoning); Colonna v. Rosedale Dairy Co., 166 Va. 314, 317-22, 186 S.E. 94 (1936) (sale of unwholesome milk). Virginia has never decided whether the implied warranty also arises in sales of food and beverages in the original sealed containers, which bear the label of reputable manufacturers. See Blythe v. Camp Manufacturing Co., 183 Va. 432, 442, 32 S.E.2d 659 (1945). The federal district court has extended the warranty to cosmetics sold in sealed containers. Higbee v. Giant Food Shopping Center, Inc., 106 F. Supp. 586, 587-88 (E.D. Va. 1952), Note, 38 Va. L. Rev. 1109 (1952).

In some other cases Virginia has recognized what seems in substance to have been a warranty of merchantability, although not called by this name. H. M. Gleason and Co., Inc. v. International Harvester Co., 197 Va. 255, 257-63, 88 S.E.2d 904 (1955) (implied warranty of tractor-trailer fifth wheel); Swersky v. Higgins, 194 Va. 983, 985-88, 76 S.E.2d 200 (1953) (implied warranty that roofing materials were reasonably fit for the purposes for which they were applied); McNeir v. Greer-Hale Chinchilla Ranch, 194 Va. 623, 627-28, 74 S.E.2d 165 (1953) (implied warranty as to the breeding qualities of chinchillas); Wood v. Quillin, 167 Va. 255, 261, 188 S.E. 216 (1936) (implied warranty that seeds of kind and name for which sold); Charles Syer & Co. v. Lester, 116 Va. 541, 545, 82 S.E. 122 (1914) (implied warranty of the quantity and quality of lemons).

This section does not purport to cover tort actions for negligence. See Standard Paint Co. v. E. K. Vietor & Co., 120 Va. 595, 91 S.E. 752 (1917), and cases cited in VIRGINIA ANNOTATIONS to UCC 2-318. By authorizing an action for breach of warranty, the UCC would probably change the result in Belcher v. Goff Bros., 145 Va. 448, 454-58, 134 S.E. 588 (1926). That decision involved an unsuccessful tort action by an injured purchaser of kerosene containing gasoline against a seller who was not the manufacturer. While the court also denied recovery on a warranty theory this result would clearly be changed by the UCC; the seller was a merchant and kerosene containing gasoline cannot be considered of merchantable quality.

Virginia, in a case involving an express warranty of merchantability, has recognized the importance of the trade in which the goods are bought and sold in determining whether goods are merchantable. Ripeness in vegetables, which would not constitute a breach of warranty of merchantability in a sale to a retailer, may, nevertheless, be a breach in a sale to a wholesaler. Newbern v. Joseph Baker & Co., Inc., 147 Va. 996, 1005-06, 133 S.E. 500 (1926). This approach is consistent with subsection 2-314(2)(a).

§ 2-315. **Implied Warranty: Fitness for Particular Purpose.** Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose.

COMMENT: Prior Uniform Statutory Provision: § 15 (1), (4), (5), Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: 1. Whether or not this warranty arises in any individual case is basically a question of fact to be determined by the circumstances of the contracting. Under this section the buyer need not bring home to the seller actual knowledge of the particular purpose for which the goods are intended or of his reliance on the seller's skill and judgment, if the circumstances are such that the seller has reason to realize the purpose intended or that the reliance exists. The buyer, of course, must actually be relying on the seller.

2. A "particular purpose" differs from the ordinary purpose for which the goods are used in that it envisages a specific use by the buyer which is peculiar to the nature of his business whereas the ordinary purposes for which goods are used are those envisaged in the concept of merchantability and go to uses which are customarily made of the goods in question. For example, shoes are generally used for the purpose of walking upon ordinary ground, but a seller may know that a particular pair was selected to be used for climbing mountains.

A contract may of course include both a warranty of merchantability and one of fitness for a particular purpose.

The provisions of this Article on the cumulation and conflict of express and implied warranties must be considered on the question of inconsistency between or among warranties. In such a case any question of fact as to which warranty was intended by the parties to apply must be resolved in favor of the warranty of fitness for particular purpose as against all other warranties except where the buyer has taken upon himself the responsibility of furnishing the technical specifications.

3. In connection with the warranty of fitness for a particular purpose the provisions of this Article on the allocation or division of risks are particularly applicable in any transaction in which the purpose for which the goods are to be used combines requirements both as to the quality of the goods themselves and compliance with certain laws or regulations. How the risks are divided is a question of fact to be determined, where not expressly contained in the agreement, from the circumstances of contracting, usage of trade, course of performance and the like, matters which may constitute the "otherwise agreement" of the parties by which they may divide the risk or burden.

4. The absence from this section of the language used in the Uniform Sales Act in referring to the seller, "whether he be the grower or manufacturer or not," is not intended to impose any requirement that the seller be a grower or manufacturer. Although normally the warranty will arise only where the seller is a merchant with the appropriate "skill or judgment," it can arise as to non-merchants where this is justified by the particular circumstances.

5. The elimination of the "patent or other trade name" exception constitutes the major extension of the warranty of fitness which has been made by the cases and continued in this Article. Under the present section the existence of a patent or other trade name and the designation of the article by that name, or indeed in any other definite manner, is only one of the facts to be considered on the question of whether the buyer actually relied on the seller, but it is not of itself decisive of the issue. If the buyer himself is insisting on a particular brand he is not relying on the seller's skill and judgment and so no warranty results. But the mere fact that the article purchased has a particular patent or trade name is not sufficient to indicate nonreliance if the article has been recommended by the seller as adequate for the buyer's purposes.

6. The specific reference forward in the present section to the following section on exclusion or modification of warranties is to call attention to the possibility of eliminating the warranty in any given case. However it must be noted that

under the following section the warranty of fitness for a particular purpose must be excluded or modified by a conspicuous writing.

Cross References:

Point 2: §§ 2-314 and 2-317.
Point 3: § 2-303.
Point 6: § 2-316.

Definitional Cross References:

"Buyer". § 2-103.
"Goods". § 2-105.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Virginia has recognized this warranty of fitness for a particular purpose. The Virginia law is discussed in Note, The Implied Warranty of Fitness in Virginia, 43 Va. L. Rev. 273 (1957). In E. I. duPont de Nemours & Co. v. Universal Moulded Products Corp., 191 Va. 525, 566, 62 S.E.2d 233 (1950), the court said, "When one contracts to supply an article in which he deals, to be applied to a particular purpose, so that the buyer necessarily trusts to the judgment or skill of the vendor, there is an implied warranty that it shall be reasonably fit for the purpose to which it is to be applied; and the better doctrine is that this rule applies to dealers as well as to manufacturers and not to manufacturers alone." See also H. M. Gleason and Co., Inc. v. International Harvester Co., 197 Va. 255, 257-63, 88 S.E.2d 904 (1955); Greenland Development Corp. v. Allied Heating Products Co., Inc., 184 Va. 588, 597-98, 35 S.E.2d 801, 164 A.L.R. 1312 (1945), Note, 32 Va. L. Rev. 679 (1946); Universal Motor Co. v. Snow, 149 Va. 690, 695-700, 140 S.E. 653, 59 A.L.R. 1174 (1927); Standard Paint Co. v. E. K. Vietor & Co., 120 Va. 595, 608-09, 91 S.E. 752 (1917); Gerst v. Jones & Co., 73 Va. (32 Gratt.) 518, 521-24 (1879).

§ 2-316. Exclusion or Modification of Warranties. (1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but subject to the provisions of this Article on parol or extrinsic evidence (§ 2-202) negation or limitation is inoperative to the extent that such construction is unreasonable.

(2) Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that "There are no warranties which extend beyond the description on the face hereof."

(3) Notwithstanding subsection (2)

(a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as is", "with all faults" or other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty; and

(b) when the buyer before entering into the contract has examined the goods or the sample or model as fully as he desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him; and

(c) an implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade.

(4) Remedies for breach of warranty can be limited in accordance with the provisions of this Article on liquidation or limitation of damages and on contractual modification of remedy (§§ 2-718 and 2-719).

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. This section is designed principally to deal with those frequent clauses in sales contracts which seek to exclude "all warranties, express or implied." It seeks to protect a buyer from unexpected and unbargained language of disclaimer by denying effect to such language when inconsistent with language of express warranty and permitting the exclusion of implied warranties only by conspicuous language or other circumstances which protect the buyer from surprise.

2. The seller is protected under this Article against false allegations of oral warranties by its provisions on parol and extrinsic evidence and against unauthorized representations by the customary "lack of authority" clauses. This Article treats the limitation or avoidance of consequential damages as a matter of limiting remedies for breach, separate from the matter of creation of liability under a warranty. If no warranty exists, there is of course no problem of limiting remedies for breach of warranty. Under subsection (4) the question of limitation of remedy is governed by the sections referred to rather than by this section.

3. Disclaimer of the implied warranty of merchantability is permitted under subsection (2), but with the safeguard that such disclaimers must mention merchantability and in case of a writing must be conspicuous.

4. Unlike the implied warranty of merchantability, implied warranties of fitness for a particular purpose may be excluded by general language, but only if it is in writing and conspicuous.

5. Subsection (2) presupposes that the implied warranty in question exists unless excluded or modified. Whether or not language of disclaimer satisfies the requirements of this section, such language may be relevant under other sections to the question whether the warranty was ever in fact created. Thus, unless the provisions of this Article on parol and extrinsic evidence prevent, oral language of disclaimer may raise issues of fact as to whether reliance by the buyer occurred and whether the seller had "reason to know" under the section on implied warranty of fitness for a particular purpose.

6. The exceptions to the general rule set forth in paragraphs (a), (b) and (c) of subsection (3) are common factual situations in which the circumstances surrounding the transaction are in themselves sufficient to call the buyer's attention to the fact that no implied warranties are made or that a certain implied warranty is being excluded.

7. Paragraph (a) of subsection (3) deals with general terms such as "as is," "as they stand," "with all faults," and the like. Such terms in ordinary commercial usage are understood to mean that the buyer takes the entire risk as to the quality of the goods involved. The terms covered by paragraph (a) are in fact merely a particularization of paragraph (c) which provides for exclusion or modification of implied warranties by usage of trade.

8. Under paragraph (b) of subsection (3) warranties may be excluded or modified by the circumstances where the buyer examines the goods or a sample or model of them before entering into the contract. "Examination" as used in this paragraph is not synonymous with inspection before acceptance or at any other time after the contract has been made. It goes rather to the nature of the responsibility assumed by the seller at the time of the making of the contract. Of course if the buyer discovers the defect and uses the goods anyway, or if he unreasonably fails to examine the goods before he uses them, resulting injuries may be found to result from his own action rather than proximately from a breach of warranty. See §§ 2-314 and 2-715 and comments thereto.

In order to bring the transaction within the scope of "refused to examine" in paragraph (b), it is not sufficient that the goods are available for inspection. There must in addition be a demand by the seller that the buyer examine the goods fully. The seller by the demand puts the buyer on notice that he is assuming the risk of defects which the examination ought to reveal. The language "refused to examine" in this paragraph is intended to make clear the necessity for such demand.

Application of the doctrine of "caveat emptor" in all cases where the buyer examines the goods regardless of statements made by the seller is, however, rejected by this Article. Thus, if the offer of examination is accompanied by words as to their merchantability or specific attributes and the buyer indicates clearly that he is relying on those words rather than on his examination, they give rise to an "express" warranty. In such cases the question is one of fact as to whether a warranty of merchantability has been expressly incorporated in the agreement. Disclaimer of such an express warranty is governed by subsection (1) of the present section.

The particular buyer's skill and the normal method of examining goods in the circumstances determine what defects are excluded by the examination. A failure to notice defects which are obvious cannot excuse the buyer. However, an examination under circumstances which do not permit chemical or other testing of the goods would not exclude defects which could be ascertained only by such testing. Nor can latent defects be excluded by a simple examination. A professional buyer examining a product in his field will be held to have assumed the risk as to all defects which a professional in the field ought to observe, while a nonprofessional buyer will be held to have assumed the risk only for such defects as a layman might be expected to observe.

9. The situation in which the buyer gives precise and complete specifications to the seller is not explicitly covered in this section, but this is a frequent circumstance by which the implied warranties may be excluded. The warranty of fitness for a particular purpose would not normally arise since in such a situation there is usually no reliance on the seller by the buyer. The warranty of merchantability in such a transaction, however, must be considered in connection with the next section on the cumulation and conflict of warranties. Under paragraph (c) of that section in case of such an inconsistency the implied warranty of merchantability is displaced by the express warranty that the goods will comply with the specifications. Thus, where the buyer gives detailed specifications as to the goods, neither of the implied warranties as to quality will normally apply to the transaction unless consistent with the specifications.

Cross References:

Point 2: §§ 2-202, 2-718 and 2-719.
Point 7: §§ 1-205 and 2-208.

Definitional Cross References:

"Agreement". § 1-201.
"Buyer". § 2-103.
"Contract". § 1-201.
"Course of dealing". § 1-205.
"Goods". § 2-105.
"Remedy". § 1-201.
"Seller". § 2-103.
"Usage of trade". § 1-205.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: The holding in Packard Norfolk, Inc. v. Miller, 198 Va. 557, 564-65, 95 S.E.2d 207 (1956), that there may be a rescission of a sales contract for fraud, even though the contract provides that all other express and implied warranties are excluded is consistent with subsection 2-316(1). This case is discussed in Note, A Seller's Liability for Innocent Misrepresentation in Virginia, 43 Va. L. Rev. 765 (1957). Similarly, the UCC is consistent with Wood v. Quillen, 167 Va. 255, 260, 188 S.E. 216 (1936), holding that a contract warranty of purity of seed did not exclude an implied warranty that the seed were of the kind and name under which they were sold.

Subsection 2-316(2) and UCC 2-202 relating to parol evidence are consistent with the holding in Bolling v. General Motors Acceptance Corp., 204 Va. 4, 9-10, 129 S.E.2d 54 (1963), that the parol evidence rule bars evidence of an express oral warranty that is in conflict with a written contractual warranty.

The Virginia cases are consistent with subsection 2-316(3)(b) as regards the effect of an inspection by the buyer on the exclusion of warranties. In Gerst v. Jones & Co., 73 Va. (32 Gratt.) 518, 524-25 (1879), the court said: "In cases like the present, the question is not whether the purchaser has an opportunity of

examining the article, but whether he has, in fact, examined it for himself, and whether the defect be one readily discoverable upon inspection. He is not bound to examine, for he has the right to rely upon the judgment of the seller, and to take it for granted the latter has furnished an article answering the terms of the contract." Johnson v. Hoffman, 130 Va. 335, 341, 107 S.E. 645 (1921), held that there was no express or implied warranty of quality, where the buyer had satisfied himself as to the quality of cattle by an inspection.

§ 2-317. Cumulation and Conflict of Warranties Express or Implied. Warranties whether express or implied shall be construed as consistent with each other and as cumulative, but if such construction is unreasonable the intention of the parties shall determine which warranty is dominant. In ascertaining that intention the following rules apply:

(a) Exact or technical specifications displace an inconsistent sample or model or general language of description.

(b) A sample from an existing bulk displaces inconsistent general language of description.

(c) Express warranties displace inconsistent implied warranties other than an implied warranty of fitness for a particular purpose.

COMMENT: **Prior Uniform Statutory Provision:** On cumulation of warranties see §§ 14, 15 and 16, Uniform Sales Act.

Changes: Completely rewritten into one section.

Purposes of Changes: 1. The present section rests on the basic policy of this Article that no warranty is created except by some conduct (either affirmative action or failure to disclose) on the part of the seller. Therefore, all warranties are made cumulative unless this construction of the contract is impossible or unreasonable.

This Article thus follows the general policy of the Uniform Sales Act except that in case of the sale of an article by its patent or trade name the elimination of the warranty of fitness depends solely on whether the buyer has relied on the seller's skill and judgment; the use of the patent or trade name is but one factor in making this determination.

2. The rules of this section are designed to aid in determining the intention of the parties as to which of inconsistent warranties which have arisen from the circumstances of their transaction shall prevail. These rules of intention are to be applied only where factors making for an equitable estoppel of the seller do not exist and where he has in perfect good faith made warranties which later turn out to be inconsistent. To the extent that the seller has led the buyer to believe that all of the warranties can be performed, he is estopped from setting up any essential inconsistency as a defense.

3. The rules in subsections (a), (b) and (c) are designed to ascertain the intention of the parties by reference to the factor which probably claimed the attention of the parties in the first instance. These rules are not absolute but may be changed by evidence showing that the conditions which existed at the time of contracting make the construction called for by the section inconsistent or unreasonable.

Cross Reference:

Point 1: § 2-315.

Definitional Cross Reference:

"Party". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Virginia, in accordance with this section, has recognized that warranties, when consistent, are cumulative. In Greenland Development Corp. v. Allied

Heating Products Co., 184 Va. 588, 597, 35 S.E.2d 801 (1945), 164 A.L.R. 1312 (1946), Note, 32 Va. L. Rev. 679 (1946), the court, saying that the precise question was one of first impression, said: "Since the express warranty . . . is in no wise inconsistent with the implied warranty of fitness . . . both were binding on the seller." See also E. I. duPont de Nemours & Co. v. Universal Molded Products Corp., 191 Va. 525, 566, 62 S.E.2d 233 (1955).

The provision in subsection 2-317 (c) that an implied warranty of fitness for a particular purpose prevails over an inconsistent express warranty changes the dictum in Greenland Development Corp. v. Allied Heating Products Co., 184 Va. 588, 596-97, 35 S.E.2d 801 (1945), 164 A.L.R. 1312 (1946), Note, 32 Va. L. Rev. 679 (1946), to the effect that an express warranty prevails over an inconsistent implied warranty.

§ 2-318. When Lack of Privity No Defense in Action Against Manufacturer or Seller of Goods. Lack of privity between plaintiff and defendant shall be no defense in any action brought against the manufacturer or seller of goods to recover damages for breach of warranty, express or implied, or for negligence, although the plaintiff did not purchase the goods from the defendant, if the plaintiff was a person whom the manufacturer or seller might reasonably have expected to use, consume, or be affected by the goods; however, this section shall not be construed to affect any litigation pending on June twenty-nine, nineteen hundred sixty-two.

(**VALC Note:** This section appears in the Official Text as follows:

§ 2-318. Third Party Beneficiaries of Warranties Express or Implied. A seller's warranty whether express or implied extends to any natural person who is in the family or household of his buyer or who is a guest in his home if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured in person by breach of the warranty. A seller may not exclude or limit the operation of this section.)

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. The last sentence of this section does not mean that a seller is precluded from excluding or disclaiming a warranty which might otherwise arise in connection with the sale provided such exclusion or modification is permitted by § 2-316. Nor does that sentence preclude the seller from limiting the remedies of his own buyer and of any beneficiaries, in any manner provided in §§ 2-718 or 2-719. To the extent that the contract of sale contains provisions under which warranties are excluded or modified, or remedies for breach are limited, such provisions are equally operative against beneficiaries of warranties under this section. What this last sentence forbids is exclusion of liability by the seller to the persons to whom the warranties which he has made to his buyer would extend under this section.

2. The purpose of this section is to give the buyer's family, household and guests the benefit of the same warranty which the buyer received in the contract of sale, thereby freeing any such beneficiaries from any technical rules as to "privity." It seeks to accomplish this purpose without any derogation of any right or remedy resting on negligence. It rests primarily upon the merchant-seller's warranty under this Article that the goods sold are merchantable and fit for the ordinary purposes for which such goods are used rather than the warranty of fitness for a particular purpose. Implicit in the section is that any beneficiary of a warranty may bring a direct action for breach of warranty against the seller whose warranty extends to him.

3. This section expressly includes as beneficiaries within its provisions the family, household, and guests of the purchaser. Beyond this, the section is neutral and is not intended to enlarge or restrict the developing case law on whether the seller's warranties, given to his buyer who resells, extend to other persons in the distributive chain.

Cross References:

Point 1: § 2-316, 2-718 and 2-719.
Point 2: § 2-314.

Definitional Cross References:

"Buyer". § 2-103.
"Goods". § 2-105.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 8-654.3 (Supp. 1962).

Comment: The 1962 Official Text of § 2-318 effects a limited abolition of the privity defense in actions for breach of warranty by specified users of goods against remote manufacturers or sellers. Only those "natural persons" who were in the family or household of the buyer or were guests in his home were protected. Recent Virginia legislation, however, has virtually abolished the privity defense in breach of warranty and negligence suits. Code § 8-654.3 (Supp. 1962). This statute reflects the increasing tendency of modern decisions and has been substituted for the section provided in the 1962 Official Text.

For a comment on the Virginia statute and the earlier law in the State, see Emroch, Statutory Elimination of Privity Requirement in Products Liability Cases, 48 Va. L. Rev. 982 (1962).

COUNCIL COMMENT

Virginia has already gone much beyond the Uniform Commercial Code in abolishing lack of privity as a defense.

§ 2-319. F.O.B. and F.A.S. Terms. (1) Unless otherwise agreed the term F.O.B. (which means "free on board") at a named place, even though used only in connection with the stated price, is a delivery term under which

(a) when the term is F.O.B. the place of shipment, the seller must at that place ship the goods in the manner provided in this Article (§ 2-504) and bear the expense and risk of putting them into the possession of the carrier; or

(b) when the term is F.O.B. the place of destination, the seller must at his own expense and risk transport the goods to that place and there tender delivery of them in the manner provided in this Article (§ 2-503);

(c) when under either (a) or (b) the term is also F.O.B. vessel, car or other vehicle, the seller must in addition at his own expense and risk load the goods on board. If the term is F.O.B. vessel the buyer must name the vessel and in an appropriate case the seller must comply with the provisions of this Article on the form of bill of lading (§ 2-323).

(2) Unless otherwise agreed the term F.A.S. vessel (which means "free alongside") at a named port, even though used only in connection with the stated price, is a delivery term under which the seller must

(a) at his own expense and risk deliver the goods alongside the vessel in the manner usual in that port or on a dock designated and provided by the buyer; and

(b) obtain and tender a receipt for the goods in exchange for which the carrier is under a duty to issue a bill of lading.

(3) Unless otherwise agreed in any case falling within subsection (1)(a) or (c) or subsection (2) the buyer must seasonably give any needed instructions for making delivery, including when the term is F.A.S. or F.O.B. the loading berth of the vessel and in an appropriate case its name and sailing date. The seller may treat the failure of needed instructions as a failure of cooperation under this Article (§ 2-311). He may also at his option move the goods in any reasonable manner preparatory to delivery or shipment.

(4) Under the term F.O.B. vessel or F.A.S. unless otherwise agreed the buyer must make payment against tender of the required documents and the seller may not tender nor the buyer demand delivery of the goods in substitution for the documents.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. This section is intended to negate the uncommercial line of decision which treats an "F.O.B." term as "merely a price term." The distinctions taken in subsection (1) handle most of the issues which have on occasion led to the unfortunate judicial language just referred to. Other matters which have led to sound results being based on unhappy language in regard to F.O.B. clauses are dealt with in this Act by § 2-311(2) (seller's option re arrangements relating to shipment) and §§ 2-614 and 615 (substituted performance and seller's excuse).

2. Subsection (1) (c) not only specifies the duties of a seller who engages to deliver "F.O.B. vessel," or the like, but ought to make clear that no agreement is soundly drawn when it looks to reshipment from San Francisco or New York, but speaks merely of "F.O.B." the place.

3. The buyer's obligations stated in subsection (1)(c) and subsection (3) are, as shown in the text, obligations of cooperation. The last sentence of subsection (3) expressly, though perhaps unnecessarily, authorizes the seller, pending instructions, to go ahead with such preparatory moves as shipment from the interior to the named point of delivery. The sentence presupposes the usual case in which instructions "fail"; a prior repudiation by the buyer, giving notice that breach was intended, would remove the reason for the sentence, and would normally bring into play, instead, the second sentence of § 2-704, which duly calls for lessening damages.

4. The treatment of "F.O.B. vessel" in conjunction with F.A.S. fits, in regard to the need for payment against documents, with standard practice and case-law; but "F.O.B. vessel" is a term which by its very language makes express the need for an "on board" document. In this respect, that term is stricter than the ordinary overseas "shipment" contract (C.I.F., etc., § 2-320).

Cross References:

§§ 2-311(3), 2-323, 2-503 and 2-504.

Definitional Cross References:

"Agreed". § 1-201.
"Bill of lading". § 1-201.
"Buyer". § 2-103.
"Goods". § 2-105.
"Seasonably". § 1-204.
"Seller". § 2-103.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: F.O.B. at a named place is a delivery term, even though only used in connection with a statement of the price. In Bott v. Snellenburg & Co., Inc., 177 Va. 331, 338, 14 S.E.2d 372 (1941), on a construction of the contract as a whole, the term F.O.B. was found to be a delivery term, but the court quoted a definition in which it was said that F.O.B. used in connection with the price of goods is a price term and not a delivery term. A contrary agreement was also found in Rountree v. Graham, 144 Va. 145, 148-50, 131 S.E. 193 (1926). The UCC rejects this approach as uncommercial. See also Geoghegan Sons & Co. v. Arbuckle Bros., 139 Va. 92, 101-04, 123 S.E. 387, 36 A.L.R. 399 (1924); Lawson v. Hobbs, 120 Va. 690, 693-95, 91 S.E. 750 (1917); Aspegren & Co. v. Wallerstein Produce Co., 111 Va. 570, 572-73, 69 S.E. 597 (1911).

The UCC is in accord with Lawson v. Hobbs, 120 Va. 690, 692-93, 91 S.E. 750 (1917), in which the court approved this statement: "A sale f.o.b. cars means that the subject of the sale is to be placed on the cars for shipment without any expense or act on the part of the buyer," although this case involved an "f.o.b. Suffolk" rather than an "f.o.b. cars" term. See also Birdsong and Co., Inc. v. American Peanut Corp., 149 Va. 755, 766-67, 141 S.E. 759 (1928).

Virginia has recognized that the buyer must give any necessary shipping instructions. James River Lumber Co. v. Smith Bros., 135 Va. 406, 413-14, 116 S.E. 241 (1923).

A seller has not complied with an F.O.B. contract if he instructs the carrier to hold the goods until the seller hears that his draft has been paid. Fulton v. W. R. Grace Co., 143 Va. 12, 23-24, 129 S.E. 374 (1925).

§ 2-320. **C.I.F. and C. & F. Terms.** (1) The term C.I.F. means that the price includes in a lump sum the cost of the goods and the insurance and freight to the named destination. The term C. & F. or C.F. means that the price so includes cost and freight to the named destination.

(2) Unless otherwise agreed and even though used only in connection with the stated price and destination, the term C.I.F. destination or its equivalent requires the seller at his own expense and risk to

(a) put the goods into the possession of a carrier at the port for shipment and obtain a negotiable bill or bills of lading covering the entire transportation to the named destination; and

(b) load the goods and obtain a receipt from the carrier (which may be contained in the bill of lading) showing that the freight has been paid or provided for; and

(c) obtain a policy or certificate of insurance, including any war risk insurance, of a kind and on terms then current at the port of shipment in the usual amount, in the currency of the contract, shown to cover the same goods covered by the bill of lading and providing for payment of loss to the order of the buyer or for the account of whom it may concern; but the seller may add to the price the amount of the premium for any such war risk insurance; and

(d) prepare an invoice of the goods and procure any other documents required to effect shipment or to comply with the contract; and

(e) forward and tender with commercial promptness all the documents in due form and with any indorsement necessary to perfect the buyer's rights.

(3) Unless otherwise agreed the term C. & F. or its equivalent has the same effect and imposes upon the seller the same obligations and risks as a C.I.F. term except the obligation as to insurance.

(4) Under the term C.I.F. or C. & F. unless otherwise agreed the buyer must make payment against tender of the required documents and the seller may not tender nor the buyer demand delivery of the goods in substitution for the documents.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: To make it clear that:

1. The C.I.F. contract is not a destination but a shipment contract with risk of subsequent loss or damage to the goods passing to the buyer upon shipment if the seller has properly performed all his obligations with respect to the goods. Delivery to the carrier is delivery to the buyer for purposes of risk and "title". Delivery of possession of the goods is accomplished by delivery of the bill of lading, and upon tender of the required documents the buyer must pay the agreed price without awaiting the arrival of the goods and if they have been lost or damaged after proper shipment he must seek his remedy against the carrier or insurer. The buyer has no right of inspection prior to payment or acceptance of the documents.

2. The seller's obligations remain the same even though the C.I.F. term is "used only in connection with the stated price and destination".

3. The insurance stipulated by the C.I.F. term is for the buyer's benefit, to protect him against the risk of loss or damage to the goods in transit. A clause in a C.I.F. contract "insurance—for the account of sellers" should be viewed in its ordinary mercantile meaning that the sellers must pay for the insurance and not that it is intended to run to the seller's benefit.

4. A bill of lading covering the entire transportation from the port of shipment is explicitly required but the provision on this point must be read in the light of its reason to assure the buyer of as full protection as the conditions of shipment reasonably permit, remembering always that this type of contract is designed to move the goods in the channels commercially available. To enable the buyer to deal with the goods while they are afloat the bill of lading must be one that covers only the quantity of goods called for by the contract. The buyer is not required to accept his part of the goods without a bill of lading because the latter covers a larger quantity, nor is he required to accept a bill of lading for the whole quantity under a stipulation to hold the excess for the owner. Although the buyer is not compelled to accept either goods or documents under such circumstances he may of course claim his rights in any goods which have been identified to his contract.

5. The seller is given the option of paying or providing for the payment of freight. He has no option to ship "freight collect" unless the agreement so provides. The rule of the common law that the buyer need not pay the freight if the goods do not arrive is preserved.

Unless the shipment has been sent "freight collect" the buyer is entitled to receive documentary evidence that he is not obligated to pay the freight; the seller is therefore required to obtain a receipt "showing that the freight has been paid or provided for." The usual notation in the appropriate space on the bill of lading that the freight has been prepaid is a sufficient receipt, as at common law. The phrase "provided for" is intended to cover the frequent situation in which the carrier extends credit to a shipper for the freight on successive shipments and receives periodical payments of the accrued freight charges from him.

6. The requirement that unless otherwise agreed the seller must procure insurance "of a kind and on terms then current at the port for shipment in the usual amount, in the currency of the contract, snfficiently shown to cover the same goods covered by the bill of lading", applies to both marine and war risk insurance. As applied to marine insurance, it means such insurance as is usual or customary at the port for shipment with reference to the particular kind of goods involved, the character and equipment of the vessel, the route of the voyage, the port of destination and any other considerations that affect the risk. It is the substantial equivalent of the ordinary insurance in the particular trade and on the particular voyage and is subject to agreed specifications of type or extent of coverage. The language does not mean that the insurance must be adequate to cover all risks to which the goods may be subject in transit. There are some types of loss or damage that are not covered by the usual marine insurance and are excepted in bills of lading or in applicable statutes from the causes of loss or damage for which the carrier or the vessel is liable. Such risks must be borne by the buyer under this Article.

Insurance secured in compliance with a C.I.F. term must cover the entire transportation of the goods to the named destination.

7. An additional obligation is imposed upon the seller in requiring him to procure customary war risk insurance at the buyer's expense. This changes the common law on the point. The seller is not required to assume the risk of including in the C.I.F. price the cost of such insurance, since it often fluctuates rapidly, but is required to treat it simply as a necessary for the buyer's account. What war risk insurance is "current" or usual turns on the standard forms of policy or rider in common use.

8. The C.I.F. contract calls for insurance covering the value of the goods at the time and place of shipment and does not include any increase in market value during transit or any anticipated profit to the buyer on a sale by him.

The contract contemplates that before the goods arrive at their destination they may be sold again and again on C.I.F. terms and that the original policy of insurance and bill of lading will run with the interest in the goods by being transferred to each successive buyer. A buyer who becomes the seller in such

an intermediate contract for sale does not thereby, if his sub-buyer knows the circumstances, undertake to insure the goods again at an increased price fixed in the new contract or to cover the increase in price by additional insurance, and his buyer may not reject the documents on the ground that the original policy does not cover such higher price. If such a sub-buyer desires additional insurance he must procure it for himself.

Where the seller exercises an option to ship "freight collect" and to credit the buyer with the freight against the C.I.F. price, the insurance need not cover the freight since the freight is not at the buyer's risk. On the other hand, where the seller prepays the freight upon shipping under a bill of lading requiring prepayment and providing that the freight shall be deemed earned and shall be retained by the carrier "ship and/or cargo lost or not lost," or using words of similar import, he must procure insurance that will cover the freight, because notwithstanding that the goods are lost in transit the buyer is bound to pay the freight as part of the C.I.F. price and will be unable to recover it back from the carrier.

9. Insurance "for the account of whom it may concern" is usual and sufficient. However, for a valid tender the policy of insurance must be one which can be disposed of together with the bill of lading and so must be "sufficiently shown to cover the same goods covered by the bill of lading." It must cover separately the quantity of goods called for by the buyer's contract and not merely insure his goods as part of a larger quantity in which others are interested, a case provided for in American mercantile practice by the use of negotiable certificates of insurance which are expressly authorized by this section. By usage these certificates are treated as the equivalent of separate policies and are good tender under C.I.F. contracts. The term "certificate of insurance", however, does not of itself include certificates or "cover notes" issued by the insurance broker and stating that the goods are covered by a policy. Their sufficiency as substitutes for policies will depend upon proof of an established usage or course of dealing. The present section rejects the English rule that not only brokers' certificates and "cover notes" but also certain forms of American insurance certificates are not the equivalent of policies and are not good tender under a C.I.F. contract.

The seller's failure to tender a proper insurance document is waived if the buyer refuses to make payment on other and untenable grounds at a time when proper insurance could have been obtained and tendered by the seller if timely objection had been made. Even a failure to insure on shipment may be cured by seasonable tender of a policy retroactive in effect; e. g., one insuring the goods "lost or not lost." The provisions of this Article on cure of improper tender and on waiver of buyer's objections by silence are applicable to insurance tenders under a C.I.F. term. Where there is no waiver by the buyer as described above, however, the fact that the goods arrive safely does not cure the seller's breach of his obligations to insure them and tender to the buyer a proper insurance document.

10. The seller's invoice of the goods shipped under a C.I.F. contract is regarded as a usual and necessary document upon which reliance may properly be placed. It is the document which evidences points of description, quality and the like which do not readily appear in other documents. This Article rejects those statements to the effect that the invoice is a usual but not a necessary document under a C.I.F. term.

11. The buyer needs all of the documents required under a C.I.F. contract, in due form and with necessary endorsements, so that before the goods arrive he may deal with them by negotiating the documents or may obtain prompt possession of the goods after their arrival. If the goods are lost or damaged in transit the documents are necessary to enable him promptly to assert his remedy against the carrier or insurer. The seller is therefore obligated to do what is mercantilely reasonable in the circumstances and should make every reasonable exertion to send forward the documents as soon as possible after the shipment. The requirement that the documents be forwarded with "commercial promptness" expresses a more urgent need for action than that suggested by the phrase "reasonable time".

12. Under a C.I.F. contract the buyer, as under the common law, must pay the price upon tender of the required documents without first inspecting the goods, but his payment in these circumstances does not constitute an acceptance of the goods nor does it impair his right of subsequent inspection or his options and remedies in the case of improper delivery. All remedies and rights for the seller's breach are reserved to him. The buyer must pay before inspection and assert his remedy against the seller afterward unless the non-conformity of the

goods amounts to a real failure of consideration, since the purpose of choosing this form of contract is to give the seller protection against the buyer's unjustifiable rejection of the goods at a distant port of destination which would necessitate taking possession of the goods and suing the buyer there.

13. A valid C.I.F. contract may be made which requires part of the transportation to be made on land and part on the sea, as where the goods are to be brought by rail from an inland point to a seaport and thence transported by vessel to the named destination under a "through" or combination bill of lading issued by the railroad company. In such a case shipment by rail from the inland point within the contract period is a timely shipment notwithstanding that the loading of the goods on the vessel is delayed by causes beyond the seller's control.

14. Although subsection (2) stating the legal effects of the C.I.F. term is an "unless otherwise agreed" provision, the express language used in an agreement is frequently a precautionary, fuller statement of the normal C.I.F. terms and hence not intended as a departure or variation from them. Moreover, the dominant outlines of the C.I.F. term are so well understood commercially that any variation should, whenever reasonably possible, be read as falling within those dominant outlines rather than as destroying the whole meaning of a term which essentially indicates a contract for proper shipment rather than one for delivery at destination. Particularly careful consideration is necessary before a printed form or clause is construed to mean agreement otherwise and where a C.I.F. contract is prepared on a printed form designed for some other type of contract, the C.I.F. terms must prevail over printed clauses repugnant to them.

15. Under subsection (4) the fact that the seller knows at the time of the tender of the documents that the goods have been lost in transit does not affect his rights if he has performed his contractual obligations. Similarly, the seller cannot perform under a C.I.F. term by purchasing and tendering landed goods.

16. Under the C. & F. term, as under the C.I.F. term, title and risk of loss are intended to pass to the buyer on shipment. A stipulation in a C. & F. contract that the seller shall effect insurance on the goods and charge the buyer with the premium (in effect that he shall act as the buyer's agent for that purpose) is entirely in keeping with the pattern. On the other hand, it often happens that the buyer is in a more advantageous position than the seller to effect insurance on the goods or that he has in force an "open" or "floating" policy covering all shipments made by him or to him, in either of which events the C. & F. term is adequate without mention of insurance.

17. It is to be remembered that in a French contract the term "C.A.F." does not mean "Cost and Freight" but has exactly the same meaning as the term "C.I.F." since it is merely the French equivalent of that term. The "A" does not stand for "and" but for "assurance" which means insurance.

Cross References:

Point 4: § 2-323.
Point 6: § 2-509(1)(a).
Point 9: §§ 2-508 and 2-605(1)(a).
Point 12: §§ 2-321(3), 2-512 and 2-513(3) and Article 5.

Definitional Cross References:

"Bill of lading". § 1-201.
"Buyer". § 2-103.
"Contract". § 1-201.
"Goods". § 2-105.
"Rights". § 1-201.
"Seller". § 2-103.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-321. C.I.F. or C. & F.: "Net Landed Weights"; "Payment on Arrival"; Warranty of Condition on Arrival. Under a contract containing a term C.I.F. or C. & F.

(1) Where the price is based on or is to be adjusted according to "net landed weights", "delivered weights", "out turn" quantity or quality or

the like, unless otherwise agreed the seller must reasonably estimate the price. The payment due on tender of the documents called for by the contract is the amount so estimated, but after final adjustment of the price a settlement must be made with commercial promptness.

(2) An agreement described in subsection (1) or any warranty of quality or condition of the goods on arrival places upon the seller the risk of ordinary deterioration, shrinkage and the like in transportation but has no effect on the place or time of identification to the contract for sale or delivery or on the passing of the risk of loss.

(3) Unless otherwise agreed where the contract provides for payment on or after arrival of the goods the seller must before payment allow such preliminary inspection as is feasible; but if the goods are lost delivery of the documents and payment are due when the goods should have arrived.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: This section deals with two variations of the C.I.F. contract which have evolved in mercantile practice but are entirely consistent with the basic C.I.F. pattern. Subsections (1) and (2), which provide for a shift to the seller of the risk of quality and weight deterioration during shipment, are designed to conform the law to the best mercantile practice and usage without changing the legal consequences of the C.I.F. or C. & F. term as to the passing of marine risks to the buyer at the point of shipment. Subsection (3) provides that where under the contract documents are to be presented for payment after arrival of the goods, this amounts merely to a postponement of the payment under the C.I.F. contract and is not to be confused with the "no arrival, no sale" contract. If the goods are lost, delivery of the documents and payment against them are due when the goods should have arrived. The clause for payment on or after arrival is not to be construed as such a condition precedent to payment that if the goods are lost in transit the buyer need never pay and the seller must bear the loss.

Cross Reference:

§ 2-324.

Definitional Cross References:

"Agreement". § 1-201.
"Contract". § 1-201.
"Delivery". § 1-201.
"Goods". § 2-105.
"Seller". § 2-103.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-322. Delivery "Ex-Ship". (1) Unless otherwise agreed a term for delivery of goods "ex-ship" (which means from the carrying vessel) or in equivalent language is not restricted to a particular ship and requires delivery from a ship which has reached a place at the named port of destination where goods of the kind are usually discharged.

(2) Under such a term unless otherwise agreed

(a) the seller must discharge all liens arising out of the carriage and furnish the buyer with a direction which puts the carrier under a duty to deliver the goods; and

(b) the risk of loss does not pass to the buyer until the goods leave the ship's tackle or are otherwise properly unloaded.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. The delivery term, "ex ship", as between seller and buyer, is the reverse of the f.a.s. term covered.

2. Delivery need not be made from any particular vessel under a clause calling for delivery "ex ship", even though a vessel on which shipment is to be made originally is named in the contract, unless the agreement by appropriate language, restricts the clause to delivery from a named vessel.

3. The appropriate place and manner of unloading at the port of destination depend upon the nature of the goods and the facilities and usages of the port.

4. A contract fixing a price "ex ship" with payment "cash against documents" calls only for such documents as are appropriate to the contract. Tender of a delivery order and of a receipt for the freight after the arrival of the carrying vessel is adequate. The seller is not required to tender a bill of lading as a document of title nor is he required to insure the goods for the buyer's benefit, as the goods are not at the buyer's risk during the voyage.

Cross Reference:

Point 1: § 2-319(2).

Definitional Cross References:

"Buyer". § 2-103.
"Goods". § 2-105.
"Seller". § 2-103.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-323. Form of Bill of Lading Required in Overseas Shipment; "Overseas". (1) Where the contract contemplates overseas shipment and contains a term C.I.F. or C. &. F. or F.O.B. vessel, the seller unless otherwise agreed must obtain a negotiable bill of lading stating that the goods have been loaded on board or, in the case of a term C.I.F. or C. & F., received for shipment.

(2) Where in a case within subsection (1) a bill of lading has been issued in a set of parts, unless otherwise agreed if the documents are not to be sent from abroad the buyer may demand tender of the full set; otherwise only one part of the bill of lading need be tendered. Even if the agreement expressly requires a full set

(a) due tender of a single part is acceptable within the provisions of this Article on cure of improper delivery (subsection (1) of § 2-508); and

(b) even though the full set is demanded, if the documents are sent from abroad the person tendering an incomplete set may nevertheless require payment upon furnishing an indemnity which the buyer in good faith deems adequate.

(3) A shipment by water or by air or a contract contemplating such shipment is "overseas" insofar as by usage of trade or agreement it is subject to the commercial, financing or shipping practices characteristic of international deep water commerce.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. Subsection (1) follows the "American" rule that a regular bill of lading indicating delivery of the goods at the dock for shipment is sufficient, except under a term "F.O.B. vessel." See § 2-319 and comment thereto.

2. Subsection (2) deals with the problem of bills of lading covering deep water shipments, issued not as a single bill of lading but in a set of parts, each part referring to the other parts and the entire set constituting in commercial practice and at law a single bill of lading. Commercial practice in international commerce is to accept and pay against presentation of the first part of a set if the part is sent from overseas even though the contract of the buyer requires presentation of a full set of bills of lading provided adequate indemnity for the missing parts is forthcoming.

This subsection codifies that practice as between buyer and seller. Article 5 (§ 5-113) authorizes banks presenting drafts under letters of credit to give indemnities against the missing parts, and this subsection means that the buyer must accept and act on such indemnities if he in good faith deems them adequate. But neither this subsection nor Article 5 decides whether a bank which has issued a letter of credit is similarly bound. The issuing bank's obligation under a letter of credit is independent and depends on its own terms. See Article 5.

Cross References:

§§ 2-508(2), 5-113.

Definitional Cross References:

"Bill of lading". § 1-201.
"Buyer". § 2-103.
"Contract". § 1-201.
"Delivery". § 1-201.
"Financing agency". § 2-104.
"Person". § 1-201.
"Seller". § 2-103.
"Send". § 1-201.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-324. "No Arrival, No Sale" Term. Under a term "no arrival, no sale" or terms of like meaning, unless otherwise agreed,

(a) the seller must properly ship conforming goods and if they arrive by any means he must tender them on arrival but he assumes no obligation that the goods will arrive unless he has caused the non-arrival; and

(b) where without fault of the seller the goods are in part lost or have so deteriorated as no longer to conform to the contract or arrive after the contract time, the buyer may proceed as if there had been casualty to identified goods (§ 2-613).

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. The "no arrival, no sale" term in a "destination" overseas contract leaves risk of loss on the seller but gives him an exemption from liability for non-delivery. Both the nature of the case and the duty of good faith require that the seller must not interfere with the arrival of the goods in any way. If the circumstances impose upon him the responsibility for making or arranging the shipment, he must have a shipment made despite the exemption clause. Further, the shipment made must be a conforming one, for the exemption under a "no arrival, no sale" term applies only to the hazards of transportation and the goods must be proper in all other respects.

The reason of this section is that where the seller is reselling goods bought by him as shipped by another and this fact is known to the buyer, so that the seller is not under any obligation to make the shipment himself, the seller is entitled under the "no arrival, no sale" clause to exemption from payment of damages for non-delivery if the goods do not arrive or if the goods which actually arrive are non-conforming. This does not extend to sellers who arrange shipment by their own agents, in which case the clause is limited to casualty due to marine hazards. But sellers who make known that they are contracting only with respect to what will be delivered to them by parties over whom they assume no control are entitled to the full quantum of the exemption.

2. The provisions of this Article on identification must be read together with the present section in order to bring the exemption into application. Until there is some designation of the goods in a particular shipment or on a particular ship as being those to which the contract refers there can be no application of an exemption for their non-arrival.

3. The seller's duty to tender the agreed or declared goods if they do arrive is not impaired because of their delay in arrival or by their arrival after transshipment.

4. The phrase "to arrive" is often employed in the same sense as "no arrival, no sale" and may then be given the same effect. But a "to arrive" term, added to a C.I.F. or C. & F. contract, does not have the full meaning given by this section to "no arrival, no sale". Such a "to arrive" term is usually intended to operate only to the extent that the risks are not covered by the agreed insurance and the loss or casualty is due to such uncovered hazards. In some instances the "to arrive" term may be regarded as a time of payment term, or, in the case of the reselling seller discussed in point 1 above, as negating responsibility for conformity of the goods, if they arrive, to any description which was based on his good faith belief of the quality. Whether this is the intention of the parties is a question of fact based on all the circumstances surrounding the resale and in case of ambiguity the rules of §§ 2-316 and 2-317 apply to preclude dishonor.

5. Paragraph (b) applies where goods arrive impaired by damage or partial loss during transportation and makes the policy of this Article on casualty to identified goods applicable to such a situation. For the term cannot be regarded as intending to give the seller an unforeseen profit through casualty; it is intended only to protect him from loss due to causes beyond his control.

Cross References:

Point 1: § 1-203.
Point 2: § 2-501(a) and (c).
Point 5: § 2-613.

Definitional Cross References:

"Buyer". § 2-103.
"Conforming". § 2-106.
"Contract". § 1-201.
"Fault". § 1-201.
"Goods". § 2-105.
"Sale". § 2-106.
"Seller". § 2-103.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-325. "Letter of Credit" Term; "Confirmed Credit". (1) Failure of the buyer seasonably to furnish an agreed letter of credit is a breach of the contract for sale.

(2) The delivery to seller of a proper letter of credit suspends the buyer's obligation to pay. If the letter of credit is dishonored, the seller may on seasonable notification to the buyer require payment directly from him.

(3) Unless otherwise agreed the term "letter of credit" or "banker's credit" in a contract for sale means an irrevocable credit issued by a financing agency of good repute and, where the shipment is overseas, of good international repute. The term "confirmed credit" means that the credit must also carry the direct obligation of such an agency which does business in the seller's financial market.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: To express the established commercial and banking understanding as to the meaning and effects of terms calling for "letters of credit" or "confirmed credit":

1. Subsection (2) follows the general policy of this Article and Article 3 (§ 3-802) on conditional payment, under which payment by check or other short-term instrument is not ordinarily final as between the parties if the recipient duly presents the instrument and honor is refused. Thus the furnishing of a letter of credit does not substitute the financing agency's obligation for the buyer's, but the seller must first give the buyer reasonable notice of his intention to demand direct payment from him.

2. Subsection (3) requires that the credit be irrevocable and be a prime credit as determined by the standing of the issuer. It is not necessary, unless otherwise agreed, that the credit be a negotiation credit; the seller can finance himself by an assignment of the proceeds under § 5-116(2).

3. The definition of "confirmed credit" is drawn on the supposition that the credit is issued by a bank which is not doing direct business in the seller's financial market; there is no intention to require the obligation of two banks both local to the seller.

Cross References:

§§ 2-403, 2-511(3) and 3-802 and Article 5.

Definitional Cross References:

"Buyer". § 2-103.
"Contract for sale". § 2-106.
"Draft". § 3-104.
"Financing agency". § 2-104.
"Notifies". § 1-201.
"Overseas". § 2-323.
"Purchaser". § 1-201.
"Seasonably". § 1-204.
"Seller". § 2-103.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-326. Sale on Approval and Sale or Return; Consignment Sales and Rights of Creditors. (1) Unless otherwise agreed, if delivered goods may be returned by the buyer even though they conform to the contract, the transaction is

(a) a "sale on approval" if the goods are delivered primarily for use; and

(b) a "sale or return" if the goods are delivered primarily for resale.

(2) Except as provided in subsection (3), goods held on approval are not subject to the claims of the buyer's creditors until acceptance; goods held on sale or return are subject to such claims while in the buyer's possession.

(3) Where goods are delivered to a person for sale and such person maintains a place of business at which he deals in goods of the kind involved, under a name other than the name of the person making delivery, then with respect to claims of creditors of the person conducting the business the goods are deemed to be on sale or return. The provisions of this subsection are applicable even though an agreement purports to reserve title to the person making delivery until payment or resale or uses such words as "on consignment" or "on memorandum". However, this subsection is not applicable if the person making delivery

(a) complies with an applicable law providing for a consignor's interest or the like to be evidenced by a sign, or

(b) establishes that the person conducting the business is generally known by his creditors to be substantially engaged in selling the goods of others, or

(c) complies with the filing provisions of the Article on Secured Transactions (Article 9).

(4) Any "or return" term of a contract for sale is to be treated as a separate contract for sale within the statute of frauds section of this Article (§ 2-201) and as contradicting the sale aspect of the contract within the provisions of this Article on parol or extrinsic evidence (§ 2-202).

COMMENT: Prior Uniform Statutory Provision: § 19(3), Uniform Sales Act.

Changes: Completely rewritten in this and the succeeding section.

Purposes of Changes: To make it clear that:

1. A "sale on approval" or "sale or return" is distinct from other types of transactions with which they have frequently been confused. The type of "sale on approval," "on trial" or "on satisfaction" dealt with involves a contract under which the seller undertakes a particular business risk to satisfy his prospective buyer with the appearance or performance of the goods in question. The goods are delivered to the proposed purchaser but they remain the property of the seller until the buyer accepts them. The price has already been agreed. The buyer's willingness to receive and test the goods is the consideration for the seller's engagement to deliver and sell. The type of "sale or return" involved herein is a sale to a merchant whose unwillingness to buy is overcome only by the seller's engagement to take back the goods (or any commercial unit of goods) in lieu of payment if they fail to be resold. These two transactions are so strongly delineated in practice and in general understanding that every presumption runs against a delivery to a consumer being a "sale or return" and against a delivery to a merchant for resale being a "sale on approval."

The right to retain the goods for failure to conform to the contract does not make the transaction a "sale on approval" or "sale or return" and has nothing to do with this and the following section. The present section is not concerned with remedies for breach of contract. It deals instead with a power given by the contract to turn back the goods even though they are wholly as warranted.

This section nevertheless presupposes that a contract for sale is contemplated by the parties altbough that contract may be of the peculiar character here described.

Where the buyer's obligation as a buyer is conditioned not on his personal approval but on the article's passing a described objective test, the risk of loss by casualty pending the test is properly the seller's and proper return is at his expense. On the point of "satisfaction" as meaning "reasonable satisfaction" where an industrial machine is involved, this Article takes no position.

2. Pursuant to the general policies of this Act which require good faith not only between the parties to the sales contract, but as against interested third parties, subsection (3) resolves all reasonable doubts as to the nature of the transaction in favor of the general creditors of the buyer. As against such creditors words such as "on consignment" or "on memorandum", with or without words of reservation of title in the seller, are disregarded when the buyer has a place of business at which he deals in goods of the kind involved. A necessary exception is made where the buyer is known to be engaged primarily in selling the goods of others or is selling under a relevant sign law, or the seller complies with the filing provisions of Article 9 as if his interest were a security interest. However, there is no intent in this Section to narrow the protection afforded to third parties in any jurisdiction which has a selling Factors Act. The purpose of the exception is merely to limit the effect of the present subsection itself, in the absence of any such Factors Act, to cases in which creditors of the buyer may reasonably be deemed to have been misled by the secret reservation.

3. Subsection (4) resolves a conflict in the pre-existing case law by recognition that an "or return" provision is so definitely at odds with any ordinary contract for sale of goods that where written agreements are involved it must be contained in a written memorandum. The "or return" aspect of a sales contract must be treated as a separate contract under the Statute of Frauds section and as contradicting the sale insofar as questions of parol or extrinsic evidence are concerned.

Cross References:

Point 2: Article 9.
Point 3: §§ 2-201 and 2-202.

Definitional Cross References:

"Between merchants". § 2-104.
"Buyer". § 2-103.
"Conform". § 2-106.
"Contract for sale". § 2-106.
"Creditor". § 1-201.
"Goods". § 2-105.
"Sale". § 2-106.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Under existing Virginia law, compliance with the Trader's Act, Code 1950, § 55-152, was the exclusive method for persons who consigned goods for sale to obtain protection from the creditors of the consignee. Under the UCC, the consignor has two additional methods of protection, perfection of a security interest under Article 9 or establishing that the consignee is generally known by his creditors to be substantially engaged in selling the goods of others.

§ 2-327. Special Incidents of Sale on Approval and Sale or Return. (1) Under a sale on approval unless otherwise agreed

(a) although the goods are identified to the contract the risk of loss and the title do not pass to the buyer until acceptance; and

(b) use of the goods consistent with the purpose of trial is not acceptance but failure seasonably to notify the seller of election to return the goods is acceptance, and if the goods conform to the contract acceptance of any part is acceptance of the whole; and

(c) after due notification of election to return, the return is at the seller's risk and expense but a merchant buyer must follow any reasonable instructions.

(2) Under a sale or return unless otherwise agreed

(a) the option to return extends to the whole or any commercial unit of the goods while in substantially their original condition, but must be exercised seasonably; and

(b) the return is at the buyer's risk and expense.

COMMENT: Prior Uniform Statutory Provision: § 19(3), Uniform Sales Act.

Changes: Completely rewritten in preceding and this section.

Purposes of Changes: To make it clear that:

1. In the case of a sale on approval:

If all of the goods involved conform to the contract, the buyer's acceptance of part of the goods constitutes acceptance of the whole. Acceptance of part falls outside the normal intent of the parties in the "on approval" situation and the policy of this Article allowing partial acceptance of a defective delivery has no application here. A case where a buyer takes home two dresses to select one commonly involves two distinct contracts; if not, it is covered by the words "unless otherwise agreed".

2. In the case of a sale or return, the return of any unsold unit merely because it is unsold is the normal intent of the "sale or return" provision, and therefore the right to return for this reason alone is independent of any other action under

the contract which would turn on wholly different considerations. On the other hand, where the return of goods is for breach, including return of items resold by the buyer and returned by the ultimate purchasers because of defects, the return procedure is governed not by the present section but by the provisions on the effects and revocation of acceptance.

3. In the case of a sale on approval the risk rests on the seller until acceptance of the goods by the buyer, while in a sale or return the risk remains throughout on the buyer.

4. Notice of election to return given by the buyer in a sale on approval is sufficient to relieve him of any further liability. Actual return by the buyer to the seller is required in the case of a sale or return contract. What constitutes due "giving" of notice, as required in "on approval" sales, is governed by the provisions on good faith and notice. "Seasonable" is used here as defined in § 1-204. Nevertheless, the provisions of both this Article and of the contract on this point must be read with commercial reason and with full attention to good faith.

Cross References:

Point 1: §§ 2-501, 2-601 and 2-603.
Point 2: §§ 2-607 and 2-608.
Point 4: §§ 1-201 and 1-204.

Definitional Cross References:

"Agreed". § 1-201.
"Buyer". § 2-103.
"Commercial unit". § 2-105.
"Conform". § 2-106.
"Contract". § 1-201.
"Goods". § 2-105.
"Merchant". § 2-104.
"Notifies". § 1-201.
"Notification". § 1-201.
"Sale on approval". § 2-326.
"Sale or return". § 2-326.
"Seasonably". § 1-204.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Subsection 2-327(1)(b) is in accord with Virginia law, although the Virginia court has put the rule in affirmative language—a retention beyond a reasonable time constitutes an acceptance. Dimos v. Stowe, 193 Va. 831, 836-37, 71 S.E.2d 186 (1952); Brown v. Austin-Western Co., 111 Va. 209, 212, 68 S.E. 184 (1910).

The UCC does not expressly state whether the buyer's nonapproval is conclusive regardless of his good or bad faith, where he is to keep the goods if they are satisfactory. Under Virginia law the buyer must act in good faith. Virginia-Carolina Chemical Co. v. Carpenter & Co., 99 Va. 292, 293-97, 38 S.E. 143 (1901); Carpenter & Co. v. Virginia-Carolina Chemical Co., 98 Va. 177, 182-85, 35 S.E. 358 (1900). A similar rule of good faith may be continued under the general obligation of good faith required by UCC 1-203.

See VIRGINIA ANNOTATIONS to UCC 2-607 for comment on actions for breach of warranty after acceptance in a sale on approval.

§ 2-328. Sale by Auction. (1) In a sale by auction if goods are put up in lots each lot is the subject of a separate sale.

(2) A sale by auction is complete when the auctioneer so announces by the fall of the hammer or in other customary manner. Where a bid is made while the hammer is falling in acceptance of a prior bid the auctioneer may in his discretion reopen the bidding or declare the goods sold under the bid on which the hammer was falling.

(3) Such a sale is with reserve unless the goods are in explicit terms put up without reserve. In an auction with reserve the auctioneer may

withdraw the goods at any time until he announces completion of the sale. In an auction without reserve, after the auctioneer calls for bids on an article or lot, that article or lot cannot be withdrawn unless no bid is made within a reasonable time. In either case a bidder may retract his bid until the auctioneer's announcement of completion of the sale, but a bidder's retraction does not revive any previous bid.

(4) If the auctioneer knowingly receives a bid on the seller's behalf or the seller makes or procures such a bid, and notice has not been given that liberty for such bidding is reserved, the buyer may at his option avoid the sale or take the goods at the price of the last good faith bid prior to the completion of the sale. This subsection shall not apply to any bid at a forced sale.

COMMENT: **Prior Uniform Statutory Provision:** § 21, Uniform Sales Act.

Changes: Completely rewritten.

Purposes of Changes: To make it clear that:

1. The auctioneer may in his discretion either reopen the bidding or close the sale on the bid on which the hammer was falling when a bid is made at that moment. The recognition of a bid of this kind by the auctioneer in his discretion does not mean a closing in favor of such a bidder, but only that the bid has been accepted as a continuation of the bidding. If recognized, such a bid discharges the bid on which the hammer was falling when it was made.

2. An auction "with reserve" is the normal procedure. The crucial point, however, for determining the nature of an auction is the "putting up" of the goods. This Article accepts the view that the goods may be withdrawn before they are actually "put up," regardless of whether the auction is advertised as one without reserve, without liability on the part of the auction announcer to persons who are present. This is subject to any peculiar facts which might bring the case within the "firm offer" principle of this Article, but an offer to persons generally would require unmistakable language in order to fall within that section. The prior announcement of the nature of the auction either as with reserve or without reserve will, however, enter as an "explicit term" in the "putting up" of the goods and conduct thereafter must be governed accordingly. The present section continues the prior rule permitting withdrawal of bids in auctions both with and without reserve; and the rule is made explicit that the retraction of a bid does not revive a prior bid.

Cross Reference:

Point 2: § 2-205.

Definitional Cross References:

"Buyer". § 2-103.
"Good faith". § 1-201.
"Goods". § 2-105.
"Lot". § 2-105.
"Notice". § 1-201.
"Sale". § 2-106.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Subsection 2-328(4) is in accord with Virginia law in undertaking to protect buyers at auction sales from having the price bid up by the seller who has not given notice of reserving liberty to make such bids. Edmunds v. Gwynn, 157 Va. 528, 541-44, 159 S.E. 205, 161 S.E. 892 (1931), like the UCC, allows the buyer to rescind the purchase where there has been illegal puffing on the seller's behalf. See also Hinde v. Pendleton, Wythe 354, 355-57 (1799).

The UCC does not cover unlawful combinations between the auctioneer and the purchaser, Brock v. Rice, 68 Va. (27 Gratt.) 812, 816-20 (1876), or unlawful combinations among purchasers, Underwood v. McVeigh, 64 Va. (23 Gratt.) 409, 428-29 (1873).

PART 4

TITLE, CREDITORS AND GOOD FAITH PURCHASERS

§ 2-401. Passing of Title; Reservation for Security; Limited Application of This Section. Each provision of this Article with regard to the rights, obligations and remedies of the seller, the buyer, purchasers or other third parties applies irrespective of title to the goods except where the provision refers to such title. Insofar as situations are not covered by the other provisions of this Article and matters concerning title become material the following rules apply:

(1) Title to goods cannot pass under a contract for sale prior to their identification to the contract (§ 2-501), and unless otherwise explicitly agreed the buyer acquires by their identification a special property as limited by this Act. Any retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest. Subject to these provisions and to the provisions of the Article on Secured Transactions (Article 9), title to goods passes from the seller to the buyer in any manner and on any conditions explicitly agreed on by the parties.

(2) Unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods, despite any reservation of a security interest and even though a document of title is to be delivered at a different time or place; and in particular and despite any reservation of a security interest by the bill of lading

(a) if the contract requires or authorizes the seller to send the goods to the buyer but does not require him to deliver them at destination, title passes to the buyer at the time and place of shipment; but

(b) if the contract requires delivery at destination, title passes on tender there.

(3) Unless otherwise explicitly agreed where delivery is to be made without moving the goods,

(a) if the seller is to deliver a document of title, title passes at the time when and the place where he delivers such documents; or

(b) if the goods are at the time of contracting already identified and no documents are to be delivered, title passes at the time and place of contracting.

(4) A rejection or other refusal by the buyer to receive or retain the goods, whether or not justified, or a justified revocation of acceptance, revests title to the goods in the seller. Such revesting occurs by operation of law and is not a "sale".

COMMENT: Prior Uniform Statutory Provision: See generally, §§ 17, 18, 19 and 20, Uniform Sales Act.

Purposes: To make it clear that:

1. This Article deals with the issues between seller and buyer in terms of step by step performance or non-performance under the contract for sale and not in terms of whether or not "title" to the goods has passed. That the rules of this section in no way alter the rights of either the buyer, seller or third parties declared elsewhere in the Article is made clear by the preamble of this section. This section, however, in no way intends to indicate which line of interpretation

should be followed in cases where the applicability of "public" regulation depends upon a "sale" or upon location of "title" without further definition. The basic policy of this Article that known purpose and reason should govern interpretation cannot extend beyond the scope of its own provisions. It is therefore necessary to state what a "sale" is and when title passes under this Article in case the courts deem any public regulation to incorporate the defined term of the "private" law.

2. "Future" goods cannot be the subject of a present sale. Before title can pass the goods must be identified in the manner set forth in § 2-501. The parties, however, have full liberty to arrange by specific terms for the passing of title to goods which are existing.

3. The "special property" of the buyer in goods identified to the contract is excluded from the definition of "security interest"; its incidents are defined in provisions of this Article such as those on the rights of the seller's creditors, on good faith purchase, on the buyer's right to goods on the seller's insolvency, and on the buyer's right to specific performance or replevin.

4. The factual situations in subsections (2) and (3) upon which passage of title turn actually base the test upon the time when the seller has finally committed himself in regard to specific goods. Thus in a "shipment" contract he commits himself by the act of making the shipment. If shipment is not contemplated subsection (3) turns on the seller's final commitment, i. e. the delivery of documents or the making of the contract.

Cross References:

Point 2: §§ 2-102, 2-501 and 2-502.
Point 3: §§ 1-201, 2-402, 2-403, 2-502 and 2-716.

Definitional Cross References:

"Agreement". § 1-201.
"Bill of lading". § 1-201.
"Buyer". § 2-103.
"Contract". § 1-201.
"Contract for sale". § 2-106.
"Delivery". § 1-201.
"Document of title". § 1-201.
"Good faith". § 2-103.
"Goods". § 2-105.
"Party". § 1-201.
"Purchaser". § 1-201.
"Receipt of goods". § 2-103.
"Remedy". § 1-201.
"Rights". § 1-201.
"Sale". § 2-106.
"Security interest". § 1-201.
"Seller". § 2-103.
"Send". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: The UCC rules as set forth in this section are generally in accord with the Virginia decisions. Under Virginia law when title passes is governed by the intention of the parties. Birdsong & Co. v. American Peanut Co., 149 Va. 755, 766, 141 S.E. 759 (1928). Under both the UCC and Virginia law title cannot pass from a seller to a buyer until there has been an identification of specific goods to the contract. Ellis & Meyers Lumber Co. v. Hubbard, 123 Va. 481, 493-99, 96 S.E. 754 (1918); Broad Street Bank v. Baker Motor Vehicle Co., 119 Va. 26, 31, 89 S.E. 110 (1916). Subject to this proviso, title passes in any manner and on any conditions expressly agreed upon by the parties. Ellis & Meyers Lumber Co. v. Hubbard, 123 Va. 481, 494, 96 S.E. 754 (1918). In the absence of express agreement, under the UCC, the rules of this section are immediately resorted to in order to determine whether title has passed. Under Virginia law, it is said, title passage is wholly a question of the intention of the parties. In Triplett Lumber Co., Inc. v. Purcell, 185 F.2d 843, 845-46 (4th Cir. 1950), it was held that no title had passed because the parties had not agreed upon a price. The facts and circumstances are examined under Virginia law in order to ascertain the intentions of the parties, and if these show no mani-

festation of intention, then resort is had to presumptions of law to find these intentions. Faulkner v. Town of South Boston, 141 Va. 517, 520, 127 S.E. 380 (1925).

Under both the UCC and Virginia law an appropriation of specific goods to the contract can be made only with the assent of both seller and buyer. Broad Street Bank v. Baker Motor Vehicle Co., 119 Va. 26, 31, 89 S.E. 110 (1916); American Hide & Leather Co. v. Chalkley & Co., 101 Va. 458, 464, 44 S.E. 705 (1903). Title may pass although the goods are still in the possession of the seller and something remains to be done, as weighing to determine the price. Drewry, Treasurer v. Baugh and Sons, Inc., 150 Va. 394, 403-05, 143 S.E. 713 (1928). Under Virginia law, title may pass while the goods are in the hands of a third person, and it is still necessary to separate the buyer's goods from a larger fungible mass. Geoghegan Sons & Co., Inc. v. Arbuckle Bros., 139 Va. 92, 106, 123 S.E. 387, 36 A.L.R. 399 (1924); Pleasants v. Pendleton, 27 Va. (6 Rand.) 473, 488-95, 499-502, 503-06 (1828). The UCC is not explicit on this point. Trigg Co. v. Bucyrus Co., 104 Va. 79, 83-86, 51 S.E. 174 (1905), recognized that title had passed to the buyer so that the seller could not reclaim the goods upon the buyer's insolvency.

Unless otherwise expressly agreed, title under both the UCC and Virginia law passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods. Faulkner v. Town of South Boston, 141 Va. 517, 520-21, 127 S.E. 380 (1925); Jacobs v. Warthen, 115 Va. 571, 573, 80 S.E. 113 (1913). Under both the UCC and Virginia law, title passes to the buyer at the time and place of shipment, under an F.O.B. place of shipment contract. Geogehegan Sons & Co. v. Arbuckle Bros., 139 Va. 92, 123 S.E. 387, 36 A.L.R. 399 (1924); J. B. Colt Co. v. Elam, 138 Va. 124, 127, 120 S.E. 857 (1924); Lawson v. Hobbs, 120 Va. 690, 693, 91 S.E. 750 (1917). If the seller is required to deliver the goods at destination, title passes under the UCC "on tender" at destination, while Virginia has spoken of title passing "on delivery" at destination. Montauk Ice Cream Co. v. Daigger, 141 Va. 686, 698, 126 S.E. 681 (1925).

The UCC would change the result in Rountree v. Graham, 144 Va. 145, 148-50, 131 S.E. 193 (1926). In this case, under an F.O.B. place of shipment term, the goods were delivered by the seller to the carrier. The seller took an order bill of lading, granting the buyer a right of inspection, and with draft attached, forwarded the documents for collection. On inspection the buyer found the goods to be defective and refused to accept them. The Virginia court, saying that passage of title is a question of the intention of the parties, found from the correspondence between the parties that title was not intended to pass at the place of shipment. The UCC is clear that the reservation of a security interest in a bill of lading does not affect the passing of title, the time and place of title passage being controlled hy the UCC in the absence of an explicit agreement. Since there was no explicit agreement in this case, title would have passed at the place of shipment, contrary to the holding in the case.

Under both the UCC and Virginia law where delivery is to be made, without moving the goods, by the delivery of a document, title passes at the time and place the document is delivered. Pleasants v. Pendleton, 27 Va. (6 Rand.) 473, 483-84 (1828). Where delivery of identified goods is to be made without moving the goods or delivery of documents, title passes at the time and place of contracting.

The UCC would change the result in F. D. Cummer and Son Co. v. R. M. Hudson Co., 141 Va. 271, 283-84, 127 S.E. 171 (1925) (goods already in possession of the buyer).

§ 2-402. Rights of Seller's Creditors Against Sold Goods. (1) Except as provided in subsections (2) and (3), rights of unsecured creditors of the seller with respect to goods which have been identified to a contract for sale are subject to the buyer's rights to recover the goods under this Article (§§ 2-502 and 2-716).

(2) A creditor of the seller may treat a sale or an identification of goods to a contract for sale as void if as against him a retention of possession by the seller is fraudulent under any rule of law of the state where the goods are situated, except that retention of possession in good faith and current course of trade by a merchant-seller for a commercially reasonable time after a sale or identification is not fraudulent.

(3) Nothing in this Article shall be deemed to impair the rights of creditors of the seller

(a) under the provisions of the Article on Secured Transactions (Article 9); or

(b) where identification to the contract or delivery is made not in current course of trade but in satisfaction of or as security for a pre-existing claim for money, security or the like and is made under circumstances which under any rule of law of the state where the goods are situated would apart from this Article constitute the transaction a fraudulent transfer or voidable preference.

COMMENT: **Prior Uniform Statutory Provision:** Subsection (2)—§ 26, Uniform Sales Act; Subsections (1) and (3)—none.

Changes: Rephrased.

Purposes of Changes and New Matter: To avoid confusion on ordinary issues between current sellers and buyers and issues in the field of preference and hindrance by making it clear that:

1. Local law on questions of hindrance of creditors by the seller's retention of possession of the goods are outside the scope of this Article, but retention of possession in the current course of trade is legitimate. Transactions which fall within the law's policy against improper preferences are reserved from the protection of this Article.

2. The retention of possession of the goods by a merchant seller for a commercially reasonable time after a sale or identification in current course is exempted from attack as fraudulent. Similarly, the provisions of subsection (3) have no application to identification or delivery made in the current course of trade, as measured against general commercial understanding of what a "current" transaction is.

Definitional Cross References:

"Contract for sale". § 2-106.
"Creditor". § 1-201.
"Good faith". § 2-103.
"Goods." § 2-105.
"Merchant". § 2-104.
"Money". § 1-201.
"Reasonable time". § 1-204.
"Rights". § 1-201.
"Sale". § 2-106.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 11-1, 55-95, 55-96.

Comment: § 2-402(2) provides an exception to the blanket statutory rule that a retention of possession by a seller of goods sold is void against creditors unless a written bill of sale exists and has been properly recorded. Va. Code 1950, §§ 11-1, 55-95, 55-96.

The UCC does not cover the situation presented in Drewry, Treasurer v. Baugh and Sons, Inc., 150 Va. 394, 403-05, 143 S.E. 713 (1928), in which the buyer, to whom title had passed, although the goods were in the possession of the seller for weighing to ascertain the price, took free of a tax lien levied against the seller. See also M'Kinley v. Ensell, 43 Va. (2 Gratt.) 333 (1845), involving a bulk sale in which the seller was thereafter employed as an agent of the buyer.

§ 2-403. Power to Transfer; Good Faith Purchase of Goods; "Entrusting". (1) A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited

interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer a good title to a good faith purchaser for value. When goods have been delivered under a transaction of purchase the purchaser has such power even though

(a) the transferor was deceived as to the identity of the purchaser, or

(b) the delivery was in exchange for a check which is later dishonored, or

(c) it was agreed that the transaction was to be a "cash sale", or

(d) the delivery was procured through fraud punishable as larcenous under the criminal law.

(2) Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business.

(3) "Entrusting" includes any delivery and any acquiescence in retention of possession regardless of any condition expressed between the parties to the delivery or acquiescence and regardless of whether the procurement of the entrusting or the possessor's disposition of the goods have been such as to be larcenous under the criminal law.

(4) The rights of other purchasers of goods and of lien creditors are governed by the Articles on Secured Transactions (Article 9), Bulk Transfers (Article 6) and Documents of Title (Article 7).

COMMENT: **Prior Uniform Statutory Provision:** §§ 20 (4), 23, 24, 25, Uniform Sales Act; § 9, especially 9(2), Uniform Trust Receipts Act; § 9, Uniform Conditional Sales Act.

Changes: Consolidated and rewritten.

Purposes of Changes: To gather together a series of prior uniform statutory provisions and the case-law thereunder and to state a unified and simplified policy on good faith purchase of goods.

1. The basic policy of our law allowing transfer of such title as the transferor has is generally continued and expanded under subsection (1). In this respect the provisions of the section are applicable to a person taking by any form of "purchase" as defined by this Act. Moreover the policy of this Act expressly providing for the application of supplementary general principles of law to sales transactions wherever appropriate joins with the present section to continue unimpaired all rights acquired under the law of agency or of apparent agency or ownership or other estoppel, whether based on statutory provisions or on case law principles. The section also leaves unimpaired the powers given to selling factors under the earlier Factors Acts. In addition subsection (1) provides specifically for the protection of the good faith purchaser for value in a number of specific situations which have been troublesome under prior law.

On the other hand, the contract of purchase is of course limited by its own terms as in a case of pledge for a limited amount or of sale of a fractional interest in goods.

2. The many particular situations in which a buyer in ordinary course of business from a dealer has been protected against reservation of property or other hidden interest are gathered by subsections (2)-(4) into a single principle protecting persons who buy in ordinary course out of inventory. Consignors have no reason to complain, nor have lenders who hold a security interest in the inventory, since the very purpose of goods in inventory is to be turned into cash by sale.

The principle is extended in subsection (3) to fit with the abolition of the old law of "cash sale" by subsection (1)(c). It is also freed from any technicalities depending on the extended law of larceny; such extension of the concept of theft to include trick, particular types of fraud, and the like is for the purpose of helping conviction of the offender; it has no proper application to the long-

standing policy of civil protection of buyers from persons guilty of such trick or fraud. Finally, the policy is extended, in the interest of simplicity and sense, to any entrusting by a bailor; this is in consonance with the explicit provisions of § 7-205 on the powers of a warehouseman who is also in the business of buying and selling fungible goods of the kind he warehouses. As to entrusting by a secured party, subsection (2) is limited by the more specific provisions of § 9-307(1), which deny protection to a person buying farm products from a person engaged in farming operations.

3. The definition of "buyer in ordinary course of business" (§ 1-201) is effective here and preserves the essence of the healthy limitations engrafted by the case-law on the older statutes. The older loose concept of good faith and wide definition of value combined to create apparent good faith purchasers in many situations in which the result outraged common sense; the court's solution was to protect the original title especially by use of "cash sale" or of over-technical construction of the enabling clauses of the statutes. But such rulings then turned into limitations on the proper protection of buyers in the ordinary market. § 1-201(9) cuts down the category of buyer in ordinary course in such fashion as to take care of the results of the cases, but with no price either in confusion or in injustice to proper dealings in the normal market.

4. Except as provided in subsection (1), the rights of purchasers other than buyers in ordinary course are left to the Articles on Secured Transactions, Documents of Title, and Bulk Sales.

Cross References:

Point 1: §§ 1-103 and 1-201.
Point 2: §§ 1-201, 2-402, 7-205 and 9-307(1).
Points 3 and 4: §§ 1-102, 1-201, 2-104, 2-707 and Articles 6, 7 and 9.

Definitional Cross References:

"Buyer in ordinary course of business". § 1-201.
"Good faith". §§ 1-201 and 2-103.
"Goods". § 2-105.
"Person". § 1-201.
"Purchaser". § 1-201.
"Signed". § 1-201.
"Term". § 1-201.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-558.

Comment: By implication the UCC recognizes, as has Virginia law, that a person without title cannot transfer title, even though the buyer has paid value in good faith without notice of the lack of title. First National Bank of Waynesboro v. Johnson, 183 Va. 227, 236, 31 S.E.2d 581 (1944). The rights of purchasers under Virginia law has been determined on the basis of where "title" to the goods has been located. In Old Dom. Steamship Co. v. Burckhardt, 72 Va. (31 Gratt.) 664, 668-69 (1879), the Supreme Court of Appeals said: "If the transaction was a sale which transferred both title and possession, although such title and possession was obtained by false and fraudulent representations . . . the goods cannot be recovered from . . . the bona fide purchaser, who paid value for them without notice of such fraud . . . . If, on the other hand, there was no sale which, upon delivery, passed the title, but it was intended to pass the bare possession only, then the sale . . . could pass no title . . ., and [the seller] not having parted with the title, could claim the goods in the hands of whomsoever they might be found." Oberdorfer v. Meyer, 88 Va. 384, 386, 13 S.E. 756 (1891), is to the same effect.

Under subsection 2-403(2) the entrusting of goods to a merchant gives him power to transfer all rights of the entruster to a buyer in ordinary course of business, but the situation when the person entrusted with the goods is not a merchant does not seem to be covered by the UCC. See Williams v. Given, 47 Va. (6 Gratt.) 268, 270-77 (1849).

The UCC leaves unchanged the result in Peshine v. Shepperson, 58 Va. (17 Gratt.) 472, 482 (1867), in which the buyer was denied good title where he had surreptitiously, at night, bought goods from a clerk and carried them away in satisfaction of debts owed to the buyer by the insolvent owner of the goods. Such a transaction would not be in good faith under the UCC. See VIRGINIA ANNOTATIONS to UCC 1-201.

This section apparently leaves unchanged the result in Philip Greenberg, Inc. v. Dunville, 166 Va. 398, 185 S.E. 892 (1936). In this case, Greenberg, through Dunville, as salesman for the Allied Company, bought some fixtures on a conditional sale contract, trading in his old fixtures. Under the contract, Greenberg was to ship the old fixtures as soon as the new fixtures were delivered. On delivery of the new fixtures, Greenberg claimed that they were defective and refused to ship the old fixtures until an adjustment was made in his complaint. Dunville, thereupon, brought an action of detinue against Greenberg for the old fixtures, claiming that he had purchased them from the Allied Company. This purchase resulted from the custom of the Allied Company of requiring their salesmen to accept as part payment for their services the traded-in equipment at the price allowed to the customer. The Virginia court allowed Dunville to recover the old equipment from Greenberg, taking the view that title passed to the Allied Company on its delivery of the new fixtures to Greenberg, and thereafter Allied Company could sell the equipment, even though it was in the possession of a third person and the bona fide character of the transaction had not been disproved.

The question might be raised under the UCC as to whether the transaction between Allied Company and its salesman was a "sale," or for that matter whether it fits into any of the categories included under the UCC definition of a "purchase." See UCC 1-201(32).

PART 5

PERFORMANCE

§ 2-501. Insurable Interest in Goods; Manner of Identification of Goods. (1) The buyer obtains a special property and an insurable interest in goods by identification of existing goods as goods to which the contract refers even though the goods so identified are non-conforming and he has an option to return or reject them. Such identification can be made at any time and in any manner explicitly agreed to by the parties. In the absence of explicit agreement identification occurs

(a) when the contract is made if it is for the sale of goods already existing and identified;

(b) if the contract is for the sale of future goods other than those described in paragraph (c), when goods are shipped, marked or otherwise designated by the seller as goods to which the contract refers;

(c) when the crops are planted or otherwise become growing crops or the young are conceived if the contract is for the sale of unborn young to be born within twelve months after contracting or for the sale of crops to be harvested within twelve months or the next normal harvest season after contracting whichever is longer.

(2) The seller retains an insurable interest in goods so long as title to or any security interest in the goods remains in him and where the identification is by the seller alone he may until default or insolvency or notification to the buyer that the identification is final substitute other goods for those identified.

(3) Nothing in this section impairs any insurable interest recognized under any other statute or rule of law.

COMMENT: Prior Uniform Statutory Provision: See §§ 17 and 19, Uniform Sales Act.

Purposes: 1. The present section deals with the manner of identifying goods to the contract so that an insurable interest in the buyer and the rights set forth in the next section will accrue. Generally speaking, identification may be made in any manner "explicitly agreed to" by the parties. The rules of paragraphs (a), (b) and (c) apply only in the absence of such "explicit agreement".

2. In the ordinary case identification of particular existing goods as goods to which the contract refers is unambiguous and may occur in one of many ways. It is possible, however, for the identification to be tentative or contingent. In view of the limited effect given to identification by this Article, the general policy is to resolve all doubts in favor of identification.

3. The provision of this section as to "explicit agreement" clarifies the present confusion in the law of sales which has arisen from the fact that under prior uniform legislation all rules of presumption with reference to the passing of title or to appropriation (which in turn depended upon identification) were regarded as subject to the contrary intention of the parties or of the party appropriating. Such uncertainty is reduced to a minimum under this section by requiring "explicit agreement" of the parties before the rules of paragraphs (a), (b) and (c) are displaced—as they would be by a term giving the buyer power to select the goods. An "explicit" agreement, however, need not necessarily be found in the terms used in the particular transaction. Thus, where a usage of the trade has previously been made explicit by reduction to a standard set of "rules and regulations" currently incorporated by reference into the contracts of the parties, a relevant provision of those "rules and regulations" is "explicit" within the meaning of this section.

4. In view of the limited function of identification there is no requirement in this section that the goods be in deliverable state or that all of the seller's duties with respect to the processing of the goods be completed in order that identification occur. For example, despite identification the risk of loss remains on the seller under the risk of loss provisions until completion of his duties as to the goods and all of his remedies remain dependent upon his not defaulting under the contract.

5. Undivided shares in an identified fungible bulk, such as grain in an elevator or oil in a storage tank, can be sold. The mere making of the contract with reference to an undivided share in an identified fungible bulk is enough under subsection (a) to effect an identification if there is no explicit agreement otherwise. The seller's duty, however, to segregate and deliver according to the contract is not affected by such an identification but is controlled by other provisions of this Article.

6. Identification of crops under paragraph (c) is made upon planting only if they are to be harvested within the year or within the next normal harvest season. The phrase "next normal harvest season" fairly includes nursery stock raised for normally quick "harvest," but plainly excludes a "timber" crop to which the concept of a harvest "season" is inapplicable.

Paragraph (c) is also applicable to a crop of wool or the young of animals to be born within twelve months after contracting. The product of a lumbering, mining or fishing operation, though seasonal, is not within the concept of "growing". Identification under a contract for all or part of the output of such an operation can be effected early in the operation.

Cross References:

Point 1: § 2-502.
Point 4: §§ 2-509, 2-510 and 2-703.
Point 5: §§ 2-105, 2-308, 2-503 and 2-509.
Point 6: §§ 2-105(1), 2-107(1) and 2-402.

Definitional Cross References:

"Agreement". § 1-201.
"Contract". § 1-201.
"Contract for sale". § 2-106.
"Future goods". § 2-105.
"Goods". § 2-105.
"Notification". § 1-201.
"Party". § 1-201.
"Sale". § 2-106.
"Security interest". § 1-201.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Both the UCC and Virginia law provide that identification, or appropriation as it is called in the Virginia cases, of existing goods to a contract may be

made at any time and in any manner expressly agreed upon by the parties. American Hide & Leather Co. v. Chalkley & Co., 101 Va. 458, 464, 44 S.E. 705 (1903). The UCC, in the absence of express agreement, provides rules to be followed in determining whether goods have been identified to a contract. While the Virginia cases speak in terms of the passage of title, the UCC states results without reference to the location of title.

The UCC is in accord with Ellis & Meyers Lumber Co. v. Hubbard, 123 Va. 481, 494-96, 96 S.E. 754 (1918), in which it was held that delivery of lumber to the place agreed upon by the seller and buyer constituted an identification, although the buyer was still to inspect the lumber—testing, measuring, recounting, and accepting—and the seller was still to deliver the lumber to the shipping point. Similarly, Drewry, Treasurer v. Baugh and Sons, Inc., 150 Va. 394, 403-05, 143 S.E. 713 (1928), held that there had been an identification of the goods to the contract and title had passed, although the goods were still in possession of the seller, being ready for loading. See also Trigg Co. v. Bucyrus Co., 104 Va. 79, 83-84, 51 S.E. 174 (1905), holding that there had been an appropriation of specific goods to a contract so that ownership passed to the vendee.

In accord with this section, Broad Street Bank v. Baker Motor Vehicle Co., 119 Va. 26, 31, 89 S.E. 110 (1916), recognized that the property in goods not ascertained by the contract does not pass until there has been an appropriation of specific goods to the contract. In this case a second buyer, who obtained a car, prevailed over a first buyer, who had ordered the car.

Subsection 2-501(2) is consistent with Trigg Co. v. Bucyrus Co., 104 Va. 79, 85, 51 S.E. 174 (1905), in recognizing that a seller may have an insurable interest in a chattel, even though title or ownership has passed to the buyer.

§ 2-502. Buyer's Right to Goods on Seller's Insolvency. (1) Subject to subsection (2) and even though the goods have not been shipped a buyer who has paid a part or all of the price of goods in which he has a special property under the provisions of the immediately preceding section may on making and keeping good a tender of any unpaid portion of their price recover them from the seller if the seller becomes insolvent within ten days after receipt of the first installment on their price.

(2) If the identification creating his special property has been made by the buyer he acquires the right to recover the goods only if they conform to the contract for sale.

COMMENT: **Prior Uniform Statutory Provision:** Compare §§ 17, 18 and 19, Uniform Sales Act.

Purposes: 1. This section gives an additional right to the buyer as a result of identification of the goods to the contract in the manner provided in § 2-501. The buyer is given a right to the goods on the seller's insolvency occurring within 10 days after he receives the first installment on their price.

2. The question of whether the buyer also acquires a security interest in identified goods and has rights to the goods when insolvency takes place after the ten-day period provided in this section depends upon compliance with the provisions of the Article on Secured Transactions (Article 9).

3. Subsection (2) is included to preclude the possibility of unjust enrichment which exists if the buyer were permitted to recover goods even though they were greatly superior in quality or quantity to that called for by the contract for sale.

Cross References:

Point 1: §§ 1-201 and 2-702.
Point 2: Article 9.

Definitional Cross References:

"Buyer". § 2-103.
"Conform". § 2-106.
"Contract for sale". § 2-106.
"Goods". § 2-105.
"Insolvent". § 1-201.
"Right". § 1-201.
"Seller". § 2-103.

Prior Statutes: None.

§ 2-503. Manner of Seller's Tender of Delivery. (1) Tender of delivery requires that the seller put and hold conforming goods at the buyer's disposition and give the buyer any notification reasonably necessary to enable him to take delivery. The manner, time and place for tender are determined by the agreement and this Article, and in particular

(a) tender must be at a reasonable hour, and if it is of goods they must be kept available for the period reasonably necessary to enable the buyer to take possession; but

(b) unless otherwise agreed the buyer must furnish facilities reasonably suited to the receipt of the goods.

(2) Where the case is within the next section respecting shipment tender requires that the seller comply with its provisions.

(3) Where the seller is required to deliver at a particular destination tender requires that he comply with subsection (1) and also in any appropriate case tender documents as described in subsections (4) and (5) of this section.

(4) Where goods are in the possession of a bailee and are to be delivered without being moved

(a) tender requires that the seller either tender a negotiable document of title covering such goods or procure acknowledgment by the bailee of the buyer's right to possession of the goods; but

(b) tender to the buyer of a non-negotiable document of title or of a written direction to the bailee to deliver is sufficient tender unless the buyer seasonably objects, and receipt by the bailee of notification of the buyer's rights fixes those rights as against the bailee and all third persons; but risk of loss of the goods and of any failure by the bailee to honor the non-negotiable document of title or to obey the direction remains on the seller until the buyer has had a reasonable time to present the document or direction, and a refusal by the bailee to honor the document or to obey the direction defeats the tender.

(5) Where the contract requires the seller to deliver documents

(a) he must tender all such documents in correct form, except as provided in this Article with respect to bills of lading in a set (subsection (2) of § 2-323); and

(b) tender through customary banking channels is sufficient and dishonor of a draft accompanying the documents constitutes non-acceptance or rejection.

COMMENT: Prior Uniform Statutory Provision: See §§ 11, 19, 20, 43(3) and (4), 46 and 51, Uniform Sales Act.

Changes: The general policy of the above sections is continued and supplemented but subsection (3) changes the rule of prior section 19 (5) as to what constitutes a "destination" contract and subsection (4) incorporates a minor correction as to tender of delivery of goods in the possession of a bailee.

Purposes of Changes: 1. The major general rules governing the manner of proper or due tender of delivery are gathered in this section. The term "tender" is used in this Article in two different senses. In one sense it refers to "due tender" which contemplates an offer coupled with a present ability to fulfill all the conditions resting on the tendering party and must be followed by actual performance if

the other party shows himself ready to proceed. Unless the context unmistakably indicates otherwise this is the meaning of "tender" in this Article and the occasional addition of the word "due" is only for clarity and emphasis. At other times it is used to refer to an offer of goods or documents under a contract as if in fulfillment of its conditions even though there is a defect when measured against the contract obligation. Used in either sense, however, "tender" connotes such performance by the tendering party as puts the other party in default if he fails to proceed in some manner.

2. The seller's general duty to tender and deliver is laid down in § 2-301 and more particularly in § 2-507. The seller's right to a receipt if he demands one and receipts are customary is governed by § 1-205. Subsection (1) of the present section proceeds to set forth two primary requirements of tender: first, that the seller "put and hold conforming goods at the buyer's disposition" and, second, that he "give the buyer any notice reasonably necessary to enable him to take delivery."

In cases in which payment is due and demanded upon delivery the "buyer's disposition" is qualified by the seller's right to retain control of the goods until payment by the provision of this Article on delivery on condition. However, where the seller is demanding payment on delivery he must first allow the buyer to inspect the goods in order to avoid impairing his tender unless the contract for sale is on C.I.F., C.O.D., cash against documents or similar terms negating the privilege of inspection before payment.

In the case of contracts involving documents the seller can "put and hold conforming goods at the buyer's disposition" under subsection (1) by tendering documents which give the buyer complete control of the goods under the provisions of Article 7 on due negotiation.

3. Under paragraph (a) of subsection (1) usage of the trade and the circumstances of the particular case determine what is a reasonable hour for tender and what constitutes a reasonable period of holding the goods available.

4. The buyer must furnish reasonable facilities for the receipt of the goods tendered by the seller under subsection (1), paragraph (b). This obligation of the buyer is no part of the seller's tender.

5. For the purposes of subsections (2) and (3) there is omitted from this Article the rule under prior uniform legislation that a term requiring the seller to pay the freight or cost of transportation to the buyer is equivalent to an agreement by the seller to deliver to the buyer or at an agreed destination. This omission is with the specific intention of negating the rule, for under this Article the "shipment" contract is regarded as the normal one and the "destination" contract as the variant type. The seller is not obligated to deliver at a named destination and bear the concurrent risk of loss until arrival, unless he has specifically agreed so to deliver or the commercial understanding of the terms used by the parties contemplates such delivery.

6. Paragraph (a) of subsection (4) continues the rule of the prior uniform legislation as to acknowledgment by the bailee. Paragraph (b) of subsection (4) adopts the rule that between the buyer and the seller the risk of loss remains on the seller during a period reasonable for securing acknowledgment of the transfer from the bailee, while as against all other parties the buyer's rights are fixed as of the time the bailee receives notice of the transfer.

7. Under subsection (5) documents are never "required" except where there is an express contract term or it is plainly implicit in the peculiar circumstances of the case or in a usage of trade. Documents may, of course, be "authorized" although not required, but such cases are not within the scope of this subsection. When documents are required, there are three main requirements of this subsection: (1) "All": each required document is essential to a proper tender; (2) "Such": the documents must be the ones actually required by the contract in terms of source and substance; (3) "Correct form": all documents must be in correct form.

When a prescribed document cannot be procured, a question of fact arises under the provision of this Article on substituted performance as to whether the agreed manner of delivery is actually commercially impracticable and whether the substitute is commercially reasonable.

Cross References:

Point 2: §§ 1-205, 2-301, 2-310, 2-507 and 2-513 and Article 7.
Point 5: §§ 2-308, 2-310 and 2-509.
Point 7: § 2-614(1).

Specific matters involving tender are covered in many additional sections of this Article. See §§ 1-205, 2-301, 2-306 to 2-319, 2-321(3), 2-504, 2-507(2), 2-511(1), 2-513, 2-612 and 2-614.

Definitional Cross References:

"Agreement". § 1-201.
"Bill of lading". § 1-201.
"Buyer". § 2-103.
"Conforming". § 2-106.
"Contract". § 1-201.
"Delivery". § 1-201.
"Dishonor". § 3-508.
"Document of title". § 1-201.
"Draft". § 3-104.
"Goods". § 2-105.
"Notification". § 1-201.
"Reasonable time". § 1-204.
"Receipt of goods". § 2-103.
"Rights". § 1-201.
"Seasonably". § 1-204.
"Seller". § 2-103.
"Written". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: For a discussion of Philip Greenberg, Inc. v. Dunville, 166 Va. 398, 185 S.E. 892 (1936), see VIRGINIA ANNOTATIONS to UCC 2-403. For comment with reference to subsection 2-503(2) see VIRGINIA ANNOTATIONS to UCC 2-504.

Subsection 2-503(5)(a) is in accord with Sauls v. Thomas Andrews and Co., 163 Va. 407, 415, 175 S.E. 760 (1934), which pointed out that in order to complete the sale of an automobile it is essential for the seller to give the buyer a proper assignment of title, and until this is done the contract is executory.

§ 2-504. Shipment by Seller. Where the seller is required or authorized to send the goods to the buyer and the contract does not require him to deliver them at a particular destination, then unless otherwise agreed he must

(a) put the goods in the possession of such a carrier and make such a contract for their transportation as may be reasonable having regard to the nature of the goods and other circumstances of the case; and

(b) obtain and promptly deliver or tender in due form any document necessary to enable the buyer to obtain possession of the goods or otherwise required by the agreement or by usage of trade; and

(c) promptly notify the buyer of the shipment.

Failure to notify the buyer under paragraph (c) or to make a proper contract under paragraph (a) is a ground for rejection only if material delay or loss ensues.

COMMENT: **Prior Uniform Statutory Provision:** § 46, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To continue the general policy of the prior uniform statutory provision while incorporating certain modifications with respect to the requirement that the contract with the carrier be made expressly on behalf of the buyer and as to the necessity of giving notice of the shipment to the buyer, so that:

1. The section is limited to "shipment" contracts as contrasted with "destination" contracts or contracts for delivery at the place where the goods are located.

The general principles embodied in this section cover the special cases of F. O. B. point of shipment contracts and C. I. F. and C. & F. contracts. Under the preceding section on manner of tender of delivery, due tender by the seller requires that he comply with the requirements of this section in appropriate cases.

2. The contract to be made with the carrier under paragraph (a) must conform to all express terms of the agreement, subject to any substitution necessary because of failure of agreed facilities as provided in the later provision on substituted performance. However, under the policies of this Article on good faith and commercial standards and on buyer's rights on improper delivery, the requirements of explicit provisions must be read in terms of their commercial and not their literal meaning. This policy is made express with respect to bills of lading in a set in the provision of this Article on form of bills of lading required in overseas shipment.

3. In the absence of agreement, the provision of this Article on options and cooperation respecting performance gives the seller the choice of any reasonable carrier, routing and other arrangements. Whether or not the shipment is at the buyer's expense the seller must see to any arrangements, reasonable in the circumstances, such as refrigeration, watering of live stock, protection against cold, the sending along of any necessary help, selection of specialized cars and the like for paragraph (a) is intended to cover all necessary arrangements whether made by contract with the carrier or otherwise. There is, however, a proper relaxation of such requirements if the buyer is himself in a position to make the appropriate arrangements and the seller gives him reasonable notice of the need to do so. It is an improper contract under paragraph (a) for the seller to agree with the carrier to a limited valuation below the true value and thus cut off the buyer's opportunity to recover from the carrier in the event of loss, when the risk of shipment is placed on the buyer by his contract with the seller.

4. Both the language of paragraph (b) and the nature of the situation it concerns indicate that the requirement that the seller must obtain and deliver promptly to the buyer in due form any document necessary to enable him to obtain possession of the goods is intended to cumulate with the other duties of the seller such as those covered in paragraph (a).

In this connection, in the case of pool car shipments a delivery order furnished by the seller on the pool car consignee, or on the carrier for delivery out of a larger quantity, satisfies the requirements of paragraph (b) unless the contract requires some other form of document.

5. This Article, unlike the prior uniform statutory provision, makes it the seller's duty to notify the buyer of shipment in all cases. The consequences of his failure to do so, however, are limited in that the buyer may reject on this ground only where material delay or loss ensues.

A standard and acceptable manner of notification in open credit shipments is the sending of an invoice and in the case of documentary contracts is the prompt forwarding of the documents as under paragraph (b) of this section. It is also usual to send on a straight bill of lading but this is not necessary to the required notification. However, should such a document prove necessary or convenient to the buyer, as in the case of loss and claim against the carrier, good faith would require the seller to send it on request.

Frequently the agreement expressly requires prompt notification as by wire or cable. Such a term may be of the essence and the final clause of paragraph (c) does not prevent the parties from making this a particular ground for rejection. To have this vital and irreparable effect upon the seller's duties, such a term should be part of the "dickered" terms written in any "form," or should otherwise be called seasonably and sharply to the seller's attention.

6. Generally, under the final sentence of the section, rejection by the buyer is justified only when the seller's dereliction as to any of the requirements of this section in fact is followed by material delay or damage. It rests on the seller, so far as concerns matters not within the peculiar knowledge of the buyer, to establish that his error has not been followed by events which justify rejection.

Cross References:

Point 1: §§ 2-319, 2-320 and 2-503(2).
Point 2: §§ 1-203, 2-323(2), 2-601 and 2-614(1).
Point 3: § 2-311(2).
Point 5: § 1-203.

Definitional Cross References:

"Agreement". § 1-201.
"Buyer". § 2-103.
"Contract". § 1-201.
"Delivery". § 1-201.
"Goods". § 2-105.
"Notifies". § 1-201.
"Seller". § 2-103.
"Send". § 1-201.
"Usage of trade". § 1-205.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: This section is in accord with Aspegren & Co. v. Wallerstein Produce Co., 111 Va. 570, 69 S.E. 957 (1911), in which it was held to be improper for the seller to enter into a private agreement with the carrier under which goods were not to go forward until the seller had heard that his draft had been paid. Since the last sentence of this section of the UCC provides that the failure to make a proper contract with the carrier is not a ground for rejection unless material delay or loss ensues, it is not entirely clear whether the UCC changes the result in the Aspegren case. The contract in this case called for December delivery. A bill of lading was taken from the carrier on December 26, but there is no evidence to indicate whether the delay occasioned in the shipment by the private agreement made by the seller with the carrier was material or not.

§ 2-505. Seller's Shipment Under Reservation. (1) Where the seller has identified goods to the contract by or before shipment:

(a) his procurement of a negotiable bill of lading to his own order or otherwise reserves in him a security interest in the goods. His procurement of the bill to the order of a financing agency or of the buyer indicates in addition only the seller's expectation of transferring that interest to the person named.

(b) a non-negotiable bill of lading to himself or his nominee reserves possession of the goods as security but except in a case of conditional delivery (subsection (2) of § 2-507) a non-negotiable bill of lading naming the buyer as consignee reserves no security interest even though the seller retains possession of the bill of lading.

(2) When shipment by the seller with reservation of a security interest is in violation of the contract for sale it constitutes an improper contract for transportation within the preceding section but impairs neither the rights given to the buyer by shipment and identification of the goods to the contract nor the seller's powers as a holder of a negotiable document.

COMMENT: **Prior Uniform Statutory Provision:** § 20(2), (3), (4), Uniform Sales Act.

Changes: Completely rephrased, the "powers" of the parties in cases of reservation being emphasized primarily rather than the "rightfulness" of reservation.

Purposes of Changes: To continue in general the policy of the prior uniform statutory provision with certain modifications of emphasis and language, so that:

1. The security interest reserved to the seller under subsection (1) is restricted to securing payment or performance by the buyer and the seller is strictly limited in his disposition and control of the goods as against the buyer and third parties. Under this Article, the provision as to the passing of interest expressly applies "despite any reservation of security title" and also provides that the "rights, obligations and remedies" of the parties are not altered by the incidence of title generally. The security interest, therefore, must be regarded as a means given to the seller to enforce his rights against the buyer which is unaffected by and in turn does not affect the location of title generally. The rules set forth in subsection (1) are not to be altered by any apparent "contrary intent" of the parties as

to passing of title, since the rights and remedies of the parties to the contract of sale, as defined in this Article, rest on the contract and its performance or breach and not on stereotyped presumptions as to the location of title.

This Article does not attempt to regulate local procedure in regard to the effective maintenance of the seller's security interest when the action is in replevin by the buyer against the carrier.

2. Every shipment of identified goods under a negotiable bill of lading reserves a security interest in the seller under subsection (1) paragraph (a).

It is frequently convenient for the seller to make the bill of lading to the order of a nominee such as his agent at destination, the financing agency to which he expects to negotiate the document or the bank issuing a credit to him. In many instances, also, the buyer is made the order party. This Article does not deal directly with the question as to whether a bill of lading made out by the seller to the order of a nominee gives the carrier notice of any rights which the nominee may have so as to limit its freedom or obligation to honor the bill of lading in the hands of the seller as the original shipper if the expected negotiation fails. This is dealt with in the Article on Documents of Title (Article 7).

3. A non-negotiable bill of lading taken to a party other than the buyer under subsection (1) paragraph (b) reserves possession of the goods as security in the seller but if he seeks to withhold the goods improperly the buyer can tender payment and recover them.

4. In the case of a shipment by non-negotiable bill of lading taken to a buyer, the seller, under subsection (1) retains no security interest or possession as against the buyer and by the shipment he *de facto* loses control as against the carrier except where he rightfully and effectively stops delivery in transit. In cases in which the contract gives the seller the right to payment against delivery, the seller, by making an immediate demand for payment, can show that his delivery is conditional, but this does not prevent the buyer's power to transfer full title to a sub-buyer in ordinary course or other purchaser under § 2-403.

5. Under subsection (2) an improper reservation by the seller which would constitute a breach in no way impairs such of the buyer's rights as result from identification of the goods. The security title reserved by the seller under subsection (1) does not protect his holding of the document or the goods for the purpose of exacting more than is due him under the contract.

Cross References:

Point 1: § 1-201.
Point 2: Article 7.
Point 3: §§ 2-501(2) and 2-504.
Point 4: §§ 2-403, 2-507(2) and 2-705.
Point 5: §§ 2-310, 2-319(4), 2-320(4), 2-501 and 2-502 and Article 7.

Definitional Cross References:

"Bill of lading". § 1-201.
"Buyer". § 2-103.
"Consignee". § 7-102.
"Contract". § 1-201.
"Contract for sale". § 2-106.
"Delivery". § 1-201.
"Financing agency". § 2-104.
"Goods". § 2-105.
"Holder". § 1-201.
"Person". § 1-201.
"Security interest". § 1-201.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: In accord with this section, Virginia has recognized in Birdsong and Co., Inc. v. American Peanut Corp., 149 Va. 755, 767, 141 S.E. 759 (1928), that the seller's taking a bill of lading to his own order is not determinative of who has title to the goods, although Virginia has indicated that this is strong evidence that the seller did not intend for title to pass to the buyer. For a discussion of Rountree v. Graham, 144 Va. 145, 148-50, 131 S.E. 193 (1926), see VIRGINIA ANNOTATIONS to UCC 2-401.

§ 2-508. Cure by Seller of Improper Tender or Delivery; Replacement. (1) Where any tender or delivery by the seller is rejected because non-conforming and the time for performance has not yet expired, the seller may seasonably notify the buyer of his intention to cure and may then within the contract time make a conforming delivery.

(2) Where the buyer rejects a non-conforming tender which the seller had reasonable grounds to believe would be acceptable with or without money allowance the seller may if he seasonably notifies the buyer have a further reasonable time to substitute a conforming tender.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. Subsection (1) permits a seller who has made a non-conforming tender in any case to make a conforming delivery within the contract time upon seasonable notification to the buyer. It applies even where the seller has taken back the non-conforming goods and refunded the purchase price. He may still make a good tender within the contract period. The closer, however, it is to the contract date, the greater is the necessity for extreme promptness on the seller's part in notifying of his intention to cure, if such notification is to be "seasonable" under this subsection.

The rule of this subsection, moreover, is qualified by its underlying reasons. Thus if, after contracting for June delivery, a buyer later makes known to the seller his need for shipment early in the month and the seller ships accordingly, the "contract time" has been cut down by the supervening modification and the time for cure of tender must be referred to this modified time term.

2. Subsection (2) seeks to avoid injustice to the seller by reason of a surprise rejection by the buyer. However, the seller is not protected unless he had "reasonable grounds to believe" that the tender would be acceptable. Such reasonable grounds can lie in prior course of dealing, course of performance or usage of trade as well in the particular circumstances surrounding the making of the contract. The seller is charged with commercial knowledge of any factors in a particular sales situation which require him to comply strictly with his obligations under the contract as, for example, strict conformity of documents in an overseas shipment or the sale of precision parts or chemicals for use in manufacture. Further, if the buyer gives notice either implicitly, as by a prior course of dealing involving rigorous inspections, or expressly, as by the deliberate inclusion of a "no replacement" clause in the contract, the seller is to be held to rigid compliance. If the clause appears in a "form" contract evidence that it is out of line with trade usage or the prior course of dealing and was not called to the seller's attention may be sufficient to show that the seller had reasonable grounds to believe that the tender would be acceptable.

3. The words "a further reasonable time to substitute a conforming tender" are intended as words of limitation to protect the buyer. What is a "reasonable time" depends upon the attending circumstances. Compare § 2-511 on the comparable case of a seller's surprise demand for legal tender.

4. Existing trade usages permitting variations without rejection but with price allowance enter into the agreement itself as contractual limitations of remedy and are not covered by this section.

Cross References:

Point 2: § 2-302.
Point 3: § 2-511.
Point 4: §§ 1-205 and 2-721.

Definitional Cross References:

"Buyer". § 2-103.
"Conforming". § 2-106.
"Contract". § 1-201.
"Money". § 1-201.
"Notifies". § 1-201.
"Reasonable time". § 1-204.
"Seasonably". § 1-204.
"Seller". § 2-103.

Prior Statutes: None.

Comment: Under Virginia law the seller would not ordinarily be permitted to cure an improper tender, but Fielding v. Robertson, 141 Va. 123, 131-32, 126 S.E. 231 (1925), recognized an exception when the seller has shipped the right quantity, but there has been a diminishment during transit. Then the buyer must notify the seller of the deficiency and give him a reasonable opportunity to make it good, at least if the time of delivery has not passed, and the buyer has no right to refuse flatly to accept a shipment because of a deficiency so caused.

§ 2-509. **Risk of Loss in the Absence of Breach.** (1) Where the contract requires or authorizes the seller to ship the goods by carrier

(a) if it does not require him to deliver them at a particular destination, the risk of loss passes to the buyer when the goods are duly delivered to the carrier even though the shipment is under reservation (§ 2-505); but

(b) if it does require him to deliver them at a particular destination and the goods are there duly tendered while in the possession of the carrier, the risk of loss passes to the buyer when the goods are there duly so tendered as to enable the buyer to take delivery.

(2) Where the goods are held by a bailee to be delivered without being moved, the risk of loss passes to the buyer

(a) on his receipt of a negotiable document of title covering the goods; or

(b) on acknowledgment by the bailee of the buyer's right to possession of the goods; or

(c) after his receipt of a non-negotiable document of title or other written direction to deliver, as provided in subsection (4)(b) of § 2-503.

(3) In any case not within subsection (1) or (2), the risk of loss passes to the buyer on his receipt of the goods if the seller is a merchant; otherwise the risk passes to the buyer on tender of delivery.

(4) The provisions of this section are subject to contrary agreement of the parties and to the provisions of this Article on sale on approval (§ 2-327) and on effect of breach on risk of loss (§ 2-510).

COMMENT: Prior Uniform Statutory Provision: § 22, Uniform Sales Act.

Changes: Rewritten, subsection (3) of this section modifying prior law.

Purposes of Changes: To make it clear that:

1. The underlying theory of these sections on risk of loss is the adoption of the contractual approach rather than an arbitrary shifting of the risk with the "property" in the goods. The scope of the present section, therefore, is limited strictly to those cases where there has been no breach by the seller. Where for any reason his delivery or tender fails to conform to the contract, the present section does not apply and the situation is governed by the provisions on effect of breach on risk of loss.

2. The provisions of subsection (1) apply where the contract "requires or authorizes" shipment of the goods. This language is intended to be construed parallel to comparable language in the section on shipment by seller. In order that the goods be "duly delivered to the carrier" under paragraph (a) a contract must be entered into with the carrier which will satisfy the requirements of the section on shipment by the seller and the delivery must be made under circumstances which will enable the seller to take any further steps necessary to a due tender. The underlying reason of this subsection does not require that the shipment be made after contracting, but where, for example, the seller buys the goods

afloat and later diverts the shipment to the buyer, he must identify the goods to the contract before the risk of loss can pass. To transfer the risk it is enough that a proper shipment and a proper identification come to apply to the same goods although, aside from special agreement, the risk will not pass retroactively to the time of shipment in such a case.

3. Whether the contract involves delivery at the seller's place of business or at the situs of the goods, a merchant seller cannot transfer risk of loss and it remains upon him until actual receipt by the buyer, even though full payment has been made and the buyer has been notified that the goods are at his disposal. Protection is afforded him, in the event of breach by the buyer, under the next section.

The underlying theory of this rule is that a merchant who is to make physical delivery at his own place continues meanwhile to control the goods and can be expected to insure his interest in them. The buyer, on the other hand, has no control of the goods and it is extremely unlikely that he will carry insurance on goods not yet in his possession.

4. Where the agreement provides for delivery of the goods as between the buyer and seller without removal from the physical possession of a bailee, the provisions on manner of tender of delivery apply on the point of transfer of risk. Due delivery of a negotiable document of title covering the goods or acknowledgment by the bailee that he holds for the buyer completes the "delivery" and passes the risk.

5. The provisions of this section are made subject by subsection (4) to the "contrary agreement" of the parties. This language is intended as the equivalent of the phrase "unless otherwise agreed" used more frequently throughout this Act. "Contrary" is in no way used as a word of limitation and the buyer and seller are left free to readjust their rights and risks as declared by this section in any manner agreeable to them. Contrary agreement can also be found in the circumstances of the case, a trade usage or practice, or a course of dealing or performance.

Cross References:

Point 1: § 2-510(1).
Point 2: §§ 2-503 and 2-504.
Point 3: §§ 2-104, 2-503 and 2-510.
Point 4: § 2-503(4).
Point 5: § 1-201.

Definitional Cross References:

"Agreement". § 1-201.
"Buyer". § 2-103.
"Contract". § 1-201.
"Delivery". § 1-201.
"Document of title". § 1-201.
"Goods". § 2-105.
"Merchant". § 2-104.
"Party". § 1-201.
"Receipt of goods". § 2-103.
"Sale on approval". § 2-326.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Under the UCC risk of loss has been divorced from the passage of title whereas under Virginia law the risk of loss follows title. These different approaches, though, usually lead to the same results. Under both the UCC and Virginia law, where the seller is to ship the goods to the buyer F.O.B. the place of shipment, the risk of loss passes to the buyer when the goods are delivered to the carrier. F. A. Rausch & Co. v. Graham Manufacturing Corp., 139 Va. 502, 506, 124 S.E. 427, 126 S.E. 2 (1924); L. J. Upton & Co. v. Reeve, 123 Va. 241, 248, 96 S.E. 277 (1918); Haxall, Brothers & Co., 56 Va. (15 Gratt.) 434, 440-54 (1859).

Under both the UCC and Virginia law the risk of loss remains with the seller while he still has possession of the goods, with something to do in order to put the goods in a deliverable state, or to ascertain the price, as by enumeration, measurement, or weighing. Thus in Dixon v. Myers & Co., 48 Va. (7 Gratt.) 240, 243-45

(1851), the risk of loss from fire was on the seller where tobacco stems in hogsheads had been put aside for the buyer, but they had not yet been marked or weighed.

The decision in Haxall, Brothers & Co. v. Barbour, unreported but noted 56 Va. (15 Gratt.) 454, 455 (1851), is in accord with UCC 2-509(2) in holding that risk of loss has passed to the buyer where goods are in the possession of a bailee and the seller has given the buyer a delivery order, which the bailee has acknowledged. Similarly, the UCC is in accord with Pleasants v. Pendleton, 27 Va. (6 Rand.) 473, 483, 502 (1828), holding that risk of loss had passed to the buyer, the seller having given the buyer a delivery order on the bailee in possession. While the UCC does not expressly cover the point, it would seem that the fact that the bailee, a warehouseman, in this case had to separate 119 barrels out of 123 barrels of flour would not prevent the risk of loss from passing.

§ 2-510. Effect of Breach on Risk of Loss. (1) Where a tender or delivery of goods so fails to conform to the contract as to give a right of rejection the risk of their loss remains on the seller until cure or acceptance.

(2) Where the buyer rightfully revokes acceptance he may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as having rested on the seller from the beginning.

(3) Where the buyer as to conforming goods already identified to the contract for sale repudiates or is otherwise in breach before risk of their loss has passed to him, the seller may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as resting on the buyer for a commercially reasonable time.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: To make clear that:

1. Under subsection (1) the seller by his individual action cannot shift the risk of loss to the buyer unless his action conforms with all the conditions resting on him under the contract.

2. The "cure" of defective tenders contemplated by subsection (1) applies only to those situations in which the seller makes changes in goods already tendered, such as repair, partial substitution, sorting out from an improper mixture and the like since "cure" by repossession and new tender has no effect on the risk of loss of the goods originally tendered. The seller's privilege of cure does not shift the risk, however, until the cure is completed.

Where defective documents are involved a cure of the defect by the seller or a waiver of the defects by the buyer will operate to shift the risk under this section. However, if the goods have been destroyed prior to the cure or the buyer is unaware of their destruction at the time he waives the defect in the documents, the risk of the loss must still be borne by the seller, for the risk shifts only at the time of cure, waiver of documentary defects or acceptance of the goods.

3. In cases where there has been a breach of the contract, if the one in control of the goods is the aggrieved party, whatever loss or damage may prove to be uncovered by his insurance falls upon the contract breaker under subsections (2) and (3) rather than upon him. The word "effective" as applied to insurance coverage in those subsections is used to meet the case of supervening insolvency of the insurer. The "deficiency" referred to in the text means such deficiency in the insurance coverage as exists without subrogation. This section merely distributes the risk of loss as stated and is not intended to be disturbed by any subrogation of an insurer.

Cross Reference:

§ 2-509.

Definitional Cross References:

"Buyer". § 2-103.
"Conform". § 2-106.
"Contract for sale". § 2-106.
"Goods". § 2-105.
"Seller". § 2-103.

Prior Statutes: None.

§ 2-511. Tender of Payment by Buyer; Payment by Check. (1) Unless otherwise agreed tender of payment is a condition to the seller's duty to tender and complete any delivery.

(2) Tender of payment is sufficient when made by any means or in any manner current in the ordinary course of business unless the seller demands payment in legal tender and gives any extension of time reasonably necessary to procure it.

(3) Subject to the provisions of this Act on the effect of an instrument on an obligation (§ 3-802), payment by check is conditional and is defeated as between the parties by dishonor of the check on due presentment.

COMMENT: Prior Uniform Statutory Provision: § 42, Uniform Sales Act.

Changes: Rewritten by this section and § 2-507.

Purposes of Changes: 1. The requirement of payment against delivery in subsection (1) is applicable to non-commercial sales generally and to ordinary sales at retail although it has no application to the great body of commercial contracts which carry credit terms. Subsection (1) applies also to documentary contracts in general and to contracts which look to shipment by the seller but contain no term on time and manner of payment, in which situations the payment may, in proper case, be demanded against delivery of appropriate documents.

In the case of specific transactions such as C.O.D. sales or agreements providing for payment against documents, the provisions of this subsection must be considered in conjunction with the special sections of the Article dealing with such terms. The provision that tender of payment is a condition to the seller's duty to tender and complete "any delivery" integrates this section with the language and policy of the section on delivery in several lots which call for separate payment. Finally, attention should be directed to the provision on right to adequate assurance of performance which recognizes, even before the time for tender, an obligation on the buyer not to impair the seller's expectation of receiving payment in due course.

2. Unless there is agreement otherwise the concurrence of the conditions as to tender of payment and tender of delivery requires their performance at a single place or time. This Article determines that place and time by determining in various other sections the place and time for tender of delivery under various circumstances and in particular types of transactions. The sections dealing with time and place of delivery together with the section on right to inspection of goods answer the subsidiary question as to when payment may be demanded before inspection by the buyer.

3. The essence of the principle involved in subsection (2) is avoidance of commercial surprise at the time of performance. The section on substituted performance covers the peculiar case in which legal tender is not available to the commercial community.

4. Subsection (3) is concerned with the rights and obligations as between the parties to a sales transaction when payment is made by check. This Article recognizes that the taking of a seemingly solvent party's check is commercially normal and proper and, if due diligence is exercised in collection, is not to be penalized in any way. The conditional character of the payment under this section refers only to the effect of the transaction "as between the parties" thereto and does not purport to cut into the law of "absolute" and "conditional" payment as applied to such other problems as the discharge of sureties or the responsibilities of a drawee bank which is at the same time an agent for collection.

The phrase "by check" includes not only the buyer's own but any check which does not effect a discharge under Article 3 (§ 3-802). Similarly the reason of this subsection should apply and the same result should be reached where the buyer "pays" by sight draft on a commercial firm which is financing him.

5. Under subsection (3) payment by check is defeated if it is not honored upon due presentment. This corresponds to the provisions of article on Commercial Paper. (§ 3-802). But if the seller procures certification of the check instead of cashing it, the buyer is discharged. (§ 3-411).

6. Where the instrument offered by the buyer is not a payment but a credit instrument such as a note or a check postdated by even one day, the seller's acceptance of the instrument insofar as third parties are concerned, amounts to a delivery on credit and his remedies are set forth in the section on buyer's insolvency. As between the buyer and the seller, however, the matter turns on the present subsection and the section on conditional delivery and subsequent dishonor of the instrument gives the seller rights on it as well as for breach of the contract for sale.

Cross References:

Point 1: §§ 2-307, 2-310, 2-320, 2-325, 2-503, 2-513 and 2-609.
Point 2: §§ 2-307, 2-310, 2-319, 2-322, 2-503, 2-504 and 2-513.
Point 3: § 2-614.
Point 5: Article 3, esp. §§ 3-802 and 3-411.
Point 6: §§ 2-507, 2-702, and Article 3.

Definitional Cross References:

"Buyer". § 2-103.
"Check". § 3-104.
"Dishonor". § 3-508.
"Party". § 1-201.
"Reasonable time". § 1-204.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: This section is in accord with Blenner v. Vim Motor Truck Co., 136 Va. 189, 203-04, 117 S.E. 834 (1923), in which it was held that the seller was in default when he refused to deliver a bill of lading against tender of payment. When UCC 2-507 and 2-511 are considered together, it would appear that the UCC requires the buyer to do the first act, that is, tender payment. Virginia has indicated that contracts for sale are mutual contracts and it is "uncertain which party is to do the first act." Ragland & Co. v. Butler, 59 Va. (18 Gratt.) 323, 334 (1868).

§ 2-512. Payment by Buyer Before Inspection. (1) Where the contract requires payment before inspection non-conformity of the goods does not excuse the buyer from so making payment unless

(a) the non-conformity appears without inspection; or

(b) despite tender of the required documents the circumstances would justify injunction against honor under the provisions of this Act (§ 5-114).

(2) Payment pursuant to subsection (1) does not constitute an acceptance of goods or impair the buyer's right to inspect or any of his remedies.

COMMENT: **Prior Uniform Statutory Provision:** None, but see §§ 47 and 49, Uniform Sales Act.

Purposes: 1. Subsection (1) of the present section recognizes that the essence of a contract providing for payment before inspection is the intention of the parties to shift to the buyer the risks which would usually rest upon the seller. The basic nature of the transaction is thus preserved and the buyer is in most cases required to pay first and litigate as to any defects later.

2. "Inspection" under this section is an inspection in a manner reasonable for detecting defects in goods whose surface appearance is satisfactory.

3. Clause (a) of this subsection states an exception to the general rule based on

common sense and normal commercial practice. The apparent non-conformity referred to is one which is evident in the mere process of taking delivery.

4. Clause (b) is concerned with contracts for payment against documents and incorporates the general clarification and modification of the case law contained in the section on excuse of a financing agency. § 5-114.

5. Subsection (2) makes explicit the general policy of the Uniform Sales Act that the payment required before inspection in no way impairs the buyer's remedies or rights in the event of a default by the seller. The remedies preserved to the buyer are all of his remedies, which include as a matter of reason the remedy for total non-delivery after payment in advance.

The provision on performance or acceptance under reservation of rights does not apply to the situations contemplated here in which payment is made in due course under the contract and the buyer need not pay "under protest" or the like in order to preserve his rights as to defects discovered upon inspection.

6. This section applies to cases in which the contract requires payment before inspection either by the express agreement of the parties or by reason of the effect in law of that contract. The present section must therefore be considered in conjunction with the provision on right to inspection of goods which sets forth the instances in which the buyer is not entitled to inspection before payment.

Cross References:

Point 4: Article 5.
Point 5: § 1-207.
Point 6: § 2-513(3).

Definitional Cross References:

"Buyer". § 2-103.
"Conform". § 2-106.
"Contract". § 1-201.
"Financing agency". § 2-104.
"Goods". § 2-105.
"Remedy". § 1-201.
"Rights". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-513. **Buyer's Right to Inspection of Goods.** (1) Unless otherwise agreed and subject to subsection (3), where goods are tendered or delivered or identified to the contract for sale, the buyer has a right before payment or acceptance to inspect them at any reasonable place and time and in any reasonable manner. When the seller is required or authorized to send the goods to the buyer, the inspection may be after their arrival.

(2) Expenses of inspection must be borne by the buyer but may be recovered from the seller if the goods do not conform and are rejected.

(3) Unless otherwise agreed and subject to the provisions of this Article on C.I.F. contracts (subsection (3) of § 2-321), the buyer is not entitled to inspect the goods before payment of the price when the contract provides

(a) for delivery "C.O.D." or on other like terms; or

(b) for payment against documents of title, except where such payment is due only after the goods are to become available for inspection.

(4) A place or method of inspection fixed by the parties is presumed to be exclusive but unless otherwise expressly agreed it does not postpone identification or shift the place for delivery or for passing the risk of loss. If compliance becomes impossible, inspection shall be as provided in this section unless the place or method fixed was clearly intended as an indispensable condition failure of which avoids the contract.

COMMENT: **Prior Uniform Statutory Provision:** § 47(2), (3), Uniform Sales Act.

Changes: Rewritten, Subsections (2) and (3) being new.

Purposes of Changes and New Matter: To correspond in substance with the prior uniform statutory provision and to incorporate in addition some of the results of the better case law so that:

1. The buyer is entitled to inspect goods as provided in subsection (1) unless it has been otherwise agreed by the parties. The phrase "unless otherwise agreed" is intended principally to cover such situations as those outlined in subsections (3) and (4) and those in which the agreement of the parties negates inspection before tender of delivery. However, no agreement by the parties can displace the entire right of inspection except where the contract is simply for the sale of "this thing." Even in a sale of boxed goods "as is" inspection is a right of the buyer, since if the boxes prove to contain some other merchandise altogether the price can be recovered back; nor do the limitations of the provision on effect of acceptance apply in such a case.

2. The buyer's right of inspection is available to him upon tender, delivery or appropriation of the goods with notice to him. Since inspection is available to him on tender, where payment is due against delivery he may, unless otherwise agreed, make his inspection before payment of the price. It is also available to him after receipt of the goods and so may be postponed after receipt for a reasonable time. Failure to inspect before payment does not impair the right to inspect after receipt of the goods unless the case falls within subsection (4) on agreed and exclusive inspection provisions. The right to inspect goods which have been appropriated with notice to the buyer holds whether or not the sale was by sample.

3. The buyer may exercise his right of inspection at any reasonable time or place and in any reasonable manner. It is not necessary that he select the most appropriate time, place or manner to inspect or that his selection be the customary one in the trade or locality. Any reasonable time, place or manner is available to him and the reasonableness will be determined by trade usages, past practices between the parties and the other circumstances of the case.

The last sentence of subsection (1) makes it clear that the place of arrival of shipped goods is a reasonable place for their inspection.

4. Expenses of an inspection made to satisfy the buyer of the seller's performance must be assumed by the buyer in the first instance. Since the rule provides merely for an allocation of expense there is no policy to prevent the parties from providing otherwise in the agreement. Where the buyer would normally bear the expenses of the inspection but the goods are rightly rejected because of what the inspection reveals, demonstrable and reasonable costs of the inspection are part of his incidental damage caused by the seller's breach.

5. In the case of payment against documents, subsection (3) requires payment before inspection, since shipping documents against which payment is to be made will commonly arrive and be tendered while the goods are still in transit. This Article recognizes no exception in any peculiar case in which the goods happen to arrive before the documents. However, where by the agreement payment is to await the arrival of the goods, inspection before payment becomes proper since the goods are then "available for inspection."

Where by the agreement the documents are to be held until arrival the buyer is entitled to inspect before payment since the goods are then "available for inspection". Proof of usage is not necessary to establish this right, but if inspection before payment is disputed the contrary must be established by usage or by an explicit contract term to that effect.

For the same reason, that the goods are available for inspection, a term calling for payment against storage documents or a delivery order does not normally bar the buyer's right to inspection before payment under subsection (3)(b). This result is reinforced by the buyer's right under subsection (1) to inspect goods which have been appropriated with notice to him.

6. Under subsection (4) an agreed place or method of inspection is generally held to be intended as exclusive. However, where compliance with such an agreed inspection term becomes impossible, the question is basically one of intention. If the parties clearly intend that the method of inspection named is to be a

necessary condition without which the entire deal is to fail, the contract is at an end if that method becomes impossible. On the other hand, if the parties merely seek to indicate a convenient and reliable method but do not intend to give up the deal in the event of its failure, any reasonable method of inspection may be substituted under this Article.

Since the purpose of an agreed place of inspection is only to make sure at that point whether or not the goods will be thrown back, the "exclusive" feature of the named place is satisfied under this Article if the buyer's failure to inspect there is held to be an acceptance with the knowledge of such defects as inspection would have revealed within the section on waiver of buyer's objections by failure to particularize. Revocation of the acceptance is limited to the situations stated in the section pertaining to that subject. The reasonable time within which to give notice of defects within the section on notice of breach begins to run from the point of the "acceptance."

7. Clauses on time of inspection are commonly clauses which limit the time in which the buyer must inspect and give notice of defects. Such clauses are therefore governed by the section of this Article which requires that such a time limitation must be reasonable.

8. Inspection under this Article is not to be regarded as a "condition precedent to the passing of title" so that risk until inspection remains on the seller. Under subsection (4) such an approach cannot be sustained. Issues between the buyer and seller are settled in this Article almost wholly by special provisions and not by the technical determination of the locus of the title. Thus "inspection as a condition to the passing of title" becomes a concept almost without meaning. However, in peculiar circumstances inspection may still have some of the consequences hitherto sought and obtained under that concept.

9. "Inspection" under this section has to do with the buyer's check-up on whether the seller's performance is in accordance with a contract previously made and is not to be confused with the "examination" of the goods or of a sample or model of them at the time of contracting which may affect the warranties involved in the contract.

Cross References:

Generally: §§ 2-310(b), 2-321(3) and 2-606(1)(b).
Point 1: § 2-607.
Point 2: §§ 2-501 and 2-502.
Point 4: § 2-715.
Point 5: § 2-321(3).
Point 6: §§ 2-606 to 2-608.
Point 7: § 1-204.
Point 8: Comment to § 2-401.
Point 9: § 2-316(2)(b).

Definitional Cross References:

"Buyer". § 2-103.
"Conform". § 2-106.
"Contract". § 1-201.
"Contract for sale". § 2-106.
"Document of title". § 1-201.
"Goods". § 2-105.
"Party". § 1-201.
"Presumed". § 1-201.
"Reasonable time". § 1-204.
"Rights". § 1-201.
"Seller". § 2-103.
"Send". § 1-201.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: This section is in accord with Rosenbaum Hardware Co. v. Paxton Lumber Co., 124 Va. 346, 353-55, 97 S.E. 784 (1919), in giving the buyer a right of inspection after arrival of goods which the seller is required or authorized to send to the buyer.

§ 2-514. When Documents Deliverable on Acceptance; When on Payment. Unless otherwise agreed documents against which a draft is drawn are to be delivered to the drawee on acceptance of the draft if it is payable more than three days after presentment; otherwise, only on payment.

COMMENT: **Prior Uniform Statutory Provision:** § 41, Uniform Bills of Lading Act.

Changes: Rewritten.

Purposes of Changes: To make the provision one of general application so that:

1. It covers any document against which a draft may be drawn, whatever may be the form of the document, and applies to interpret the action of a seller or consignor insofar as it may affect the rights and duties of any buyer, consignee or financing agency concerned with the paper. Supplementary or corresponding provisions are found in §§ 4-503 and 5-112.

2. An "arrival" draft is a sight draft within the purpose of this section.

Cross References:

Point 1: See §§ 2-502, 2-505(2), 2-507(2), 2-512, 2-513, 2-607 concerning protection of rights of buyer and seller, and 4-503 and 5-112 on delivery of documents.

Definitional Cross References:

"Delivery". § 1-201.
"Draft". § 3-104.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-515. Preserving Evidence of Goods in Dispute. In furtherance of the adjustment of any claim or dispute

(a) either party on reasonable notification to the other and for the purpose of ascertaining the facts and preserving evidence has the right to inspect, test and sample the goods including such of them as may be in the possession or control of the other; and

(b) the parties may agree to a third party inspection or survey to determine the conformity or condition of the goods and may agree that the findings shall be binding upon them in any subsequent litigation or adjustment.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. To meet certain serious problems which arise when there is a dispute as to the quality of the goods and thereby perhaps to aid the parties in reaching a settlement, and to further the use of devices which will promote certainty as to the condition of the goods, or at least aid in preserving evidence of their condition.

2. Under paragraph (a), to afford either party an opportunity for preserving evidence, whether or not agreement has been reached, and thereby to reduce uncertainty in any litigation and, in turn perhaps, to promote agreement.

Paragraph (a) does not conflict with the provisions on the seller's right to resell rejected goods or the buyer's similar right. Apparent conflict between these provisions which will be suggested in certain circumstances is to be resolved by requiring prompt action by the parties. Nor does paragraph (a) impair the effect of a term for payment before inspection. Short of such defects as amount to fraud or substantial failure of consideration, non-conformity is neither an excuse nor a defense to an action for non-acceptance of documents. Normally, therefore, until the buyer has made payment, inspected and rejected the goods, there is no occasion or use for the rights under paragraph (a).

3. Under paragraph (b), to provide for third party inspection upon the agreement of the parties, thereby opening the door to amicable adjustments based upon the findings of such third parties.

The use of the phrase "conformity or condition" makes it clear that the parties' agreement may range from a complete settlement of all aspects of the dispute by a third party to the use of a third party merely to determine and record the condition of the goods so that they can be resold or used to reduce the stake in controversy. "Conformity", at one end of the scale of possible issues, includes the whole question of interpretation of the agreement and its legal effect, the state of the goods in regard to quality and condition, whether any defects are due to factors which operate at the risk of the buyer, and the degree of non-conformity where that may be material. "Condition", at the other end of the scale, includes nothing but the degree of damage or deterioration which the goods show. Paragraph (b) is intended to reach any point in the gamut which the parties may agree upon.

The principle of the section on reservation of rights reinforces this paragraph in simplifying such adjustments as the parties wish to make in partial settlement while reserving their rights as to any further points. Paragraph (b) also suggests the use of arbitration, where desired, of any points left open, but nothing in this section is intended to repeal or amend any statute governing arbitration. Where any question arises as to the extent of the parties' agreement under the paragraph, the presumption should be that it was meant to extend only to the relation between the contract description and the goods as delivered, since that is what a craftsman in the trade would normally be expected to report upon. Finally, a written and authenticated report of inspection or tests by a third party, whether or not sampling has been practicable, is entitled to be admitted as evidence under this Act, for it is a third party document.

Cross References:

Point 2: §§ 2-513(3), 2-706 and 2-711(2) and Article 5.
Point 3: §§ 1-202 and 1-207.

Definitional Cross References:

"Conform". § 2-106.
"Goods". § 2-105.
"Notification". § 1-201.
"Party". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

PART 6

BREACH, REPUDIATION AND EXCUSE

§ 2-601. Buyer's Rights on Improper Delivery. Subject to the provisions of this Article on breach in installment contracts (§ 2-612) and unless otherwise agreed under the sections on contractual limitations of remedy (§§ 2-718 and 2-719), if the goods or the tender of delivery fail in any respect to conform to the contract, the buyer may

(a) reject the whole; or

(b) accept the whole; or

(c) accept any commercial unit or units and reject the rest.

COMMENT: **Prior Uniform Statutory Provision:** No one general equivalent provision but numerous provisions, dealing with situations of non-conformity where buyer may accept or reject, including §§ 11, 44 and 69(1), Uniform Sales Act.

Changes: Partial acceptance in good faith is recognized and the buyer's remedies on the contract for breach of warranty and the like, where the buyer has returned the goods after transfer of title, are no longer barred.

Purposes of Changes: To make it clear that:

1. A buyer accepting a non-conforming tender is not penalized by the loss of any remedy otherwise open to him. This policy extends to cover and regulate the acceptance of a part of any lot improperly tendered in any case where the price can reasonably be apportioned. Partial acceptance is permitted whether the part of the goods accepted conforms or not. The only limitation on partial acceptance is that good faith and commercial reasonableness must be used to avoid undue impairment of the value of the remaining portion of the goods. This is the reason for the insistence on the "commercial unit" in paragraph (c). In this respect, the test is not only what unit has been the basis of contract, but whether the partial acceptance produces so materially adverse an effect on the remainder as to constitute bad faith.

2. Acceptance made with the knowledge of the other party is final. An original refusal to accept may be withdrawn by a later acceptance if the seller has indicated that he is holding the tender open. However, if the buyer attempts to accept, either in whole or in part, after his original rejection has caused the seller to arrange for other disposition of the goods, the buyer must answer for any ensuing damage since the next section provides that any exercise of ownership after rejection is wrongful as against the seller. Further, he is liable even though the seller may choose to treat his action as acceptance rather than conversion, since the damage flows from the misleading notice. Such arrangements for resale or other disposition of the goods by the seller must be viewed as within the normal contemplation of a buyer who has given notice of rejection. However, the buyer's attempts in good faith to dispose of defective goods where the seller has failed to give instructions within a reasonable time are not to be regarded as an acceptance.

Cross References:

§§ 2-602(2)(a), 2-612, 2-718 and 2-719.

Definitional Cross References:

"Buyer". § 2-103.
"Commercial unit". § 2-105.
"Conform". § 2-106.
"Contract". § 1-201.
"Goods". § 2-105.
"Installment contract". § 2-612.
"Rights". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: To the extent that this section permits a buyer to accept any commercial unit of nonconforming goods and to reject the rest, the UCC is contrary to Virginia law as broadly laid down in Charles Syer & Co. v. Lester, 116 Va. 541, 545-46, 82 S.E. 122 (1914). In this case the court said that if the buyer knows of the nonconformity of the goods he must either reject the whole or accept the whole under protest and bring an action for damages, and that he has no right to accept part and to reject the remainder. Furthermore, the court said that an acceptance of a part of a shipment implies an agreement to accept the whole. In this case the buyer had actually taken possession of all the goods, sold part of them, and then endeavored to return those remaining on the ground that they were nonconforming. Later Virginia cases, however, have seemed to limit the rule. It was held inapplicable where the buyer accepted part of the nonconforming goods in the belief that the nonconformity arose from the buyer's own failure to make a timely inspection and acceptance. Rennolds v. Avery, 132 Va. 335, 340-41, 111 S.E. 123 (1922). The rule is also inapplicable where the seller agrees to take back nonconforming goods. Lamborn & Co. v. Bristol Grocery Co., 140 Va. 77, 81-82, 124 S.E. 184 (1924). The rule was also held not applicable where the buyer had accepted a part in order to avoid litigation. Gibney & Co. v. Arlington Brewing Co., 112 Va. 117, 121-22, 70 S.E. 487 (1917). Pettibone Wood Manufacturing Co. v. Pioneer Construction Co., 203 Va. 152, 159-60, 122 S.E.2d 885 (1961), held that in a sale on approval, an acceptance of nonconforming goods is final—the buyer must either accept or reject the goods.

§ 2-602. Manner and Effect of Rightful Rejection. (1) Rejection of goods must be within a reasonable time after their delivery or tender. It is ineffective unless the buyer seasonably notifies the seller.

(2) Subject to the provisions of the two following sections on rejected goods (§§ 2-603 and 2-604),

(a) after rejection any exercise of ownership by the buyer with respect to any commercial unit is wrongful as against the seller; and

(b) if the buyer has before rejection taken physical possession of goods in which he does not have a security interest under the provisions of this Article (subsection (3) of § 2-711), he is under a duty after rejection to hold them with reasonable care at the seller's disposition for a time sufficient to permit the seller to remove them; but

(c) the buyer has no further obligations with regard to goods rightfully rejected.

(3) The seller's rights with respect to goods wrongfully rejected are governed by the provisions of this Article on Seller's remedies in general (§ 2-703).

COMMENT: **Prior Uniform Statutory Provision:** § 50, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To make it clear that:

1. A tender or delivery of goods made pursuant to a contract of sale, even though wholly non-conforming, requires affirmative action by the buyer to avoid acceptance. Under subsection (1), therefore, the buyer is given a reasonable time to notify the seller of his rejection, but without such seasonable notification his rejection is ineffective. The sections of this Article dealing with inspection of goods must be read in connection with the buyer's reasonable time for action under this subsection. Contract provisions limiting the time for rejection fall within the rule of the section on "Time" and are effective if the time set gives the buyer a reasonable time for discovery of defects. What constitutes a due "notifying" of rejection by the buyer to the seller is defined in § 1-201.

2. Subsection (2) lays down the normal duties of the buyer upon rejection, which flow from the relationship of the parties. Beyond his duty to hold the goods with reasonable care for the buyer's disposition, this section continues the policy of prior uniform legislation in generally relieving the buyer from any duties with respect to them, except when the circumstances impose the limited obligation of salvage upon him under the next section.

3. The present section applies only to rightful rejection by the buyer. If the seller has made a tender which in all respects conforms to the contract, the buyer has a positive duty to accept and his failure to do so constitutes a "wrongful rejection" which gives the seller immediate remedies for breach. Subsection (3) is included here to emphasize the sharp distinction between the rejection of an improper tender and the non-acceptance which is a breach by the buyer.

4. The provisions of this section are to be appropriately limited or modified when a negotiation is in process.

Cross References:

Point 1: §§ 1-201, 1-204(1) and (3), 2-512(2), 2-513(1) and 2-606(1)(b).
Point 2: § 2-603(1).
Point 3: § 2-703.

Definitional Cross References:

"Buyer". § 2-103.
"Commercial unit". § 2-105.
"Goods". § 2-105.
"Merchant". § 2-104.

"Notifies". § 1-201.
"Reasonable time". § 1-204.
"Remedy". § 1-201.
"Rights". § 1-201.
"Seasonably". § 1-204.
"Security interest". § 1-201.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-603. Merchant Buyer's Duties as to Rightfully Rejected Goods. (1) Subject to any security interest in the buyer (subsection (3) of § 2-711), when the seller has no agent or place of business at the market of rejection a merchant buyer is under a duty after rejection of goods in his possession or control to follow any reasonable instructions received from the seller with respect to the goods and in the absence of such instructions to make reasonable efforts to sell them for the seller's account if they are perishable or threaten to decline in value speedily. Instructions are not reasonable if on demand indemnity for expenses is not forthcoming.

(2) When the buyer sells goods under subsection (1), he is entitled to reimbursement from the seller or out of the proceeds for reasonable expenses of caring for and selling them, and if the expenses include no selling commission then to such commission as is usual in the trade or if there is none to a reasonable sum not exceeding ten per cent on the gross proceeds.

(3) In complying with this section the buyer is held only to good faith and good faith conduct hereunder is neither acceptance nor conversion nor the basis of an action for damages.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. This section recognizes the duty imposed upon the merchant buyer by good faith and commercial practice to follow any reasonable instructions of the seller as to reshipping, storing, delivery to a third party, reselling or the like. Subsection (1) goes further and extends the duty to include the making of reasonable efforts to effect a salvage sale where the value of the goods is threatened and the seller's instructions do not arrive in time to prevent serious loss.

2. The limitations on the buyer's duty to resell under subsection (1) are to be liberally construed. The buyer's duty to resell under this section arises from commercial necessity and thus is present only when the seller has "no agent or place of business at the market of rejection". A financing agency which is acting in behalf of the seller in handling the documents rejected by the buyer is sufficiently the seller's agent to lift the burden of salvage resale from the buyer. (See provisions of §§ 4-503 and 5-112 on bank's duties with respect to rejected documents.) The buyer's duty to resell is extended only to goods in his "possession or control", but these are intended as words of wide, rather than narrow, import. In effect, the measure of the buyer's "control" is whether he can practicably effect control without undue commercial burden.

3. The explicit provisions for reimbursement and compensation to the buyer in subsection (2) are applicable and necessary only where he is not acting under instructions from the seller. As provided in subsection (1) the seller's instructions to be "reasonable" must on demand of the buyer include indemnity for expenses.

4. Since this section makes the resale of perishable goods an affirmative duty in contrast to a mere right to sell as under the case law, subsection (3) makes it clear that the buyer is liable only for the exercise of good faith in determining whether the value of the goods is sufficiently threatened to justify a quick resale or whether he has waited a sufficient length of time for instructions, or what a reasonable means and place of resale is.

5. A buyer who fails to make a salvage sale when his duty to do so under this section has arisen is subject to damages pursuant to the section on liberal administration of remedies.

Cross References:

Point 2: §§ 4-503 and 5-112.
Point 5: § 1-106. Compare generally § 2-706.

Definitional Cross References:

"Buyer". § 2-103.
"Good faith". § 1-201.
"Goods". § 2-105.
"Merchant". § 2-104.
"Security interest". § 1-201.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-604. Buyer's Options as to Salvage of Rightfully Rejected Goods. Subject to the provisions of the immediately preceding section on perishables if the seller gives no instructions within a reasonable time after notification of rejection the buyer may store the rejected goods for the seller's account or reship them to him or resell them for the seller's account with reimbursement as provided in the preceding section. Such action is not acceptance or conversion.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: The basic purpose of this section is twofold: on the one hand it aims at reducing the stake in dispute and on the other at avoiding the pinning of a technical "acceptance" on a buyer who has taken steps towards realization on or preservation of the goods in good faith. This section is essentially a salvage section and the buyer's right to act under it is conditioned upon (1) nonconformity of the goods, (2) due notification of rejection to the seller under the section on manner of rejection, and (3) the absence of any instructions from the seller which the merchant-buyer has a duty to follow under the preceding section.

This section is designed to accord all reasonable leeway to a rightfully rejecting buyer acting in good faith. The listing of what the buyer may do in the absence of instructions from the seller is intended to be not exhaustive but merely illustrative. This is not a "merchant's" section and the options are pure options given to merchant and non-merchant buyers alike. The merchant-buyer, however, may in some instances be under a duty rather than an option to resell under the provisions of the preceding section.

Cross References:

§§ 2-602(1), and 2-603(1) and 2-706.

Definitional Cross References:

"Buyer". § 2-103.
"Notification". § 1-201.
"Reasonable time". § 1-204.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-605. Waiver of Buyer's Objections by Failure to Particularize. (1) The buyer's failure to state in connection with rejection a particular defect which is ascertainable by reasonable inspection precludes him from relying on the unstated defect to justify rejection or to establish breach

(a) where the seller could have cured it if stated seasonably; or

(b) between merchants when the seller has after rejection made a request in writing for a full and final written statement of all defects on which the buyer proposes to rely.

(2) Payment against documents made without reservation of rights precludes recovery of the payment for defects apparent on the face of the documents.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. The present section rests upon a policy of permitting the buyer to give a quick and informal notice of defects in a tender without penalizing him for omissions in his statement, while at the same time protecting a seller who is reasonably misled by the buyer's failure to state curable defects.

2. Where the defect in a tender is one which could have been cured by the seller, a buyer who merely rejects the delivery without stating his objections to it is probably acting in commercial bad faith and seeking to get out of a deal which has become unprofitable. Subsection (1)(a), following the general policy of this Article which looks to preserving the deal wherever possible, therefore insists that the seller's right to correct his tender in such circumstances be protected.

3. When the time for cure is past, subsection (1)(b) makes it plain that a seller is entitled upon request to a final statement of objections upon which he can rely. What is needed is that he make clear to the buyer exactly what is being sought. A formal demand under paragraph (b) will be sufficient in the case of a merchant-buyer.

4. Subsection (2) applies to the particular case of documents the same principle which the section on effects of acceptance applies to the case of goods. The matter is dealt with in this section in terms of "waiver" of objections rather than of right to revoke acceptance, partly to avoid any confusion with the problems of acceptance of goods and partly because defects in documents which are not taken as grounds for rejection are generally minor ones. The only defects concerned in the present subsection are defects in the documents which are apparent on their face. Where payment is required against the documents they must be inspected before payment, and the payment then constitutes acceptance of the documents. Under the section dealing with this problem, such acceptance of the documents does not constitute an acceptance of the goods or impair any options or remedies of the buyer for their improper delivery. Where the documents are delivered without requiring such contemporary action as payment from the buyer, the reason of the next section on what constitutes acceptance of goods, applies. Their acceptance by non-objection is therefore postponed until after a reasonable time for their inspection. In either situation, however, the buyer "waives" only what is apparent on the face of the documents.

Cross References:

Point 2: § 2-508.
Point 4: §§ 2-512(2), 2-606(1)(b), 2-607(2).

Definitional Cross References:

"Between merchants". § 2-104.
"Buyer". § 2-103.
"Seasonably". § 1-204.
"Seller". § 2-103.
"Writing" and "written". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: The doctrine of waiver has been given a somewhat wider application in Virginia than has been provided for in this section. Fielding v. Robertson, 141 Va. 123, 132-33, 126 S.E. 231 (1925), indicated that the statement of one ground of objection is a waiver of the tender on all other grounds that could have been given, but were not. The case actually held that a refusal of tender on the ground of delay in delivery was not a waiver of a deficiency in the quantity since this deficiency could not have been known at the time of the tender.

§ 2-606. **What Constitutes Acceptance of Goods.** (1) Acceptance of goods occurs when the buyer

(a) after a reasonable opportunity to inspect the goods signifies to the seller that the goods are conforming or that he will take or retain them in spite of their non-conformity; or

(b) fails to make an effective rejection (subsection (1) of § 2-602), but such acceptance does not occur until the buyer has had a reasonable opportunity to inspect them; or

(c) does any act inconsistent with the seller's ownership; but if such act is wrongful as against the seller it is an acceptance only if ratified by him.

(2) Acceptance of a part of any commercial unit is acceptance of that entire unit.

COMMENT: Prior Uniform Statutory Provision: § 48, Uniform Sales Act.

Changes: Rewritten, the qualification in paragraph (c) and subsection (2) being new; otherwise the general policy of the prior legislation is continued.

Purposes of Changes and New Matter: To make it clear that:

1. Under this Article "acceptance" as applied to goods means that the buyer, pursuant to the contract, takes particular goods which have been appropriated to the contract as his own, whether or not he is obligated to do so, and whether he does so by words, action, or silence when it is time to speak. If the goods conform to the contract, acceptance amounts only to the performance by the buyer of one part of his legal obligation.

2. Under this Article acceptance of goods is always acceptance of identified goods which have been appropriated to the contract or are appropriated by the contract. There is no provision for "acceptance of title" apart from acceptance in general, since acceptance of title is not material under this Article to the detailed rights and duties of the parties. (See § 2-401). The refinements of the older law between acceptance of goods and of title become unnecessary in view of the provisions of the sections on effect and revocation of acceptance, on effects of identification and on risk of loss, and those sections which free the seller's and buyer's remedies from the complications and confusions caused by the question of whether title has or has not passed to the buyer before breach.

3. Under paragraph (a), payment made after tender is always one circumstance tending to signify acceptance of the goods but in itself it can never be more than one circumstance and is not conclusive. Also, a conditional communication of acceptance always remains subject to its expressed conditions.

4. Under paragraph (c), any action taken by the buyer, which is inconsistent with his claim that he has rejected the goods, constitutes an acceptance. However, the provisions of paragraph (c) are subject to the sections dealing with rejection by the buyer which permit the buyer to take certain actions with respect to the goods pursuant to his options and duties imposed by those sections, without effecting an acceptance of the goods. The second clause of paragraph (c) modifies some of the prior case law and makes it clear that "acceptance" in law based on the wrongful act of the acceptor is acceptance only as against the wrongdoer and then only at the option of the party wronged.

In the same manner in which a buyer can bind himself, despite his insistence that he is rejecting or has rejected the goods, by an act inconsistent with the seller's ownership under paragraph (c), he can obligate himself by a communication of acceptance despite a prior rejection under paragraph (a). However, the sections on buyer's rights on improper delivery and on the effect of rightful rejection, make it clear that after he once rejects a tender, paragraph (a) does not operate in favor of the buyer unless the seller has re-tendered the goods or has taken affirmative action indicating that he is holding the tender open. See also Comment 2 to § 2-601.

5. Subsection (2) supplements the policy of the section on buyer's rights on improper delivery, recognizing the validity of a partial acceptance but insisting that the buyer exercise this right only as to whole commercial units.

Cross References:

Point 2: §§ 2-401, 2-509, 2-510, 2-607, 2-608 and Part 7.
Point 4: §§ 2-601 through 2-604.
Point 5: § 2-601.

Definitional Cross References:

"Buyer". § 2-103.
"Commercial unit". § 2-105.
"Goods". § 2-105.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Subsection 2-606(1)(a) is in accord with Rosenbaum Hardware Co. v. Paxton Lumber Co., 124 Va. 346, 353-55, 97 S.E. 784 (1919), in holding that a buyer does not accept goods until he has had a reasonable opportunity to inspect the goods.

§ 2-607. Effect of Acceptance; Notice of Breach; Burden of Establishing Breach After Acceptance; Notice of Claim or Litigation to Person Answerable Over. (1) The buyer must pay at the contract rate for any goods accepted.

(2) Acceptance of goods by the buyer precludes rejection of the goods accepted and if made with knowledge of a non-conformity cannot be revoked because of it unless the acceptance was on the reasonable assumption that the non-conformity would be seasonably cured but acceptance does not of itself impair any other remedy provided by this Article for non-conformity.

(3) Where a tender has been accepted

(a) the buyer must within a reasonable time after he discovers or should have discovered any breach notify the seller of breach or be barred from any remedy; and

(b) if the claim is one for infringement or the like (subsection (3) of § 2-312) and the buyer is sued as a result of such a breach he must so notify the seller within a reasonable time after he receives notice of the litigation or be barred from any remedy over for liability established by the litigation.

(4) The burden is on the buyer to establish any breach with respect to the goods accepted.

(5) Where the buyer is sued for breach of a warranty or other obligation for which his seller is answerable over

(a) he may give his seller written notice of the litigation. If the notice states that the seller may come in and defend and that if the seller does not do so he will be bound in any action against him by his buyer by any determination of fact common to the two litigations, then unless the seller after seasonable receipt of the notice does come in and defend he is so bound.

(b) if the claim is one for infringement or the like (subsection (3) of § 2-312) the original seller may demand in writing that his buyer turn over to him control of the litigation including settlement or else be barred

from any remedy over and if he also agrees to bear all expense and to satisfy any adverse judgment, then unless the buyer after seasonable receipt of the demand does turn over control the buyer is so barred.

(6) The provisions of subsections (3), (4) and (5) apply to any obligation of a buyer to hold the seller harmless against infringement or the like (subsection (3) of § 2-312).

COMMENT: Prior Uniform Statutory Provision: Subsection (1)—§ 41, Uniform Sales Act; Subsections (2) and (3)—§§ 49 and 69, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To continue the prior basic policies with respect to acceptance of goods while making a number of minor though material changes in the interest of simplicity and commercial convenience so that:

1. Under subsection (1), once the buyer accepts a tender the seller acquires a right to its price on the contract terms. In cases of partial acceptance, the price of any part accepted is, if possible, to be reasonably apportioned, using the type of apportionment familiar to the courts in quantum valebat cases, to be determined in terms of the "contract rate," which is the rate determined from the bargain in fact (the agreement) after the rules and policies of this Article have been brought to bear.

2. Under subsection (2) acceptance of goods precludes their subsequent rejection. Any return of the goods thereafter must be by way of revocation of acceptance under the next section. Revocation is unavailable for a non-conformity known to the buyer at the time of acceptance, except where the buyer has accepted on the reasonable assumption that the non-conformity would be seasonably cured.

3. All other remedies of the buyer remain unimpaired under subsection (2). This is intended to include the buyer's full rights with respect to future installments despite his acceptance of any earlier non-conforming installment.

4. The time of notification is to be determined by applying commercial standards to a merchant buyer. "A reasonable time" for notification from a retail consumer is to be judged by different standards so that in his case it will be extended, for the rule of requiring notification is designed to defeat commercial bad faith, not to deprive a good faith consumer of his remedy.

The content of the notification need merely be sufficient to let the seller know that the transaction is still troublesome and must be watched. There is no reason to require that the notification which saves the buyer's rights under this section must include a clear statement of all the objections that will be relied on by the buyer, as under the section covering statements of defects upon rejection (§ 2-605). Nor is there reason for requiring the notification to be a claim for damages or of any threatened litigation or other resort to a remedy. The notification which saves the buyer's rights under this Article need only be such as informs the seller that the transaction is claimed to involve a breach, and thus opens the way for normal settlement through negotiation.

5. Under this Article various beneficiaries are given rights for injuries sustained by them because of the seller's breach of warranty. Such a beneficiary does not fall within the reason of the present section in regard to discovery of defects and the giving of notice within a reasonable time after acceptance, since he has nothing to do with acceptance. However, the reason of this section does extend to requiring the beneficiary to notify the seller that an injury has occurred. What is said above, with regard to the extended time for reasonable notification from the lay consumer after the injury is also applicable here; but even a beneficiary can be properly held to the use of good faith in notifying, once he has had time to become aware of the legal situation.

6. Subsection (4) unambiguously places the burden of proof to establish breach on the buyer after acceptance. However, this rule becomes one purely of procedure when the tender accepted was non-conforming and the buyer has given the seller notice of breach under subsection (3). For subsection (2) makes it clear that acceptance leaves unimpaired the buyer's right to be made whole, and that right can be exercised by the buyer not only by way of cross-claim for damages, but also by way of recoupment in diminution or extinction of the price.

7. Subsections (3)(b) and (5)(b) give a warrantor against infringement an opportunity to defend or compromise third-party claims or be relieved of his liability. Subsection (5)(a) codifies for all warranties the practice of voucher to defend. Compare § 3-803. Subsection (6) makes these provisions applicable to the buyer's liability for infringement under § 2-312.

8. All of the provisions of the present section are subject to any explicit reservation of rights.

Cross References:

Point 1: § 1-201.
Point 2: § 2-608.
Point 4: §§ 1-204 and 2-605.
Point 5: § 2-318.
Point 6: § 2-717.
Point 7: §§ 2-312 and 3-803.
Point 8: § 1-207.

Definitional Cross References:

"Burden of establishing". § 1-201.
"Buyer". § 2-103.
"Conform". § 2-106.
"Contract". § 1-201.
"Goods". § 2-105.
"Notifies". § 1-201.
"Reasonable time". § 1-204.
"Remedy". § 1-201.
"Seasonably". § 1-204.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Subsection 5(a) establishes rules for vouching in closely analogous to the provisions of § 49-29 of the Code of 1950, under which a principal who knows of the pendency of suit against his surety and fails to offer to defend such suit is precluded from later making any defense to the claim of the surety which he might have made against the creditor. Though akin to it, the procedure thus established does not constitute third party practice, because the person vouched in does not become a party to the action and no judgment can be rendered against him. It is not therefore a legislative exception to Rule of Court 3:9.1.

§ 2-608. Revocation of Acceptance in Whole or in Part. (1) The buyer may revoke his acceptance of a lot or commercial unit whose non-conformity substantially impairs its value to him if he has accepted it

(a) on the reasonable assumption that its non-conformity would be cured and it has not been seasonably cured; or

(b) without discovery of such non-conformity if his acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances.

(2) Revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by their own defects. It is not effective until the buyer notifies the seller of it.

(3) A buyer who so revokes has the same rights and duties with regard to the goods involved as if he had rejected them.

COMMENT: Prior Uniform Statutory Provision: § 69(1) (d), (3), (4) and (5), Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To make it clear that:

1. Although the prior basic policy is continued, the buyer is no longer required to elect between revocation of acceptance and recovery of damages for breach. Both are now available to him. The non-alternative character of the two remedies is stressed by the terms used in the present section. The section no longer speaks of "rescission," a term capable of ambiguous application either to transfer of title to the goods or to the contract of sale and susceptible also of confusion with cancellation for cause of an executed or executory portion of the contract. The remedy under this section is instead referred to simply as "revocation of acceptance" of goods tendered under a contract for sale and involves no suggestion of "election" of any sort.

2. Revocation of acceptance is possible only where the non-conformity substantially impairs the value of the goods to the buyer. For this purpose the test is not what the seller had reason to know at the time of contracting; the question is whether the non-conformity is such as will in fact cause a substantial impairment of value to the buyer though the seller had no advance knowledge as to the buyer's particular circumstances.

3. "Assurances" by the seller under paragraph (b) of subsection (1) can rest as well in the circumstances or in the contract as in explicit language used at the time of delivery. The reason for recognizing such assurances is that they induce the buyer to delay discovery. These are the only assurances involved in paragraph (b). Explicit assurances may be made either in good faith or bad faith. In either case any remedy accorded by this Article is available to the buyer under the section on remedies for fraud.

4. Subsection (2) requires notification of revocation of acceptance within a reasonable time after discovery of the grounds for such revocation. Since this remedy will be generally resorted to only after attempts at adjustment have failed, the reasonable time period should extend in most cases beyond the time in which notification of breach must be given, beyond the time for discovery of non-conformity after acceptance and beyond the time for rejection after tender. The parties may by their agreement limit the time for notification under this section, but the same sanctions and considerations apply to such agreements as are discussed in the comment on manner and effect of rightful rejection.

5. The content of the notice under subsection (2) is to be determined in this case as in others by considerations of good faith, prevention of surprise, and reasonable adjustment. More will generally be necessary than the mere notification of breach required under the preceding section. On the other hand the requirements of the section on waiver of buyer's objections do not apply here. The fact that quick notification of trouble is desirable affords good ground for being slow to bind a buyer by his first statement. Following the general policy of this Article, the requirements of the content of notification are less stringent in the case of a non-merchant buyer.

6. Under subsection (2) the prior policy is continued of seeking substantial justice in regard to the condition of goods restored to the seller. Thus the buyer may not revoke his acceptance if the goods have materially deteriorated except by reason of their own defects. Worthless goods, however, need not be offered back and minor defects in the articles reoffered are to be disregarded.

7. The policy of the section allowing partial acceptance is carried over into the present section and the buyer may revoke his acceptance, in appropriate cases, as to the entire lot or any commercial unit thereof.

Cross References:

Point 3: § 2-721.
Point 4: §§ 1-204, 2-602 and 2-607.
Point 5: §§ 2-605 and 2-607.
Point 7: § 2-601.

Definitional Cross References:

"Buyer". § 2-103.
"Commercial unit". § 2-105.
"Conform". § 2-106.
"Goods". § 2-105.
"Lot". § 2-105.
"Notifies". § 1-201.

"Reasonable time". § 1-204.
"Rights". § 1-201.
"Seasonably". § 1-204.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: This section is in accord with Ney v. Wrenn, 117 Va. 85, 95, 84 S.E. 1 (1915), in which a buyer was held not liable for the purchase price after rightfully revoking acceptance of goods, because of a breach of warranty.

§ 2-609. **Right to Adequate Assurance of Performance.** (1) A contract for sale imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired. When reasonable grounds for insecurity arise with respect to the performance of either party the other may in writing demand adequate assurance of due performance and until he receives such assurance may if commercially reasonable suspend any performance for which he has not already received the agreed return.

(2) Between merchants the reasonableness of grounds for insecurity and the adequacy of any assurance offered shall be determined according to commercial standards.

(3) Acceptance of any improper delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.

(4) After receipt of a justified demand failure to provide within a reasonable time not exceeding thirty days such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract.

COMMENT: Prior Uniform Statutory Provision: See §§ 53, 54(1)(b), 55 and 63(2), Uniform Sales Act.

Purposes: 1. The section rests on the recognition of the fact that the essential purpose of a contract between commercial men is actual performance and they do not bargain merely for a promise, or for a promise plus the right to win a law suit and that a continuing sense of reliance and security that the promised performance will be forthcoming when due, is an important feature of the bargain. If either the willingness or the ability of a party to perform declines materially between the time of contracting and the time for performance, the other party is threatened with the loss of a substantial part of what he has bargained for. A seller needs protection not merely against having to deliver on credit to a shaky buyer, but also against having to procure and manufacture the goods, perhaps turning down other customers. Once he has been given reason to believe that the buyer's performance has become uncertain, it is an undue hardship to force him to continue his own performance. Similarly, a buyer who believes that the seller's deliveries have become uncertain cannot safely wait for the due date of performance when he has been buying to assure himself of materials for his current manufacturing or to replenish his stock of merchandise.

2. Three measures have been adopted to meet the needs of commercial men in such situations. First, the aggrieved party is permitted to suspend his own performance and any preparation therefor, with excuse for any resulting necessary delay, until the situation has been clarified. "Suspend performance" under this section means to hold up performance pending the outcome of the demand, and includes also the holding up of any preparatory action. This is the same principle which governs the ancient law of stoppage and seller's lien, and also of excuse of a buyer from prepayment if the seller's actions manifest that he cannot or will not perform. (Original Act, § 63(2).)

Secondly, the aggrieved party is given the right to require adequate assurance that the other party's performance will be duly forthcoming. This principle is

reflected in the familiar clauses permitting the seller to curtail deliveries if the buyer's credit becomes impaired, which when held within the limits of reasonableness and good faith actually express no more than the fair business meaning of any commercial contract.

Third, and finally, this section provides the means by which the aggrieved party may treat the contract as broken if his reasonable grounds for insecurity are not cleared up within a reasonable time. This is the principle underlying the law of anticipatory breach, whether by way of defective part performance or by repudiation. The present section merges these three principles of law and commercial practice into a single theory of general application to all sales agreements looking to future performance.

3. Subsection (2) of the present section requires that "reasonable" grounds and "adequate" assurance as used in subsection (1) be defined by commercial rather than legal standards. The express reference to commercial standards carries no connotation that the obligation of good faith is not equally applicable here.

Under commercial standards and in accord with commercial practice, a ground for insecurity need not arise from or be directly related to the contract in question. The laws as to "dependence" or "independence" of promises within a single contract does not control the application of the present section.

Thus a buyer who falls behind in "his account" with the seller, even though the items involved have to do with separate and legally distinct contracts, impairs the seller's expectation of due performance. Again, under the same test, a buyer who requires precision parts which he intends to use immediately upon delivery, may have reasonable grounds for insecurity if he discovers that his seller is making defective deliveries of such parts to other buyers with similar needs. Thus, too, in a situation such as arose in Jay Dreher Corporation v. Delco Appliance Corporation, 93 F.2d 275 (C.C.A.2, 1937), where a manufacturer gave a dealer an exclusive franchise for the sale of his product but on two or three occasions breached the exclusive dealing clause, although there was no default in orders, deliveries or payments under the separate sales contract between the parties, the aggrieved dealer would be entitled to suspend his performance of the contract for sale under the present section and to demand assurance that the exclusive dealing contract would be lived up to. There is no need for an explicit clause tying the exclusive franchise into the contract for the sale of goods since the situation itself ties the agreements together.

The nature of the sales contract enters also into the question of reasonableness. For example, a report from an apparently trustworthy source that the seller had shipped defective goods or was planning to ship them would normally give the buyer reasonable grounds for insecurity. But when the buyer has assumed the risk of payment before inspection of the goods, as in a sales contract on C.I.F. or similar cash against documents terms, that risk is not to be evaded by a demand for assurance. Therefore no ground for insecurity would exist under this section unless the report went to a ground which would excuse payment by the buyer.

4. What constitutes "adequate" assurance of due performance is subject to the same test of factual conditions. For example, where the buyer can make use of a defective delivery, a mere promise by a seller of good repute that he is giving the matter his attention and that the defect will not be repeated, is normally sufficient. Under the same circumstances, however, a similar statement by a known corner-cutter might well be considered insufficient without the posting of a guaranty or, if so demanded by the buyer, a speedy replacement of the delivery involved. By the same token where a delivery has defects, even though easily curable, which interfere with easy use by the buyer, no verbal assurance can be deemed adequate which is not accompanied by replacement, repair, money-allowance, or other commercially reasonable cure.

A fact situation such as arose in Corn Products Refining Co. v. Fasola, 94 N.J.L. 181, 109 A. 505 (1920) offers illustration both of reasonable grounds for insecurity and "adequate" assurance. In that case a contract for the sale of oils on 30 days' credit, 2% off for payment within 10 days, provided that credit was to be extended to the buyer only if his financial responsibility was satisfactory to the seller. The buyer had been in the habit of taking advantage of the discount but at the same time that he failed to make his customary 10 day payment, the seller heard rumors, in fact false, that the buyer's financial condition was shaky. Thereupon, the seller demanded cash before shipment or security satisfactory to him. The buyer sent a good credit report from his banker, ex-

pressed willingness to make payments when due on the 30 day terms and insisted on further deliveries under the contract. Under this Article the rumors, although false, were enough to make the buyer's financial condition "unsatisfactory" to the seller under the contract clause. Moreover, the buyer's practice of taking the cash discounts is enough, apart from the contract clause, to lay a commercial foundation for suspicion when the practice is suddenly stopped. These matters, however, go only to the justification of the seller's demand for security, or his "reasonable grounds for insecurity".

The adequacy of the assurance given is not measured as in the type of "satisfaction" situation affected with intangibles, such as in personal service cases, cases involving a third party's judgment as final, or cases in which the whole contract is dependent on one party's satisfaction, as in a sale on approval. Here, the seller must exercise good faith and observe commercial standards. This Article thus approves the statement of the court in James B. Berry's Sons Co. of Illinois v. Monark Gasoline & Oil Co., Inc., 32 F.2d 74, (C.C.A.8, 1929), that the seller's satisfaction under such a clause must be based upon reason and must not be arbitrary or capricious; and rejects the purely personal "good faith" test of the Corn Products Refining Co. case, which held that in the seller's sole judgment, if for *any* reason he was dissatisfied, he was entitled to revoke the credit. In the absence of the buyer's failure to take the 2% discount as was his custom, the banker's report given in that case would have been "adequate" assurance under this Act, regardless of the language of the "satisfaction" clause. However, the seller is reasonably entitled to feel insecure at a sudden expansion of the buyer's use of a credit term, and should be entitled either to security or to a satisfactory explanation.

The entire foregoing discussion as to adequacy of assurance by way of explanation is subject to qualification when repeated occasions for the application of this section arise. This Act recognizes that repeated delinquencies must be viewed as cumulative. On the other hand, commercial sense also requires that if repeated claims for assurance are made under this section, the basis for these claims must be increasingly obvious.

5. A failure to provide adequate assurance of performance and thereby to reestablish the security of expectation, results in a breach only "by repudiation" under subsection (4). Therefore, the possibility is continued of retraction of the repudiation under the section dealing with that problem, unless the aggrieved party has acted on the breach in some manner.

The thirty day limit on the time to provide assurance is laid down to free the question of reasonable time from uncertainty in later litigation.

6. Clauses seeking to give the protected party exceedingly wide powers to cancel or readjust the contract when ground for insecurity arises must be read against the fact that good faith is a part of the obligation of the contract and not subject to modification by agreement and includes, in the case of a merchant, the reasonable observance of commercial standards of fair dealing in the trade. Such clauses can thus be effective to enlarge the protection given by the present section to a certain extent, to fix the reasonable time within which requested assurance must be given, or to define adequacy of the assurance in any commercially reasonable fashion. But any clause seeking to set up arbitrary standards for action is ineffective under this Article. Acceleration clauses are treated similarly in the Articles on Commercial Paper and Secured Transactions.

Cross References:

Point 3: § 1-203.
Point 5: § 2-611.
Point 6: §§ 1-203 and 1-208 and Articles 3 and 9.

Definitional Cross References:

"Aggrieved party". § 1-201.
"Between merchants". § 2-104.
"Contract". § 1-201.
"Contract for sale". § 2-106.
"Party". § 1-201.
"Reasonable time". § 1-204.
"Rights". § 1-201.
"Writing". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Virginia law has not recognized this right to demand adequate assur-

ance of performance, although the point has not been squarely decided. In Smokeless Fuel Co. v. W. E. Seaton & Sons, 105 Va. 170, 176, 52 S.E. 829 (1906), it was said that a seller's demand for an indemnifying bond to induce the seller to complete the contract was "wholly unwarranted," but there was no evidence that the seller had reasonable grounds for insecurity. Virginia has recognized and given effect to similar contractual provisions. J. Maury Dove Co., Inc. v. New River Coal Co., 150 Va. 796, 823, 143 S.E. 317 (1928). It was held in Sun Co. v. Burruss, 139 Va. 279, 287-90, 122 S.E. 347 (1924), that a contractual clause that the buyer's financial responsibility must at all times be satisfactory to the seller or shipments might be suspended could only be invoked if there was a "good faith" dissatisfaction.

§ 2-610. **Anticipatory Repudiation.** When either party repudiates the contract with respect to a performance not yet due the loss of which will substantially impair the value of the contract to the other, the aggrieved party may

(a) for a commercially reasonable time await performance by the repudiating party; or

(b) resort to any remedy for breach (§ 2-703 or § 2-711), even though he has notified the repudiating party that he would await the latter's performance and has urged retraction; and

(c) in either case suspend his own performance or proceed in accordance with the provisions of this Article on the seller's right to identify goods to the contract notwithstanding breach or to salvage unfinished goods (§ 2-704).

COMMENT: **Prior Uniform Statutory Provision:** See §§ 63(2) and 65, Uniform Sales Act.

Purposes: To make it clear that:

1. With the problem of insecurity taken care of by the preceding section and with provision being made in this Article as to the effect of a defective delivery under an installment contract, anticipatory repudiation centers upon an overt communication of intention or an action which renders performance impossible or demonstrates a clear determination not to continue with performance.

Under the present section when such a repudiation substantially impairs the value of the contract, the aggrieved party may at any time resort to his remedies for breach, or he may suspend his own performance while he negotiates with, or awaits performance by, the other party. But if he awaits performance beyond a commercially reasonable time he cannot recover resulting damages which he should have avoided.

2. It is not necessary for repudiation that performance be made literally and utterly impossible. Repudiation can result from action which reasonably indicates a rejection of the continuing obligation. And, a repudiation automatically results under the preceding section on insecurity when a party fails to provide adequate assurance of due future performance within thirty days after a justifiable demand therefor has been made. Under the language of this section, a demand by one or both parties for more than the contract calls for in the way of counter-performance is not in itself a repudiation nor does it invalidate a plain expression of desire for future performance. However, when under a fair reading it amounts to a statement of intention not to perform except on conditions which go beyond the contract, it becomes a repudiation.

3. The test chosen to justify an aggrieved party's action under this section is the same as that in the section on breach in installment contracts—namely the substantial value of the contract. The most useful test of substantial value is to determine whether material inconvenience or injustice will result if the aggrieved party is forced to wait and receive an ultimate tender minus the part or aspect repudiated.

4. After repudiation, the aggrieved party may immediately resort to any remedy he chooses provided he moves in good faith (see § 1-203). Inaction and silence by the aggrieved party may leave the matter open but it cannot be regarded as misleading the repudiating party. Therefore the aggrieved party is left free to proceed at any time with his options under this section, unless he has taken

some positive action which in good faith requires notification to the other party before the remedy is pursued.

Cross References:

Point 1: §§ 2-609 and 2-612.
Point 2: § 2-609.
Point 3: § 2-612.
Point 4: § 1-203.

Definitional Cross References:

"Aggrieved party". § 1-201.
"Contract". § 1-201.
"Party". § 1-201.
"Remedy". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Only one Virginia sales case has discussed the effect of an anticipatory breach. In Virginia Hardwood Lumber Co. v. Hughes, 140 Va. 249, 259, 124 S.E. 283 (1924), the court said that upon the seller being notified of the breach it is the seller's duty "to accept the situation and terminate all relations and sue for the breach and prove his damages." The seller was, therefore, denied the price of the goods, and because he had failed to prove any damages, the seller was denied damages as well. In Baker-Matthews Lumber Co., Inc. v. Lincoln Furniture Co., Inc., 153 Va. 14, 149 S.E. 517 (1929), it was found that the seller was unreasonable in thinking that the buyer had made an anticipatory repudiation of the contract. For other cases on anticipatory breach see Mutual Reserve Fund Life Ass'n v. Taylor, 99 Va. 208, 37 S.E. 854 (1901) (life insurance); Lee v. Mutual Reserve Fund Life Ass'n, 97 Va. 160, 33 S.E. 556 (1899) (life insurance); James v. Kibler's Adm'r, 94 Va. 165, 26 S.E. 417 (1896) (lease).

§ 2-611. Retraction of Anticipatory Repudiation. (1) Until the repudiating party's next performance is due he can retract his repudiation unless the aggrieved party has since the repudiation cancelled or materially changed his position or otherwise indicated that he considers the repudiation final.

(2) Retraction may be by any method which clearly indicates to the aggrieved party that the repudiating party intends to perform, but must include any assurance justifiably demanded under the provisions of this Article (§ 2-609).

(3) Retraction reinstates the repudiating party's rights under the contract with due excuse and allowance to the aggrieved party for any delay occasioned by the repudiation.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: To make it clear that:

1. The repudiating party's right to reinstate the contract is entirely dependent upon the action taken by the aggrieved party. If the latter has cancelled the contract or materially changed his position at any time after the repudiation, there can be no retraction under this section.

2. Under subsection (2) an effective retraction must be accompanied by any assurances demanded under the section dealing with right to adequate assurance. A repudiation is of course sufficient to give reasonable ground for insecurity and to warrant a request for assurance as an essential condition of the retraction. However, after a timely and unambiguous expression of retraction, a reasonable time for the assurance to be worked out should be allowed by the aggrieved party before cancellation.

Cross Reference:

Point 2: § 2-609.

Definitional Cross References:

"Aggrieved party". § 1-201.
"Cancellation". § 2-106.
"Contract". § 1-201.
"Party". § 1-201.
"Rights". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: This section is in accord with Norfolk Hosiery and Underwear Mills v. Aetna Hosiery Co., 124 Va. 221, 243-44, 98 S.E. 43 (1919), in recognizing that a repudiating party may retract his repudiation before performance is due unless the other party has cancelled or otherwise materially changed his position.

§ 2-612. **"Installment Contract"; Breach.** (1) An "installment contract" is one which requires or authorizes the delivery of goods in separate lots to be separately accepted, even though the contract contains a clause "each delivery is a separate contract" or its equivalent.

(2) The buyer may reject any installment which is non-conforming if the non-conformity substantially impairs the value of that installment and cannot be cured or if the non-conformity is a defect in the required documents; but if the non-conformity does not fall within subsection (3) and the seller gives adequate assurance of its cure the buyer must accept that installment.

(3) Whenever non-conformity or default with respect to one or more installments substantially impairs the value of the whole contract there is a breach of the whole. But the aggrieved party reinstates the contract if he accepts a non-conforming installment without seasonably notifying of cancellation or if he brings an action with respect only to past installments or demands performance as to future installments.

COMMENT: **Prior Uniform Statutory Provision:** § 45(2), Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To continue prior law but to make explicit the more mercantile interpretation of many of the rules involved, so that:

1. The definition of an installment contract is phrased more broadly in this Article so as to cover installment deliveries tacitly authorized by the circumstances or by the option of either party.

2. In regard to the apportionment of the price for separate payment this Article applies the more liberal test of what can be apportioned rather than the test of what is clearly apportioned by the agreement. This Article also recognizes approximate calculation or apportionment of price subject to subsequent adjustment. A provision for separate payment for each lot delivered ordinarily means that the price is at least roughly calculable by units of quantity, but such a provision is not essential to an "installment contract." If separate acceptance of separate deliveries is contemplated, no generalized contrast between wholly "entire" and wholly "divisible" contracts has any standing under this Article.

3. This Article rejects any approach which gives clauses such as "each delivery is a separate contract" their legalistically literal effect. Such contracts nonetheless call for installment deliveries. Even where a clause speaks of "a separate contract for all purposes", a commercial reading of the language under the section on good faith and commercial standards requires that the singleness of the document and the negotiation, together with the sense of the situation, prevail over any uncommercial and legalistic interpretation.

4. One of the requirements for rejection under subsection (2) is non-conformity substantially impairing the value of the installment in question. However, an

installment agreement may require accurate conformity in quality as a condition to the right to acceptance if the need for such conformity is made clear either by express provision or by the circumstances. In such a case the effect of the agreement is to define explicitly what amounts to substantial impairment of value impossible to cure. A clause requiring accurate compliance as a condition to the right to acceptance must, however, have some basis in reason, must avoid imposing hardship by surprise and is subject to waiver or to displacement by practical construction.

Substantial impairment of the value of an installment can turn not only on the quality of the goods but also on such factors as time, quantity, assortment, and the like. It must be judged in terms of the normal or specifically known purposes of the contract. The defect in required documents refers to such matters as the absence of insurance documents under a C. I. F. contract, falsity of a bill of lading, or one failing to show shipment within the contract period or to the contract destination. Even in such cases, however, the provisions on cure of tender apply if appropriate documents are readily procurable.

5. Under subsection (2) an installment delivery must be accepted if the non-conformity is curable and the seller gives adequate assurance of cure. Cure of non-conformity of an installment in the first instance can usually be afforded by an allowance against the price, or in the case of reasonable discrepancies in quantity either by a further delivery or a partial rejection. This Article requires reasonable action by a buyer in regard to discrepant delivery and good faith requires that the buyer make any reasonable minor outlay of time or money necessary to cure an overshipment by severing out an acceptable percentage thereof. The seller must take over a cure which involves any material burden; the buyer's obligation reaches only to cooperation. Adequate assurance for purposes of subsection (2) is measured by the same standards as under the section on right to adequate assurance of performance.

6. Subsection (3) is designed to further the continuance of the contract in the absence of an overt cancellation. The question arising when an action is brought as to a single installment only is resolved by making such action waive the right of cancellation. This involves merely a defect in one or more installments, as contrasted with the situation where there is a true repudiation within the section on anticipatory repudiation. Whether the non-conformity in any given installment justifies cancellation as to the future depends, not on whether such non-conformity indicates an intent or likelihood that the future deliveries will also be defective, but whether the non-conformity substantially impairs the value of the whole contract. If only the seller's security in regard to future installments is impaired, he has the right to demand adequate assurances of proper future performance but has not an immediate right to cancel the entire contract. It is clear under this Article, however, that defects in prior installments are cumulative in effect, so that acceptance does not wash out the defect "waived." Prior policy is continued, putting the rule as to buyer's default on the same footing as that in regard to seller's default.

7. Under the requirement of seasonable notification of cancellation under subsection (3), a buyer who accepts a non-conforming installment which substantially impairs the value of the entire contract should properly be permitted to withhold his decision as to whether or not to cancel pending a response from the seller as to his claim for cure or adjustment. Similarly, a seller may withhold a delivery pending payment for prior ones, at the same time delaying his decision as to cancellation. A reasonable time for notifying of cancellation, judged by commercial standards under the section on good faith, extends of course to include the time covered by any reasonable negotiation in good faith. However, during this period the defaulting party is entitled, on request, to know whether the contract is still in effect, before he can be required to perform further.

Cross References:

Point 2: §§ 2-307 and 2-607.
Point 3: § 1-203.
Point 5: §§ 2-208 and 2-609.
Point 6: § 2-610.

Definitional Cross References:

"Action". § 1-201.
"Aggrieved party". § 1-201.
"Buyer". § 2-103.
"Cancellation". § 2-106.
"Conform". § 2-106.

"Contract". § 1-201.
"Lot". § 2-105.
"Notifies". § 1-201.
"Seasonably". § 1-204.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Subsection 2-612(3), which provides that an aggrieved party reinstates the contract by accepting a nonconforming installment without seasonably notifying the other party of cancellation, is in accord with Virginia law, at least where the nonconformity is a delay in delivery. The Virginia cases hold that a buyer who has the right to rescind the contract of sale upon the failure of the seller to deliver the subject matter at the time specified waives his right to rescind and the contract is kept alive against the buyer as well as against the seller, so that neither can maintain an action against the other, except for a breach thereafter occurring. Goldstein v. Old Dominion Peanut Corp., 177 Va. 716, 722-26, 15 S.E.2d 103 (1941); Tidewater Plumbing Supply Co., Inc. v. Emory Foundry Co., 141 Va. 363, 367, 127 S.E. 87 (1925); Richmond Leather Manufacturing Co. v. Fawcett, 130 Va. 484, 508, 107 S.E. 800 (1921) and Fawcett v. Richmond Leather Manufacturing Co., 155 Va. 518, 524, 155 S.E. 714 (1930); Eichelbaum v. Klaff, 125 Va. 98, 99-101, 99 S.E. 721 (1919); Norfolk Hosiery and Underwear Mills Co. v. Aetna Hosiery, 124 Va. 221, 236-38, 98 S.E. 43 (1919).

It is not entirely clear under Virginia law whether the buyer may, without giving notice, reject delayed deliveries after he has accepted late deliveries while pressing for greater promptness. In Richmond Leather Manufacturing Co. v. Fawcett, 130 Va. 484, 508, 107 S.E. 800 (1921), it was said that the buyer "was required to give notice . . . that thereafter he stood upon his legal rights, and the contracts must be discharged strictly according to their terms." See also Smith v. Snyder, 77 Va. 432, 440-43 (1883), 82 Va. 614 (1886). However, W. S. Forbes & Co. v. Southern Cotton Oil Co., 130 Va. 245, 251-52, 108 S.E. 15 (1921), held that accepting late delivery on one contract did not constitute a waiver of the requirement of delivery on time as to another contract.

By accepting delayed payments, under Virginia law, the seller waives his right to insist on payment for future installments in strict accordance with the terms of the contract. If the seller intends to require strict punctuality of payment in the future he must give the buyer notice of that fact. Cocoa Products Co. of America, Inc. v. Duche, 156 Va. 86, 96-98, 158 S.E. 719 (1931). Nevertheless, payments by the buyer at greater than the contract rate does not preclude the buyer from later insisting on the seller making deliveries at the contract rate. C. G. Blake Co., Inc. v. W. R. Smith and Son, Ltd., 147 Va. 960, 980-81, 133 S.E. 685 (1926).

§ 2-613. Casualty to Identified Goods. Where the contract requires for its performance goods identified when the contract is made, and the goods suffer casualty without fault of either party before the risk of loss passes to the buyer, or in a proper case under a "no arrival, no sale" term (§ 2-324) then

(a) if the loss is total the contract is avoided; and

(b) if the loss is partial or the goods have so deteriorated as no longer to conform to the contract the buyer may nevertheless demand inspection and at his option either treat the contract as avoided or accept the goods with due allowance from the contract price for the deterioration or the deficiency in quantity but without further right against the seller.

COMMENT: Prior Uniform Statutory Provision: §§ 7 and 8, Uniform Sales Act.

Changes: Rewritten, the basic policy being continued but the test of a "divisible" or "indivisible" sale or contract being abandoned in favor of adjustment in business terms.

Purposes of Changes: 1. Where goods whose continued existence is presupposed by the agreement are destroyed without fault of either party, the buyer is relieved

from his obligation but may at his option take the surviving goods at a fair adjustment. "Fault" is intended to include negligence and not merely wilful wrong. The buyer is expressly given the right to inspect the goods in order to determine whether he wishes to avoid the contract entirely or to take the goods with a price adjustment.

2. The section applies whether the goods were already destroyed at the time of contracting without the knowledge of either party or whether they are destroyed subsequently but before the risk of loss passes to the buyer. Where under the agreement, including of course usage of trade, the risk has passed to the buyer before the casualty, the section has no application. Beyond this, the essential question in determining whether the rules of this section are to be applied is whether the seller has or has not undertaken the responsibility for the continued existence of the goods in proper condition through the time of agreed or expected delivery.

3. The section on the term "no arrival, no sale" makes clear that delay in arrival, quite as much as physical change in the goods, gives the buyer the options set forth in this section.

Cross Reference:

Point 3: § 2-324.

Definitional Cross References:

"Buyer". § 2-103.
"Conform". § 2-106.
"Contract". § 1-201.
"Fault". § 1-201.
"Goods". § 2-105.
"Party". § 1-201.
"Rights". § 1-201.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-614. Substituted Performance. (1) Where without fault of either party the agreed berthing, loading, or unloading facilities fail or an agreed type of carrier becomes unavailable or the agreed manner of delivery otherwise becomes commercially impracticable but a commercially reasonable substitute is available, such substitute performance must be tendered and accepted.

(2) If the agreed means or manner of payment fails because of domestic or foreign governmental regulation, the seller may withhold or stop delivery unless the buyer provides a means or manner of payment which is commercially a substantial equivalent. If delivery has already been taken, payment by the means or in the manner provided by the regulation discharges the buyer's obligation unless the regulation is discriminatory, oppressive or predatory.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. Subsection (1) requires the tender of a commercially reasonable substituted performance where agreed to facilities have failed or become commercially impractical. Under this Article, in the absence of specific agreement, the normal or usual facilities enter into the agreement either through the circumstances, usage of trade or prior course of dealing.

This section appears between § 2-613 on casualty to identified goods and the next section on excuse by failure of presupposed conditions, both of which deal with excuse and complete avoidance of the contract where the occurrence or nonoccurrence of a contingency which was a basic assumption of the contract makes the expected performance impossible. The distinction between the present section

and those sections lies in whether the failure or impossibility of performance arises in connection with an incidental matter or goes to the very heart of the agreement. The differing lines of solution are contrasted in a comparison of International Paper Co. v. Rockefeller, 161 App. Div. 180, 146 N.Y.S. 371 (1914) and Meyer v. Sullivan, 40 Cal. App. 723, 181 P. 847 (1919). In the former case a contract for the sale of spruce to be cut from a particular tract of land was involved. When a fire destroyed the trees growing on that tract the seller was held excused since performance was impossible. In the latter case the contract called for delivery of wheat "f.o.b. Kosmos Steamer at Seattle." The war led to cancellation of that line's sailing schedule after space had been duly engaged and the buyer was held entitled to demand substituted delivery at the warehouse on the line's loading dock. Under this Article, of course, the seller would also be entitled, had the market gone the other way, to make a substituted tender in that manner.

There must, however, be a true commercial impracticability to excuse the agreed to performance and justify a substituted performance. When this is the case a reasonable substituted performance tendered by either party should excuse him from strict compliance with contract terms which do not go to the essence of the agreement.

2. The substitution provided in this section as between buyer and seller does not carry over into the obligation of a financing agency under a letter of credit, since such an agency is entitled to performance which is plainly adequate on its face and without need to look into commercial evidence outside of the documents. See Article 5, especially §§ 5-102, 5-103, 5-109, 5-110, 5-114.

3. Under subsection (2) where the contract is still executory on both sides, the seller is permitted to withdraw unless the buyer can provide him with a commercially equivalent return despite the governmental regulation. Where, however, only the debt for the price remains, a larger leeway is permitted. The buyer may pay in the manner provided by the regulation even though this may not be commercially equivalent provided that the regulation is not "discriminatory, oppressive or predatory."

Cross Reference:

Point 2: Article 5.

Definitional Cross References:

"Buyer". § 2-103.
"Fault". § 1-201.
"Party". § 1-201.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-615. Excuse by Failure of Presupposed Conditions. Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance:

(a) Delay in delivery or non-delivery in whole or in part by a seller who complies with paragraphs (b) and (c) is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.

(b) Where the causes mentioned in paragraph (a) affect only a part of the seller's capacity to perform, he must allocate production and deliveries among his customers but may at his option include regular customers not then under contract as well as his own requirements for further manufacture. He may so allocate in any manner which is fair and reasonable.

(c) The seller must notify the buyer seasonably that there will be delay or non-delivery and, when allocation is required under paragraph (b), of the estimated quota thus made available for the buyer.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. This section excuses a seller from timely delivery of goods contracted for, where his performance has become commercially impracticable because of unforeseen supervening circumstances not within the contemplation of the parties at the time of contracting. The destruction of specific goods and the problem of the use of substituted performance on points other than delay or quantity, treated elsewhere in this Article, must be distinguished from the matter covered by this section.

2. The present section deliberately refrains from any effort at an exhaustive expression of contingencies and is to be interpreted in all cases sought to be brought within its scope in terms of its underlying reason and purpose.

3. The first test for excuse under this Article in terms of basic assumption is a familiar one. The additional test of commercial impracticability (as contrasted with "impossibility," "frustration of performance" or "frustration of the venture") has been adopted in order to call attention to the commercial character of the criterion chosen by this Article.

4. Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of the performance. Neither is a rise or a collapse in the market in itself a justification, for that is exactly the type of business risk which business contracts made at fixed prices are intended to cover. But a severe shortage of raw materials or of supplies due to a contingency such as war, embargo, local crop failure, unforeseen shutdown of major sources of supply or the like, which either causes a marked increase in cost or altogether prevents the seller from securing supplies necessary to his performance, is within the contemplation of this section. (See Ford & Sons, Ltd., v. Henry Leetham & Sons, Ltd., 21 Com. Cas. 55 (1915, K.B.D.).)

5. Where a particular source of supply is exclusive under the agreement and fails through casualty, the present section applies rather that the provision on destruction or deterioration of specific goods. The same holds true where a particular source of supply is shown by the circumstances to have been contemplated or assumed by the parties at the time of contracting. (See Davis Co. v. Hoffmann-LaRoche Chemical Works, 178 App.Div. 855, 166 N.Y.S. 179 (1917) and International Paper Co. v. Rockefeller, 161 App.Div. 180, 146 N.Y.S. 371 (1914)). There is no excuse under this section, however, unless the seller has employed all due measures to assure himself that his source will not fail. (See Canadian Industrial Alcohol Co., Ltd., v. Dunbar Molasses Co., 258 N.Y. 194, 179 N.E. 383, 80 A.L.R. 1173 (1932) and Washington Mfg. Co. v. Midland Lumber Co., 113 Wash. 593, 194 P. 777 (1921).)

In the case of failure of production by an agreed source for causes beyond the seller's control, the seller should, if possible, be excused since production by an agreed source is without more a basic assumption of the contract. Such excuse should not result in relieving the defaulting supplier from liability nor in dropping into the seller's lap an unearned bonus of damages over. The flexible adjustment machinery of this Article provides the solution under the provision on the obligation of good faith. A condition to his making good the claim of excuse is the turning over to the buyer of his rights against the defaulting source of supply to the extent of the buyer's contract in relation to which excuse is being claimed.

6. In situations in which neither sense nor justice is served by either answer when the issue is posed in flat terms of "excuse" or "no excuse," adjustment under the various provisions of this Article is necessary, especially the sections on good faith, on insecurity and assurance and on the reading of all provisions in the light of their purposes, and the general policy of this Act to use equitable principles in furtherance of commercial standards and good faith.

7. The failure of conditions which go to convenience or collateral values rather than to the commercial practicability of the main performance does not amount to a complete excuse. However, good faith and the reason of the present section and of the preceding one may properly be held to justify and even to require any needed delay involved in a good faith inquiry seeking a readjustment of the contract terms to meet the new conditions.

8. The provisions of this section are made subject to assumption of greater liability by agreement and such agreement is to be found not only in the expressed terms of the contract but in the circumstances surrounding the contracting, in

trade usage and the like. Thus the exemptions of this section do not apply when the contingency in question is sufficiently foreshadowed at the time of contracting to be included among the business risks which are fairly to be regarded as part of the dickered terms, either consciously or as a matter of reasonable, commercial interpretation from the circumstances. (See Madeirense Do Brasil, S. A. v. Stulman-Emerick Lumber Co., 147 F.2d 399 (C.C.A., 2 Cir., 1945)). The exemption otherwise present through usage of trade under the present section may also be expressly negated by the language of the agreement. Generally, express agreements as to exemptions designed to enlarge upon or supplant the provisions of this section are to be read in the light of mercantile sense and reason, for this section itself sets up the commercial standard for normal and reasonable interpretation and provides a minimum beyond which agreement may not go.

Agreement can also be made in regard to the consequences of exemption as laid down in paragraphs (b) and (c) and the next section on procedure on notice claiming excuse.

9. The case of a farmer who has contracted to sell crops to be grown on designated land may be regarded as falling either within the section on casualty to identified goods or this section, and he may be excused, when there is a failure of the specific crop, either on the basis of the destruction of identified goods or because of the failure of a basic assumption of the contract.

Exemption of the buyer in the case of a "requirements" contract is covered by the "Output and Requirements" section both as to assumption and allocation of the relevant risks. But when a contract by a manufacturer to buy fuel or raw material makes no specific reference to a particular venture and no such reference may be drawn from the circumstances, commercial understanding views it as a general deal in the general market and not conditioned on any assumption of the continuing operation of the buyer's plant. Even when notice is giveu by the buyer that the supplies are needed to fill a specific contract of a normal commercial kind, commercial understanding does not see such a supply contract as conditioned on the continuance of the buyer's further contract for outlet. On the other hand, where the buyer's contract is in reasonable commercial understanding conditioned on a definite and specific venture or assumption as, for instance, a war procurement subcontract known to be based on a prime contract which is subject to termination, or a supply contract for a particular construction venture, the reason of the present section may well apply and entitle the buyer to the exemption.

10. Following its basic policy of using commercial practicability as a test for excuse, this section recognizes as of equal significance either a foreign or domestic regulation and disregards any technical distinctions between "law," "regulation," "order" and the like. Nor does it make the present action of the seller depend upon the eventual judicial determination of the legality of the particular governmental action. The seller's good faith belief in the validity of the regulation is the test under this Article and the best evidence of his good faith is the general commercial acceptance of the regulation. However, governmental interference cannot excuse unless it truly "supervenes" in such a manner as to be beyond the seller's assumption of risk. And any action by the party claiming excuse which causes or colludes in inducing the governmental action preventing his performance would be in breach of good faith and would destroy his exemption.

11. An excused seller must fulfill his contract to the extent which the supervening contingency permits, and if the situation is such that his customers are generally affected he must take account of all in supplying one. Subsections (a) and (b), therefore, explicitly permit in any proration a fair and reasonable attention to the needs of regular customers who are probably relying on spot orders for supplies. Customers at different stages of the manufacturing process may be fairly treated by including the seller's manufacturing requirements. A fortiori, the seller may also take account of contracts later in date than the one in question. The fact that such spot orders may be closed at an advanced price causes no difficulty, since any allocation which exceeds normal past requirements will not be reasonable. However, good faith requires, when prices have advanced, that the seller exercise real care in making his allocations, and in case of doubt his contract customers should be favored and supplies prorated evenly among them regardless of price. Save for the extra care thus required by changes in the market, this section seeks to leave every reasonable business leeway to the seller.

Cross References:

Point 1: §§ 2-613 and 2-614.
Point 2: § 1-102.

Point 5: §§ 1-203 and 2-613.
Point 6: §§ 1-102, 1-203 and 2-609.
Point 7: § 2-614.
Point 8: §§ 1-201, 2-302 and 2-616.
Point 9: §§ 1-102, 2-306 and 2-613.

Definitional Cross References:

"Between merchants". § 2-104.
"Buyer". § 2-103.
"Contract". § 1-201.
"Contract for sale". § 2-106.
"Good faith". § 1-201.
"Merchant". § 2-104.
"Notifies". § 1-201.
"Seasonably". § 1-204.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: In Goldstein v. Old Dominion Peanut Corp., 177 Va. 716, 726-28, 15 S.E. 2d 103 (1941), the Snpreme Court of Appeals refused to recognize inconvenience or cost, though they might make compliance a hardship, as excuses for nonperformance on the ground that they constitute supervening causes, not within the contemplation of the parties. Virginia has required reasonable diligence to comply with a contract even though the contract does not expressly provide for liability in case of nonperformance. Richmond Ice Co. v. Crystal Ice Co., 99 Va. 285, 289-90, 38 S.E. 141 (1901); James River and Kanawha Co. v. Adams, 58 Va. (17 Gratt.) 427, 437-38 (1867). In Bardach Iron and Steel Co., Inc. v. Tenenbaum, 136 Va. 163, 174-76, 118 S.E. 502 (1923), as a matter of interpretation of the contract, the seller was held not responsible for contingencies beyond his control.

§ 2-616. Procedure on Notice Claiming Excuse. (1) Where the buyer receives notification of a material or indefinite delay or an allocation justified under the preceding section he may by written notification to the seller as to any delivery concerned, and where the prospective deficiency substantially impairs the value of the whole contract under the provisions of this Article relating to breach of installment contracts (§ 2-612), then also as to the whole,

(a) terminate and thereby discharge any unexecuted portion of the contract; or

(b) modify the contract by agreeing to take his available quota in substitution.

(2) If after receipt of such notification from the seller the buyer fails so to modify the contract within a reasonable time not exceeding thirty days the contract lapses with respect to any deliveries affected.

(3) The provisions of this section may not be negated by agreement except in so far as the seller has assumed a greater obligation under the preceding section.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: This section seeks to establish simple and workable machinery for providing certainty as to when a supervening and excusing contingency "excuses" the delay, "discharges" the contract, or may result in a waiver of the delay by the buyer. When the seller notifies, in accordance with the preceding section, claiming excuse, the buyer may acquiesce, in which case the contract is so modified. No consideration is necessary in a case of this kind to support such a modification. If the buyer does not elect so to modify the contract, he may terminate it and under subsection (2) his silence after receiving the seller's claim of excuse operates as such a termination. Subsection (3) denies effect to any contract clause made in

advance of trouble which would require the buyer to stand ready to take delivery whenever the seller is excused from delivery by unforeseen circumstances.

Cross References:

Point 1: §§ 2-209 and 2-615.

Definitional Cross References:

"Buyer". § 2-103.
"Contract". § 1-201.
"Installment contract". § 2-612.
"Notification". § 1-201.
"Reasonable time". § 1-204.
"Seller". § 2-103.
"Termination". § 2-106.
"Written". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

PART 7

REMEDIES

§ 2-701. Remedies for Breach of Collateral Contracts Not Impaired. Remedies for breach of any obligation or promise collateral or ancillary to a contract for sale are not impaired by the provisions of this Article.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: Whether a claim for breach of an obligation collateral to the contract for sale requires separate trial to avoid confusion of issues is beyond the scope of this Article; but contractual arrangements which as a business matter enter vitally into the contract should be considered a part thereof in so far as cross-claims or defenses are concerned.

Definitional Cross References:

"Contract for sale". § 2-106.
"Remedy". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-702. Seller's Remedies on Discovery of Buyer's Insolvency. (1) Where the seller discovers the buyer to be insolvent he may refuse delivery except for cash including payment for all goods theretofore delivered under the contract, and stop delivery under this Article (§ 2-705).

(2) Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.

(3) The seller's right to reclaim under subsection (2) is subject to the rights of a buyer in ordinary course or other good faith purchaser or lien creditor under this Article (§ 2-403). Successful reclamation of goods excludes all other remedies with respect to them.

COMMENT: **Prior Uniform Statutory Provision:** Subsection (1)—§§ 53(1)(b), 54(1)(c) and 57, Uniform Sales Act; Subsection (2)—none; Subsection (3)—§ 76(3), Uniform Sales Act.

Changes: Rewritten, the protection given to a seller who has sold on credit and has delivered goods to the buyer immediately preceding his insolvency being extended.

Purposes of Changes and New Matter: To make it clear that:

1. The seller's right to withhold the goods or to stop delivery except for cash when he discovers the buyer's insolvency is made explicit in subsection (1) regardless of the passage of title, and the concept of stoppage has been extended to include goods in the possession of any bailee who has not yet attorned to the buyer.

2. Subsection (2) takes as its base line the proposition that any receipt of goods on credit by an insolvent buyer amounts to a tacit business misrepresentation of solvency and therefore is fraudulent as against the particular seller. This Article makes discovery of the buyer's insolvency and demand within a ten day period a condition of the right to reclaim goods on this ground. The ten day limitation period operates from the time of receipt of the goods.

An exception to this time limitation is made when a written misrepresentation of solvency has been made to the particular seller within three months prior to the delivery. To fall within the exception the statement of solvency must be in writing, addressed to the particular seller and dated within three months of the delivery.

3. Subsection (3) subjects the right of reclamation to certain rights of third parties "under this Article (§ 2-403)." The rights so given priority of course include the rights given to purchasers from the buyer by § 2-403(1) and (2). They also include other rights arising under Article 2, such as the rights of lien creditors of the buyer under § 2-326(3) on consignment sales. Moreover, since § 2-403(4) incorporates by reference rights given to other purchasers and to lien creditors by Articles 6, 7 and 9, such rights have the same priority. "Lien creditor" here has the same meaning as in § 9-301(3). Thus if a seller retains an unperfected security interest, subordinate under § 9-301(1)(b) to the rights of a levying creditor of the buyer, his right of reclamation under this section is also subject to the creditor's rights. Purchasers or lien creditors may also have rights not arising under this Article; under § 1-103 such rights may have priority by virtue of supplementary principles not displaced by this Section. See In re Kravitz, 278 F.2d 820 (3d Cir. 1960).

Because the right of the seller to reclaim goods under this section constitutes preferential treatment as against the buyer's other creditors, subsection (3) provides that such reclamation bars all of his other remedies as to the goods involved.

Cross References:

Point 1: §§ 2-401 and 2-705.
Compare § 2-502.

Definitional Cross References:

"Buyer". § 2-103.
"Buyer in ordinary course of business". § 1-201.
"Contract". § 1-201.
"Good faith". § 1-201.
"Goods". § 2-105.
"Insolvent". § 1-201.
"Person". § 1-201.
"Purchaser". § 1-201.
"Receipt of goods". § 2-103.
"Remedy". § 1-201.
"Rights". § 1-201.
"Seller". § 2-103.
"Writing". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: The right given by subsection 2-702(2) to the seller to reclaim goods, when he discovers that the buyer is insolvent and makes demand for their return

within ten days after delivery, changes Virginia law. In James v. Bird's Adm'r, 35 Va. (8 Leigh) 510, 513 (1837), the court said that the seller of personal property has no implied or equitable lien for the purchase money and that he must look solely to the personal responsibility of the buyer. In Trigg v. Bucyrus Co., 104 Va. 79, 81-88, 51 S.E. 174 (1905), the seller was not permitted to recover a chattel from an insolvent buyer, ownership having passed to the buyer, but since the insolvency apparently occurred much more than ten days after the delivery of the chattel, the result would be the same under the UCC.

Subsection 2-702(3) is in accord with Oberdorfer v. Meyer, 88 Va. 384, 386, 13 S.E. 756 (1891), which indicated that a seller could reclaim goods from a buyer who had fraudulently misrepresented his solvency, but denied reclamation because the goods had passed into the hands of a party who had taken them in good faith without notice of the seller's rights.

§ 2-703. **Seller's Remedies in General.** Where the buyer wrongfully rejects or revokes acceptance of goods or fails to make a payment due on or before delivery or repudiates with respect to a part or the whole, then with respect to any goods directly affected and, if the breach is of the whole contract (§ 2-612), then also with respect to the whole undelivered balance, the aggrieved seller may

(a) withhold delivery of such goods;

(b) stop delivery by any bailee as hereafter provided (§ 2-705);

(c) proceed under the next section respecting goods still unidentified to the contract;

(d) resell and recover damages as hereafter provided (§ 2-706);

(e) recover damages for non-acceptance (§ 2-708) or in a proper case the price (§ 2-709);

(f) cancel.

COMMENT: Prior Uniform Statutory Provision: No comparable index section.

Purposes: 1. This section is an index section which gathers together in one convenient place all of the various remedies open to a seller for any breach by the buyer. This Article rejects any doctrine of election of remedy as a fundamental policy and thus the remedies are essentially cumulative in nature and include all of the available remedies for breach. Whether the pursuit of one remedy bars another depends entirely on the facts of the individual case.

2. The buyer's breach which occasions the use of the remedies under this section may involve only one lot or delivery of goods, or may involve all of the goods which are the subject matter of the particular contract. The right of the seller to pursue a remedy as to all the goods when the breach is as to only one or more lots is covered by the section on breach in installment contracts. The present section deals only with the remedies available after the goods involved in the breach have been determined by that section.

3. In addition to the typical case of refusal to pay or default in payment, the language in the preamble, "fails to make a payment due," is intended to cover the dishonor of a check on due presentment, or the non-acceptance of a draft, and the failure to furnish an agreed letter of credit.

4. It should also be noted that this Act requires its remedies to be liberally administered and provides that any right or obligation which it declares is enforceable by action unless a different effect is specifically prescribed (§ 1-106).

Cross References:

Point 2: § 2-612.
Point 3: § 2-325.
Point 4: § 1-106.

Definitional Cross References:

"Aggrieved party". § 1-201.
"Buyer". § 2-103.
"Cancellation". § 2-106.
"Contract". § 1-201.
"Goods". § 2-105.
"Remedy". § 1-201.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: For a comment on the seller's remedies under the UCC as compared with the remedies under Virginia law, see Rowe, Seller's Remedies and Article 2, 20 Wash. & Lee L. Rev. (Fall 1963).

The different seller's remedies under Virginia law were summarized in Rosenbaums v. Weeden, Johnson & Co., 59 Va. (18 Gratt.) 785, 790 (1868) as follows: "If a vendee of goods refuse to accept them when tendered according to the contract of sale, the vendor may elect to rescind the contract and keep or dispose of the goods for his own use, or to let it remain in full force and hold the vendee liable for the price of the goods and all damages arising from his breach of the contract. If he elects to let the contract remain in full force, he may either bring his action for the price of the goods when it is due and payable, or he may sell the goods, apply the net proceeds of sale to the credit of the vendee on account of the money due by him, and bring an action against him to recover the balance." Although the Rosenbaums case referred to the remedy of cancellation, there appears to be no Virginia case involving the situation. For purposes of venue, Big Seam Coal Corp. v. Atlantic Coast Line Railroad Co., 196 Va. 590, 594-95, 85 S.E.2d 239 (1955), held that a contract for coal F.O.B. mine was breached at the mine where the buyer refused to accept shipments. The UCC does not cover the point.

§ 2-704. Seller's Right to Identify Goods to the Contract Notwithstanding Breach or to Salvage Unfinished Goods. (1) An aggrieved seller under the preceding section may

(a) identify to the contract conforming goods not already identified if at the time he learned of the breach they are in his possession or control;

(b) treat as the subject of resale goods which have demonstrably been intended for the particular contract even though those goods are unfinished.

(2) Where the goods are unfinished an aggrieved seller may in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization either complete the manufacture and wholly identify the goods to the contract or cease manufacture and resell for scrap or salvage value or proceed in any other reasonable manner.

COMMENT: Prior Uniform Statutory Provision: §§ 63(3) and 64(4), Uniform Sales Act.

Changes: Rewritten, the seller's rights being broadened.

Purposes of Changes: 1. This section gives an aggrieved seller the right at the time of breach to identify to the contract any conforming finished goods, regardless of their resalability, and to use reasonable judgment as to completing unfinished goods. It thus makes the goods available for resale under the resale section, the seller's primary remedy, and in the special case in which resale is not practicable, allows the action for the price which would then be necessary to give the seller the value of his contract.

2. Under this Article the seller is given express power to complete manufacture or procurement of goods for the contract unless the exercise of reasonable commercial judgment as to the facts as they appear at the time he learns of the breach makes it clear that such action will result in a material increase in damages. The burden is on the buyer to show the commercially unreasonable nature of the seller's action in completing manufacture.

Cross References:

§§ 2-703 and 2-706.

Definitional Cross References:

"Aggrieved party". § 1-201.
"Conforming". § 2-106.
"Contract". § 1-201.
"Goods". § 2-105.
"Rights". § 1-201.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-705. Seller's Stoppage of Delivery in Transit or Otherwise. (1) The seller may stop delivery of goods in the possession of a carrier or other bailee when he discovers the buyer to be insolvent (§ 2-702) and may stop delivery of carload, truckload, planeload or larger shipments of express or freight when the buyer repudiates or fails to make a payment due before delivery or if for any other reason the seller has a right to withhold or reclaim the goods.

(2) As against such buyer the seller may stop delivery until

(a) receipt of the goods by the buyer; or

(b) acknowledgment to the buyer by any bailee of the goods except a carrier that the bailee holds the goods for the buyer; or

(c) such acknowledgment to the buyer by a carrier by reshipment or as warehouseman; or

(d) negotiation to the buyer of any negotiable document of title covering the goods.

(3) (a) To stop delivery the seller must so notify as to enable the bailee by reasonable diligence to prevent delivery of the goods.

(b) After such notification the bailee must hold and deliver the goods according to the directions of the seller but the seller is liable to the bailee for any ensuing charges or damages.

(c) If a negotiable document of title has been issued for goods the bailee is not obliged to obey a notification to stop until surrender of the document.

(d) A carrier who has issued a non-negotiable bill of lading is not obliged to obey a notification to stop received from a person other than the consignor.

COMMENT: Prior Uniform Statutory Provision: §§ 57-59, Uniform Sales Act; see also §§ 12, 14 and 42, Uniform Bills of Lading Act and §§ 9, 11 and 49, Uniform Warehouse Receipts Act.

Changes: This section continues and develops the above sections of the Uniform Sales Act in the light of the other uniform statutory provisions noted.

Purposes: To make it clear that:

1. Subsection (1) applies the stoppage principle to other bailees as well as carriers.

It also expands the remedy to cover the situations, in addition to buyer's insolvency, specified in the subsection. But since stoppage is a burden in any case

to carriers, and might be a very heavy burden to them if it covered all small shipments in all these situations, the right to stop for reasons other than insolvency is limited to carload, truckload, planeload or larger shipments. The seller shipping to a buyer of doubtful credit can protect himself by shipping C.O.D.

Where stoppage occurs for insecurity it is merely a suspension of performance, and if assurances are duly forthcoming from the buyer the seller is not entitled to resell or divert.

Improper stoppage is a breach by the seller if it effectively interferes with the buyer's right to due tender under the section on manner of tender of delivery. However, if the bailee obeys an unjustified order to stop he may also be liable to the buyer. The measure of his obligation is dependent on the provisions of the Documents of Title Article (§ 7-303). Subsection 3 (b) therefore gives him a right of indemnity as against the seller in such a case.

2. "Receipt by the buyer" includes receipt by the buyer's designated representative, the sub-purchaser, when shipment is made direct to him and the buyer himself never receives the goods. It is entirely proper under this Article that the seller, by making such direct shipment to the sub-purchaser, be regarded as acquiescing in the latter's purchase and as thus barred from stoppage of the goods as against him.

As between the buyer and the seller, the latter's right to stop the goods at any time until they reach the place of final delivery is recognized by this section.

Under subsection (3)(c) and (d), the carrier is under no duty to recognize the stop order of a person who is a stranger to the carrier's contract. But the seller's right as against the buyer to stop delivery remains, whether or not the carrier is obligated to recognize the stop order. If the carrier does obey it, the buyer cannot complain merely because of that circumstance; and the seller becomes obligated under subsection (3)(b) to pay the carrier any ensuing damages or charges.

3. A diversion of a shipment is not a "reshipment" under subsection (2)(c) when it is merely an incident to the original contract of transportation. Nor is the procurement of "exchange bills" of lading which change only the name of the consignee to that of the buyer's local agent but do not alter the destination of a reshipment.

Acknowledgment by the carrier as a "warehouseman" within the meaning of this Article requires a contract of a truly different character from the original shipment, a contract not in extension of transit but as a warehouseman.

4. Subsection (3)(c) makes the bailee's obedience of a notification to stop conditional upon the surrender of any outstanding negotiable document.

5. Any charges or losses incurred by the carrier in following the seller's orders, whether or not he was obligated to do so, fall to the seller's charge.

6. After an effective stoppage under this section the seller's rights in the goods are the same as if he had never made a delivery.

Cross References:

§§ 2-702 and 2-703.
Point 1: §§ 2-503 and 2-609, and Article 7.
Point 2: § 2-103 and Article 7.

Definitional Cross References:

"Buyer". § 2-103.
"Contract for sale". § 2-106.
"Document of title". § 1-201.
"Goods". § 2-105.
"Insolvent". § 1-201.
"Notification". § 1-201.
"Receipt of goods". § 2-103.
"Rights". § 1-201.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Virginia has recognized the doctrine of stoppage in transit. In Howatt & Co. v. Davis & Chalmers, 19 Va. (5 Munf.) 34, 37-39 (1816), a seller was allowed a right of stoppage when the buyer became insolvent while the goods were

still in the hands of the seller's agent, the court speaking of the goods as being "in legal phrase, in transitu." The doctrine was discussed in Pleasants v. Pendleton, 27 Va. (6 Rand.) 473, 484-85 (1828).

§ 2-706. **Seller's Resale Including Contract for Resale.** (1) Under the conditions stated in § 2-703 on seller's remedies, the seller may resell the goods concerned or the undelivered balance thereof. Where the resale is made in good faith and in a commercially reasonable manner the seller may recover the difference between the resale price and the contract price together with any incidental damages allowed under the provisions of this Article (§ 2-710), but less expenses saved in consequence of the buyer's breach.

(2) Except as otherwise provided in subsection (3) or unless otherwise agreed resale may be at public or private sale including sale by way of one or more contracts to sell or of identification to an existing contract of the seller. Sale may be as a unit or in parcels and at any time and place and on any terms but every aspect of the sale including the method, manner, time, place and terms must be commercially reasonable. The resale must be reasonably identified as referring to the broken contract, but it is not necessary that the goods be in existence or that any or all of them have been identified to the contract before the breach.

(3) Where the resale is at private sale the seller must give the buyer reasonable notification of his intention to resell.

(4) Where the resale is at public sale

(a) only identified goods can be sold except where there is a recognized market for a public sale of futures in goods of the kind; and

(b) it must be made at a usual place or market for public sale if one is reasonably available and except in the case of goods which are perishable or threaten to decline in value speedily the seller must give the buyer reasonable notice of the time and place of the resale; and

(c) if the goods are not to be within the view of those attending the sale the notification of sale must state the place where the goods are located and provide for their reasonable inspection by prospective bidders; and

(d) the seller may buy.

(5) A purchaser who buys in good faith at a resale takes the goods free of any rights of the original buyer even though the seller fails to comply with one or more of the requirements of this section.

(6) The seller is not accountable to the buyer for any profit made on any resale. A person in the position of a seller (§ 2-707) or a buyer who has rightfully rejected or justifiably revoked acceptance must account for any excess over the amount of his security interest, as hereinafter defined (subsection (3) of § 2-711).

COMMENT: Prior Uniform Statutory Provision: § 60, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To simplify the prior statutory provision and to make it clear that:

1. The only condition precedent to the seller's right of resale under subsection (1) is a breach by the buyer within the section on the seller's remedies in general

or insolvency. Other meticulous conditions and restrictions of the prior uniform statutory provision are disapproved by this Article and are replaced by standards of commercial reasonableness. Under this section the seller may resell the goods after any breach by the buyer. Thus, an anticipatory repudiation by the buyer gives rise to any of the seller's remedies for breach, and to the right of resale. This principle is supplemented by subsection (2) which authorizes a resale of goods which are not in existence or were not identified to the contract before the breach.

2. In order to recover the damages prescribed in subsection (1) the seller must act "in good faith and in a commercially reasonable manner" in making the resale. This standard is intended to be more comprehensive than that of "reasonable care and judgment" established by the prior uniform statutory provision. Failure to act properly under this section deprives the seller of the measure of damages here provided and relegates him to that provided in § 2-708.

Under this Article the seller resells by authority of law, in his own behalf, for his own benefit and for the purpose of fixing his damages. The theory of a seller's agency is thus rejected.

3. If the seller complies with the prescribed standard of duty in making the resale, he may recover from the buyer the damages provided for in subsection (1). Evidence of market or current prices at any particular time or place is relevant only on the question of whether the seller acted in a commercially reasonable manner in making the resale.

The distinction drawn by some courts between cases where the title had not passed to the buyer and the seller had resold as owner, and cases where the title had passed and the seller had resold by virtue of his lien on the goods, is rejected.

4. Subsection (2) frees the remedy of resale from legalistic restrictions and enables the seller to resell in accordance with reasonable commercial practices so as to realize as high a price as possible in the circumstances. By "public" sale is meant a sale by auction. A "private" sale may be effected by solicitation and negotiation conducted either directly or through a broker. In choosing between a public and private sale the character of the goods must be considered and relevant trade practices and usages must be observed.

5. Subsection (2) merely clarifies the common law rule that the time for resale is a reasonable time after the buyer's breach, by using the language "commercially reasonable." What is such a reasonable time depends upon the nature of the goods, the condition of the market and the other circumstances of the case; its length cannot be measured by any legal yardstick or divided into degrees. Where a seller contemplating resale receives a demand from the buyer for inspection under the section of preserving evidence of goods in dispute, the time for resale may be appropriately lengthened.

On the question of the place for resale, subsection (2) goes to the ultimate test, the commercial reasonableness of the seller's choice as to the place for an advantageous resale. This Article rejects the theory that the seller is required to resell at the agreed place for delivery and that a resale elsewhere can be permitted only in exceptional cases.

6. The purpose of subsection (2) being to enable the seller to dispose of the goods to the best advantage, he is permitted in making the resale to depart from the terms and conditions of the original contract for sale to any extent "commercially reasonable" in the circumstances.

7. The provision of subsection (2) that the goods need not be in existence to be resold applies when the buyer is guilty of anticipatory repudiation of a contract for future goods, before the goods or some of them have come into existence. In such a case the seller may exercise the right of resale and fix his damages by "one or more contracts to sell" the quantity of conforming future goods affected by the repudiation. The companion provision of subsection (2) that resale may be made although the goods were not identified to the contract prior to the buyer's breach, likewise contemplates an anticipatory repudiation by the buyer but occurring after the goods are in existence. If the goods so identified conform to the contract, their resale will fix the seller's damages quite as satisfactorily as if they had been identified before the breach.

8. Where the resale is to be by private sale, subsection (3) requires that reasonable notification of the seller's intention to resell must be given to the buyer. The length of notification of a private sale depends upon the urgency of the matter. Notification of the time and place of this type of sale is not required.

Subsection (4)(b) requires that the seller give the buyer reasonable notice of the time and place of a public resale so that he may have an opportunity to bid or to

secure the attendance of other bidders. An exception is made in the case of goods "which are perishable or threaten to decline speedily in value."

9. Since there would be no reasonable prospect of competitive bidding elsewhere, subsection (4) requires that a public resale "must be made at a usual place or market for public sale if one is reasonably available;" i. e., a place or market which prospective bidders may reasonably be expected to attend. Such a market may still be "reasonably available" under this subsection, though at a considerable distance from the place where the goods are located. In such a case the expense of transporting the goods for resale is recoverable from the buyer as part of the seller's incidental damages under subsection (1). However, the question of availability is one of commercial reasonableness in the circumstances and if such "usual" place or market is not reasonably available, a duly advertised public resale may be held at another place if it is one which prospective bidders may reasonably be expected to attend, as distinguished from a place where there is no demand whatsoever for goods of the kind.

Paragraph (a) of subsection (4) qualifies the last sentence of subsection (2) with respect to resales of unidentified and future goods at public sale. If conforming goods are in existence the seller may identify them to the contract after the buyer's breach and then resell them at public sale. If the goods have not been identified, however, he may resell them at public sale only as "future" goods and only where there is a recognized market for public sale of futures in goods of the kind. The provisions of paragraph (c) of subsection (4) are intended to permit intelligent bidding.

The provision of paragraph (d) of subsection (4) permitting the seller to bid and, of course, to become the purchaser, benefits the original buyer by tending to increase the resale price and thus decreasing the damages he will have to pay.

10. This Article departs in subsection (5) from the prior uniform statutory provision in permitting a good faith purchaser at resale to take a good title as against the buyer even though the seller fails to comply with the requirements of this section.

11. Under subsection (6), the seller retains profit, if any, without distinction based on whether or not he had a lien since this Article divorces the question of passage of title to the buyer from the seller's right of resale or the consequences of its exercise. On the other hand, where "a person in the position of a seller" or a buyer acting under the section on buyer's remedies, exercises his right of resale under the present section he does so only for the limited purpose of obtaining cash for his "security interest" in the goods. Once that purpose has been accomplished any excess in the resale price belongs to the seller to whom an accounting must be made as provided in the last sentence of subsection (6).

Cross References:

Point 1: §§ 2-610, 2-702 and 2-703.
Point 2: § 1-201.
Point 3: §§ 2-708 and 2-710.
Point 4: § 2-328.
Point 8: § 2-104.
Point 9: § 2-710.
Point 11: §§ 2-401, 2-707 and 2-711(3).

Definitional Cross References:

"Buyer". § 2-103.
"Contract". § 1-201.
"Contract for sale". § 2-106.
"Good faith". § 2-103.
"Goods". § 2-105.
"Merchant". § 2-104.
"Notification". § 1-201.
"Person in position of seller". § 2-707.
"Purchase". § 1-201.
"Rights". § 1-201.
"Sale". § 2-106.
"Security interest". § 1-201.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: This section is in accord with Virginia law in allowing the seller to re-

sell goods that the buyer has refused to accept and to collect damages from the buyer. John H. Maclin Peanut Co., Inc. v. Pretlow and Co., 176 Va. 400, 11 S.E.2d 607 (1940); Rosenbaums v. Weeden, Johnson & Co., 49 Va. (18 Gratt.) 785, 790 (1868). Such a resale must be made in good faith, which according to Baker-Matthews Lumber Co. v. Lincoln Furniture Manufacturing Co., Inc., 148 Va. 413, 423, 139 S.E. 254 (1927), is because the seller is acting as an agent of the buyer in making the resale. See also Rosenbaums v. Weeden, Johnson & Co., 49 Va. (18 Gratt.) 785, 793 (1868). This rationale is rejected by the UCC in Comment, Point 2.

If the resale is made in a commercially reasonable manner the seller may recover under both the UCC and Virginia law the difference between the resale price and the contract price, plus incidental damages, but less expenses saved in consequence of the breach. Mayflower Mills v. Hardy, 138 Va. 134, 147-48, 120 S.E. 861 (1924).

According to the Comment, Point 5, the requirement that the resale be commercially reasonable includes a requirement that the resale be within a reasonable time after the buyer's breach. Mayflower Mills v. Hardy, 138 Va. 138, 147, 120 S.E. 861 (1924), treated resale within a reasonable time as a separate and distinct requirement.

Both the UCC and Virginia cases require the seller to give notice to the buyer that he is going to make a resale. In Rosenbaums v. Weeden, Johnson & Co., 49 Va. (18 Gratt.) 785, 793 (1868), the court said, "If the vendor elects to sell the goods and hold the vendee liable for the loss, he ought, of course, to notify the vendee that such is his election, in order that the vendee may know what the consequences of his continued default may be, and may, if he can and chooses to do so, avert it by performing his contract and receiving the goods; or at least may endeavor to mitigate his loss by paying some attention to the resale of the goods." The notice, under both the UCC and the Virginia cases, is of an intention to resell and bind the buyer as to the price obtained, and not notice of the sale itself. Walker v. Gateway Milling Co., 121 Va. 217, 228, 92 S.E. 826 (1917); American Hide & Leather Co. v. Chalkley & Co., 101 Va. 458, 463, 44 S.E. 705 (1903).

§ 2-707. "Person in the Position of a Seller". (1) A "person in the position of a seller" includes as against a principal an agent who has paid or become responsible for the price of goods on behalf of his principal or anyone who otherwise holds a security interest or other right in goods similar to that of a seller.

(2) A person in the position of a seller may as provided in this Article withhold or stop delivery (§ 2-705) and resell (§ 2-706) and recover incidental damages (§ 2-710).

COMMENT: Prior Uniform Statutory Provision: § 52(2), Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To make it clear that:

In addition to following in general the prior uniform statutory provision, the case of a financing agency which has acquired documents by honoring a letter of credit for the buyer or by discounting a draft for the seller has been included in the term "a person in the position of a seller."

Cross Reference:

Article 5, § 2-506.

Definitional Cross References:

"Consignee". § 7-102.
"Consignor". § 7-102.
"Goods". § 2-105.
"Security interest". § 1-201.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-708. Seller's Damages for Non-acceptance or Repudiation. (1) Subject to subsection (2) and to the provisions of this Article with respect

to proof of market price (§ 2-723), the measure of damages for non-acceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price together with any incidental damages provided in this Article (§ 2-710), but less expenses saved in consequence of the buyer's breach.

(2) If the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this Article (§ 2-710), due allowance for costs reasonably incurred and due credit for payments or proceeds of resale.

COMMENT: **Prior Uniform Statutory Provision:** § 64, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To make it clear that:

1. The prior uniform statutory provision is followed generally in setting the current market price at the time and place for tender as the standard by which damages for non-acceptance are to be determined. The time and place of tender is determined by reference to the section on manner of tender of delivery, and to the sections on the effect of such terms as FOB, FAS, CIF, C & F, Ex Ship and No Arrival, No Sale.

In the event that there is no evidence available of the current market price at the time and place of tender, proof of a substitute market may be made under the section on determination and proof of market price. Furthermore, the section on the admissibility of market quotations is intended to ease materially the problem of providing competent evidence.

2. The provision of this section permitting recovery of expected profit including reasonable overhead where the standard measure of damages is inadequate, together with the new requirement that price actions may be sustained only where resale is impractical, are designed to eliminate the unfair and economically wasteful results arising under the older law when fixed price articles were involved. This section permits the recovery of lost profits in all appropriate cases, which would include all standard priced goods. The normal measure there would be list price less cost to the dealer or list price less manufacturing cost to the manufacturer. It is not necessary to a recovery of "profit" to show a history of earnings, especially if a new venture is involved.

3. In all cases the seller may recover incidental damages.

Cross References:

Point 1: §§ 2-319 through 2-324, 2-503, 2-722 and 2-724.
Point 2: § 2-709.
Point 3: § 2-710.

Definitional Cross References:

"Buyer". § 2-103.
"Contract". § 1-201.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Virginia cases are in accord with subsection 2-708(1) in allowing the seller to retain the goods and maintain an action for damages, measured by the difference between the contract price and the market price, at the time and place of tender, plus incidental damages incurred, and less any expenses the seller is saved by the breach. Sanitary Grocery Co. v. Wright, 158 Va. 312, 321-23, 163 S.E. 86 (1932); Frank v. East Carolina Lumber Co., 153 Va. 649, 151 S.E. 135

(1930) (no breach found); Wessel, Duval & Co. v. Crozet Cooperage Co., 143 Va. 469, 477, 130 S.E. 393 (1925); J. B. Colt Co. v. Elam, 138 Va. 124, 131, 120 S.E. 857 (1924) (seller failed to prove any damages); James River Lumber Co., Inc. v. Smith Bros., 135 Va. 406, 415-16, 116 S.E. 421 (1923); McCormick & Co. v. Hamilton Wood & Co., 64 Va. (23 Gratt.) 561, 577-78 (1873); Rosenbaums v. Weeden, Johnson & Co., 59 Va. (18 Gratt.) 785, 790 (1868), Note, 8 Va. L. Rev. 393 (1922); Yellow Poplar Lumber Co. v. Chapman, 74 Fed. 444, 454-56 (4th Cir. 1896). Virginia has not specifically made an award of incidental damages, as expressly authorized by the UCC.

If this measure of damages, that is, the contract price less the market price is inadequate, then subsection 2-708(2) provides that the measure of damages shall be the profit lost. Virginia has also recognized that when the goods have not yet been manufactured, the measure of damages is either the profit lost or the contract price less the cost of manufacturing and delivery. A "profits lost" rule was applied in A.I.M. Percolating Corp. v. Ferrodine Chemical Corp., 139 Va. 366, 378-79, 124 S.E. 442 (1924). A "contract price less cost of manufacturing and delivery" rule was applied in the following cases: Tidewater Plumbing Supply Co., Inc. v. Emory Foundry Co., 141 Va. 363, 368-69, 127 S.E. 87 (1925); Norfolk Hosiery and Underwear Mills v. Aetna Hosiery Co., 124 Va. 221, 239-41, 98 S.E. 43 (1919); Duke v. Norfolk and Western Railway Co., 106 Va. 152, 156-59, 55 S.E. 548 (1906); Worrell & Williams v. Kinnear Manufacturing Co., 103 Va. 719, 722, 49 S.E. 988 (1905); Alleghany Iron Co. v. Teaford, 96 Va. 372, 377-80, 31 S.E. 525 (1898).

§ 2-709. **Action for the Price.** (1) When the buyer fails to pay the price as it becomes due the seller may recover, together with any incidental damages under the next section, the price

(a) of goods accepted or of conforming goods lost or damaged within a commercially reasonable time after risk of their loss has passed to the buyer; and

(b) of goods identified to the contract if the seller is unable after reasonable effort to resell them at a reasonable price or the circumstances reasonably indicate that such effort will be unavailing.

(2) Where the seller sues for the price he must hold for the buyer any goods which have been identified to the contract and are still in his control except that if resale becomes possible he may resell them at any time prior to the collection of the judgment. The net proceeds of any such resale must be credited to the buyer and payment of the judgment entitles him to any goods not resold.

(3) After the buyer has wrongfully rejected or revoked acceptance of the goods or has failed to make a payment due or has repudiated (§ 2-610), a seller who is held not entitled to the price under this section shall nevertheless be awarded damages for non-acceptance under the preceding section.

COMMENT: Prior Uniform Statutory Provision: § 63, Uniform Sales Act.

Changes: Rewritten, important commercially needed changes being incorporated.

Purposes of Changes: To make it clear that:

1. Neither the passing of title to the goods nor the appointment of a day certain for payment is now material to a price action.

2. The action for the price is now generally limited to those cases where resale of the goods is impracticable except where the buyer has accepted the goods or where they have been destroyed after risk of loss has passed to the buyer.

3. This section substitutes an objective test by action for the former "not readily resalable" standard. An action for the price under subsection (1)(b) can be sustained only after a "reasonable effort to resell" the goods "at reasonable price" has actually been made or where the circumstances "reasonably indicate" that such an effort will be unavailing.

4. If a buyer is in default not with respect to the price, but on an obligation to make an advance, the seller should recover not under this section for the price as such, but for the default in the collateral (though coincident) obligation to finance the seller. If the agreement between the parties contemplates that the buyer will acquire, on making the advance, a security interest in the goods, the buyer on making the advance has such an interest as soon as the seller has rights in the agreed collateral. See § 9-204.

5. "Goods accepted" by the buyer under subsection (1)(a) include only goods as to which there has been no justified revocation of acceptance, for such a revocation means that there has been a default by the seller which bars his rights under this section. "Goods lost or damaged" are covered by the section on risk of loss. "Goods identified to the contract" under subsection (1)(b) are covered by the section on identification and the section on identification notwithstanding breach.

6. This section is intended to be exhaustive in its enumeration of cases where an action for the price lies.

7. If the action for the price fails, the seller may nonetheless have proved a case entitling him to damages for non-acceptance. In such a situation, subsection (3) permits recovery of those damages in the same action.

Cross References:

Point 4: § 1-106.
Point 5: §§ 2-501, 2-509, 2-510 and 2-704.
Point 7: § 2-708.

Definitional Cross References:

"Action". § 1-201.
"Buyer". § 2-103.
"Conforming". § 2-106.
"Contract". § 1-201.
"Goods". § 2-105.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Under Virginia law the location of the title has been determinative of the remedy available, so that an action for the price could only be maintained where title had passed to the buyer. Montauk Ice Cream Co. v. Daigger Co., 141 Va. 686, 695-705, 126 S.E. 681 (1925); J. B. Colt Co. v. Elam, 138 Va. 124, 131, 120 S.E. 857 (1924). The Montauk case distinguished earlier cases in which there had been some indications that an action for the price could be maintained even though title had not passed at the time of the buyer's breach. See James River Lumber Co., Inc. v. Smith Bros., 135 Va. 406, 416, 116 S.E. 241 (1923); Rosenbaums v. Weeden, Johnson & Co., 59 Va. (18 Gratt.) 785, 790 (1868).

Where the buyer has accepted the goods, under Virginia law title has passed and the seller may maintain an action for the price. Morton Marks and Sons, Inc. v. Hill-Chase Steel Co. of Maryland, 196 Va. 268, 272-74, 83 S.E.2d 356 (1954); Birdsong & Co. v. American Peanut Co., 149 Va. 755, 767-68, 141 S.E. 759 (1928); Travers v. Teese, 148 Va. 378, 138 S.E. 494 (1927) (nothing due from buyer to seller); Geoghegan Sons & Co., Inc. v. Arbuckle Bros., 139 Va. 92, 112-13, 123 S.E. 387, 36 A.L.R. 399 (1924); Pleasants v. Pendleton, 27 Va. (6 Rand.) 473, 502, 506 (1828).

§ 2-710. Seller's Incidental Damages. Incidental damages to an aggrieved seller include any commercially reasonable charges, expenses or commissions incurred in stopping delivery, in the transportation, care and custody of goods after the buyer's breach, in connection with return or resale of the goods or otherwise resulting from the breach.

COMMENT: **Prior Uniform Statutory Provision:** See §§ 64 and 70, Uniform Sales Act.

Purposes: To authorize reimbursement of the seller for expenses reasonably incurred by him as a result of the buyer's breach. The section sets forth the prin-

cipal normal and necessary additional elements of damage flowing from the breach but intends to allow all commercially reasonable expenditures made by the seller.

Definitional Cross References:

"Aggrieved party". § 1-201.
"Buyer". § 2-103.
"Goods". § 2-105.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: While it would appear that Virginia recognizes that the seller is entitled to incidental damages, as under the UCC, the subject has not been explicitly discussed in the Virginia cases.

§ 2-711. Buyer's Remedies in General; Buyer's Security Interest in Rejected Goods. (1) Where the seller fails to make delivery or repudiates or the buyer rightfully rejects or justifiably revokes acceptance then with respect to any goods involved, and with respect to the whole if the breach goes to the whole contract (§ 2-612), the buyer may cancel and whether or not he has done so may in addition to recovering so much of the price as has been paid

(a) "cover" and have damages under the next section as to all the goods affected whether or not they have been identified to the contract; or

(b) recover damages for non-delivery as provided in this Article (§ 2-713).

(2) Where the seller fails to deliver or repudiates the buyer may also

(a) if the goods have been identified recover them as provided in this Article (§ 2-502); or

(b) in a proper case obtain specific performance or replevy the goods as provided in this Article (§ 2-716).

(3) On rightful rejection or justifiable revocation of acceptance a buyer has a security interest in goods in his possession or control for any payments made on their price and any expenses reasonably incurred in their inspection, receipt, transportation, care and custody and may hold such goods and resell them in like manner as an aggrieved seller (§ 2-706).

COMMENT: Prior Uniform Statutory Provision: No comparable index section; Subsection (3)—§ 69(5), Uniform Sales Act.

Changes: The prior uniform statutory provision is generally continued and expanded in Subsection (3).

Purposes of Changes and New Matter: 1. To index in this section the buyer's remedies, subsection (1) covering those remedies permitting the recovery of money damages, and subsection (2) covering those which permit reaching the goods themselves. The remedies listed here are those those available to a buyer who has not accepted the goods or who has justifiably revoked his acceptance. The remedies available to a buyer with regard to goods finally accepted appear in the section dealing with breach in regard to accepted goods. The buyer's right to proceed as to all goods when the breach is as to only some of the goods is determined by the section on breach in installment contracts and by the section on partial acceptance.

Despite the seller's breach, proper retender of delivery under the section on cure of improper tender or replacement can effectively preclude the buyer's remedies under this section, except for any delay involved.

2. To make it clear in subsection (3) that the buyer may hold and resell rejected goods if he has paid a part of the price or incurred expenses of the type specified. "Paid" as used here includes acceptance of a draft or other time negotiable instrument or the signing of a negotiable note. His freedom of resale is coextensive with that of a seller under this Article except that the buyer may not keep any profit resulting from the resale and is limited to retaining only the amount of the price paid and the costs involved in the inspection and handling of the goods. The buyer's security interest in the goods is intended to be limited to the items listed in subsection (3), and the buyer is not permitted to retain such funds as he might believe adequate for his damages. The buyer's right to cover, or to have damages for non-delivery, is not impaired by his exercise of his right of resale.

3. It should also be noted that this Act requires its remedies to be liberally administered and provides that any right or obligation which it declares is enforceable by action unless a different effect is specifically prescribed (§ 1-106).

Cross References:

Point 1: §§ 2-508, 2-601(c), 2-608, 2-612 and 2-714.
Point 2: § 2-706.
Point 3: § 1-106.

Definitional Cross References:

"Aggrieved party". § 1-201.
"Buyer". § 2-103.
"Cancellation". § 2-106.
"Contract". § 1-201.
"Cover". § 2-712.
"Goods". § 2-105.
"Notifies". § 1-201.
"Receipt of goods". § 2-103.
"Remedy". § 1-201.
"Security interest". § 1-201.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: For a comment on the buyer's remedies under the UCC as compared with the remedies under Virginia law, see Sharp, Buyer's Remedies and Article 2, 20 Wash. & Lee L. Rev. (Fall 1963).

The right of the buyer to rescind for breach of warranty was recognized in Jacobs v. Warthen, 115 Va. 571, 574-75, 80 S.E. 113 (1913). The UCC does not have any provision covering the situation in Berlin v. McCall Co., 161 Va. 967, 172 S.E. 153 (1934), in which the buyer contended that the seller agreed to pay the buyer for goods returned.

§ 2-712. "Cover"; Buyer's Procurement of Substitute Goods. (1) After a breach within the preceding section the buyer may "cover" by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller.

(2) The buyer may recover from the seller as damages the difference between the cost of cover and the contract price together with any incidental or consequential damages as hereinafter defined (§ 2-715), but less expenses saved in consequence of the seller's breach.

(3) Failure of the buyer to effect cover within this section does not bar him from any other remedy.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. This section provides the buyer with a remedy aimed at enabling him to obtain the goods he needs thus meeting his essential need. This remedy is the buyer's equivalent of the seller's right to resell.

2. The definition of "cover" under subsection (1) envisages a series of contracts or sales, as well as a single contract or sale; goods not identical with those involved but commercially usable as reasonable substitutes under the circumstances of the particular case; and contracts on credit or delivery terms differing from the contract in breach, but again reasonable under the circumstances. The test of proper cover is whether at the time and place the buyer acted in good faith and in a reasonable manner, and it is immaterial that hindsight may later prove that the method of cover used was not the cheapest or most effective.

The requirement that the buyer must cover "without unreasonable delay" is not intended to limit the time necessary for him to look around and decide as to how he may best effect cover. The test here is similar to that generally used in this Article as to reasonable time and seasonable action.

3. Subsection (3) expresses the policy that cover is not a mandatory remedy for the buyer. The buyer is always free to choose between cover and damages for non-delivery under the next section.

However, this subsection must be read in conjunction with the section which limits the recovery of consequential damages to such as could not have been obviated by cover. Moreover, the operation of the section on specific performance of contracts for "unique" goods must be considered in this connection for availability of the goods to the particular buyer for his particular needs is the test for that remedy and inability to cover is made an express condition to the right of the buyer to replevy the goods.

4. This section does not limit cover to merchants, in the first instance. It is the vital and important remedy for the consumer buyer as well. Both are free to use cover: the domestic or non-merchant consumer is required only to act in normal good faith while the merchant buyer must also observe all reasonable commercial standards of fair dealing in the trade, since this falls within the definition of good faith on his part.

Cross References:

Point 1: § 2-706.
Point 2: § 1-204.
Point 3: §§ 2-713, 2-715 and 2-716.
Point 4: § 1-203.

Definitional Cross References:

"Buyer". § 2-103.
"Contract". § 1-201.
"Good faith". § 2-103.
"Goods". § 2-105.
"Purchase". § 1-201.
"Remedy". § 1-201.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: This section is in accord with Virginia law in authorizing a buyer, upon learning of a seller's default in delivery, to use reasonable diligence to cover by the purchase of substitute goods, measuring his damages by the difference between the contract price and the cost of the substitute goods, plus incidental damages and less any expenses saved. Goldstein v. Old Dominion Peanut Corp., 177 Va. 716, 725, 15 S.E.2d 103 (1941); C. G. Blake Co., Inc. v. W. R. Smith and Son, Ltd., 147 Va. 960, 982-84, 133 S.E. 685 (1926); Hopkins v. LeCato, 142 Va. 769, 783-84, 128 S.E. 347 (1925); Manor v. Hindman, 123 Va. 767, 775, 97 S.E. 332, 334 (1918); Richardson Construction Co. v. Whiting Lumber Co., 116 Va. 490, 491-92, 82 S.E. 87 (1914); Long Pole Lumber Co. v. Saxon Lime and Lumber Co., 108 Va. 497, 499-500, 62 S.E. 349 (1908); O. H. Perry Tie & Lumber Co. v. Reynolds & Bros., 100 Va. 264, 269-74, 40 S.E. 919 (1902). Under both the UCC and Virginia law, as long as the buyer acts reasonably and in good faith, proof that his method of obtaining cover was not the cheapest or best will not defeat his action for damages. In Triplett v. Nichols, 139 Va. 321, 329-30, 123 S.E. 339 (1924), it was recognized that a buyer acted reasonably when he bought steel articles costing $1,509, plus $76 freight, as cover for timber, having a contract price of $467, which was unavailable.

§ 2-713. **Buyer's Damages for Non-Delivery or Repudiation.** (1) Subject to the provisions of this Article with respect to proof of market price (§ 2-723), the measure of damages for non-delivery or repudiation by the seller is the difference between the market price at the time when the buyer learned of the breach and the contract price together with any incidental and consequential damages provided in this Article (§ 2-715), but less expenses saved in consequence of the seller's breach.

(2) Market price is to be determined as of the place for tender or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival.

COMMENT: **Prior Uniform Statutory Provision:** § 67(3), Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To clarify the former rule so that:

1. The general baseline adopted in this section uses as a yardstick the market in which the buyer would have obtained cover had he sought that relief. So the place for measuring damages is the place of tender (or the place of arrival if the goods are rejected or their acceptance is revoked after reaching their destination) and the crucial time is the time at which the buyer learns of the breach.

2. The market or current price to be used in comparison with the contract price under this section is the price for goods of the same kind and in the same branch of trade.

3. When the current market price under this section is difficult to prove the section on determination and proof of market price is available to permit a showing of a comparable market price or, where no market price is available, evidence of spot sale prices is proper. Where the unavailability of a market price is caused by a scarcity of goods of the type involved, a good case is normally made for specific performance under this Article. Such scarcity conditions, moreover, indicate that the price has risen and under the section providing for liberal administration of remedies, opinion evidence as to the value of the goods would be admissible in the absence of a market price and a liberal construction of allowable consequential damages should also result.

4. This section carries forward the standard rule that the buyer must deduct from his damages any expenses saved as a result of the breach.

5. The present section provides a remedy which is completely alternative to cover under the preceding section and applies only when and to the extent that the buyer has not covered.

Cross References:

Point 3: §§ 1-106, 2-716 and 2-723.
Point 5: § 2-712.

Definitional Cross References:

"Buyer". § 2-103.
"Contract". § 1-201.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: The Virginia cases are in accord with subsection 2-713(1). Sun Co. v. Burruss, 139 Va. 279, 286-87, 123 S.E. 347 (1924); Richmond Leather Manufacturing Co. v. Fawcett, 130 Va. 484, 490-91, 107 S.E. 800 (1921); Nottingham Coal & Ice Co. v. Preas, 102 Va. 820, 822-23, 47 S.E. 823 (1904); Trigg v. Clay, 88 Va. 330, 332-36, 13 S.E. 434 (1891).

Under subsection 2-713(2) it is not clear where "the place for tender" is when a seller is required to ship the goods to the buyer, but not required to deliver them at destination. See UCC §§ 2-503, 2-504. Under Sun Co. v. Burruss, 139 Va. 279, 286-87, 123 S.E. 347 (1924), the market price is determined at the place of destina-

tion, even though the "delivery point" is the place of shipment. See also VIRGINIA ANNOTATIONS to UCC 2-723 for comment on Nottingham Coal & Ice Co. v. Preas, 120 Va. 820, 823, 47 S.E. 823 (1904).

§ 2-714. Buyer's Damages for Breach in Regard to Accepted Goods. (1) Where the buyer has accepted goods and given notification (subsection (3) of § 2-607) he may recover as damages for any non-conformity of tender the loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable.

(2) The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount.

(3) In a proper case any incidental and consequential damages under the next section may also be recovered.

COMMENT: **Prior Uniform Statutory Provision:** § 69(6) and (7), Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: 1. This section deals with the remedies available to the buyer after the goods have been accepted and the time for revocation of acceptance has gone by. In general this section adopts the rule of the prior uniform statutory provision for measuring damages where there has been a breach of warranty as to goods accepted, but goes further to lay down an explicit provision as to the time and place for determining the loss.

The section on deduction of damages from price provides an additional remedy for a buyer who still owes part of the purchase price, and frequently the two remedies will be available concurrently. The buyer's failure to notify of his claim under the section on effects of acceptance, however, operates to bar his remedies under either that section or the present section.

2. The "non-conformity" referred to in subsection (1) includes not only breaches of warranties but also any failure of the seller to perform according to his obligations under the contract. In the case of such non-conformity, the buyer is permitted to recover for his loss "in any manner which is reasonable."

3. Subsection (2) describes the usual, standard and reasonable method of ascertaining damages in the case of breach of warranty but it is not intended as an exclusive measure. It departs from the measure of damages for non-delivery in utilizing the place of acceptance rather than the place of tender. In some cases the two may coincide, as where the buyer signifies his acceptance upon the tender. If, however, the non-conformity is such as would justify revocation of acceptance, the time and place of acceptance under this section is determined as of the buyer's decision not to revoke.

4. The incidental and consequential damages referred to in subsection (3), which will usually accompany an action brought under this section, are discussed in detail in the comment on the next section.

Cross References:

Point 1: Compare § 2-711; §§ 2-607 and 2-717.
Point 2: § 2-106.
Point 3: §§ 2-608 and 2-713.
Point 4: § 2-715.

Definitional Cross References:

"Buyer". § 2-103.
"Conform". § 2-106.
"Goods". § 1-201.
"Notification". § 1-201.
"Seller". § 2-103.

Prior Statutes: None.

Comment: The section is in accord with Virginia law. Smith v. Hensley, 202 Va. 700, 705, 119 S.E.2d 332 (1961); E. I. duPont de Nemours & Co. v. Universal Moulded Products Corp., 191 Va. 525, 569-81, 62 S.E.2d 233 (1950); Greenland Development Corp. v. Allied Heating Products Co., Inc., 184 Va. 538, 600-01, 35 S.E.2d 801, 164 A.L.R. 1312 (1945), Note, 32 Va. L. Rev. 679 (1946); Newbern v. Joseph Baker & Co., Inc., 147 Va. 996, 1001-02, 133 S.E. 500 (1926); Southern Tire Sales Corp. v. A. M. Dudley & Co., 138 Va. 582, 587-89, 121 S.E. 885 (1924); Jacobs v. Warthen, 115 Va. 571, 575, 80 S.E. 113 (1913); Thornton v. Thompson, 45 Va. (4 Gratt.) 121 (1847).

§ 2-715. Buyer's Incidental and Consequential Damages. (1) Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach.

(2) Consequential damages resulting from the seller's breach include

(a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and

(b) injury to person or property proximately resulting from any breach of warranty.

COMMENT: Prior Uniform Statutory Provisions: Subsection (2)(b)—§§ 69(7) and 70, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes and New Matter: 1. Subsection (1) is intended to provide reimbursement for the buyer who incurs reasonable expenses in connection with the handling of rightfully rejected goods or goods whose acceptance may be justifiably revoked, or in connection with effecting cover where the breach of the contract lies in non-conformity or non-delivery of the goods. The incidental damages listed are not intended to be exhaustive but are merely illustrative of the typical kinds of incidental damage.

2. Subsection (2) operates to allow the buyer, in an appropriate case, any consequential damages which are the result of the seller's breach. The "tacit agreement" test for the recovery of consequential damages is rejected. Although the older rule at common law which made the seller liable for all consequential damages of which he had "reason to know" in advance is followed, the liberality of that rule is modified by refusing to permit recovery unless the buyer could not reasonably have prevented the loss by cover or otherwise. Subparagraph (2) carries forward the provisions of the prior uniform statutory provision as to consequential damages resulting from breach of warranty, but modifies the rule by requiring first that the buyer attempt to minimize his damages in good faith, either by cover or otherwise.

3. In the absence of excuse under the section on merchant's excuse by failure of presupposed conditions, the seller is liable for consequential damages in all cases where he had reason to know of the buyer's general or particular requirements at the time of contracting. It is not necessary that there be a conscious acceptance of an insurer's liability on the seller's part, nor is his obligation for consequential damages limited to cases in which he fails to use due effort in good faith.

Particular needs of the buyer must generally be made known to the seller while general needs must rarely be made known to charge the seller with knowledge.

Any seller who does not wish to take the risk of consequential damages has available the section on contractual limitation of remedy.

4. The burden of proving the extent of loss incurred by way of consequential damage is on the buyer, but the section on liberal administration of remedies

rejects any doctrine of certainty which requires almost mathematical precision in the proof of loss. Loss may be determined in any manner which is reasonable under the circumstances.

5. Subsection (2)(b) states the usual rule as to breach of warranty, allowing recovery for injuries "proximately" resulting from the breach. Where the injury involved follows the use of goods without discovery of the defect causing the damage, the question of "proximate" cause turns on whether it was reasonable for the buyer to use the goods without such inspection as would have revealed the defects. If it was not reasonable for him to do so, or if he did in fact discover the defect prior to his use, the injury would not proximately result from the breach of warranty.

6. In the case of sale of wares to one in the business of reselling them, resale is one of the requirements of which the seller has reason to know within the meaning of subsection (2)(a).

Cross References:

Point 1: § 2-608.
Point 3: §§ 1-203, 2-615 and 2-719.
Point 4: § 1-106.

Definitional Cross References:

"Cover". § 2-712.
"Goods". § 1-201.
"Person". § 1-201.
"Receipt of goods". § 2-103.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Virginia law is in accord with this section in recognizing the buyer's right to incidental and consequential damages. In O. H. Perry Tie & Lumber Co. v. Reynolds & Bros., 100 Va. 264, 268-74, 40 S.E. 919 (1902), the seller had delayed in making delivery and the buyer was allowed damages for demurrage, for damages paid to a subvendee, and for profits. Bristol Belt Line Railway Co. v. Bullock Electric Manufacturing Co., 101 Va. 652, 656-57, 44 S.E. 892 (1903), allowed the recovery of profits in the contemplation of the parties that were the natural result of the seller's breach in making delayed delivery of goods, and which could be proved with reasonable certainty. A recovery of profits was also allowed in the following cases: Shenandoah Milling Co., Inc. v. Phosphate Products Corp., 161 Va. 642, 649-50, 171 S.E. 681 (1933); Newbern v. Baker, 147 Va. 996, 1001-02, 133 S.E. 500 (1926); Arkla Lumber and Manufacturing Co. v. West Virginia Timber Co., 146 Va. 641, 652, 132 S.E. 840 (1926); New Idea Spreader Co. v. R. M. Rogers & Sons, 122 Va. 54, 66-68, 94 S.E. 351 (1917); Consumers Ice Co. v. Jennings, 100 Va. 719, 725, 42 S.E. 879 (1902); Trigg v. Clay, 88 Va. 330, 333-36, 13 S.E. 434 (1891).

While the general rule of damages for breach of warranty of tires is the difference between the actual value of the tires when delivered and the value which they would have had, if as warranted, Southern Tire Sales Corp. v. A. M. Dudley & Co., 138 Va. 582, 587-89, 121 S.E. 885 (1924), allowed the buyer to recover for loss of time in use of a truck and for labor expended on account of defective tires. In Gerst v. Jones & Co., 73 Va. (32 Gratt.) 518, 526-27 (1879), a buyer recovered special damages for tobacco damaged because of a breach of warranty as to boxes supplied by the seller. The same results would be reached under the UCC which allows damages on account of injuries proximately resulting from a breach of warranty. However, consequential damages are not recoverable for items that are uncertain, exaggerated, and fantastic. Mount Rogers Furniture Co. v. Virginia Mirror Co., 155 Va. 201, 204-09, 154 S.E. 600 (1930). And consequential damages are not recoverable for a loss that could easily be avoided, as for the value of a potato crop that was not raised, the buyer having planted half-rotten potatoes, warranted to be first class. Moon v. Washington-Beaufort Land Co., 147 Va. 912, 917-18, 133 S.E. 498 (1926).

In accord with the UCC, Virginia assumed in Cody v. Norton Coal Co., 110 Va. 363, 366, 66 S.E. 33 (1909), that consequential damages were recoverable for an injury to the person proximately resulting from a breach of warranty, but only

if the article purchased was used in a reasonably careful and proper manner, and the damages sustained might not have been reasonably anticipated.

See also Washington and Old Dominion Railway v. Westinghouse Electric and Manufacturing Co., 120 Va. 620, 627-36, 89 S.E. 131 (1916), for a discussion of consequential damages.

§ 2-716. Buyer's Right to Specific Performance or Replevin. (1) Specific performance may be decreed where the goods are unique or in other proper circumstances.

(2) The decree for specific performance may include such terms and conditions as to payment of the price, damages, or other relief as the court may deem just.

(3) The buyer has a right of replevin for goods identified to the contract if after reasonable effort he is unable to effect cover for such goods or the circumstances reasonably indicate that such effort will be unavailing or if the goods have been shipped under reservation and satisfaction of the security interest in them has been made or tendered.

COMMENT: **Prior Uniform Statutory Provision:** § 68, Uniform Sales Act.

Changes: Rephrased.

Purposes of Changes: To make it clear that:

1. The present section continues in general prior policy as to specific performance and injunction against breach. However, without intending to impair in any way the exercise of the court's sound discretion in the matter, this Article seeks to further a more liberal attitude than some courts have shown in connection with the specific performance of contracts of sale.

2. In view of this Article's emphasis on the commercial feasibility of replacement, a new concept of what are "unique" goods is introduced under this section. Specific performance is no longer limited to goods which are already specific or ascertained at the time of contracting. The test of uniqueness under this section must be made in terms of the total situation which characterizes the contract. Output and requirements contracts involving a particular or peculiarly available source or market present today the typical commercial specific performance situation, as contrasted with contracts for the sale of heirlooms or priceless works of art which were usually involved in the older cases. However, uniqueness is not the sole basis of the remedy under this section for the relief may also be granted "in other proper circumstances" and inability to cover is strong evidence of "other proper circumstances".

3. The legal remedy of replevin is given the buyer in cases in which cover is reasonably unavailable and goods have been identified to the contract. This is in addition to the buyer's right to recover identified goods on the seller's insolvency (§ 2-502).

4. This section is intended to give the buyer rights to the goods comparable to the seller's rights to the price.

5. If a negotiable document of title is outstanding, the buyer's right of replevin relates of course to the document not directly to the goods. See Article 7, especially § 7-602.

Cross References:

Point 3: § 2-502.
Point 4: § 2-709.
Point 5: Article 7.

Definitional Cross References:

"Buyer". § 2-103.
"Goods". § 1-201.
"Rights". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 8-647.

Comment: Virginia has recognized in dictum that a buyer who has tendered the purchase money for goods and made a demand is entitled to maintain detinue or trover if he is refused. Chapman v. Campbell, 54 Va. (13 Gratt.) 105, 110 (1856). On refusal to deliver, the seller having made a subsequent sale to a second buyer, the first buyer may maintain an action for damages against the seller. Sweeney v. Foster, 112 Va. 499, 503, 71 S.E. 548 (1911).

While the UCC does not refer to the rights of marketing cooperatives with reference to crops grown by their members, the section would seem to be in accord with Layne v. Tobacco Growers Co-operative Association, 147 Va. 878, 881-82, 133 S.E. 358 (1926), which recognized that an injunction might issue in a proper case to restrain a grower from disposing of tobacco in violation of a contract.

The section recognizes the acts of replevin, a form of action abolished in Virginia by Code 1950, § 8-647.

§ 2-717. Deduction of Damages From the Price. The buyer on notifying the seller of his intention to do so may deduct all or any part of the damages resulting from any breach of the contract from any part of the price still due under the same contract.

COMMENT: **Prior Uniform Statutory Provision:** See § 69(1) (a), Uniform Sales Act.

Purposes: 1. This section permits the buyer to deduct from the price damages resulting from any breach by the seller and does not limit the relief to cases of breach of warranty as did the prior uniform statutory provision. To bring this provision into application the breach involved must be of the same contract under which the price in question is claimed to have been earned.

2. The buyer, however, must give notice of his intention to withhold all or part of the price if he wishes to avoid a default within the meaning of the section on insecurity and right to assurances. In conformity with the general policies of this Article, no formality of notice is required and any language which reasonably indicates the buyer's reason for holding up his payment is sufficient.

Cross Reference:

Point 2: § 2-609.

Definitional Cross References:

"Buyer". § 2-103.
"Notifies". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: The UCC is in accord with Virginia law in allowing the buyer to deduct damages for a breach from any part of the price still due to the seller. Dester-Portland Cement Co. v. Acme Supply Co., 147 Va. 758, 770-74, 133 S.E. 788 (1926); Jeffries and Co., Inc. v. Kramer Brothers Co., 135 Va. 419, 116 S.E. 232 (1926); New Idea Spreader Co. v. R. M. Rogers & Sons, 122 Va. 54, 65-66, 94 S.E. 351 (1917).

This section does not affect the Virginia rules of set-off, as set forth in Code 1950, §§ 8-239, 8-239.1, and 8-239.2, and Rule 3:8. These statutes and the Rule of Court change the law applied in earlier cases under which the buyer's claims for unliquidated damages could not be set-off against the price claimed by the seller. See Dexter-Portland Cement Co. v. Acme Supply Co., Inc., 147 Va. 758, 768, 133 S.E. 788 (1926); Joseph H. Baker & Co., Inc. v. Hartman, 139 Va. 612, 613-14, 124 S.E. 425 (1924). The earlier rule was avoided in Richardson Construction Co. v. Whiting Lumber Co., 116 Va. 490, 491-94, 82 S.E. 87 (1914), in which the buyer's damages calculated on the basis of "cover" were found to be liquidated. See also F. A. Rausch & Co. v. Graham Manufacturing Corp., 139 Va. 502, 505-06, 124 S.E. 427 (1924); 145 Va. 681, 134 S.E. 692 (1926), for a case involving set-off.

§ 2-718. **Liquidation or Limitation of Damages; Deposits.** (1) Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or non-feasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

(2) Where the seller justifiably withholds delivery of goods because of the buyer's breach, the buyer is entitled to restitution of any amount by which the sum of his payments exceeds

(a) the amount to which the seller is entitled by virtue of terms liquidating the seller's damages in accordance with subsection (1), or

(b) in the absence of such terms, twenty per cent of the value of the total performance for which the buyer is obligated under the contract or $500, whichever is smaller.

(3) The buyer's right to restitution under subsection (2) is subject to offset to the extent that the seller establishes

(a) a right to recover damages under the provisions of this Article other than subsection (1), and

(b) the amount or value of any benefits received by the buyer directly or indirectly by reason of the contract.

(4) Where a seller has received payment in goods their reasonable value or the proceeds of their resale shall be treated as payments for the purposes of subsection (2); but if the seller has notice of the buyer's breach before reselling goods received in part performance, his resale is subject to the conditions laid down in this Article on resale by an aggrieved seller (§ 2-706).

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. Under subsection (1) liquidated damage clauses are allowed where the amount involved is reasonable in the light of the circumstances of the case. The subsection sets forth explicitly the elements to be considered in determining the reasonableness of a liquidated damage clause. A term fixing unreasonably large liquidated damages is expressly made void as a penalty. An unreasonably small amount would be subject to similar criticism and might be stricken under the section on unconscionable contracts or clauses.

2. Subsection (2) refuses to recognize a forfeiture unless the amount of the payment so forfeited represents a reasonable liquidation of damages as determined under subsection (1). A special exception is made in the case of small amounts (20% of the price or $500, whichever is smaller) deposited as security. No distinction is made between cases in which the payment is to be applied on the price and those in which it is intended as security for performance. Subsection (2) is applicable to any deposit or down or part payment. In the case of a deposit or turn in of goods resold before the breach, the amount actually received on the resale is to be viewed as the deposit rather than the amount allowed the buyer for the trade in. However, if the seller knows of the breach prior to the resale of the goods turned in, he must make reasonable efforts to realize their true value, and this is assured by requiring him to comply with the conditions laid down in the section on resale by an aggrieved seller.

Cross References:

Point 1: § 2-302.
Point 2: § 2-706.

Definitional Cross References:

"Aggrieved". § 1-201.
"Agreement". § 1-201.
"Buyer". § 2-103.
"Goods". § 2-105.
"Notice". § 1-201.
"Party". § 1-201.
"Remedy". § 1-201.
"Seller". § 2-103.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-719. Contractual Modification or Limitation of Remedy. (1) Subject to the provisions of subsections (2) and (3) of this section and of the preceding section on liquidation and limitation of damages,

(a) the agreement may provide for remedies in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of non-conforming goods or parts; and

(b) resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.

(2) Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act.

(3) Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. Under this section parties are left free to shape their remedies to their particular requirements and reasonable agreements limiting or modifying remedies are to be given effect.

However, it is of the very essence of a sales contract that at least minimum adequate remedies be available. If the parties intend to conclude a contract for sale within this Article they must accept the legal consequence that there be at least a fair quantum of remedy for breach of the obligations or duties outlined in the contract. Thus any clause purporting to modify or limit the remedial provisions of this Article in an unconscionable manner is subject to deletion and in that event the remedies made available by this Article are applicable as if the stricken clause had never existed. Similarly, under subsection (2), where an apparently fair and reasonable clause because of circumstances fails in its purpose or operates to deprive either party of the substantial value of the bargain, it must give way to the general remedy provisions of this Article.

2. Subsection (1)(b) creates a presumption that clauses prescribing remedies are cumulative rather than exclusive. If the parties intend the term to describe the sole remedy under the contract, this must be clearly expressed.

3. Subsection (3) recognizes the validity of clauses limiting or excluding consequential damages but makes it clear that they may not operate in an unconscionable manner. Actually such terms are merely an allocation of unknown or undeterminable risks. The seller in all cases is free to disclaim warranties in the manner provided in § 2-316.

Cross References:

Point 1: § 2-302.
Point 3: § 2-316.

Definitional Cross References:

"Agreement". § 1-201.
"Buyer". § 2-103.
"Conforming". § 2-106.
"Contract". § 1-201.
"Goods". § 2-105.
"Remedy". § 1-201.
"Seller". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Virginia has recognized that the remedies of parties to a sales contract may be limited by contract. The buyer's remedy may be limited to a return of the goods and repayment of the purchase price, and additional contractual requirements may be made as to the giving of notice of nonconformity of the goods and regarding the exercise of an option to return the goods. Monroe & Monroe, Inc. v. Cowne, 133 Va. 181, 198-204, 112 S.E. 848 (1922). Such contractual requirements may he waived by the seller, as by endeavoring to repair a machine and make it work. Monroe & Monroe, Inc. v. Cowne, 133 Va. 181, 198-204, 112 S.E. 848 (1922); Economic Water Heating Corp. v. Dillon Suppiy Co., 156 Va. 597, 607-08, 159 S.E. 78 (1931). The Economic case also held that if, with the knowledge of the seller, the goods are purchased for resale, the buyer is required to return only those goods that have not been resold.

The parties may by contract limit the seller's liability to the repair and replacement of nonconforming goods or parts. With reference to such a limitation, the Supreme Court of Appeals in Wright & Co., Inc. v. Shackleford, 152 Va. 635, 648, 148 S.E. 807 (1929), quoted the following passage from 35 Cyc. 428: "Unless there is a definite condition to that effect, the buyer is not obligated, as a condition precedent to recovery on the warranty, to allow the seller to remedy defects. If, however, the contract so stipulates, no liability for a breach of warranty attaches until the seller has had an opportunity to remedy defects, but on such opportunity being afforded by proper notice, the failure or refusal of the seller to act fixes his liability. So too an unsuccessful effort to remedy the defects renders the seller liable on his warranty, and the buyer is not bound to allow him a second opportunity. On the other hand, an offer on the part of the seller to remedy defects not accepted by the buyer releases the seller from liability on the warranty, provided the offer or effort to repair is made within a reasonable time."

In one instance Virginia has in effect rendered ineffective a contractual limitation on liability by finding the seller had not delivered the particular goods purchased, instead of finding that the goods had been delivered but a warranty had been breached. International Harvester Co. v. Smith, 105 Va. 683, 688, 54 S.E. 859 (1906) (new machine ordered; old machine delivered).

§ 2-720. Effect of "Cancellation" or "Rescission" on Claims for Antecedent Breach. Unless the contrary intention clearly appears, expressions of "cancellation" or "rescission" of the contract or the like shall not be construed as a renunciation or discharge of any claim in damages for an antecedent breach.

COMMENT: Prior Uniform Statutory Provision: None.

Purpose: This section is designed to safeguard a person holding a right of action from any unintentional loss of rights by the ill-advised use of such terms as "cancellation", "rescission", or the like. Once a party's rights have accrued they are not to be lightly impaired by concessions made in business decency and without intention to forego them. Therefore, unless the cancellation of a contract expressly declares that it is "without reservation of rights", or the like, it cannot be considered to be a renunciation under this section.

Cross Reference:

§ 1-107.

Definitional Cross References:

"Cancellation". § 2-106.
"Contract". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-721. **Remedies for Fraud.** Remedies for material misrepresentation or fraud include all remedies available under this Article for non-fraudulent breach. Neither rescission or a claim for rescission of the contract for sale nor rejection or return of the goods shall bar or be deemed inconsistent with a claim for damages or other remedy.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: To correct the situation by which remedies for fraud have been more circumscribed than the more modern and mercantile remedies for breach of warranty. Thus the remedies for fraud are extended by this section to coincide in scope with those for non-fraudulent breach. This section thus makes it clear that neither rescission of the contract for fraud nor rejection of the goods bars other remedies unless the circumstances of the case make the remedies incompatible.

Definitional Cross References:

"Contract for sale". § 2-106.
"Goods". § 1-201.
"Remedy". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: See Note, A Seller's Liability for Innocent Misrepresentations in Virginia, 43 Va. L. Rev. 765 (1957). Packard Norfolk, Inc. v. Miller, 198 Va. 557, 564-66, 95 S.E.2d 207 (1956), allowed a buyer to rescind a purchase contract for a new car on account of an innocent material misrepresentation made by the seller.

§ 2-722. **Who Can Sue Third Parties for Injury to Goods.** Where a third party so deals with goods which have been identified to a contract for sale as to cause actionable injury to a party to that contract

(a) a right of action against the third party is in either party to the contract for sale who has title to or a security interest or a special property or an insurable interest in the goods; and if the goods have been destroyed or converted a right of action is also in the party who either bore the risk of loss under the contract for sale or has since the injury assumed that risk as against the other;

(b) if at the time of the injury the party plaintiff did not bear the risk of loss as against the other party to the contract for sale and there is no arrangement between them for disposition of the recovery, his suit or settlement is, subject to his own interest, as a fiduciary for the other party to the contract;

(c) either party may with the consent of the other sue for the benefit of whom it may concern.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: To adopt and extend somewhat the principle of the statutes which provide for suit by the real party in interest. The provisions of this section apply

only after identification of the goods. Prior to that time only the seller has a right of action. During the period between identification and final acceptance (except in the case of revocation of acceptance) it is possible for both parties to have the right of action. Even after final acceptance both parties may have the right of action if the seller retains possession or otherwise retains an interest.

Definitional Cross References:

"Action". § 1-201.
"Buyer". § 2-103.
"Contract for sale". § 2-106.
"Goods". § 2-105.
"Party". § 1-201.
"Rights". § 1-201.
"Security interest". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-723. **Proof of Market Price: Time and Place.** (1) If an action based on anticipatory repudiation comes to trial before the time for performance with respect to some or all of the goods, any damages based on market price (§ 2-708 or § 2-713) shall be determined according to the price of such goods prevailing at the time when the aggrieved party learned of the repudiation.

(2) If evidence of a price prevailing at the times or places described in this Article is not readily available the price prevailing within any reasonable time before or after the time described or at any other place which in commercial judgment or under usage of trade would serve as a reasonable substitute for the one described may be used, making any proper allowance for the cost of transporting the goods to or from such other place.

(3) Evidence of a relevant price prevailing at a time or place other than the one described in this Article offered by one party is not admissible unless and until he has given the other party such notice as the court finds sufficient to prevent unfair surprise.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: To eliminate the most obvious difficulties arising in connection with the determination of market price, when that is stipulated as a measure of damages by some provision of this Article. Where the appropriate market price is not readily available the court is here granted reasonable leeway in receiving evidence of prices current in other comparable markets or at other times comparable to the one in question. In accordance with the general principle of this Article against surprise, however, a party intending to offer evidence of such a substitute price must give suitable notice to the other party.

This section is not intended to exclude the use of any other reasonable method of determining market price or of measuring damages if the circumstances of the case make this necessary.

Definitional Cross References:

"Action". § 1-201.
"Aggrieved party". § 1-201.
"Goods". § 2-105.
"Notifies". § 1-201.
"Party". § 1-201.
"Reasonable time". § 1-204.
"Usage of trade". § 1-205.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Virginia has recognized that if evidence of a prevailing price at the time and place to measure damages is not readily available, the price at a different place may be used. In Cocoa Products Co. of America, Inc. v. Duche, 156 Va. 86, 99-101, 158 S.E. 719 (1931), there was no market price for cocoa butter at Norfolk, and so damages were ascertained by reference to market prices at Philadelphia, New York, and Chicago, plus freight to Norfolk. Other cases to the same effect are: Nottingham Coal & Ice Co. v. Preas, 102 Va. 820, 823, 47 S.E. 823 (1904); McCormick & Co. v. Hamilton, Wood & Co., 64 Va. (23 Gratt.) 561, 577-78 (1873).

§ 2-724. **Admissibility of Market Quotations.** Whenever the prevailing price or value of any goods regularly bought and sold in any established commodity market is in issue, reports in official publications or trade journals or in newspapers or periodicals of general circulation published as the reports of such market shall be admissible in evidence. The circumstances of the preparation of such a report may be shown to affect its weight but not its admissibility.

COMMENT: **Prior Uniform Statutory Provision: None.**

Purposes: To make market quotations admissible in evidence while providing for a challenge of the material by showing the circumstances of its preparation.

No explicit provision as to the weight to be given to market quotations is contained in this section, but such quotations, in the absence of compelling challenge, offer an adequate basis for a verdict.

Market quotations are made admissible when the price or value of goods traded "in any established market" is in issue. The reason of the section does not require that the market be closely organized in the manner of a produce exchange. It is sufficient if transactions in the commodity are frequent and open enough to make a market established by usage in which one price can be expected to affect another and in which an informed report of the range and trend of prices can be assumed to be reasonably accurate.

This section does not in any way intend to limit or negate the application of similar rules of admissibility to other material, whether by action of the courts or by statute. The purpose of the present section is to assure a minimum of mercantile administration in this important situation and not to limit any liberalizing trend in modern law.

Definitional Cross Reference:

"Goods". § 2-105.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 2-725. **Statute of Limitations in Contracts for Sale.** (1) An action for breach of any contract for sale must be commenced within four years after the cause of action has accrued. By the original agreement the parties may reduce the period of limitation to not less than one year but may not extend it.

(2) A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach. A breach of warranty occurs when tender of delivery is made, except that where a warranty explicitly extends to future performance of the goods and discovery of the breach must await the time of such performance the cause of action accrues when the breach is or should have been discovered.

(3) Where an action commenced within the time limited by subsection (1) is so terminated as to leave available a remedy by another action for the same breach such other action may be commenced after the expiration of the time limited and within six months after the termination of the first action unless the termination resulted from voluntary discontinuance or from dismissal for failure or neglect to prosecute.

(4) This section does not alter the law on tolling of the statute of limitations nor does it apply to causes of action which have accrued before this Act becomes effective.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: To introduce a uniform statute of limitations for sales contracts, thus eliminating the jurisdictional variations and providing needed relief for concerns doing business on a nationwide scale whose contracts have heretofore been governed by several different periods of limitation depending upon the state in which the transaction occurred. This Article takes sales contracts out of the general laws limiting the time for commencing contractual actions and selects a four year period as the most appropriate to modern business practice. This is within the normal commercial record keeping period.

Subsection (1) permits the parties to reduce the period of limitation. The minimum period is set at one year. The parties may not, however, extend the statutory period.

Subsection (2), providing that the cause of action accrues when the breach occurs, states an exception where the warranty extends to future performance.

Subsection (3) states the saving provision included in many state statutes and permits an additional short period for bringing new actions, where suits begun within the four year period have been terminated so as to leave a remedy still available for the same breach.

Subsection (4) makes it clear that this Article does not purport to alter or modify in any respect the law on tolling of the Statute of Limitations as it now prevails in the various jurisdictions.

Definitional Cross References:

"Action". § 1-201.
"Aggrieved party". § 1-201.
"Agreement". § 1-201.
"Contract for sale". § 2-106.
"Goods". § 2-105.
"Party". § 1-201.
"Remedy". § 1-201.
"Term". § 1-201.
"Termination". § 2-106.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 8-13, 8-25, 8-27, 8-30, 8-34.

This section, which provides a uniform four-year statute of limitations on contracts for sale, subject to reduction to one year by agreement between the parties, changes the Virginia limitation periods. Code 1950, § 8-13, provides a ten-year limitation period on written contracts under seal, five year period on other written contracts, and two years on other express or implied contracts. The statute also provides for a five-year period after cessation of dealings "upon accounts concerning the trade of merchandise between merchant and merchant, their factors, or servants." This statutory provision is discussed in Ellison v. Weintrob, 139 Va. 29, 123 S.E. 512 (1924).

This section expressly provides that it does not affect tolling statutes, but its effect on "saving provisions" is not clear. Subsection 2-725(3) is similar in some respects to Code 1950, § 8-34, but the Virginia statute is broader. See Jones v. Morris Plan Bank of Portsmouth, 170 Va. 88, 195 S.E. 525 (1938). It is not

entirely clear whether statutes such as Code 1950, § 8-30, which provides a saving provision as to persons under disability, are considered tolling statutes, so as to remain in effect under subsection (4), or saving provisions that have been superseded by subsection (3).

The UCC provides that in the original agreement, the parties may reduce the period of limitations to one year. This provision appears to be in conflict with the policy underlying Code 1950, § 8-27, under which a promisor who has made a promise not to plead the statute of limitations is estopped to plead such statute if to do so would operate as a fraud on the promisee. Otherwise, unwritten promises not to plead the statute are void and written promises not to plead the statute have the same effect as promises to pay the debt, which is to start the statute running anew. Code 1950, § 8-25. (But see Code 1950, § 8-28 relating to personal representatives and joint contractors. See also Sobel & Herman, 175 Va. 489, 9 S.E.2d 459 (1940), for a construction of these statutes.) The UCC would seem to change Virginia law in that it allows the parties to contract for shorter periods of limitation. The UCC is not clear as to whether it is intended to affect a statute such as Code 1950, § 8-25, under which a new promise in writing starts this statute running anew. Literally, the text of the UCC does not affect this statute, but the Comment indicates that the draftsmen intended to preclude parties from extending the statutory limitation periods.

ARTICLE 3

COMMERCIAL PAPER

PART 1

SHORT TITLE, FORM AND INTERPRETATION

§ 3-101. **Short Title.** This Article shall be known and may be cited as Uniform Commercial Code—Commercial Paper.

COMMENT: This Article represents a complete revision and modernization of the Uniform Negotiable Instruments Law.

The Comments which follow will point out the respects in which this Article changes the Negotiable Instruments Law, which was promulgated by the National Conference of Commissioners on Uniform State Laws in 1896, and was subsequently enacted in every American jurisdiction. Needless to say, in the 50-odd years of the history of that statute, there have been vast changes in commercial practices relating to the handling of negotiable instruments. The need for revision of this important statute was felt for some years before the present project was undertaken.

It should be noted especially that this Article does not apply in any way to the handling of securities. Article 8 deals with that subject. See § 3-103.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, Title 6, Chapter 10.

Comment: Article 3 is discussed in Ritz, Virginia Law and the Commercial Paper Article of the Uniform Commercial Code, 12 Wash. & Lee L. Rev. 1 (1955).

The UCC continues the original purposes of the Negotiable Instruments Law. The NIL embodied in a single statute all the rules of the law merchant and decisions on the law of negotiable instruments. Trustees of American Bank v. McComb, 105 Va. 473, 476-77, 54 S.E. 14 (1906); Fleshman v. Bibb, 118 Va. 582, 585, 88 S.E. 64 (1916). It resolves doubts and secures uniformity of the law of negotiable instruments. Dunnington v. Bank of Crewe, 144 Va. 36, 50-51, 131 S.E. 221 (1926). It is designed to facilitate, not impede and confuse, trade and commerce in and by means of negotiable paper. Fleshman v. Bibb, 118 Va. 582, 585, 88 S.E. 64 (1916). Decisions from other jurisdictions are persuasive authority in interpreting the statute. Colley v. Summers Parrott Hardware Co., 119 Va. 439, 445, 89 S.E. 906 (1916).

§ 3-102. **Definitions and Index of Definitions.** (1) In this Article unless the context otherwise requires

(a) "Issue" means the first delivery of an instrument to a holder or a remitter.

(b) An "order" is a direction to pay and must be more than an authorization or request. It must identify the person to pay with reasonable certainty. It may be addressed to one or more such persons jointly or in the alternative but not in succession.

(c) A "promise" is an undertaking to pay and must be more than an acknowledgement of an obligation.

(d) "Secondary party" means a drawer or endorser.

(e) "Instrument" means a negotiable instrument.

(2) Other definitions applying to this Article and the sections in which they appear are:

"Acceptance". § 3-410.
"Accommodation party". § 3-415.
"Alteration". § 3-407.
"Certificate of deposit". § 3-104.
"Certification". § 3-411.
"Check". § 3-104.
"Definite time". § 3-109.
"Dishonor". § 3-507.
"Draft". § 3-104.
"Holder in due course". § 3-302.
"Negotiation". § 3-202.
"Note". § 3-104.
"Notice of dishonor". § 3-508.
"On demand". § 3-108.
"Presentment". § 3-504.
"Protest". § 3-509.
"Restrictive Indorsement". § 3-205.
"Signature". § 3-401.

(3) The following definitions in other Articles apply to this Article:

"Account". § 4-104.
"Banking Day". § 4-104.
"Clearing house". § 4-104.
"Collecting bank". § 4-105.
"Customer". § 4-104.
"Depositary Bank". § 4-105.
"Documentary Draft". § 4-104.
"Intermediary Bank". § 4-105.
"Item". § 4-104.
"Midnight deadline". § 4-104.
"Payor bank". § 4-105.

(4) In addition Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

COMMENT: Prior Uniform Statutory Provision: §§ 1(5), 128 and 191, Uniform Negotiable Instruments Law.

Changes: See below.

Purposes of Changes: 1. The definition of "issue" in § 191 of the original act has been clarified in two respects. The § 191 definition required that the instrument delivered be "complete in form" inconsistently with the provisions of §§ 14 and 15 (relating to incomplete instruments) of the original act. The "complete in form" language has therefore been deleted. Furthermore the § 191 definition required that the delivery be "to a person who takes as a holder", thus raising difficulties in the case of the remitter (see Comment 3 to § 3-302) who may not be a party to the instrument and thus not a holder. The definition in subsection (1)(a) of this section thus provides that the delivery may be to a holder or to a remitter.

2. The definitions of "order" [subsection (b)] and "promise" [subsection (c)] are new, but state principles clearly recognized by the courts. In the case of orders the dividing line between "a direction to pay" and "an authorization or request" may not be self-evident in the occasional unusual, and therefore non-commercial, case. The prefixing of words of courtesy to the direction—as "please pay" or "kindly pay"—should not lead to a holding that the direction has degenerated into a mere request. On the other hand informal language—such as "I wish you would pay"—would not qualify as an order and such an instrument would be non-negotiable. The definition of "promise" is intended to make it clear that a mere I.O.U. is not a negotiable instrument, and to change the result in occasional cases which have

held that "Due Currier & Barker seventeen dollars and fourteen cents, value received." and "I borrowed from P. Shemonia the sum of five hundred dollars with four per cent interest; the borrowed money ought to be paid within four months from the above date" were promises sufficient to make the instruments into notes.

3. The last sentence of subsection (1) (b) ("order") permits the order to be addressed to one or more persons (as drawees) in the alternative, recognizing the practice of corporations issuing dividend checks and of other drawers who for commercial convenience name a number of drawees, usually in different parts of the country. The section on presentment provides that presentment may be made to any one of such drawees. Drawees in succession are not permitted because the holder should not be required to make more than one presentment, and upon the first dishonor should have his recourse against the drawer and indorsers.

4. Comments on the definitions indexed follow the sections in which the definitions are contained.

Cross Reference:

Point 3: § 3-504(3) (a).

Definitional Cross References:
"Bank". § 1-201.
"Delivery". § 1-201.
"Holder". § 1-201.
"Money". § 1-201.
"Person". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-353(5), 6-481, 6-544.

§ 3-103. **Limitations on Scope of Article.** (1) This Article does not apply to money, documents of title or investment securities.

(2) The provisions of this Article are subject to the provisions of the Article on Bank Deposits and Collections (Article 4) and Secured Transactions (Article 9).

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. This Article is restricted to commercial paper—that is to say, to drafts, checks, certificates of deposit and notes as defined in § 3-104(2). Subsection (1) expressly excludes any money, as defined in this Act (§ 1-201), even though the money may be in the form of a bank note which meets all the requirements of § 3-104(1). Money is of course negotiable at common law or under separate statutes, but no provision of this Article is applicable to it. Subsection (1) also expressly excludes documents of title and investment securities which fall within Articles 7 and 8, respectively. To this extent the section follows decisions which held that interim certificates calling for the delivery of securities were not negotiable instruments under the original statute. Such paper is now covered under Article 8, but is not within any section of this Article. Likewise, bills of lading, warehouse receipts and other documents of title which fall within Article 7 may be negotiable under the provision of that Article, but are not covered by any section of this Article.

2. Instruments which fall within the scope of this Article may also be subject to other Articles of the Code. Many items in course of bank collection will of course be negotiable instruments, and the same may be true of collateral pledged as security for a debt. In such cases this Article, which is general, is, in case of conflicting provisions, subject to the Articles which deal specifically with the type of transaction or instrument involved: Article 4 (Bank Deposits and Collections) and Article 9 (Secured Transactions). In the case of a negotiable instrument which is subject to Article 4 because it is in course of collection or to Article 9 because it is used as collateral the provisions of this Article continue to be applicable except insofar as there may be conflicting provisions in the Bank Collection or Secured Transactions Article.

An instrument which qualifies as "negotiable" under this Article may also qualify as a "security" under Article 8. It will be noted that the formal requisites of negotiability (§ 3-104) go to matters of form exclusively; the definition of

"security" on the other hand (§ 8-102) looks principally to the manner in which an instrument is used ("commonly dealt in upon securities exchanges . . . or commonly recognized . . . as a medium for investment"). If an instrument negotiable in form under § 3-104 is, because of the manner of its use, a "security" under § 8-102, Article 8 and not this Article applies. See subsection (1) of this section and § 8-102(1)(b).

Cross References:
Point 1: Articles 7 and 8; §§ 1-201, 3-104(1) and (2), 3-107.
Point 2: Articles 4 and 9; §§ 3-104 and 8-102.

Definitional Cross References:
"Document of title". § 1-201.
"Money". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 3-104. **Form of Negotiable Instruments; "Draft"; "Check"; "Certificate of Deposit"; "Note".** (1) Any writing to be a negotiable instrument within this Article must

(a) be signed by the maker or drawer; and

(b) contain an unconditional promise or order to pay a sum certain in money and no other promise, order, obligation or power given by the maker or drawer except as authorized by this Article; and

(c) be payable on demand or at a definite time; and

(d) be payable to order or to bearer.

(2) A writing which complies with the requirements of this section is

(a) a "draft" ("bill of exchange") if it is an order;

(b) a "check" if it is a draft drawn on a bank and payable on demand;

(c) a "certificate of deposit" if it is an acknowledgment by a bank of receipt of money with an engagement to repay it;

(d) a "note" if it is a promise other than a certificate of deposit.

(3) As used in other Articles of this Act, and as the context may require, the terms "draft", "check", "certificate of deposit" and "note" may refer to instruments which are not negotiable within this Article as well as to instruments which are so negotiable.

COMMENT: Prior Uniform Statutory Provision: §§ 1, 5, 10, 126, 184 and 185, Uniform Negotiable Instruments Law.

Changes: Parts of original sections combined and reworded; new provisions; original § 10 omitted.

Purposes of Changes and New Matter: The changes are intended to bring together in one section related provisions and definitions formerly widely separated.

1. Under subsection (1)(b) any writing, to be a negotiable instrument within this Article, must be payable in money. In a few states there are special statutes, enacted at an early date when currency was less sound and barter was prevalent, which make promises to pay in commodities negotiable. Even under these statutes commodity notes are now little used and have no general circulation. This Article makes no attempt to provide for such paper, as it is a matter of purely local concern. Even if retention of the old statutes is regarded in any state as important, amendment of this section may not be necessary, since "within this Article" in subsection (1) leaves open the possibility that some writings may be made negotiable by other statutes or by judicial decision. The same is true as to any new type of paper which commercial practice may develop in the future.

2. While a writing cannot be made a negotiable instrument within this Article by contract or by conduct, nothing in this section is intended to mean that in a particular case a court may not arrive at a result similar to that of negotiability by finding that the obligor is estopped by his conduct from asserting a defense against a bona fide purchase. Such an estoppel rests upon ordinary principles of the law of simple contract; it does not depend upon negotiability, and it does not make the writing negotiable for any other purpose. But a contract to build a house or to employ a workman, or equally a security agreement does not become a negotiable instrument by the mere insertion of a clause agreeing that it shall be one.

3. The words "no other promise, order, obligation or power" in subsection (1)(b) are an expansion of the first sentence of the original § 5. § 3-112 permits an instrument to carry certain limited obligations or powers in addition to the simple promise or order to pay money. Subsection (1) of this section is intended to say that it cannot carry others.

4. Any writing which meets the requirements of subsection (1) and is not excluded under § 3-103 is a negotiable instrument, and all sections of this Article apply to it, even though it may contain additional language beyond that contemplated by this section. Such an instrument is a draft, a check, a certificate of deposit or a note as defined in subsection (2). Traveler's checks in the usual form, for instance, are negotiable instruments under this Article when they have been completed by the identifying signature.

5. This Article omits the original § 10, which provided that the instrument need not follow the language of the act if it "clearly indicates an intention to conform" to it. The provision has served no useful purpose, and it has been an encouragement to bad drafting and to liberality in holding questionable paper to be negotiable. The omission is not intended to mean that the instrument must follow the language of this section, or that one term may not be recognized as clearly the equivalent of another, as in the case of "I undertake" instead of "I promise," or "Pay to holder" instead of "Pay to bearer." It does mean that either the language of the section or a clear equivalent must be found, and that in doubful cases the decision should be against negotiability.

6. Subsection (3) is intended to make clear the same policy expressed in § 3-805.

Cross References:

§§ 3-105 through 3-112, 3-401, 3-402 and 3-403.
Point 1: § 3-107.
Point 3: § 3-112.
Point 4: §§ 3-103 and 3-805.
Point 6: § 3-805.

Definitional Cross References:

"Bank". § 1-201.
"Bearer". § 1-201.
"Definite time". § 3-109.
"Money". § 1-201.
"On demand". § 3-108.
"Order". § 3-102.
"Promise". § 3-102.
"Signed". § 1-201.
"Term". § 1-201.
"Writing". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-353, 6-357, 6-362, 6-479, 6-537, 6-538.

Comment: The instrument in Wall v. Fairfax, 180 Va. 421, 423-24, 23 S.E.2d 130 (1942), which was referred to in the case as a "promissory bond", would be a "note" as defined in this section since it contained a promise and was not a certificate of deposit. It is possible that such an instrument might be commonly recognized as a medium of investment in the area in which it was issued or dealt in, in which case it would also be a "security" as defined in UCC 8-102(1)(a)(ii), and so also subject to Article 8.

The definition of a certificate of deposit accords with that used in Dickenson v. Charles, 173 Va. 393, 399, 4 S.E. 2d 356 (1939).

§ 3-105. When Promise or Order Unconditional. (1) A promise or order otherwise unconditional is not made conditional by the fact that the instrument

(a) is subject to implied or constructive conditions; or

(b) states its consideration, whether performed or promised, or the transaction which gave rise to the instrument, or that the promise or order is made or the instrument matures in accordance with or "as per" such transaction; or

(c) refers to or states that it arises out of a separate agreement or refers to a separate agreement for rights as to prepayment or acceleration; or

(d) states that it is drawn under a letter of credit; or

(e) states that it is secured, whether by mortgage, reservation of title or otherwise; or

(f) indicates a particular account to be debited or any other fund or source from which reimbursement is expected; or

(g) is limited to payment out of a particular fund or the proceeds of a particular source, if the instrument is issued by a government or governmental agency or unit; or

(h) is limited to payment out of the entire assets of a partnership, unincorporated association, trust or estate by or on behalf of which the instrument is issued.

(2) A promise or order is not unconditional if the instrument

(a) states that it is subject to or governed by any other agreement; or

(b) states that it is to be paid only out of a particular fund or source except as provided in this section.

COMMENT: **Prior Uniform Statutory Provision:** § 3, Uniform Negotiable Instruments Law.

Changes: Completely revised.

Purposes of Changes: The section is intended to make it clear that, so far as negotiability is affected, the conditional or unconditional character of the promise or order is to be determined by what is expressed in the instrument itself; and to permit certain specific limitations upon the terms of payment.

1. Paragraph (a) of subsection (1) rejects the theory of decisions which have held that a recital in an instrument that it is given in return for an executory promise gives rise to an implied condition that the instrument is not to be paid if the promise is not performed, and that this condition destroys negotiability. Nothing in the section is intended to imply that language may not be fairly construed to mean what it says, but implications, whether of law or fact, are not to be considered in determining negotiability.

2. Paragraph (b) of subsection (1) is an amplification of § 3(2) of the original act. The final clause is intended to resolve a conflict in the decisions over the effect of such language as "This note is given for payment as per contract for the purchase of goods of even date, maturity being in conformity with the terms of such contract." It adopts the general commercial understanding that such language is intended as a mere recital of the origin of the instrument and a reference to the transaction for information, but is not meant to condition payment according to the terms of any other agreement.

3. Paragraph (c) of subsection (1) likewise is intended to resolve a conflict, and to reject cases in which a reference to a separate agreement was held to mean that payment of the instrument must be limited in accordance with the terms of the agreement, and hence was conditioned by it. Such a reference normally is

inserted for the purpose of making a record or giving information to anyone who may be interested, and in the absence of any express statement to that effect is not intended to limit the terms of payment. Inasmuch as rights as to prepayment or acceleration has to do with a "speed-up" in payment and since notes frequently refer to separate agreements for a statement of these rights, such reference does not destroy negotiability even though it has mild aspects of incorporation by reference. The general reasoning with respect to subparagraph (c) also applies to a draft which on its face states that it is drawn under a letter of credit (subparagraph (d)). Paragraphs (c) and (d) therefore adopt the position that negotiability is not affected. If the reference goes further and provides that payment must be made according to the terms of the agreement, it falls under paragraph (a) of subsection (2).

4. Paragraph (e) of subsection (1) is intended to settle another conflict in the decisions, over the effect of "title security notes" and other instruments which recite the security given. It rejects cases which have held that the mere statement that the instrument is secured, by reservation of title or otherwise, carries the implied condition that payment is to be made only if the security agreement is fully performed. Again such a recital normally is included only for the purpose of making a record or giving information, and is not intended to condition payment in any way. The provision adopts the position of the great majority of the courts.

5. Paragraph (f) of subsection (1) is a rewording of § 3(1) of the original act.

6. Paragraph (g) of subsection (1) is new. It is intended to permit municipal corporations or other governments or governmental agencies to draw checks or to issue other short-term commercial paper in which payment is limited to a particular fund or to the proceeds of particular taxes or other sources of revenue. The provision will permit some municipal warrants to be negotiable if they are in proper form. Normally such warrants lack the words "order" or "bearer," or are marked "Not Negotiable," or are payable only in serial order, which makes them conditional.

7. Paragraph (h) of subsection (1) is new. It adopts the policy of decisions holding that an instrument issued by an unincorporated association is negotiable although its payment is expressly limited to the assets of the association, excluding the liability of individual members; and recognizing as negotiable an instrument issued by a trust estate without personal liability of the trustee. The policy is extended to a partnership and to any estate. The provision affects only the negotiability of the instrument, and is not intended to change the law of any state as to the liability of a partner, trustee, executor, administrator, or any other person on such an instrument.

8. Paragraph (a) of subsection (2) retains the generally accepted rule that where an instrument contains such language as "subject to terms of contract between maker and payee of this date," its payment is conditioned according to the terms of the agreement and the instrument is not negotiable. The distinction is between a mere recital of the existence of the separate agreement or a reference to it for information, which under paragraph (c) of subsection (1) will not affect negotiability, and any language which, fairly construed, requires the holder to look to the other agreement for the terms of payment. The intent of the provision is that an instrument is not negotiable unless the holder can ascertain all of its essential terms from its face. In the specific instance of rights as to prepayment or acceleration, however, there may be a reference to a separate agreement without destroying negotiability.

9. Paragraph (b) of subsection (2) restates the last sentence of § 3 of the original act. As noted above, exceptions are made by paragraphs (g) and (h) of subsection (1) in favor of instruments issued by governments or governmental agencies, or by a partnership, unincorporated association, trust or estate.

Cross Reference: § 3-104.

Definitional Cross References:

"Account". § 4-104.
"Agreement". § 1-201.
"Instrument". § 3-102.
"Issue". § 3-102.
"Order". § 3-102.
"Promise". § 3-102.

Prior Statutes: Code 1950, §§ 6-355, 6-357, as amended in 1960.

Comment: Subsection 3-105(1)(e) is in accord with Garrett v. International Motor Truck Agency, Inc., 151 Va. 795, 800, 146 S.E. 252 (1928), which recognized that negotiability is not affected by a statement that the note is secured. It is broad enough so as to cover a statement that an instrument is secured by a deed of trust, a provision added to Code 1950, § 6-357, by a 1960 amendment.

Garrett v. International Motor Truck Agency, Inc., 151 Va. 795, 145 S.E. 252 (1928), also held that a statement on a note is not subject to Code 1950, § 11-4, regulating the size of type to be used in printed contracts.

§ 3-106. Sum Certain. (1) The sum payable is a sum certain even though it is to be paid

(a) with stated interest or by stated installments; or

(b) with stated different rates of interest before and after default or a specified date; or

(c) with a stated discount or addition if paid before or after the date fixed for payment; or

(d) with exchange or less exchange, whether at a fixed rate or at the current rate; or

(e) with costs of collection or an attorney's fee or both upon default.

(2) Nothing in this section shall validate any term which is otherwise illegal.

COMMENT: Prior Uniform Statutory Provision: §§ 2 and 6(5), Uniform Negotiable Instruments Law.

Changes: Reworded.

Purposes of Changes: The new language is intended to clarify doubts arising under the original section as to interest, discounts or additions, exchange, costs and attorney's fees, and acceleration or extension.

1. The section rejects decisions which have denied negotiability to a note with a term providing for a discount for early payment on the ground that at the time of issue the amount payable was not certain. It is sufficient that at any time of payment the holder is able to determine the amount then payable from the instrument itself with any necessary computation. Thus a demand note bearing interest at six per cent is negotiable. A stated discount or addition for early or late payment does not affect the certainty of the sum so long as the computation can be made, nor do different rates of interest before and after default or a specified date. The computation must be one which can be made from the instrument itself without reference to any outside source, and this section does not make negotiable a note payable with interest "at the current rate."

2. Paragraph (d) recognizes the occasional practice of making the instrument payable with exchange deducted rather than added.

3. In paragraph (e) "upon default" is substituted for the language of the original § 2(5) in order to include any default in payment of interest or installments.

4. The section contains no specific language relating to the effect of acceleration clauses on the certainty of the sum payable. § 2(3) of the original act contained a saving clause for provisions accelerating principal on default in payment of an instalment or of interest, which led to doubt as to the effect of other accelerating provisions. This Article (§ 3-109, Definite Time) broadly validates acceleration clauses; it is not necessary to state the matter in this section as well. The disappearance of the language referred to in old § 2(3) means merely that it was regarded as surplusage.

5. Most states have usury laws prohibiting excessive rates of interest. In some states there are statutes or rules of law invalidating a term providing for increased interest after maturity, or for costs and attorney's fees. Subsection (2) is in-

tended to make it clear that this section is concerned only with the effect of such terms upon negotiability, and is not meant to change the law of any state as to the validity of the term itself.

Cross References:
§ 3-104.
Point 4: § 3-109.

Definitional Cross Reference:
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-354, 6-358(5).

Comment: The UCC provides that a clause providing for payment of costs of collection or an attorney's fee upon default does not affect the negotiability of the instrument, but the UCC does not as such validate any term that is otherwise illegal under other state law. Virginia has long recognized the validity of clauses providing for the payment of reasonable attorney fees. Pulaski Nat'l Bank v. Harrell, 203 Va. 227, 235, 123 S.E.2d 382 (1962); Merchants and Planters Bank v. Forney, 183 Va. 83, 94-95, 31 S.E.2d 340 (1944); Richardson v. Breeding, 167 Va. 30, 33-34, 187 S.E. 454 (1936); Parksley Nat'l Bank v. Accomac Banking Co., 166 Va. 459, 186 S.E. 38 (1936); Sutherland v. Receiver for Dickenson County Bank, 163 Va. 949, 955-56, 178 S.E. 12 (1935); Conway v. American Nat'l Bank, 146 Va. 357, 364-65, 131 S.E. 803 (1926); Atkinson v. Neblett, 144 Va. 220, 235-36, 135 S.E. 326 (1926); Cox v. Hagan, 125 Va. 656, 669-71, 100 S.E. 666 (1919); Triplett v. Second Nat'l Bank, 121 Va. 189, 92 S.E. 897 (1917); Colley v. Summers Parrott Hardware Co., 119 Va. 439, 442-46, 89 S.E. 906 (1916); R. S. Oglesby Co. v. Bank of New York, 114 Va. 663, 77 S.E. 468 (1913) (enforcement of New York instrument not against public policy).

The UCC does not affect the Virginia rule under which the court may reduce the attorney fee provided for in the instrument. Richardson v. Breeding, 167 Va. 30, 33-34, 187 S.E. 454 (1936) (attorney fee of 10% on $18,650 collection reduced to $800); Triplett v. Second Nat'l Bank, 121 Va. 189, 193, 92 S.E. 897 (1917).

The UCC does not affect the holding in Sands v. Roller, 118 Va. 191, 86 S.E. 857 (1915) that when judgment is taken for the debt only on a note calling for payment of attorney fees, there is a merger of the cause of action into the judgment, and so a separate action for the attorney fees cannot thereafter be maintained.

§ 3-107. **Money.** (1) An instrument is payable in money if the medium of exchange in which it is payable is money at the time the instrument is made. An instrument payable in "currency" or "current funds" is payable in money.

(2) A promise or order to pay a sum stated in a foreign currency is for a sum certain in money and, unless a different medium of payment is specified in the instrument, may be satisfied by payment of that number of dollars which the stated foreign currency will purchase at the buying sight rate for that currency on the day on which the instrument is payable or, if payable on demand, on the day of demand. If such an instrument specifies a foreign currency as the medium of payment the instrument is payable in that currency.

COMMENT: **Prior Uniform Statutory Provision:** § 6(5), Uniform Negotiable Instruments Law.

Changes: Completely rewritten.

Purposes of Changes and New Matter: To make clear when an instrument is payable in money and to state rules applicable to instruments drawn payable in a foreign currency.

1. The term "money" is defined in § 1-201 as "a medium of exchange authorized or adopted by a domestic or foreign government as a part of its currency". That definition rejects the narrow view of some early cases that "money" is limited to legal tender. Legal tender acts do no more than designate a particular kind

of money which the obligee will be required to accept in discharge of an obligation. It rejects also the contention sometimes advanced that "money" includes any medium of exchange current and accepted in the particular community, whether it be gold dust, beaver pelts, or cigarettes in occupied Germany. Such unusual "currency" is necessarily of uncertain and fluctuating value, and an instrument intended to pass generally in commerce as negotiable may not be made payable therein.

The test adopted is that of the sanction of government, which recognizes the circulating medium as a part of the official currency of that government. In particular the provision adopts the position that an instrument expressing the amount to be paid in sterling, francs, lire or other recognized currency of a foreign government is negotiable even though payable in the United States.

2. The provision on "currency" or "current funds" accepts the view of the great majority of the decisions, that "currency" or "current funds" means that the instrument is payable in money.

3. Either the amount to be paid or the medium of payment may be expressed in terms of a particular kind of money. A draft passing between Toronto and Buffalo may, according to the desire and convenience of the parties, call for payment of 100 United States dollars or of 100 Canadian dollars; and it may require either sum to be paid in either currency. Under this section an instrument in any of these forms is negotiable, whether payable in Toronto or in Buffalo.

4. As stated in the preceding paragraph the intention of the parties in making an instrument payable in a foreign currency may be that the medium of payment shall be either dollars measured by the foreign currency or the foreign currency in which the instrument is drawn. Under subsection (2) the presumption is, unless the instrument otherwise specifies, that the obligation may be satisfied by payment in dollars in an amount determined by the buying sight rate for the foreign currency on the day the instrument becomes payable. Inasmuch as the buying sight rate will fluctuate from day to day, it might be argued that an instrument expressed in a foreign currency but actually payable in dollars is not for a "sum certain". Subsection (2) makes it clear that for the purposes of negotiability under this Article such an instrument, despite exchange fluctuations, is for a sum certain.

Cross References:

§ 3-104.
Point 1: § 1-201.
Point 4: § 4-212(6)

Definitional Cross References:

"Instrument". § 3-102.
"Money". § 1-201.
"Order". § 3-102.
"Promise". § 3-102.
"Purchase". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-358(5), 6-341.

Comment: Subsection 3-107(2) apparently contemplates the possibility of entering a judgment requiring payment in a foreign currency. Virginia Code 1950, § 6-341, which is not a part of the NIL, probably prevents the entry of a judgment in any currency other than American. See also George Campbell Co. v. George Angus & Co., 91 Va. 438, 22 S.E. 167 (1895), involving a judgment in dollars on an open account obligation in pounds sterling.

§ 3-108. **Payable on Demand.** Instruments payable on demand include those payable at sight or on presentation and those in which no time for payment is stated.

COMMENT: Prior Uniform Statutory Provision: § 7, Uniform Negotiable Instruments Law.

Changes: Reworded, final sentence of original section omitted.

Purposes of Changes: Except for the omission of the final sentence this section restates the substance of original § 7. The final sentence dealt with the status

of a person issuing, accepting or indorsing an instrument after maturity and provided that as to such a person the instrument was payable on demand. That language implied that the ordinary rules relating to demand instruments as to due course, holding, presentment, notice of dishonor and so on were applicable. This Article abandons that concept which served no special purpose except to trap the unwary. Under § 3-302 (Holder in Due Course) and in view of the deletion from this section of the final sentence of original § 7 there is no longer the possibility that one taking time paper after maturity may acquire due course rights against a post-maturity indorser. § 3-501(4), however, provides that the indorser after maturity is not entitled to presentment, notice of dishonor or protest.

Cross References:
§§ 3-104, 3-302 and 3-501(4).

Definitional Cross Reference:
"Instrument". § 3-102.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-359.

§ 3-109. Definite Time. (1) An instrument is payable at a definite time if by its terms it is payable

(a) on or before a stated date or at a fixed period after a stated date; or

(b) at a fixed period after sight; or

(c) at a definite time subject to any acceleration; or

(d) at a definite time subject to extension at the option of the holder, or to extension to a further definite time at the option of the maker or acceptor or automatically upon or after a specified act or event.

(2) An instrument which by its terms is otherwise payable only upon an act or event uncertain as to time of occurrence is not payable at a definite time even though the act or event has occurred.

COMMENT: Prior Uniform Statutory Provision: §§ 4 and 17(3), Uniform Negotiable Instruments Law.

Changes: Reworded; new provisions; rule of original § 4(3) reversed.

Purposes of Changes and New Matter: To remove uncertainties arising under the original section, and to eliminate commercially unacceptable instruments.

1. Subsection (2) reverses the rule of the original § 4(3) as to instruments payable after events certain to happen but uncertain as to time. Almost the only use of such instruments has been in the anticipation of inheritance or future interests by borrowing on post-obituary notes. These have been much more common in England than in the United States. They are at best questionable paper, not acceptable in general commerce, with no good reason for according them free circulation as negotiable instruments. As in the case of the occasional note payable "one year after the war" or at a similar uncertain date, they are likely to be made under unusual circumstances suggesting good reason for preserving defenses of the maker. They are accordingly eliminated.

2. With this change "definite time" is substituted for "fixed or determinable future time." The time of payment is definite if it can be determined from the face of the instrument.

3. An undated instrument payable "thirty days after date" is not payable at a definite time, since the time of payment cannot be determined on its face. It is, however, an incomplete instrument within the provisions of § 3-115 dealing with such instruments and may be completed by dating it. It is then payable at a definite time.

4. Paragraph (c) of subsection (1) resolves a conflict in the decisions on the negotiability of instruments containing acceleration clauses as to the meaning and effect of "on or before a fixed or determinable future time" in the original

§ 4(2). (Instruments expressly stated to be payable "on or before" a given date are dealt with in subsection (1) (a). So far as certainty of time of payment is concerned a note payable at a definite time but subject to acceleration is no less certain than a note payable on demand, whose negotiability never has been questioned. It is in fact more certain, since it at least states a definite time beyond which the instrument cannot run. Objections to the acceleration clause must be based rather on the possibility of abuse by the holder, which has nothing to do with negotiability and is not limited to negotiable instruments. That problem is now covered by § 1-208.

Subsection (1) (c) is intended to mean that the certainty of time of payment or the negotiability of the instrument is not affected by any acceleration clause, whether acceleration be at the option of the maker or the holder, or automatic upon the occurrence of some event, and whether it be conditional or unrestricted. If the acceleration term itself is uncertain it may fail on ordinary contract principles, but the instrument then remains negotiable and is payable at the definite time.

The effect of acceleration clauses upon a holder in due course is covered by the new definition of the holder in due course (§ 3-302) and by the section on notice to purchaser (subsection (3) of § 3-304). If the purchaser is not aware of any acceleration, his delay in making presentment may be excused under the section dealing with excused presentment (subsection (1) of § 3-511).

5. Paragraph (d) of subsection (1) is new. It adopts the generally accepted rule that a clause providing for extension at the option of the holder, even without a time limit, does not affect negotability since the holder is given only a right which he would have without the clause. If the extension is to be at the option of the maker or acceptor or is to be automatic, a definite time limit must be stated or the time of payment remains uncertain and the instrument is not negotiable. Where such a limit is stated, the effect upon certainty of time of payment is the same as if the instrument were made payable at the ultimate date with a term providing for acceleration.

The construction and effect of extension clauses is covered by paragraph (f) of § 3-118 on ambiguous terms and rules of construction, to which reference should be made.

Cross References:
§ 3-104.
Point 3: § 3-115.
Point 4: §§ 1-208, 3-118(f), 3-304(3), and 3-511(1).
Point 5: § 3-118(f).

Definitional Cross References:
"Holder". § 1-201.
"Instrument". § 3-102.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-356, 6-369(3), 6-348.

Comment: The section accords with Jones v. Morris Plan Bank, 168 Va. 284, 290, 191 S.E. 608 (1937); Country Club of Portsmouth, Inc., v. Wilkins, 166 Va. 325, 330, 186 S.E. 23 (1936), in recognizing the negotiability of instruments subject to acceleration clauses. It accords with Holcomb v. Webley, 185 Va. 150, 156, 37 S.E.2d 762 (1946), in providing that a right to accelerate is limited to the grounds set forth in the instrument, or, under UCC 3-105(1)(c), in a separate agreement.

The section does not affect the holding in Country Club of Portsmouth, Inc., v. Wilkins, 166 Va. 325, 186 S.E. 23 (1936), that the statute of limitations begins to run immediately on an instrument, which by its terms has been accelerated automatically upon a default.

The provision in Code 1950, § 6-348, not a part of the NIL, recognizing that acceleration clauses in certain instruments do not affect negotiability, is unnecessary in light of this section, although not inconsistent therewith.

§ 3-110. Payable to Order. (1) An instrument is payable to order when by its terms it is payable to the order or assigns of any person therein specified with reasonable certainty, or to him or his order, or when it is

conspicuously designated on its face as "exchange" or the like and names a payee. It may be payable to the order of

(a) the maker or drawer; or

(b) the drawee; or

(c) a payee who is not maker, drawer or drawee; or

(d) two or more payees together or in the alternative; or

(e) an estate, trust or fund, in which case it is payable to the order of the representative of such estate, trust or fund or his successors; or

(f) an office, or an officer by his title as such in which case it is payable to the principal but the incumbent of the office or his successors may act as if he or they were the holder; or

(g) a partnership or unincorporated association, in which case it is payable to the partnership or association and may be indorsed or transferred by any person thereto authorized.

(2) An instrument not payable to order is not made so payable by such words as "payable upon return of this instrument properly indorsed."

(3) An instrument made payable both to order and to bearer is payable to order unless the bearer words are handwritten or typewritten.

COMMENT: Prior Uniform Statutory Provision: § 8, Uniform Negotiable Instruments Law.

Changes: Reworded, new provisions.

Purposes of Changes and New Matter: The changes are intended to remove uncertainties arising under the original section.

1. Paragraph (d) of subsection (1) replaces the original subsections (4) and (5). It eliminates the word "jointly," which has carried a possible implication of a right of survivorship. Normally an instrument payable to "A and B" is intended to be payable to the two parties as tenants in common, and there is no survivorship in the absence of express language to that effect. The instrument may be payable to "A or B," in which case it is payable to either A or B individually. It may even be made payable to "A and/or B," in which case it is payable either to A or to B singly, or to the two together. The negotiation, enforcement and discharge of the instrument in all such cases are covered by the section on instruments payable to two or more persons (§ 3-116).

2. Paragraph (e) of subsection (1) is intended to change the result of decisions which have held that an instrument payable to the order of the estate of a decedent was payable to bearer, on the ground that the name of the payee did not purport to be that of any person. The intent in such cases is obviously not to make the instrument payable to bearer, but to the order of the representative of the estate. The provision extends the same principle to an instrument payable to the order of "Tilden Trust," or "Community Fund". So long as the payee can be identified, it is not necessary that it be a legal entity; and in each case the instrument is treated as payable to the order of the appropriate representative or his successor.

3. Under paragraph (f) of subsection (1) an instrument may be made payable to the office itself ("Swedish Consulate") or to the officer by his title as such ("Treasurer of City Club"). In either case it runs to the incumbent of the office and his successors. The effect of instruments in such a form is covered by the section on instruments payable with words of description (§ 3-117).

4. Vestigial theories relating to the lack of "legal entity" of partnerships and various forms of unincorporated associations—such as labor unions and business trusts—make it the part of wisdom to specify that instruments made payable to such groups are order paper payable as designated and not bearer paper (subsection (1)(g)). As in the case of incorporated associations, any person having authority from the partnership or association to whose order the instrument is payable may indorse or otherwise deal with the instrument.

5. Subsection (2) is intended to change the result of cases holding that "payable upon return of this certificate properly indorsed" indicated an intention to make the instrument payable to any indorsee and so must be construed as the equivalent of "Pay to order." Ordinarily the purpose of such language is only to insure return of the instrument with endorsement in lieu of a receipt, and the word "order" is omitted with the intentiou that the instrument shall not be negotiable.

6. Subsection (3) is directed at occasional instruments reading "Pay to the order of John Doe or bearer." Such language usually is found only where the drawer has filled in the name of the payee on a printed form, without intending the ambiguity or noticing the word "bearer." Under such circumstances the name of the specified payee indicates an intent that the order words shall control. If the word "bearer" is handwritten or typewritten, there is sufficient indication of an intent that the instrument shall be payable to bearer. Instruments payable to "order of bearer" are covered not by this section but by the following § 3-111.

Cross References:

§§ 3-104 and 3-111.
Point 1: § 3-116.
Points 2, 3 and 4: § 3-117.

Definitional Cross References:

"Bearer". § 1-201.
"Conspicuous". § 1-201.
"Instrument". § 3-102.
"Negotiation". § 3-202.
"Person". § 1-201.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-360.

§ 3-111. **Payable to Bearer.** An instrument is payable to bearer when by its terms it is payable to

(a) bearer or the order of bearer; or

(b) a specified person or bearer; or

(c) "cash" or the order of "cash", or any other indication which does not purport to designate a specific payee.

COMMENT: Prior Uniform Statutory Provision: § 9, Uniform Negotiable Instruments Law.

Changes: Reworded; original subsections (3) and (5) omitted here but covered by sections on impostors and signature in name of payee (§ 3-405) and on special and blank indorsements (§ 3-204).

Purposes of Changes: The rewording is intended to remove uncertainties.

1. Language such as "order of bearer" usually results when a printed form is used and the word "bearer" is filled in. Subsection (a) rejects the view that the instrument is payable to order, and adopts the position that "bearer" is the unusual word and should control. Compare Comment 6 to § 3-110.

2. Paragraph (c) is reworded to remove any possible implication that "Pay to the order of ———" makes the instrument payable to bearer. It is an incomplete order instrument, and falls under § 3-115. Likewise "Pay Treasurer of X Corporation" does not mean pay bearer, even though there may be no such officer. Instruments payable to the order of an estate, trust, fund, partnership, unincorporated association or office are covered by the preceding section. This subsection applies only to such language as "Pay Cash," "Pay to the order of cash," "Pay bills payable," "Pay to the order of one keg of nails," or other words which do not purport to designate any specific payee.

3. Under § 40 of the original Act an instrument payable to bearer on its face remained bearer paper negotiable by delivery although subsequently specially indorsed. It should be noted that § 3-204 on special indorsement reverses this rule and allows the special indorsement to control.

Cross References:

§§ 3-104, 3-405 and 3-204.
Point 2: §§ 3-110(1)(a) and (f) and 3-115.
Point 3: § 3-204.

Definitional Cross References:

"Bearer". § 1-201.
"Instrument". § 3-102.
"Person". § 1-201.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-361.

Comment: The problem of the fictitious payee, which had been dealt with in Code 1950, § 6-361(3), as amended in 1956, is now covered by UCC 3-405. For a comment on the effect of the UCC on First Wisconsin Nat'l Bank v. People's Nat'l Bank, 136 Va. 276, 118 S.E. 82, 36 A.L.R. 736 (1923), see VIRGINIA ANNOTATIONS to UCC 3-405.

§ 3-112. **Terms and Omissions Not Affecting Negotiability.** (1) The negotiability of an instrument is not affected by

(a) the omission of a statement of any consideration or of the place where the instrument is drawn or payable; or

(b) a statement that collateral has been given to secure obligations either on the instrument or otherwise of an obligor on the instrument or that in case of default on those obligations the holder may realize on or dispose of the collateral; or

(c) a promise or power to maintain or protect collateral, to give additional collateral, to furnish financial information or to do or refrain from doing any other act for the protection of the obligation expressed in the instrument not involving the payment of money on account of the indebtedness evidenced by the instrument; or

(d) a term authorizing a confession of judgment on the instrument if it is not paid when due; or

(e) a term purporting to waive the benefit of any law intended for the advantage or protection of any obligor; or

(f) a term in a draft providing that the payee by indorsing or cashing it acknowledges full satisfaction of an obligation of the drawer; or

(g) a statement in a draft drawn in a set of parts (§ 3-801) to the effect that the order is effective only if no other part has been honored.

(2) Nothing in this section shall validate any term which is otherwise illegal.

(VALC Note: Paragraph (1) (c) appears in the Official Text as follows:
(c) a promise or power to maintain or protect collateral or to give additional collateral; or)

COMMENT: **Prior Uniform Statutory Provision:** §§ 5 and 6, Uniform Negotiable Instruments Law.

Changes: Reworded; new provisions; Subsection (4) of original § 5 omitted. Subsection (4) of the original § 6 is now covered by § 3-113, and Subsection (5) by § 3-107.

Purposes of Changes and New Matter: The changes are intended to remove uncertainties arising under the original sections. Subsection (4) of the original § 5 is omitted because it has been important only in connection with bonds and other

investment securities now covered by Article 8 of this Act. An option to require something to be done in lieu of payment of money is uncommon and not desirable in commercial paper.

This section permits the insertion of certain obligations and powers in addition to the simple promise or order to pay money. Under § 3-104, dealing with form of negotiable instruments, the instrument may not contain any other promise, order, obligation or power.

1. Paragraph (b) of subsection (1) permits a clause authorizing the sale or disposition of collateral given to secure obligations either on the instrument or otherwise of an obligor on the instrument upon any default in those obligations, including a default in payment of an installment or of interest. It is not limited, as was the original § 5(1), to default at maturity. The reference to obligations of an obligor on the instrument is intended to recognize so-called cross collateral provisions that appear in collateral note forms used by banks and others throughout the United States and to permit the use of these provisions without destroying negotiability. Paragraph (c) is new. It permits a clause, apparently not within the original section, containing a promise or power to maintain or protect collateral or to give additional collateral, whether on demand or on some other condition. Such terms frequently are accompanied by a provision for acceleration if the collateral is not given, which is now permitted by the section on what constitutes a definite time. § 1-208 should be consulted as to the construction to be given such clauses under this Act.

2. As under the original § 5(2), paragraph (d) is intended to mean that a confession of judgment may be authorized only if the instrument is not paid when due, and that otherwise negotiability is affected. The use of judgment notes is confined to two or three states, and in others the judgment clauses are made illegal or ineffective either by special statutes or by decision. Subsection (2) is intended to say that any such local rule remains unchanged, and that the clause itself may be invalid, although the negotiability of the instrument is not affected.

3. As in the case of the original § 5(3), paragraph (e) applies not only to any waiver of the benefits of this Article, such as presentment, notice of dishonor or protest, but also to a waiver of the benefits of any other law such as a homestead exemption. Again subsection (2) is intended to mean that any rule which invalidates the waiver itself is not changed, and that while negotiability is not affected, a waiver of the statute of limitations contained in an instrument may be invalid.

This paragraph is to be read together with subsection (1) of § 3-104 on form of negotiable instruments. A waiver cannot make the instrument negotiable within this Article where it does not comply with the requirements of that section.

4. Paragraph (f) is new. The effect of a clause of acknowledgment of satisfaction upon negotiability has been uncertain under the original section.

5. Paragraph (g) is intended to insure that a condition arising from the statement in question will not adversely affect negotiability.

Cross References:

§§ 3-104 and 3-105.
Point 1: §§ 1-208 and 3-109(1) (c).
Point 3: § 3-104.

Definitional Cross References:

"Draft". § 3-104.
"Instrument". § 3-102.
"On demand". § 3-108.
"Promise". § 3-102.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-357, 6-358.

Comment: The UCC recognizes that negotiability is not affected by a term authorizing a confession of judgment if an instrument is not paid when due. Such clauses are valid in Virginia. Johnson v. Aivis, 159 Va. 229, 165 S.E. 489 (1932); Walker v. Temple, 130 Va. 567, 107 S.E. 720 (1921); Colona v. Parksley Nat'l Bank, 120 Va. 812, 825-26, 92 S.E. 979 (1917). The power must be exercised

in strict accordance with the terms of the authorization. Bank of Marion v. Spence, 155 Va. 51, 154 S.E. 488 (1930). The UCC does not affect the holding in Walker v. Temple, 130 Va. 567, 107 S.E. 720 (1921), that the statute of limitations begins to run from the due date of the instrument, and the mere presence of a clause authorizing a confession of judgment at any time does not accelerate the running of the statute.

In Walker v. Temple, 130 Va. 567, 107 S.E. 720 (1921), the Supreme Court of Appeals impliedly recognized the validity of a warrant of attorney to confess judgment "at any time," although the judgment involved was actually confessed after maturity.

COUNCIL COMMENT

We recommend the language as set forth in the body of the bill, which follows the section as adopted in New York. The additional conditions which would be permitted are designed to provide greater security to the lender and should not interfere with negotiability of an instrument.

§ 3-113. Seal. An instrument otherwise negotiable is within this Article even though it is under a seal.

COMMENT: Prior Uniform Statutory Provision: § 6(4) Uniform Negotiable Instruments Law.

Changes: Reworded.

Purposes of Changes: The revised wording is intended to change the result of decisions holding that while a seal does not affect the negotiability of an instrument it may affect it in other respects falling within the statute, such as the conclusiveness of consideration. The section is intended to place sealed instruments on the same footing as any other instruments so far as all sections of this Article are concerned. It does not affect any other statutes or rules of law relating to sealed instruments except insofar as, in the case of negotiable instruments, they are inconsistent with this Article. Thus a sealed instrument which is within this Article may still be subject to a longer statute of limitations than negotiable instruments not under seal, or to such local rules of procedure as that it may be enforced by an action of special assumpsit.

Cross Reference:
§ 3-104.

Definitional Cross Reference:
"Instrument". § 3-102.

VIRGINIA ANNOTATIONS

Prior Statues: Code 1950, § 6-358(4).

Comment: Sealed instruments under the UCC are subject to all the provisions of Article 3, but other consistent statutes or rules relating to sealed instruments are also applicable. The statute of limitations of ten years on sealed instruments and five years on instruments not under seal, contained in Code 1950, § 8-13, remains in effect. This statute was applied to an instrument not under seal in Quackenbush v. Isley, 154 Va. 407, 153 S.E. 818 (1930).

§ 3-114. Date, Antedating, Postdating. (1) The negotiability of an instrument is not affected by the fact that it is undated, antedated or postdated.

(2) Where an instrument is antedated or postdated the time when it is payable is determined by the stated date if the instrument is payable on demand or at a fixed period after date.

(3) Where the instrument or any signature thereon is dated, the date is presumed to be correct.

COMMENT: Prior Uniform Statutory Provision: §§ 6(1), 11, 12 and 17(3), Uniform Negotiable Instruments Law.

Changes: Reworded; new provision; parts of original § 12 omitted.

Purposes of Changes and New Matter: The rewording is intended to remove uncertainties arising under the original sections.

1. The reference to an "illegal or fraudulent purpose" in the original § 12 is omitted as inaccurate and misleading. Any fraud or illegality connected with the date of an instrument does not affect its negotiability, but is merely a defense under §§ 3-306 and 3-307 to the same extent as any other fraud or illegality. The provision in the same section as to acquisition of title upon delivery is also omitted, as obvious and unnecessary.

2. Subsection (2) is new. An undated instrument payable "thirty days after date" is uncertain as to time of payment, and does not fall within § 3-109(1)(a) on definite time. It is, however, an incomplete instrument, and the date may be inserted as provided in the section dealing with such instruments (§ 3-115). When the instrument has been dated, this subsection follows decisions under the original Act in providing that the time of payment is to be determined from the stated date, even though the instrument is antedated or postdated. An antedated instrument may thus be due before it is issued. As to the liability of indorsers in such a case, see § 3-501(4), on indorsement after maturity.

3. Subsection (3) extends the original § 11 to any signature on an instrument. As to the meaning of "presumed," see § 1-201.

Cross References:

Point 1: §§ 3-306 and 3-307.
Point 2: §§ 3-109(1)(a), 3-115 and 3-501(4).
Point 3: § 1-201.

Definitional Cross References:

"Instrument". § 3-102.
"Issue". § 3-102.
"On demand". § 3-108.
"Presumed". § 1-201.
"Signature". § 3-401.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-358(1), 6-363, 6-364, 6-369(3).

§ 3-115. **Incomplete Instruments.** (1) When a paper whose contents at the time of signing show that it is intended to become an instrument is signed while still incomplete in any necessary respect it cannot be enforced until completed, but when it is completed in accordance with authority given it is effective as completed.

(2) If the completion is unauthorized the rules as to material alteration apply (§ 3-407), even though the paper was not delivered by the maker or drawer; but the burden of establishing that any completion is unauthorized is on the party so asserting.

COMMENT: Prior Uniform Statutory Provision: §§ 13, 14 and 15, Uniform Negotiable Instruments Law.

Changes: Condensed and reworded; original § 13 and parts of § 14 omitted; rule of § 15 reversed.

Purposes of Changes: 1. The original sections were lengthy and confusing. **§ 13 is** eliminated because it has suggested some uncertain distinction between undated instruments and those incomplete in other respects, and has carried the inference that only a holder may fill in the date. An instrument lacking in an essential date is merely one kind of incomplete instrument, to be treated like any other. The third sentence of § 14, providing that the instrument must be filled up strictly in accordance with the authority given and within a reasonable time, is eliminated as entirely superfluous, since any authority must always be exercised in accordance with its limitations, and expires within a reasonable time unless a time limit is fixed.

2. The language "signed while still incomplete in any necessary respect" in subsection (1) is substituted for "wanting in any material particular" in the original § 14, in order to make it entirely clear that a complete writing which lacks an essential element of an instrument and contains no blanks or spaces or

anything else to indicate that what is missing is to be supplied, does not fall within the section. "Necessary" means necessary to a complete instrument. It will always include the promise or order, the designation of the payee, and the amount payable. It may include the time of payment where a blank is left for that time to be filled in; but where it is clear that no time is intended to be stated the instrument is complete, and is payable on demand under § 3-108. It does not include the date of issue, which under § 3-114(1) is not essential, unless the instrument is made payable at a fixed period after that date.

3. This section omits the second sentence of the original § 14, providing that "a signature on a blank paper delivered by the person making the signature in order that the paper may be converted into a negotiable instrument operates as a prima facie authority to fill it up as such for any amount." This had utility only in connection with the ancient practice of signing blank paper to be filled in later as an acceptance, at a time when communications were slow and difficult. The practice has been obsolete for nearly a century. It affords obvious opportunity for fraud, and should not be encouraged by express sanction in the statute. The omission is not intended, however, to mean that any person may not be authorized to write in an instrument over a signature either before or after delivery.

4. Subsection (2) states the rule generally recognized by the courts, that any unauthorized completion is an alteration of the instrument which stands on the same footing as any other alteration. Reference is therefore made to § 3-407 where the effect of alteration is stated. Subsection (3) of that section provides that a subsequent holder in due course may in all cases enforce the instrument as completed, and replaces the final sentence of the original § 14.

5. The language "even though the paper was not delivered" reverses the rule of the original § 15, which provides that where an incomplete instrument has not been delivered it will not, if completed, be a valid contract in the hands of any holder as against any person whose signature was placed thereon before delivery. Since under this Article (§§3-305 and 3-407) neither non-delivery or unauthorized completion is a defense against a holder in due course, it has always been illogical that the two together should invalidate the instrument in his hands. A holder in due course sees and takes the same paper, whether it was complete when stolen or completed afterward by the thief, and in each case he relies in good faith on the maker's signature. The loss should fall upon the party whose conduct in signing blank paper has made the fraud possible, rather than upon the innocent purchaser. The result is consistent with the theory of decisions holding the drawer of a check stolen and afterwards filled in to be estopped from setting up the non-delivery against an innocent party.

A similar provision protecting a depositary bank which pays an item in good faith is contained in § 4-401. The policy of that section should apply in favor of drawees other than banks.

6. The language on burden of establishing unauthorized completion is substituted for the "prima facie authority" of the original § 14. It follows the generally accepted rule that the full burden of proof by a preponderance of the evidence is upon the party attacking the completed instrument. "Burden of establishing" is defined in § 1-201.

Cross References:

Point 2: §§ 3-108 and 3-114(1).
Point 4: § 3-407.
Point 5: §§ 3-305(2), 3-407(3) and 4-401.
Point 6: § 1-201.

Definitional Cross References:

"Alteration". § 3-407.
"Burden of establishing". § 1-201.
"Delivery". § 1-201.
"Instrument". § 3-102.
"Party". § 1-201.
"Signed". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-365, 6-366, 6-367.

Comment: It is not clear whether the subsection 3-115(1) requirement that an instrument incomplete in any necessary respect cannot be enforced until completed

affects the result in Allen v. Rouseville Cooperage Co., 157 Va. 355, 161 S.E. 50 (1931). In that case the instrument sued upon was payable "forty-five . . . after date." The plaintiff in his pleading set forth the exact text of the note and alleged that it was payable "forty-five days after date." Parole evidence showed that this was the true intention, and the court held that by this allegation the plaintiff "in effect exercises his authority to fill in the blank." 157 Va. at 371. The court distinguished Chestnut v. Chestnut, 104 Va. 539, 52 S.E. 348 (1905), in which a note was held inadmissible in evidence, the note containing a marginal notation, "$1,800. Eighteen hundred dollars," but which was blank in the body as to the amount payable. The distinction was that in the Chestnut case there was a "variance between the note declared upon and the note offered in evidence." 157 Va. at 355.

The UCC continues the rule of the NIL that the person in possession of an incomplete instrument only has prima facie authority to complete, and that a transferee must ascertain the real authority of the person intrusted with the incomplete instrument. Brown v. Thomas, 120 Va. 763, 767-69, 92 S.E. 977 (1917); Guerrant v. Guerrant, 7 Va. L. Reg. 639 (Corp. Ct. of Danville 1902).

Under the UCC an unauthorized completion of an incomplete instrument is subject to the rules relating to material alteration, as set forth in UCC 3-407. This is in accord with State Bank of Pamplin v. Payne, 156 Va. 837, 850-51, 159 S.E. 163 (1931), in which the unauthorized completion was fraudulent and material, and so as against a party not a holder in due course the instrument had been discharged.

§ 3-116. Instruments Payable to Two or More Persons. An instrument payable to the order of two or more persons

(a) if in the alternative is payable to any one of them and may be negotiated, discharged or enforced by any of them who has possession of it;

(b) if not in the alternative is payable to all of them and may be negotiated, discharged or enforced only by all of them.

COMMENT: Prior Uniform Statutory Provision: § 41, Uniform Negotiable Instruments Law.

Changes: Revised in wording and substance.

Purposes of Changes: The changes are intended to make clear the distinction between an instrument payable to "A or B" and one payable to "A and B." The first names either A or B as payee, so that either of them who is in possession becomes a holder as that term is defined in § 1-201 and may negotiate, enforce or discharge the instrument. The second is payable only to A and B together, and as provided in the original section both must indorse in order to negotiate the instrument, although one may of course be authorized to sign for the other. Likewise both must join in any action to enforce the instrument, and the rights of one are not discharged without his consent by the act of the other.

If the instrument is payable to "A and/or B," it is payable in the alternative to A, or to B, or to A and B together, and it may be negotiated, enforced or discharged accordingly.

Cross Reference:

§ 1-201.

Definitional Cross References:

"Instrument". § 3-102.
"Person". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-393.

§ 3-117. Instruments Payable With Words of Description. An instrument made payable to a named person with the addition of words describing him

(a) as agent or officer of a specified person is payable to his principal but the agent or officer may act as if he were the holder;

(b) as any other fiduciary for a specified person or purpose is payable to the payee and may be negotiated, discharged or enforced by him;

(c) in any other manner is payable to the payee unconditionally and the additional words are without effect on subsequent parties.

COMMENT: Prior Uniform Statutory Provision: § 42, Uniform Negotiable Instruments Law.

Changes: Revised and extended.

Purposes of Changes: 1. Subsection (a) extends the policy of the original § 42, which covered only cashiers and fiscal officers of banks and corporations, to any case where a payee is named with words describing him as agent or officer of another named person. The intent is to include all such descriptions as "John Doe, Treasurer of Town of Framingham," "John Doe, President Home Telephone Co.," "John Doe, Secretary of City Club," or "John Doe, agent of Richard Roe." In all such cases it is commercial understanding that the description is not added for mere identification but for the purpose of making the instrument payable to the principal, and that the agent or officer is named as payee only for convenience in enabling him to cash the check.

2. Subsection (b) covers such descriptions as "John Doe, Trustee of Smithers Trust," "John Doe, Administrator of the Estate of Richard Roe," or "John Doe, Executor under Will of Richard Roe." In such cases the instrument is payable to the individual named, and he may negotiate it, enforce it or discharge it, but he remains subject to any liability for breach of his obligation as a fiduciary. Any subsequent holder of the instrument is put on notice of the fiduciary position, and under the section on notice to purchaser (§ 3-304) is not a holder in due course if he takes with notice that John Doe has negotiated the instrument in payment of or as security for his own debt or in any transaction for his own benefit, or otherwise in breach of duty.

3. Any other words of description, such as "John Doe, 1121 Main Street," "John Doe, Attorney," or "Jane Doe, unremarried widow," are to be treated as mere identification, and not in any respect as a condition of payment. The same is true of any description of the payee as "Treasurer," "President," "Agent," "Trustee," "Executor," or "Administrator," which does not name the principal or beneficiary. In all such cases the person named may negotiate, enforce or discharge the instrument if he is otherwise identified, even though he does not meet the description. Any subsequent party dealing with the instrument may disregard the description and treat the paper as payable unconditionally to the individual, and is fully protected in the absence of independent notice of other facts sufficient to affect his position.

Cross Reference:

Point 2: § 3-304(2).

Definitional Cross References:

"Holder". § 1-201.
"Instrument". § 3-102.
"Party". § 1-201.
"Person". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-394.

§ 3-118. Ambiguous Terms and Rules of Construction. The following rules apply to every instrument:

(a) Where there is doubt whether the instrument is a draft or a note the holder may treat it as either. A draft drawn on the drawer is effective as a note.

(b) Handwritten terms control typewritten and printed terms, and typewritten control printed.

(c) Words control figures except that if the words are ambiguous figures control.

(d) Unless otherwise specified a provision for interest means interest at the judgment rate at the place of payment from the date of the instrument, or if it is undated from the date of issue.

(e) Unless the instrument otherwise specifies two or more persons who sign as maker, acceptor or drawer or indorser and as a part of the same transaction are jointly and severally liable even though the instrument contains such words as "I promise to pay."

(f) Unless otherwise specified consent to extension authorizes a single extension for not longer than the original period. A consent to extension, expressed in the instrument, is binding on secondary parties and accommodation makers. A holder may not exercise his option to extend an instrument over the objection of a maker or acceptor or other party who in accordance with § 3-604 tenders full payment when the instrument is due.

COMMENT: Prior Uniform Statutory Provision: §§ 17 and 68, Uniform Negotiable Instruments Law.

Changes: Reworded; new provisions; original subsections (3) and (6) of § 17 omitted. The original § 17(3) is covered, so far as the question can arise, by §§ 3-109(1)(a) and 3-114 of this Article. The original § 17(6) is now covered by § 3-402.

Purposes of Changes and New Matter: 1. The purpose of this section is to protect holders and to encourage the free circulation of negotiable paper by stating rules of law which will preclude a resort to parol evidence for any purpose except reformation of the instrument. Except as to such reformation, these rules cannot be varied by any proof that any party intended the contrary.

2. Subsection (a): The language of the original § 17(5) is changed to make it clear that the provision is not limited to ambiguities of phrasing, but extends to any case where the form of the instrument leaves its character as a draft or a note in doubt.

3. Subsection (b): The original § 17(4) is revised to cover typewriting because of its frequent use in instruments, particularly in promissory notes.

4. Subsection (c): The rewording of the original § 17(1) is intended to make it clear that figures control only where the words are ambiguous and the figures are not.

5. Subsection (d): The revision of the original § 17(2) is intended to make it clear that where the instrument provides for payment "with interest" without specifying the rate, the judgement rate of interest of the place of payment is to be taken as intended.

6. Subsection (e): This subsection combines and revises the original § 17(7) and the last sentence of the original § 68. The rule applies to any two or more persons who sign in the same capacity, whether as makers, drawers, acceptors or indorsers. It applies only where such parties sign as a part of the same transaction; successive indorsers are, of course, liable severally but not jointly.

7. Subsection (f): This provision is new. It has reference to such clauses as "The makers and indorsers of this note consent that it may be extended without notice to them." Such terms usually are inserted to obtain the consent of the indorsers and any accommodation maker to extension which might otherwise discharge them under § 3-606 dealing with impairment of recourse or collateral. An extension in accord with these terms binds secondary parties. The holder may not force an extension on a maker or acceptor who makes due tender; the holder is not free to refuse payment and keep interest running on a good note or other instrument by extending it over the objection of a maker or acceptor or other party who in accordance with § 3-604 tenders full payment when the instrument is due. Where consent to extension has been given, the subsection provides that unless otherwise specified the consent is to be construed as authorizing only one extension for not longer than the original period of the note.

Cross References:

§§ 3-109, 3-114, 3-402 and 3-606.
Point 7: §§ 3-604 and 3-606.

Definitional Cross References:

"Draft". § 3-104.
"Holder". § 1-201.
"Instrument". § 3-102.
"Issue". § 3-102.
"Note". § 3-104.
"Person". § 1-201.
"Promise". § 3-102.
"Signed". § 1-201.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-369, 6-420.

§ 3-119. **Other Writings Affecting Instrument.** (1) As between the obligor and his immediate obligee or any transferee the terms of an instrument may be modified or affected by any other written agreement executed as a part of the same transaction, except that a holder in due course is not affected by any limitation of his rights arising out of the separate written agreement if he had no notice of the limitation when he took the instrument.

(2) A separate agreement does not affect the negotiability of an instrument.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: This section is new. It is intended to resolve conflicts as to the effect of a separate writing upon a negotiable instrument.

1. This Article does not attempt to state general rules as to when an instrument may be varied or affected by parol evidence, except to the extent indicated by the comment to the preceding section. This section is limited to the effect of a separate written agreement executed as a part of the same transaction. The separate writing is most commonly an agreement creating or providing for a security interest such as a mortgage, chattel mortgage, conditional sale or pledge. It may, however, be any type of contract, including an agreement that upon certain conditions the instrument shall be discharged or is not to be paid, or even an agreement that it is a sham and not to be enforced at all. Nothing in this section is intended to validate any such agreement which is fraudulent or void as against public policy, as in the case of a note given to deceive a bank examiner.

2. Other parties, such as an accommodation indorser, are not affected by the separate writing unless they were also parties to it as a part of the transaction by which they became bound on the instrument.

3. The section applies to negotiable instruments the ordinary rule that writings executed as a part of the same transaction are to be read together as a single agreement. As between the immediate parties a negotiable instrument is merely a contract, and is no exception to the principle that the courts will look to the entire contract in writing. Accordingly a note may be affected by an acceleration clause, a clause providing for discharge under certain conditions, or any other relevant term in the separate writing. "May be modified or affected" does not mean that the separate agreement must necessarily be given effect. There is still room for construction of the writing as not intended to affect the instrument at all, or as intended to affect it only for a limited purpose such as foreclosure or other realization of collateral. If there is outright contradiction between the two, as where the note is for $1,000 but the accompanying mortgage recites that it is for $2,000, the note may be held to stand on its own feet and not to be affected by the contradiction.

4. Under this Article a purchaser of the instrument may become a holder in due course although he takes it with knowledge that it was accompanied by a separate agreement, if he has no notice of any defense or claim arising from the terms of the agreement. If any limitation in the separate writing in itself amounts to a defense or claim, as in the case of an agreement that the note is a sham and cannot be enforced, a purchaser with notice of it cannot be a holder in due course. The section also covers limitations which do not in themselves give notice of any present defense or claim, such as conditions providing that under certain conditions the note shall be extended for one year. A purchaser with notice of such limitations

may be a holder in due course, but he takes the instrument subject to the limitation. If he is without such notice, he is not affected by such a limiting clause in the separate writing.

5. Subsection (2) rejects decisions which have carried the rule that contemporaneous writings must be read together to the length of holding that a clause in a mortgage affecting a note destroyed the negotiability of the note.

The negotiability of an instrument is always to be determined by what appears on the face of the instrument alone, and if it is negotiable in itself a purchaser without notice of a separate writing is in no way affected by it. If the instrument itself states that it is subject to or governed by any other agreement, it is not negotiable under this Article; but if it merely refers to a separate agreement or states that it arises out of such an agreement, it is negotiable.

Cross References:

Point 1: § 8-119.
Point 4: § 3-304(4)(b).
Point 5: § 3-105(2)(a) and (1)(c).

Definitional Cross References:

"Agreement". § 1-201.
"Holder in due course". § 3-302.
"Instrument". § 3-102.
"Notice". § 1-201.
"Rights". § 1-201.
"Term". § 1-201.
"Written" and "writing". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: The section is in accord with Virginia law as stated in Richmond Postal Credit Union, Inc. v. Booker, 170 Va. 129, 195 S.E. 662 (1938), that negotiable instruments and contemporaneous written agreements executed as part of the same transaction are to be construed as a single contract, so that as between the immediate parties the negotiable instruments may be modified by the separate written agreement. A holder in due course under the UCC is not affected by any limitation in the separate agreement of which he did not have notice when he took the negotiable instrument. The rule that the negotiable instruments and the separate written agreements are to be construed as a single contract was applied in Nottingham v. Ackiss, 107 Va. 63, 66, 57 S.E. 592 (1907); 110 Va. 810, 811, 67 S.E. 351 (1910) so as to limit the rights of the transferee from the payee. Since there was no discussion in these latter cases, which have not been cited in later cases, of the possibility that the transferee from the payee was a holder in due course, the cases should not be construed as applying this single-contract rule so as to limit the rights of a holder in due course without notice of the separate agreement.

For the admissibility of oral evidence to show conditions affecting a negotiable instrument see VIRGINIA ANNOTATIONS to UCC 3-307.

§ 3-120. Instruments "Payable Through" Bank. An instrument which states that it is "payable through" a bank or the like designates that bank as a collecting bank to make presentment but does not of itself authorize the bank to pay the instrument.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: Insurance, dividend or payroll checks, and occasionally other types of instruments, are sometimes made payable "through" a particular bank. This section states the commercial understanding as to the effect of such language. The bank is not named as drawee, and it is not ordered or even authorized to pay the instrument out of the drawer's account or any other funds of the drawer in its hands. Neither is it required to take the instrument for collection in the absence of special agreement to that effect. It is merely designated as a collecting bank through which presentment is properly made to the drawee.

Definitional Cross References:

"Bank". § 1-201.
"Collecting bank". § 4-105.
"Instrument". § 3-102.
"Presentment". § 3-504.

Prior Statutes: None.

§ 3-121. Instruments Payable at Bank. A note or acceptance which states that it is payable at a bank is not of itself an order to the bank to pay it, but the bank may consider it an authorization to pay.

(VALC Note: The Official Text offers Alternative versions of this section as follows:

Alternative A—A note or acceptance which states that it is payable at a bank is the equivalent of a draft drawn on the bank payable when it falls due out of any funds of the maker or acceptor in current account or otherwise available for such payment.

Alternative B—A note or acceptance which states that it is payable at a bank is not of itself an order or authorization to the bank to pay it.

The UCC COMMENT applies to these Alternatives)

COMMENT: Prior Uniform Statutory Provision: § 87, Uniform Negotiable Instruments Law.

Changes: Alternative sections offered.

Purposes of Changes: The original § 87 has been amended so extensively that no uniformity has been achieved; and in many parts of the country it has been consistently disregarded in practice.

The original section represents the commercial and banking practice of New York and the surrounding states, according to which a note or acceptance made payable at a bank is treated as the equivalent of a draft drawn on the bank. The bank is not only authorized but ordered to make payment out of the account of the maker or acceptor when the instrument falls due, and it is expected to do so without consulting him. In the western and southern states a contrary understanding prevails. The note or acceptance payable at a bank is treated as merely designating a place of payment, as if the instrument were made payable at the office of an attorney. The bank's only function is to notify the maker or acceptor that the instrument has been presented and to ask for his instructions; and in the absence of specific instructions it is not regarded as required or even authorized to pay. Notwithstanding the original section western and southern banks have consistently followed the practice of asking for instructions and treating a direction not to pay as a revocation, equivalent to a direction to stop payment.

Both practices are well established, and the division is along geographical lines. A change in either practice might lead to undesirable consequences for holders, banks or depositors. The instruments involved are chiefly promissory notes, which infrequently cross state lines. There is no great need for uniformity. This section therefore offers alternative provisions, the first of which states the New York commercial understanding, and the second that of the south and west.

Cross Reference: § 3-502.

Definitional Cross References:
"Acceptance". § 3-410.
"Account". § 4-104.
"Bank". § 1-201.
"Draft". § 3-104.
"Instrument". § 3-102.
"Note". § 3-104.
"Order". § 3-102.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-440.

Comment: As indicated above, the 1962 Official Text offers alternative wording for this section.

In providing that an instrument payable at a bank is the equivalent of a draft on (or order to) the bank to pay it, Alternative A follows existing Virginia law (§ 6-440). In practice, however, as suggested under "Purposes of Changes" above, this provision of existing law has been largely disregarded in Virginia and in

other southern states. In most instances, the note or acceptance payable at a bank is treated as merely designating a place of payment, requiring only the bank's notice to the maker or acceptor that the instrument has been or will be presented on its maturity date and the bank's action on his instructions. At the same time, under present law, the bank is protected if, in the absence or unavailability of instructions, it should elect to pay such an instrument for the account of the principal debtor thereon in an effort to interpret his intent or to look out for his interests.

No such protection would be available to a bank under Alternative B which would make an instrument payable at a bank neither an order nor an authorization to the bank to pay it.

Since there is no great need for uniformity, the present wording of this section was adopted to conform to present practice in Virginia generally and, at the same time, to retain the authorization feature of existing Virginia law.

For the effect of this section on tender of payment, see the Virginia Annotations to § 3-604.

COUNCIL COMMENT

Neither of the alternatives set forth in the Uniform Commercial Code accords with actual banking practice in Virginia. There is no uniformity even in the states which have adopted the Code; the proposed wording was selected to conform to present practice in Virginia generally and, at the same time, to retain the authorization feature of Virginia law.

§ 3-122. **Accrual of Cause of Action.** (1) A cause of action against a maker or an acceptor accrues

(a) in the case of a time instrument on the day after maturity;

(b) in the case of a demand instrument upon its date or, if no date is stated, on the date of issue.

(2) A cause of action against the obligor of a demand or time certificate of deposit accrues upon demand, but demand on a time certificate may not be made until on or after the date of maturity.

(3) A cause of action against a drawer of a draft or an indorser of any instrument accrues upon demand following dishonor of the instrument. Notice of dishonor is a demand.

(4) Unless an instrument provides otherwise, interest runs at the rate provided by law for a judgment

(a) in the case of a maker, acceptor or other primary obligor of a demand instrument, from the date of demand;

(b) in all other cases from the date of accrual of the cause of action.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purpose: 1. This section is new. It follows the generally accepted rule that action may be brought on a demand note immediately upon issue, without demand, since presentment is not required to charge the maker under the original Act or under this Article. An exception is made in the case of certificates of deposit for the reason that banking custom and expectation is that demand will be made before any liability is incurred by the bank, and the additional reason that such certificates are issued with the understanding that they will be held for a considerable length of time, which in many instances exceeds the period of the statute of limitations. As to makers and acceptors of time instruments generally, the cause of action accrues on the day after maturity. As to drawers of drafts (including checks) and all indorsers, the cause of action accrues, in conformity with their underlying contract on the instrument (§§ 3-413 and 3-414), only upon demand made, typically in the form of a notice of dishonor, after the instrument has been presented to and dishonored by the person designated on the instrument to pay it.

2. Closely related to the accrual of a cause of action is the question of when interest begins to run where the instrument is blank on the point. A term in

the instrument providing for interest controls. (See § 3-118(d) for the construction of a term which provides for interest but does not specify the rate or the time from which it runs.) In the absence of such a term and except in the case of a maker, acceptor or other primary obligor of a demand instrument subsection (4) states the rule that interest at the judgment rate runs from the date the cause of action accrues. In the case of a primary obligor of a demand instrument, interest runs from the date of demand although the cause of action (subsection (1) (a)) accrues on the stated date of the instrument or on issue. There has been a conflict in the decisions as to when "legal" interest begins to run on a demand note. Some courts have taken the view that, since the note is due when issued without demand, it should follow that interest runs from the same date. On the other hand it is clear that there is no default until after demand by the holder and thus no reason for the imposition of the penalty on the maker. Subsection (4), therefore, adopts the position of the majority of the courts that on a demand note interest runs only from demand. This same rule is applied to acceptors and other primary obligors on a demand instrument.

Cross References:

Point 1: §§ 3-501, 3-413 and 3-414.
Point 2: § 3-118(d).

Definitional Cross References:

"Action". § 1-201.
"Certificate of deposit". § 3-102.
"Dishonor". § 3-507.
"Draft". § 3-104.
"Instrument". § 3-102.
"Note". § 3-104.
"Notice of dishonor". § 3-508.
"On demand". § 3-108.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 8-13.

Comment: Subsection 3-122(1)(b) is consistent with Bacon's Adm'r v. Bacon's Trustees, 94 Va. 686, 687, 27 S.E. 576 (1897), that a cause of action on a demand instrument accrues from its date, or if no date is stated, from the date of issue.

Subsection 3-122(2) is consistent with the proviso in Code 1950, § 8-13, under which the statute of limitations on certificates of deposit does not run until a demand has been made, but with this UCC section the proviso in § 8-13 is no longer necessary.

In Mann v. Bradshaw's Adm'r, 136 Va. 351, 376-77, 118 S.E. 326 (1923), the Supreme Court of Appeals said that the cause of action of the last indorser against a prior indorser accrued upon payment by the last indorser, and that the cause of action was on the instrument and so covered by the five-year statute of limitations provided in § 8-13, and not by the three-year statute on implied contracts. The point does not seem to be covered by the UCC, which apparently is limited to the accrual of the cause of action by the holder against an indorser, and does not extend to actions between indorsers.

The UCC does not make any explicit reference to when a cause of action accrues on paper that has been accelerated or which contains an authority to confess judgment. In Country Club of Portsmouth, Inc. v. Wilkins, 166 Va. 325, 186 S.E. 23 (1936), the due date starting the statute of limitations running was clear from the terms of the acceleration clause. Walker v. Temple, 130 Va. 567, 107 S.E. 720 (1921), held that a warrant of attorney authorizing the confession of judgment "at any time" did not start the statute of limitations to run, the statute still runs from the due date stated in the instrument.
The subject of interest in Virginia is comprehensively discussed in Smedley, Interest Damages in Virginia, 28 Va. L. Rev. 1138 (1942), who points out that Virginia law on the subject is not clear on some points.

The UCC provides that interest on a demand note, unless the instrument otherwise provides, does not begin running until a demand has been made, which changes the rule stated in Bacon's Adm'r v. Bacon's Trustees, 94 Va. 686, 687, 27 S.E. 576 (1897), that interest begins running from the date of the note.

The UCC provides that interest on an instrument with a definite time for payment begins to run from the date of accrual of a cause of action on the instru-

ment, which is the day after maturity. Virginia cases have contained conflicting dictum as to whether interest on a note with a definite time for payment, but with no provision as to interest, would begin to run from the date of the receipt of the money or from the day of maturity. The following cases support a view that interest runs from the day the money is received: Hall v. Graham, 112 Va. 560, 72 S.E. 105 (1911); Vashon v. Barrett, 105 Va. 490, 54 S.E. 705 (1906); Southern Railway Co. v. Glenn's Adm'r, 102 Va. 529, 46 S.E. 776 (1904); Craufurd's Adm'r v. Smith's Ex'r, 93 Va. 623, 23 S.E. 235, 25 S.E. 657 (1896). The following cases support a view that interest runs from the day the loan becomes due and payable: Beale v. Moore, 183 Va. 519, 32 S.E.2d 696 (1945); Parsons v. Parsons, 167 Va. 374, 189 S.E. 448 (1937); McVeigh's Ex'r v. Howard, 87 Va. 599, 13 S.E. 31 (1891); Roberts' Adm'r v. Cocke, 69 Va. (28 Gratt.) 207 (1877); Chapman's Adm'rs v. Shepherd's Adm'r, 65 Va. (24 Gratt.) 377 (1874).

The UCC does not say whether an instrument expressly providing that it is "without interest" bears interest after maturity. Goins v. Garber, 131 Va. 59, 68, 108 S.E. 868 (1921), held that such an instrument does bear interest after maturity.

Under Code 1950, § 8-223, the jury, and perhaps the court, has discretion to fix the time when interest commences and the rate in "any action . . . on contract." As applied to commercial paper, this statute seems to be in fundamental conflict with the UCC.

The Virginia law as to the interest rate provided by law for a judgment is not clear. A federal court seems to have taken what may be conflicting views of Virginia law on the point. City of Danville v. Chesapeake & O. Ry., 34 F. Supp. 620 (W.D. Va. 1940), indicates that the legal rate of 6 per cent is required, while Boswell v. Big Vein Pocahontas Co., 217 Fed. 822 (W.D. Va. 1914) indicates that an express contract rate of interest will continue after judgment.

Some amendment of the Virginia statutes would seem to be desirable so as to make clear that UCC 3-122(4) prevails over Code 1950, § 8-223, and to clarify Virginia law as to the interest rate provided by law for a judgment on commercial paper.

PART 2

TRANSFER AND NEGOTIATION

§ 3-201. Transfer: Right to Indorsement. (1) Transfer of an instrument vests in the transferee such rights as the transferor has therein, except that a transferee who has himself been a party to any fraud or illegality affecting the instrument or who as a prior holder had notice of a defense or claim against it cannot improve his position by taking from a later holder in due course.

(2) A transfer of a security interest in an instrument vests the foregoing rights in the transferee to the extent of the interest transferred.

(3) Unless otherwise agreed any transfer for value of an instrument not then payable to bearer gives the transferee the specifically enforceable right to have the unqualified indorsement of the transferor. Negotiation takes effect only when the indorsement is made and until that time there is no presumption that the transferee is the owner.

COMMENT: **Prior Uniform Statutory Provision:** §§ 27, 49 and 58, Uniform Negotiable Instruments Law.

Changes: Combined and reworded; new provisions.

Purposes of Changes and New Matter: To make it clear that:

1. The section applies to any transfer, whether by a holder or not. Any person who transfers an instrument transfers whatever rights he has in it. The transferee acquires those rights even though they do not amount to "title."

2. The transfer of rights is not limited to transfers for value. An instrument may be transferred as a gift, and the donee acquires whatever rights the donor had.

3. A holder in due course may transfer his rights as such. The "shelter" provision of the last sentence of the original § 58 is merely one illustration of the rule that anyone may transfer what he has. Its policy is to assure the holder in due course a free market for the paper, and that policy is continued in this section. The provision is not intended and should not be used to permit any holder who has himself been a party to any fraud or illegality affecting the instrument, or who has received notice of any defense or claim against it, to wash the paper clean by passing it into the hands of a holder in due course and then repurchasing it. The operation of the provision is illustrated by the following examples:

(a) A induces M by fraud to make an instrument payable to A, A negotiates it to B, who takes as a holder in due course. After the instrument is overdue B gives it to C, who has notice of the fraud. C succeeds to B's rights as a holder in due course, cutting off the defense.

(b) A induces M by fraud to make an instrument payable to A, A negotiates it to B, who takes as a holder in due course. A then repurchases the instrument from B. A does not succeed to B's rights as a holder in due course, and remains subject to the defense of fraud.

(c) A induces M by fraud to make an instrument payable to A, A negotiates it to B, who takes with notice of the fraud. B negotiates it to C, a holder in due course, and then repurchases the instrument from C. B does not succeed to C's rights as a holder in due course, and remains subject to the defense of fraud.

(d) The same facts as (c), except that B had no notice of the fraud when he first acquired the instrument, but learned of it while he was a holder and with such knowledge negotiated to C. B does not succeed to C's rights as a holder in due course, and his position is not improved by the negotiation and repurchase.

4. The rights of a transferee with respect to collateral for the instrument are determined by Article 9 (Secured Transactions).

5. Subsection (2) restates original § 27 and is intended to make it clear that a transfer of a limited interest in the instrument passes the rights of the transferor to the extent of the interest given. Thus a transferee for security acquires all such rights subject of course to the provisions of Article 9 (Secured Transactions).

6. Subsection (3) applies only to the transfer for value of an instrument payable to order or specially indorsed. It has no application to a gift, or to an instrument payable or indorsed to bearer or indorsed in blank. The transferee acquires, in the absence of any agreement to the contrary, the right to have the indorsement of the transferor. This right is now made enforceable by an action for specific performance. Unless otherwise agreed, it is a right to the general indorsement of the transferor with full liability as indorser, rather than to an indorsement without recourse. The question commonly arises where the purchaser has paid in advance and the indorsement is omitted fraudulently or through oversight; a transferor who is willing to indorse only without recourse or unwilling to indorse at all should make his intentions clear. The agreement for the transferee to take less than an unqualified indorsement need not be an express one, and the understanding may be implied from conduct, from past practice, or from the circumstances of the transaction.

7. Subsection (3) follows the second sentence of the original § 49 in providing that there is no effective negotiation until the indorsement is made. Until that time the purchaser does not become a holder, and if he receives earlier notice of defense against or claim to the instrument he does not qualify as a holder in due course under § 3-302(1)(c).

8. The final clause of subsection (3), which is new, is intended to make it clear that the transferee without indorsement of an order instrument is not a holder and so is not aided by the presumption that he is entitled to recover on the instrument provided in § 3-307(2). The terms of the obligation do not run to him, and he must account for his possession of the unindorsed paper by proving the transaction through which he acquired it. Proof of a transfer to him by a holder is proof that he has acquired the rights of a holder and that he is entitled to the presumption.

Cross References:

§§ 3-202 and 3-416.
Point 5: Article 9.
Point 7: § 3-302(1)(c).
Point 8: § 3-307(2).

Definitional Cross References:

"Bearer". § 1-201.
"Holder". § 1-201.
"Holder in due course". § 3-302.
"Instrument". § 3-102.
"Negotiation". § 3-202.
"Notice". § 1-201.
"Party". § 1-201.
"Presumption". § 1-201.
"Rights". § 1-201.
"Security interest". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-379, 6-401, 6-410.

Comment: The UCC continues prior law under which a transfer of the instrument vests in the transferee such rights as the transferor had therein. This accords with Kentucky Virginia Stone Co. v. Fortner, 159 Va. 234, 238, 165 S.E. 401 (1932); Carter v. Piercy, 156 Va. 640, 649-50, 159 S.E. 154 (1931). Wheeler v. Wardell, 173 Va. 168, 175, 3 S.E.2d 377 (1939), gave the receiver of a bank the holder in due course rights of the bank itself.

The shelter doctrine and its exceptions are continued under the UCC. A holder in due course who, having guaranteed payment of an instrument, takes it up after acquiring knowledge of a defense still has the rights of a holder in due course. Ratcliffe v. Costello, 117 Va. 563, 567, 85 S.E. 469 (1915).

A fraudulent payee cannot improve his position by reacquiring an instrument he transferred to a holder in due course. The same principle prevents a third person, who ostensibly acts for himself but in fact acts for the fraudulent payee, from acquiring the rights of a holder in due course by a transfer from such a holder. Elkhart State Bank v. Bristol Broom Co., 143 Va. 1, 10, 129 S.E. 371 (1925); Aragon Coffee Co. v. Rogers, 105 Va. 51, 54, 52 S.E. 843 (1906). The UCC does not cover the precise point involved in Nachman v. Chatham-Phenix Nat'l Bank & Trust Co., 161 Va. 576, 171 S.E. 676 (1933), in which the court found there had been a novation, the holder with notice of the fraud being substituted for the holder in due course, so that the maker's defense was not cut-off. The application of the shelter principle to Citizen's Nat'l Bank v. McDannald, 116 Va. 834, 83 S.E. 389 (1914), is not clear. This was an action against the maker of a promissory note who had borrowed money from a bank for use in a wagering transaction, the bank not knowing of this illegal purpose. The note had been indorsed for accommodation by Carpenter, who did know of the illegal purpose. It was held that the bank, suing for the benefit of Carpenter, could recover from McDannald, the court saying, "It was a valid security in the hands of the bank, and therefore the bank 'was entitled to have the whole world for its market,' and could transmit a complete title to Carpenter, although he had notice of the use that McDannald intended to make of the money; 'the general rule being that if a person with notice purchase from one without notice, he is entitled to stand in the latter's shoes and take shelter under his good faith'." 116 Va. at 836. Since the accommodation indorser was "a party" to the illegality it is difficult to see how he could be protected by the doctrine of shelter; and yet an accommodation indorser does not appear to be "a party" within the meaning of Code 1950, § 11-14, as to whom a gaming contract is void. The case probably rests on the peculiar factual situation.

As under prior law a negotiation does not take place until any necessary indorsement is actually made, so that the transferee cannot become a holder in due course until the indorsement is made. Nat'l Mechanics Bank v. Schmelz Nat'l Bank, 136 Va. 33, 39, 116 S.E. 380 (1923).

§ 3-202. Negotiation. (1) Negotiation is the transfer of an instrument in such form that the transferee becomes a holder. If the instrument is payable to order it is negotiated by delivery with any necessary indorsement; if payable to bearer it is negotiated by delivery.

(2) An indorsement must be written by or on behalf of the holder and on the instrument or on a paper so firmly affixed thereto as to become a part thereof.

(3) An indorsement is effective for negotiation only when it conveys the entire instrument or any unpaid residue. If it purports to be of less it operates only as a partial assignment.

(4) Words of assignment, condition, waiver, guaranty, limitation or disclaimer of liability and the like accompanying an indorsement do not affect its character as an indorsement.

COMMENT: **Prior Uniform Statutory Provision:** §§ 30, 31 and 32, Uniform Negotiable Instruments Law.

Changes: Combined and reworded; new provisions.

Purposes of Changes and New Matter: To make it clear that:

1. Negotiation is merely a special form of transfer, the importance of which lies entirely in the fact that it makes the transferee a holder as defined in § 1-201. Any negotiation carries a transfer of rights as provided in the section on transfer (subsections (1) and (2) of § 3-201).

2. Any instrument which has been specially indorsed can be negotiated only with the indorsement of the special indorsee as provided in § 3-204 on special indorsement. An instrument indorsed in blank may be negotiated by delivery alone, provided that it bears the indorsement of all prior special indorsees.

3. Subsection (2) follows decisions holding that a purported indorsement on a mortgage or other separate paper pinned or clipped to an instrument is not sufficient for negotiation. The indorsement must be on the instrument itself or on a paper intended for the purpose which is so firmly affixed to the instrument as to become an extension or part of it. Such a paper is called an allonge.

4. The cause of action on an instrument cannot be split. Any indorsement which purports to convey to any party less than the entire amount of the instrument is not effective for negotiation. This is true of either "Pay A one-half," or "Pay A two-thirds and B one-third," and neither A nor B becomes a holder. On the other hand an indorsement reading merely "Pay A and B" is effective, since it transfers the entire cause of action to A and B as tenants in common.

The partial indorsement does, however, operate as a partial assignment of the cause of action. The provision makes no attempt to state the legal effect of such an assignment, which is left to the local law. In a jurisdiction in which a partial assignee has any rights, either at law or in equity, the partial indorsee has such rights; and in any jurisdiction where a partial assignee has no rights the partial indorsee has none.

5. Subsection (4) is intended to reject decisions holding that the addition of such words as "I hereby assign all my right, title and interest in the within note" prevents the signature from operating as an indorsement. Such words usually are added by laymen out of an excess of caution and a desire to indicate formally that the instrument is conveyed, rather than with any intent to limit the effect of the signature.

6. Subsection (4) is also intended to reject decisions which have held that the addition of "I guarantee payment" indicates an intention not to indorse but merely to guarantee. Any signature with such added words is an indorsement, and if it is made by a holder is effective for negotiation; but the liability of the indorser may be affected by the words of guarantee as provided in the section on the contract of a guarantor (§ 3-416).

Cross References:

§ 3-417.
Point 1: §§ 1-201 and 3-201(1) and (2).
Point 2: § 3-204.
Point 6: § 3-416.

Definitional Cross References:

"Bearer". § 1-201.
"Delivery". § 1-201.
"Holder". § 1-201.
"Instrument". § 3-102.
"Written". § 1-201.

Prior Statutes: Code 1950, §§ 6-382, 6-383, 6-384.

Comment: Negiotiation involves a transfer that gives the transferee both legal and equitable title. Stegal v. Union Bank & Federal Trust Co., 163 Va. 417, 442, 176 S.E. 438 (1934). An instrument payable to bearer is negotiated by delivery. An instrument payable to order is negotiated by indorsement and delivery. A transfer of an order instrument without a necessary indorsement is not a negotiation. Citizens Bank and Trust Co. v. Chase, 151 Va. 65, 69, 144 S.E. 464 (1928). The rule applies to an order instrument drawn to the order of the maker. Reid's Adm'r v. Windsor, 111 Va. 825, 829, 69 S.E. 1101 (1911); Pettyjohn v. Nat'l Exchange Bank, 101 Va. 111, 123, 43 S.E. 203 (1903). For a discussion of negotiation as it relates to the payee being a holder in due course, see VIRGINIA ANNOTATIONS to UCC 3-302.

Since the UCC requires that an indorsement must be written on the instrument or on a paper so firmly affixed thereto as to become a part thereof, it changes the result in Colona v. Parksley Nat'l Bank, 120 Va. 812, 821-23, 92 S.E. 979 (1917), in which a signature in a letter of assignment attached to a note was held to be a sufficient indorsement. By implication the Colona case also holds that an indorsement may be written on a separate paper even though there is room on the instrument for additional indorsements. This question, on which there has been a conflict of authority, is not dealt with in the UCC, so that the implicit holding of the Colona case remains unchanged.

An indorsement that purports to convey less than the entire instrument operates as a partial assignment, and has the effect prescribed under other state law for such assignments. In Virginia the action must be brought in the name of the assignor. Newton v. White, 115 Va. 844, 80 S.E. 561 (1914). Where the action is brought in the name of the assignor, an obligor cannot object to a partial assignment because a determination of the issues involved will settle and determine all claims against him. Tyler v. Ricamore, 87 Va. 466, 469, 12 S.E. 799 (1891). An assignee of a part of an obligation cannot sue in his own name. Phillips v. City of Portsmouth, 112 Va. 164, 70 S.E. 502 (1911).

The UCC accords with the holding in Blanton v. Keneipp, 155 Va. 668, 681, 156 S.E. 413 (1931), that an instrument continues to be negotiable after maturity, until it is discharged by payment or otherwise.

§ 3-203. Wrong or Misspelled Name. Where an instrument is made payable to a person under a misspelled name or one other than his own he may indorse in that name or his own or both; but signature in both names may be required by a person paying or giving value for the instrument.

COMMENT: Prior Uniform Statutory Provision: § 43, Uniform Negotiable Instruments Law.

Changes: Reworded.

Purposes of Changes: To make it clear that:

1. **The party whose name is wrongly designated or misspelled may make an indorsement effective for negotiation by signing in his true name only. This is not commercially satisfactory, since any subsequent purchaser may be left in doubt as to the state of the title; but whether it is done intentionally or through oversight, the party transfers his rights and is liable on his indorsement, and there is a negotiation if identity exists.**

2. He may make an effective indorsement in the wrongly designated or misspelled name only. This again is not commercially satisfactory, since his liability as an indorser may require proof of identity.

3. He may indorse in both names. This is the proper and desirable form of indorsement, and any person called upon to pay an instrument or under contract to purchase it may protect his interest by demanding indorsement in both names, and is not in default if such demand is refused.

Cross Reference:

§ 3-401(2).

Definitional Cross References:

"Instrument". § 3-102.
"Person". § 1-201.
"Signature". § 3-401.

Prior Statutes: Code 1950, § 6-395.

Comment: This section accords with the statement in First Nat'l Bank v. Peoples Nat'l Bank, 136 Va. 276, 282-83, 118 S.E. 82, 36 A.L.R. 736 (1923), that a draft drawn in the name of the wrong payee because of a clerical error may be indorsed in the name of the payee to whom it is drawn, the indorser adding his true name if he sees fit.

§ 3-204. Special Indorsement; Blank Indorsement. (1) A special indorsement specifies the person to whom or to whose order it makes the instrument payable. Any instrument specially indorsed becomes payable to the order of the special indorsee and may be further negotiated only by his indorsement.

(2) An indorsement in blank specifies no particular indorsee and may consist of a mere signature. An instrument payable to order and indorsed in blank becomes payable to bearer and may be negotiated by delivery alone until specially indorsed.

(3) The holder may convert a blank indorsement into a special indorsement by writing over the signature of the indorser in blank any contract consistent with the character of the indorsement.

COMMENT: Prior Uniform Statutory Provision: §§ 9(5), 33, 34, 35, 36 and 40, Uniform Negotiable Instruments Law.

Changes: Combined and reworded; rule of § 40 reversed.

Purposes of Changes: The last sentence of subsection (1) reverses the rule of the original § 40, under which an instrument drawn payable to bearer and specially indorsed could be further negotiated by delivery alone. The principle here adopted is that the special indorser, as the owner even of a bearer instrument, has the right to direct the payment and to require the indorsement of his indorsee as evidence of the satisfaction of his own obligation. The special indorsee may of course make it payable to bearer again by himself indorsing in blank.

Cross Reference: § 3-202.

Definitional Cross References:

"Bearer". § 1-201.
"Delivery". § 1-201.
"Instrument". § 3-102.
"Person". § 1-201.
"Signature". § 3-401.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-361(5), 6-385, 6-386, 6-387, 6-388, 6-392, 6-391 (NIL 39), 6-400 (NIL 48).

Comment: In Wall v. Fairfax, 180 Va. 421, 427, 23 S.E. 2d 130 (1942), the Virginia court appears to have departed from the NIL classification of indorsements. Under Code 1950, § 6-385 (NIL § 33), which was not cited, all indorsements are either special or in blank, and in addition they may be restrictive, qualified or conditional. In this case the court appears to have thought that an indorsement is either special or conditional, but not both. The UCC retains the original classification of the NIL, under which all indorsements can be classified as either special or in blank.

The instrument involved in Wall v. Fairfax was payable to bearer on its face. By denying that the instrument carried a special indorsement, the court denied the applicability of Code 1950, § 6-392 (NIL § 40), which provides that an instrument payable to bearer but indorsed specially may nevertheless be further negotiated by delivery alone, and the applicability of Code 1950, § 6-400 (NIL § 48), which permits the holder to strike out any indorsement not necessary to his title. In this way the court held in accordance with Code 1950, § 6-391 (NIL § 39), but without citation of the section, that the holder under a conditional indorsement holds in accordance with the terms of the indorsement. This

result in the case could have been reached by other routes, as by holding that the indorsee never obtained delivery of the instrument so as to become the holder, since the instrument had been placed in the indorser's own safe deposit box. Furthermore, the indorsee was not a holder in due course with reference to the indorser, so that whatever the indorsee's rights may have been against the maker, as between the indorser, and his successors in interest, and the indorsee, the terms of the conditional indorsement would control.

The UCC abolishes the rule that an instrument drawn payable to bearer and specially indorsed can be further negotiated by delivery alone, and provides instead that an instrument drawn payable to bearer can be changed into an order instrument by a special indorsement. Since a special indorsement now controls the paper, the result reached in Ward v. Fairfax can be obtained directly.

A special indorsement passes title to the entire instrument, as was held in Fleshman v. Bibb, 118 Va. 582, 585, 88 S.E. 64 (1916), in which the indorsee provided only one-half of the consideration for the transfer.

§ 3-205. Restrictive Indorsements. An indorsement is restrictive which either

(a) is conditional; or

(b) purports to prohibit further transfer of the instrument; or

(c) includes the words "for collection", "for deposit", "pay any bank", or like terms signifying a purpose of deposit or collection; or

(d) otherwise states that it is for the benefit or use of the indorser or of another person.

COMMENT: Prior Uniform Statutory Provision: §§ 36 and 39, Uniform Negotiable Instruments Law.

Changes: Combined and reworded; new provisions.

Purposes of Changes and New Matter: 1. This section is intended to provide a definition of restrictive indorsements which will include the varieties of indorsement described in original §§ 36 and 39. The separate mention of conditional indorsements, those prohibiting transfer, indorsements in the bank deposit or collection process, and other indorsements to a fiduciary, permits separate treatment in subsequent sections where policy so requires.

2. This is part of a series of changes of the prior uniform statutory provisions effected by §§ 3-102, 3-205, 3-206, 3-304, 3-419, 3-603, and in Article 4, §§ 4-203 and 4-205. The purpose of the changes is generally to require a taker or payor under restrictive indorsement to apply or pay value given consistently with the indorsement, but to provide certain exceptions applying to banks in the collection process (other than depositary banks), and to some other takers and payors.

Cross References:

§§ 3-102, 3-202(2), 3-205, 3-206, 3-304, 3-419, 3-603, 4-203 and 4-205.

Definitional Cross References:

"Instrument". § 3-102.
"Person". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-388, 6-391.

Comment: Under the UCC the conditional and qualified indorsements are treated as particular kinds of restrictive indorsements. The indorsement in Power v. Finnie, 8 Va. (4 Call) 411 (1797), which was "Pay A Only", thus becomes one form of restrictive indorsement. Similarly, the indorsement in Wall v. Fairfax, 180 Va. 421, 23 S.E.2d 130 (1942), called a conditional indorsement by the court, becomes a form of restrictive indorsement.

§ 3-206. Effect of Restrictive Indorsement. (1) No restrictive indorsement prevents further transfer or negotiation of the instrument.

(2) An intermediary bank, or a payor bank which is not the depositary bank, is neither given notice nor otherwise affected by a restrictive indorsement of any person except the bank's immediate transferor or the person presenting for payment.

(3) Except for an intermediary bank, any transferee under an indorsement which is conditional or includes the words "for collection", "for deposit", "pay any bank", or like terms (subparagraphs (a) and (c) of § 3-205) must pay or apply any value given by him for or on the security of the instrument consistently with the indorsement and to the extent that he does so he becomes a holder for value. In addition such transferee is a holder in due course if he otherwise complies with the requirements of § 3-302 on what constitutes a holder in due course.

(4) The first taker under an indorsement for the benefit of the indorser or another person (subparagraph (d) of § 3-205) must pay or apply any value given by him for or on the security of the instrument consistently with the indorsement and to the extent that he does so he becomes a holder for value. In addition such taker is a holder in due course if he otherwise complies with the requirements of § 3-302 on what constitutes a holder in due course. A later holder for value is neither given notice nor otherwise affected by such restrictive indorsement unless he has knowledge that a fiduciary or other person has negotiated the instrument in any transaction for his own benefit or otherwise in breach of duty (subsection (2) of § 3-304).

COMMENT: Prior Uniform Statutory Provision: §§ 36, 37, 39 and 47, Uniform Negotiable Instruments Law.

Changes: Completely revised.

Purposes of Changes: 1. Subsections (1) and (2) apply to all four classes of restrictive indorsements defined in § 3-205. Conditional indorsements and indorsements for deposit or collection, defined in paragraphs (a) and (c) of § 3-205, are also subject to subsection (3); and trust indorsements as defined in paragraph (d) of § 3-205 are subject to subsection (4). This section negates the implication which has sometimes been found in the original §§ 37 and 47, that under a restrictive indorsement neither the indorsee nor any subsequent taker from him could become a holder in due course. By omitting the original § 47, this Article also avoids any implication that a discharge is effective against a holder in due course. See § 3-602.

2. Under subsection (1) an indorsement reading "Pay A only," or any other indorsement purporting to prohibit further transfer, is without effect for that purpose. Such indorsements have rarely appeared in reported American cases. Ordinarily further negotiation will be contemplated by the indorser, if only for bank collection. The indorsee becomes a holder, and the indorsement does not of itself give notice to subsequent parties of any defense or claim of the indorser. Hence this section gives such an indorsement the same effect as an unrestricted indorsement.

3. Subsection (2) permits an intermediary bank (§§ 3-102(3) and 4-105) or a payor bank which is not a depositary bank (§§ 3-102(3) and 4-105) to disregard any restrictive indorsement except that of the bank's immediate transferor. Such banks ordinarily handle instruments, especially checks, in bulk and have no practicable opportunity to consider the effect of restrictive indorsements. Subsection (2) does not affect the rights of the restrictive indorser against parties outside the bank collection process or against the first bank in the collection process; such rights are governed by subsections (3) and (4) and § 3-603.

4. Conditional indorsements are treated by this section like indorsements for deposit or collection. Under subsection (3) any transferee under such an indorsement except an intermediary bank becomes a holder for value to the extent that he acts consistently with the indorsement in paying or applying any value given by him for or on the security of the instrument. Contrary to the original § 39, subsection (3) permits a transferee under a conditional indorsement to become a holder in due course free of the conditional indorser's claim.

5. Of the indorsements covered by this section those "for collection", "for deposit" and "pay any bank" are overwhelmingly the most frequent. Indorsements "for collection" or "for deposit" may be either special or blank; indorsements "pay any bank" are governed by § 4-201(2). Instruments so indorsed are almost invariably destined to be lodged in a bank for collection. Subsection (3) requires any transferee other than an intermediary bank to act consistently with the purpose of collection, and § 3-603 lays down a similar rule for payors not covered by subsection (2).

6. Subsection (4), applying to trust indorsements other than those for deposit or collection (paragraph (d) of § 3-205) is similar to subsection (3); but in subsection (4) the duty to act consistently with the indorsement is limited to the first taker under it. If an instrument is indorsed "Pay T in trust for B" or "Pay T for B" or "Pay T for account of B" or "Pay T as agent for B," whether B is the indorser or a third person, T is of course subject to liability for any breach of his obligation as fiduciary. But trustees commonly and legitimately sell trust assets in transactions entirely outside the bank collection process; the trustee therefore has power to negotiate the instrument and make his transferee a holder in due course. Whether transferees from T have notice of a breach of trust such as to deny them the status of holders in due course is governed by the section on notice to purchasers (§ 3-304); the trust indorsement does not of itself give such notice. Payors are immunized either by subsection (2) of this section or by § 3-603: payment to the trustee or to a purchaser from the trustee is "consistent with the terms" of the trust indorsement under § 3-603(1) (b).

7. Several sections of Article 3 and Article 4 are explicitly made subject to the rules stated in this section. See §§ 3-306, 3-419, 4-203 and 4-205.

Cross References:

Point 1: §§ 3-205 and 3-602.
Point 2: § 3-205(b).
Point 3: §§ 3-102(3), 3-419(4), 3-603, 4-105, 4-205(2).
Point 4: § 3-205(a).
Point 5: §§ 3-205, 3-603 and 4-201.
Point 6: §§ 3-205, 3-304 and 3-603.
Point 7: §§ 3-306, 3-419, 4-203 and 4-205.

Definitional Cross References:

"Bank". § 1-201.
"Depositary bank". §§ 3-102(3) and 4-105.
"Holder in due course". § 3-302.
"Intermediary bank". §§ 3-102(3) and 4-105.
"Negotiation". §§ 3-102(2) and 3-202.
"Payor bank". §§ 3-102(3) and 4-105.
"Restrictive indorsement". § 3-205.
"Transfer". § 3-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-388, 6-389, 6-391, 6-399.

Comment: Under this section an instrument restrictively indorsed may, nevertheless, be transferred or negotiated, thus changing the rule of the NIL and as stated in Blanton v. Keneipp, 155 Va. 668, 681, 156 S.E. 413 (1931), and Cussen v. Brandt, 97 Va. 1, 9-10, 33 S.E. 791 (1899), in which it was said that an indorsement for collection destroys negotiability. Under this section the indorsement, "Pay A Only," as in Power v. Finnie, 8 Va. (4 Call) 411 (1797), is ineffective to prevent further transfer.

In Commercial Saving Bank v. Maher, 202 Va. 286, 117 S.E. 2d 120 (1960), involving a check restrictively indorsed and collected through banking channels, no point was made concerning the applicability of Code 1950, § 6-399 (NIL § 47), which provides that an instrument continues to be negotiable "until it has been restrictively indorsed." Under the UCC, instruments entering the banking chain for collection become subject to Article 4. The UCC leaves unmodified the holding in Federal Reserve Bank of Richmond v. Bohannon, 141 Va. 285, 291, 127 S.E. 161 (1925), that a bank holding a check as indorsee for collection can bring an action against the indorser in its own name.

The section accords with Wall v. Fairfax, 180 Va. 421, 427-28, 23 S.E. 2d 130 (1942), holding that the indorsee under a conditional indorsement holds the instrument in accordance with the terms of the indorsement.

§ 3-207. **Negotiation Effective Although It May Be Rescinded.** (1) Negotiation is effective to transfer the instrument although the negotiation is

(a) made by an infant, a corporation exceeding its powers, or any other person without capacity; or

(b) obtained by fraud, duress or mistake of any kind; or

(c) part of an illegal transaction; or

(d) made in breach of duty.

(2) Except as against a subsequent holder in due course such negotiation is in an appropriate case subject to rescission, the declaration of a constructive trust or any other remedy permitted by law.

COMMENT: Prior Uniform Statutory Provision: §§ 22, 58 and 59, Uniform Negotiable Instruments Law.

Changes: Completely revised.

Purposes of Changes: To make it clear that:

1. The original § 22, which covered only negotiation by an infant or a corporation, is extended by this section to include other negotiations which may be rescinded. The provision applies even though the party's lack of capacity, or the illegality, is of a character which goes to the essence of the transaction and makes it entirely void, and even though the party negotiating has incurred no liability and is entitled to recover the instrument and have his indorsement cancelled.

2. It is inherent in the character of negotiable paper that any person in possession of an instrument which by its terms runs to him is a holder, and that anyone may deal with him as a holder. The principle finds its most extreme application in the well settled rule that a holder in due course may take the paper even from a thief and be protected against the claim of the rightful owner. Where there is actual negotiation, even in an entirely void transaction, it is no less effective. The policy of this provision, as well as of the last sentence of the original § 59, is that any person to whom an instrument is negotiated is a holder until the instrument has been recovered from his possession; and that any person who negotiates an instrument thereby parts with all his rights in it until such recovery. The remedy of any such claimant is to recover the paper by replevin or otherwise; to impound it or to enjoin its enforcement, collection or negotiation; to recover its proceeds from the holder; or to intervene in any action brought by the holder against the obligor. As provided in the section on the rights of one not a holder in due course (§ 3-306) his claim is not a defense to the obligor unless he himself defends the action.

3. Negotiation under this Article always includes delivery. (§ 3-202, and see § 1-201(14)). Acquisition of possession by a thief can therefore never be negotiation under this section. But delivery by the thief to another person may be.

4. Nothing in this section is intended to impose any liability on the party negotiating. He may assert any defense available to him under §§ 3-305, 3-306 and 3-307.

5. A holder in due course takes the instrument free from all claims to it on the part of any person (§ 3-305(1)). Against him there can be no rescission or other remedy, even though the prior negotiation may have been fraudulent or illegal in its essence and entirely void. As against any other party the claimant may have any remedy permitted by law. This section is not intended to specify what that remedy may be, or to prevent any court from imposing conditions or limitations such as prompt action or return of the consideration received. All such questions are left to the law of the particular jurisdiction. Subsection (2) of § 3-207 gives no right where it would not otherwise exist. The section is intended to mean that any remedies afforded by the local law are cut off only by a holder in due course, and that other parties, such as a bona fide purchaser with notice that the instrument is overdue, take it subject to the claim as provided in paragraph (a) of the section on the rights of one not a holder in due course (§ 3-306).

Cross References:

Point 2: §§ 1-201 and 3-306(d).
Point 3: §§ 1-201 and 3-202.
Point 4: §§ 3-305, 3-306 and 3-307.
Point 5: §§ 3-305(1) and 3-306(a).

Definitional Cross References:

"Holder in due course". § 3-302.
"Instrument". § 3-102.
"Negotiation". § 3-202.
"Person". § 1-201.
"Remedy". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-374, 6-410, 6-411.

Comment: The UCC continues prior law as expressed in Strother v. Lynchburg Trust and Savings Bank, 155 Va. 826, 156 S.E. 426, 73 A.L.R. 166 (1931), that an infant's indorsement is effective as a negotiation of an instrument, even though it may later be rescinded. For Comments on an infant's right to disaffirm such an indorsement see VIRGINIA ANNOTATIONS to UCC 3-305.

§ 3-208. **Reacquisition.** Where an instrument is returned to or reacquired by a prior party he may cancel any indorsement which is not necessary to his title and reissue or further negotiate the instrument, but any intervening party is discharged as against the reacquiring party and subsequent holders not in due course and if his indorsement has been cancelled is discharged as against subsequent holders in due course as well.

COMMENT: **Prior Uniform Statutory Provision:** §§ 48, 50 and 121, Uniform Negotiable Instruments Law.

Changes: Parts of original sections combined and rephrased.

Purposes of Changes: No change in the substance of the law is intended. "Returned to or required by" is substituted for "negotiated back to" in the original § 50 in order to make it clear that the section applies to a return by an indorsee who does not himself indorse. "Discharged" is substituted for the original language to make it clear that the discharge of the intervening party is included within the rule of the section on effect of discharge against a holder in due course (§ 3-602) and is not effective against a subsequent holder in due course who takes without notice of it.

The reacquirer may keep the instrument himself or he may further negotiate it. On further negotiation he may or may not cancel intervening indorsements. In any case intervening indorsers are discharged as to the reacquirer, since if he attempted to enforce it against them they would have an action back against him. Where the reacquirer negotiates without cancelling the intervening indorsements, the section provides that such indorsers are discharged except against subsequent holders in due course. The intervening indorser whose indorsement is stricken is, in conformity with § 3-605, discharged even as against subsequent holders in due course.

Cross References:

§§ 3-602, 3-603(2) and 3-605.

Definitional Cross References:

"Holder in due course". § 3-302.
"Instrument". § 3-102.
"Party". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-400, 6-402, 6-474.

Comment: This section does not affect the rights of a holder in due course who takes up an instrument which has not been paid, and the payment of which he has guaranteed, after he has learned of fraud in its procurement. Ratcliffe v. Costello, 117 Va. 563, 567-68, 85 S.E. 469 (1915).

PART 3

RIGHTS OF A HOLDER

§ 3-301. **Rights of a Holder.** The holder of an instrument whether or not he is the owner may transfer or negotiate it and, except as otherwise provided in § 3-603 on payment or satisfaction, discharge it or enforce payment in his own name.

COMMENT: **Prior Uniform Statutory Provision:** § 51, Uniform Negotiable Instruments Law.

Changes: Reworded. The provision in the original § 51 as to discharge by payment is now covered by § 3-603(1).

Purposes of Changes: The section is revised to state in one provision all the rights of a holder, and to make it clear that every holder has such rights. The only limitations are those found in § 3-603 on payment or satisfaction. That section provides (with stated exceptions) that payment to a holder discharges the liability of the party paying even though made with knowledge of a claim of another person to the instrument, unless the adverse claimant posts indemnity or procures the issuance of appropriate legal process restraining the payment. Thus payment to a holder in an adverse claim situation would not give discharge if the adverse claimant had followed either of the procedures provided for in the "unless" clause of § 3-603; nor would a discharge result from payment in two other specific situations described in § 3-603.

Cross References:

§§ 1-201, 3-307 and 3-603(1).

Definitional Cross References:

"Holder". § 1-201.
"Instrument". § 3-102.
"Rights". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-403.

Comment: This section continues prior law under which the holder may sue in his own name. Federal Reserve Bank of Richmond v. Bohannan, 141 Va. 285, 127 S.E. 161 (1925) (holder for collection); Fleshman v. Bibb, 118 Va. 582, 88 S.E. 64 (1916) (holder only furnished one-half of the consideration for the transfer). The section is in accord with Anderson v. Union Bank of Richmond, 117 Va. 1, 3-6, 83 S.E. 1080 (1915), holding that the pledgee of a note as collateral is a holder so as to be entitled to enforce payment.

§ 3-302. **Holder in Due Course.** (1) A holder in due course is a holder who takes the instrument

(a) for value; and

(b) in good faith; and

(c) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person.

(2) A payee may be a holder in due course.

(3) A holder does not become a holder in due course of an instrument:

(a) by purchase of it at judicial sale or by taking it under legal process; or

(b) by acquiring it in taking over an estate; or

(c) by purchasing it as part of a bulk transaction not in regular course of business of the transferor.

(4) A purchaser of a limited interest can be a holder in due course only to the extent of the interest purchased.

COMMENT: **Prior Uniform Statutory Provision:** § 52, Uniform Negotiable Instruments Law.

Changes: Reworded; new provisions.

Purposes of Changes and New Matter: The changes are intended to remove uncertainties arising under the original section.

1. The language "without notice that it is overdue" is substituted for that of the original subsection (2) in order to make it clear that the purchaser of an instrument which is in fact overdue may be a holder in due course if he takes it without notice that it is overdue. Such notice is covered by the section on notice to purchaser (§ 3-304).

2. Subsection (2) is intended to settle the long continued conflict over the status of the payee as a holder in due course. This conflict has turned very largely upon the word "negotiated" in the original § 52(4), which is now eliminated. The position here taken is that the payee may become a holder in due course to the same extent and under the same circumstances as any other holder. This is true whether he takes the instrument by purchase from a third person or directly from the obligor. All that is necessary is that the payee meet the requirements of this section. In the following cases, among others, the payee is a holder in due course:

a. A remitter, purchasing goods from P, obtains a bank draft payable to P and forwards it to P, who takes it for value, in good faith and without notice as required by this section.

b. The remitter buys the bank draft payable to P, but it is forwarded by the bank directly to P, who takes it in good faith and without notice in payment of the remitter's obligation to him.

c. A and B sign a note as co-makers. A induces B to sign by fraud, and without authority from B delivers the note to P, who takes it for value, in good faith and without notice.

d. A defrauds the maker into signing an instrument payable to P. P pays A for it in good faith and without notice, and the maker delivers the instrument directly to P.

e. D draws a check payable to P and gives it to his agent to be delivered to P in payment of D's debt. The agent delivers it to P, who takes it in good faith and without notice in payment of the agent's debt to P. But as to this case see § 3-304(2), which may apply.

f. D draws a check payable to P but blank as to the amount, and gives it to his agent to be delivered to P. The agent fills in the check with an excessive amount, and P takes it for value, in good faith and without notice.

g. D draws a check blank as to the name of the payee, and gives it to his agent to be filled in with the name of A and delivered to A. The agent fills in the name of P, and P takes the check in good faith, for value and without notice.

3. Subsection (3) is intended to state existing case law. It covers a few situations in which the purchaser takes the instrument under unusual circumstances which indicate that he is merely a successor in interest to the prior holder and can acquire no better rights. (If such prior holder was himself a holder in due course, the purchaser succeeds to that status under § 3-201 on Transfer.) The provision applies to a purchaser at an execution sale, a sale in bankruptcy or a sale by a state bank commissioner of the assets of an insolvent bank. It applies equally to an attaching creditor or any other person who acquires the instrument by legal process, even under an antecedent claim; and equally to a representative, such as an executor, administrator, receiver or assignee for the benefit of creditors, who takes over the instrument as part of an estate, even though he is representing antecedent creditors.

Subsection (3)(c) applies to bulk purchases lying outside of the ordinary course of business of the seller. It applies, for example, when a new partnership takes over for value all of the assets of an old one after a new member has entered the firm, or to a reorganized or consolidated corporation taking over in bulk the assets of a predecessor. It has particular application to the purchase by one bank of a substantial part of the paper held by another bank which is threatened with insolvency and seeking to liquidate its assets.

4. A purchaser of a limited interest—as a pledgee in a security transaction—may become a holder in due course, but he may enforce the instrument over defenses only to the extent of his interest, and defenses good against the pledgor remain available insofar as the pledgor retains an equity in the instrument. This is merely a special application of the general rule (§ 1-201) that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. § 27 of the original Act contained a similar provision.

Cross References:

§§ 1-201, 3-303, 3-305 and 3-306.
Point 1: § 3-304(5).
Point 3: § 3-201.
Point 4: § 1-201.

Definitional Cross References:

"Good faith". § 1-201.
"Holder". § 1-201.
"Instrument". § 3-102.
"Notice". § 1-201.
"Notice of dishonor". § 3-508.
"Person". § 1-201.
"Purchase". § 1-201.
"Purchaser". § 1-201.
"Value". § 3-303.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-404.

Comment: The UCC continues prior law as to the requisites of due course holding. Baird v. Crank, 182 Va. 455, 29 S. E. 2d 225 (1944); Wheeler v. Wardell, 173 Va. 168, 174-75, 3 S.E. 2d 377 (1939); American Bank of Orange v. McComb, 105 Va. 473, 475-76, 54 S.E. 14 (1906).

This section categorically states that a payee may be a holder in due course, the result reached by Virginia in Nat'l Bank of Suffolk v. American Bank and Trust Co., 163 Va. 710, 712-23, 177 S.E. 229 (1934). Virginia reached this result on the theory that the NIL definition of negotiation as set forth in Code 1950, § 6-382 (NIL § 30), was not exclusive and that a payee may take by negotiation. This theory is also available under UCC 3-202(1), which provides that an instrument payable to order may be negotiated by delivery with any necessary indorsement. Since no endorsement is necessary to make the payee a holder, the payee may be deemed to take by negotiation. However, the UCC eliminates any requirement that the payee take by negotiation in order to become a holder in due course. Coal River Collieries v. Eureka Coal and Wood Co., 144 Va. 263, 132 S.E. 337 (1926), is an example of the type of case in which it is possible, under the UCC, that a payee might be found to be a holder in due course, although the application of the UCC to this factual situation is not entirely clear. See VIRGINIA ANNOTATIONS to UCC 3-403.

The UCC expressly states the result reached in Baach v. Bank of Pocahontas, 157 Va. 274, 282-83, 160 S.E. 68 (1931), that a holder does not acquire due course status by the purchase of an instrument as part of a bulk transfer not in the regular course of business of the transferor. Of course, if the transferor was a holder in due course, the transferee succeeds to these same rights. Wheeler v. Wardell, 173 Va. 168, 175, 3 S.E. 2d 377 (1939). See VIRGINIA ANNOTATIONS to UCC 3-201.

A holder does not become a holder in due course by taking an instrument under legal process. While perhaps not precisely in point, the principle is in accord with the holding in Browning v. Fuller, 153 Va. 36, 149 S.E. 462 (1929), that a bank receiver is not as such a holder in due course, and the holding in Schmitt v. Redd, 151 Va. 333, 338. 143 S.E. 884 (1928), that a receiver appointed to take over pledged collateral does not thereby become a holder in due course.

§ 3-303. **Taking for Value.** A holder takes the instrument for value

(a) to the extent that the agreed consideration has been performed or that he acquires a security interest in or a lien on the instrument otherwise than by legal process; or

(b) when he takes the instrument in payment of or as security for an antecedent claim against any person whether or not the claim is due; or

(c) when he gives a negotiable instrument for it or makes an irrevocable commitment to a third person.

COMMENT: **Prior Uniform Statutory Provision:** §§ 25, 26, 27 and 54, Uniform Negotiable Instruments Law.

Changes: Combined and reworded; original § 26 omitted.

Purposes of Changes: The changes are intended to remove uncertainties arising under the original Act.

1. The original § 26 which had reference to the liability of accomodation parties is omitted as erroneous and misleading, since a holder who does not himself give value cannot qualify as a holder in due course in his own right merely because value has previously been given for the instrument.

2. In this Article value is divorced from consideration (§ 3-408). The latter is important only on the question of whether the obligation of a party can be enforced against him; while value is important only on the question of whether the holder who has acquired that obligation qualifies as a particular kind of holder.

3. Paragraph (a) resolves an apparent conflict between the original § 54 and the first sentence of the original § 25, by requiring that the agreed consideration shall actually have been given. An executory promise to give value is not itself value, except as provided in paragraph (c). The underlying reason of policy is that when the purchaser learns of a defense against the instrument or of a defect in the title he is not required to enforce the instrument, but is free to rescind the transaction for breach of the transferor's warranty (§ 3-417). There is thus not the same necessity for giving him the status of a holder in due course, cutting off claims and defenses, as where he has actually paid value. A common illustration is the bank credit not drawn upon, which can be and is revoked when a claim or defense appears.

4. Paragraph (a) limits the language of the original § 27, eliminating the attaching creditor or any other person who acquires a lien by legal process. Any such lienor has been uniformly held not to be a holder in due course.

5. Paragraph (b) restates the last sentence of the original § 25. It adopts the generally accepted rule that the holder takes for value when he takes the instrument as security for an antecedent debt, even though there is no extension of time or other concession, and whether or not the debt is due. The provision extends the same rule to any claim against any person; there is no requirement that the claim arise out of contract. In particular the provision is intended to apply to an instrument given in payment of or as security for the debt of a third person, even though no concession is made in return.

6. Paragraph (c) is new, but states generally recognized exceptions to the rule that an executory promise is not value. A negotiable instrument is value because it carries the possibility of negotiation to a holder in due course, after which the party who gives it cannot refuse to pay. The same reasoning applies to any irrevocable commitment to a third person, such as a letter of credit issued when an instrument is taken.

Cross References:

§§ 3-302 and 3-415.
Point 1: § 3-415.
Point 2: § 3-408.
Point 3: § 3-417.

Definitional Cross References:

"Holder". § 1-201.
"Instrument". § 3-102.
"Person". § 1-201.
"Security interest". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-377, 6-378, 6-379, 6-406.

Comment: The UCC distinguishes between value and consideration. Value is relevant in determining the status, and so the rights of the holder or transferee of

an instrument. Consideration is relevant in determining whether one party is liable to another party on the instrument, and is covered by UCC 3-408. This distinction is consistent with Virginia law, although the terminology has not always been adhered to.

The question of whether a giving of bank credit is value falls within the scope of Article 4. For comments on McAuley v. Morris Plan Bank, 155 Va. 777, 156 S.E. 418 (1931), holding that bank credit drawn upon constitutes a giving of value, see VIRGINIA ANNOTATIONS to UCC 4-208.

As under prior law a taking of an instrument for collateral security is a taking for value. Dunnington v. Bank of Crewe, 144 Va. 36, 51-52, 131 S.E. 221 (1926); City Coal and Ice Co. v. Union Trust Co., 140 Va. 600, 603, 125 S.E. 697 (1924); Colona v. Parksley Nat'l Bank, 120 Va. 812, 823, 92 S.E. 979 (1917); Anderson v. Union Bank of Richmond, 117 Va. 1, 5-6, 83 S.E. 1080 (1915).

As under prior law a taking in payment or as security for an antecedent debt, whether or not due, is a taking for value. American Bank of Orange v. McComb, 105 Va. 473, 475-76, 54 S.E. 14 (1906); Payne v. Zell, 98 Va. 294, 36 S.E. 379 (1900).

§ 3-304. **Notice to Purchaser.** (1) The purchaser has notice of a claim or defense if

(a) the instrument is so incomplete, bears such visible evidence of forgery or alteration, or is otherwise so irregular as to call into question its validity, terms or ownership or to create an ambiguity as to the party to pay; or

(b) the purchaser has notice that the obligation of any party is voidable in whole or in part, or that all parties have been discharged.

(2) The purchaser has notice of a claim against the instrument when he has knowledge that a fiduciary has negotiated the instrument in payment of or as security for his own debt or in any transaction for his own benefit or otherwise in breach of duty.

(3) The purchaser has notice that an instrument is overdue if he has reason to know

(a) that any part of the principal amount is overdue or that there is an uncured default in payment of another instrument of the same series; or

(b) that acceleration of the instrument has been made; or

(c) that he is taking a demand instrument after demand has been made or more than a reasonable length of time after its issue. A reasonable time for a check drawn and payable within the states and territories of the United States and the District of Columbia is presumed to be thirty days.

(4) Knowledge of the following facts does not of itself give the purchaser notice of a defense or claim

(a) that the instrument is antedated or postdated;

(b) that it was issued or negotiated in return for an executory promise or accompanied by a separate agreement, unless the purchaser has notice that a defense or claim has arisen from the terms thereof;

(c) that any party has signed for accommodation;

(d) that an incomplete instrument has been completed, unless the purchaser has notice of any improper completion;

(e) that any person negotiating the instrument is or was a fiduciary;

(f) that there has been default in payment of interest on the instrument or in payment of any other instrument, except one of the same series.

(5) The filing or recording of a document does not of itself constitute notice within the provisions of this Article to a person who would otherwise be a holder in due course.

(6) To be effective notice must be received at such time and in such manner as to give a reasonable opportunity to act on it.

(7) In any event, to constitute notice of a claim or defense, the purchaser must have knowledge of the claim or defense or knowledge of such facts that his action in taking the instrument amounts to bad faith. If the purchaser is an organization and maintains within the organization reasonable routines for communicating significant information to the appropriate part of the organization apparently concerned, the individual conducting the transaction on behalf of the purchaser must have the knowledge.

(VALC Note: The Official Text does not contain subsection (7) as set forth above.)

COMMENT: Prior Uniform Statutory Provision: §§ 45, 52, 53, 55 and 56, Uniform Negotiable Instruments Law.

Changes: Combined and reworded; new provisions.

Purposes of Changes and New Matter: The original sections are expanded, with the addition of specific provisions intended to remove uncertainties in the existing law.

1. "Notice" is defined in § 1-201.

2. Paragraph (a) of subsection (1) replaces the provision in the original § 52(1) requiring that the instrument be "complete and regular on its face." An instrument may be blank as to some unnecessary particular, may contain minor erasures, or even have an obvious change in the date, as where "January 2, 1948" is changed to "January 2, 1949", without even exciting suspicion. Irregularity is properly a question of notice to the purchaser of something wrong, and is so treated here.

3. "Voidable" obligation in paragraph (b) of subsection (1) is intended to limit the provision to notice of defense which will permit any party to avoid his original obligation on the instrument, as distinguished from a set-off or counterclaim.

4. Notice that one party has been discharged is not notice to the purchaser of an infirmity in the obligation of other parties who remain liable on the instrument. A purchaser with notice that an indorser is discharged takes subject to that discharge as provided in the section on effect of discharge against a holder in due course (§ 3-602) but is not prevented from taking the obligation of the maker in due course. If he has notice that all parties are discharged he cannot be a holder in due course.

5. Subsection (2) follows the policy of § 6 of the Uniform Fiduciaries Act, and specifies the same elements as notice of improper conduct of a fiduciary. Under paragraph (e) of subsection (4) mere notice of the existence of the fiduciary relation is not enough in itself to prevent the holder from taking in due course, and he is free to take the instrument on the assumption that the fiduciary is acting properly. The purchaser may pay cash into the hands of the fiduciary without notice of any breach of the obligation. § 3-206 should be consulted for the effect of a restrictive indorsement.

6. Subsection (3) removes an uncertainty in the original Act by providing that reason to know of an overdue installment or other part of the principal amount is notice that the instrument is overdue and thus prevents the purchaser from taking in due course. On the other hand subsection (4)(f) makes notice that interest is overdue insufficient, on the basis of banking and commercial practice, the decisions under the original Act, and the frequency with which interest payments are in fact delayed. Notice of default in payment of any other instrument, except an uncured default in another instrument of the same series, is likewise insufficient.

7. Subsection (3) departs from the original § 52(2) by providing that the purchaser may take accelerated paper, or a demand instrument on which demand has in fact been made, as a holder in due course if he takes without notice of the acceleration or demand. With this change the original § 45 is eliminated, as the presumption that any negotiation has taken place before the instrument was in fact overdue is of importance only in aid of a holder in due course. Under this

section it is not conclusive that the instrument was in fact overdue when it was negotiated, if the holder takes without notice of that fact.

The "reasonable time after issue" is retained from the original § 53, but paragraph (c) adds a presumption, as that term is defined in this Act (§ 1-201), that a domestic check is stale after thirty days.

8. Paragraph (a) of subsection (4) rejects decisions holding that an instrument known to be antedated or postdated is not "regular." Such knowledge does not prevent a holder from taking in due course.

9. Paragraph (b) of subsection (4) is to be read together with the provisions of this Article as to when a promise or order is unconditional and as to other writings affecting the instrument (§§ 3-105 and 3-119). Mere notice of the existence of an executory promise or a separate agreement does not prevent the holder from taking in due course, and such notice may even appear in the instrument itself. If the purchaser has notice of any default in the promise or agreement which gives rise to a defense or claim against the instrument, he is on notice to the same extent as in the case of any other information as to the existence of a defense or claim.

10. Paragraph (d) of subsection (4) follows the policy of the original § 14, under which any person in possession of an instrument has prima facie authority to fill blanks. It is intended to mean that the holder may take in due course even though a blank is filled in bis presence, if he is without notice that the filling is improper. § 3-407 on alteration should be consulted as to the rights of subsequent holders following such an alteration.

11. Subsection (5) is new. It removes an uncertainty arising under the original Act as to the effect of "constructive notice" through public filing or recording.

12. Subsection (6) is new. It means that notice must be received with a sufficient margin of time to afford a reasonable opportunity to act on it, and that a notice received by the president of a bank one minute before the bank's teller cashes a check is not effective to prevent the bank from becoming a holder in due course. See in this connection the provision on notice to an organization, § 1-201(27).

Cross References:

§§ 3-201 and 3-302.
Point 1: § 1-201.
Point 4: § 3-602.
Point 5: § 3-206.
Point 7: § 1-201.
Point 9: §§ 3-105(1)(b) and (c) and 3-119.
Point 10: § 3-407.
Point 12: § 1-201.

Definitional Cross References:

"Accommodation party". § 3-415.
"Agreement". § 1-201.
"Alteration". § 3-407.
"Bank". § 1-201.
"Check". § 3-104.
"Holder in due course". § 3-302.
"Instrument". § 3-102.
"Issue". § 3-102.
"Negotiation". § 3-202.
"Notice". § 1-201.
"Party". § 1-201.
"Person". § 1-201.
"Presumed". § 1-201.
"Promise". § 3-102.
"Purchaser". § 1-201.
"Reasonable time". § 1-204.
"Signed". § 1-201.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-397, 6-404, 6-405, 6-407, 6-408, 6-546 (NIL 193).

Comment: The requirements of taking "in good faith" and "without notice" are interrelated concepts. While this section spells out in detail what constitutes notice

to a purchaser, definitions of the concepts are to be found in UCC 1-201, subsection (19) for "good faith" and subsections (25) through (27) for "without notice." The UCC definition of good faith, as contained in UCC 1-201(19), is "honesty in fact in the conduct or transaction concerned." This is in accord with the definition used by the Supreme Court of Appeals, which has said, "The rights of the holder are to be determined by the simple test of honesty and good faith, and not by a speculative issue as to his diligence or negligence." Moore v. Potomac Savings Bank, 160 Va. 597, 608, 169 S.E. 922 (1933). That the purchaser may have acted negligently or been affected with notice of some suspicious circumstances is not sufficient to charge him with notice so as to deny due course holding status. Crum v. Hanna, 140 Va. 366, 369, 125 S.E. 219 (1924). The following cases provide examples of holders who acted in good faith and without notice so as to become holders in due course: Nat'l Bank of Suffolk v. American Bank and Trust Co., 163 Va. 710, 723-26, 177 S.E. 229 (1934) (a payee); City National Bank v. Hundley, 112 Va. 51, 55-56, 70 S.E. 494 (1911); Fleshman v. Bibb, 118 Va. 582, 586-87, 88 S.E. 64 (1916).

The UCC does not affect the frequent holdings of the Supreme Court of Appeals that the purchase of an instrument at a considerable discount does not show knowledge of such facts as to constitute bad faith. Moore v. Potomac Savings Bank, 160 Va. 597, 169 S.E. 922 (1933) (notes for $6,000 purchased for $5,400); Coopersmith v. Mahoney, 150 Va. 685, 696-700, 143 S.E. 313 (1928) (purchase at 25% discount); Crum v. Hanna, 140 Va. 366, 367, 125 S.E. 219 (1924) (bond for $500 purchased at discount of $25); Catron v. Bostic, 123 Va. 355, 371-72, 96 S.E. 845 (1918) (note for $4,000 purchased for $3,200); Fleshman v. Bibb, 118 Va. 582, 88 S.E. 64 (1916) (notes sold at discount of 20% on day following their execution); City National Bank v. Hundley, 112 Va. 51, 70 S.E. 494 (1911) (notes for $2,400 purchased for $1,750).

However, a makeshift transaction between a payee and his purchaser for the purpose of cutting off the maker's defenses does not result in a taking in good faith: Whaley Bros. v. Stevens, 159 Va. 388, 165 S.E. 645 (1932); Stevens v. Clintwood Drug Co., 156 Va. 353, 154 S.E. 515 (1930); Duncan v. Carson, 127 Va. 306, 324-25, 103 S.E. 665, 105 S.E. 62 (1920) (transfer from a company to its president).

The UCC eliminates the taking of an instrument "complete and regular upon its face" as a separate requirement for due course holding, this former requirement being treated as an aspect of notice. The UCC approach as set forth in subsection 3-304(1)(a) is consistent with that taken in American Bank of Orange v. McComb, 105 Va. 473, 478, 54 S.E. 14 (1906), in which an instrument materially altered by the addition of the words "Payable with Interest" was nevertheless held to be complete and regular on its face. Similarly, this subsection is consistent with Cussen v. Brandt & Dunlop, 97 Va. 1, 9-10, 33 S.E. 791 (1899), in which it was held that a purchaser of a note indorsed "for collection" had notice of an adverse claim of ownership and could not be a holder in due course.

Under subsection 3-304(1)(b) the purchaser has notice of a defense if he has notice that the obligation of any party is voidable. This is a direct approach to the result reached in Whaley Bros. v. Stevens, 159 Va. 388, 165 S.E. 645 (1932), in which the status of due course holding was denied to a purchaser who took the instrument with full knowledge of the underlying contract and of the methods being followed by the payee in doing business.

Under subsection 3-304(1)(b) the purchaser has notice of a claim if he has notice that the obligation of any party is voidable in whole or *in part*. This probably changes the result in Moore v. Potomac Savings Bank, 160 Va. 597, 169 S.E. 922 (1933), which involved application of the law of the District of Columbia, but the law of the District was taken to be the same as that of Virginia. In this case a payee fraudulently secured notes from the maker. The payee then transferred them to a bank as security for a loan, a usurious rate of interest being charged. It was held that the bank could recover against the maker since it was "not charged with knowledge of defect in title to the notes in question because it discounted them at a greater rate of interest than that allowed lenders." 160 Va. at 605. Since the bank had notice that the obligation of a party was voidable in part, that is, the obligation of the payee as respected usurious interest, under the UCC it would seem that the purchaser had notice of a defense, and so could not recover on the notes, although admittedly the defense of which the holder had notice was different from the defense on which the maker relied.

Subsection 3-304(2) continues the approach of § 6 of the Uniform Fiduciaries Act, under which a purchaser has notice of a claim against the instrument if he has

knowledge that a fiduciary transferring it is committing a breach of trust. This approach has been followed in Virginia. In Sawyer v. Nat'l Bank of Commerce, 166 Va. 439, 186 S.E. 1 (1936), the notes carried a marginal notation that the payee was the trustee in a deed of trust. The transferee knew the payee was unable to meet his financial obligations, that he frequently loaned money for clients, naming himself as trustee in deeds of trust, and the transferee took the note in exchange for another note as security for the payee's personal indebtedness to the bank. On these facts, a verdict holding that the bank had notice of a claim against the instrument was sustained.

Subsection 3-304(4)(e) accords with the Virginia rule that knowledge that a person negotiating an instrument is or was a fiduciary does not give notice of a defense or claim. Trust Company of Norfolk v. Snyder, 152 Va. 572, 579-86, 147 S.E. 234 (1929); Cocke's Adm'r v. Loyall, 150 Va. 336, 143 S.E. 881 (1928).

This section probably would not affect the result in Chase & Co. v. Norfolk Nat'l Bank, 151 Va. 1040, 145 S.E. 725 (1928). The Chase Company carried accounts in a Norfolk Bank and a Rocky Mount Bank. Custis, an agent of the company drew a check in the name of the company, signed by himself as agent, on the Rocky Mount Bank, payable to the order of the Norfolk Bank, and deposited it in the Norfolk Bank, but to his own personal account. When the proceeds were dissipated, the Chase Company sued the Norfolk Bank for the amount of the check, claiming the bank had acted with gross negligence and breach of its duty to a depositor in permitting the agent, Custis, to commit this fraud. It was held that this entire transaction showed that the check was drawn for the purpose of deposit to the company's account, and so held the bank had notice that the agent was committing a breach of trust.

The UCC continues the rule that a purchaser who takes an instrument knowing that it is overdue cannot be a holder in due course. Citizens Bank and Trust Co. v. Chase, 151 Va. 65, 144 S.E. 464 (1928). However, a purchaser who takes an instrument not knowing it is overdue can be a holder in due course. Consequently, the purchaser may be a holder in due course of overdue paper, such as that which has been accelerated or of a demand instrument on which a demand has been made, if he takes it without notice of the acceleration or the demand. The purchaser has notice that a demand note is overdue if he has notice that he is taking it more than a reasonable time after its issue. In Nat'l Mechanics Bank v. Schmelz Nat'l Bank, 136 Va. 33, 40, 116 S.E. 380 (1923); Colona v. Parksley Nat'l Bank, 120 Va. 812, 824, 92 S.E. 79 (1917), it was found that the negotiation of demand notes had been within a reasonable time. In Stegal v. Union Bank and Federal Trust Co., 163 Va. 417, 434, 176 S.E. 438 (1934), however, the holder was denied due course standing because the demand note had been negotiated an unreasonable time after its issue.

Where the evidence is in conflict as to whether a holder had notice so as to bar standing as a holder in due course, the question is for the jury. Goodloe v. Smith, 158 Va. 571, 164 S.E. 379 (1932).

COUNCIL COMMENT

We feel that the Uniform Commercial Code has departed from the "good faith" concept of the Uniform Negotiable Instruments Law. The language which we recommend, which follows the New York statute, is more nearly in line with present law; it is also more desirable from the standpoint of public policy.

§ 3-305. **Rights of a Holder in Due Course.** To the extent that a holder is a holder in due course he takes the instrument free from

(1) all claims to it on the part of any person; and

(2) all defenses of any party to the instrument with whom the holder has not dealt except

(a) infancy, to the extent that it is a defense to a simple contract; and

(b) such other incapacity, or duress, or illegality of the transaction, as renders the obligation of the party a nullity; and

(c) such misrepresentation as has induced the party to sign the instrument with neither knowledge nor reasonable opportunity to obtain knowledge of its character or its essential terms; and

(d) discharge in insolvency proceedings; and

(e) any other discharge of which the holder has notice when he takes the instrument.

COMMENT: **Prior Uniform Statutory Provision:** §§ 15, 16 and 57, Uniform Negotiable Instruments Law.

Changes: Combined and reworded; new provisions; rule of original § 15 reversed.

Purposes of Changes and New Matter: 1. The section applies to any person who is himself a holder in due course, and equally to any transferee who acquires the rights of one (§ 3-201). "Takes" is substituted for "holds" in the original § 57 because a holder in due course may still be subject to any claims or defenses which arise against him after he has taken the instrument.

2. The language "all claims to it on the part of any person" is substituted for "any defect of title of prior parties" in the original § 57 in order to make it clear that the holder in due course takes the instrument free not only from any claim of legal title but also from all liens, equities or claims of any other kind. This includes any claim for rescission of a prior negotiation, in accordance with the provisions of the section on reacquisition (§ 3-208).

3. "All defenses" includes nondelivery, conditional delivery or delivery for a special purpose. Under this Article such nondelivery or qualified delivery is a defense (§§ 3-306 and 3-307) and the defendant has the full burden of establishing it. Accordingly the "conclusive presumption" of the third sentence of the original § 16 is abrogated in favor of a rule of law cutting off the defense.

The effect of this section, together with the sections dealing with incomplete instruments (§ 3-115) and alteration (§ 3-407) is to cut off the defense of nondelivery of an incomplete instrument against a holder in due course, and to change the rule of the original § 15.

4. Paragraph (a) of subsection (2) is new. It follows the decisions under the original Act in providing that the defense of infancy may be asserted against a holder in due course, even though its effect is to render the instrument voidable but not void. The policy is one of protection of the infant against those who take advantage of him, even at the expense of occasional loss to an innocent purchaser. No attempt is made to state when infancy is available as a defense or the conditions under which it may be asserted. In some jurisdictions it is held that an infant cannot rescind the transaction or set up the defense unless he restores the holder to his former position, which in the case of a holder in due course is normally impossible. In other states an infant who has misrepresented his age may be estopped to assert his infancy. Such questions are left to the local law, as an integral part of the policy of each state as to the protection of infants.

5. Paragraph (b) of subsection (2) is new. It covers mental incompetence, guardianship, **ultra vires** acts or lack of corporate capacity to do business, any remaining incapacity of married women, or any other incapacity apart from infancy. Such incapacity is largely statutory. Its existence and effect is left to the law of each state. If under the local law the effect is to render the obligation of the instrument entirely null and void, the defense may be asserted against a holder in due course. If the effect is merely to render the obligation voidable at the election of the obligor, the defense is cut off.

6. Duress is a matter of degree. An instrument signed at the point of a gun is void, even in the hands of a holder in due course. One signed under threat to prosecute the son of the maker for theft may be merely voidable, so that the defense is cut off. Illegality is most frequently a matter of gaming or usury, but may arise in many other forms under a great variety of statutes. The statutes differ greatly in their provisions and the interpretations given them. They are primarily a matter of local concern and local policy. All such matters are therefore left to the local law. If under that law the effect of the duress or the illegality is to make the obligation entirely null and void, the defense may be asserted against a holder in due course. Otherwise it is cut off.

7. Paragraph (c) of subsection (2) is new. It follows the great majority of the decisions under the original Act in recognizing the defense of "real" or "essential" fraud, sometimes called fraud in the essence or fraud in the factum, as effective against a holder in due course. The common illustration is that of the maker who is tricked into signing a note in the belief that it is merely a receipt or some

other document. The theory of the defense is that his signature on the instrument is ineffective because he did not intend to sign such an instrument at all. Under this provision the defense extends to an instrument signed with knowledge that it is a negotiable instrument, but without knowledge of its essential terms.

The test of the defense here stated is that of excusable ignorance of the contents of the writing signed. The party must not only have been in ignorance, but must also have had no reasonable opportunity to obtain knowledge. In determining what is a reasonable opportunity all relevant factors are to be taken into account, including the age and sex of the party, his intelligence, education and business experience; his ability to read or to understand English, the representations made to him and his reason to rely on them or to have confidence in the person making them; the presence or absence of any third person who might read or explain the instrument to him, or any other possibility of obtaining independent information; and the apparent necessity, or lack of it, for acting without delay.

Unless the misrepresentation meets this test, the defense is cut off by a holder in due course.

8. Paragraph (d) is also new. It is inserted to make it clear that any discharge in bankruptcy or other insolvency proceedings, as defined in this Article, is not cut off when the instrument is purchased by a holder in due course.

9. Paragraph (e) of subsection (2) is also new. Under the notice to purchaser section of this Article (§ 3-304), notice of any discharge which leaves other parties liable on the instrument does not prevent the purchaser from becoming a holder in due course. The obvious case is that of the cancellation of an indorsement, which leaves the maker and prior indorsers liable. As to such parties the purchaser may be a holder in due course, but he takes the instrument subject to the discharge of which he has notice. If he is without such notice, the discharge is not effective against him (§ 3-602).

Cross References:

Point 1: § 3-201(1).
Point 2: § 3-208.
Point 3: §§ 3-115(2), 3-306(c), 3-307(2) and 3-407(3).
Point 9: §§ 3-304(1)(b) and 3-602.

Definitional Cross References:

"Contract". § 1-201.
"Holder in due course". § 3-302.
"Insolvency proceedings". § 1-201.
"Instrument". § 3-102.
"Notice". § 1-201.
"Party". § 1-201.
"Person". § 1-201.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-367, 6-368, 6-409.

Comment: Under the UCC the rights of the holder in due course are as large, and even larger, than under prior law. The holder in due course takes the instrument free of all defenses, except certain listed real defenses. In this respect the UCC is consistent with prior Virginia law: Early v. Citizens Bank of Sneedville, 173 Va. 436, 440-41, 3 S.E.2d 167 (1939) (defense of conditional delivery); Wheeler v. Wardell, 173 Va. 168, 175-76, 3 S.E.2d 377 (1939) (defense of conditional delivery); City Coal and Ice Co. v. Union Trust Co., 140 Va. 600, 608, 125 S.E. 697 (1924) (defense of ultra vires); Duncan v. Broadway Nat'l Bank, 127 Va. 34, 102 S.E. 577 (1920) (defenses of failure of consideration and fraud); Hawkes v. Bowles, 119 Va. 108, 89 S.E. 93 (1916) (defense of fraud); Fleshman v. Bibb, 118 Va. 582, 586, 88 S.E. 64 (1916) (defense of fraud); Ratcliffe v. Costello, 117 Va. 563, 566-68, 85 S.E. 469 (1915) (defense of fraud); Anderson v. Union Bank of Richmond, 117 Va. 1, 5-6 (defense of prior payment); City Nat'l Bank v. Hundley, 112 Va. 51, 52, 70 S.E. 494 (1911) (defense of fraud).

Defenses of incapacity, duress, or illegality, which under other state law renders the obligation of a party a nullity, are also available under the UCC, even as against a holder in due course. Thus the UCC does not affect Code 1950, § 11-14, which makes gaming contracts void. It appears doubtful that Virginia would apply this statute so as to bar the rights of a holder in due course. See Citizens Nat'l Bank v. McDannald, 116 Va. 834, 83 S.E. 389 (1914); Krake v. Alexander, 86 Va. 206, 9 S.E. 991 (1889).

In Food Products Co. v. Pierce, 154 Va. 74, 152 S.E. 562 (1930), Virginia took the view that, if a corporation has a general power to be a party to a negotiable instrument, it will be presumed that an instrument in the hands of a holder in due course was executed in the legitimate course of business. Unless specially authorized, though, a corporation has no authority to become an accommodation party to negotiable paper, and so a defense of ultra vires is available against a holder not in due course. See also City Coal and Ice Co. v. Union Trust Co., 140 Va. 600, 608, 125 S.E. 697 (1924), for a dictum that where there is an entire want of power in a corporation to issue negotiable paper, such paper will be void in the hands of a bona fide purchaser for value.

The UCC changes prior law so as to provide that claims or equities of ownership are no longer good against a holder in due course. This changes the result in Strother v. Lynchburg Trust and Savings Bank, 155 Va. 826, 156 S.E. 426, 73 A.L.R. 166 (1931). The lands of an infant were sold under a decree of court, the court directing that coupon bonds be taken in payment and delivered to the infant when he reached his majority. The commissioner appointed to make the conveyance procured the infant's indorsement on the bonds and pledged them as collateral to a bank to secure his personal loan. On reaching his majority the infant endeavored to disaffirm his indorsement and recover the bonds from the bank. The Virginia court held that the infant's indorsement was effective so as to constitute a negotiation of the bonds, but that the transfer could be disaffirmed and the infant could recover back the bonds even from the holder in due course. Under the UCC whether the infant has a defense to an action brought by the holder in due course on his indorsement is a question left to other state law, but under the UCC the claim to recover the bonds would be cut-off by the negotiation to a holder in due course. See also VIRGINIA ANNOTATIONS to UCC 3-207.

§ 3-306. **Rights of One Not Holder in Due Course.** Unless he has the rights of a holder in due course any person takes the instrument subject to

(a) all valid claims to it on the part of any person; and

(b) all defenses of any party which would be available in an action on a simple contract; and

(c) the defenses of want or failure of consideration, nonperformance of any condition precedent, non-delivery, or delivery for a special purpose (§ 3-408); and

(d) the defense that he or a person through whom he holds the instrument acquired it by theft, or that payment or satisfaction to such holder would be inconsistent with the terms of a restrictive indorsement. The claim of any third person to the instrument is not otherwise available as a defense to any party liable thereon unless the third person himself defends the action for such party.

COMMENT: **Prior Uniform Statutory Provision:** §§ 16, 28, 58 and 59, Uniform Negotiable Instruments Law.

Changes: Combined, condensed and reworded.

Purposes of Changes: The changes are intended to remove the following uncertainties arising under the original sections:

1. Any transferee who acquires the rights of a holder in due course under the transfer section of this Article (§ 3-201) is included within the provisions of the preceding § 305. This section covers any person who neither qualifies in his own right as a holder in due course nor has acquired the rights of one by transfer. In particular the section applies to a bona fide purchaser with notice that the instrument is overdue.

2. "All valid claims to it on the part of any person" includes not only claims or legal title, but all liens, equities, or other claims of right against the instrument or its proceeds. It includes claims to rescind a prior negotiation and to recover the instrument or its proceeds.

3. Paragraph (b) restates the first sentence of the original § 58.

4. Paragraph (c) condenses the original §§ 16 and 28. Want or failure of consideration is specifically mentioned, as in the original § 28, in order to make it clear that either is a defense which the defendant has the burden of establishing under the following section of this Article. The language as to an "ascertained or liquidated amount or otherwise" in the original § 28 is omitted because it is believed to be superfluous. The third sentence of § 16 is now covered by the preceding section. The fourth sentence is omitted in favor of the rule stated in the following section, which places the full burden of establishing the defense of non-delivery, conditional delivery or delivery for a special purpose upon the defendant, and makes any presumption unnecessary.

5. Paragraph (d) is substituted for the last sentence of the original § 59, as a more detailed and explicit statement of the same policy, which is also found in the original § 22. The contract of the obligor is to pay the holder of the instrument, and the claims of other persons against the holder are generally not his concern. He is not required to set up such a claim as a defense, since he usually will have no satisfactory evidence of his own on the issue; and the provision that he may not do so is intended as much for his protection as for that of the holder. The claimant who has lost possession of an instrument so payable or indorsed that another may become a holder has lost his rights on the instrument, which by its terms no longer runs to him. The provision includes all claims for rescission of a negotiation, whether based in incapacity, fraud, duress, mistake, illegality, breach of trust or duty or any other reason. It includes claims based on conditional delivery or delivery for a special purpose. It includes claims of legal title, lien, constructive trust or other equity against the instrument or its proceeds. The exception made in the case of theft is based on the policy which refuses to aid a proved thief to recover, and refuses to aid him indirectly by permitting his transferee to recover unless the transferee is a holder in due course. The exception concerning restrictive indorsements is intended to achieve consistency with § 3-603 and related sections.

Nothing in this section is intended to prevent the claimant from intervening in the holder's action against the obligor or defending the action for the latter, and asserting his claim in the course of such intervention or defense. Nothing here stated is intended to prevent any interpleader, deposit in court or other available procedure under which the defendant may bring the claimant into court or be discharged without himself litigating the claim as a defense. Compare § 3-803 on vouching in other parties alleged to be liable.

Cross References:

§ 3-302.
Point 1: §§ 3-201(1) and 3-305.
Point 2: § 3-207.
Point 3: § 3-307(2).
Point 4: §§ 3-305 and 3-307(2).
Point 5: § 3-803.

Definitional Cross References:

"Action". § 1-201.
"Contract". § 1-201.
"Delivery". § 1-201.
"Holder in due course". § 3-302.
"Instrument". § 3-102.
"Party". § 1-201.
"Person". § 1-201.
"Rights". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-368, 6-380, 6-410, 6-411.

Comment: The UCC continues prior law under which a holder not in due course takes subject to the obligor's defenses: Whaley Bros. v. Stevens, 159 Va. 388, 165 S.E. 645 (1932) (fraud); Baach v. Bank of Pocahontas, 157 Va. 274, 283, 160 S.E. 68 (1931) (failure of consideration); Stevens v. Clintwood Drug Co., 156 Va. 353, 154 S.E. 515 (1930) (fraud); Atkinson v. Neblett and Hatch, 144 Va. 220, 230, 132 S.E. 326 (1926) (fraud); Irby v. Harvey, 143 Va. 51, 129 S.E. 220 (1925) (fraud); Wallinger v. Kelly, 136 Va. 547, 117 S.E. 850 (1923) (failure of consideration); Duncan v. Carson, 127 Va. 306, 103 S.E. 665, 105 S.E. 62 (1920) (fraud in the procurement); Andrews & Stone v. Fidelity Loan & Trust Co., 103 Va. 196, 48 S.E. 884 (1904) (failure of consideration); Embrey v.

Jemison, 131 U.S. 336 (1889) (wagering transaction); Woodson v. Barrett, 12 Va. (2 Hen. & M.) 80 (1808) (wagering transaction).

The UCC does not affect the Virginia holding in Stegal v. Union Bank and Federal Trust Co., 163 Va. 417, 434-61, 176 S.E. 438 (1934), that a right of set-off is not a claim or defense.

The UCC expressly provides that nonperformance of conditions as a defense refers only to conditions precedent and not to conditions subsequent. This is in accord with Virginia law, under which oral evidence of a condition subsequent is inadmissible as being in violation of the parol evidence rule. Virginia cases allowing the admission of oral evidence to show a condition precedent include: Nottingham v. Farmers & Merchants Trust Bank, 170 Va. 291, 299, 196 S.E. 634 (1938); Meadows v. McClaugherty, 167 Va. 41, 44-46, 187 S.E. 475 (1936); Robertson v. Virginia Nat'l Bank, 135 Va. 166, 115 S.E. 536 (1923); Hawse v. First Nat'l Bank, 113 Va. 588, 590-92, 75 S.E. 127 (1912). Virginia cases denying the admission of oral evidence to show a condition subsequent include: Godwin v. Kerns, 178 Va. 447, 17 S.E.2d 410 (1941); Cox v. Parsons, 165 Va. 575, 183 S.E. 440 (1936); Barrett v. Vaughan & Co., 163 Va. 811, 818, 178 S.E. 64 (1935); Clark v. Miller, 148 Va. 83, 88-96, 138 S.E. 556 (1927); Conway v. American Nat'l Bank, 146 Va. 357, 361-63, 131 S.E. 803 (1926); Crafts v. Broadway Nat'l Bank, 142 Va. 702, 128 S.E. 364 (1925); Continental Trust Co. v. Witt, 139 Va. 458, 466-69, 124 S.E. 265 (1924). The difficulty of drawing a line between a condition precedent and a condition subsequent is illustrated by Harris v. Sanford, 148 Va. 181, 138 S.E. 465, 54 A.L.R. 699 (1927), in which a postdated check was given in payment for a lot, but not to be effective if the drawer notified the payee that he would not buy the lot. This was held to be a condition precedent, and so oral evidence to show the agreement was admitted into evidence to establish a defense.

§ 3-307. Burden of Establishing Signatures, Defenses and Due Course. (1) Unless specifically denied in the pleadings each signature on an instrument is admitted. When the effectiveness of a signature is put in issue

(a) the burden of establishing it is on the party claiming under the signature; but

(b) the signature is presumed to be genuine or authorized except where the action is to enforce the obligation of a purported signer who has died or become incompetent before proof is required.

(2) When signatures are admitted or established, production of the instrument entitles a holder to recover on it unless the defendant establishes a defense.

(3) After it is shown that a defense exists a person claiming the rights of a holder in due course has the burden of establishing that he or some person under whom he claims is in all respects a holder in due course.

COMMENT: Prior Uniform Statutory Provision: § 59, Uniform Negotiable Instruments Law.

Changes: Reworded; new provisions.

Purposes of Changes and New Matter: 1. Subsection (1) is new, although similar provisions are found in a number of states. The purpose of the requirement of a specific denial in the pleadings is to give the plaintiff notice that he must meet a claim of forgery or lack of authority as to the particular signature, and to afford him an opportunity to investigate and obtain evidence. Where local rules of pleading permit, the denial may be on information and belief, or it may be a denial of knowledge or information sufficient to form a belief. It need not be under oath unless the local statutes or rules require verification. In the absence of such specific denial the signature stands admitted, and is not in issue. Nothing in this section is intended, however, to prevent amendment of the pleading in a proper case.

The question of the burden of establishing the signature arises only when it has been put in issue by specific denial. "Burden of establishing" is defined in the definitions section of this Act (§ 1-201). The burden is on the party claiming under the signature, but he is aided by the presumption that it is genuine or authorized stated in paragraph (b). "Presumption" is also defined in this Act

(§ 1-201). It means that until some evidence is introduced which would support a finding that the signature is forged or unauthorized the plaintiff is not required to prove that it is authentic. The presumption rests upon the fact that in ordinary experience forged or unauthorized signatures are very uncommon, and normally any evidence is within the control of the defendant or more accessible to him. He is therefore required to make some sufficient showing of the grounds for his denial before the plaintiff is put to his proof. His evidence need not be sufficient to require a directed verdict in his favor, but it must be enough to support his denial by permitting a finding in his favor. Until he introduces such evidence the presumption requires a finding for the plaintiff. Once such evidence is introduced the burden of establishing the signature by a preponderauce of the total evidence is on the plaintiff.

Under paragraph (b) this presumption does not arise where the action is to enforce the obligation of a purported signer who has died or become incompetent before the evidence is required, and so is disabled from obtaining or introducing it. "Action" of course includes a claim asserted against the estate of a deceased or an incompetent.

2. Subsection (2) is substituted for the first clause of the original § 59. Once signatures are proved or admitted, a holder makes out his case by mere production of the instrument, and is entitled to recover in the absence of any further evidence. The defendant has the burden of establishing any and all defenses, not only in the first instance but by a preponderance of the total evidence. The provision applies only to a holder, as defined in this Act (§ 1-201). Any other person in possession of an instrument must prove his right to it and account for the absence of any necessary indorsement. If he establishes a transfer which gives him the rights of a holder (§ 3-201), this provision becomes applicable, and he is then entitled to recover unless the defendant establishes a defense.

3. Subsection (3) rephrases the last clause of the first sentence of the original § 59. Until it is shown that a defense exists the issue as to whether the holder is a holder in due course does not arise. In the absence of a defense any holder is entitled to recover and there is no occasion to say that he is deemed prima facie to be a holder in due course. When it is shown that a defense exists the plaintiff may, if he so elects, seek to cut off the defense by establishing that he is himself a holder in due course, or that he has acquired the rights of a prior holder in due course (§ 3-201). On this issue he has the full burden of proof by a preponderance of the total evidence. "In all respects" means that he must sustain this burden by affirmative proof that the instrument was taken for value, that it was taken in good faith, and that it was taken without notice (§ 3-302).

Nothing in this section is intended to say that the plainiff must necessarily prove that he is a holder in due course. He may elect to introduce no further evidence, in which case a verdict may be directed for the plaintiff or the defendant, or the issue of the defense may be left to the jury, according to the weight and sufficiency of the defendant's evidence. He may elect to rebut the defense itself by proof to the contrary, in which case again a verdict may be directed for either party or the issue may be for the jury. This subsection means only that if the plaintiff claims the rights of a holder in due course against the defense he has the burden of proof upon that issue.

Cross References:

§§ 3-305, 3-306, 3-401, 3-403 and 3-404.
Point 1: § 1-201.
Point 2: §§ 1-201 and 3-201(1).
Point 3: §§ 3-201(1) and 3-302.

Definitional Cross References:

"Action". § 1-201.
"Burden of establishing". § 1-201.
"Defendant". § 1-201.
"Genuine". § 1-201.
"Holder". § 1-201.
"Holder in due course". § 3-302.
"Instrument". § 3-102.
"Party". § 1-201.
"Person". § 1-201.
"Presumed". § 1-201.
"Rights". § 1-201.
"Signature". § 3-401.

Prior Statutes: Code 1950, §§ 6-411, 6-376 (NIL 24), 8-114.

Comment: The provisions of this section are to some extent covered by Code 1950, § 8-114, under which handwriting is admitted unless "denied by an affidavit accompanying the plea putting it in issue." The UCC requires the "effectiveness" of a signature, rather than handwriting, to be put in issue and the UCC does not require verification.

Hillman v. Cornett, 137 Va. 200, 119 S.E. 74 (1923), held that once the signature was put in issue, the burden of proving the signature is on the plaintiff and "in the absence of any evidence of the genuineness of the signature . . . judgment should have been given for the defendant." 137 Va. at 203. This rule would be changed under the UCC, which aids the party claiming under the signature with a presumption. UCC 1-201(31) defines a presumption as meaning that the trier of fact must find the existence of the fact presumed unless and until evidence is introduced which would support a finding of its nonexistence. So, under the UCC, the party denying a signature must make a sufficient showing in support of such a denial, so that a finding in his favor can be supported, before the plaintiff is required to produce any evidence. Until the party denying the signature introduces such sufficient evidence, the presumption requires a finding for the party relying on the effectiveness of the signature. The exception in the UCC regarding the signature of a dead person or an incompetent, in which case upon a denial there is no presumption that the signature is genuine, states what has been the general rule in Virginia regarding any signature that has been denied.

The UCC follows prior law under which the production of a negotiable instrument, the necessary signatures being admitted or established, entitles the holder to recover unless the defendant establishes a defense. Cox v. Parsons, 165 Va. 575, 183 S.E. 440 (1936); Holdsworth v. Anderson Drug Co., 118 Va. 359, 87 S.E. 565 (1916).

The defendant has the burden of introducing evidence of a defense and of establishing it by a preponderance of the evidence. See Catron v. Bostic, 123 Va. 355, 372, 96 S.E. 845 (1918). In light of this provision requiring the defendant to establish every defense, the NIL provision under which every negotiable instrument is deemed prima facie to have been issued for a valuable consideration has been eliminated. Wheeler v. Wardell, 173 Va. 168, 3 S.E.2d 377 (1939). The Virginia holdings to the effect that want or failure of consideration is a defense remain unchanged. Turner v. First Nat'l Bank, 166 Va. 520, 186 S.E. 19 (1936); Brenard Manufacturing Co. v. Brown, 120 Va. 757, 92 S.E. 850 (1917); Murphy's Hotel Co. v. Herndon's Adm'r, 120 Va. 505, 518, 91 S.E. 634 (1917); Ford v. Engleman, 118 Va. 89, 86 S.E. 852 (1915); Hawse v. First Nat'l Bank, 113 Va. 588, 590, 75 S.E. 127 (1912); Reid's Adm'r v. Windsor, 111 Va. 825, 831, 69 S.E. 1101 (1911).

As under the NIL and Virginia decisions the burden of establishing want or failure of consideration is on the defendant. Trevillian v. Bullock, 185 Va. 958, 960-61, 40 S.E.2d 920 (1947); Bernard Smith Co. v. Bernard, 124 Va. 518, 98 S.E. 677 (1919). In Good v. Dyer, 137 Va. 114, 126-27, 130-32, 138-39, 119 S.E. 277 (1923), the trial court appears to have given inconsistent instructions on the burden of proof where the defense is want of consideration. In the case a verdict for the plaintiff was affirmed on appeal, but it is not clear from the opinion which party bears the risk of nonpersuasion when the defense is want or failure of consideration.

Where the holder produces the instrument, payment is an affirmative defense, with the burden of proving the defense on the party who alleges it. American Security and Trust Co. v. John L. Juliano, Inc., 203 Va. 827, 833, 127 S.E.2d 348 (1962); Snidow v. Woods, 198 Va. 692, 695-96, 96 S.E.2d 157 (1957). In Schmitt v. Redd, 151 Va. 33, 338-44, 143 S.E. 384 (1928), where the instrument was in the hands of the payee, the court said there was a presumption of nonpayment, but on the facts found the presumption to have been rebutted.

The UCC accords with the NIL and Virginia decisions in providing that after a defense is shown to exist, the party claiming the rights of a holder in due course has the burden of establishing that he, or a person under whom he claims, is a holder in due course. Moore v. Potomac Savings Bank, 160 Va. 597, 602, 169 S.E. 922 (1933); Mann v. Osborne, 153 Va. 190, 149 S.E. 537 (1929); Coopersmith v. Mahoney, 150 Va. 685, 691-96, 143 S.E. 313 (1928); Atkinson v. Neblett and Hatch, 144 Va. 220, 227-32, 132 S.E. 326 (1926); Elkhart State Bank v. Bristol Broom Co., 143 Va. 1, 9-10, 129 S.E. 371 (1925); Continental Trust Co. v. Witt, 139 Va. 458, 124 S.E. 265 (1924); Duncan v. Carson, 127 Va. 306, 320-22, 103 S.E. 665, 105 S.E. 62 (1920); Piedmont Bank v. Hatcher, 94 Va. 229, 26 S.E. 505 (1897).

PART 4

LIABILITY OF PARTIES

§ 3-401. Signature. (1) No person is liable on an instrument unless his signature appears thereon.

(2) A signature is made by use of any name, including any trade or assumed name, upon an instrument, or by any word or mark used in lieu of a written signature.

COMMENT: Prior Uniform Statutory Provision: § 18, Uniform Negotiable Instruments Law.

Changes: Reworded.

Purposes of Changes: To make it clear that:

1. No one is liable on an instrument unless and until he has signed it. The chief application of the rule has been in cases holding that a principal whose name does not appear on an instrument signed by his agent is not liable on the instrument even though the payee knew when it was issued that it was intended to be the obligation of one who did not sign. The exceptions made as to collateral and virtual acceptance by the original §§ 134 and 135 are now abrogated by the definition of an acceptance and the rules governing its operation. An allonge is part of the instrument to which it is affixed. § 3-202(2).

Nothing in this section is intended to prevent any liability arising apart from the instrument itself. The party who does not sign may still be liable on the original obligation for which the instrument was given, or for breach of any agreement to sign, or in tort for misrepresentation, or even on an oral guaranty of payment where the statute of frauds is satisfied. He may of course be liable under any separate writing. The provision is not intended to prevent an estoppel to deny that the party has signed, as where the instrument is purchased in good faith reliance upon his assurance that a forged signature is genuine.

2. A signature may be handwritten, typed, printed or made in any other manner. It need not be subscribed, and may appear in the body of the instrument, as in the case of "I, John Doe, promise to pay—" without any other signature. It may be made by mark, or even by thumbprint. It may be made in any name, including any trade name or assumed name, however false and fictitious, which is adopted for the purpose. Parol evidence is admissible to identify the signer, and when he is identified the signature is effective.

This section is not intended to affect any local statute or rule of law requiring a signature by mark to be witnessed, or any signature to be otherwise authenticated, or requiring any form of proof. It is to be read together with the provision under which a person paying or giving value for the instrument may require indorsement in both the right name and the wrong one; and with the provision that the absence of an indorsement in the right name may make an instrument so irregular as to call its ownership into question and put a purchaser upon notice which will prevent his taking as a holder in due course.

Cross References:

§§ 3-202(2), 3-402 through 3-406.
Point 1: § 3-410.
Point 2: § 3-203.

Definitional Cross References:

"Person". § 1-201.
"Instrument". § 3-102.
"Signed". § 1-201.
"Written". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-370.

Comment: The UCC continues the rule of the common law and the NIL. Hawthorne v. Austin Organ Co., 71 F.2d 945, 951-52 (4th Cir. 1934). This section

does not affect any liability arising apart from the instrument itself, as by an oral guaranty of payment, the statute of frauds being satisfied. Parksley Nat'l Bank v. Chandler's Adm'rs, 170 Va. 394, 398-404, 196 S.E. 676 (1938).

§ 3-402. **Signature in Ambiguous Capacity.** Unless the instrument clearly indicates that a signature is made in some other capacity it is an indorsement.

COMMENT: **Prior Uniform Statutory Provision:** §§ 17(6) and 63, Uniform Negotiable Instruments Law.

Changes: Combined and reworded.

Purposes of Changes: The revised language is intended to say that any ambiguity as to the capacity in which a signature is made must be resolved by a rule of law that it is an indorsement. Parol evidence is not admissible to show any other capacity, except for the purpose of reformation of the instrument as it may be permitted under the rules of the particular jurisdiction. The question is to be determined from the face of the instrument alone, and unless the instrument itself makes it clear that he has signed in some other capacity the signer must be treated as an indorser.

The indication that the signature is made in another capacity must be clear without reference to anything but the instrument. It may be found in the language used. Thus if John Doe signs after "I, John Doe, promise to pay," he is clearly a maker; and "John Doe, witness" is not liable at all. The capacity may be found in any clearly evidenced purpose of the signature, as where a drawee signing in an unusual place on the paper has no visible reason to sign at all unless he is an acceptor. It may be found in usage or custom. Thus by long established practice judicially noticed or otherwise established a signature in the lower right hand corner of an instrument indicates an intent to sign as the maker of a note or the drawer of a draft. Any similar clear indication of an intent to sign in some other capacity may be enough to remove the signature from the application of this section.

Cross References:

§ 3-401.

Definitional Cross References:

"Instrument". § 3-102.
"Signature". § 3-401.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-369(6), 6-415.

Comment: The UCC is in accord with the holding in Colona v. Parksley Nat'l Bank, 120 Va. 812, 819-21, 92 S.E. 979 (1917), that an anomalous signature is an indorsement, and with Colley v. Summers Parrott Hardware Co., 119 Va. 439, 442, 89S.E. 906 (1916), that a person who signs his name on the back of an instrument is to be deemed an indorser.

Colona v. Parksley Nat'l Bank, 120 Va. 812, 92 S.E. 979 (1917), held that certain signatures on the face of a note were made in the capacity of indorsers and not as makers. This result might have been reached on the basis of an examination of the instrument itself. However, the court appears also to have admitted parol evidence to show the intention of the parties. According to the UCC comment, parol evidence is not admissible to show that a person signed in any capacity other than as an indorser. Literally, this permits the admission of parol evidence to show that a person did sign as an indorser, the situation in the Colona case. Although susceptible of this construction, the basis objective of the UCC appears to be to make parol evidence inadmissible in either situation and to determine from the instrument itself the capacity in which a person has signed. Even if the UCC changes this aspect of the Colona case, the change seems to be of little significance.

§ 3-403. **Signature by Authorized Representative.** (1) A signature may be made by an agent or other representative, and his authority to make it may be established as in other cases of representation. No particular form of appointment is necessary to establish such authority.

(2) An authorized representative who signs his own name to an instrument

(a) is personally obligated if the instrument neither names the person represented nor shows that the representative signed in a representative capacity;

(b) except as otherwise established between the immediate parties, is personally obligated if the instrument names the person represented but does not show that the representative signed in a representative capacity, or if the instrument does not name the person represented but does show that the representative signed in a representative capacity.

(3) Except as otherwise established the name of an organization preceded or followed by the name and office of an authorized individual is a signature made in a representative capacity.

COMMENT: **Prior Uniform Statutory Provision:** §§ 19, 20 and 21, Uniform Negotiable Instruments Law.

Changes: Combined and reworded; original § 21 omitted.

Purposes of Changes: 1. The definition of "representative" in this Act (§ 1-201) includes an officer of a corporation or association, a trustee, an executor or administrator of an estate, or any person empowered to act for another. It is not intended to mean that a trust or an estate is necessarily a legal entity with the capacity to issue negotiable instruments, but merely that if it can issue them they may be signed by the representative.

The power to sign for another may be an express authority, or it may be implied in law or in fact, or it may rest merely upon apparent authority. It may be established as in other cases of representation, and when relevant parol evidence is admissible to prove or to deny it.

2. Subsection (2) applies only to the signature of a representative whose authority to sign for another is established. If he is not authorized his signature has the effect of an unauthorized signature (§ 3-404). Even though he is authorized the principal is not liable on the instrument, under the provisions (§ 3-401) relating to signatures, unless the instrument names him and clearly shows that the signature is made on his behalf.

3. Assuming that Peter Pringle is a principal and Arthur Adams is his agent, an instrument might, for example, bear the following signatures affixed by the agent—

(a) "Peter Pringle", or
(b) "Arthur Adams", or
(c) "Peter Pringle by Arthur Adams, Agent", or
(d) "Arthur Adams, Agent", or
(e) "Peter Pringle
Arthur Adams", or
(f) "Peter Pringle Corporation
Arthur Adams".

A signature in form (a) does not bind Adams if authorized (§§ 3-401 and 3-404). A signature as in (b) personally obligates the agent and parol evidence is inadmissible under subsection (2) (a) to disestablish his obligation.

The unambiguous way to make the representation clear is to sign as in (c). Any other definite indication is sufficient, as where the instrument reads "Peter Pringle promises to pay" and it is signed "Arthur Adams, Agent." Adams is not bound if he is authorized (§ 3-404).

Subsection 2(b) adopts the New York (minority) rule of Megowan v. Peterson, 173 N.Y. 1 (1902), in such a case as (d); and adopts the majority rule in such a case as (e). In both cases the section admits parol evidence in litigation between the immediate parties to prove signature by the agent in his representative capacity. Case (f) is subject to the same rule.

4. The original § 21, covering signatures by "procuration," is omitted. It was based on English practice under which the words "per procuration" added to any signature are understood to mean that the signer is acting under a power of attorney which the holder is free to examine. The holder is thus put on notice of the limited authority, and there can be no apparent authority extending beyond the power of attorney. This meaning of "per procuration" is almost unknown

in the United States, and the words are understood by the ordinary banker or attorney to be merely the equivalent of "by." The omission is not intended to suggest that a signature "by procuration" can no longer have the effect which it had under the original § 21, in any case where a party chooses to use the expression.

Cross References:

Point 1: § 1-201.
Point 2: §§ 3-401(1), 3-404 and 3-405.

Definitional Cross References:

"Instrument". § 3-102.
"Person". § 2-201.
"Representative". § 1-201.
"Signature". § 3-401.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-371, 6-372, 6-373.

Comment: Subsection 3-403(1) is in accord with Sutherland v. Receiver for Dickenson County Bank, 163 Va. 949, 951-54, 178 S.E. 12 (1935), that a signature may be made by an authorized representative, and such authority is to be established as in other cases.

Subsection 3-403(2) by necessary implication accords with Hawthorne v. Austin Organ Co., 71 F.2d 945, 946-47 (4th Cir. 1934), in holding that an authorized representative who signs in a representative capacity is not liable on the instrument. The UCC is in accord with Baach v. Bank of Pocahontas, 157 Va. 274, 281-83, 160 S.E. 68 (1931), in which an indorser was permitted to show as between the immediate parties that he had signed in a representative capacity and not personally, the instrument showing the name of the person represented.

The application of the UCC to Coal River Collieries v. Eureka Coal and Wood Co., 144 Va. 263, 132 S.E. 337 (1926), is not clear. The payee by letter sought payment of a past due account and by mail received from the debtor a note made payable to the order of the payee and signed:

"Eureka Coal and Wood Co., Inc.,
J. Liebman, Treasurer, N. Orleans".

When the note was not paid and suit was brought by the payee, N. Orleans sought to introduce parol evidence to show that he was president of the Eureka Company, and the parties did not intend that he should be bound personally. The court held that such evidence was inadmissible under Code 1950, § 6-372 (NIL 20), and common law rules relating to parol evidence. Since the instrument showed "the person represented," if this transaction is found to be "between the immediate parties," under the UCC Orleans would be permitted to introduce parol evidence to show that he signed in a representative capacity. However, since the payee gave value, by taking the note for an antecedent debt and extending the time for payment, the payee might qualify as a holder in due course under UCC 3-302(2), in which case parol evidence would be inadmissible to show that Orleans signed in a representative capacity. To succeed in this, though, the holder must carry the burden, imposed by UCC 3-307, of establishing due course holding, which would be impossible if it is found that the form of the signature gave the payee sufficient notice that Orleans was signing in a representative capacity.

§ 3-404. Unauthorized Signatures. (1) Any unauthorized signature is wholly inoperative as that of the person whose name is signed unless he ratifies it or is precluded from denying it; but it operates as the signature of the unauthorized signer in favor of any person who in good faith pays the instrument or takes it for value.

(2) Any unauthorized signature may be ratified for all purposes of this Article. Such ratification does not of itself affect any rights of the person ratifying against the actual signer.

COMMENT: **Prior Uniform Statutory Provision:** § 23, Uniform Negotiable Instruments Law.

Changes: Reworded; new provisions.

Purpose of Changes and New Matter: The changes are intended to remove uncertainties arising under the original section:

1. "Unauthorized signature" is a defined term (§ 1-201). It includes both a forgery and a signature made by an agent exceeding his actual or apparent authority.

2. The final clause of subsection (1) is new. It states the generally accepted rule that the unauthorized signature, while it is wholly inoperative as that of the person whose name is signed, is effective to impose liability upon the actual signer or to transfer any rights that he may have in the instrument. His liability is not in damages for breach of a warranty of his authority, but is full liability on the instrument in the capacity in which he has signed. It is, however, limited to parties who take or pay the instrument in good faith; and one who knows that the signature is unauthorized cannot recover from the signer on the instrument.

3. Subsection (2) is new. It settles the conflict which has existed in the decisions as to whether a forgery may be ratified. A forged signature may at least be adopted; and the word "ratified" is used in order to make it clear that the adoption is retroactive, and that it may be found from conduct as well as from express statements. Thus it may be found from the retention of benefits received in the transaction with knowledge of the unauthorized signature; and although the forger is not an agent, the ratification is governed by the same rules and principles as if he were.

This provision makes ratification effective only for the purposes of this Article. The unauthorized signature becomes valid so far as its effect as a signature is concerned. The ratification relieves the actual signer from liability on the signature. It does not of itself relieve him from liability to the person whose name is signed. It does not in any way affect the criminal law. No policy of the criminal law requires that the person whose name in forged shall not assume liability to others on the instrument; but he cannot affect the rights of the state. While the ratification may be taken into account with other relevant facts in determining punishment, it does not relieve the signer of criminal liability.

4. The words "or is precluded from denying it" are retained in subsection (1) to recognize the possibility of an estoppel against the person whose name is signed, as where he expressly or tacitly represents to an innocent purchaser that the signature is genuine; and to recognize the negligence which precludes a denial of the signature.

Cross References:

§§ 3-307, 3-401, 3-403 and 3-405.
Point 1: § 1-201.
Point 4: § 3-406.

Definitional Cross References:

"Good faith". § 1-201.
"Instrument". § 3-102.
"Person". § 1-201.
"Rights". § 1-201.
"Signature". § 3-401.
"Signed". § 1-201.
"Unauthorized signature". § 1-201.
"Value". § 3-303.

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Prior Statutes: Code 1950, § 6-375.

Comment: The UCC continues prior law under which an unauthorized signature is wholly inoperative as to the person whose name is signed, unless he ratifies it or is precluded from denying the signature. Commercial & Sav. Bank v. Maher, 202 Va. 286, 117 S.E.2d. 120 (1960); Central Nat'l Bank v. First and Merchants Nat'l Bank, 171 Va. 289, 303-04, 198 S.E. 883 (1938); Hillman v. Cornett, 137 Va. 200, 203-04, 119 S.E. 74 (1923); Pettyjohn v. Nat'l Exchange Bank, 101 Va. 111, 121-25, 43 S.E. 203 (1903) (silence must amount to bad faith in order to preclude the person whose name has been forged from denying his signature). A result consistent with the UCC was reached in Shepherd v. Mortgage Security Corp., 139 Va. 274, 276-78, 123 S.E. 553 (1924), in which the defendant, whose signature was forged as a maker, but was genuine as an indorser, was held to be liable on the indorsement to a holder in due course. In Fitchette

v. Cape Charles Bank, 146 Va. 715, 132 S.E. 688, 133 S.E. 492 (1926), the Supreme Court of Appeals affirmed the action of the chancellor in holding a signature to be genuine, after setting aside a contrary jury verdict on an issue out of chancery.

The UCC expressly adopts the rule that a forgery may be ratified, but this does not affect a forger's liability under the criminal law. The Supreme Court of Appeals classified the indorsement, "Deposit to credit of Stella Maher," in Commercial Sav. Bank v. Maher, 202 Va. 286, 117 S.E.2d 120 (1960), as one made without authority rather than a forgery. On the facts of the case it did not make any difference whether this was an unauthorized signature or a forgery, since it was inoperative as Stella Maher's indorsement in either case. The distinction would have been of significance if the evidence had shown that Stella Maher ratified the indorsement, for then, if a forgery, the question would have been presented as to whether a forgery may be ratified. A dictum in Pulaski Nat'l Bank v. Harrell, 203 Va. 227, 234, 123 S.E.2d 382 (1962), indicates that Virginia would recognize that a forgery may be ratified. For further discussion of the Maher case see VIRGINIA ANNOTATIONS to UCC 4-207.

§ 3-405. **Impostors; Signature in Name of Payee.** (1) An indorsement by any person in the name of a named payee is effective if

(a) an impostor by use of the mails or otherwise has induced the maker or drawer to issue the instrument to him or his confederate in the name of the payee; or

(b) a person signing as or on behalf of a maker or drawer intends the payee to have no interest in the instrument; or

(c) an agent or employee of the maker or drawer has supplied him with the name of the payee intending the latter to have no such interest.

(2) Nothing in this section shall affect the criminal or civil liability of the person so indorsing.

COMMENT: **Prior Uniform Statutory Provision:** § 9(3), Uniform Negotiable Instruments Law.

Changes: Reworded; new provisions.

Purposes of Changes and New Matter: 1. This section enlarges the original subsection to include additional situations which it has not been held to cover. The words "fictitious or nonexisting person" have been eliminated as misleading, since the existence or nonexistence of the named payee is not decisive and is important only as it may bear on the intent that he shall have no interest in the instrument. The instrument is not made payable to bearer and indorsements are still necessary to negotiation. The section however recognizes as effective indorsement of the types of paper covered no matter by whom made. This solution is thought preferable to making such instruments bearer paper; on the face of things they are payable to order and a subsequent taker should require what purports to be a regular chain of indorsements. On the other hand it is thought to be unduly restrictive to require that the actual indorsement be made by the impostor or other fraudulent actor. In most cases the person whose fraud procured the instrument to he issued will himself indorse; when some other third person indorses it will most probably be a case of theft or a second independent fraud superimposed upon the original fraud. In neither case does there seem to be sufficient reason to reverse the rule of the section. To recapitulate: the instrument does not become bearer paper, a purportedly regular chain in indorsements is required, but any person—first thief, second impostor or third murderer—can effectively indorse in the name of the payee.

2. Subsection (1) (a) is new. It rejects decisions which distinguish between face-to-face imposture and imposture by mail and hold that where the parties deal by mail the dominant intent of the drawer is to deal with the name rather than with the person so that the resulting instrument may be negotiated only by indorsement of the payee whose name has been taken in vain. The result of the distinction has been under some prior law, to throw the loss in the mail imposture forward to a subsequent holder or to the drawee. Since the maker or drawer believes the two to be one and the same, the two intentions cannot be separated, and the "dominant intent" is a fiction. The position here taken is that the loss, regardless of the type of fraud which the particular impostor has committed, should fall upon the maker or drawer.

"Impostor" refers to impersonation, and does not extend to a false representation that the party is the authorized agent of the payee. The maker or drawer who takes the precaution of making the instrument payable to the principal is entitled to have his indorsement.

3. Subsection (1) (b) restates the substance of the original subsection 9(3). The test stated is not whether the named payee is "fictitious," but whether the signer intends that he shall have no interest in the instrument. The following situations illustrate the application of the subsection.

a. The drawer of a check, for his own reasons, makes it payable to P knowing that P does not exist.

b. The drawer makes the check payable in the name of P. A person named P exists, but the drawer does not know it.

c. The drawer makes the check payable to P, an existing person whom he knows, intending to receive the money himself and that P shall have no interest in the check.

d. The treasurer of a corporation draws its check payable to P, who to the knowledge of the treasurer does not exist.

e. The treasurer of a corporation draws its check payable to P. P exists but the treasurer has fraudulently added his name to the payroll intending that he shall not receive the check.

f. The president and the treasurer of a corporation both sign its check payable to P. P does not exist. The treasurer knows it but the president does not.

g. The same facts as f, except that P exists and the treasurer knows it, but intends that P shall have no interest in the check.

In all the cases stated an indorsement by any person in the name of P is effective.

4. Paragraph (c) is new. It extends the rule of the original Subsection 9(3) to include the padded payroll cases, where the drawer's agent or employee prepares the check for signature or otherwise furnishes the signing officer with the name of the payee. The principle followed is that the loss should fall upon the employer as a risk of his business enterprise rather than upon the subsequent holder or drawee. The reasons are that the employer is normally in a better position to prevent such forgeries by reasonable care in the selection or supervision of his employees, or, if he is not, is at least in a better position to cover the loss by fidelity insurance; and that the cost of such insurance is properly an expense of his business rather than of the business of the holder or drawee.

The provision applies only to the agent or employee of the drawer, and only to the agent or employee who supplies him with the name of the payee. The following situations illustrate its application.

a. An employee of a corporation prepares a padded payroll for its treasurer, which includes the name of P. P does not exist, and the employee knows it, but the treasurer does not. The treasurer draws the corporation's check payable to P.

b. The same facts as a, except that P exists and the employee knows it but intends him to have no interest in the check. In both cases an indorsement by any person in the name of P is effective and the loss falls on the corporation.

5. The section is not intended to affect criminal liability for forgery or any other crime, or civil liability to the drawer or to any other person. It is to be read together with the section under which an unauthorized signer is personally liable on the signature to any person who takes the instrument in good faith (3-404(1)).

Cross References:

§§ 3-401, 3-403, 3-404 and 3-406.
Point 5: § 3-404(1).

Definitional Cross References:

"Instrument". § 3-102.
"Issue". § 3-102.
"Person". § 1-201.
"Signature". § 3-401.

Prior Statutes: Code 1950, § 6-361(3), as amended in 1956.

Comment: The section follows the fictitious payee rule embodied in the amended NIL 9(3), adopted in Virginia in 1956. The UCC changes the rule, but not the result, of First Wisconsin Nat'l Bank v. People's Nat'l Bank, 136 Va. 276, 283, 118 S.E. 82, 36 A.L.R. 736 (1923), which held that a draft inadvertently made payable to a nonexistent payee (a bank that had been consolidated with another) was a bearer instrument. Such an instrument is not made payable to bearer under UCC 3-111, nor excluded from being order paper under UCC 3-110.

Whereas under the NIL, instruments payable to fictitious payees were bearer instruments and could be negotiated without indorsement, under the UCC such instruments are treated as payable to order, but the indorsement of any person in the name of the named payee is effective to negotiate the instrument. Consequently, the UCC would give the same result, but reach it by a different route, as in Norton v. City Bank & Trust Co., 294 Fed. 839 (4th Cir. 1923), which held that a drawee bank was not liable for paying an instrument payable to a fictitious payee, because it was a bearer instrument and so needed no indorsement.

§ 3-406. Negligence Contributing to Alteration or Unauthorized Signature. Any person who by his negligence substantially contributes to a material alteration of the instrument or to the making of an unauthorized signature is precluded from asserting the alteration or lack of authority against a holder in due course or against a drawee or other payor who pays the instrument in good faith and in accordance with the reasonable commercial standards of the drawee's or payor's business.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. This section is new. It adopts the doctrine of Young v. Grote, 4 Bing. 253 (1827), which held that a drawer who so negligently draws an instrument as to facilitate its material alteration is liable to a drawee who pays the altered instrument in good faith. It should be noted that the rule as stated in the section requires that the negligence "substantially" contribute to the alteration.

2. The section extends the above principle to the protection of a holder in due course and of payors who may not technically be drawees. It rejects decisions which have held that the maker of a note owes no duty of care to the holder because at the time the instrument is drawn there is no contract between them. By drawing the instrument and "setting it afloat upon a sea of strangers" the maker or drawer voluntarily enters into a relation with later holders which justifies his responsibility. In this respect an instrument so negligently drawn as to facilitate alteration does not differ in principle from an instrument containing blanks which may be filled.

The holder in due course under the rules governing alteration (§ 3-407) may enforce the altered instrument according to its original tenor. Where negligence of the obligor has substantially contributed to the alteration, this section gives the holder the alternative right to enforce the instrument as altered.

3. No attempt is made to define negligence which will contribute to an alteration. The question is left to the court or the jury upon the circumstances of the particular cases. Negligence usually has been found where spaces are left in the body of the instrument in which words or figures may be inserted. No unusual precautions are required, and the section is not intended to change decisions holding that the drawer of a bill is under no duty to use sensitized paper, indelible ink or a protectograph; or that it is not negligence to leave spaces between the lines or at the end of the instrument in which a provision for interest or the like can be written.

4. The section applies only where the negligence contributes to the alteration. It must afford an opportunity of which advantage is in fact taken. The section approves decisions which have refused to hold the drawer responsible where he has left spaces in a check but the payee erased all the writing with chemicals and wrote in an entirely new check.

5. This section does not make the negligent party liable in tort for damages resulting from the alteration. Instead it estops him from asserting it against the holder in due course or drawee. The reason is that in the usual case the extent of the loss, which involves the possibility of ultimate recovery from the wrong-

doer, cannot be determined at the time of litigation, and the decision would have to be made on the unsatisfactory basis of burden of proof. The holder or drawee is protected by an estoppel, and the task of pursuing the wrongdoer is left to the negligent party. Any amount in fact recovered from the wrongdoer must be held for the benefit of the negligent party under ordinary principles of equity.

6. The section protects parties who act not only in good faith, (§ 1-201) but also in observance of the reasonable standards of their business. Thus any bank which takes or pays an altered check which ordinary banking standards would require it to refuse cannot take advantage of the estoppel.

7. The section applies the same rule to negligence which contributes to a forgery or other unauthorized signature, as defined in this Act (§ 1-201). The most obvious case is that of the drawer who makes use of a signature stamp or other automatic signing device and is negligent in looking after it. The section extends, however, to cases where the party has notice that forgeries of his signature have occurred and is negligent in failing to prevent further forgeries by the same person. It extends to negligence which contributes to a forgery of the signature of another, as in the case where a check is negligently mailed to the wrong person having the same name as the payee. As in the case of alteration, no attempt is made to specify what is negligence, and the question is one for the court or the jury on the facts of the particular case.

Cross References:

§§ 3-401 and 3-404.
Point 2: § 3-407(3).
Point 6: § 1-201.
Point 7: § 1-201.

Definitional Cross References:

"Alteration". § 3-407.
"Good faith". § 1-201.
"Holder in due course". § 3-302.
"Instrument". § 3-102.
"Person". § 1-201.
"Unauthorized signature". § 1-201.

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Prior Statutes: None.

Comment: The UCC is in accord with the suggestion in Hoffman v. Planters Nat'l Bank, 99 Va. 480, 485, 39 S.E. 134 (1901), that the maker of a note, who carelessly executes the instrument so as to leave spaces, might be liable in accordance with a material alteration made possible by his negligence. Nat'l Bank of Virginia v. Nolting, 94 Va. 263, 267, 26 S.E. 826 (1897), said that it is not negligence to give one's check to a stranger in return for cash, but since the check was not negligently drawn, the court did not have to consider the applicability of the rule of Young v. Grote, 4 Bing. 253 (1827).

§ 3-407. Alteration. (1) Any alteration of an instrument is material which changes the contract of any party thereto in any respect, including any such change in

(a) the number or relations of the parties; or

(b) an incomplete instrument, by completing it otherwise than as authorized; or

(c) the writing as signed, by adding to it or by removing any part of it.

(2) As against any person other than a subsequent holder in due course

(a) alteration by the holder which is both fraudulent and material discharges any party whose contract is thereby changed unless that party assents or is precluded from asserting the defense;

(b) no other alteration discharges any party and the instrument may be enforced according to its original tenor, or as to incomplete instruments according to the authority given.

(3) A subsequent holder in due course may in all cases enforce the instrument according to its original tenor, and when an incomplete instrument has been completed, he may enforce it as completed.

COMMENT: Prior Uniform Statutory Provision: §§ 14, 15, 124 and 125, Uniform Negotiable Instruments Law.

Changes: Combined and reworded; new provisions; rule of original § 15 reversed.

Purposes of Changes and New Matter: The changes are intended to remove uncertainties arising under the original sections, and to modify the rules as to discharge:

1. Subsection (1) substitutes a general definition for the list of illustrations in the original § 125. Any alteration is material only as it may change the contract of a party to the instrument; and the addition or deletion of words which do not in any way affect the contract of any previous signer is not material. But any change in the contract of a party, however slight, is a material alteration; and the addition of one cent to the amount payable, or an advance of one day in the date of payment, will operate as a discharge if it is fraudulent.

Specific mention is made of a change in the number or relations of the parties in order to make it clear that any such change is material only if it changes the contract of one who has signed. The addition of a co-maker or a surety does not change in most jurisdictions the contract of one who has already signed as maker and should not be held material as to him. The addition of the name of an alternative payee is material, since it changes his obligation. Paragraph (c) makes special mention of a change in the writing signed in order to cover occasional cases of addition of sticker clauses, scissoring or perforating instruments where the separation is not authorized.

2. Paragraph (b) of subsection (1) is to be read together with § 3-115 on incomplete instruments. Where an instrument contains blanks or is otherwise incomplete, it may be completed in accordance with the authority given and is then valid and effective as completed. If the completion is unauthorized and has the effect of changing the contract of any previous signer, this provision follows the generally accepted rule in treating it as a material alteration which may operate as a discharge.

3. Subsection (2) modifies the very rigorous rule of the original § 124. The changes made are as follows:

a. A material alteration does not discharge any party unless it is made by the holder. Spoliation by any meddling stranger does not affect the rights of the holder. It is of course intended that the acts of the holder's authorized agent or employee, or of his confederates, are to be attributed to him.

b. A material alteration does not discharge any party unless it is made for a fraudulent purpose. There is no discharge where a blank is filled in the honest belief that it is as authorized; or where a change is made with a benevolent motive such as a desire to give the obligor the benefit of a lower interest rate. Changes favorable to the obligor are unlikely to be made with any fraudulent intent; but if such an intent is found the alteration may operate as a discharge.

c. The discharge is a personal defense of the party whose contract is changed by the alteration, and anyone whose contract is not affected cannot assert it. The contract of any party is necessarily affected, however, by the discharge of any party against whom he has a right of recourse on the instrument. Assent to the alteration given before or after it is made will prevent the party from asserting the discharge. "Or is precluded from asserting the defense" is added in paragraph (a) to recognize the possibility of an estoppel or other ground barring the defense which does not rest on assent.

d. If the alteration is not material or if it is not made for a fraudulent purpose there is no discharge, and the instrument may be enforced according to its original tenor. Where blanks are filled or an incomplete instrument is otherwise completed there is no original tenor, but the instrument may be enforced according to the authority in fact given.

4. Subsection (3) combines the final sentences of the original §§ 14 and 124, and provides that a subsequent holder in due course takes free of the discharge in all cases. The provision is merely one form of the general rule governing the effect of discharge against a holder in due course (§ 3-602). The holder in due course may enforce the instrument according to its original tenor. In this con-

nection reference should be made to the section giving the holder in due course the right, where the maker's or drawer's negligence has substantially contributed to the alteration, to enforce the instrument in its altered form (§ 3-406). Reference should also be made to § 4-401 covering a bank's right to charge its customer's account in the case of altered instruments.

Where blanks are filled or an incomplete instrument is otherwise completed, this subsection follows the original § 14 in placing the loss upon the party who left the instrument incomplete and permitting the holder to enforce it in its completed form. As indicated in the comment to § 3-115 on incomplete instruments, this result is intended even though the instrument was stolen from the maker or drawer and completed after the theft; and the effect of this subsection, together with the section on incomplete instruments is to reverse the rule of the original § 15.

There is no inconsistency between subsection (3) and paragraph (b) of subsection (2). The holder in due course may elect to enforce the instrument either as provided in that paragraph or as provided in subsection (3).

It should be noted that a purchaser who takes the instrument with notice of any material alteration, including the unauthorized completion of an incomplete instrument, takes with notice of a claim or defense and cannot be a holder in due course (§ 3-304).

Cross References:

§§ 3-305, 3-306 and 3-307.
Point 2: § 3-115.
Point 4: §§ 3-115, 3-304(2), 4-401 and 3-602.

Definitional Cross References:

"Contract". § 1-201.
"Holder". § 1-201.
"Holder in due course". § 3-302.
"Instrument". § 3-102.
"Party". § 1-201.
"Person". § 1-201.
"Signed". § 1-201.
"Writing". § 1-201.

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Prior Statutes: Code 1950, §§ 6-366, 6-367, 6-477, 6-478.

Comment: Under the UCC any alteration that changes the contract of a party is a material alteration. This is in accord with most Virginia cases: Harnsberger v. Nicholas, 176 Va. 225, 10 S.E.2d 873 (1940) (shortening date of maturity from ten years to one year); Early v. Citizens Bank of Sneedville, 173 Va. 436, 438, 3 S.E.2d 167 (1939) (addition of a place of payment); Hoffman v. Planters Nat'l Bank, 99 Va. 480, 481-83, 39 S.E. 134 (1901) (change of name of payee). The statement in Whaley Bros. v. Stevens, 159 Va. 388, 392, 165 S.E. 645 (1932), that "The detachment of a negotiable note from a memorandum qualifying its terms is of itself a material alteration," seems to be of doubtful validity as a general proposition. The UCC is in accord with Stegal v. Union Bank Trust Co., 163 Va. 417, 433, 176 S.E. 438 (1934), holding that a false and unauthorized notation that interest has been paid is not a material alteration, since this does not change the contract of any party.

The UCC treats an unauthorized completion of an incomplete instrument as a material alteration. If it is fraudulent the instrument cannot be enforced against any party except a holder in due course, unless the party is precluded from raising the defense of alteration. This approach is in accord with State Bank of Pamplin v. Payne, 156 Va. 837, 850-51, 159 S.E. 163 (1931).

The UCC changes the NIL rule that any material alteration, even spoilation, avoids the instrument. To have any effect under the UCC the alteration must be both material and fraudulent. This result, as distinguished from the method by which it is reached, accords with that reached in Harnsberger v. Nicholas, 176 Va. 255, 259-62, 19 S.E.2d 873 (1940), in which an innocent alteration was held to avoid the instrument, but recovery was allowed on the underlying obligation. The UCC would apparently change the result in Hoffman v. Planters Nat'l Bank, 99 Va. 480, 484-85, 39 S.E. 134 (1901), which held that a material alteration without more avoided the instrument, the full circumstances of the situation being immaterial.

The UCC accords with Early v. Citizens Bank of Sneedville, 173 Va. 436, 438, 3 S.E.2d 167 (1939), and American Bank of Orange v. McComb, 105 Va. 473, 475, 54 S.E. 14 (1906), in allowing a holder in due course to enforce the instrument according to its original tenor.

§ 3-408. **Consideration.** Want or failure of consideration is a defense as against any person not having the rights of a holder in due course (§ 3-305), except that no consideration is necessary for an instrument or obligation thereon given in payment of or as security for an antecedent obligation of any kind. Nothing in this section shall be taken to displace any statute outside this Act under which a promise is enforceable notwithstanding lack or failure of consideration. Partial failure of consideration is a defense pro tanto whether or not the failure is in an ascertained or liquidated amount.

COMMENT: **Prior Uniform Statutory Provision:** §§ 24, 25 and 28, Uniform Negotiable Instruments Law.

Changes: Combined and reworded.

Purposes of Changes: 1. "Consideration" is distinguished from "value" throughout this Article. "Consideration" refers to what the obligor has received for his obligation, and is important only on the question of whether his obligation can be enforced against him.

2. The "except" clause is intended to remove the difficulties which have arisen where a note or a draft, or an indorsement of either, is given as payment or as security for a debt already owed by the party giving it, or by a third person. The provision is inteuded to change the result of decisions holding that where no extension of time or other concession is given by the creditor the new obligation fails for lack of legal consideration. It is intended also to mean that an instrument given for more or less than the amount of a liquidated obligation does not fail by reason of the common law rule that an obligation for a lesser liquidated amount cannot be consideration for the surrender of a greater.

3. With respect to the necessity or sufficiency of consideration other obligations on an instrument are subject to the ordinary rules of contract law relating to contracts not under seal. Promissory estoppel or any other equivalent or substitute for consideration is to be recognized as in other contract cases. The provision of the original § 28 as to absence or failure of consideration is now covered by the section dealing with the rights of one not a holder in due course; and the "presumption" of consideration in the original § 24 is replaced by the provision relating to the burden of establishing defenses.

Cross References:

Point 1: § 3-303.
Point 3: §§ 3-306(c) and 3-307(2).

Definitional Cross References:

"Holder in due course". § 3-302.
"Instrument". § 3-102.
"Person". § 1-201.
"Rights". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-376, 6-377, 6-380.

Comment: Consideration is what the obligor has received for his obligation and is important only on the question of whether the obligation can be enforced against him. In this sense the section is in accord with Virginia decisions. Want of consideration is a defense as against a party who is not a holder in due course. Good v. Dyer, 137 Va. 114, 133-36, 119 S.E. 277 (1923). Sufficient consideration was found in the following cases: Catlett v. Hawthorne, 157 Va. 372, 381, 161 S.E. 47 (1931) (extension of time for payment); Coal River Collieries v. Eureka Coal and Wood Co., 144 Va. 263, 284-85, 132 S.E. 337 (1926) (extension of time for payment); Brenard Manufacturing Co. v. Brown, 120 Va. 757, 92 S.E. 850 (1917) (sale of advertising scheme); Colley v. Summers Parrott Hardware Co., 119 Va. 439, 442, 89 S.E. 906 (1916) (extension of time for payment); Ford v. Engleman, 118 Va. 89, 86 S.E. 852 (1915) (release of a cause of action for breach of promise to marry).

§ 3-409. **Draft Not an Assignment.** (1) A check or other draft does not of itself operate as an assignment of any funds in the hands of the drawee available for its payment, and the drawee is not liable on the instrument until he accepts it.

(2) Nothing in this section shall affect any liability in contract, tort or otherwise arising from any letter of credit or other obligation or representation which is not an acceptance.

COMMENT: Prior Uniform Statutory Provision: §§ 127 and 189, Uniform Negotiable Instruments Law.

Changes: Combined and reworded; new provisions.

Purposes of Changes and New Matter: The two original sections are combined, brought forward to appear in connection with acceptance, and reworded to remove uncertainties.

1. As under the original sections, a check or other draft does not of itself operate as an assignment in law or equity. The assignment may, however, appear from other facts, and particularly from other agreements, express or implied; and when the intent to assign is clear the check may be the means by which the assignment is effected.

2. The language of the original § 189, that the drawee is not liable "to the holder", is changed as inaccurate and not intended. The drawee is not liable on the instrument until he accepts; but he remains subject to any other liability to the holder. In this connection reference should be made to § 4-302 on the payor bank's liability for late return. Such a bank if it does not either make prompt settlement or return on an item received by it will become liable to a holder of the item.

3. Subsection (2) is new. It is intended to make it clear that this section does not in any way affect any liability which may arise apart from the instrument itself. The drawee who fails to accept may be liable to the drawer or to the holder for breach of the terms of a letter of credit or any other agreement by which he is obligated to accept. He may be liable in tort or upon any other basis because of his representation that he has accepted, or that he intends to accept. The section leaves unaffected any liability of any kind apart from the instrument.

Cross References:

§§ 3-410, 3-411, 3-412 and 3-415.
Point 2: § 4-302.

Definitional Cross References:

"Acceptance". § 3-410.
"Check". § 3-104.
"Contract". § 1-201.
"Draft". § 3-104.
"Instrument". § 3-102.
"Letter of credit". § 5-104.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-480, 6-543.

Comment: The UCC continues prior law to the effect that a draft is not an assignment: Reaves Warehouse Corp. v. Easley, 150 Va. 236, 242, 142 S.E. 356 (1928); Gardner v. Moore's Adm'r, 122 Va. 10, 94 S.E. 162 (1917); Jones v. Crumpler, 119 Va. 143, 147-48, 89 S.E. 232 (1916); Baltimore & Ohio R.R. v. First Nat'l Bank, 102 Va. 753, 47 S.E. 837 (1904).

§ 3-410. **Definition and Operation of Acceptance.** (1) Acceptance is the drawee's signed engagement to honor the draft as presented. It must be written on the draft, and may consist of his signature alone. It becomes operative when completed by delivery or notification.

(2) A draft may be accepted although it has not been signed by the drawer or is otherwise incomplete or is overdue or has been dishonored.

(3) Where the draft is payable at a fixed period after sight and the acceptor fails to date his acceptance the holder may complete it by supplying a date in good faith.

COMMENT: **Prior Uniform Statutory Provision:** §§ 132, 133, 134, 135, 136, 137, 138, 161-170, and 191, Uniform Negotiable Instruments Law.

Changes: Combined, reworded; original §§ 134, 135, 137 and 161-170 eliminated.

Purposes of Changes: 1. The original §§ 161-170 providing for acceptance for honor are omitted from this Article. This ancient practice developed at a time when communications were slow, and particularly in overseas transactions there might be a delay of several months before the drawer could be notified of dishonor by nonacceptance and take steps to protect his credit. The need for intervention by a third party has passed with the development of the cable transfer, the letter of credit, and numerous other devices by which a substitute arrangement is promptly made. The practice has been obsolete for many years, and the sections are therefore eliminated.

2. Under § 3-417 a person obtaining acceptance gives a warranty against alteration of the instrument before acceptance.

3. Subsection (1) adopts the rule of § 17 of the English Bills of Exchange Act that the acceptance must be written on the draft. It eliminates the original §§ 134 and 135, providing for "virtual" acceptance by a written promise to accept drafts to be drawn, and "collateral" acceptance by a separate writing. Both have been anomalous exceptions to the policy that no person is liable on an instrument unless his signature appears on it. Both are derived from a line of early American cases decided at a time when difficulties of communication, particularly overseas, might leave the holder in doubt for a long period whether the draft was accepted. Such conditions have long since ceased to exist, and the "virtual" or "collateral" acceptance is now almost entirely obsolete. Good commercial and banking practice does not sanction acceptance by any separate writing because of the dangers and uncertainties arising when it becomes separated from the draft. The instrument is now forwarded to the drawee for his acceptance upon it, or reliance is placed upon the obligation of the separate writing itself, as in the case of a letter of credit.

Nothing in this section is intended to eliminate any liability of the drawee in contract, tort or otherwise arising from the separate writing of any other obligation or representation, as provided in § 3-409.

Subsection (1) likewise eliminates the original § 137, providing for acceptance by delay or refusal to return the instrument but the drawee may be liable for a conversion of the instrument under § 3-419.

4. Subsection (1) states the generally recognized rule that the mere signature of the drawee on the instrument is a sufficient acceptance. Customarily the signature is written vertically across the face of the instrument; but since the drawee has no reason to sign for any other purpose his signature in any other place, even on the back of the instrument, is sufficient. It need not be accompanied by such words as "Accepted," "Certified," or "Good." It must not, however, bear any words indicating an intent to refuse to honor the bill; and nothing in this provision is intended to change such decisions as Norton v. Knapp, 64 Iowa 112, 19 N.W. 867, (1884), holding that the drawee's signature accompanied by the words "Kiss my foot" is not an acceptance.

5. The final sentence of subsection (1) expressly states the generally recognized rule, implied in the definition of acceptance in the original § 191, that an acceptance written on the draft takes effect when the drawee notifies the holder or gives notice according to his instructions. Acceptance is thus an exception to the usual rule that no obligation on an instrument is effective until delivery.

6. Subsection (3) changes the last sentence of the original § 138. The purpose of the provision is to provide a definite date of payment where none appears on the instrument. An undated acceptance of a draft payable "thirty days after sight" is incomplete; and unless the acceptor himself writes in a different date the holder is authorized to complete the acceptance according to the terms of the draft by supplying a date of presentment. Any date which the holder chooses to write in is effective providing his choice of date is made in good faith. Any different agreement not written on the draft is not effective, and parol evidence is not admissible to show it.

Cross References:

§§ 3-411, 3-412 and 3-418.
Point 2: § 3-417.
Point 3: §§ 3-401(1), 3-409(2) and 3-419.
Point 6: § 3-412.

Definitional Cross References:

"Delivery". § 1-201.
"Dishonor". § 3-507.
"Draft". § 3-104.
"Good faith". § 1-201.
"Holder". § 1-201.
"Honor". § 1-201.
"Notification". § 1-201.
"Presentment". § 3-504.
"Signature". § 3-401.
"Signed". § 1-201.
"Written". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-485 through 6-491; 6-541 through 6-523, 6-554.

Comment: An acceptance under the UCC must be written on the draft. This is in accord with Jones v. Crumpler, 119 Va. 143, 146-47, 89 S.E. 232 (1916), in which it was held that a letter was not an acceptance of a draft.

§ 3-411. Certification of a Check. (1) Certification of a check is acceptance. Where a holder procures certification the drawer and all prior indorsers are discharged.

(2) Unless otherwise agreed a bank has no obligation to certify a check.

(3) A bank may certify a check before returning it for lack of proper indorsement. If it does so the drawer is discharged.

COMMENT: Prior Uniform Statutory Provision: §§ 187 and 188, Uniform Negotiable Instruments Law.

Changes: Combined and reworded; new provisions.

Purposes of Changes and New Matter: 1. The second sentence of subsection (1) continues the rule of original § 188 that, while certification procured by a holder discharges the drawer and other prior parties, certification procured by the drawer leaves him liable. Under this provision any certification procured by a holder discharges the drawer and prior indorsers. Any indorsement made after a certification so procured remains effective; and where it is intended that any indorser shall remain liable notwithstanding certification, he may indorse with the words "after certification" to make his liability clear.

2. Subsection (2) is new. It states the generally recognized rule that in the absence of agreement a bank is under no obligation to certify a check, because it is a demand instrument calling for payment rather than acceptance. The bank may be liable for breach of any agreement with the drawer, the holder, or any other person by which it undertakes to certify. Its liability is not on the instrument, since the drawee is not so liable until acceptance (§ 3-409(1)). Any liability is for breach of the separate agreement.

3. Subsection (3) is new. It recognizes the banking practice of certifying a check which is returned for proper indorsement in order to protect the drawer against a longer contingent liability. It is consistent with the provision of § 3-410(2) permitting certification although the check has not been signed or is otherwise incomplete.

Cross References:

§§ 3-412, 3-413, 3-417 and 3-418.
Point 2: § 3-409(1).
Point 3: § 3-410(2).

Definitional Cross References:

"Acceptance". §3-410.
"Bank". § 1-201.
"Check". § 3-104.
"Holder". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-541, 6-542, 6-543.

Comment: Under this section the certification of a check is an acceptance, having the effect of an assignment, a result that is in accord with Nat'l Mechanics Bank v. Schmelz Nat'l Bank, 136 Va. 33, 40-42, 116 S.E. 380 (1923). The UCC does not cover the point decided in Kasco Mills, Inc. v. Ferebee, 197 Va. 589, 593-95, 90 S.E. 2d 866 (1956), wherein it was held, applying Code 1950, § 11-12, that the holder's procurement of certification does not operate as an accord and satisfaction as a matter of law. The court did not cite Code 1950, § 6-542 (NIL 188), which provides for discharge of the drawer when the holder obtains certification. The UCC continues the NIL rule that a holder procuring certification discharges the drawer. Consequently, the precise status of the Kasco case is not clear.

§ 3-412. **Acceptance Varying Draft.** (1) Where the drawee's proffered acceptance in any manner varies the draft as presented the holder may refuse the acceptance and treat the draft as dishonored in which case the drawee is entitled to have his acceptance cancelled.

(2) The terms of the draft are not varied by an acceptance to pay at any particular bank or place in the United States, unless the acceptance states that the draft is to be paid only at such bank or place.

(3) Where the holder assents to an acceptance varying the terms of the draft each drawer and indorser who does not affirmatively assent is discharged.

COMMENT: Prior Uniform Statutory Provision: §§ 139, 140, 141 and 142, Uniform Negotiable Instruments Law.

Changes: Combined and reworded; law changed as to qualified acceptances.

Purposes of Changes: 1. The section applies to conditional acceptances, acceptances for part of the amount, acceptances to pay at a different time from that required by the draft, or to the acceptance of less than all of the drawees, all of which are covered by the original § 141. It applies to any other engagement changing the essential terms of the draft.

2. Where the drawee offers such a varied engagement the holder has an election. He may reject the offer, insist on acceptance of the draft as presented, and treat the refusal to give it as a dishonor. In that event the drawee is not bound by his engagement, and is entitled to have it cancelled. After any necessary notice of dishonor and protest the holder may have his recourse against the drawer and indorsers.

If the holder elects to accept the offer, this section does not invalidate the drawee's varied engagement. It remains his effective obligation, which the holder may enforce against him. By his assent, however, the holder discharges any drawer or indorser who does not also assent. The rule of the original § 142 is changed to require that the assent of the drawer or indorser be affirmatively expressed. Mere failure to object within a reasonable time is not assent which will prevent the discharge.

3. The rule of original § 140 that an acceptance to pay at a particular place is an unqualified acceptance is modified by the provision of subsection (2) that the terms of the draft are not varied by an acceptance to pay at any particular bank or place in the United States unless the acceptance states that the draft is to be paid only at such bank or place. § 3-504(4) provides that a draft accepted payable at a bank in the United States must be presented at the bank designated.

Cross References:

§§ 3-410 and 3-413.
Point 3: § 3-504(4).

Definitional Cross References:

"Acceptance". § 3-410.
"Bank". § 1-201.
"Dishonor". § 3-507.
"Draft". § 3-104.
"Holder". § 1-201.
"Term". § 1-201.
"Written". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-492, 6-493, 6-494, 6-495.

§ 3-413. **Contract of Maker, Drawer and Acceptor.** (1) The maker or acceptor engages that he will pay the instrument according to its tenor at the time of his engagement or as completed pursuant to § 3-115 on incomplete instruments.

(2) The drawer engages that upon dishonor of the draft and any necessary notice of dishonor or protest he will pay the amount of the draft to the holder or to any indorser who takes it up. The drawer may disclaim this liability by drawing without recourse.

(3) By making, drawing or accepting the party admits as against all subsequent parties including the drawee the existence of the payee and his then capacity to indorse.

COMMENT: Prior Uniform Statutory Provision: §§ 60, 61 and 62, Uniform Negotiable Instruments Law.

Changes: Combined and reworded.

Purposes of Changes: The original sections are combined for convenience and condensed to avoid duplication of language. This section should be read in connection with the sections on incomplete instruments (3-115), negligence contributing to alteration or unauthorized signature (3-406), alteration (3-407), acceptances varying a draft (3-412) and finality of payment or acceptance (3-418). Thus a maker who signs an incomplete note engages under this section to pay it according to its tenor at the time he signs it, but by virtue of §§ 3-115 and 3-407 the note may thereafter be completed and enforced against him. In the same way, if the maker's negligence substantially contributes to alteration of the instrument, he will become liable on his note as altered under § 3-406. When a holder assents to an acceptance varying a draft (§ 3-412) he can of course hold the acceptor only according to the form of acceptance to which the holder agreed. § 3-418 applies the rule of Price v. Neal both to acceptance and payment; thus an acceptor may not, after acceptance, assert that the drawer's signature is unauthorized.

Subsection (1) applies to all drafts (including checks) the rule that the acceptance relates to the instrument as it was at the time of its acceptance and not (in case of alteration before acceptance) to its original tenor. The cases on this point under the original act (all of which involved checks) have been in conflict. It should be noted that under § 3-417 a person who obtains acceptance warrants to the acceptor that the instrument has not been materially altered.

Except as indicated in the foregoing comment the section makes no change in substance from the provision of the original act.

Cross References:
§§ 3-115, 3-406, 3-407, 3-412, 3-417 and 3-418.

Definitional Cross References:

"Contract". § 1-201.
"Dishonor". § 3-507.
"Draft". § 3-104.
"Holder". § 1-201.
"Instrument". § 3-102.
"Notice of dishonor". § 3-508.
"Party". § 1-201.
"Protest". § 3-509.

Prior Statutes: Code 1950, §§ 6-412, 6-413, 6-414.

Comment: Since the maker engages that he will pay the instrument, an accommodation indorser who pays the instrument is entitled to reimbursement from the maker. See Dickenson v. Charles, 173 Va. 393, 400, 4 S.E. 2d 356 (1939).

§ 3-414. Contract of Indorser; Order of Liability. (1) Unless the indorsement otherwise specifies (as by such words as "without recourse") every indorser engages that upon dishonor and any necessary notice of dishonor and protest he will pay the instrument according to its tenor at the time of his indorsement to the holder or to any subsequent indorser who takes it up, even though the indorser who takes it up was not obligated to do so.

(2) Unless they otherwise agree indorsers are liable to one another in the order in which they indorse, which is presumed to be the order in which their signatures appear on the instrument.

COMMENT: Prior Uniform Statutory Provision: §§ 38, 44, 66, 67 and 68, Uniform Negotiable Instruments Law.

Changes: Combined and reworded.

Purposes of Changes: 1. Subsection (1) states the contract of indorsement—that if the instrument is dishonored and any protest or notice of dishonor which may be necessary under § 3-501 is given, the indorser will pay the instrument. The indorser's engagement runs to any holder (whether or not for value) and to any indorser subsequent to him who has taken the instrument up. An indorser may disclaim his liability on the contract of indorsement, but only if the indorsement itself so specifies. Since the disclaimer varies the written contract of indorsement, the disclaimer itself must be written on the instrument and cannot be proved by parol. The customary manner of disclaiming the indorser's liability under this section is to indorse "without recourse". Apart from such a disclaimer all indorsers incur this liability, without regard to whether or not the indorser transferred the instrument for value or received consideration for his indorsement.

Original § 44, permitting a representative to indorse in such terms as to exclude personal liability, is omitted as unnecessary and included in the broader right to disclaim any liability. No change in the law is intended by this omission.

2. In addition to his liability on the contract of indorsement, an indorser, if a transferor, gives the warranties stated in § 3-417.

3. As in the case of acceptor's liability (§ 3-413), this section conditions the indorser's liability on the tenor of the instrument at the time of his indorsement. Thus if a person indorses an altered instrument he assumes liability as indorser on the instrument as altered.

4. Subsection (2) is intended to clarify existing law under original § 68.

The section states two presumptions: One is that the indorsers are liable to one another in the order in which they have in fact indorsed. The other is that they have in fact indorsed in the order in which their names appear. Parol evidence is admissible to show that they have indorsed in another order, or that they have otherwise agreed as to their liability to one another.

The last sentence of the original § 68 is now covered by § 3-118(e) (Ambiguous Terms and Rules of Construction).

Cross References:

Point 1: § 3-501.
Point 2: § 3-417.
Point 3: § 3-413.
Point 4: § 3-118(e).

Definitional Cross References:

"Contract". § 1-201.
"Dishonor". § 3-507.
"Holder". § 1-201.
"Instrument". § 3-102.
"Notice of dishonor". § 3-508.
"Presumed". §1-201.
"Protest". § 3-509.
"Signature". § 3-401.

Prior Statutes: Code 1950, §§ 6-390, 6-396, 6-418, 6-419, 6-420.

Comment: The indorser engages that upon dishonor and any necessary notice of dishonor and protest he will pay the instrument according to its tenor at the time of his endorsement. This accords with Shepherd v. Mortgage Securities Corp., 139 Va. 274, 276-78, 123 S.E. 553 (1924); Citizens Nat'l Bank v. Walton, 96 Va. 435, 31 S.E. 890 (1898). The UCC does not expressly cover, but apparently does not affect the result in Barrett v. Vaughan & Co., 163 Va. 811, 814-15, 178 S.E. 64 (1935), holding that an indorser may voluntarily bind himself to assume the obligations of a maker.

The UCC continues the rule that indorsers are prima facie liable in the order in which they indorse, but parol evidence is admissible as between them to show that they have agreed otherwise. Winckel v. Carter, 198 Va. 550, 552-55, 95 S.E.2d 148 (1956); Mann v. Bradshaw's Adm'r, 136 Va. 351, 368-76, 118 S.E. 326 (1923); Cox v. Hagan, 125 Va. 656, 668-69, 671-72, 100 S.E. 666 (1919); Alphin v. Lowman, 115 Va. 441, 443-46, 79 S.E. 1029 (1913) (agreement as to liability not within the statute of frauds). Where shareholders in a corporation indorse the corporation's notes for accommodation, and there is no indication that any of them have a peculiar interest, the inference of fact is that they agreed among themselves to be jointly bound. Van Winckel v. Carter, 198 Va. 550, 95 S.E. 2d 148 (1956); Mann v. Bradshaw's Adm'r, 136 Va. 351, 118 S.E. 326 (1923).

While not explicit on the point, it would appear that under the UCC parol evidence would be admissible as between the parties to show that the maker and indorsers are all primarily liable on the instrument. This was the position taken in Houston v. Bain, 170 Va. 378, 390-92, 196 S.E. 657 (1938), holding that the position of the signature is not controlling and that a person signing on the back of the instrument may be a maker, and so the person signing the instrument as maker on its face was held to be entitled to contribution from persons signing on the back of the instrument.

The UCC does not deal with the right of set-off between an accommodation indorser and the holder. Dickenson v. Charles, 173 Va. 393, 401-05, 4 S.E. 2d 356 (1939).

§ 3-415. **Contract of Accommodation Party.** (1) An accommodation party is one who signs the instrument in any capacity for the purpose of lending his name to another party to it.

(2) When the instrument has been taken for value before it is due the accommodation party is liable in the capacity in which he has signed even though the taker knows of the accommodation.

(3) As against a holder in due course and without notice of the accommodation oral proof of the accommodation is not admissible to give the accommodation party the benefit of discharges dependent on his character as such. In other cases the accommodation character may be shown by oral proof.

(4) An indorsement which shows that it is not in the chain of title is notice of its accommodation character.

(5) An accommodation party is not liable to the party accommodated, and if he pays the instrument has a right of recourse on the instrument against such party.

COMMENT: **Prior Uniform Statutory Provision:** §§ 28, 29 and 64, Uniform Negotiable Instruments Law.

Changes: Combined and reworded; new provisions.

Purposes of Changes and New Matter: To make it clear that:

1. Subsection (1) recognizes that an accommodation party is always a surety (which includes a guarantor), and it is his only distinguishing feature. He differs from other sureties only in that his liability is on the instrument and he is a surety for another party to it. His obligation is therefore determined by the capacity in which he signs. An accommodation maker or acceptor is bound on the

instrument without any resort to his principal, while an accommodation indorser may be liable only after presentment, notice of dishonor and protest. The subsection recognizes the defenses of a surety in accordance with the provisions subjecting one not a holder in due course to all simple contract defenses, as well as his rights against his principal after payment. Under subsection (3) except as against a holder in due course without notice of the accommodation, parol evidence is admissible to prove that the party has signed for accommodation. In any case, however, under subsection (4) an indorsement which is not in the chain of title (the irregular or anomalous indorsement) is notice to all subsequent takers of the instrument of the accommodation character of the indorsement.

2. Subsection (1) eliminates the language of the old § 29 requiring that the accommodation party sign the instrument "without receiving value therefor." The essential characteristic is that the accommodation party is a surety, and not that he has signed gratuitously. He may be a paid surety, or receive other compensation from the party accommodated. He may even receive it from the payee, as where A and B buy goods and it is understood that A is to pay for all of them and that B is to sign a note only as a surety for A.

3. The obligation of the accommodation party is supported by any consideration for which the instrument is taken before it is due. Subsection (2) is intended to change occasional decisions holding that there is no sufficient consideration where an accomodation party signs a note after it is in the hands of a holder who has given value. The party is liable to the holder in such a case even though there is no extension of time or other concession. This is consistent with the provision as to antecedent obligations as consideration (§ 3-408). The limitation to "before it is due" is one of suretyship law, by which the obligation of the surety is terminated at the time limit unless in the meantime the obligation of the principal has become effective.

4. As a surety the accommodation party is not liable to the party accommodated; but he is otherwise liable on the instrument in the capacity in which he has signed. This general statement of the rule makes unnecessary the detailed provisions of the original § 64, which is therefore eliminated, without any change in substance.

5. Subsection (5) is intended to change the result of such decisions as Quimby v. Varnum, 190 Mass. 211, 76 N.E. 671 (1906), which held that an accommodation indorser who paid the instrument could not maintain an action on it against the accommodated party since he had no "former rights" to which he was remitted. Under ordinary principles of suretyship the accommodation party who pays is subrogated to the rights of the holder paid, and should have his recourse on the instrument.

Cross References:

§§ 3-305, 3-408, 3-603, 3-604 and 3-606.
Point 1: § 3-306(b).
Point 3: § 3-408.

Definitional Cross References:

"Holder in due course". § 3-302.
"Instrument". § 3-102.
"Notice". § 1-201.
"Party". § 1-201.
"Presentment". § 3-504.
"Signed". § 1-201.
"Writing". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-380, 6-381, 6-416, 49-25, 49-26.

Comment: The UCC definition of an accommodation party contains an ambiguity, so that it is not clear whether the NIL has been changed. Under the NIL, Code 1950, § 6-381 (NIL 29), an accommodation party signs the instrument for the purpose of lending his name "to some other person." Under the UCC, an accommodation party signs the instrument for the purpose of lending his name "to another party to it." It would seem that the "it" in the UCC refers to the instrument, and so in order for a person to qualify as an accommodation party it is necessary that the party accommodated also be a party to the instrument. It is possible, though, that the "it" could be interpreted as referring to the overall transaction or agreement, and the definition of "party" in UCC 1-201(29) lends some support to this interpretation, so that the party accommodated can still be

some other person who is not a party to the instrument. If this latter interpretation is adopted, the UCC would not change the result in Wilson v. Stowers, 161 Va. 418, 170 S.E. 745 (1933). In this case, Stowers, as maker, gave a note payable to Wilson, as payee, for the accommodation of Dutton, who was not a party to the instrument. Stowers, as an accommodation party, was held liable to Wilson, consideration having moved from Wilson to Dutton. However, if Stowers is not an accommodation party, and so subjected to liability under subsection 3-415(2), the defense of want of consideration would seem to be available under UCC 3-408 as against a person not having the rights of a holder in due course.

The UCC accords with McFall v. Bank of Hays, 163 Va. 278, 175 S.E. 721 (1934), and Colona v. Parksley Nat'l Bank, 120 Va. 812, 819-21, 92 S.E. 979 (1917), that when the instrument has been taken for value before it is due, the accommodation party is liable in the capacity in which he has signed, as well to a person who knows of the accommodation as one who does not. Similarly, the UCC recognizes that it is not necessary for consideration to move to the accommodation party. Ward v. Bank of Pocahontas, 167 Va. 169, 187 S.E. 491 (1936); Wilson v. Stowers, 161 Va. 418, 170 S.E. 745 (1933). The UCC does not expressly cover the point, but it would not appear to change the holding in Cooper v. Greenberg, 191 Va. 495, 499-500, 61 S.E. 2d 875 (1950), that accommodation parties are liable as between themselves in accordance with their agreement, which agreement may be shown by parol evidence. Subsection 3-415(5) makes clear that an accommodation party is not liable to the party accommodated, the result reached in Webb v. Pleasants, 144 Va. 516, 132 S.E. 249 (1926), in which the accommodation maker of a note, used as collateral for a loan, was held not liable to the receiver of the bank, whose crooked employee had procured the making of the note.

The UCC recognizes that an accommodation party is always a surety, an approach that is in accord with Dickenson v. Charles, 173 Va. 393, 399-400, 4 S.E. 2d 356 (1939). As a surety, the accommodation party is entitled to defenses available under general suretyship law. This approach was recognized in Ward v. Bank of Pocahontas, 167 Va. 169, 178-79, 187 S.E. 491 (1936). The application of these principles though may present some difficulties.

Under subsection 3-415(3) parol evidence is admissible to show that a person has signed as an accommodation party, except as against a holder in due course without notice of the accommodation. This provision may change the result in Elswick v. Combs, 171 Va. 112, 198 S.E. 501 (1938). The receiver of an insolvent bank held notes signed by T. C. Elswick and indorsed by Gusta Elswick, his wife, and B. E. Elswick, their son; the opinion does not disclose who was named as payee. The Elswicks endeavored to set-off a deposit belonging to Gusta against liability on the note. Under Virginia law the deposit of an indorser cannot be set-off against the liability of a solvent maker, unless the indorser is the principal debtor with the maker only an accommodation party. The Supreme Court of Appeals held that parol evidence was inadmissible to show a relationship of the parties other than that disclosed by the instrument, unless the holder took the instrument knowing of the accommodation. If the bank was not a holder in due course it would appear that under the UCC parol evidence would be admissible to show the relationship of the parties, and to give Gusta Elswick a right of set-off. However, since under UCC 3-302(2) a payee may be a holder in due course, the bank might be found to be a holder in due course without notice of the accommodation, and so the parol evidence would be inadmissible, in which case the result under the UCC would be the same as that reached by the Virginia Supreme Court of Appeals.

The UCC probably leaves unchanged the result in Cox v. Hagan, 125 Va. 656, 100 S.E. 666 (1919), the situation not being expressly covered by the UCC. In Cox v. Hagan, several makers signed a note, some of them for the accommodation of others. Hagan then signed as accommodation indorser, not knowing that some of the makers were accommodation parties. Hagan paid the note and brought action against the makers. The court held that parol evidence was inadmissible to show the accommodation character of the makers' signatures since the accommodation indorser did not know of it. The court did not indicate whether the result would have been different if the indorser had known the accommodation. Subsection 3-415(2) does not seem to be applicable since the accommodation indorser is not a "taker." UCC 3-414(2), relating to the order of liability of indorsers, is not applicable since the accommodation maker is not an indorser. UCC 3-415(5) is not applicable since an accommodation maker is not the party accommodated.

§ 3-416. **Contract of Guarantor.** (1) "Payment guaranteed" or equivalent words added to a signature mean that the signer engages that if the

instrument is not paid when due he will pay it according to its tenor without resort by the holder to any other party.

(2) "Collection guaranteed" or equivalent words added to a signature mean that the signer engages that if the instrument is not paid when due he will pay it according to its tenor, but only after the holder has reduced his claim against the maker or acceptor to judgment and execution has been returned unsatisfied, or after the maker or acceptor has become insolvent or it is otherwise apparent that it is useless to proceed against him.

(3) Words of guaranty which do not otherwise specify guarantee payment.

(4) No words of guaranty added to the signature of a sole maker or acceptor affect his liability on the instrument. Such words added to the signature of one or two or more makers or acceptors create a presumption that the signature is for the accommodation of the others.

(5) When words of guaranty are used presentment, notice of dishonor and protest are not necessary to charge the user.

(6) Any guaranty written on the instrument is enforcible notwithstanding any statute of frauds.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: The section is new. It states the commercial understanding as to the meaning and effect of words of guaranty added to a signature.

An indorser who guarantees payment waives not only presentment, notice of dishonor and protest, but also all demand upon the maker or drawee. Words of guaranty do not affect the character of the indorsement as an indorsement (§ 3-202(4)); but the liability of the indorser becomes indistinguishable from that of a co-maker. A guaranty of collection likewise waives formal presentment, notice of dishonor and protest, but requires that the holder first proceed against the maker or acceptor by suit and execution, or show that such proceeding would be useless.

Subsection (6) is concerned chiefly with the type of statute of frauds which provides that no promise to answer for the debt, default or miscarriage of another is enforceable unless it is evidenced by a writing which states the consideration for the promise. It is unusual to state any consideration when a guaranty is added to a signature on a negotiable instrument, which in itself sufficiently shows the nature of the transaction; and such statutes have commonly been held not to apply to such guaranties.

Cross References:

§§ 3-202(4) and 3-415.

Definitional Cross References:

"Holder". § 1-201.
"Insolvent". § 1-201.
"Instrument". § 3-102.
"Notice of dishonor". § 3-508.
"Party". § 1-201.
"Presumption". § 1-201.
"Protest". § 3-509.
"Signature". § 3-401.
"Written". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: No uniform statutes. Code 1950, §§ 49-25, 49-26.

Comment: This section is in accord with Barrett v. Vaughan & Co., 163 Va. 811, 815-18, 178 S.E. 64 (1935), in that a party who uses the term "Payment guaranteed," or equivalent words engages to pay without resort by the holder to any other party.

§ 3-417. **Warranties on Presentment and Transfer.** (1) Any person who obtains payment or acceptance and any prior transferor warrants to a person who in good faith pays or accepts that

(a) he has a good title to the instrument or is authorized to obtain payment or acceptance on behalf of one who has a good title; and

(b) he has no knowledge that the signature of the maker or drawer is unauthorized, except that this warranty is not given by a holder in due course acting in good faith

(i) to a maker with respect to the maker's own signature; or

(ii) to a drawer with respect to the drawer's own signature, whether or not the drawer is also the drawee; or

(iii) to an acceptor of a draft if the holder in due course took the draft after the acceptance or obtained the acceptance without knowledge that the drawer's signature was unauthorized; and

(c) the instrument has not been materially altered, except that this warranty is not given by a holder in due course acting in good faith

(i) to the maker of a note; or

(ii) to the drawer of a draft whether or not the drawer is also the drawee; or

(iii) to the acceptor of a draft with respect to an alteration made prior to the acceptance if the holder in due course took the draft after the acceptance, even though the acceptance provided "payable as originally drawn" or equivalent terms; or

(iv) to the acceptor of a draft with respect to an alteration made after the acceptance.

(2) Any person who transfers an instrument and receives consideration warrants to his transferee and if the transfer is by indorsement to any subsequent holder who takes the instrument in good faith that

(a) he has a good title to the instrument or is authorized to obtain payment or acceptance on behalf of one who has a good title and the transfer is otherwise rightful; and

(b) all signatures are genuine or authorized; and

(c) the instrument has not been materially altered; and

(d) no defense of any party is good against him; and

(e) he has no knowledge of any insolvency proceeding instituted with respect to the maker or acceptor or the drawer of an unaccepted instrument.

(3) By transferring "without recourse" the transferor limits the obligation stated in subsection (2) (d) to a warranty that he has no knowledge of such a defense.

(4) A selling agent or broker who does not disclose the fact that he is acting only as such gives the warranties provided in this section, but if he makes such disclosure warrants only his good faith and authority.

COMMENT: Prior Uniform Statutory Provision: §§ 65 and 69, Uniform Negotiable Instruments Law.

Changes: Combined and reworded; new provisions added.

Purposes of Changes and New Matter: 1. The obligations imposed by this section are stated in terms of warranty. Warranty terms, which are not limited to sale transactions, are used with the intention of bringing in all the usual rules of law applicable to warranties, and in particular the necessity of reliance in good faith and the availability of all remedies for breach of warranty, such as rescission of the transaction or an action for damages. Like other warranties, those stated in

this section may be disclaimed by agreement between the immediate parties. In the case of an indorser, disclaimer of his liability as a transferor, to be effective, must appear in the form of the indorsement, and no parol proof of "agreement otherwise" is admissible. For corresponding warranties in the case of items in the bank collection process, § 4-207 should be consulted.

2. Subsection (1) is new. It is intended to state the undertaking to a party who accepts or pays of one who obtains payment or acceptance or of any prior transferor. It is closely connected with the following section on the finality of acceptance or payment (§ 3-418), and should be read together with it.

3. Subsection (1)(a) retains the generally accepted rule that the party who accepts or pays does not "admit" the genuineness of indorsements, and may recover from the person presenting the instrument when they turn out to be forged. The justification for the distinction between forgery of the signature of the drawer and forgery of an indorsement is that the drawee is in a position to verify the drawer's signature by comparison with one in his hands, but has ordinarily no opportunity to verify an indorsement.

4. Subsection (1)(b) recognizes and deals with competing equities of parties accepting or paying instruments bearing unauthorized maker's or drawer's signatures and those obtaining acceptances or receiving payment. The warranties prescribed and exceptions thereto follow closely principles established at common law, particularly, those under Price v. Neal, 3 Burr. 1354 (1762).

The basic warranty that the person obtaining payment or acceptance and any prior transferor warrants that he has no knowledge that the signature of the maker or drawer is unauthorized stems from the general principle that one who presents an instrument knowing that the signature of the maker or drawer is forged or unauthorized commits an obvious fraud upon the party to whom presentment is made. However, few cases present this simple fact situation. If the signature of a maker or drawer has been forged, the parties include the dishonest forger himself and usually one or more innocent holders taking from him. Frequently, the state of knowledge of a holder is difficult to determine and sometimes a holder takes such a forged instrument in perfect good faith but subsequently learns of the forgery. Since in different fact situations holders have equities of varying strength, it is necessary to have some exceptions to the basic warranty. The exceptions apply only in favor of a holder in due course and, within the provisions of § 3-201, to all subsequent transferees from a holder in due course. Since a condition of the status of a holder in due course under § 3-302(1)(a) is that the holder takes the instrument without notice of any defense against it, this condition presupposes that at the time of taking such a holder had no knowledge of the unauthorized signature. Consequently, the warranty of subsection (1)(h) is pertinent in the case of a holder in due course only in the relatively few cases where he acquires knowledge of the forgery after the taking but before the presentment. In this situation the holder in due course must continue to act in good faith to be exempted from the basic warranty.

The first exemption from the warranty by such a holder, made by subparagraph (i), is that the warranty does not run to a maker of a note with respect to the maker's own signature. This codifies the rule of Price v. Neal, and related cases. Since a maker of a note is presumed to know his own signature, if he fails to detect a forgery of his own signature and pays the note, under the Price v. Neal principle he should not be permitted to recover such payment from a holder in due course acting in good faith. Similarly, under subparagraph (ii) a drawer of a draft is presumed to know his own signature and if he fails to detect a forgery of his signature and pays a draft he may not recover that payment from a holder in due course acting in good faith. This rule applies if the drawer pays the instrument as drawer and also if he pays the instrument as drawee in a case where he is both drawer and drawee.

Under the principle of Price v. Neal a drawee of a draft is presumed to know the signature of his customer, the drawer. However, under subsection (1)(b) and subparagraph (iii) of this subsection this presumption is not strong enough to deprive such a drawee (either in accepting or paying an instrument) of the warranty of no knowledge of the unauthorized drawer's signature, unless the holder in due course took the instrument and became such a holder after the drawee's acceptance; or obtained the acceptance without knowledge that the drawer's signature was unauthorized. In the former case, the holder taking after and thereby presumably in reliance on the acceptance should be protected as against the drawee who accepted without detecting the unauthorized signature. In the latter case the holder, having no knowledge of the unauthorized signature at the time of the drawee's acceptance, would not be charged with this warranty and

would be entitled to enforce such acceptance under § 3-418, even if thereafter he acquired knowledge of the unauthorized signature prior to enforcement of the acceptance. Such right of the holder to enforce the acceptance would be valueless if immediately upon enforcing it and obtaining payment the holder became obligated to return the payment by reason of breach of the warranty of no knowledge at the time of payment.

5. Subsection (1)(c) retains the common law rule, followed by several decisions under the original Act, which has permitted a party paying a materially altered instrument in good faith to recover, and a party who accepts such an instrument to avoid such acceptance. As in the case of subsection (1)(b) this warranty is not imposed against a holder in due course acting in good faith in favor of a maker of a note or a drawer of a draft on the ground that such maker or drawer should know the form and amount of the note or draft which he has signed. The exception made by subparagraph (iii) in the case of a holder in due course of a draft accepted after the alteration follows the decisions in National City Bank of Chicago v. National Bank of Republic of Chicago, 300 Ill. 103, 132 N.E. 832, 22 A.L.R. 1153 (1921), and Wells Fargo Bank and Union Trust Company v. Bank of Italy, 214 Cal. 156, 4 P.2d 781 (1931), and is based on the principle that an acceptance is an undertaking relied upon in good faith by an innocent party. The attempt to avoid this result by certifying checks "payable as originally drawn" leaves the subsequent purchaser in uncertainty as to the amount for which the instrument is certified, and so defeats the entire purpose of certification, which is to obtain the definite obligation of the bank to honor a definite instrument. Subparagraph (iii) accordingly provides that such language is not sufficient to impose on the holder in due course the warranty of no material alteration where the holder took the draft after the acceptance and presumably in reliance on it.

Subparagraph (iv) of subsection (1)(c) exempts a holder in due course from the warranty of no material alteration to the acceptor of a draft with respect to an alteration made after the acceptance. A drawee accepting a draft has an opportunity of ascertaining the form and particularly the amount of the draft accepted. If, thereafter, the draft is materially altered and is thereupon presented for payment to the acceptor, the acceptor has the necessary information in its records to verify the form and particularly the amount of the draft. If in spite of this available information it pays the draft, there is as much reason to leave the responsibility for such payment upon the acceptor (as against a holder in due course acting in good faith) as there is in the case of a maker or drawer paying a materially altered note or draft.

6. Under § 3-201 parties taking from or holding under a holder in due course, within the limits of that section, will have the same rights under § 4-317(1) as a holder in due course. Of course such parties claiming under a holder in due course must act in good faith and be free from fraud, illegality and notice as provided in § 3-201.

7. The liabilities imposed by subsection (2) in favor of the immediate transferee apply to all persons who transfer an instrument for consideration whether or not the transfer is accompanied by indorsement. Any consideration sufficient to support a simple contract will support those warranties.

8. Subsection (2) changes the original § 65 to extend the warranties of any *indorser* beyond the immediate transferee in all cases. Where there is an indorsement the warranty runs with the instrument and the remote holder may sue the indorser-warrantor directly and thus avoid a multiplicity of suits which might be interrupted by the insolvency of an intermediate transferor. The language of subsections (2)(b) and (2)(c) is substituted for "genuine and what it purports to be" in the original § 65(1). The language of subsection (2)(a) is substituted for that of § 65(2) in order to cover the case of the agent who transfers for another.

9. Subsection (2)(d) resolves a conflict in the decisions as to whether the transferor warrants that there are no defenses to the instrument good against him. The position taken is that the buyer does not undertake to buy an instrument incapable of enforcement, and that in the absence of contrary understanding the warranty is implied. Even where the buyer takes as a holder in due course who will cut off the defense, he still does not undertake to buy a lawsuit with the necessity of proving his status. Subsection (3) however provides that an indorsement "without recourse" limits the (2)(d) warranty to one that the indorser has no knowledge of such defenses. With this exception the liabilities of a "without recourse" indorser under this section are the same as those of any other transferor. Under § 3-414 "without recourse" in an indorsement is effective to disclaim the general contract of the indorser stated in that section.

10. Subsection (2)(e) is substituted for § 65(4). The transferor does not warrant against difficulties of collection, apart from defenses, or against impairment of the credit of the obligor or even his insolvency in the commercial sense. The buyer is expected to determine such questions for himself before he takes the obligation. If insolvency proceedings as defined in this Act (§ 1-201) have been instituted against the party who is expected to pay and the transferor knows it, the concealment of that fact amounts to a fraud upon the buyer, and the warranty against knowledge of such proceedings is provided accordingly.

11. Subsection (4) is substituted for § 69 of the original Act. It applies only to a selling agent, as distinguished from an agent for collection. It follows the rule generally accepted that an agent who makes the disclosure warrants his good faith and authority and may not by contract assume a lesser warranty.

Cross References:

§§ 3-404, 3-405, 3-406, 3-414 and 4-207.
Point 1: § 4-207.
Point 2: § 3-418.
Point 4: §§ 3-201, 3-302 and 3-418.
Point 9: § 3-414.
Point 10: § 1-201.

Definitional Cross References:

"Acceptance". § 3-410.
"Alteration". § 3-407.
"Bank". § 1-201.
"Draft". § 3-104.
"Genuine". § 1-201.
"Good faith". § 1-201.
"Holder in due course". § 3-302.
"Instrument". § 3-102.
"Note". § 3-104.
"Party". § 1-201.
"Person". § 1-201.
"Signature". § 3-401.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-417, 6-421.

Comment: Subsection 3-417(2)(b) is in accord with Main Street Bank, Inc. v. Planters Nat'l Bank, 116 Va. 137, 81 S.E. 24 (1914), in holding that an indorser warrants that all signatures are genuine. Subsection 3-417(2) is also in accord with Parksley Nat'l Bank v. Chandler's Adm'rs, 170 Va. 394, 397, 196 S.E. 676 (1938), holding that a person who transfers a negotiable instrument for consideration, but without indorsement, warrants the genuineness of the instrument but he does not guarantee the solvency of the maker. However, such a transferor may orally guarantee payment and be held to his undertaking. See VIRGINIA ANNOTATIONS to UCC 3-401.

For comments on Commercial and Savings Bank v. Maher, 202 Va. 286, 117 S.E. 2d 120 (1960) and Central Nat'l Bank v. First and Merchants Nat'l Bank, 171 Va. 289, 198 S.E. 883 (1940), see VIRGINIA ANNOTATIONS to UCC 4-207.

§ 3-418. **Finality of Payment or Acceptance.** Except for recovery of bank payments as provided in the Article on Bank Deposits and Collections (Article 4) and except for liability for breach of warranty on presentment under the preceding section, payment or acceptance of any instrument is final in favor of a holder in due course, or a person who has in good faith changed his position in reliance on the payment.

COMMENT: Prior Uniform Statutory Provision: § 62, Uniform Negotiable Instruments Law.

Changes: Completely restated.

Purposes of Changes: The rewording is intended to remove a number of uncertainties arising under the original section.

1. The section follows the rule of Price v. Neal, 3 Burr. 1354 (1762), under which a drawee who accepts or pays an instrument on which the signature of the drawer

is forged is bound on his acceptance and cannot recover back his payment. Although the original Act is silent as to payment, the common law rule has been applied to it by all but a very few jurisdictions. The traditional justification for the result is that the drawee is in a superior position to detect a forgery because he has the maker's signature and is expected to know and compare it; a less fictional rationalization is that it is highly desirable to end the transaction on an instrument when it is paid rather than reopen and upset a series of commercial transactions at a later date when the forgery is discovered.

The rule as stated in the section is not limited to drawees, but applies equally to the maker of a note or to any other party who pays an instrument.

2. The section follows the decisions under the original Act applying the rule of Price v. Neal to the payment of over-drafts, or any other payment made in error as to the state of the drawer's account. The same argument for finality applies, with the additional reason that the drawee is responsible for knowing the state of the account before he accepts or pays.

3. The section follows decisions under the original Act, in making payment or acceptance final only in favor of a holder in due course, or a transferee who has the rights of a holder in due course under the shelter principle. If no value has been given for the instrument the holder loses nothing by the recovery of the payment or the avoidance of the acceptance, and is not entitled to profit at the expense of the drawee; and if he has given only an executory promise or credit he is not compelled to perform it after the forgery or other reason for recovery is discovered. If he has taken the instrument in bad faith or with notice he has no equities as against the drawee.

4. The section rejects decisions under the original Act permitting recovery on the basis of mere negligence of the holder in taking the instrument. If such negligence amounts to a lack of good faith as defined in this Act (§ 1-201) or to notice under the rules (§ 3-304) relating to notice to a purchaser of an instrument, the holder is not a holder in due course and is not protected; but otherwise the holder's negligence does not affect the finality of the payment or acceptance.

5. This section is to be read together with the preceding section, which states the warranties given by the person obtaining acceptance or payment. It is also limited by the bank collection provision (§ 4-301) permitting a payor bank to recover a payment improperly paid if it returns the item or sends notice of dishonor within the limited time provided in that section. But notice that the latter right is sharply limited in time, and terminates in any case when the bank has made final payment, as defined in § 4-213.

Cross References:

§§ 3-302, 3-303 and 3-417.
Point 2: § 3-201(1).
Point 4: §§ 1-201, 3-302 and 3-304.
Point 5: §§ 3-417, 4-213 and 4-301.

Definitional Cross References:

"Acceptance". § 3-410.
"Account". § 4-104.
"Bank". § 1-201.
"Holder in due course". § 3-302.
"Instrument". § 3-102.
"Presentment". § 3-504.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-414, 6-543 (NIL 189).

The section accords with Citizens Bank of Norfolk v. Schwarzchild and Sultzberger Co., 109 Va. 539, 64 S.E. 954 (1909), applying the rule of Price v. Neal to a payment made by a drawee who is mistaken as to the status of the drawer's account.

Although the point is not expressly covered, the UCC seems to be in accord with Nat'l Mechanics Bank v. Schmelz Nat'l Bank, 136 Va. 33, 43, 116 S.E. 380 (1923), holding that after certification of a check for the drawer, the bank cannot set-off the amount of the check against an indebtedness owing by the drawer, the check having passed into the hands of a holder in due course.

For comments on Central Nat'l Bank v. First and Merchants Nat'l Bank, 171 Va. 289, 198 S.E. 883 (1938), see VIRGINIA ANNOTATIONS to UCC 4-207.

§ 3-419. **Conversion of Instrument; Innocent Representative.** (1) An instrument is converted when

(a) a drawee to whom it is delivered for acceptance refuses to return it on demand; or

(b) any person to whom it is delivered for payment refuses on demand either to pay or to return it; or

(c) it is paid on a forged indorsement.

(2) In an action against a drawee under subsection (1) the measure of the drawee's liability is the face amount of the instrument. In any other action under subsection (1) the measure of liability is presumed to be the face amount of the instrument.

(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.

(4) An intermediary bank or payor bank which is not a depositary bank is not liable in conversion solely by reason of the fact that proceeds of an item indorsed restrictively (§§ 3-205 and 3-206) are not paid or applied consistently with the restrictive indorsement of an indorser other than its immediate transferor.

COMMENT: **Prior Uniform Statutory Provision:** § 137, Uniform Negotiable Instruments Law.

Changes: Rule changed; new provisions.

Purposes of Changes and New Matter: To remove difficulties arising under the original section, and to cover additional situations:

1. The provision of the original § 137 that refusal to return a bill presented for acceptance is deemed to be acceptance has led to difficulties. If the bill is accepted it is not dishonored, and the holder is left without recourse against the drawer and indorsers when he has most need for immediate recourse. The drawee does not in fact accept and does everything he can to display an intention not to accept; and the "acceptance" is useless to the holder for any purpose other than an action against the drawee, since he has nothing that he can negotiate. The original rule has therefore been changed (see § 3-410).

2. A negotiable instrument is the property of the holder. It is a mercantile specialty which embodies rights against other parties, and a thing of value. This section adopts the generally recognized rule that a refusal to return it on demand is a conversion. The provision is not limited to drafts presented for acceptance, but extends to any instrument presented for payment, including a note presented to the maker. The action is not on the instrument, but in tort for its conversion.

The detention of an instrument voluntarily delivered is not wrongful unless and until there is demand for its return. Demand for a return at a particular time may, however, be made at the time of delivery; or it may be implied under the circumstances or understood as a matter of custom. If the holder is to call for the instrument and fails to do so, he is to be regarded as extending the time. "Refuses" is meant to cover any intentional failure to return the instrument, including its intentional destruction. It does not cover a negligent loss or destruction, or any other unintentional failure to return. In such a case the party may be liable in tort for any damage sustained as a result of his negligence, but he is not liable as a converter under this section.

3. Subsection (1) (c) is new. It adopts the prevailing view of decisions holding that payment on a forged indorsement is not an acceptance, but that even though made in good faith it is an exercise of dominion and control over the instrument inconsistent with the rights of the owner, and results in liability for conversion.

4. Subsection (2) is new. It adopts the rule generally applied to the conversion of negotiable instruments, that the obligation of any party on the instrument is presumed, in the sense that the term is defined in this Act (§ 1-201), to be worth its face value. Evidence is admissible to show that for any reason such as insolvency or the existence of a defense the obligation is in fact worth less, or even that it is without value. In the case of the drawee, however, the presumption is replaced by a rule of absolute liability.

5. Subsection (3), which is new, is intended to adopt the rule of decisions which has held that a representative, such as a broker or depositary bank, who deals with a negotiable instrument for his principal in good faith is not liable to the true owner for conversion of the instrument or otherwise, except that he may be compelled to turn over to the true owner the instrument itself or any proceeds of the instrument remaining in his hands. The provisions of subsection (3) are, however, subject to the provisions of this Act concerning restrictive indorsements (§§ 3-205, 3-206 and related sections).

6. The provisions of this section are not intended to eliminate any liability on warranties of presentment and transfer (§ 3-417). Thus a collecting bank might be liable to a drawee bank which had been subject to liability under this section, even though the collecting bank might not be liable directly to the owner of the instrument.

Cross References:

§§ 3-409, 3-410, 3-411 and 3-603.
Point 4: § 1-201.
Point 5: §§ 1-201, 3-205 and 3-206.
Point 6: § 3-417.

Definitional Cross References:

"Acceptance". § 3-410.
"Action". § 1-201.
"Bank". § 1-201.
"Collecting bank". §§ 3-102 and 4-105.
"Depositary bank". §§ 3-102 and 4-105.
"Good faith". § 1-201.
"Instrument". § 3-102.
"Intermediary bank". §§ 3-102 and 4-105.
"On demand". § 3-108.
"Person". § 1-201.
"Presumed". § 1-201.
"Representative". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-490.

PART 5

PRESENTMENT, NOTICE OF DISHONOR AND PROTEST

§ 3-501. When Presentment, Notice of Dishonor, and Protest Necessary or Permissible. (1) Unless excused (§ 3-511) presentment is necessary to charge secondary parties as follows:

(a) presentment for acceptance is necessary to charge the drawer and indorsers of a draft where the draft so provides, or is payable elsewhere than at the residence or place of business of the drawee, or its date of payment depends upon such presentment. The holder may at his option present for acceptance any other draft payable at a stated date;

(b) presentment for payment is necessary to charge any indorser;

(c) in the case of any drawer, the acceptor of a draft payable at a bank or the maker of a note payable at a bank, presentment for payment

is necessary, but failure to make presentment discharges such drawer, acceptor or maker only as stated in § 3-502(1) (b).

(2) Unless excused (§ 3-511)

(a) notice of any dishonor is necessary to charge any indorser;

(b) in the case of any drawer, the acceptor of a draft payable at a bank or the maker of a note payable at a bank, notice of any dishonor is necessary, but failure to give such notice discharges such drawer, acceptor or maker only as stated in § 3-502(1) (b).

(3) Unless excused (§ 3-511) protest of any dishonor is necessary to charge the drawer and indorsers of any draft which on its face appears to be drawn or payable outside of the states and territories of the United States and the District of Columbia. The holder may at his option make protest of any dishonor of any other instrument and in the case of a foreign draft may on insolvency of the acceptor before maturity make protest for better security.

(4) Notwithstanding any provision of this section, neither presentment nor notice of dishonor nor protest is necessary to charge an indorser who has indorsed an instrument after maturity.

COMMENT: **Prior Uniform Statutory Provision:** §§ 70, 89, 118, 129, 143, 144, 150, 151, 152, 157, 158 and 186, Uniform Negotiable Instruments Law.

Changes: Combined and simplified.

Purposes of Changes: 1. Part 5 simplifies the requirements of the original Act as to presentment for acceptance or payment, notice of dishonor and protest. This section assembles in one place all provisions as to when any such proceeding is necessary. It eliminates some of the requirements and simplifies others. The effect of unexcused delay in any such proceeding as a discharge is covered by the next section, and the sections following prescribe the details of the proceedings.

2. The words "Necessary to charge" are retained from the original Act. They mean that the necessary proceeding is a condition precedent to any right of action against the drawer or indorser. He is not liable and cannot be sued without the proceedings however long delayed. Under some circumstances delay is excused. If it is not excused it may operate as a discharge under the next section. Under some circumstances the proceeding may be entirely excused and the drawer or indorser is then liable as if the proceeding had been duly taken. § 3-511 states the circumstances under which delay may be excused or the proceeding entirely excused.

3. Subsection (1) (a) retains the substance of the original §§ 143, 144 and 150. The last sentence of the subsection states the rule of the decisions both at common law and under the original Act, that the holder may at his option present any time draft for acceptance, and is not required to wait until the due date to know whether the drawee will accept it; but that if he does make presentment and acceptance is refused he must give notice of dishonor. There is no similar right to present for acceptance a draft payable on demand, since a demand draft entitles the holder to immediate payment but not to acceptance.

4. Subsections (1) (b) and (1) (c) on presentment for payment follow § 70 of the original Act with one important change. Under the original Act and under this section ((1) (b)) presentment for payment is necessary (unless excused) to charge any drawer. Under the original Act drawers of drafts other than checks were wholly discharged by a failure to make due presentment but drawers of checks (§ 70 in conjunction with § 186) were discharged only "to the extent of the loss caused by the delay"—that is to say, when insolvency of the drawee bank occurred after the time when presentment was due. The check rule of the original Act (somewhat modified—see § 3-502(1)(b) and Comment thereto) is by subsection (1) (c) extended to all drawers, and also to the acceptors and makers of domiciled—"payable at a bank"—drafts and notes. Thus drawers of drafts other than checks are not, as they were under § 70, wholly discharged by failure to make due presentment but, like drawers of checks, are discharged only as they may have suffered loss as provided in § 3-502(1)(b). As to domiciled

paper original § 70 provided that ability and willingness to pay at the place named at maturity were "equivalent to a tender of payment"—that is to say would stop the running of interest, but had no other effect. Accordingly cases have held that makers and acceptors of domiciled paper were not discharged to any extent by the holder's failure to make presentment even when the obligor had funds available in the paying bank on the date for presentment and the bank subsequently failed. Subsection (1) (c) applies the check rule to such makers and acceptors; the "tender" language of § 70 is eliminated; and the result in the cases referred to in the preceding sentence is reversed. Under this section as under the original act presentment for payment is not necessary to charge primary parties (makers and acceptors of undomiciled paper).

5. Under subsection (2) the rules as to necessity of notice of dishonor run parallel with the rules as to necessity of presentment stated in subsection (1).

6. Under the original §§ 129 and 152 protest is required in the case of every "foreign draft", defined as a draft which on its face is not both drawn and payable "within this state." The result has been that upon dishonor in New York a check which appears on its face to be drawn in Jersey City must be protested in order to sue the drawer or any indorser. This has led to great inconvenience and expense of protest fees. The only function of protest is that of proof of dishonor, and it adds nothing to notice of dishonor as such.

Subsection (3) eliminates the requirement of protest except upon dishonor of a draft which on its face appears to be either drawn or payable outside of the United States. The requirement is left as to such international drafts because it is generally required by foreign law, which this Article cannot affect. The formalities of protest are covered by § 3-509 on protest, and substitutes for protest as proof of dishonor are provided for in § 3-510 on evidence of dishonor and of notice.

This provision retains from the original § 118 the rule permitting the holder at his option to make protest of any dishonor of any other instrument. Even when not required protest may have definite convenience where process does not run to another state and the taking of depositions is a slow and expensive matter. Even where the instrument is drawn and payable entirely within a state there may be convenience in saving the trip of a witness from Buffalo to New York to testify to dishonor, where the substitute evidence of dishonor and notice of dishonor cannot be relied on. Either required or optional protest is presumptive evidence of dishonor. (§ 3-510).

7. The permissible "protest for better security" of original § 158 is retained in the case of a foreign draft, as the practice is common in certain foreign countries.

8. Under the final sentence of § 7 of the original Act an instrument indorsed when overdue became payable on demand as to the indorser. That language has been deleted from this Article—see § 3-108 and Comment. It meant, among other things and in view of the provisions of the original Act as to demand paper, that such an indorser was discharged unless the instrument was presented for payment within a reasonable time after his indorsement. Presentment of overdue paper for the purpose of charging an indorser is unusual and not an expected commercial practice; the rule has been little more than a trap for those not familiar with the Act. Subsection (4), reversing the original Act, provides that as to indorsers after maturity neither presentment nor notice of dishonor nor protest is necessary; like primary parties therefore they will remain liable on the instrument for the period of the applicable statute of limitations.

Cross References:

Point 1: §§ 3-502 through 3-508.
Point 2: §§ 3-413, 3-414 and 3-511.
Point 3: §§ 3-413, 3-414 and 3-511.
Point 4: § 3-502.
Point 6: §§ 3-413, 3-414, 3-509, 3-510 and 3-511.
Point 8: § 3-108.

Definitional Cross References:

"Acceptance". § 3-410.
"Bank". § 1-201.
"Certificate of deposit". § 3-104.
"Dishonor". § 3-507.
"Draft". § 3-104.

"Holder". § 1-201.
"Instrument". § 3-102.
"Note". 3-104.
"Notice of dishonor". § 3-508.
"Party". § 1-201.
"Presentment". § 3-504.
"Protest". § 3-509.
"Secondary party". § 3-102.
"Signature". § 3-401.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-423, 6-442, 6-471, 6-482, 6-496, 6-497, 6-503, 6-504, 6-505, 6-510, 6-511, 6-539.

§ 3-502. **Unexcused Delay; Discharge.** (1) Where without excuse any necessary presentment or notice of dishonor is delayed beyond the time when it is due

(a) any indorser is discharged; and

(b) any drawer or the acceptor of a draft payable at a bank or the maker of a note payable at a bank who because the drawee or payor bank becomes insolvent during the delay is deprived of funds maintained with the drawee or payor bank to cover the instrument may discharge his liability by written assignment to the holder of his rights against the drawee or payor bank in respect of such funds, but such drawer, acceptor or maker is not otherwise discharged.

(2) Where without excuse a necessary protest is delayed beyond the time when it is due any drawer or indorser is discharged.

COMMENT: Prior Uniform Statutory Provisions: §§ 7, 70, 89, 144, 150, 152 and 186, Uniform Negotiable Instruments Law.

Changes: Combined and simplfied.

Purposes of Changes: This section is the complement of the preceding section. It covers in one section widely scattered provisions of the original Act:

1. The circumstances under which presentment or notice of dishonor or protest or delay therein are excused are stated in § 3-511. When not excused delay operates as a discharge as provided in this section.

2. Subsection (1) (b) applies to any drawer, as well as to the makers and acceptors of drafts and notes payable at a bank, the rule of the original § 186 providing for discharge only where the drawer of a check has sustained loss through the delay. This section expressly limits the rule to loss sustained through insolvency of the drawee or payor which was the only type of loss to which the § 186 rule has ever been applied in the cases arising under it.

The purpose of the rule is to avoid hardship upon the holder through complete discharge, and unjust enrichment of the drawer or other party who normally has received goods or other consideration for the issue of the instrument. He is "deprived of funds" in any case where bank failure or other insolvency of the drawee or payor has prevented him from receiving the benefit of funds which would have paid the instrument if it had been duly presented.

The original language discharging the drawer "to the extent of the loss caused by the delay" has not worked out satisfactorily in the decided cases, since the amount of the loss caused by the failure of a bank is almost never ascertainable at the time of suit and may not be ascertained until some years later. The decisions have turned upon burden of proof, and the drawer has seldom succeeded in proving his discharge. Subsection (1) (b) therefore substitutes a right to discharge liability by written assignment to the holder of rights against the drawee or payor as to the funds which cover the particular instrument. The assignment is intended to give the holder an effective right to claim against the drawee or payor.

3. Subsection (2) retains the rule of the original § 152, that any unexcused delay of a required protest is a complete discharge of all drawers and indorsers.

Cross References:

Point 1: § 3-511(1).
Point 2: § 3-501.
Point 3: § 3-509.

Definitional Cross References:

"Bank". § 1-201.
"Draft". § 3-104.
"Holder". § 1-201.
"Insolvent". § 1-201.
"Instrument". § 3-102.
"Note". § 3-104.
"Notice of dishonor". § 3-508
"Payor bank". § 4-105.
"Presentment". § 3-504.
"Protest". § 3-509.
"Rights". § 1-201.
"Signature". § 3-401.
"Written". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-359, 6-423, 6-442, 6-497, 6-503, 6-505, 6-539.

Comment: The section is consistent with the dictum in Citizens and Marine Bank v. McMurran, 138 Va. 657, 662, 123 S.E. 507 (1924), in which it is said that an indorser is a surety, and any change in his contract without his consent, however immaterial, and even though to his advantage, discharges an indorser.

§ 3-503. **Time of Presentment.** (1) Unless a different time is expressed in the instrument the time for any presentment is determined as follows:

(a) where an instrument is payable at or a fixed period after a stated date any presentment for acceptance must be made on or before the date it is payable;

(b) where an instrument is payable after sight it must either be presented for acceptance or negotiated within a reasonable time after date or issue whichever is later;

(c) where an instrument shows the date on which it is payable presentment for payment is due on that date;

(d) where an instrument is accelerated presentment for payment is due within a reasonable time after the acceleration;

(e) with respect to the liability of any secondary party presentment for acceptance or payment of any other instrument is due within a reasonable time after such party becomes liable thereon.

(2) A reasonable time for presentment is determined by the nature of the instrument, any usage of banking or trade and the facts of the particular case. In the case of an uncertified check which is drawn and payable within the United States and which is not a draft drawn by a bank the following are presumed to be reasonable periods within which to present for payment or to initiate bank collection:

(a) with respect to the liability of the drawer, thirty days after date or issue whichever is later; and

(b) with respect to the liability of an indorser, seven days after his indorsement.

(3) Where any presentment is due on a day which is not a full business day for either the person making presentment or the party to pay or accept, presentment is due on the next following day which is a full business day for both parties.

(4) Presentment to be sufficient must be made at a reasonable hour, and if at a bank during its banking day.

COMMENT: **Prior Uniform Statutory Provision:** §§ 71, 72, 75, 85, 86, 144, 145, 146, 186 and 193, Uniform Negotiable Instruments Law.

Changes: Combined and simplified; new provisions.

Purposes of Changes and New Matter: 1. This section states in one place all of the rules applicable to the time of presentment. Excused delay is covered by § 3-511 on waiver and excuse, and the effect of unexcused delay by § 3-502 on discharge.

The original § 86, as to the determination of the time of payment by calculation from the day the time is to run, is omitted as superfluous. It states a rule universally applied to all time calculations in the law of contracts, and has no special application to negotiable instruments. No change in the law is intended.

2. Subsection (1) contains new provisions stating the commercial understanding as to the presentment of instruments payable after sight, and of accelerated paper.

3. Subsection (2) retains the substance of the original § 193 as to the determination of a reasonable time. It provides specific time limits which are presumed, as that term is defined in this Act (§ 1-201), to be reasonable for uncertified checks drawn and payable within the continental limits of the United States. The courtmade time limit of one day after the receipt of the instrument found in decisions under the original Act has proved to be too short a time for some holders, such as the department store or other large business clearing many checks through its books shortly after the first of the month, as well as the farmer or other individual at a distance from a bank.

The time limit provided differs as to drawer and indorser. The drawer, who has himself issued the check and normally expects to have it paid and charged to his account is reasonably required to stand behind it for a longer period, especially in view of the protection now provided by Federal Deposit Insurance. The thirty days specified coincides with the time after which a purchaser has notice that a check has become stale (§ 3-304(3)(c)). The indorser, who has normally merely received the check and passed it on, and does not expect to have to pay it, is entitled to know more promptly whether it is to be dishonored, in order that he may have recourse against the person with whom he has dealt.

4. Subsection (3) replaces the original §§ 85 and 146. It is intended to make allowance for the increasing practice of closing banks or businesses on Saturday or other days of the week. It is not intended to mean that any drawee or obligor can avoid dishonor of instruments by extended closing.

5. Subsection (4) eliminates the provision of the original § 75 permitting presentment "at any hour before the bank is closed" if the drawer has no funds in the bank. The change is made to avoid inconvenience to the bank.

"Banking day" is defined in § 4-104.

Cross References:

Point 1: §§ 3-501, 3-502, 3-505, 3-506 and 3-511.
Point 3: §§ 1-201 and 3-304(3)(c).
Point 5: § 4-104.

Definitional Cross References:

"Acceptance". § 3-410.
"Bank". § 1-201.
"Banking day". § 4-104.
"Check". § 3-104.
"Draft". § 3-104.
"Instrument". § 3-102.
"Issue". § 3-102.
"Party". § 1-201.
"Person". § 1-201.
"Presentment". § 3-504.
"Presumed". § 1-201.
"Reasonable time". § 1-204.
"Secondary party". § 3-102.
"Usage of trade". § 1-205.

Prior Statutes: Code 1950, §§ 6-424, 6-425, 6-428, 6-438, 6-439, 6-497, 6-498, 6-499, 6-539, 6-546.

Comment: Subsection 3-503(1) (e) provides that presentment to bind a secondary party must be made within a reasonable time after the party becomes liable, an approach that is consistent with the statement in Bacon's Adm'r v. Bacon's Trustee, 94 Va. 686, 688, 27 S.E. 576 (1897) that a demand note must be presented for payment within a reasonable time in order to charge the indorser.

§ 3-504. **How Presentment Made.** (1) Presentment is a demand for acceptance or payment made upon the maker, acceptor, drawee or other payor by or on behalf of the holder.

(2) Presentment may be made

(a) by mail, in which event the time of presentment is determined by the time of receipt of the mail; or

(b) through a clearing house; or

(c) at the place of acceptance or payment specified in the instrument or if there be none at the place of business or residence of the party to accept or pay. If neither the party to accept or pay nor anyone authorized to act for him is present or accessible at such place presentment is excused.

(3) It may be made

(a) to any one of two or more makers, acceptors, drawees or other payors; or

(b) to any person who has authority to make or refuse the acceptance or payment.

(4) A draft accepted or a note made payable at a bank in the United States must be presented at such bank.

(5) In the cases described in § 4-210 presentment may be made in the manner and with the result stated in that section.

COMMENT: Prior Uniform Statutory Provision: §§ 72, 73, 77, 78 and 145, Uniform Negotiable Instruments Law.

Changes: Combined and simplified.

Purposes of changes: 1. This section is intended to simplify the rules as to how presentment is made and to make it clear that any demand upon the party to pay is a presentment no matter where or how. Former technical requirements of exhibition of the instrument and the like are not required unless insisted upon by the party to pay (§ 3-505).

2. Paragraph (a) of subsection (2) authorizes presentment by mail directly to the obligor. The presentment is sufficient and the instrument is dishonored by non-acceptance or non-payment even though the party making presentment may be liable for improper collection methods. "Through a clearing-house" means that presentment is not made when the demand reaches the clearing-house, but when it reaches the obligor. § 4-210 should also be consulted for the methods of presenting which may properly be employed by a collecting bank. Subsection (5) of this section makes it clear that presentment made under § 4-210 is proper presentment.

3. Paragraph (a) of subsection (3) eliminates the requirement of the original §§ 78 and 145(1) that presentment be made to each of two or more makers, acceptors or drawees unless they are partners or one has authority to act for the others. The holder is entitled to expect that any one of the named parties will pay or accept, and should not be required to go to the trouble and expense of making separate presentment to a number of them.

4. § 3-412 provides that an acceptance made payable at a bank in the United States does not vary the draft. Subsection (4) of this section makes it clear that

a draft so accepted must be presented at the bank so designated. The same rule is applied to notes made payable at a bank. The rule of the subsection is in conformity with the provisions of § 3-501 on presentment and § 3-502 on the effect of failure to make presentment with reference to domiciled paper.

Cross References:

Point 1: §§ 3-501, 3-502, 3-505 and 3-511.
Point 2: § 4-210.
Point 5: §§ 3-412, 3-501 and 3-502.

Definitional Cross References:

"Acceptance". § 3-410.
"Bank". § 1-201.
"Clearing house". § 4-104.
"Draft". § 3-104.
"Holder". § 1-201.
"Instrument". § 3-102.
"Note". § 3-104.
"Party". § 1-201.
"Person". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-425, 6-426, 6-430, 6-431, 6-498.

§ 3-505. **Rights of Party to Whom Presentment Is Made.** (1) The party to whom presentment is made may without dishonor require

(a) exhibition of the instrument; and

(b) reasonable identification of the person making presentment and evidence of his authority to make it if made for another; and

(c) that the instrument be produced for acceptance or payment at a place specified in it, or if there be none at any place reasonable in the circumstances; and

(d) a signed receipt on the instrument for any partial or full payment and its surrender upon full payment.

(2) failure to comply with any such requirement invalidates the presentment but the person presenting has a reasonable time in which to comply and the time for acceptance or payment runs from the time of compliance.

COMMENT: Prior Uniform Statutory Provision: § 74, Uniform Negotiable Instruments Law.

Changes: Expanded and modified.

Purposes of Changes: To supplement the provisions as to how presentment is made, by permitting the party to whom it is made to insist on additional requirements:

1. In the first instance a mere demand for acceptance or payment is sufficient presentment, and if the payment is unqualifiedly refused nothing more is required. The party to whom presentment is made may, however, require exhibition of the instrument, its production at the proper place, identification of the party making presentment, and a signed receipt on the instrument, or its surrender on full payment. Failure to comply with any such requirement invalidates the presentment and means that the instrument is not dishonored. The time for presentment is, however, extended to give the person presenting a reasonable opportunity to comply with the requirements.

2. "Reasonable identification" means identification reasonable under all the circumstances. If the party on whom demand is made knows the person making presentment, no requirement of identification is reasonable, while if the circumstances are suspicious a great deal may be required. The requirement applies whether the instrument presented is payable to order or to bearer.

Cross References:

Point 1: §§ 3-504 and 3-506.

Definitional Cross References:

"Acceptance". § 3-410.
"Dishonor". § 3-507.
"Instrument". § 3-102.
"Party". § 1-201.
"Person". § 1-201.
"Presentment". § 3-504.
"Reasonable time". § 1-204.
"Signed". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-427.

§ 3-506. **Time Allowed for Acceptance or Payment.** (1) Acceptance may be deferred without dishonor until the close of the next business day following presentment. The holder may also in a good faith effort to obtain acceptance and without either dishonor of the instrument or discharge of secondary parties allow postponement of acceptance for an additional business day.

(2) Except as a longer time is allowed in the case of documentary drafts drawn under a letter of credit, and unless an earlier time is agreed to by the party to pay, payment of an instrument may be deferred without dishonor pending reasonable examination to determine whether it is properly payable, but payment must be made in any event before the close of business on the day of presentment.

COMMENT: Prior Uniform Statutory Provision: § 136, Uniform Negotiable Instruments Law.

Changes: Expanded.

Purposes of Changes: The original section covered only the time allowed to the drawee on presentment for acceptance. This section also covers the time allowed on presentment for payment.

§ 5-112 (Time Allowed for Honor) states the time, longer than here provided, during which a bank to which drafts are presented under a letter of credit may defer payment or acceptance without dishonor of the drafts. As to drafts drawn under a letter of credit § 5-112 of course controls.

§ 4-301 on deferred posting should be consulted for the right of a payor bank to recover tentative settlements made by it on the day an item is received. That right does not survive final payment (§ 4-213).

Cross References:

§§ 4-301 and 5-112.

Definitional Cross References:

"Acceptance". § 3-410.
"Dishonor". § 3-507.
"Documentary draft". §§ 3-102 and 4-104.
"Instrument". § 3-102.
"Letter of credit". § 5-103.
"Party". § 1-201.
"Presentment". § 3-504.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-489.

§ 3-507. **Dishonor; Holder's Right of Recourse; Term Allowing Re-Presentment.** (1) An instrument is dishonored when

(a) a necessary or optional presentment is duly made and due acceptance or payment is refused or cannot be obtained within the prescribed

time or in case of bank collections the instrument is seasonably returned by the midnight deadline (§ 4-301); or

(b) presentment is excused and the instrument is not duly accepted or paid.

(2) Subject to any necessary notice of dishonor and protest, the holder has upon dishonor an immediate right of recourse against the drawers and indorsers.

(3) Return of an instrument for lack of proper indorsement is not dishonor.

(4) A term in a draft or an indorsement thereof allowing a stated time for re-presentment in the event of any dishonor of the draft by non-acceptance if a time draft or by nonpayment if a sight draft gives the holder as against any secondary party bound by the term an option to waive the dishonor without affecting the liability of the secondary party and he may present again up to the end of the stated time.

COMMENT: **Prior Uniform Statutory Provision:** §§ 83 and 149, Uniform Negotiable Instruments Law.

Changes: Reworded.

Purposes of Changes: 1. The language of the section is changed in accordance with the provisions of the preceding section as to the time allowed for acceptance or payment.

2. Subsection (3) is new. It states general banking and commercial understanding. The time within which a payor bank must return items, and the methods of returning, are stated in § 4-301. Under § 3-411(3) a bank may certify an item so returned.

Cross References:

Point 1: §§ 3-503, 3-504, 3-505, 3-508 and 4-301.
Point 2: §§ 3-411(3), 4-301.

Definitional Cross References:

"Acceptance". § 3-410.
"Bank". § 1-201.
"Draft". § 3-104.
"Holder". § 1-201.
"Instrument". § 3-102.
"Midnight deadline". § 4-104.
"Notice of dishonor". § 3-508.
"Presentment". § 3-504.
"Protest". § 3-509.
"Right". § 1-201.
"Seasonably". § 1-204.
"Secondary party". § 3-102.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-436, 6-502.

§ 3-508. Notice of Dishonor. (1) Notice of dishonor may be given to any person who may be liable on the instrument by or on behalf of the holder or any party who has himself received notice, or any other party who can be compelled to pay the instrument. In addition an agent or bank in whose hands the instrument is dishonored may give notice to his principal or customer or to another agent or bank from which the instrument was received.

(2) Any necessary notice must be given by a bank before its midnight deadline and by any other person before midnight of the third business day after dishonor or receipt of notice of dishonor.

(3) Notice may be given in any reasonable manner. It may be oral or written and in any terms which identify the instrument and state that it has been dishonored. A misdescription which does not mislead the party notified does not vitiate the notice. Sending the instrument bearing a stamp, ticket or writing stating that acceptance or payment has been refused or sending a notice of debit with respect to the instrument is sufficient.

(4) Written notice is given when sent although it is not received.

(5) Notice to one partner is notice to each although the firm has been dissolved.

(6) When any party is in insolvency proceedings instituted after the issue of the instrument notice may be given either to the party or to the representative of his estate.

(7) When any party is dead or incompetent notice may be sent to his last known address or given to his personal representative.

(8) Notice operates for the benefit of all parties who have rights on the instrument against the party notified.

COMMENT: Prior Uniform Statutory Provision: §§ 90 through 108, Uniform Negotiable Instruments Law.

Changes: Combined and simplified.

Purposes of Changes: To simplify notice of dishonor and eliminate many of the detailed requirements of the original Act:

1. Notice is normally given by the holder or by an indorser who has himself received notice. Subsection (1) is intended to encourage and facilitate notice of dishonor by permitting any party who may be compelled to pay the instrument to notify any party who may be liable on it. Thus an indorser may notify another indorser who is not liable to the one who gives notice, even when the latter has not received notice from any other party to the instrument.

2. Except as to collecting banks, as to whom § 4-212 controls, the time within which necessary notice must be given is extended to three days after dishonor or receipt of notice from another party. In the case of individuals the one-day time limit of the original Act has proved too short in many cases. It is extended to give the party a margin of time within which to ascertain what is required of him and get out an ordinary business letter. This time leeway eliminates the elaborate provisions as to the time of mailing in the original §§ 103 and 104.

3. Subsection (3) retains the substance of the original §§ 95 and 96. The provision approves the bank practice of returning the instrument bearing a stamp, ticket or other writing, or a notice of debit of the account, as sufficient notice. Subsection (4) retains the substance of the original § 105.

4. Subsection (7) permits notice to be sent to the last known address of a party who is dead or incompetent rather than to his personal representative. The provision is intended to save time, as the name of the personal representative often cannot easily be ascertained, and mail addressed to the original party will reach the representative.

Cross References:

§§ 3-501, 3-507 and 3-511.
Point 2: § 4-212.

Definitional Cross References:

"Acceptance". § 3-410.
"Bank". § 1-201.
"Customer". § 4-104.
"Dishonor". § 3-507.
"Holder". § 1-201.
"Insolvency proceedings". § 1-201.
"Instrument". § 3-102.
"Issue". § 3-102.
"Midnight deadline". § 4-104.

"Notifies". § 1-201.
"Party". § 1-201.
"Person". § 1-201.
"Representative". § 1-201.
"Rights". § 1-201.
"Send". § 1-201.
"Written" and "writing". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-443 through 6-461.

Comment: The section is consistent with Myers v. Bibee Grocery Co., 148 Va. 282, 138 S.E. 570 (1927), which held that a letter from the payee to an indorser constituted sufficient notice of dishonor. Although the case is not directly in point, the UCC is also consistent with Harris v. Citizens Bank & Trust Co., 172 Va. 111, 134-35, 200 S.E. 652 (1939), which held it to be proper for an as-yet unqualified executor to pay a note on which the testator was an indorser, without waiting for notice of dishonor.

§ 3-509. **Protest; Noting for Protest.** (1) A protest is a certificate of dishonor made under the hand and seal of a United States consul or vice consul or a notary public or other person authorized to certify dishonor by the law of the place where dishonor occurs. It may be made upon information satisfactory to such person.

(2) The protest must identify the instrument and certify either that due presentment has been made or the reason why it is excused and that the instrument has been dishonored by nonacceptance or nonpayment.

(3) The protest may also certify that notice of dishonor has been given to all parties or to specified parties.

(4) Subject to subsection (5) any necessary protest is due by the time that notice of dishonor is due.

(5) If, before protest is due, an instrument has been noted for protest by the officer to make protest, the protest may be made at any time thereafter as of the date of the noting.

COMMENT: Prior Uniform Statutory Provision: §§ 153, 154, 155, 156, 158 and 160, Uniform Negotiable Instruments Law.

Changes: Combined and simplified.

Purposes of Changes: 1. Protest is not necessary except on drafts drawn or payable outside of the United States. § 3-501(3) which also permits the holder at his option to make protest on dishonor of any other instrument. This section is intended to simplify either necessary or optional protest when it is made.

2. "Protest" has been used to mean the act of making protest, and sometimes loosely to refer to the entire process of presentment, notice of dishonor and protest. In this Article it is given its original, technical meaning, that of the official certificate of dishonor.

3. Subsection (1) adds to the notary public the United States consul or vice consul, and any other person authorized to certify dishonor by the law of the place where dishonor occurs. It eliminates the requirement of the original § 156 that protest must be made at the place of dishonor. It eliminates also the provision of the original § 154 permitting protest by "any respectable resident of the place where the bill is dishonored, in the presence of two or more credible witnesses." This has at least left uncertainty as to the identity and credibility of the persons certifying, and has almost never been used. Any necessary delay in finding the proper officer to make protest is excused under § 3-511.

4. "Information satisfactory to such person" does away with the requirement occasionally stated, that the person making protest must certify as of his own knowledge. The requirement has been more honored in the breach than in the observance, and in practice protest has been made upon hearsay which the officer regards as reliable, upon the admission of the person who has dishonored, or

at most upon re-presentment, which is only indirect proof of the original dishonor. There is seldom any possible motive for false protest, and the basis on which it is made is never questioned. Subsection (1) leaves to the certifying officer the responsibility for determining whether he has satisfactory information. The provision is not intended to affect any personal liability of the officer for making a false certificate.

5. The protest need not be in any particular form, so long as it certifies the matters stated in Subsection (2). It need not be annexed to the instrument, and may be forwarded separately; but annexation may identify the instrument. If the instrument is lost, destroyed, or wrongfully withheld, protest is still sufficient if it identifies the instrument; but the owner must prove his rights as in any action under this Article on a lost, destroyed or stolen instrument (§ 3-804).

6. Subsection (3) recognizes the practice of including in the protest a certification that notice of dishonor has been given to all parties or to specified parties. The next section makes such a certification presumptive evidence that the notice has been given.

7. Protest is normally forwarded with notice of dishonor. Subsection (4) extends the time for making a necessary protest to coincide with the time for giving notice of dishonor. Any delay due to circumstances beyond the holder's control is excused under § 3-511 on waiver or excuse. Any protest which is not necessary but merely optional with the holder may be made at any time before it is used as evidence.

8. Subsection (5) retains from the original § 155 the provision permitting the officer to note the protest and extend it formally later.

Cross References:

Point 1: §§ 3-501(3) and 3-511.
Point 3: § 3-511(1).
Point 5: § 3-804.
Point 6: § 3-510(a).
Point 7: §§ 3-508(2) and 3-511(1).

Definitional Cross References:

"Dishonor". § 3-507.
"Instrument". § 3-102.
"Notice of dishonor". § 3-508.
"Party". § 1-201.
"Person". § 1-201.
"Presentment". § 3-504.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-506, 6-507, 6-508, 6-509, 6-511, 6-513.

§ 3-510. Evidence of Dishonor and Notice of Dishonor. The following are admissible as evidence and create a presumption of dishonor and of any notice of dishonor therein shown:

(a) a document regular in form as provided in the preceding section which purports to be a protest;

(b) the purported stamp or writing of the drawee, payor bank or presenting bank on the instrument or accompanying it stating that acceptance or payment has been refused for reasons consistent with dishonor;

(c) any book or record of the drawee, payor bank, or any collecting bank kept in the usual course of business which shows dishonor, even though there is no evidence of who made the entry.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: This section is new. It states the effect of protest as evidence, and provides two substitutes for protest as proof of dishonor:

1. Paragraph (a) states the generally accepted rule that a protest is not only admissible as evidence, but creates a presumption, as that term is defined in this Act (§ 1-201), of the dishonor which it certifies. The rule is extended to include

the giving of any notice of dishonor certified by the protest. The provision also relieves the holder of the necessity of proving that a document regular in form which purports to be a protest is authentic, or that the person making it was qualified. Nothing in the provision is intended to prevent the obligor from overthrowing the presumption by evidence that there was in fact no dishonor, that notice was not given, or that the protest is not authentic or not made by a proper officer.

2. Paragraph (b) recognizes as the full equivalent of protest the stamp, ticket or other writing of the drawee, payor or presenting bank. The drawee's statement that payment is refused on account of insufficient funds always has been commercially acceptable as full proof of dishonor. It should be satisfactory evidence in any court. It is therefore made admissible, and creates a presumption of dishonor. The provision applies only where the stamp or writing states reasons for refusal which are consistent with dishonor. Thus the following reasons for refusal are not evidence of dishonor, but of justifiable refusal to pay or accept:

Indorsement missing
Signature missing
Signature illegible
Forgery
Payee altered
Date altered
Post dated
Not on us

On the other hand the following reasons are satisfactory evidence of dishonor, consistent with due presentment, and are within this provision:

Not sufficient funds
Account garnished
No account
Payment stopped

3. Paragraph (c) recognizes as the full equivalent of protest any books or records of the drawee, payor bank or any collecting bank kept in its usual course of business, even though there is no evidence of who made the entries. The provision, as well as that of paragraph (b), rests upon the inherent improbability that bank records, or those of the drawee, will show any dishonor which has not in fact occurred, or that the holder will attempt to proceed on the basis of dishonor if he could in fact have obtained payment.

Cross References:

§§ 3-501 and 3-508.
Point 1: § 1-201.

Definitional Cross References:

"Acceptance". § 3-410.
"Collecting bank". § 4-105.
"Dishonor". § 3-507.
"Instrument". § 3-102.
"Notice of dishonor". § 3-508.
"Payor bank". § 4-105.
"Presumption". § 1-201.
"Protest". § 3-509.
"Writing". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 3-511. Waived or Excused Presentment, Protest or Notice of Dishonor or Delay Therein. (1) Delay in presentment, protest or notice of dishonor is excused when the party is without notice that it is due or when the delay is caused by circumstances beyond his control and he exercises reasonable diligence after the cause of the delay ceases to operate.

(2) Presentment or notice or protest as the case may be is entirely excused when

(a) the party to be charged has waived it expressly or by implication either before or after it is due; or

(b) such party has himself dishonored the instrument or has countermanded payment or otherwise has no reason to expect or right to require that the instrument be accepted or paid; or

(c) by reasonable diligence the presentment or protest cannot be made or the notice given.

(3) Presentment is also entirely excused when

(a) the maker, acceptor or drawee of any instrument except a documentary draft is dead or in insolvency proceedings instituted after the issue of the instrument; or

(b) acceptance or payment is refused but not for want of proper presentment.

(4) Where a draft has been dishonored by nonacceptance a later presentment for payment and any notice of dishonor and protest for nonpayment are excused unless in the meantime the instrument has been accepted.

(5) A waiver of protest is also a waiver of presentment and of notice of dishonor even though protest is not required.

(6) Where a waiver of presentment or notice or protest is embodied in the instrument itself it is binding upon all parties; but where it is written above the signature of an indorser it binds him only.

COMMENT: Prior Uniform Statutory Provision: §§ 79, 80, 81, 82, 109, 111, 112, 113, 114, 115, 116, 130, 147, 148, 150, 151, 159, Uniform Negotiable Instruments Law.

Changes: Combined and simplified.

Purposes of Changes: This section combines widely scattered sections of the original Act and is intended to simplify the rules as to when presentment, notice or protest is excused: 1. The single term "excused" is substituted for "excused," "dispensed with," "not necessary," "not required," as used variously in the original Act. No change in meaning is intended.

2. Subsection (1) combines provisions found in the original §§ 81, 113, 147 and 159. Delay in making presentment either for payment or for acceptance, in giving notice of dishonor or in making protest is excused when the party has acted with reasonable diligence and the delay is not his fault. This is true where an instrument has been accelerated without his knowledge, or demand has been made by a prior holder immediately before his purchase. It is true under any other circumstances where the delay is beyond his control. The words "not imputable to his default, misconduct or negligence" found in the original §§ 81, 113 and 159 are omitted as superfluous, but no change in substance is intended.

3. Any waived presentment, notice or protest is excused, as under the original §§ 82, 109, 110 and 111. The waiver may be express or implied, oral or written, and before or after the proceeding waived is due. It may be, and often is, a term of the instrument when it is issued. Subsection (5) retains as standard commercial usage the meaning attached by the original § 111 to "protest waived."

4. Parapraph (b) of subsection (2) combines the substance of provisions found in the original §§ 79, 80, 114, 115 and 130. A party who has no right to require or reason to expect that the instrument will be honored is not entitled to presentment, notice or protest. This is of course true where he has himself dishonored the instrument or has countermanded payment. It is equally true, for example, where he is an accommodated party and has himself broken the accommodation agreement.

5. Paragraph (c) of subhsection (2) combines provisions found in the original §§ 82(1), 112 and 159. The excuse is established only by proof that reasonable diligence has been exercised without success, or that reasonable diligence would in any case have been unsuccessful.

6. Paragraph (a) of subsection (3) is new. It excuses presentment in situations where immediate payment or acceptance is impossible or so unlikely that the holder cannot reasonably be expected to make presentment. He is permitted

instead to have his immediate recourse upon the drawer or indorser, and let the latter file any necessary claim in probate or insolvency proceedings. The exception for the documentary draft is to preserve any profit on the resale of goods for the creditors of the drawee if his representative can find the funds to pay.

7. Paragraph (b) of subsection (3) extends the original § 148(3) to include any case where payment or acceptance is definitely refused and the refusal is not on the ground that there has been no proper presentment. The purpose of presentment is to determine whether or not the maker, acceptor or drawee will pay or accept; and when that question is clearly determined the holder is not required to go through a useless ceremony. The provision applies to a definite refusal stating no reasons.

8. Subsection (4) retains the rule of the original §§ 116 and 151.

9. Subsection (6) retains the rule of original § 110.

Cross References:

§§ 3-501, 3-502, 3-503, 3-507 and 3-509.

Definitional Cross References:

"Acceptance". § 3-410.
"Dishonor". § 3-507.
"Documentary draft". § 4-104.
"Draft". § 3-104.
"Insolvency proceedings". § 1-201.
"Instrument". § 3-102.
"Issue". § 3-102.
"Notice of dishonor". § 3-508.
"Party". § 1-201.
"Presentment". § 3-504.
"Protest". § 3-509.
"Right". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-432, 6-433, 6-434, 6-435, 6-462, 6-464, 6-465, 6-466, 6-467, 4-468, 4-469, 6-483, 6-500, 6-501, 6-503, 6-504, 6-512.

Comment: The section continues the rule that notice of dishonor may be waived, either expressly or impliedly, and either before or after it is due. In Inge v. Bryant, 144 Va. 782, 789-92, 130 S.E. 773 (1925), and First National Bank v. Anderson, 125 Va. 102, 99 S.E. 561 (1919), the court found implied waivers of notice, after such notice was due. In Security Loan and Trust Co. v. Fields, 110 Va. 827, 67 S.E. 342 (1910), it was found that there had been no waiver.

PART 6

DISCHARGE

§ 3-601. **Discharge of Parties.** (1) The extent of the discharge of any party from liability on an instrument is governed by the sections on

(a) payment or satisfaction (§ 3-603); or

(b) tender of payment (§ 3-604); or

(c) cancellation or renunciation (§ 3-605); or

(d) impairment of right of recourse or of collateral (§ 3-606): or

(e) reacquisition of the instrument by a prior party (§ 3-208): or

(f) fraudulent and material alteration (§ 3-407); or

(g) certification of a check (§ 3-411); or

(h) acceptance varying a draft (§ 3-412); or

(i) unexcused delay in presentment or notice of dishonor or protest (§ 3-502).

(2) Any party is also discharged from his liability on an instrument to another party by any other act or agreement with such party which would discharge his simple contract for the payment of money.

(3) The liability of all parties is discharged when any party who has himself no right of action or recourse on the instrument

(a) reacquires the instrument in his own right; or

(b) is discharged under any provision of this Article, except as otherwise provided with respect to discharge for impairment of recourse or of collateral (§ 3-606).

COMMENT: Prior Uniform Statutory Provision: §§ 119, 120 and 121, Uniform Negotiable Instruments Law.

Changes: Portions of original sections combined and reworded; new provisions.

Purposes of Changes: 1. Subsection (1) contains an index referring to all of the sections of this Article which provide for the discharge of any party. The list is exclusive so far as the provisions of this Article are concerned, but it is not intended to prevent or affect any discharge arising apart from this statute, as for example a discharge in bankruptcy or a statutory provision for discharge if the instrument is negotiated in a gaming transaction.

2. A negotiable instrument is in itself merely a piece of paper bearing a writing, and strictly speaking is incapable of being discharged. The parties are rather discharged from liability on their contracts on the instrument. The language of the original § 119 as to discharge of the instrument itself has left uncertainties as to the effect of the discharge upon the rights of a subsequent holder in due course. It is therefore eliminated, and this section now distinguishes instead between the discharge of a single party and the discharge of all parties.

So far as the discharge of any one party is concerned a negotiable instrument differs from any other contract only in the special rules arising out of its character to which paragraphs (a) to (i) of subsection (1) are an index, and in the effect of the discharge against a subsequent holder in due course (§ 3-602). Subsection (2) therefore retains from the original § 119(4) the provision for discharge by "any other act which will discharge a simple contract for the payment of money," and specifically recognizes the possibility of a discharge by agreement.

The discharge of any party is a defense available to that party as provided in sections on rights of those who are and are not holders in due course (§§ 3-305 and 3-306). He has the burden of establishing the defense (§ 3-307).

3. Subsection (3) substitutes for the "discharge of the instrument" the discharge of all parties from liability on their contracts on the instrument. It covers a part of the substance of the original § 119(1), (2) and (5), the original § 120(1) and (3), and the original § 121(1) and (2). It states a general principle in lieu of the original detailed provisions. The principle is that all parties to an instrument are discharged when no party is left with rights against any other party on the paper.

When any party reacquires the instrument in his own right his own liability is discharged; and any intervening party to whom he was liable is also discharged as provided in § 3-208 on reacquisition. When he is left with no right of action against an intervening party and no right of recourse against any prior party, all parties are obviously discharged. The instrument itself is not necessarily extinct, since it may be reissued or renegotiated with a new and further liability; and if it subsequently reaches the hands of a holder in due course without notice of the discharge he may still enforce it as provided in § 3-602 on effect of discharge against a holder in due course.

Under § 3-606 on impairment of recourse or collateral, the discharge of any party discharges those who have a right of recourse against him, except in the case of a release with reservation of rights or a failure to give notice of dishonor. A discharge of one who has himself no right of action or recourse on the instrument may thus discharge all parties. Again the instrument itself is not necessarily extinct, and if it is negotiated to a subsequent holder in due course without notice of the discharge he may enforce it as provided in § 3-602 on effect of discharge against a holder in due course.

4. The language "any party who has himself no right of action or recourse on the instrument" is substituted for "principal debtor," which is not defined by the original Act and has been misleading. This Article also omits the original § 192, defining the "person primarily liable." Under § 3-415 on accommodation parties an accommodation maker or acceptor, although he is primarily liable on the instrument in the sense that he is obligated to pay it without recourse upon another, has himself a right of recourse against the accommodated payee; and his reacquisition or discharge leaves the accommodated party liable to him. The accommodated payee, although he is not primarily liable to others, has no right of action or recourse against the accommodation maker, and his reacquisition or discharge may discharge all parties.

Cross References:

§§ 3-406, 3-411, 3-412, 3-509, 3-603, 3-604 and 3-605.
Point 2: §§ 3-305, 3-306, 3-307 and 3-602.
Point 3: §§ 3-208, 3-602 and 3-606.
Point 4: § 3-415.

Definitional Cross References:

"Action". § 1-201.
"Agreement". § 1-201.
"Alteration". § 3-407.
"Certification". § 3-411.
"Check". § 3-104.
"Contract". § 1-201.
"Draft". § 3-104.
"Instrument". § 3-102.
"Money". § 1-201.
"Notice of dishonor". § 3-508.
"Party". § 1-201.
"Presentment". § 3-504.
"Rights". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-472, 6-473, 6-474.

Comment: The UCC approaches discharge from the standpoint of the discharge of parties on the instrument rather than of the instrument itself. All parties are discharged when any party who himself has no right of action or recourse on the instrument reacquires it in his own right. This is the same result as has been reached under Virginia cases: Sherwood v. Lohman, 184 Va. 511, 517, 35 S.E. 2d 757; Whitehead's Ex'x v. Planters Bank and Trust Co., 180 Va. 76, 80-82, 21 S.E. 2d 724 (1942); Cussen v. Brandt, 97 Va. 1, 9, 33 S.E. 791 (1899). A note is not discharged as to the principal obligor by another party to the instrument making payment. Loughran v. Kincheloe, 160 Va. 292, 168 S.E. 362 (1933).

When the NIL was adopted in Virginia, § 119(4) was omitted. The substance of this subsection is now embodied in UCC 3-601(2), which provides that a party is discharged by any act or agreement other than those listed that would discharge a simple contract for the payment of money. Rector v. Hancock, 127 Va. 101, 113-15, 102 S.E. 663 (1920), indicates that an accord and satisfaction will discharge a negotiable instrument, and that such an accord and satisfaction may be shown by parol evidence. In Nachman v. Chatham-Phenix Nat'l Bank & Trust Co., 161 Va. 576, 584-88, 171 S.E. 676 (1933), the court recognized that there had been a novation, by which the holder substituted the obligation of an indorser for that of the maker, and so the maker was discharged. These holdings indicate that the omission of subsection 119(4) of the NIL has not had any significant effect on Virginia. The provision of the UCC seems to state present Virginia law, even though it is not set forth in the Virginia adoption of the NIL.

§ 3-602. Effect of Discharge Against Holder in Due Course. No discharge of any party provided by this Article is effective against a subsequent holder in due course unless he has notice thereof when he takes the instrument.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: The section is intended to remove an uncertainty as to which the original Act is silent. It rests on the principle that any discharge of a party provided

under any section of this Article is a personal defense of the party, which is cut off when a subsequent holder in due course takes the instrument without notice of the defense. Thus where an instrument is paid without surrender such a subsequent purchase cuts off the defense. This section applies only to discharges arising under the provisions of this Article, and it has no application to any discharge arising apart from it, such as a discharge in bankruptcy.

Under § 3-304(1)(b) on notice to purchaser it is possible for a holder to take the instrument in due course even though he has notice that one or more parties have been discharged, so long as any party remains undischarged. Thus he may take with notice that an indorser of a note has been released, and still be a holder in due course as to the liability of the maker. In that event, the holder in due course is subject to the defense of the discharge of which he had notice when he took the instrument.

Cross References:

§§ 3-302, 3-304, 3-305 and 3-601.

Definitional Cross References:

"Holder in due course". § 3-302.
"Instrument". § 3-102.
"Notice". § 1-201.
"Party". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 3-603. **Payment or Satisfaction.** (1) The liability of any party is discharged to the extent of his payment or satisfaction to the holder even though it is made with knowledge of a claim of another person to the instrument unless prior to such payment or satisfaction the person making the claim either supplies indemnity deemed adequate by the party seeking the discharge or enjoins payment or satisfaction by order of a court of competent jurisdiction in an action in which the adverse claimant and the holder are parties. This subsection does not, however, result in the discharge of the liability

(a) of a party who in bad faith pays or satisfies a holder who acquired the instrument by theft or who (unless having the rights of a holder in due course) holds through one who so acquired it; or

(b) of a party (other than an intermediary bank or a payor bank which is not a depositary bank) who pays or satisfies the holder of an instrument which has been restrictively indorsed in a manner not consistent with the terms of such restrictive indorsement.

(2) Payment or satisfaction may be made with the consent of the holder by any person including a stranger to the instrument. Surrender of the instrument to such a person gives him the rights of a transferee (§ 3-201).

COMMENT: Prior Uniform Statutory Provision: §§ 51, 88, 119, 121 and 171-177, Uniform Negotiable Instruments Law.

Changes: Parts of original sections combined and reworded; law changed.

Purposes of Changes: This section changes the law as follows: **1.** It eliminates the "payment in due course" found in the original §§ 51, 88 and 119. "Payment in due course" discharged all parties where it was made by one who has no right of recourse on the instrument; but this is true of any other discharge of such a party, and is now covered by § 3-601(3) on discharge of parties. Such payment was effective as a discharge against a subsequent purchaser; but since it is made at or after maturity of the instrument a purchaser with notice of that fact cannot be a holder in due course, and one who takes without notice of the payment and the maturity should be protected against failure to take up the instrument. The matter is now covered by § 3-602.

2. The original §§ 171-177 provide for payment of a draft "for honor" after protest. The practice originated at a time when communications were slow and difficult, and in overseas transactions there might be a delay of several months before the drawer could act upon any dishonor. It provided a method by which a third party might intervene to protect the credit of the drawer and at the same time preserve his own rights. Cable, telegraph and telephone have made the practice obsolete for nearly a century, and it is today almost entirely unknown. It has been replaced by the cable transfer, the letter of credit and numerous other devices by which a substitute arrangement is promptly made. "Payment for honor" is therefore eliminated; and subsection (2) now provides that any person may pay with the consent of the holder.

3. Payment to the holder discharges the party who makes it from his own liability on the instrument, and a part payment discharges him pro tanto. The same is true of any other satisfaction. Subsection (1) changes the law by eliminating the requirement of the original § 88 that the payment be made in good faith and without notice that the title of the holder is defective. It adopts as a general principle the position that a payor is not required to obey an order to stop payment received from an indorser. However, this general principle is qualified by the provisions of subsection (1)(a) and (b) respecting persons who acquire an instrument by theft, or through a restrictive indorsement (§ 3-205). These provisions are thus consistent with § 3-306 covering the rights of one not a holder in due course.

When the party to pay is notified of an adverse claim to the instrument he has normally no means of knowing whether the assertion is true. The "unless" clause of subsection (1) follows statutes which have been passed in many states on adverse claims to bank deposits. The paying party may pay despite notification of the adverse claim unless the adverse claimant supplies indemnity deemed adequate by the paying party or procures the issuance of process restraining payment in an action in which the adverse claimant and the holder of the instrument are both parties. If the paying party chooses to refuse payment and stand suit, even though not indemnified or enjoined, he is free to do so, although, under § 3-306(d) on the rights of one not a holder in due course, except where theft or taking through a restrictive indorsement is alleged the payor must rely on the third party claimant to litigate the issue and may not himself defend on such a ground. His contract is to pay the holder of the instrument, and he performs it by making such payment. Except in cases of theft or restrictive indorsement there is no good reason to put him to inconvenience because of a dispute between two other parties unless he is indemnified or served with appropriate process.

4. With the elimination of "payment for honor", subsection (2) provides that with the consent of the holder payment may be made by anyone, including a stranger. The subsection omits the provision of the original § 121 by which the payor is "remitted to his former rights". It rejects such decisions as Quimby v. Varnum, 190 Mass. 211, 76 N.E. 671 (1906), holding that an irregular indorser who makes payment cannot recover on the instrument. The same result is reached under § 3-415(5) on accommodation parties. Upon payment and surrender of the paper the payor succeeds to the rights of the holder, subject to the limitation found in § 3-201 on transfer that one who has himself been a party to any fraud or illegality affecting the instrument or who as a prior holder had notice of a defense or claim against it cannot improve his position by taking from a later holder in due course.

5. Payment discharges the liability of the person making it. It discharges the liability of other parties only as

a. The discharge of the payor discharges others who have a right of recourse against him under § 3-606; or

b. Reacquisition of the instrument discharges intervening parties under § 3-208 on reacquisition; or

c. The discharge of one who has himself no right of recourse on the instrument discharges all parties under § 3-601 on discharge of parties.

Cross References:

§§ 3-604 and 3-606.
Point 1: § 3-601(3).
Point 3: §§ 3-205 and 3-306(d).
Point 4: §§ 3-201 and 3-415(5).
Point 5: §§ 3-606, 3-208, 3-601.

Definitional Cross References:

"Action". § 1-201.
"Holder". § 1-201.
"Instrument". § 3-102.
"Order". § 3-102.
"Party". § 1-201.
"Person". § 1-201.
"Rights". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-403, 6-441, 6-472, 6-473, 6-524 through 6-530.

Comment: Payment is an affirmative defense, the burden of proving which is on the party who alleges it. American Security and Trust Co. v. John L. Juliano, Inc., 203 Va. 827, 833, 127 S.E. 2d 348 (1962); Snidow v. Woods, 198 Va. 692, 695-96, 96 S.E. 2d 157 (1957). Where the instrument is in the hands of the payee, there is a presumption of nonpayment, but on the facts of Schmitt v. Redd, 151 Va. 333, 338-44, 143 S.E. 884 (1928), this presumption was rebutted. See also VIRGINIA ANNOTATIONS to UCC 3-307.

The UCC clarifies the rights of the parties where payment or satisfaction is made with the consent of the holder by a person who is a stranger to the instrument. Under UCC 3-201 such a person acquires the rights of a transferee. This is in accord with the result reached in Union Trust Corp. v. Fugate, 172 Va. 82, 89-90, 200 S.E. 624 (1939), where in an action against the transferor, the court held that prima facie such a transaction represents a purchase and does not discharge the instrument. The UCC does change the result in Cussen v. Brandt, 97 Va. 1, 7, 33 S.E. 791 (1899), which held that payment of an instrument by a stranger constituted a discharge of the parties if the intention of the parties was that the transaction involved a payment rather than a purchase.

§ 3-604. **Tender of Payment.** (1) Any party making tender of full payment to a holder when or after it is due is discharged to the extent of all subsequent liability for interest, costs and attorney's fees.

(2) The holder's refusal of such tender wholly discharges any party who has a right of recourse against the party making the tender.

(3) Where the maker or acceptor of an instrument payable otherwise than on demand is able and ready to pay at every place of payment specified in the instrument when it is due, it is equivalent to tender; provided, however, that in the case of an instrument which states that it is payable at a bank the maker or acceptor shall not be considered able and ready to pay unless he has specifically ordered the bank to pay the instrument out of funds on deposit with or otherwise provided to the bank for such payment.

(VALC Note: Subsection (3) of § 3-604 appears in the Official Text as follows:

(3) Where the maker or the acceptor of an instrument payable otherwise than on demand is able and ready to pay at every place of payment specified in the instrument when it is due, it is equivalent to tender.)

COMMENT: **Prior Uniform Statutory Provision:** §§ 70 and 120, Uniform Negotiable Instruments Law.

Changes: Parts of original sections combined and reworded; new provisions.

Purpose of Changes and New Matter: 1. Subsection (1) is new. It states the general accepted rule as to the effect of tender.

2. Subsection (2) rewords the original subsection 120(4). The party discharged is one who has a right of recourse against the party making tender, whether the latter be a prior party or a subsequent one who has been accommodated.

3. Subsection (3) rewords the final clause of the first sentence of the original § 70. Where the instrument is payable at any one of two or more specified places,

the maker or acceptor must be able and ready to pay at each of them. The language in original § 70 was taken to mean that makers and acceptors of notes and drafts payable at a bank were not discharged by failure of a holder to make due presentment of such paper at the designated bank. This Article reverses that rule. See § 3-501 on necessity of presentment, 3-504 on how presentment is made, and 3-502 on effect of delay in presentment.

Cross References:

§ 3-601.
Point 3: §§ 3-501, 3-502 and 3-504.

Definitional Cross References:

"Holder". § 1-201.
"Instrument". § 3-102.
"On demand". § 3-108.
"Party". § 1-201.
"Right". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-423, 6-473.

Comment: § 3-121 provides that a note or acceptance payable at a bank is not of itself an order to pay it although the bank may consider it an authorization to pay. A mere authorization, and not an order, to the bank should not be considered a tender of payment. But if a maker or acceptor has specifically ordered the bank to make payment, and has provided the funds to the bank by deposit or otherwise for such payment, then he should not be denied the right to make an effective tender in this way.

To make clear the requirements of an effective tender through a bank, the following provision has been added to Subsection (3) of the 1962 Official Text:

"provided, however, that in the case of an instrument which states that it is payable at a bank the maker or acceptor shall not be considered able and ready to pay unless he has specifically ordered the bank to pay the instrument out of funds on deposit with or otherwise provided to the bank for such payment."

COUNCIL COMMENT

We regard the clarifying language as essential in view of the form in which we have recommended the adoption of § 3-121.

§ 3-605. **Cancellation and Renunciation.** (1) The holder of an instrument may even without consideration discharge any party

(a) in any manner apparent on the face of the instrument or the indorsement, as by intentionally cancelling the instrument or the party's signature by destruction or mutilation, or by striking out the party's signature; or

(b) by renouncing his rights by a writing signed and delivered or by surrender of the instrument to the party to be discharged.

(2) Neither cancellation nor renunciation without surrender of the instrument affects the title thereto.

COMMENT: Prior Uniform Statutory Provision: §§ 48, 119(3), 120(2), 122 and 123, Uniform Negotiable Instruments Law.

Changes: Combined and reworded.

Purposes of Changes: 1. The original Act does not state how cancellation is to be effected, except as to striking indorsements under the original § 48. It must be done in such a manner as to be apparent on the face of the instrument, and the methods stated, which are supported by the decisions, are exclusive.

2. Subsection (1)(b) restates the original § 122. The provision as to "discharge of the instrument" is now covered by discharge, § 3-601(3); that as to subsequent holders in due course by § 3-602 on effect of discharge against a holder in due course.

3. Subsection (2) is new. It is intended to make it clear that the striking of an indorsement, or any other cancellation or renunciation, does not affect the title.

Cross References:

Point 2: §§ 3-601 and 3-602.

Definitional Cross References:

"Holder". § 1-201.
"Instrument". § 3-102.
"Party". § 1-201.
"Rights". § 1-201.
"Signature". § 3-401.
"Signed". § 1-201.
"Writing". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-400, 6-472, 6-473, 6-475, 6-476.

Comment: The UCC distinguishes, although not in so many words, between a cancellation, which involves an act done to the instrument itself, and a renunciation, which is done by a separate writing, signed and delivered, or by surrender of the instrument. The UCC requires a cancellation to be "apparent on the face of the instrument or the indorsement." It would seem that the words "on the face of" are unnecessary, as is illustrated by Farmer v. Farmer, 195 Va. 92, 77 S.E. 2d 415 (1953), in which a holder wrote a statement on the back of the note that it was to be cancelled at his death. Since the writing was on the back, it would not be a cancellation under the UCC. However, the UCC provides that rights to an instrument may be renounced by a writing signed and delivered. In the Farmer case, the note was delivered to the obligor, and so the writing on the back would constitute a renunciation under the UCC.

The UCC requires that a writing be signed and delivered or the instrument itself surrendered in order to have a renunciation. This is in accord with Isbell v. Flippen, 185 Va. 977, 41 S.E. 2d 31 (1947), holding that a renunciation could not be shown by oral evidence, the instrument not being surrendered.

Since the UCC does not cover the point, it would not affect the result in Farmer v. Farmer, 195 Va. 92, 77 S.E. 2d 415 (1953), upholding the validity of a renunciation to be effective upon death, as against contentions that the act did not meet the requirements for testamentary disposition or a gift inter vivos.

The UCC has eliminated any reference to the burden of proof, which under the NIL lay on a party who alleged that a cancellation of an instrument was unintentional, accidental, or without authority. The NIL was applied in Jones's Adm'rs v. Coleman, 121 Va. 86, 92 S. E. 910 (1917), so as to deny recovery on a note, the date and signature of which had been destroyed by burning. Since as a general proposition the burden of proof rests with the plaintiff it does not appear that the UCC has made any change in the holding of this case.

§ 3-606. Impairment of Recourse or of Collateral. (1) The holder discharges any party to the instrument to the extent that without such party's consent the holder

(a) without express reservation of rights releases or agrees not to sue any person against whom the party has to the knowledge of the holder a right of recourse or agrees to suspend the right to enforce against such person the instrument or collateral or otherwise discharges such person, except that failure or delay in effecting any required presentment, protest or notice of dishonor with respect to any such person does not discharge any party as to whom presentment, protest or notice of dishonor is effective or unnecessary; or

(b) unjustifiably impairs any collateral for the instrument given by or on behalf of the party or any person against whom he has a right of recourse.

(2) By express reservation of rights against a party with a right of recourse the holder preserves

(a) all his rights against such party as of the time when the instrument was originally due; and

(b) the right of the party to pay the instrument as of that time; and

(c) all rights of such party to recourse against others.

COMMENT: **Prior Uniform Statutory Provision:** § 120, Uniform Negotiable Instruments Law.

Changes: Reworded; new provisions.

Purposes of Changes and New Matter: To make it clear that:

1. The words "any party to the instrument" remove an uncertainty arising under the original section. The suretyship defenses here provided are not limited to parties who are "secondarily liable," but are available to any party who is in the position of a surety, having a right of recourse either on the instrument or dehors it, including an accommodation maker or acceptor known to the holder to be so.

2. Consent may be given in advance, and is commonly incorporated in the instrument; or it may be given afterward. It requires no consideration, and operates as a waiver of the consenting party's right to claim his own discharge.

3. The words "to the knowledge of the holder" exclude the latent surety, as for example the accommodation maker where there is nothing on the instrument to show that he has signed for accommodation and the holder is ignorant of that fact. In such a case the holder is entitled to proceed according to what is shown by the face of the paper or what he otherwise knows, and does not discharge the surety when he acts in ignorance of the relation.

4. This section retains the right of the holder to release one party, or to postpone his time of payment, while expressly reserving rights against others. Subsection (2), which is new, states the generally accepted rule as to the effect of such an express reservation of rights which to be effective must be accompanied by notification to any party against whom rights are so reserved (subsection (3)).

5. Paragraph (b) of subsection (1) is new. The suretyship defense stated has been generally recognized as available to indorsers or accommodation parties. As to when a holder's actions in dealing with collateral may be "unjustifiable", the section on rights and duties with respect to collateral in the possession of a secured party (§ 9-207) should be consulted.

Cross Reference:

Point 5: § 9-207.

Definitional Cross References:

"Agreement". § 1-201.
"Holder". § 1-201.
"Instrument". § 3-102.
"Notice of dishonor". § 3-508.
"Party". § 1-201.
"Person". § 1-201.
"Rights". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-473.

Comment: Under the NIL an agreement to extend the time of payment in order to have the effect of discharging parties secondarily liable had to be "binding upon the holder." The UCC, in accordance with its general definition of an agreement as being a bargain in fact, as distinguished from a contract, which is the effect given by law to an agreement, eliminates the requirement that the agreement be binding. Accordingly, Virginia law, following the NIL, as expressed in Cawley v. Hanes, 173 Va. 381, 389, 4 S.E. 2d 376 (1939), and Cape Charles Bank, Inc. v. Farmers Mutual Exchange, 120 Va. 771, 777, 92 S.E. 918 (1917), is changed under the UCC.

With this change the UCC continues the defense available to sureties of extensions of time of payment. Cawley v. Hanes, 173 Va. 331, 4 S.E. 2d 376 (1939); Harris v. Citizens Bank & Trust Co., 172 Va. 111, 136-39, 200 S.E. 652 (1939); Dunnington v. Bank of Crewe, 144 Va. 36, 131 S.E. 221 (1926); Cape Charles Bank, Inc. v. Farmers Mutual Exchange, 120 Va. 771, 92 S.E. 918 (1917). While the rule was recognized in Heldreth v. Moore, 153 Va. 156, 161, 149 S.E. 472 (1929), and Settle v. Browning, 145 Va. 307, 315, 133 S.E. 769 (1926), the facts showed that no extensions of time had been given.

The holding in Dunnington v. Bank of Crewe, 144 Va. 36, 131 S.E. 221 (1926), that an extension of time on a "principal" note does not discharge indorsers on a "collateral" note seems implicit in the UCC. Similarly, the UCC does not affect the holding in Whitehead v. Planters Bank and Trust Co., 180 Va. 76, 81-83, 21 S.E. 2d 724 (1942), that a waiver in the instrument of extensions of time terminates with the death of the indorser.

Only an "unjustifiable" impairment of collateral operates as a discharge under the UCC. What constitutes an unjustifiable impairment is left to the law of suretyship and secured transactions, an approach that is in accord with Ward v. Bank of Pocahontas, 167 Va. 169, 178-79, 187 S.E. 491 (1936). The UCC modifies the extreme dictum of Citizens and Marine Bank v. McMurran, 138 Va. 657, 662, 123 S.E. 507 (1924), in which the court quoted from a pre-NIL case, which had said, "An endorser of a note is a surety for the maker; and the doctrine is well established that any change in the contract, however immaterial, and even though it be for his advantage, discharges the surety, if made without his consent." Triplett v. Second Nat'l Bank, 121 Va. 189, 92 S.E. 897 (1917), recognized that a surety is released if the creditor releases a lien on any property held as security for the debt, but on the facts it was found that the creditor did not have any control over the collateral security. Lynch v. O'Brien, 115 Va. 350, 79 S.E. 389 (1913), recognized that an indorser may, by indorsing with knowledge, waive a defense based on impairment of security.

PART 7

ADVICE OF INTERNATIONAL SIGHT DRAFT

§ 3-701. **Letter of Advice of International Sight Draft.** (1) A "letter of advice" is a drawer's communication to the drawee that a described draft has been drawn.

(2) Unless otherwise agreed when a bank receives from another bank a letter of advice of an international sight draft the drawee bank may immediately debit the drawer's account and stop the running of interest pro tanto. Such a debit and any resulting credit to any account covering outstanding drafts leaves in the drawer full power to stop payment or otherwise dispose of the amount and creates no trust or interest in favor of the holder.

(3) Unless otherwise agreed and except where a draft is drawn under a credit issued by the drawee, the drawee of an international sight draft owes the drawer no duty to pay an unadvised draft but if it does so and the draft is genuine, may appropriately debit the drawer's account.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: To recognize and clarify, in law, certain established practices of international banking.

1. Checks drawn by one international bank on the account it carries (in a currency foreign to itself) in another international bank are still handled under practices which reflect older conditions, but which have a real, continuing reason in the typical, European rule that a bank paying a check in good faith and in ordinary course can charge its depositor's account notwithstanding forgery of a necessary indorsement. To decrease the risk that forgery will prove successful, the practice is to send a letter of advice that a draft has been drawn and will be forthcoming. Subsection 3 recognizes that a drawer who sends no such letter forfeits any rights for improper dishonor, while still permitting the drawee to protect his delinquent drawer's credit.

2. Subsection (2) clears up for American courts, the meaning of another international practice: that of charging the drawer's account on receipt of the letter of advice. This practice involves no conception of trust or the like and the rule of § 3-409(1) (Draft not an assignment) still applies. The debit has to do with the payment of interest only. The section recognizes the fact.

Cross Reference:

Point 2: § 3-409(1).

Definitional Cross References:

"Account". § 4-104.
"Bank". § 1-201.
"Credit". § 5-103.
"Draft". § 3-104.
"Genuine". § 1-201.
"Holder". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

PART 8

MISCELLANEOUS

§ 3-801. **Drafts in a Set.** (1) Where a draft is drawn in a set of parts, each of which is numbered and expressed to be an order only if no other part has been honored, the whole of the parts constitutes one draft but a taker of any part may become a holder in due course of the draft.

(2) Any person who negotiates, indorses or accepts a single part of a draft drawn in a set thereby becomes liable to any holder in due course of that part as if it were the whole set, but as between different holders in due course to whom different parts have been negotiated the holder whose title first accrues has all rights to the draft and its proceeds.

(3) As against the drawee the first presented part of a draft drawn in a set is the part entitled to payment, or if a time draft to acceptance and payment. Acceptance of any subsequently presented part renders the drawee liable thereon under subsection (2). With respect both to a holder and to the drawer payment of a subsequently presented part of a draft payable at sight has the same effect as payment of a check notwithstanding an effective stop order (§ 4-407).

(4) Except as otherwise provided in this section, where any part of a draft in a set is discharged by payment or otherwise the whole draft is discharged.

COMMENT: Prior Uniform Statutory Provision: §§ 178-183, Uniform Negotiable Instruments Law.

Changes: Combined and reworded.

Purposes of Changes: The revised language makes no important change in substance, and is intended only as a clarification and supplementation of the original sections: 1. Drafts in a set customarily contain such language as "Pay ——— this first of exchange (second unpaid)," with equivalent language in the second part. Today a part also commonly bears conspicuous indication of its number. At least the first factor is necessary to notify the holder of his rights, and is therefore necessary in order to make this section apply. Subsection (1) so provides, thus stating in the statute a matter left previously to a commercial practice long uniform but expensive to establish in court.

2. The final sentence of subsection (3) is new. Payment of the part of the draft subsequently presented is improper and the drawee may not charge it to the

account of the drawer, but some one has probably been unjustly enriched on the total transaction, at the expense of the drawee. So the drawee is like a bank which has paid a check over an effective stop payment order, and is subrogated as provided in that situation. § 4-407.

3. A statement in a draft drawn in a set of parts to the effect that the order is effective only if no other part has been honored does not render the draft non-negotiable as conditional. See § 3-112(1)(g).

Cross References:

Point 2: § 4-407.
Point 3: § 3-112.

Definitional Cross References:

"Acceptance". § 3-410.
"Check". § 3-104.
"Draft". § 3-104.
"Holder". § 1-201.
"Holder in due course". § 3-302.
"Honor". § 1-201.
"Person". § 1-201.
"Rights". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-531 through 6-536.

§ 3-802. Effect of Instrument on Obligation for Which It Is Given. (1) Unless otherwise agreed where an instrument is taken for an underlying obligation

(a) the obligation is pro tanto discharged if a bank is drawer, maker or acceptor of the instrument and there is no recourse on the instrument against the underlying obligor; and

(b) in any other case the obligation is suspended pro tanto until the instrument is due or if it is payable on demand until its presentment. If the instrument is dishonored action may be maintained on either the instrument or the obligation; discharge of the underlying obligor on the instrument also discharges him on the obligation.

(2) The taking in good faith of a check which is not postdated does not of itself so extend the time on the original obligation as to discharge a surety.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. The section is new. It is intended to settle conflicts as to the effect of an instrument as payment of the obligation for which it is given.

2. Where a holder procures certification of a check the drawer is discharged under § 3-411 on check certification. Thereafter the original obligation is regarded as paid, and the holder must look to the certifying bank. The circumstances may indicate a similar intent in other transactions, and the question may be one of fact for the jury. Subsection (1)(a) states a rule discharging the obligation pro tanto when the instrument taken carries the obligation of a bank as drawer, maker or acceptor and there is no recourse on the instrument against the underlying obligor.

3. It is commonly said that a check or other negotiable instrument is "conditional payment." By this it is normally meant that taking the instrument is a surrender of the right to sue on the obligation until the instrument is due, but if the instrument is not paid on due presentment the right to sue on the obligation is "revived." Subsection (1)(b) states this result in terms of suspension of the obligation, which is intended to include suspension of the running of the statute of limitations. On dishonor of the instrument the holder is given his option to sue either on the instrument or on the underlying obligation. If, however, the original obligor has been discharged on the instrument (see § 3-601) he is also discharged on the original obligation.

4. Subsection (2) is intended to remove any implication that a check given in payment of an obligation discharges a surety. The check is taken as a means of immediate payment; the thirty day period for presentment specified in § 3-503 does not affect the surety's liability.

Cross References:

Point 2: §§ 1-201, 3-411 and 3-601.
Point 4: § 3-503.

Definitional Cross References:

"Action". § 1-201.
"Bank". § 1-201.
"Check". § 3-104.
"Dishonor". § 3-507.
"Good faith". § 1-201.
"Instrument". § 3-102.
"On demand". § 3-108.
"Presentment". § 3-504.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 3-803. **Notice to Third Party.** Where a defendant is sued for breach of an obligation for which a third person is answerable over under this Article he may give the third person written notice of the litigation, and the person notified may then give similar notice to any other person who is answerable over to him under this Article. If the notice states that the person notified may come in and defend and that if the person notified does not do so he will in any action against him by the person giving the notice be bound by any determination of fact common to the two litigations, then unless after seasonable receipt of the notice the person notified does come in and defend he is so bound.

COMMENT: Prior Uniform Statutory Provisions: None.

Purposes: The section is new. It is intended to supplement, not to displace existing procedures for interpleader or joinder of parties.

The section conforms to the analogous provision in § 2-607. It extends to such liabilities as those arising from forged indorsements even though not "on the instrument," and is intended to make it clear that the notification is not effective until received. In Hartford Accident and Indemnity Co. v. First Nat'l Bank and Trust Co., 281 N.Y. 162, 22 N.E.2d 324, 123 A.L.R. 1149 (1939), the common-law doctrine of "vouching in" was held inapplicable where the party notified had no direct liability to the party giving the notice. In that case the drawer of a check, sued by the payee whose indorsement had been forged, gave notice to a collecting bank. In a second action the drawee was held liable to the drawer; but in an action by the drawee for judgment over against the collecting bank the determinations of fact in the first action were held not conclusive. This section does not disturb this result; the section is limited to cases where the person notified is "answerable over" to the person giving the notice.

Cross Reference:

§ 2-607.

Definitional Cross References:

"Action". § 1-201.
"Defendant". § 1-201.
"Instrument". § 3-102.
"Notifies". § 1-201.
"Person". § 1-201.
"Right". § 1-201.
"Seasonably". § 1-204.
"Written". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: This section establishes rules for vouching in closely analogous to the provisions of § 49-29 of the Code of 1950, under which a principal who knows of the pendency of suit against his surety and fails to offer to defend such suit is precluded from later making any defense to the claim of the surety which he might have made against the creditor. Though akin to it, the procedure thus established does not constitute third party practice, because the person vouched in does not become a party to the action and no judgment can be rendered against him. It is not therefore a legislative exception to Rule of Court 3:3.1.

§ 3-804. **Lost, Destroyed or Stolen Instruments.** The owner of an instrument which is lost, whether by destruction, theft or otherwise, may maintain an action in his own name and recover from any party liable thereon upon due proof of his ownership, the facts which prevent his production of the instrument and its terms. The court may require security indemnifying the defendant against loss by reason of further claims on the instrument.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: This section is new. It is intended to provide a method of recovery on instruments which are lost, destroyed or stolen. The plaintiff who claims to be the owner of such an instrument is not a holder as that term is defined in this Act, since he is not in possession of the paper, and he does not have the holder's prima facie right to recover under the section on the burden of establishing signatures. He must prove his case. He must establish the terms of the instrument and his ownership, and must account for its absence.

If the claimant testifies falsely, or if the instrument subsequently turns up in the hands of a holder in due course, the obligor may be subjected to double liability. The court is therefore authorized to require security indemnifying the obligor against loss by reason of such possibilities. There may be cases in which so much time has elapsed, or there is so little possible doubt as to the destruction of the instrument and its ownership that there is no good reason to require the security. The requirement is therefore not an absolute one, and the matter is left to the discretion of the court.

Cross References:

§§ 1-201 and 3-307.

Definitional Cross References:

"Action". § 1-201.
"Defendant". § 1-201.
"Instrument". § 3-102.
"Party". § 1-201.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: This section is in accord with Settle v. Browning, 145 Va. 307, 133 S.E. 769 (1926), in which recovery was allowed against all parties on an instrument that had been destroyed by its maker, who had obtained possession by giving a worthless check in payment.

§ 3-805. **Instruments Not Payable to Order or to Bearer.** This Article applies to any instrument whose terms do not preclude transfer and which is otherwise negotiable within this Article but which is not payable to order or to bearer, except that there can be no holder in due course of such an instrument.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: This section covers the "non-negotiable instrument." As it has been used by most courts, this term has been a technical one of art. It does not refer to a writing, such as a note containing an express condition, which is not nego-

tiable and is entirely outside of the scope of this Article and to be treated as a simple contract. It refers to a particular type of instrument which meets all requirements as to form of a negotiable instrument except that it is not payable to order or to bearer. The typical example is the check reading merely "Pay John Doe."

Such a check is not a negotiable instrument under this Article. At the same time it is still a check, a mercantile specialty which differs in many respects from a simple contract. Commercial and banking practice treats it as a check, and a long line of decisions before and after the original Act have made it clear that it is subject to the law merchant as distinguished from ordinary contract law. Although the Negotiable Instruments Law has been held by its terms not to apply to such "non-negotiable instruments" it has been recognized as a codification and restatement of the law merchant, and has in fact been applied to them by analogy.

Thus the holder of the check reading "Pay A" establishes his case by production of the instrument and proof of signatures; and the burden of proving want of consideration or any other defense is upon the obligor. Such a check passes by indorsement and delivery without words of assignment, and the indorser undertakes greater liabilities than those of an assignor. This section resolves a conflict in the decisions as to the extent of that undertaking by providing in effect that the indorser of such an instrument is not distinguished from any indorser of a negotiable instrument. The indorser is entitled to presentment, notice of dishonor and protest, and the procedure and liabilities in bank collection are the same. The rules as to alteration, the filling of blanks, accommodation parties, the liability of signing agents, discharge, and the like are those applied to negotiable instruments.

In short, the "non-negotiable instrument" is treated as a negotiable instrument, so far as its form permits. Since it lacks words of negotiability there can be no holder in due course of such an instrument, and any provision of any section of this Article peculiar to a holder in due course cannot apply to it. With this exception, such instruments are covered by all sections of this Article.

Cross Reference:

§ 3-104.

Definitional Cross References:

"Bearer". § 1-201.
"Holder in due course". § 3-302.
"Instrument". § 3-102.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: The UCC is consistent with the principle recognized in Daniel v. Yearick, 187 Va. 396, 404, 46 S.E.2d 333 (1948), that the assignor of an instrument not payable to order, and so non-negotiable, impliedly agrees that he will reimburse the assignee for the consideration paid if the assignee by the exercise of due diligence cannot recover the debt assigned. The same principle was recognized in Long v. Pence's Committee, 93 Va. 584, 25 S.E. 593 (1896), which involved an instrument admittedly non-negotiable under pre-NIL law.

ARTICLE 4

BANK DEPOSITS AND COLLECTIONS

PART 1

GENERAL PROVISIONS AND DEFINITIONS

§ 4-101. **Short Title.** This Article shall be known and may be cited as Uniform Commercial Code—Bank Deposits and Collections.

COMMENT: The tremendous number of checks handled by banks and the country-wide nature of the bank collection process require uniformity in the law of bank collections. Individual Federal Reserve banks process as many as 1,000,000 items a day; large metropolitan banks average 300,000 a day; banks with less than $5,000,000 on deposit handle from 1,000 to 2,000 daily. There is needed a uniform statement of the principal rules of the bank collection process with ample provision for flexibility to meet the needs of the large volume handled and the changing needs and conditions that are bound to come with the years.

The American Bankers Association Bank Collection Code, enacted in eighteen states, has stated many of the bank collection rules that have developed, and more recently Deferred Posting statutes have developed and varied further rules. With items flowing in great volume not only in and around metropolitan and smaller centers but also continuously across state lines and back and forth across the entire country, a proper situation exists for uniform rules that will state in modern concepts at least some of the rights of the parties and in addition aid this flow and not interfere with its progress.

This Article adopts many of the rules of the American Bankers Association Code that are still in current operation, the principles and rules of the Deferred Posting and other statutes, codifies some rules established by court decisions and in addition states certain patterns and procedures that exist even though not heretofore covered by statute.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, Title 6, Chapter 10.

Comment: Article 4 is discussed in Harrell, Virginia and Article 4 of the Uniform Commercial Code, 18 Wash. and Lee L. Rev. 350 (1961).

This Article replaces the Uniform Negotiable Instruments Law, enacted in Virginia in 1897, to the extent that it applied to this subject. See VIRGINIA ANNOTATIONS to Article 3. Virginia never adopted the Bank Collection Code of the American Bankers Association, the basis for many of the rules contained in this Article.

§ 4-102. **Applicability.** (1) To the extent that items within this Article are also within the scope of Articles 3 and 8, they are subject to the provisions of those Articles. In the event of conflict the provisions of this Article govern those of Article 3 but the provisions of Article 8 govern those of this Article.

(2) The liability of a bank for action or non-action with respect to any item handled by it for purposes of presentment, payment or collection is governed by the law of the place where the bank is located. In the case of action or non-action by or at a branch or separate office of a bank, its liability is governed by the law of the place where the branch or separate office is located.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. The rules governing negotiable instruments, their transfer, and the contracts of the parties thereto apply to the items collected through banking channels wherever no specific provision is found in this Article. In the case of conflict, this Article governs. See § 3-103(2).

Bonds and like instruments constituting investment securities under Article 8 may also be handled by banks for collection purposes. Various sections of Article 8 prescribe rules of transfer some of which (see §§ 8-304 and 8-306) may conflict with provisions of this Article (§§ 4-205 and 4-207). In the case of conflict, Article 8 governs.

§ 4-208 deals specifically with overlapping problems and possible conflicts between this Article and Article 9. However, similar reconciling provisions are not necessary in the case of Articles 5 and 7. §§ 4-301 and 4-302 are consistent with § 5-112. In the case of Article 7 documents of title frequently accompany items but they are not themselves items. See § 4-104(g).

2. Subsection (2) is designed to state a workable rule for the solution of otherwise vexatious problems of the conflicts of laws:

a. The routine and mechanical nature of bank collections makes it imperative that one law govern the activities of one office of a bank. The requirement found in some cases that to hold an indorser notice must be given in accordance with the law of the place of indorsement, since that method of notice became an implied term of the indorser's contract, is more theoretical than practical.

b. Adoption of what is in essence a tort theory of the conflict of laws is consistent with the general theory of this Article that the basic duty of a collecting bank is one of good faith and the exercise of ordinary care. Justification lies in the fact that, in using an ambulatory instrument, the drawer, payee, and indorsers must know that action will be taken with respect to it in other jurisdictions. This is especially pertinent with respect to the law of the place of payment.

c. The phrase "action or nonaction with respect to any item handled by it for purposes of presentment, payment or collection" is intended to make the conflicts rule of subsection (2) apply from the inception of the collection process of an item through all phases of deposit, forwarding, presentment, payment and remittance or credit of proceeds. Specifically the subsection applies to the initial act of a depositary bank in receiving an item and to the incidents of such receipt. The conflicts rule of Weissman v. Banque de Bruxelles, 254 N.Y. 488, 173 N.E. 835 (1930), is rejected. The subsection applies to questions of possible vicarious liability of a bank for action or non-action of sub-agents (see § 4-202(3)) and tests these questions by the law of the state of the location of the bank which uses the sub-agent. The conflicts rule of St. Nicholas Bank of New York v. State Nat. Bank, 128 N.Y. 26, 27 N.E. 849, 13 L.R.A. 241 (1891), is rejected. The subsection applies to action or non-action of a payor bank in connection with handling an item (see §§ 4-213(1), 4-301, 4-302, 4-303) as well as action or non-action of a collecting bank (§§ 4-201 through 4-214); to action or non-action of a bank which suspends payment or is affected by another bank suspending payment (§ 4-214); to action or non-action of a bank with respect to an item under the rules of Part 4 of Article 4.

d. Where subsection (2) makes this Article applicable, § 4-103(1) leaves open the possibility of an agreement with respect to applicable law. Such freedom of agreement follows the general policy of § 1-105.

Cross References:

§§ 1-105; 3-103(2) and Article 3; all sections of Article 4; § 5-112; Article 7; §§ 8-304 and 8-306; Article 9.

Definitional Cross References:

"Bank". § 1-201.
"Branch". § 1-201.
"Item". § 4-104.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: This section is consistent with Fourth National Bank v. Bragg, 127 Va. 47, 60-64, 102, S.E. 452 (1920), which applied the law of the place where a bank took an instrument from its customer to determine whether the bank was a purchaser or agent. Under this section the question would be determined by the law of the place where the bank is located.

§ 4-103. Variation by Agreement; Measure of Damages; Certain Action Constituting Ordinary Care. (1) The effect of the provisions of this Article may be varied by agreement except that no agreement can disclaim

a bank's responsibility for its own lack of good faith or failure to exercise ordinary care or can limit the measure of damages for such lack or failure; but the parties may by agreement determine the standards by which such responsibility is to be measured if such standards are not manifestly unreasonable.

(2) Federal Reserve regulations and operating letters, clearing house rules, and the like, have the effect of agreements under subsection (1), whether or not specifically assented to by all parties interested in items handled.

(3) Action or non-action approved by this Article or pursuant to Federal Reserve regulations or operating letters constitutes the exercise of ordinary care and, in the absence of special instructions, action or non-action consistent with clearing house rules and the like or with a general banking usage not disapproved by this Article, prima facie constitutes the exercise of ordinary care.

(4) The specification or approval of certain procedures by this Article does not constitute disapproval of other procedures which may be reasonable under the circumstances.

(5) The measure of damages for failure to exercise ordinary care in handling an item is the amount of the item reduced by an amount which could not have been realized by the use of ordinary care, and where there is bad faith it includes other damages, if any, suffered by the party as a proximate consequence.

COMMENT: Prior Uniform Statutory Provision: None; but see §§ 5 and 6 of the American Bankers Association Bank Collection Code.

Purposes: 1. § 1-102 states the general principles and rules for variation of the effect of this Act by agreement and the limitations to this power. § 4-103 states the specific rules for variation of Article 4 by agreement and also certain standards of ordinary care. In view of the technical complexity of the field of bank collections, the enormous number of items handled by banks, the certainty that there will be variations from the normal in each day's work in each bank, the certainty of changing conditions and the possibility of developing improved methods of collection to speed the process, it would be unwise to freeze present methods of operation by mandatory statutory rules. This section, therefore, permits within wide limits variation of provisions of the Article by agreement.

2. Subsection (1) confers blanket power to vary all provisions of the Article by agreements of the ordinary kind. The agreements may not disclaim a bank's responsibility for its own lack of good faith or failure to exercise ordinary care and may not limit the measure of damages for such lack or failure, but this subsection like § 1-102(3) approves the practice of parties determining by agreement the standards by which such responsibility is to be measured. In the absence of a showing that the standards manifestly are unreasonable, the agreement controls. Owners of items and other interested parties are not affected by agreements under this subsection unless they are parties to the agreement or are bound by adoption, ratification, estoppel or the like.

As here used "agreement" has the meaning given to it by § 1-201(3). The agreement may be direct, as between the owner and the depositary bank; or indirect, as where the owner authorizes a particular type of precedure and any bank in the collection chain acts pursuant to such authorization. It may be with respect to a single item; or to all items handled for a particular customer, e. g., a general agreement between the depositary bank and the customer at the time a deposit account is opened. Legends on deposit tickets, collection letters and acknowledgments of items, coupled with action by the affected party constituting acceptance, adoption, ratification, estoppel or the like, are agreements if they meet the tests of the definition of "agreement". See § 1-201(3). First Nat. Bank of Denver v. Federal Reserve Bank, 6 F.2d 339 (8th Cir. 1925) (deposit slip); Jefferson County Bldg. Ass'n. v. Southern Bank & Trust Co., 225 Ala. 25, 142 So. 66 (1932) (signature card and deposit slip); Semingson v. Stock Yards Nat. Bank, 162 Minn. 424, 203 N.W. 412 (1925) (passbook); Farmers State Bank v. Union Nat. Bank, 42 N.D. 449, 454, 173 N.W. 789, 790 (1919) (acknowledgment of receipt of item).

3. Subsection (1) (subject to its limitations with respect to good faith and ordinary care) goes far to meet the requirements of flexibility. However, it does not by itself confer fully effective flexibility. When it is recognized that banks handle probably 25,000,000 items every business day and that the parties interested in each item include the owner of the item, the drawer (if it is a check), all non-bank indorsers, the payor bank and from one to five or more collecting banks, it is obvious that it is impossible, practically, to obtain direct agreements from all of these parties on all items. *En masse*, the interested parties constitute virtually every adult person and business organization in the United States. On the other hand they may become bound to agreements on the principle that collecting banks acting as agents have authority to make binding agreements with respect to items being handled. This conclusion was assumed but was not flatly decided in Federal Reserve Bank of Richmond v. Malloy, 264 U.S. 160, at 167, 44 S.Ct. 296, at 298, 68 L.Ed. 617, 31 A.L.R. 1261 (1924).

To meet this problem subsection (2) provides that official or quasi-official rules of collection, that is Federal Reserve regulations and operating letters, clearing house rules, and the like, have the effect of agreements under subsection (1), whether or not specifically assented to by all parties interested in items handled. Consequently, such official or quasi-official rules may, standing by themselves but subject to the good faith and ordinary care limitations, vary the effect of the provisions of Article 4.

Federal Reserve regulations. Various sections of the Federal Reserve Act (12 U.S.C.A. § 221 et seq.) authorize the Board of Governors of the Federal Reserve System to direct the Federal Reserve banks to exercise bank collection functions. For example, § 16 (12 U.S.C.A. § 248(o)) authorizes the Board to require each Federal Reserve bank to exercise the functions of a clearing house for its members and § 13 (12 U.S.C.A. § 342) authorizes each Federal Reserve bank to receive deposits from non-member banks solely for the purposes of exchange or of collection. Under this statutory authorization the Board has issued Regulation J (Check Clearing and Collection), which has been infrequently amended over the many years during which it has been in force. (Regulation G, issued under comparable statutory authority, covers the handling of "non-cash items"). Where regulations issued hy the Board in pursuance of its statutory mandate may be said to have some force of law and constitute an effective means of maintaining flexibility, it is appropriate to provide that such regulations may vary this Article even though not specifically assented to by all parties interested in items handled.

Federal Reserve operating letters. The regulations of the Federal Reserve Board authorize the Federal Reserve banks to promulgate rules covering operating details. Regulation J, for example, provides that each bank may promulgate rules "not inconsistent with the terms of the law or of this regulation governing the sorting, listing, packaging and transmission of items and other details of its check clearing and collection operation. Such rules . . . shall be set forth . . . in . . . letters of instructions to . . . member and non-member clearing banks." The term "operating letters" means these "letters of instructions", sometimes called "operating circulars", issued by the Federal Reserve banks under appropriate regulation of the Board. This Article recognizes such "operating letters" issued pursuant to the regulations and concerned with operating details as appropriate means, within their proper sphere, to vary the effect of the Article.

Clearing House Rules. Local clearing houses have long issued rules governing the details of clearing; hours of clearing, media of remittance, time for return of mis-sent items and the like. The case law has recognized such rules, within their proper sphere, as binding on affected parties and as appropriate sources for the courts to look to in filling out details of bank collection law. Subsection (2) in recognizing clearing house rules as a means of preserving flexibility continues the sensible approach indicated in the cases. Included in the term "clearing houses" are county and regional clearing houses as well as those within a single city or town. There is, of course, no intention of authorizing a local clearing house or a group of clearing houses to rewrite the basic law generally. The term "clearing house rules" should be understood in the light of functions the clearing houses have exercised in the past.

And the like. This phrase is to be construed in the light of the foregoing. "Federal Reserve regulations and operating letters" cover rules and regulations issued by public or quasi-public agencies under statutory authority. "Clearing house rules" cover rules issued by a group of banks which have associated themselves to perform through a clearing house some of their collection, payment and clearing functions. Other such agencies or associations may be established in the future whose rules and regulations could be appropriately looked on as constituting means of avoiding absolute statutory rigidity. The phrase "and the like" leaves open such

possibilities of future development. An agreement between a number of banks or even all the banks in an area simply because they are banks, would not of itself, by virtue of the phrase "and the like," meet the purposes and objectives of subsection (2).

4. Under this Article banks come under the general obligations of the use of good faith and the exercise of ordinary care. "Good faith" is defined in this Act (§ 1-201 (19)) as "honesty in fact in the conduct or transaction concerned." The term "ordinary care" is not defined and is here used with its normal tort meaning and not in any special sense relating to bank collections. No attempt is made in the Article to define *in toto* what constitutes ordinary care or lack of it. § 4-202 states respects in which collecting banks must use ordinary care. Subsection (3) of 4-103 provides that action or non-action approved by the Article or pursuant to Federal Reserve regulations or operating letters constitutes the exercise of ordinary care. Where Federal Reserve regulations and operating letters are issued pursuant to statutory mandate as indicated above, they constitute an affirmative standard of ordinary care equally with the provisions of Article 4 itself.

Subsection (3) further provides that, absent special instructions, action or non-action consistent with clearing house rules and the like or with a general banking usage not disapproved by the Article, prima facie constitutes the exercise of ordinary care. Clearing house rules and the phrase "and the like" have the significance set forth above in these Comments. The term "general banking usage" is not defined but should be taken to mean a general usage common to banks in the area concerned. See § 1-205(2). Where the adjective "general" is used, the intention is to require a usage broader than a mere practice between two or three banks but it is not intended to require anything as broad as a country-wide usage. A usage followed generally throughout a state, a substantial portion of a state, a metropolitan area or the like would certainly be sufficient. Consistently with the principle of § 1-205(3), action or non-action consistent with clearing house rules or the like or with such banking usages prima facie constitutes the exercise of ordinary care. However, the phrase "in the absence of special instructions" affords owners of items an opportunity to prescribe other standards and where there may be no direct supervision or control of clearing houses or banking usages by official supervisory authorities, the confirmation of ordinary care by compliance with these standards is *prima facie* only, thus conferring on the courts the ultimate power to determine ordinary care in any case where it should appear desirable to do so. The *prima facie* rule does, however, impose on the party contesting the standards to establish that they are unreasonable, arbitrary or unfair.

5. Subsection (4), in line with the flexible approach required for the bank collection process is designed to make clear that a novel procedure adopted by a bank is not to be considered unreasonable merely because that procedure is not specifically contemplated by this Article or by agreement, or because it has not yet been generally accepted as a bank usage. Changing conditions constantly call for new procedures and someone has to use the new procedure first. If such a procedure when called in question is found to be reasonable under the circumstances, provided, of course, that it is not inconsistent with any provision of the Article or other law or agreement, the bank which has followed the new procedure should not be found to have failed in the exercise of ordinary care.

6. Subsection (5) sets forth a rule for determining the measure of damages which, under subsection (1), cannot be limited by agreement. In the absence of bad faith the maximum recovery is the amount of the item concerned. When it is established that some part or all of the item could not have been collected even by the use of ordinary care the recovery is reduced by the amount which would have been in any event uncollectible. This limitation on recovery follows the case law. Finally, when bad faith is established the rule opens to allow the recovery of other damages, whose "proximateness" is to be tested by the ordinary rules applied in comparable cases. Of course, it continues to be as necessary under subsection (5) as it has been under ordinary common law principles that, before the damage rule of the subsection becomes operative, liability of the bank and some loss to the customer or owner must be established.

Cross References:

§§ 1-102(3), 1-203, 1-205 and 4-202.

Definitional Cross References:

"Bank". § 1-201.
"Good faith". § 1-201.
"Item". § 4-104.
"Usage". § 1-205.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 4-104. **Definitions and Index of Definitions.** (1) In this Article unless the context otherwise requires

(a) "Account" means any account with a bank and includes a checking, time, interest or savings account;

(b) "Afternoon" means the period of a day between noon and midnight;

(c) "Banking day" means that part of any day on which a bank is open to the public for carrying on substantially all of its banking functions;

(d) "Clearing house" means any association of banks or other payors regularly clearing items;

(e) "Customer" means any person having an account with a bank or for whom a bank has agreed to collect items and includes a bank carrying an account with another bank;

(f) "Documentary draft" means any negotiable or non-negotiable draft with accompanying documents, securities or other papers to be delivered against honor of the draft;

(g) "Item" means any instrument for the payment of money even though it is not negotiable but does not include money;

(h) "Midnight deadline" with respect to a bank is midnight on its next banking day following the banking day on which it receives the relevant item or notice or from which the time for taking action commences to run, whichever is later;

(i) "Properly payable" includes the availability of funds for payment at the time of decision to pay or dishonor;

(j) "Settle" means to pay in cash, by clearing house settlement, in a charge or credit or by remittance, or otherwise as instructed. A settlement may be either provisional or final;

(k) "Suspends payments" with respect to a bank means that it has been closed by order of the supervisory authorities, that a public officer has been appointed to take it over or that it ceases or refuses to make payments in the ordinary course of business.

(2) Other definitions applying to this Article and the sections in which they appear are:

"Collecting bank"	§ 4-105.
"Depositary bank"	§ 4-105.
"Intermediary bank"	§ 4-105.
"Payor bank"	§ 4-105.
"Presenting bank"	§ 4-105.
"Remitting bank"	§ 4-105.

(3) The following definitions in other Articles apply to this Article:

"Acceptance"	§ 3-410.
"Certificate of deposit"	§ 3-104.
"Certification"	§ 3-411.
"Check"	§ 3-104.
"Draft"	§ 3-104.
"Holder in due course"	§ 3-302.
"Notice of dishonor"	§ 3-508.
"Presentment"	§ 3-504.
"Protest"	§ 3-509.
"Secondary party"	§ 3-102.

(4) In addition Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. Subsection (1) (c): "Banking Day". Under this definition that part of a business day when a bank is open only for limited functions, e. g., on Saturday evenings to receive deposits and cash checks, but with loan, bookkeeping and other departments closed, is not part of a banking day.

2. Subsection (1) (d): "Clearing House". Occasionally express companies, governmental agencies and other non-banks deal directly with a clearing house; hence the definition does not limit the term to an association of banks.

3. Subsection (1) (e): "Customer". It is to be noted that this term includes a bank carrying an account with another bank as well as the more typical non-bank customer or depositor.

4. Subsection (1) (g): The word "item" is chosen because it is "banking language" and includes non-negotiable as well as negotiable paper calling for money and also similar paper governed by the Article on Investment Securities (Article 8) as well as that governed by the Article on Commercial Paper (Article 3).

5. Subsection (1) (h): "Midnight Deadline". The use of this phrase is an example of the more mechanical approach used in this Article. Midnight is selected as a termination point or time limit to obtain greater uniformity and definiteness than would be possible from other possible termination points, such as the close of the banking day or business day.

6. Subsection (1) (j): The term "settle" is a new term in bank collection language that has substantial importance throughout Article 4. In the American Bankers Association Bank Collection Code, in deferred posting statutes, in Federal Reserve regulations and operating letters, in clearing house rules, in agreements between banks and customers and in legends on deposit tickets and collection letters, there is repeated reference to "conditional" or "provisional" credits or payments. Tied in with this concept of credits or payments being in some way tentative, has been a related but somewhat different problem as to when an item is "paid" or "finally paid" either to determine the relative priority of the item as against attachments, stop payment orders and the like or in insolvency situations. There has been extensive litigation in the various states on these problems. To a substantial extent the confusion, the litigation and even the resulting court decisions fail to take into account that in the collection process some debits or credits are provisional or tentative and others are final and that very many debits or credits are provisional or tentative for a while but later become final. Similarly, some cases fail to recognize that within a single bank, particularly a payor bank, each item goes through a series of processes and that in a payor bank most of these processes are preliminary to the basic act of payment or "final payment".

The term "settle" is used as a convenient term to characterize a broad variety of conditional, provisional, tentative and also final payments of items. Such a comprehensive term is needed because it is frequently difficult or unnecessary to determine whether a particular action is tentative or final or when a particular credit shifts from the tentative class to the final class. Therefore, its use throughout the Article indicates that in that particular context it is unnecessary or unwise to determine whether the debit or the credit or the payment is tentative or final. However, when qualified by the adjective "provisional" its tentative nature is intended, and when qualified by the adjective "final" its permanent nature is intended.

Examples of the various types of settlement contemplated by the term include payments in cash; the efficient but somewhat complicated process of payment through the adjustment and off-setting of balances through clearing houses; debit or credit entries in accounts between banks; the forwarding of various types of remittance instruments, sometimes to cover a particular item but more frequently to cover an entire group of items received on a particular day.

7. Subsection (1) (k): "Suspends payments". This term is designed to afford an objective test to determine when a bank is no longer operating as a part of the banking system.

Definitional Cross References:

"Bank". § 1-201.
"Documents". § 1-201.
"Money". § 1-201.

"Negotiable". § 3-104.
"Notice". § 1-201.
"Person". § 1-201.
"Securities". § 8-102.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 4-105. **"Depositary Bank"; "Intermediary Bank"; "Collecting Bank"; "Payor Bank"; "Presenting Bank"; "Remitting Bank".** In this Article unless the context otherwise requires:

(a) "Depositary bank" means the first bank to which an item is transferred for collection even though it is also the payor bank;

(b) "Payor bank" means a bank by which an item is payable as drawn or accepted;

(c) "Intermediary bank" means any bank to which an item is transferred in course of collection except the depositary or payor bank;

(d) "Collecting bank" means any bank handling the item for collection except the payor bank;

(e) "Presenting bank" means any bank presenting an item except a payor bank;

(f) "Remitting bank" means any payor or intermediary bank remitting for an item.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. The definitions in general exclude a bank to which an item is issued, as such bank does not take by transfer except in the particular case covered where the item is issued to a payee for collection, as where a corporation is transferring balances from one account to another. Thus, the definition of "depositary bank" does not include the bank to which a check is made payable where a check is given in payment of a mortgage. Such a bank has the status of a payee under Article 3 on Commercial Paper and not that of a collecting bank.

2. The term payor bank includes a drawee bank and also a bank at which an item is payable if the item constitutes an order on the bank to pay, for it is then "payable by" the bank. If the "at" item is not an order in the particular state, (See § 3-121) then the bank is not a payor, but will be a presenting or collecting bank.

3. Items are sometimes drawn or accepted "payable through" a particular bank. Under this Section and § 3-120 the "payable through" bank (if it in fact handles the item) will be a collecting (and often a presenting) bank; it is not a "payor bank."

4. The term intermediary bank includes the last bank in the collection process where the payor is not a bank. Usually the last bank is also a presenting bank.

Cross References:
Article 3, especially §§ 3-120 and 3-121.

Definitional Cross References:
"Bank". § 1-201.
"Customer". § 4-104.
"Item". § 4-104.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 4-106. **Separate Office of a Bank.** A branch or separate office of a bank maintaining its own deposit ledgers is a separate bank for the purpose of computing the time within which and determining the place at or to which action may be taken or notices or orders shall be given under this Article and under Article 3.

(VALC Note: The words "maintaining its own deposit ledgers" are optional in the Official Text.)

COMMENT: Prior Uniform Statutory Provision: None; but see § 1, American Bankers Association Bank Collection Code.

Purposes: 1. A rule with respect to the status of a branch or separate office of a bank as a part of any statute on bank collections is highly desirable if not absolutely necessary. However, practices in the operations of branches and separate offices vary substantially in the different states and it has not been possible to find any single rule that is logically correct, fair in all situations and workable under all different types of practices.

2. In many states and for many purposes a branch or separate office of the bank needs to be treated as a separate bank. Many branches function as separate banks in the handling and payment of items and require time for doing so similar to that of a separate bank. This is particularly true where branch banking is permitted throughout a state or in different towns and cities. Similarly, where there is this separate functioning a particular branch or separate office is the only proper place for various types of action to be taken or orders or notices to be given. Examples include the drawing of a check on a particular branch by a customer whose account is carried at that branch; the presentment of that same check at that branch; the issuance of an order to the branch to stop payment on the check.

3. § 1 of the American Bankers Association Bank Collection Code provides simply: "A branch or office of any such bank shall be deemed a bank." Although this rule appears to be brief and simple, as applied to particular sections of the ABA Code it produces illogical and, in some cases, unreasonable results. For example, under § 11 of the ABA Code it seems anomalous for one branch of a bank to have charged an item to the account of the drawer and another branch to have the power to elect to treat the item as dishonored. Similar logical problems would flow from applying the same rule to Article 4. Warranties by one branch to another branch under § 4-207 (each considered a separate bank) do not make sense.

4. Assuming that it is not desirable to make each branch a separate bank for all purposes, this Section provides that a branch or separate office is a separate bank for certain purposes. In so doing the single legal entity of the bank as a whole is preserved, thereby carrying with it the liability of the institution as a whole on such obligations as it may be under. On the other hand, where the Article provides a number of time limits for different types of action by banks, if a branch functions as a separate bank, it should have the time limits available to a separate bank. Similarly if in its relations to customers a branch functions as a separate bank, notices and orders with respect to accounts of customers of the branch should be given at the branch. For example, whether a branch has notice sufficient to affect its status as a holder in due course of an item taken by it should depend upon what notice that branch has received with respect to the item. Similarly the receipt of a payment order at one branch should not be notice to another branch so as to impair the right of the second branch to be a holder in due course of the item, although in circumstances in which ordinary care requires the communication of a notice or order to the proper branch of a bank, such notice or order would be effective at such proper branch from the time it was or should have been received. See § 1-201(27).

5. Whether a branch functions as a separate bank may vary depending upon the type of activity taking place and upon practices in the different states. If the activity is that of a payor bank paying items, a branch will usually function as a separate bank if it maintains its own deposit ledgers. Similarly whether a branch functions as a separate bank in the collection of items usually depends also on whether it maintains its own deposit ledgers. Conversely, if a particular bank having branches does all of its bookkeeping at its head office, the branches of that bank do not usually function as separate banks either in the payment or collection of items.

On the other hand, in its relations to customers a branch may function as a separate bank regardless of whether it maintains its own deposit ledgers. Checks may be drawn on a particular branch and notices and stop orders delivered to that branch even though all the bookkeeping is done at the head office or another branch.

Where the words "maintaining its own deposit ledgers" are bracketed, the option is given to each state enacting the Code to include these words as a test of separateness. In those states where the maintainance by a branch of its own deposit ledgers will serve as a satisfactory standard, the bracketed words should be retained. In those states where these words will cause more problems than benefits, they may be deleted. Insofar as this latter rule allows extra time to banks maintaining branches

where such extra time is not needed, it is not ideal. However, it has not been found possible to find a rule that will meet this problem and will work in all cases. Further, it is highly unlikely that large banks maintaining branches will needlessly take advantage of extra time under this rule.

Cross References:

§§ 3-504, 4-102(2).

Definitional Cross References:

"Bank". § 1-201.
"Branch". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

COUNCIL COMMENT

Banks in Virginia have time deposit ledgers and demand deposit ledgers and it is possible in either instance for the ledger record to be either centralized or maintained in a branch. The handling and payment of items normally takes place at the point where the ledgers are maintained; hence our decision.

While there is no way for someone presenting an item to know where the ledgers are kept, yet from the standpoint of counting time it should begin from receipt at the office maintaining the ledgers. After all, they alone are able to act from the records at hand.

§ 4-107. **Time of Receipt of Items.** (1) For the purpose of allowing time to process items, prove balances and make the necessary entries on its books to determine its position for the day, a bank may fix an afternoon hour of two P.M. or later as a cut-off hour for the handling of money and items and the making of entries on its books.

(2) Any item or deposit of money received on any day after a cut-off hour so fixed or after the close of the banking day may be treated as being received at the opening of the next banking day.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. After an item has been received by a bank it goes through a series of processes varying with the type of item that it is. It moves from the teller's window, branch office, or mail desk at which it is received through settlement and proving departments until it is forwarded or presented to a clearing house or another bank, if it is a transit item, or until it reaches the bookkeeping department, if the bank receiving it is the payor bank. In addition, in order that the books of the bank always remain in balance while items are moving through it, the amount of each item is included in lists or proofs of debits or credits several times as it progresses through the bank. The running of proofs, the making of debit and credit entries in subsidiary and general ledgers and the striking of a general balance for each day requires a considerable amount of time. If these processes are to be completed on any particular day during normal working hours without the employment of night forces, a number of banks have found it necessary to establish a "cut-off hour" to allow time to obtain final figures to be incorporated into the bank's position for the day. Subsection (1) approves a cut-off hour of this type provided it is not earlier than 2 P. M. Subsection (2) provides that if such a cut-off hour is fixed, items received after the cut-off hour may be treated as being received at the opening of the next banking day. Where the number of items received either through the mail or over the counter tends to taper off radically as the afternoon hours progress, a 2 P. M. cut-off hour does not involve a large portion of the items received but at the same time permits a bank using such a cut-off hour to leave its doors open later in the afternoon without forcing into the evening the completion of its settling and proving process.

2. The alternative provision in Subsection (2) ~~that items~~ or deposits received after the close of the banking day may be treated ~~as received at~~ the opening of the next banking day is important ~~in cases~~ where a bank closes at twelve or one o'clock, e. g., on a Saturday, but continues ~~to receive~~ some items by mail or over the counter if, for example, it opens Saturday evening for the limited purpose of receiving deposits and cashing checks.

Definitional Cross References:

"Afternoon". § 4-104.
"Bank". § 1-201.
"Banking day". § 4-104.
"Item". § 4-104.
"Money". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 4-108. **Delays.** (1) Unless otherwise instructed, a collecting bank in a good faith effort to secure payment may, in the case of specific items and with or without the approval of any person involved, waive, modify or extend time limits imposed or permitted by this Act for a period not in excess of an additional banking day without discharge of secondary parties and without liability to its transferor or any prior party.

(2) Delay by a collecting bank or payor bank beyond time limits prescribed or permitted by this Act or by instructions is excused if caused by interruption of communication facilities, suspension of payments by another bank, war, emergency conditions or other circumstances beyond the control of the bank provided it exercises such diligence as the circumstances require.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. §§ 4-202(2), 4-212, 4-301 and 4-302 prescribe various time limits for the handling of items. These are the limits of time within which a bank, in fulfilment of its obligation to exercise ordinary care, must handle items entrusted to it for collection or payment. Under § 4-103 they may be varied by agreement or by Federal Reserve regulations or operating letters, clearing house rules, or the like.

2. Subsection (1) of this section permits a limited extension of these time limits in special cases. It permits collecting banks to grant, within a rather narrow field, an additional banking day and to do so with or without the approval of any interested party. Such one-day extension can only be granted in a good faith effort to secure payment and only with respect to specific items. It cannot be exercised if the customer instructs otherwise. Thus limited the escape provision should afford a limited degree of flexibility in special cases but should not interfere with the overall requirement and objective of speedy collections.

3. Notice that an extension granted under Subsection (1) is "without discharge of secondary parties". It therefore extends also the times for presentment or payment, as the case may be, specified in Article 3. See §§ 3-503 and 3-506. Where this Article and Article 3 conflict, this Article controls. See §§ 3-103(2) and 4-102(1).

4. Subsection (2) is another escape clause from time limits. This clause operates not only with respect to time limits imposed by the article itself but also time limits imposed by special instructions, by agreement or by Federal Reserve regulations or operating letters, clearing house rules or the like. The latter time limits are "permitted" by the Code. This clause operates, however, only in the types of situation specified. Examples of these situations include blizzards, floods, or hurricanes, and other "Act of God" events or conditions, and wrecks or disasters, interfering with mails; suspension of payments by another bank; abnormal operating conditions such as substantial increased volume or substantial shortage of personnel during war or emergency situations. When delay is sought to be excused under this subsection the bank must "exercise such diligence as the circumstances require" and it has the burden of proof. See § 4-202(2).

Cross References:

§§ 3-103(2), 3-503, 3-506, 4-102(1), 4-103, 4-104, 4-202(2), 4-212, 4-213, 4-301, 4-302.

Definitional Cross References:

"Bank". § 1-201.
"Banking day". § 4-104.
"Collecting bank". § 4-105.
"Good faith". § 1-201.
"Item". § 4-104.
"Party". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 4-109. **Process of Posting.** The "process of posting" means the usual procedure followed by a payor bank in determining to pay an item and in recording the payment including one or more of the following or other steps as determined by the bank:

(a) verification of any signature;

(b) ascertaining that sufficient funds are available;

(c) affixing a "paid" or other stamp;

(d) entering a charge or entry to a customer's account;

(e) correcting or reversing an entry or erroneous action with respect to the item.

COMMENT: **Prior Uniform Statutory Provisions:** None.

Purposes: Completion of the "process of posting" is one of the measuring points for determining when an item is finally paid (subsection (1) (c) of § 4-213) and when knowledge, notice, stop order, legal process and set-off come too late to affect a payor bank's right or duty to pay an item (subsection (1) (d) of § 4-303). This Section defines what is meant by the "process of posting". It is the "usual procedure followed by a payor bank in determining to pay an item and in recording the payment . . .". It involves the two basic elements of some decision to pay and some recording of the payment with a listing of some of the typical steps that might be involved. Procedures followed by banks in determining to pay an item and in recording the payment vary. Examples of some of these procedures will illustrate what is meant by completion of the "process of posting".

Example 1. A payor bank receives an item through the clearing on Monday morning. It is sorted under the name of the customer on Monday and under deferred posting routines (§ 4-301) reaches the bookkeeper for that customer on Tuesday morning. The bookkeeper examines the signature, verifies there are sufficient funds and decides at 11 A. M. on Tuesday to pay the item. A debit entry for or including the amount of the item is entered in the customer's account at 12 noon on Tuesday. The process of posting is completed at 12 noon on Tuesday.

Example 2. A payor bank with branches receives an item through the clearing on Monday morning. One branch does all the bookkeeping for itself and nine other branches. The item is sent to that branch and a provisional debit is entered to the customer's account for the amount of the item on Monday. After this entry is made the item is sent to the branch where the customer transacts business and at this branch a clerk verifies the signature on Tuesday, e.g. at 12 noon. If the clerk determines the signature is valid and makes a decision to pay, the process of posting is completed at 12 noon on Tuesday because there has been both a charge to the customer's account and a determination to pay. If, however, the clerk determines the signature is not valid or that the item should not be paid for some other reason, the item is then returned to the presenting bank through the clearing house and an offsetting credit entry is made in the customer's account by the bookkeeping branch. In this case there has been no determination to pay the item, no completion of the process of posting and no payment of the item.

Example 3. A payor bank receives in the mail on Monday an item drawn upon it. The item is sorted and otherwise processed on Monday and during Monday night is provisionally recorded on tape by an electronic computer as charged to the customer's account. On Tuesday a clerk examines the signature on the item and makes other checks to determine finally whether the item should be paid. If the clerk determines the signature is valid and makes a decision to pay and all processing of

this item is complete, e. g., at 12 noon on Tuesday, the "process of posting" is completed at that time. If, however, the clerk determines the signature is not valid or that the item should not be paid for some other reason, the item is returned to the presenting bank and in the regular Tuesday night run of the computer the debit to the customer's account for the item is reversed or an offsetting credit entry is made. In this case, as in Example 2, there has been no determination to pay the item, no completion of the process of posting and no payment of the item.

Cross References:

§§ 4-213(1) (c), 4-303(1) (d).

Definitional Cross References:

"Account". § 4-104(1) (a).
"Customer". § 4-104(1) (e).
"Item". § 4-104(1) (g).
"Payor bank". § 4-105(b).

VIRGINIA ANNOTATIONS

Prior Statutes: None.

PART 2

COLLECTION OF ITEMS; DEPOSITARY AND COLLECTING BANKS

§ 4-201. Presumption and Duration of Agency Status of Collecting Banks and Provisional Status of Credits; Applicability of Article; Item Indorsed "Pay Any Bank". (1) Unless a contrary intent clearly appears and prior to the time that a settlement given by a collecting bank for an item is or becomes final (subsection (3) of § 4-211 and §§ 4-212 and 4-213) the bank is an agent or sub-agent of the owner of the item and any settlement given for the item is provisional. This provision applies regardless of the form of indorsement or lack of indorsement and even though credit given for the item is subject to immediate withdrawal as of right or is in fact withdrawn; but the continuance of ownership of an item by its owner and any rights of the owner to proceeds of the item are subject to rights of a collecting bank such as those resulting from outstanding advances on the item and valid rights of setoff. When an item is handled by banks for purposes of presentment, payment and collection, the relevant provisions of this Article apply even though action of parties clearly establishes that a particular bank has purchased the item and is the owner of it.

(2) After an item has been indorsed with the words "pay any bank" or the like, only a bank may acquire the rights of a holder

(a) until the item has been returned to the customer initiating collection; or

(b) until the item has been specially indorsed by a bank to a person who is not a bank.

COMMENT: Prior Uniform Statutory Provision: None; but see §§ 2 and 4 of the American Bankers Association Bank Collection Code.

Purposes: 1. This section states certain basic rules and presumptions of the bank collection process. One basic rule, appearing in the last sentence of subsection (1), is that, to the extent applicable, the provisions of the Article govern without regard to whether a bank handling an item owns the item or is an agent for collection. Historically, much time has been spent and effort expended in determining or attempting to determine whether a bank was a purchaser of an item or merely an agent for collection. See discussion of this subject and cases cited in 11 A.L.R. 1043, 16 A.L.R. 1084, 42 A.L.R. 492, 68 A.L.R. 725, 99 A.L.R. 486. See also § 4 of

the American Bankers Association Bank Collection Code. The general approach of Article 4, similar to that of other articles, is to provide, within reasonable limits, rules or answers to major problems known to exist in the bank collection process without regard to questions of status and ownership but to keep general principles such as status and ownership available to cover residual areas not covered by specific rules. In line with this approach, the last sentence of subsection (1) says in effect that Article 4 applies to practically every item moving through banks for the purpose of presentment, payment or collection.

2. Within this general rule of broad coverage, the first two sentences of subsection (1) state a rule of status in terms of a strong presumption. "Unless a contrary intent clearly appears" the status of a collecting bank is that of an agent or subagent for the owner of the item. Although as indicated in Comment 1 it is much less important under Article 4 to determine status than has been the case heretofore, such status may have importance in some residual areas not covered by specific rules. Further, where status has been considered so important in the past, to omit all reference to it might cause confusion. The presumption of agency "applies regardless of the form of indorsement or lack of indorsement and even though credit given for the item is subject to immediate withdrawal as of right or is in fact withdrawn". Thus questions heretofore litigated as to whether ordinary indorsements "for deposit", "for collection" or in blank have the effect of creating an agency status or a purchase, no longer have significance in varying the prima facie rule of agency. Similarly, the nature of the credit given for an item or whether it is subject to immediate withdrawal as of right or is in fact withdrawn, do not rebut the general presumption. See A.L.R. references supra in Comment 1.

A contrary intent can rebut the presumption but this must be clear. An example of a clear contrary intent would be if collateral papers established or the item bore a legend stating that the item was sold absolutely to the depositary bank.

3. The prima facie agency status of collecting banks is consistent with prevailing law and practice today. § 2 of the American Bankers Association Bank Collection Code so provides. Legends on deposit tickets, collection letters and acknowledgements of items and Federal Reserve operating letters consistently so provide. The status is consistent with rights of charge-back (§ 4-212 and § 11 of the ABA Code) and risk of loss in the event of insolvency (§ 4-214 and § 13 of the ABA Code).

4. Affirmative statement of a prima facie agency status for collecting banks requires certain limitations and qualifications. Under current practices substantially all bank collections sooner or later merge into bank credits, at least if collection is effected. Usually, this takes place within a few days of the initiation of collection. An intermediary bank receives final collection and evidences the result of its collection by a "credit" on its books to the depositary bank. The depositary bank evidences the results of its collection by a "credit" in the account of its customer. As used in these instances the term "credit" clearly indicates a debtor-creditor relationship. At some stage in the bank collection process the agency status of a collecting bank changes to that of debtor, a debtor of its customer. Usually at about the same time it also becomes a creditor for the amount of the item, a creditor of some intermediary, payor or other bank. Thus the collection is completed, all agency aspects are terminated and the identity of the item has become completely merged in bank accounts, that of the customer with the depositary bank and that of one bank with another.

Although § 4-213(1) provides that an item is finally paid when the payor bank takes certain action with respect to the item such final payment of the item may or may not result in the simultaneous *final settlement* for the item in the case of all prior parties. If a series of provisional debits and credits for the item have been entered in accounts between banks, the final payment of the item by the payor bank may result in the automatic firming up of all these provisional debits and credits under § 4-213(2), and the consequent receipt of final settlement for the item by each collecting bank and the customer of the depositary bank simultaneously with such action of the payor bank. However, if the payor bank or some intermediary bank accounts for the item with a remittance draft, the next prior bank usually does not receive final settlement for the item until such remittance draft finally clears. See § 4-211(3)(a). The first sentence of subsection (1) provides that the agency status of a collecting bank (whether intermediary or depositary) continues until the settlement *given by it for the item* is or becomes final, referring to §§ 4-211(3), 4-212, and 4-213. In the case of the series of provisional credits covered by § 4-213(2), this could be simultaneously with the final payment of the item by the payor bank. In cases where remittance drafts are used or in straight non-cash collections, this would not be until the times specified in §§ 4-211(3) and 4-213(3).

A number of practical results flow from this rule continuing the agency status of a collecting bank until its settlement for the item is or becomes final, some of which are specifically set forth in this Article. One is that risk of loss continues in the owner of the item rather than the agent bank. See § 4-212. Offsetting rights favorable to the owner are that pending such final settlment, the owner has the preference rights of § 4-214 and the direct rights of § 4-302 against the payor bank. It also follows from this rule that the dollar limitations of Federal Deposit Insurance are measured by the claim of the owner of the item rather than that of the collecting bank.

5. In those cases where some period of time elapses between the final payment of the item by the payor bank and the time that the settlement of the collecting bank is or becomes final, e. g., where the payor bank or intermediary bank accounts for the item with a remittance draft or in straight non-cash collections, the continuance of the agency status of the collecting bank necessarily carries with it the continuance of the owner's status as principal. The second sentence of subsection (1) provides that whatever rights the owner has to proceeds of the item are subject to the rights of collecting banks for outstanding advances on the item and other valid rights, if any. The rule provides a sound rule to govern cases of attempted attachment of proceeds of a non-cash item in the hands of the payor bank as property of the absent owner. If a collecting bank has made an advance on an item which is still outstanding, its right to obtain reimbursement for this advance should be superior to the rights of the owner to the proceeds or to the rights of a creditor of the owner. The phrase "other valid rights, if any" is broad enough to cover legitimate rights of set-off of accounts between banks without attempting to provide that all set-offs may be valid. An intentional crediting of proceeds of an item to the account of a prior bank known to be insolvent, for the purpose of acquiring a right of set-off, would not produce a valid set-off. See 8 Zollman, Banks and Banking (1936) § 5443.

6. This section and Article 4 as a whole represent an intentional abandonment of the approach to bank collection problems appearing in § 4 of the American Bankers Association Bank Collection Code. Where the tremendous volume of items handled makes impossible the examination by all banks of all indorsements on all items and where in fact this examination is not made, except perhaps by depositary banks, it is unrealistic to base the rights and duties of all banks in the collection chain on variations in the form of indorsements. It is anomalous to provide throughout the ABA Code that the prima facie status of collecting banks is that of agent or sub-agent but in § 4 to provide that subsequent holders (sub-agents) shall have the right to rely on the presumption that the bank of deposit (the primary agent) is the owner of the item. It is unrealistic, particularly in this background, to base rights and duties on status of agent or owner. This § 4-201 makes the pertinent provisions of Article 4 applicable to substantially all items handled by banks for presentment, payment or collection, recognizes the prima facie status of most banks as agents, and then seeks to state appropriate limits and some attributes to the general rules and presumptions so expressed.

7. Subsection (2) protects the ownership rights with respect to an item indorsed "pay any bank or banker" or in similar terms of a customer initiating collection or of any bank acquiring a security interest under § 4-208, in the event the item is subsequently acquired under improper circumstances by a person who is not a bank and transferred by that person to another person, whether or not a bank. Upon return to the customer initiating collection of an item so indorsed, indorsement may be cancelled (§ 3-208). A bank holding an item so indorsed may transfer the item out of banking channels by special indorsement; however, under § 4-103(5), such bank would be liable to the owner of the item for any loss resulting therefrom if the transfer had been made in bad faith or with lack of ordinary care. If briefer and more simple forms of bank indorsements are developed under § 4-206 (e. g., the use of bank transit numbers in lieu of present lengthy forms of bank indorsements), a depositary bank having the transit number "X100" could make subsection (2) operative by indorsements such as "Pay any bank-X100".

Cross References:

§§ 3-206, 3-208, 4-103, 4-206, 4-208, 4-212, 4-213, 4-214, 4-302.

Definitional Cross References:

"Bank". § 1-201.
"Collecting bank". § 4-105.
"Customer". § 4-104.
"Depositary bank". § 4-105.
"Holder". § 1-201.

"Item". § 4-104.
"Indorsements". §§ 3-202, 3-204, 3-205 and 3-206.
"Person". § 1-201.
"Settle". § 4-104.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: The considerably litigated question of whether a bank takes an item as purchaser or as agent for collection is settled under the UCC in favor of the view that the bank always takes "for collection" unless a contrary intent clearly appears. The form of the indorsement is immaterial. It may be, though, that the same problem remains under a somewhat different name.

The problem often arises in this manner: A seller sends goods to a buyer, drawing a draft on the buyer, attaching a bill of lading and perhaps other documents, and places them with his bank for collection. The draft with documents is forwarded to another bank for collection. That bank collects the proceeds from the buyer, but immediately thereafter the buyer, considering the goods not up to contract, attaches the proceeds while they are still in the hands of the collecting bank. Elkhart State Bank v. Bristol Broom Co., 143 Va. 1, 129 S.E. 371 (1925); Greensburg Nat'l Bank v. C. Syer & Co., 113 Va. 53, 73 S.E. 438 (1912); Lynchburg Milling Co. v. Nat'l Exchange Bank, 109 Va. 639, 64 S.E. 980 (1909). Or, a third person, who has no connection with the transaction, attaches the proceeds. Fourth Nat'l Bank v. Bragg, 127 Va. 47, 102 S.E. 649 (1920); Buckeye Nat'l Bank v. Huff & Cook, 114 Va. 1, 75 S. E. 769 (1912). The virtue of this procedure is that the buyer, or the third person, can enforce his claim in his own home area—to the extent of the proceeds of the draft—and so does not have to seek a remedy against the seller in the seller's own jurisdiction. The depositary bank, in which the seller initially deposited the draft, may intervene claiming the proceeds for itself. Under prior law, the party that would succeed was generally determined by ascertaining whether the depositary bank purchased the draft or only took it as an agent for collection. Under the UCC a somewhat similar question can arise, but it will be phrased in terms of the rights of the collecting bank, such as whether the bank under UCC 4-208 has a security interest in the proceeds.

Previously, the form of an indorsement and the entry made on a deposit slip by the original owner of the draft have been considered of large significance in determining whether a bank was a purchaser or an agent. Fourth Nat'l Bank v. Bragg, 127 Va. 47, 102 S.E. 649 (1920); Greenburg Nat'l Bank v. C. Syer & Co., 113 Va. 53, 73 S.E. 438 (1912). These forms are no longer of significance under the UCC.

Virginia has not attached any particular significance to the form of indorsement placed on the draft by the depositary bank itself, or to a right of recourse by the depositary bank against the drawer of the draft. Fourth Nat'l Bank v. Bragg, 127 Va. 47, 102 S.E. 649 (1920); Lynchburg Milling Co. v. Nat'l Exchange Bank, 109 Va. 639, 64 S.E. 980 (1909). This aspect of the Virginia approach is consistent with the UCC.

The UCC does not expressly cover drafts in which the depositary bank is named as payee. Virginia has held that when the draft is drawn payable to the depositary bank, the bank is prima facie the owner. First Wisconsin Nat'l Bank v. People's Nat'l Bank, 136 Va. 276, 283-84, 118 S.E. 82 (1923); Lynchburg Milling Co. v. Nat'l Exchange Bank, 109 Va. 639, 64 S.E. 980 (1909). It may be that such an instrument, under the UCC, shows a clear intent that the depositary bank is to be the owner.

In Fine v. Receiver of Dickenson County Bank, 163 Va. 157, 175 S.E. 863, 94 A.L.R. 1393 (1934), a customer was held entitled to the proceeds of a check deposited for collection as against the receiver of the insolvent depositary bank, the deposit slip stating that the bank was acting only as a collection agent. A similar result would be reached under the UCC, even without the deposit slip statement. Under UCC 4-214 the owner of the item is given a preference.

§ 4-202. Responsibility for Collection; When Action Seasonable. (1) A collecting bank must use ordinary care in

(a) presenting an item or sending it for presentment; and

(b) sending notice of dishonor or non-payment or returning an item other than a documentary draft to the bank's transferor or directly to the depositary bank under subsection (2) of § 4-212 after learning that the item has not been paid or accepted, as the case may be; and

(c) settling for an item when the bank receives final settlement; and

(d) making or providing for any necessary protest; and

(e) notifying its transferor of any loss or delay in transit within a reasonable time after discovery thereof.

(2) A collecting bank taking proper action before its midnight deadline following receipt of an item, notice or payment acts seasonably; taking proper action within a reasonably longer time may be seasonable but the bank has the burden of so establishing.

(3) Subject to subsection (1) (a), a bank is not liable for the insolvency, neglect, misconduct, mistake or default of another bank or person or for loss or destruction of an item in transit or in the possession of others.

(VALC Note: The words "or directly to the depositary bank under subsection (2) of § 4-212" are optional in the Official Text.)

COMMENT: Prior Uniform Statutory Provision: None; but see §§ 5 and 6, American Bankers Association Bank Collection Code.

Purposes: 1. Subsection (1) states the basic responsibilities of a collecting bank. Of course, under § 1-203 a collecting bank is subject to the standard requirement of good faith. By subsection (1) it must also use ordinary care in the exercise of its basic collection tasks. By § 4-103(1) neither requirement may be disclaimed.

2. If the bank makes presentment itself, subsection 1(a) requires ordinary care with respect both to the time and manner of presentment. (§§ 3-503, 3-504, 4-210.) If it forwards the item to be presented the subsection requires ordinary care with respect to routing (§ 4-204), and also in the selection of intermediary banks or other agents.

3. Subsection (1) describes *types* of basic action with respect to which a collecting bank must use ordinary care. Subsection (2) deals with the *time* for taking action. It first prescribes the general standard for seasonable action, namely, for items received on Monday, proper action (such as forwarding or presenting) on Monday or Tuesday is seasonable. Although under current "production line" operations banks customarily move items along on regular schedules substantially briefer than two days, the subsection states an outside time within which a bank may know it has acted seasonably. To provide flexibility from this standard norm, the subsection further states that action within a reasonably longer time may be seasonable but the bank has the burden of proof. In the case of time items, action after the midnight deadline, but sufficiently in advance of maturity for proper presentation, is a clear example of a "reasonably longer time" that is seasonable. The standard of requiring action not later than Tuesday in the case of Monday items is also subject to possibilities of variation under the general provisions of § 4-103, or under the special provisions regarding time of receipt of items (§ 4-107), and regarding delays (§ 4-108). This subsection (2) deals only with collecting banks. The time limits applicable to payor banks appear in §§ 4-301 and 4-302.

4. At common law the so-called New York collection rule subjected the initial collecting bank to liability for the actions of subsequent banks in the collection chain; the so-called Massachusetts rule was that each bank, subject to the duty of selecting proper intermediaries, was liable only for its own negligence. Subsection (3) adopts the Massachusetts rule. But since this is stated to be subject to subsection (1)(a) a collecting bank remains responsible for using ordinary care in selecting properly qualified intermediary banks and agents and in giving proper instructions to them.

Cross References:

§§ 1-203, 4-103, 4-107, 4-108, 4-301 and 4-302.

Definitional Cross References:

"Collecting bank". § 4-105.
"Depositary bank". § 4-105.
"Documentary draft". § 4-104.
"Item". § 4-104.
"Midnight deadline". § 4-104.
"Presentment". Article 3, Part 5.
"Protest". § 3-509.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-63.

Comment: This section is in accord with Code 1950, § 6-63, which authorizes direct forwarding to a payor bank for collection, in requiring the collecting bank to use due diligence in other respects in the collection of the item.

Under the UCC the collecting bank must use ordinary care in settling for an item when the bank has received final payment. This is in accord with the general views expressed in First Wisconsin Nat'l Bank v. People's Nat'l Bank, 136 Va. 276, 284-88, 118 S.E. 82 (1923). In this case a collecting bank was found to be negligent in failing to remit proceeds of a draft collected from a non-bank payor, in that it held the proceeds for six days, during which time they were attached. The Supreme Court of Appeals also thought the bank was negligent in not promptly informing its principal of an adverse claim to the proceeds; in not disclosing its agency to the court during the attachment proceedings; and in neither employing counsel at its principal's request, or notifying the principal of its refusal to do so. The UCC is silent as respects these other duties owed by a collecting bank to its principal.

A collecting bank must use ordinary care in giving notice of dishonor or non-payment or returning the item after learning that it has not been paid or accepted. This is in accord with the views expressed in Smith v. Bank of Glade Springs, 12 F.2d 535, 538-39, (4th Cir. 1926), in which it was held that the bank did exercise ordinary care and reasonable diligence in giving notice of dishonor.

COUNCIL COMMENT

The optional language is necessary in view of the adoption of the optional subsection in § 4-212.

§ 4-203. Effect of Instructions. Subject to the provisions of Article 3 concerning conversion of instruments (§ 3-419) and the provisions of both Article 3 and this Article concerning restrictive indorsements only a collecting bank's transferor can give instructions which affect the bank or constitute notice to it and a collecting bank is not liable to prior parties for any action taken pursuant to such instructions or in accordance with any agreement with its transferor.

COMMENT: Prior Uniform Statutory Provision: None; but see § 2 of the American Bankers Association Bank Collection Code.

Purposes: This Section adopts a "chain of command" theory which renders it unnecessary for an intermediary or collecting bank to determine whether its transferor is "authorized" to give the instructions. Equally the bank is not put on notice of any "revocation of authority" or "lack of authority" by notice received from any other person. The desirability of speed in the collection process and the fact that, by reason of advances made, the transferor may have the paramount interest in the item requires the rule.

The Section is made subject to the provisions of Article 3 concerning conversion of instruments (§ 3-419) and other provisions of Article 3 and this Article concerning restrictive indorsements (§§ 3-205, 3-206, 3-419, 3-603, 4-205). Of course instructions from or an agreement with its transferor does not relieve a collecting bank of its general obligation to exercise good faith and ordinary care. See § 4-103(1). If in any particular case a bank has exercised good faith and ordinary care and is relieved of responsibility by reason of instructions of or an agreement with its transferor, the owner of the item may still have a remedy for loss against the transferor (another bank) if such transferor has given wrongful instructions. The rules of the Section are applied only to collecting banks. Payor banks always have the problem of making proper payment of an item; whether such payment is proper should be based upon all of the rules of Articles 3 and 4 and all of the facts of any particular case, and should not be dependent exclusively upon instructions from or an agreement with a person presenting the item.

Cross References:

§§ 3-205, 3-206, 3-419, 3-603, 4-103(1) and 4-205.

Definitional Cross References:

"Collecting bank". § 4-105.
"Restrictive indorsement". § 3-205.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 4-204. Methods of Sending and Presenting; Sending Direct to Payor Bank. (1) A collecting bank must send items by reasonably prompt method taking into consideration any relevant instructions, the nature of the item, the number of such items on hand, and the cost of collection involved and the method generally used by it or others to present such items.

(2) A collecting bank may send

(a) any item direct to the payor bank;

(b) any item to any non-bank payor if authorized by its transferor; and

(c) any item other than documentary drafts to any non-bank payor, if authorized by Federal Reserve regulation or operating letter, clearing house rule or the like.

(3) Presentment may be made by a presenting bank at a place where the payor bank has requested that presentment be made.

COMMENT: **Prior Uniform Statutory Provision:** None; but see § 6, American Bankers Association Bank Collection Code.

Purposes: 1. Subsection (1) prescribes the general standards applicable to proper sending or forwarding of items. Because of the many types of methods available and the desirability of preserving flexibility any attempt to prescribe limited or precise methods is avoided.

2. Subsection (2) (a) codifies the practice of direct mail, express, messenger or like presentment to payor banks. The practice is now country-wide and is justified by the need for speed, the general responsibility of banks, Federal Deposit Insurance protection and other reasons.

3. Full approval of the practice of direct sending is limited to cases where a bank is a payor. Where non-bank drawees or payors may be of unknown responsibility, substantial risks may be attached to placing in their hands the instruments calling for payments from them. This is obviously so in the case of documentary drafts. However, in some cities practices have long existed under clearing house procedures to forward certain types of items to certain non-bank payors. Examples include insurance loss drafts drawn by field agents on home offices. For the purpose of leaving the door open to legitimate practices of this kind, subsection (2) (c) affirmatively approves direct sending of any item other than documentary drafts to any non-bank payor, if authorized by Federal Reserve regulation or operating letter, clearing house rule or the like.

On the other hand sub-section (2)(b) approves sending any item direct to a non-bank payor if authorized by a collecting bank's transferor. This permits special instructions or agreements out of the norm and is consistent with the "chain of command" theory of § 4-203. However, if a transferor other than the owner of the item, e. g., a prior collecting bank, authorizes a direct sending to a non-bank payor, such transferor assumes responsibility for the propriety or impropriety of such authorization.

4. § 3-504 states how presentment is made and subsection (2) of that Section affirmatively approves three specific methods by which presentment may be made. The methods so specified are permissive and do not foreclose other possible methods. However, in view of the substantial increase in recent years of presentment at centralized bookkeeping centers and electronic processing centers maintained or used by payor banks, many of which are at locations other than the banks themselves, subsection (3) specifically approves presentment by a presenting bank at any place requested by the payor bank.

Cross References:

§§ 3-504, 4-501 and 4-502.

Definitional Cross References:

"Collecting bank". § 4-105.
"Documentary draft". § 4-104.
"Item". § 4-104.
"Payor bank'. § 4-105.
"Presenting bank". § 4-105.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-63.

Comment: The UCC is in accord with Code 1950, § 6-63, which authorizes a collecting bank to forward an item directly to the payor bank. The Virginia statute also gives a preference, if the payor bank fails before a check or draft given in payment is finally paid. UCC 4-214 contains a more general provision regarding insolvency. See VIRGINIA ANNOTATIONS to UCC 4-214.

In Federal Reserve Bank of Richmond v. Peters, 139 Va. 45, 54, 123 S.E. 379 (1924), the Supreme Court of Appeals said, "When a bank receives from its correspondent a check upon itself it is an agent for its correspondent to make a presentation to itself." The UCC accomplishes the same result, more directly.

§ 4-205. **Supplying Missing Indorsement; No Notice from Prior Indorsement.** (1) A depositary bank which has taken an item for collection may supply any indorsement of the customer which is necessary to title unless the item contains the words "payee's indorsement required" or the like. In the absence of such a requirement a statement placed on the item by the depositary bank to the effect that the item was deposited by a customer or credited to his account is effective as the customer's indorsement.

(2) An intermediary bank, or payor bank which is not a depositary bank, is neither given notice nor otherwise affected by a restrictive indorsement of any person except the bank's immediate transferor.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. Subsection (1) is designed to speed up collections by eliminating any necessity to return to a non-bank depositor any items he may have failed to indorse.

2. For the purpose of permitting items to move rapidly through banking channels, intermediary banks and payor banks which are not also depositary banks are permitted to ignore restrictive indorsements of any person except the bank's immediate transferor. However, depositary banks may not so ignore restrictive indorsements. If an owner of an item indorses it "for deposit" or "for collection" he usually does so in the belief such indorsement will guard against further negotiation of the item to a holder in due course by a finder or a thief. This belief is reasonably justified if at least one bank in any chain of banks, collecting the item has a responsibility to act consistently with the indorsement.

Cross References:

§§ 3-205, 3-206, 3-419, 3-603, 4-203.

Definitional Cross References:

"Collecting bank". § 4-105.
"Customer". § 4-104.
"Depositary bank". § 4-105.
"Intermediary bank". § 4-105.
"Item". § 4-104.
"Payor bank". § 4-105.
"Restrictive indorsement". § 3-205.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 4-206. **Transfer Between Banks.** Any agreed method which identifies the transferor bank is sufficient for the item's further transfer to another bank.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: This section is designed to permit the simplest possible form of transfer from one bank to another, once an item gets in the bank collection chain, provided only identity of the transferor bank is preserved. This is important for tracing purposes and if recourse is necessary. However, since the responsibilities of the various banks appear in the Article it becomes unnecessary to have liability or

responsibility depend on more formal indorsements. Simplicity in the form of transfer is conducive to speed. Where the transfer is between banks this section takes the place of the more formal requirements of § 3-202.

Cross References:
§§ 3-201, 3-202.

Definitional Cross References:
"Bank". § 1-201.
"Item". § 4-104.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 4-207. Warranties of Customer and Collecting Bank on Transfer or Presentment of Items; Time for Claims. (1) Each customer or collecting bank who obtains payment or acceptance of an item and each prior customer and collecting bank warrants to the payor bank or other payor who in good faith pays or accepts the item that

(a) he has a good title to the item or is authorized to obtain payment or acceptance on behalf of one who has a good title; and

(b) he has no knowledge that the signature of the maker or drawer is unauthorized, except that this warranty is not given by any customer or collecting bank that is a holder in due course and acts in good faith

(i) to a maker with respect to the maker's own signature; or

(ii) to a drawer with respect to the drawer's own signature, whether or not the drawer is also the drawee; or

(iii) to an acceptor of an item if the holder in due course took the item after the acceptance or obtained the acceptance without knowledge that the drawer's signature was unauthorized; and

(c) the item has not been materially altered, except that this warranty is not given by any customer or collecting bank that is a holder in due course and acts in good faith

(i) to the maker of a note; or

(ii) to the drawer of a draft whether or not the drawer is also the drawee; or

(iii) to the acceptor of an item with respect to an alteration made prior to the acceptance if the holder in due course took the item after the acceptance, even though the acceptance provided "payable as originally drawn" or equivalent terms; or

(iv) to the acceptor of an item with respect to an alteration made after the acceptance.

(2) Each customer and collecting bank who transfers an item and receives a settlement or other consideration for it warrants to his transferee and to any subsequent collecting bank who takes the item in good faith that

(a) he has a good title to the item or is authorized to obtain payment or acceptance on behalf of one who has a good title and the transfer is otherwise rightful; and

(b) all signatures are genuine or authorized; and

(c) the item has not been materially altered; and

(d) no defense of any party is good against him; and

(e) he has no knowledge of any insolvency proceeding instituted with respect to the maker or acceptor or the drawer of an unaccepted item.

In addition each customer and collecting bank so transferring an item and receiving a settlement or other consideration engages that upon dishonor and any necessary notice of dishonor and protest he will take up the item.

(3) The warranties and the engagement to honor set forth in the two preceding subsections arise notwithstanding the absence of indorsement or words of guaranty or warranty in the transfer or presentment and a collecting bank remains liable for their breach despite remittance to its transferor. Damages for breach of such warranties or engagement to honor shall not exceed the consideration received by the customer or collecting bank responsible plus finance charges and expenses related to the item, if any.

(4) Unless a claim for breach of warranty under this section is made within a reasonable time after the person claiming learns of the breach, the person liable is discharged to the extent of any loss caused by the delay in making claim.

COMMENT: **Prior Uniform Statutory Provision:** None; but see American Bankers Association Bank Collection Code, § 4.

Purposes: 1. Subject to certain exceptions peculiar to the bank collection process and except that they apply only to customers and collecting banks, the warranties and engagements to honor in this section are identical in substance with those provided in the Article on Commercial Paper (Article 3). See §§ 3-414, 3-417. For a more complete explanation of the purposes of these warranties and engagements see the Comments to §§ 3-414 and 3-417.

2. In addition to imposing upon customers and collecting banks the warranties and engagements imposed by the original §§ 65 and 66 of the Uniform Negotiable Instruments Law and those of §§ 3-414 and 3-417 of Article 3, with some variations, this § 4-207 is intended to give the effect presently obtained in bank collections by the words "prior indorsements guaranteed" in collection transfers and presentments between banks. The warranties and engagements arise automatically as a part of the bank collection process. Receipt of a settlement or other consideration by a customer or collecting bank is a requirement but any settlement is sufficient regardless of whether the settlement is concurrent with the transfer, as in the case of a cash item, or delayed, as in the case of a non-cash straight collection item. Further, the warranties and engagements run with the item with the result that a collecting bank may sue a remote prior collecting bank or a remote customer and thus avoid multiplicity of suits. This section is also intended to make it clear that the so-called equitable defense of "payment over" does not apply to a collecting bank and that no statute of frauds provision will defeat recovery. Subsections (2) and (3) indicate that these results are intended notwithstanding the absence of indorsement or words of guarantee or warranty in a transfer or presentment. Consequently, if for purposes of simplification or the speeding up of the bank collection process, banks desire to cut down the length or size of indorsements (§ 4-206), they may do so and the standard warranties and engagements to honor still apply.

3. With respect to the exceptions to the warranties in favor of a holder in due course specified in sub-paragraphs (b) and (c) of subsection (1), collecting banks usually have holder in due course status (§§ 4-208, 4-209). However, if in any case there is a holder in due course but a subsequent collecting bank does not have holder in due course status (e. g., in a straight non-cash collection where no settlement of any kind is made until the bank itself receives final settlement) the bank still has the benefit of the exceptions (if it acts in good faith) under the shelter of § 3-201. It is to be noted that these shelter provisions, by virtue of successive transfers, benefit not only the immediate transferee from a holder in due course but also subsequent transferees.

4. In this section as in § 3-417, the (a), (b) and (c) warranties to transferees and collecting banks under subsection (2) are in general similar to the (a), (b) and (c) warranties to payors under subsection (1); but the warranties to payors are less inclusive because of exceptions reflecting the rule of Price v. Neal, 3 Burr. 1354 (1762), and related principles. See Comment to § 3-417. Thus collecting banks are given not only all the warranties given to payors by subsection (1), without those exceptions, but also the (d) and (e) warranties of subsection (2).

5. The last sentence of subsection (3) provides that damages for breach of warranties or the engagement to honor shall not exceed the consideration received by the customer or collecting bank responsible "plus finance charges and expenses related to the item, if any". The "expenses" referred to in this phrase may be ordinary collecting expenses and in appropriate cases could also include such expenses as attorneys fees. "Finance charges" are also referred to because in some cases interest or a finance charge is charged by the collecting bank for the time that the bank's advance on the item is outstanding prior to receipt of proceeds of collection. An example of this type of case would be where a bank undertakes a foreign collection in South America or Europe and makes an advance on the item at the time of receipt but may not receive proceeds of the foreign collection for three months or more.

Cross References:

§§ 3-201, 3-414, 3-417, 3-418, 4-206, 4-208, 4-209 and 4-406.

Definitional Cross References:

"Collecting bank". § 4-105.
"Customer". § 4-104.
"Draft". § 3-104.
"Genuine". § 1-201.
"Good faith". § 1-201.
"Holder". § 1-201.
"Holder in due course". § 3-302.
"Insolvency proceedings". § 1-201.
"Item". § 4-104.
"Party". § 1-201.
"Payor bank". § 4-105.
"Person". § 1-201.
"Presentment". § 3-504.
"Protest". § 3-509.
"Unauthorized signature". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-417 (NIL 65), 6-421 (NIL 69).

Comment: The warranties imposed by this section are similar in substance to the warranties imposed under UCC 3-417, but their application to particular factual situations, often complex, is not always clear.

The section is in accord with Main Street Bank v. Planters Nat'l Bank, 116 Va. 137, 81 S.E. 24 (1914), which held that an indorser warrants the genuineness of signatures. It also appears to be consistent with Commercial Savings Bank v. Maher, 202 Va. 286, 117 S.E. 2d 120 (1960), although this case did not decide on which party a loss would ultimately fall.

In Commercial Savings Bank v. Maher, 202 Va. 286, 117 S.E. 2d 120 (1960), a deed of trust and a bearer negotiable instrument for $6,000 were transferred to the Shenandoah bank in exchange for a bank check payable to the order of Stella Maher. This instrument was indorsed, "Deposit to credit of Stella Maher," also rubberstamped, "For Deposit Only Shawnee Building and Loan Association, Inc.". In this form it was transferred to the Commercial bank, which deposited the proceeds to the account of Shawnee. Commercial indorsed the check, "Pay to the order of any Bank or Trust Company. All Prior Endorsements Guaranteed, March 4, 1955. The Commercial and Savings Bank, Winchester, Virginia." In this form it was presented to the Shenandoah bank and paid. Stella Maher brought an action against both banks in which she established that the indorsement "Deposit to credit of Stella Maher" had been made without her authority, and so judgment was entered in her favor, without determining on which bank the loss would ultimately rest. Since the Commercial bank, in presenting the instrument to Shenandoah bank for payment, guaranteed all prior indorsements it would seem that the loss would fall on Commercial bank, which also was the bank that dealt with the wrongdoer. This would be the result reached under UCC 4-207 (1)(a), even without the indorsement guaranteeing prior indorsements.

Although not expressly covered by the UCC, this section appears to be in accord with Citizens Bank of Norfolk v. Schwarzchild and Sultzberger Co., 109 Va. 539, 64 S.E. 954 (1909), in applying the rule of Price v. Neal to a payment made by a drawee who was mistaken as to the status of the drawer's account.

The case of Central Nat'l Bank v. First and Merchants Nat'l Bank, 171 Va. 289, 198 S.E. 883 (1940), involves problems of interpretation that make it difficult to

draw categorical conclusions. The facts of the case have been summarized as follows: "A fraudulent party, who called himself Clancy, learned that one Justin Moore had a substantial checking account with the Central Bank. He forged Moore's name as drawer of a check for $8,500 on the Central Bank and deposited it in the Merchants Bank to the credit of Moore. Previous to the time of this transaction, Moore already had a substantial checking account with the Merchants Bank. Central Bank paid the full amount of the original check through the clearing house to Merchants Bank by checks to which Moore's name was forged. Moore discovered the forgery of the $8,500 check and demanded that the Central Bank recredit his account for that amount. Central did recredit Moore's account and demanded of Merchants that they return the $8,500. Merchants refused and Central brought suit against Merchants for money had and received under mistake. Merchants' main defense is that under the rule of Price v. Neal and § 62 of the N.I.L., Central is not entitled to recover because of its legal responsibility for recognizing its own depositor's signature." McDowell, Equitable Exceptions to Price v. Neal, 1 Wash. & Lee L. Rev. 224, 225.

The Supreme Court of Appeals allowed a recovery by Central Bank, holding that Price v. Neal was not applicable since Merchants Bank was not a holder of the forged check. The court said, "Even if it be assumed that First was not a collecting agent in this instance by reason of the unusual manner in which it received the check, certainly title to the check which had been forged would not have passed to it from the forger." 171 Va. at 308. The court cited NIL 23, Code 1950, § 6-375, and Hillman v. Cornett, 137 Va. 200, 119 S.E. 74 (1923). The difficulty with this approach is that where forgery is involved the transferee never gets good title; the rule of Price v. Neal applies in spite of the fact that the payor did not get title and the transferor could not convey a good title. A more tenable rationale for this decision is that the case presented a situation calling for the application of an equitable exception to the Price v. Neal rule, that is, that Merchants Bank was itself negligent and so not in a position to invoke the doctrine of Price v. Neal. This equitable exception to the Price v. Neal doctrine is apparently abolished by UCC 3-418. However, the comment to this section, Point 4, speaks in terms of negligence on the part of the person who takes the instrument and later receives payment, and not of negligence on the part of the party who pays other and subsequent checks on forged indorsements, the situation in this Central Bank case. Another difficulty in applying the UCC to this case is that the UCC provisions do not exactly mesh. Since Merchants Bank collected the check, under subsection 4-207(1)(b) the Merchants Bank would warrant to Central Bank that it "has no knowledge that the signature of the . . . drawer is unauthorized." Merchants Bank, not having this knowledge, would not break the warranty. However, under UCC 3-418 payment is not final unless Merchants Bank is a holder in due course. Consequently, the decision would turn upon whether or not Merchants Bank gave value, a question the Virginia court did not decide. This leads to the intricacies of bank credit as value as set forth in UCC 4-208. Under the language of subsection 4-208(1)(a) it would seem that to the extent that credit was withdrawn from the Merchants Bank, it would have obtained a security interest in the item, and so would have given value under UCC 4-209. This would lead to the conclusion that Central Bank would not be able to recover the payment, a result opposite to that actually reached in the case.

§ 4-208. Security Interest of Collecting Bank in Items, Accompanying Documents and Proceeds. (1) A bank has a security interest in an item and any accompanying documents or the proceeds of either

(a) in case of an item deposited in an account to the extent to which credit given for the item has been withdrawn or applied;

(b) in case of an item for which it has given credit available for withdrawal as of right, to the extent of the credit given whether or not the credit is drawn upon and whether or not there is a right of charge-back; or

(c) if it makes an advance on or against the item.

(2) When credit which has been given for several items received at one time or pursuant to a single agreement is withdrawn or applied in part the security interest remains upon all the items, any accompanying documents or the proceeds of either. For the purpose of this section, credits first given are first withdrawn.

(3) Receipt by a collecting bank of a final settlement for an item is a realization on its security interest in the item, accompanying documents and proceeds. To the extent and so long as the bank does not receive final settlement for the item or give up possession of the item or accompanying documents for purposes other than collection, the security interest continues and is subject to the provisions of Article 9 except that

(a) no security agreement is necessary to make the security interest enforceable (subsection (1) (b) of § 9-203); and

(b) no filing is required to perfect the security interest; and

(c) the security interest has priority over conflicting perfected security interests in the item, accompanying documents or proceeds.

COMMENT: Prior Uniform Statutory Provision: None; but see American Bankers Association Bank Collection Code, Section 2.

Purposes: 1. Subsection (1) states a rational rule for the interest of a bank in an item. The customer of the depositary bank is normally the owner of the item and the several collecting banks are his agents (§ 4-201). A collecting agent may properly make advances on the security of paper held by him for collection, and when he does acquires at common law a possessory lien for his advances. Subsection (1) applies an analogous principle to a bank in the collection chain which extends credit on items in the course of collection. The bank has a security interest to the extent stated in this section. To the extent of its security interest it is a holder for value (§§ 3-303, 4-209) and a holder in due course if it satisfies the other requirements for that status. (§ 3-302). Subsection (1) does not derogate from the banker's general common-law lien or right of set-off against indebtedness owing in deposit accounts. See § 1-103. Rather subsection (1) specifically implements and extends the principle as a part of the bank collection process.

2. Subsection (2) spreads the security interest of the bank over all items in a single deposit or received under a single agreement and a single giving of credit. It also adopts the "first-in, first-out" rule.

3. Collection statistics establish that in excess of ninety-nine per cent of items handled for collection are in fact collected. The first sentence of subsection (3) reflects the fact that in such normal case the bank's security interest is self-liquidating. The remainder of the subsection correlates the security interest with the provisions of Article 9, particularly for use in the cases of non-collection where the security interest may be important.

Cross References:

§§ 3-302, 3-303, 4-201, 4-209, 9-203(1) (b) and 9-302.

Definitional Cross References:

"Account". § 4-104.
"Agreement". § 1-201.
"Bank". § 1-201.
"Item". § 4-104.
"Security interest". § 1-201.
"Settlement". § 4-104.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: The UCC recognizes that a bank has a security interest in an item or its proceeds to the extent that bank credit given on the basis of the item has been withdrawn. This is in accord with McAuley v. Morris Plan Bank, 155 Va. 777, 156 S.E. 418 (1931), which held that a bank was a taker for value, where bank credit had been withdrawn, even though the bank had a right of charge-back. This case appears by inference to overrule the approval given by the Supreme Court of Appeals in Greensburg Nat'l Bank v. C. Syer & Co., 113 Va. 53, 57, 73 S.E. 438 (1912), to a trial court instruction that included the following language: "Checks or drafts deposited or credited, if intended to be for collection only do not become the property of the bank, even if the depositor has been allowed to check against the deposit before the paper is collected." In this case, in which an attaching

drawee was held to be entitled to the proceeds of a draft rather than the depositary bank, it is not clear whether the bank credit was in fact withdrawn.

In speaking of bank credit as value, the Supreme Court of Appeals in Miller v. Norton, 114 Va. 609, 617, 77 S.E. 452 (1913), said: "In this country, though the rule seems to be different in England, it is settled that the mere giving of credit to a depositor's account of a check does not constitute the bank a holder for value, but in order to have that effect the credit must be drawn upon." The holding in Fayette Nat'l Bank v. Summers, 105 Va. 689, 54 S.E. 862 (1906), in which a bank was found not to be a purchaser for value of a check on which payment had been stopped, is an earlier application of the same rule.

Point 3 of the comment to UCC 3-303 is consistent with this Virginia rule, the comment referring to "bank credit not drawn upon, which can be and is revoked when a claim or defense appears," as an example of what is not a taking for value. However, UCC 4-208(1)(b) recognizes that a bank may have a security interest in an item, and so have given value, if the credit is available for withdrawal as of right, whether or not drawn upon. Since the UCC does make clear exactly what this provision is intended to cover, its effect on Miller v. Norton is not clear.

See also VIRGINIA ANNOTATIONS to UCC 4-201.

§ 4-209. When Bank Gives Value for Purposes of Holder in Due Course. For purposes of determining its status as a holder in due course, the bank has given value to the extent that it has a security interest in an item provided that the bank otherwise complies with the requirements of § 3-302 on what constitutes a holder in due course.

COMMENT: **Prior Uniform Statutory Provision:** Negotiable Instruments Law, § 27.

Purpose: The section completes the thought of the previous section and makes clear that a security interest in an item is "value" for the purpose of determining the holder's status as a holder in due course. The provision is in accord with the prior law (N.I.L. § 27) and with Article 3 (§ 3-303). The section does not prescribe a security interest under § 4-208 as a test of "value" generally because the meaning of "value" under other Articles is adequately defined in § 1-201.

Cross References:

§§ 1-201, 3-302, 3-303 and 4-208.

Definitional Cross References:

"Bank". § 1-201.
"Holder in due course". § 3-302.
"Item". § 4-104.
"Security interest". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-379, 6-378 (NIL 26).

Comment: The UCC is in accord with McAuley v. Morris Plan Bank, 155 Va. 777, 156 S.E. 418 (1931), which held that a bank could be a holder in due course of a check, whether it was an absolute owner or had made advances by giving bank credit that had been drawn upon. See also VIRGINIA ANNOTATIONS to UCC 4-208.

§ 4-210. Presentment by Notice of Item Not Payable by, Through or at a Bank; Liability of Secondary Parties. (1) Unless otherwise instructed, a collecting bank may present an item not payable by, through or at a bank by sending to the party to accept or pay a written notice that the bank holds the item for acceptance or payment. The notice must be sent in time to be received on or before the day when presentment is due and the bank must meet any requirement of the party to accept or pay under § 3-505 by the close of the bank's next banking day after it knows of the requirement.

(2) Where presentment is made by notice and neither honor nor request for compliance with a requirement under § 3-505 is received by the close of business on the day after maturity or in the case of demand items by the close of business on the third banking day after notice was sent, the presenting bank may treat the item as dishonored and charge any secondary party by sending him notice of the facts.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. This section codifies a practice extensively followed in presentation of trade acceptances and documentary and other drafts drawn on non-bank payors. It imposes a duty on the payor to respond to the notice of the item if the item is not to be considered dishonored. Notice of such a dishonor charges parties secondarily liable. Presentment under this Section is good presentment under Article 3. See § 3-504(5).

2. A drawee not receiving notice is not, of course, liable to the drawer for wrongful dishonor.

3. A bank so presenting an instrument must be sufficiently close to the drawee to be able to exhibit the instrument on the day it is requested to do so or the next business day at the latest.

Cross References:

§§ 3-501 through 3-508, 4-501 and 4-502.

Definitional Cross References:

"Acceptance". § 3-410.
"Banking day". § 4-104.
"Collecting bank". § 4-105.
"Item". § 4-104.
"Party". § 1-201.
"Presentment". § 3-504.
"Secondary party". § 3-102.
"Send". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 4-211. Media of Remittance; Provisional and Final Settlement in Remittance Cases. (1) A collecting bank may take in settlement of an item

(a) a check of the remitting bank or of another bank on any bank except the remitting bank; or

(b) a cashier's check or similar primary obligation of a remitting bank which is a member of or clears through a member of the same clearing house or group as the collecting bank; or

(c) appropriate authority to charge an account of the remitting bank or of another bank with the collecting bank; or

(d) if the item is drawn upon or payable by a person other than a bank, a cashier's check, certified check or other bank check or obligation.

(2) If before its midnight deadline the collecting bank properly dishonors a remittance check or authorization to charge on itself or presents or forwards for collection a remittance instrument of or on another bank which is of a kind approved by subsection (1) or has not been authorized by it, the collecting bank is not liable to prior parties in the event of the dishonor of such check, instrument or authorization.

(3) A settlement for an item by means of a remittance instrument or authorization to charge is or becomes a final settlement as to both the person making and the person receiving the settlement

(a) if the remittance instrument or authorization to charge is of a kind approved by subsection (1) or has not been authorized by the person receiving the settlement and in either case the person receiving the settlement acts seasonably before its midnight deadline in presenting, forwarding for collection or paying the instrument or authorization,—at the time the remittance instrument or authorization is finally paid by the payor by which it is payable;

(b) if the person receiving the settlement has authorized remittance by a non-bank check or obligation or by a cashier's check or similar primary obligation of or a check upon the payor or other remitting bank which is not of a kind approved by subsection (1) (b),—at the time of the receipt of such remittance check or obligation; or

(c) if in a case not covered by sub-paragraphs (a) or (b) the person receiving the settlement fails to seasonably present, forward for collection, pay or return a remittance instrument or authorization to it to charge before its midnight deadline,—at such midnight deadline.

COMMENT: **Prior Uniform Statutory Provision:** None; but see §§ 9 and 10, American Bankers Association Bank Collection Code.

Purposes: 1. Subsection (1) states various types of remittance instruments and authorities to charge which may be received by a collecting bank in a settlement for an item, without the collecting bank being responsible if such form of remittance is not itself paid. The action of the collecting bank in receiving these provisional forms of remittance is approved and the risk that they are not paid is placed on the owner of the item, and not on the collecting bank. Justification for these results lies in the fact that with the tremendous volume of items collected it is simply not mechanically feasible to remit or pay in money or other forms of technical "legal tender". Since it is not feasible for banks to perform their collection functions except with the use of these provisional remittances, they should not be penalized for acting in the only way they can act.

2. The first approved form of provisional remittance having these results is a check of the remitting bank or of another bank on any bank except the remitting bank (subsection (1)(a)). A check on the remitting bank itself is not approved because this would merely be substituting for the original item another item on the same payor.

3. A cashier's check or similar primary obligation of the remitting bank which is a member of or clears through a member of the same clearing house or group as the collecting bank is approved by subsection (1)(b) because this is just as speedy and effective a means of settlement through a clearing house as any other type of instrument or a check on another bank. On the other hand such cashier's checks or primary obligations are not approved for use, at the owner's risk, outside a single clearing house or clearing area because when so used they do not constitute a means of final settlement but merely substitute one item on the remitting bank for another one on the same bank. To the remitting bank they may have benefit in maintaining "float" or having the use of money even though drawn against, but this is not looked upon as sound practice.

4. Subsection (1)(d) recognizes and approves the general and consistent practice of collecting banks to accept cashier's checks, certified checks or other bank checks or obligations as a proper means of remittance from non-bank payors, with the owner of the original item carrying the risk of non-payment of these bank instruments rather than the collecting bank, to the extent there is any risk. Here again this rule and practice is justified by the fact that payment in money for all practical purposes is no longer feasible and consequently is not used except in rare instances. Subsection (1)(d) recognizes the standard medium that is used.

5. This section does not purport to deal with all kinds of settlements for items. It does not purport to deal with settlements for "cash items" (described in Comments to § 4-212), settlements merely by debits and credits in accounts between banks (§ 4-213) or settlements through clearing houses. The section is limited to those situations where a collecting or payor bank or a non-bank payor receives an item and accounts for it by "remitting" or "sending back" something for the item, usually some form of a remittance instrument, order or authorization. Some specific rules are needed for remittance cases because of time required to process the remittance instrument.

Failure to mention in subsection (1) entries in accounts between banks and clearing house settlements carries no implication of impropriety of these types of provisional or final settlement. Approval of these means of settlement is evidenced by the definition of "settle" in § 4-104(j), provision for charge-back and refund in § 4-212, and provisions regarding settlements becoming final (§ 4-213). Further, the specific listing in subsection (1) of certain usual types of remittances does not imply that all other types of remittances are improper (§ 4-103(4)).

6. Subsection (2) provides that if a remittance is one of the kinds approved by subsection (1) and the collecting bank receiving the item acts seasonably in handling it before the bank's midnight deadline, the bank is not liable to prior parties in the event of dishonor. The subsection also provides for an additional situation. If without any authorization whatsoever the payor or remitting bank or person remits with an improper remittance instrument, the collecting bank should not be penalized where it is without fault. Nevertheless, the owner of the item may not be served if the collecting bank rejects the improper instrument. In many cases the best course would be to collect the instrument as rapidly as possible. Subsection (2) provides that if this is done the collecting bank is not responsible in the event of dishonor.

7. Subsection (3) complements subsections (1) and (2) by providing when a settlement by means of a remittance instrument or authorization to charge becomes final. Subparagraph (a) provides that in situations specified in subsection (2) the settlement becomes final at the time the remittance instrument or authorization is finally paid by the payor by which it is payable. The standards determining this final payment are those prescribed in § 4-213. Conversely, under subparagraph (b) if the person receiving the settlement has authorized remittance by certain specified media not approved by subsection (1) the settlement becomes final at the time of receipt of such check or obligation. In this event the person receiving the settlement assumes the risk that the remittance instrument is not itself paid. A prior course of dealing of receiving unapproved forms of remittances from the payor or remitting person in question would be the equivalent of an authorization and effective as such. Subparagraph (c) provides for most, if not all, remaining remittance situations. Here settlement becomes final at the midnight deadline of the person receiving the remittance.

Subsection (3) provides that the times of final settlement prescribed apply both to the person making and the person receiving the settlement. Further, by use of the term "person", these rules also apply to non-bank payors of items and non-bank customers for whom items are being collected, as well as to collecting and payor banks.

8. When settlement is by credit in an account with another bank § 4-213 controls.

Cross Reference:

§ 4-213.

Definitional Cross References:

"Account". § 4-104.
"Bank". § 1-201.
"Clearing house". § 4-104.
"Collecting bank". § 4-105.
"Item". § 4-104.
"Midnight deadline". § 4-104.
"Money". § 1-201.
"Payor bank". § 4-105.
"Person". § 1-201.
"Remitting bank". § 4-105.
"Settle". § 4-104.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: A collecting bank may take from a payor other than a bank in settlement of an item a cashier's check, certified check or obligation. If this is an exclusive enumeration, the type of payment that may be taken may be narrower than that impliedly authorized in Lifsey v. Goodyear Tire & Rubber Co., 67 F.2d 82 (4th Cir. 1933), in which the collecting bank took the personal check of the payor.

§ 4-212. **Right of Charge-Back or Refund.** (1) If a collecting bank has made provisional settlement with its customer for an item and itself fails by reason of dishonor, suspension of payments by a bank or otherwise to receive a settlement for the item which is or becomes final, the bank may revoke the settlement given by it, charge back the amount of any credit given for the item to its customer's account or obtain refund from its customer whether or not it is able to return the item if by its midnight deadline or within a longer reasonable time after it learns the facts it returns the item or sends notification of the facts. These rights to revoke, charge-back and obtain refund terminate if and when a settlement for the item received by the bank is or becomes final (subsection (3) of § 4-211 and subsections (2) and (3) of § 4-213).

(2) Within the time and manner prescribed by this section and § 4-301, an intermediary or payor bank, as the case may be, may return an unpaid item directly to the depositary bank and may send for collection a draft on the depositary bank and obtain reimbursement. In such case, if the depositary bank has received provisional settlement for the item, it must reimburse the bank drawing the draft and any provisional credits for the item between banks shall become and remain final.

(3) A depositary bank which is also the payor may charge-back the amount of an item to its customer's account or obtain refund in accordance with the section governing return of an item received by a payor bank for credit on its books (§ 4-301).

(4) The right to charge-back is not affected by

(a) prior use of the credit given for the item; or

(b) failure by any bank to exercise ordinary care with respect to the item but any bank so failing remains liable.

(5) A failure to charge-back or claim refund does not affect other rights of the bank against the customer or any other party.

(6) If credit is given in dollars as the equivalent of the value of an item payable in a foreign currency the dollar amount of any charge-back or refund shall be calculated on the basis of the buying sight rate for the foreign currency prevailing on the day when the person entitled to the charge-back or refund learns that it will not receive payment in ordinary course.

(VALC Note: Subsection (2) is contained as an option in the Official Text.)

COMMENT: Prior Uniform Statutory Provision: None; but see §§ 2 and 11, American Bankers Association Bank Collection Code.

Purposes: 1. Under current bank practice, in a major portion of cases banks make provisional settlement for items when they are first received and then await subsequent determination of whether the item will be finally paid. This is the principal characteristic of what are referred to in banking parlance as "cash items". Statistically, this practice of settling provisionally first and then awaiting final payment is justified because more than ninety-nine per cent of such cash items are finally paid, with the result that in this great preponderance of cases it becomes unnecessary for the banks making the provisional settlements to make any further entries. In due course the provisional settlements become final simply with the lapse of time. However, in those cases where the item being collected is not finally paid or where for various reasons the bank making the provisional settlement does not itself receive final payment, under the American Bankers Association Bank Collection Code, under Federal Reserve Regulations and operating letters and under various types of agreements between banks and between customers and banks, provision is made for the reversal of the provisional settlements, charge-back of provisional credits and the right to obtain refund. Subsection (1) codifies and simplifies the statement of these rights.

2. Various causes of a bank not receiving final payment, with the resulting right of charge-back or refund, are stated or suggested in subsection (1). These include dishonor of the original item; dishonor of a remittance instrument given for it; reversal of a provisional credit for the item; suspension of payments by another bank. The causes stated are illustrative; the right of charge-back or refund is stated to exist whether the failure to receive final payment in ordinary course arises through one of them "or otherwise".

3. The right of charge-back or refund exists if a collecting bank has made a provisional settlement for an item with its customer but terminates if and when a settlement received by the bank for the item is or becomes final. If the bank fails to receive such a final settlement the right of charge-back or refund must be exercised promptly after the bank learns the facts. The right exists (if so promptly exercised) whether or not the bank is able to return the item.

4. Subsection (2) is an affirmative provision for so-called "direct returns". This is a new practice that is currently in the process of developing in a few sections of the country. Its purpose is to speed up the return of unpaid items by avoiding handling by one or more intermediate banks. The subsection is bracketed because the practice is not yet well established and some bankers and bank lawyers would prefer to let the practice develop by agreement. The contention is made that substantive rights between banks may be affected, e. g. available set-offs, but proponents contend advantages of direct returns outweigh possible detriments. However, if the subsection were omitted, the election to use direct returns would be on the depositary bank and it would probably be necessary for that bank to specifically authorize direct returns with each outgoing letter. This is a cumbersome way of meeting the problem. If the subsection is retained the payor bank, unless it has been specifically directed otherwise, will have the right to make the decision whether it will return an unpaid item directly. Since the subsection is permissive and its inclusion tends toward greater flexibility, its retention is recommended.

5. The rule of subsection (4) relating to charge-back (as distinguished from claim for refund) applies irrespective of the cause of the nonpayment, and of the person ultimately liable for nonpayment. Thus charge-back is permitted even where nonpayment results from the depositary bank's own negligence. Any other rule would result in litigation based upon a claim for wrongful dishonor of other checks of the customer, with potential damages far in excess of the amount of the item. Any other rule would require a bank to determine difficult questions of fact. The customer's protection is found in the general obligation of good faith (§§ 1-203 and 4-103). If bad faith is established the customer's recovery "includes other damages, if any, suffered by the party as a proximate consequence" (§ 4-103 (5); see also § 4-402).

6. It is clear that the charge-back does not relieve the bank from any liability for failure to exercise ordinary care in handling the item. The measure of damages for such failure is stated in § 4-103(5).

7. Subsection (6) states a rule fixing the time for determining the rate of exchange if there is a charge-back or refund of a credit given in dollars for an item payable in a foreign currency. Compare § 3-107(2). Fixing such a rule is desirable to avoid disputes. If in any case the parties wish to fix a different time for determining the rate of exchange, they may do so by agreement.

Cross References:

§§ 1-203, 3-107, 4-103, 4-211(3), 4-213(2) and (3), 4-402.

Definitional Cross References:

"Account". § 4-104.
"Collecting bank". § 4-105.
"Customer". § 4-104.
"Depositary bank". § 4-105.
"Intermediary bank". § 4-105.
"Item". § 4-104.
"Midnight deadline". § 4-104.
"Payor bank". § 4-105.
"Send". § 1-201.
"Settlement". § 4-104.
"Suspension of payment". § 4-104.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

COUNCIL COMMENT

The optional language is permissive and we see no objection to its inclusion in this section. However, we are not advised that the practice of direct returns is being used in Virginia at the present time.

§ 4-213. **Final Payment of Item by Payor Bank; When Provisional Debits and Credits Become Final; When Certain Credits Become Available for Withdrawal.** (1) An item is finally paid by a payor bank when the bank has done any of the following, whichever happens first:

(a) paid the item in cash; or

(b) settled for the item without reserving a right to revoke the settlement and without having such right under statute, clearing house rule or agreement; or

(c) completed the process of posting the item to the indicated account of the drawer, maker or other person to be charged therewith; or

(d) made a provisional settlement for the item and failed to revoke the settlement in the time and manner permitted by statute, clearing house rule or agreement.

Upon a final payment under subparagraphs (b), (c) or (d) the payor bank shall be accountable for the amount of the item.

(2) If provisional settlement for an item between the presenting and payor banks is made through a clearing house or by debits or credits in an account between them, then to the extent that provisional debits or credits for the item are entered in accounts between the presenting and payor banks or between the presenting and successive prior collecting banks seriatim, they become final upon final payment of the item by the payor bank.

(3) If a collecting bank receives a settlement for an item which is or becomes final (subsection (3) of § 4-211, subsection (2) of § 4-213) the bank is accountable to its customer for the amount of the item and any provisional credit given for the item in an account with its customer becomes final.

(4) Subject to any right of the bank to apply the credit to an obligation of the customer, credit given by a bank for an item in an account with its customer becomes available for withdrawal as of right

(a) in any case where the bank has received a provisional settlement for the item,—when such settlement becomes final and the bank has had a reasonable time to learn that the settlement is final;

(b) in any case where the bank is both a depositary bank and a payor bank and the item is finally paid,—at the opening of the bank's second banking day following receipt of the item.

(5) A deposit of money in a bank is final when made but, subject to any right of the bank to apply the deposit to an obligation of the customer. the deposit becomes available for withdrawal as of right at the opening of the bank's next banking day following receipt of the deposit.

COMMENT: Prior Uniform Statutory Provisions: None; but see § 11, American Bankers Association Bank Collection Code.

Purposes: 1. By the definition and use of the term "settle" (§ 4-104(j)) this Article recognizes that various debits or credits, remittances, settlements or payments given for an item may be either provisional or final, that settlements some-

times are provisional and sometimes are final and sometimes are provisional for awhile but later become final. Subsection (1) of § 4-213 defines when settlement for an item or other action with respect to it constitutes final payment.

Final payment of an item is important for a number of reasons. It is one of several factors determining the relative priorities between items and notices, stop orders, legal process and set-offs (§ 4-303). It is the "end of the line" in the collection process and the "turn around" point commencing the return flow of proceeds. It is the point at which many provisional settlements become final. See § 4-213(2). Final payment of an item by the payor bank fixes preferential rights under § 4-214(1) and (2).

2. If an item being collected moves through several states, e. g., is deposited for collection in California, moves through two or three California banks to the Federal Reserve Bank of San Francisco, to the Federal Reserve Bank of Boston, to a payor bank in Maine, the collection process involves the eastward journey of the item from California to Maine and the westward journey of the proceeds from Maine to California. Subsection (1) adopts the basic policy that final payment occurs at some point in the processing of the item by the payor bank. This policy recognizes that final payment does not take place, in such hypothetical case, on the journey of the item eastward. It also adopts the view that neither does final payment occur on the journey westward because what in fact is journeying westward are *proceeds* of the item. Because the true tests of final payment are the same in all cases and to avoid the confusion resulting from variable standards, the rule basing final payment exclusively on action of the payor bank is not affected by whether payment is made by a remittance draft or whether such draft is itself paid. Consequently, subsection (1) rejects those cases which base time of payment of the item in remittance cases on whether the remittance draft was *accepted* by the presenting bank; Page v. Holmes-Darst Coal Co., 269 Mich. 159, 256 N.W. 840 (1934); Tobiason v. First State Bank of Ashby, 173 Minn. 533, 217 N.W. 934 (1928); Bohlig v. First Nat'l Bank in Wadena, 233 Minn. 523, 48 N.W.2d 445 (1951); Dewey v. Margolis & Brooks, 195 N.C. 307, 142 S.E. 22 (1928); Texas Electric Service Co. v. Clark, 47 S.W.2d 483 (Tex. Civ. App. 1932); cf. Ellis Way Drug Co. v. McLean, 176 Miss. 830, 170 So. 288 (1936); 2 Paton's Digest 1332; or whether the remittance draft was itself *paid;* Cleve v. Craven Chemical Co., 18 F.2d 711 (4th Cir. 1927); Holdingford Milling Co. v. Hillman Farmers' Cooperative Creamery, 181 Minn. 212, 231 N.W. 928 (1930); or upon an election of a collecting bank under § 11 of the American Bankers Association Bank Collection Code; United States Pipe & Foundry Co. v. City of Hornell, 146 Misc. 812, 263 N.Y.S. 89 (1933); Jones v. Board of Education, 242 App.Div. 17, 272 N.Y.S. 5 (1934); Matter of State Bank of Binghamton, 156 Misc. 353, 281 N.Y.S. 706 (1935); cf. Malcolm, Inc. v. Burlington City Loan & Trust Co., 115 N.J. Eq. 227, 170 A. 32 (1934). Of course, the time of payment of the remittance draft will be governed by subsection (1) but payment or nonpayment of the remittance draft will not change the time of payment of the original item.

3. In fixing the point of time within the payor bank when an item is finally paid, subsection (1) recognizes and is framed on the basis that in a payor bank an item goes through a series of processes before its handling is completed. The item is received first from the clearing house or over the counter or through the mail. When received over the counter, the bank may receipt for it in some way by making a notation in the customer's passbook or by receipting a duplicate deposit slip. After the initial receipt the item moves to the sorting and proving departments. When sorted and proved it may be photographed. Still later it moves to the bookkeeping department where it is examined for form and signature and compared against the ledger account of the customer to whom it is to be charged. If it is in good form and there are funds to cover it, it is posted to the drawer's account, either immediately or at a later time. If paid, it is so marked and filed with other items of the same customer. This process may take either a few hours or substantially all of the day of receipt and of the next banking day.

Within this period of processing by the payor bank subsection (1) first recognizes two types of overt external acts constituting final payment. Traditionally and under various decisions payment in cash of an item by a payor bank has been considered final payment. Chambers v. Miller, 13 C.B.N.S. 125 (Eng. 1862); Fidelity & Casualty Co. of New York v. Planenscheck, 200 Wis. 304, 309, 227 N.W. 387, 389, 71 A.L.R. 331 (1929); see Bellevue Bank of Allen Kimberly & Co. v. Security Nat. Bank of Sioux City, 168 Iowa 707, 712, 150 N.W. 1076, 1077 (1915); 1 Paton's Digest 1066. Subsection (1)(a) first recognizes and provides that payment of an item in cash by a payor bank is final payment.

4. § 4-104(j) defines "settle" as meaning " to pay in cash, by clearing house settlement, in a charge or credit or by remittance, or otherwise as instructed. A

settlement may be either provisional or final;" Subsection (1)(b) of § 4-213 provides that an item is finally paid by a payor bank when the bank has "settled for the item without reserving a right to revoke the settlement and without having such right under statute, clearing house rule or agreement". Subsection (1)(b) provides in effect that if the payor bank finally settles for an item this constitutes final payment of the item. The subsection operates if nothing has occurred and no situation exists making the settlement provisional. If at the time of settlement the payor bank reserves a right to revoke the settlement, the settlement is provisional. In the alternative, if under statute, clearing house rule or agreement, a right of revocation of the settlement exists the settlement is provisional. Conversely, if there is an absence of a reservation of the right to revoke and also an absence of a right to revoke under statute, clearing house rule or agreement, the settlement is final and such final settlement constitutes final payment of the item.

A primary example of a statutory right on the part of the payor bank to revoke a settlement is the right to revoke conferred by § 4-301. The underlying theory and reason for deferred posting statutes (§ 4-301) is to require a settlement on the date of receipt of an item but to keep that settlement provisional with the right to revoke prior to the midnight deadline. In any case where § 4-301 is applicable, any settlement by the payor bank is provisional solely by virtue of the statute, subsection (1)(b) of § 4-213 does not operate and such provisional settlement does not constitute final payment of the item.

A second important example of a right to revoke a settlement is that arising under clearing house rules. It is very common for clearing house rules to provide that items exchanged and settled for in a clearing, (e. g., before 10:00 A. M. on Monday) may be returned and the settlements revoked up to but not later than 2:00 P. M. on the same day (Monday) or under deferred posting at some hour on the next business day (e. g., 2:00 P.M. Tuesday). Under this type of rule the Monday morning settlement is provisional and being provisional does not constitute a final payment of the item.

An example of a reservation of a right to revoke a settlement is where the payor bank is also the depositary bank and has signed a receipt or duplicate deposit ticket or has made an entry in a passbook acknowledging receipt, for credit to the account of A, of a check drawn on it by B. If the receipt, deposit ticket, passbook or other agreement with A is to the effect that any credit so entered is provisional and may be revoked pending the time required by the payor bank to process the item to determine if it is in good form and there are funds to cover it, such reservation or agreement keeps the receipt or credit provisional and avoids it being either final settlement or final payment.

In other ways the payor bank may keep settlements provisional: by general or special agreement with the presenting party or bank; by simple reservation at the time the settlement is made; or otherwise. Thus a payor bank (except in the case of statutory provisions) has control whether a settlement made by it is provisional or final, by participating in general agreements or clearing house rules or by special agreement or reservation. If it fails to keep a settlement provisional and if no applicable statute keeps the settlement provisional, its settlement is final and, unless the item had previously been paid by one of the other methods prescribed in subsection (1), such final settlement constitutes final payment. In this manner payor banks may without difficulty avoid the effect of such cases as: Cohen v. First Nat. Bank of Nogales, 22 Ariz. 394, 400, 198 P. 122, 124, 15 A.L.R. 701 (1921); Briviesca v. Coronado, 19 Cal.2d 244, 120 P.2d 649 (1941); White Brokerage Co. v. Cooperman, 207 Minn. 239, 290 N.W. 790 (1940); Scotts Bluff County v. First Nat. Bank of Gering, 115 Neb. 273, 212 N.W. 617 (1927); Provident Savings Bank & Trust Co. v. Hildebrand, 49 Ohio App. 207, 196 N.E. 790, 791 (1934); Schaer v. First Nat. Bank of Brenham, 132 Tex. 499, 124 S.W.2d 108 (1939) (bill of exchange); Union State Bank of Lancaster v. Peoples State Bank of Lancaster, 192 Wis. 28, 33, 211 N.W. 931, 933 (1927); 1 Paton's Digest 1067.

5. If a payor bank has not previously paid an item in cash or finally settled for it, certain internal acts or procedures will produce final payment of the item. Exclusive of the external acts of payment in cash or final settlement, the key point at which the decision of the bank to pay or dishonor is made is when the bookkeeper for the drawer's account determines or verifies that the check is in good form and that there are sufficient funds in the drawer's account to cover it. Previous steps in the processing of an item are preliminary to this vital step and in no way indicate a decision to pay. However, a more tangible measuring point is desirable than a mere examination of the account of the person to be charged. The mechanical step that usually indicates that the examination has been com-

pleted and the decision to pay has been made is the posting of the item to the account to be charged. Therefore, subsection (1)(c) adopts as the third measuring point the completion of the process of posting. The phrase "completed the process of posting" is used rather than simple "posting" because under current machine operations posting is a process and something more than simply making entries on the customer's ledger. Subsection (1) follows fairly closely the New York statute, 37 McKinney's Consolidated Laws of New York, Negotiable Instruments, Art. 19-A, § 350-b as amended by L. 1950, C. 153, § 1. However, subsections (1)(a) and (b) furnish more precise rules for determining "final settlement" by the payor bank than does the New York statute in using the term "irrevocable credit", the definition of which is not helpful.

6. Subsection (1)(d) covers the situation where the payor bank makes a provisional settlement for an item, which settlement becomes final at a later time by reason of the failure of the payor bank to revoke it in the time and manner permitted by statute, clearing house rule or agreement. An example of this type of situation is the clearing house settlement referred to in Comment 4. In the illustration there given if the time limit for the return of items received in the Monday morning clearing is 2:00 P. M. on Tuesday and the provisional settlement has not been revoked at that time in a manner permitted by the clearing house rules, the provisional settlement made on Monday morning becomes final at 2:00 P.M. on Tuesday. Subsection (1)(d) provides specifically that in this situation the item is finally paid at 2:00 P.M. Tuesday. If on the other hand a payor bank receives an item in the mail on Monday and makes some provisional settlement for the item on Monday, it has until midnight on Tuesday to return the item or give notice and revoke any settlement under § 4-301. In this situation subsection (1)(d) of § 4-213 provides that if the provisional settlement made on Monday is not revoked before midnight on Tuesday as permitted by § 4-301, the item is finally paid at midnight on Tuesday even if the process of posting the item to the account of the drawer has not been completed at that time.

7. Subsection (1) provides that an item is finally paid by the payor bank when any one of the four events set forth in subparagraphs (a), (b), (c) and (d) have occurred, whichever happens first, and then provides that upon a final payment under subparagraphs (b), (c) or (d) the payor bank shall be accountable for the amount of the item. It is not made accountable if it has paid the item in cash because such payment is itself a sufficient accounting. The term "accountable" is used as imposing a duty to account, which duty is met if and when a settlement for the item satisfactorily clears. The fact that determination of the time of final payment is based exclusively upon action of the payor bank is not detrimental to the interests of owners of items or collecting banks because of the general obligations of payors to honor or dishonor and the time limits for action imposed by §§ 4-301 and 4-302.

8. Subsection (2) states the country-wide usage that when the item is finally paid by the payor bank under subsection (1) this final payment automatically without further action "firms up" other provisional settlements made for it. However, the subsection makes clear that this "firming up" occurs only where the settlement between the presenting and payor banks was made either through a clearing house or by debits and credits in accounts between them. It does not take place where the payor bank remits for the item with some form of remittance instrument. Further, the "firming up" continues only to the extent that provisional debits and credits are entered seriatim in accounts between banks which are successive to the presenting bank. The automatic "firming up" is broken at any time that any collecting bank remits for the item with a remittance draft, because final payment to the remittee then usually depends upon final payment of the remittance draft.

9. Subsection (3) states the general rule that if a collecting bank receives settlement for an item which is or becomes final, the bank is accountable to its customer for the amount of the item. One means of accounting is to remit to its customer the amount it has received on the item. If previously it gave to its customer a provisional credit for the item in an account its receipt of final settlement for the item "firms up" this provisional credit and makes it final. When this credit given by it so becomes final, in the usual case its agency status terminates and it becomes a debtor to its customer for the amount of the item. See § 4-201(1). If the accounting is by a remittance instrument or authorization to charge further time will usually be required to complete its accounting (§ 4-211).

10. Subsection (4) states when certain credits given by a bank to its customer become available for withdrawal as of right. Subsection (4)(a) deals with the situation where a bank has given a credit (usually provisional) for an item to

its customer and in turn has received a provisional settlement for the item from an intermediary or payor bank to which it has forwarded the item. In this situation before the provisional credit entered by the collecting bank in the account of its customer becomes available for withdrawal as of right, it is not only necessary that the provisional settlement received by the bank for the item becomes final but also that the collecting bank has a reasonable time to learn that this is so. Hence, subsection (4)(a) imposes both of these conditions. If the provisional settlement received is a provisional debit or credit in an account with the intermediary or payor bank or a remittance instrument on some bank other than the collecting bank itself, the collecting bank will usually learn that this debit or credit is final or that the remittance instrument has been paid merely by not learning the opposite within a reasonable time. How much time is "reasonable" for these purposes will of course depend on the distance the item has to travel and the number of banks through which it must pass (having in mind not only travel time by regular lines of transmission but also the successive midnight deadlines of the several banks) and other pertinent facts. Also, if the provisional settlement received is some form of a remittance instrument or authorization to charge, the "reasonable" time depends on the identity and location of the payor of the remittance instrument, the means for clearing such instrument and other pertinent facts.

11. Subsection (4)(b) deals with the situation of a bank which is both a depositary bank and a payor bank. The subsection recognizes that where A and B are both customers of a depositary-payor bank and A deposits B's check on the depositary-payor in A's account on Monday, time must be allowed to permit the check under the deferred posting rules of § 4-301 to reach the bookkeeper for B's account at some time on Tuesday, and if there are insufficient funds in B's account to reverse or charge back the provisional credit in A's account. Consequently this provisional credit in A's account does not become available for withdrawal as of right until the opening of business on Wednesday. If it is determined on Tuesday that there are insufficient funds in B's account to pay the check the credit to A's account can be reversed on Tuesday. On the other hand if the item is in fact paid on Tuesday, the rule of subsection (4)(b) is desirable to avoid uncertainty and possible disputes between the bank and its customer as to exactly what hour within the day the credit is available.

12. Subsection (5) recognizes that even when A makes a deposit of cash in his account on Monday it takes some period of time to record that cash deposit and communicate it to A's bookkeeper (the bookkeeper handling A's account) so that A's bookkeeper has a record of it when she considers whether there are available funds to pay A's check. Where as indicated in Comment 5 A's bookkeeper is the particular employee in the bank to determine, in most cases and subject to supervisory control, whether the item may be paid, the effectiveness of a deposit of cash as a basis for paying a check must of necessity rest upon when the record of that deposit reaches such bookkeeper rather than when it passes through the teller's window. Consequently, although the bank is charged with responsibility for cash deposited from the moment it is received on Monday the cash is not effective as a basis for paying checks until the opening of business on Tuesday.

Cross References:

§§ 3-418, 4-107, 4-201, 4-211, 4-212, 4-214, 4-301, 4-302, 4-303.

Definitional Cross References:

"Account". § 4-104.
"Agreement". § 1-201.
"Banking day". § 4-104.
"Clearing house". § 4-104.
"Collecting bank". § 4-105.
"Customer". § 4-104.
"Depositary bank". § 4-105.
"Item". § 4-104.
"Money". § 1-201.
"Notice". § 1-201.
"Payor bank". § 4-105.
"Presenting bank". § 4-105.
"Settlement". § 4-104.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 4-214. **Insolvency and Preference.** (1) Any item in or coming into the possession of a payor or collecting bank which suspends payment and which item is not finally paid shall be returned by the receiver, trustee or agent in charge of the closed bank to the presenting bank or the closed bank's customer.

(2) If a payor bank finally pays an item and suspends payments without making a settlement for the item with its customer or the presenting bank which settlement is or becomes final, the owner of the item has a preferred claim against the payor bank.

(3) If a payor bank gives or a collecting bank gives or receives a provisional settlement for an item and thereafter suspends payments, the suspension does not prevent or interfere with the settlement becoming final if such finality occurs automatically upon the lapse of certain time or the happening of certain events (subsection (3) of § 4-211, subsections (1)(d), (2) and (3) of § 4-213).

(4) If a collecting bank receives from subsequent parties settlement for an item which settlement is or becomes final and suspends payments without making a settlement for the item with its customer which is or becomes final, the owner of the item has a preferred claim against such collecting bank.

COMMENT: **Prior Uniform Statutory Provision:** None; but see § 13, American Bankers Association Bank Collection Code.

Purposes: 1. The underlying purpose of the provisions of this section is not to confer upon banks, holders of items or anyone else preferential positions in the event of bank failures over general depositors or any other creditors of the failed banks. The purpose is to fix as definitely as possible the cut-off point of time for the completion or cessation of the collection process in the case of items that happen to be in such process at the time a particular bank suspends payments. It must be remembered that in bank collections as a whole and in the handling of items by an individual bank, items go through a whole series of processes. It must also be remembered that at any particular point of time a particular bank (at least one of any size) is functioning as a depositary bank for some items, as an intermediary bank for others, as a presenting bank for still others and as a payor bank for still others, and that when it suspends payments it will have close to its normal load of items working through its various processes. For the convenience of receivers, owners of items, banks, and in fact substantially everyone concerned, it is recognized that at the particular moment of time that a bank suspends payment, a certain portion of the items being handled by it have progressed far enough in the bank collection process that it is preferable to permit them to continue the remaining distance, rather than to send them back and reverse the many entries that have been made or the steps that have been taken with respect to them. Therefore, having this background and these purposes in mind, the section states what items must be turned backward at the moment suspension intervenes and what items have progressed far enough that the collection process with respect to them continues, with the resulting necessary statement of rights of various parties flowing from this prescription of the cut-off time.

2. The rules stated are similar to those stated in the American Bankers Association Bank Collection Code, but with the abandonment of any theory of trust. Although for practical purposes Federal Deposit Insurance affects materially the result of bank failures on holders of items and banks, no attempt is made to vary the rules of the section by reason of such insurance.

3. It is recognized that in view of Jennings v. United States Fidelity & Guaranty Co., 294 U.S. 216, 55 S.Ct. 394, 79 L.Ed. 869, 99 A.L.R. 1248 (1935), amendment of the National Bank Act would be necessary to have this section apply to national banks. But there is no reason why it should not apply to others. See § 1-108.

Cross References:

§§ 1-108, 4-211(3) and 4-213.

Definitional Cross References:

"Collecting bank". § 4-105.
"Customer". § 4-104.
"Item". § 4-104.
"Payor bank". § 4-105.
"Presenting bank". § 4-105.
"Settlement". § 4-104.
"Suspends payment". § 4-104.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-63.

Comment: Code 1950, § 6-63, in terms covers only situations in which items have been forwarded directly to the payor bank for collection. The UCC section is not so limited. It may be, however, that the Virginia statute is as comprehensive since any situation in which a remittance is used might be considered an example of direct forwarding.

The UCC accords with present Virginia law under which the owner of an item has a preference when a bank collects the item and because of insolvency fails to remit the proceeds. Webb v. O'Geary, 145 Va. 356, 133 S.E. 568 (1926); Federal Reserve Bank of Richmond v. Peters, 139 Va. 45, 54-69, 123 S.E. 379 (1924); Miller v. Norton, 114 Va. 609, 617-18, 77 S.E. 452 (1913); First Nat'l Bank v. Payne & Co's. Assignees, 85 Va. 890, 9 S.E. 153 (1898).

The UCC does not cover the subject of whether the right of set-off against a bank operates as a preference. See Dickenson v. Charles, 173 Va. 393, 405, 4 S.E.2d 356 (1939).

The UCC does not affect the holding in Lifsey v. Goodyear Tire & Rubber Co., 67 F.2d 82 (4th Cir. 1933), in which a preference was denied in the assets of a bank to which a note had been forwarded for collection, but which failed before it had done anything with a check given by its depositor in payment of the note, the depositor at the time being indebted to the bank in a greater amount than his deposit.

The UCC permits the owner to recover an item not finally paid because of insolvency of a payor or collecting bank. In Fine v. Receiver of Dickenson County Bank, 163 Va. 157, 175 S.E. 863, 94 A.L.R. 1393 (1934), the depositor tried to stop payment on a check, when the depositary bank failed before it was collected. The check was eventually paid to the insolvent bank, but the depositor was permitted to recover the entire amount of the check from the insolvent bank, since the deposit slip showed that the bank was acting as a collection agent for the owner as its principal. The UCC would give the same result, although it would seem the owner should be able to stop payment and recover the item itself.

PART 3

COLLECTION OF ITEMS: PAYOR BANKS

§ 4-301. Deferred Posting; Recovery of Payment by Return of Items; Time of Dishonor. (1) Where an authorized settlement for a demand item (other than a documentary draft) received by a payor bank otherwise than for immediate payment over the counter has been made before midnight of the banking day of receipt the payor bank may revoke the settlement and recover any payment if before it has made final payment (subsection (1) of § 4-213) and before its midnight deadline it

(a) returns the item; or

(b) sends written notice of dishonor or nonpayment if the item is held for protest or is otherwise unavailable for return

(2) If a demand item is received by a payor bank for credit on its books it may return such item or send notice of dishonor and may revoke any credit given or recover the amount thereof withdrawn by its customer, if it acts within the time limit and in the manner specified in the preceding subsection.

(3) Unless previous notice of dishonor has been sent an item is dishonored at the time when for purposes of dishonor it is returned or notice sent in accordance with this section.

(4) An item is returned:

(a) as to an item received through a clearing house, when it is delivered to the presenting or last collecting bank or to the clearing house or is sent or delivered in accordance with its rules; or

(b) in all other cases, when it is sent or delivered to the bank's customer or transferor or pursuant to his instructions.

COMMENT: Prior Uniform Statutory Provision: None; but see American Bankers Association Model Deferred Posting Statute.

Purposes: 1. Deferred posting and delayed returns is that practice whereby a payor bank sorts and proves items received by it on the day they are received, e. g. Monday, but does not post the items to the customer's account or return "not good" items until the next day, e. g. Tuesday. The practice typifies "production line" methods currently used in bank collection and is based upon the necessity of an even flow of items through payor banks on a day by day basis in a manner which can be handled evenly by employee personnel without abnormal peak load periods, night work, and other practices objectionable to personnel. Since World War II statutes authorizing deferred posting and delayed returns have been passed in almost all of the forty-eight states. This section codifies the content of these statutes and approves the practice.

2. The time limits for action imposed by Subsection (1) are adopted by Subsection (2) for cases where the payor bank is also the depositary bank, but in this case the requirement of a settlement on the day of receipt is omitted.

3. Subsection (3) fixes a base point from which to measure the time within which notice of dishonor must be given. See § 3-508.

4. Subsection (4) leaves banks free to agree upon the manner of returning items but establishes a precise time when an item is "returned". For definition of "sent" as used in subsections (a) and (b) see § 1-201(38).

5. Obviously the section assumes that the item has not been "finally paid" under § 4-213(1). If it has been, this section has no operation.

Cross References:

§§ 3-508, 4-213, 4-302.

Definitional Cross References:

"Banking day". § 4-104.
"Clearing house". § 4-104.
"Collecting bank". § 4-105.
"Customer". § 4-104.
"Documentary draft". § 4-104.
"Item". § 4-104.
"Midnight deadline". § 4-104.
"Notice of dishonor". § 3-508.
"Payor bank". § 4-105.
"Presenting bank". § 4-105.
"Sent". § 1-201(38).
"Settlement". § 4-104.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-543.1, 6-543.2, 6-543.3.

Comment: The deferred posting sections of the UCC carry out the same basic purposes as the Virginia statutes. Code 1950, § 6-543.1, applies when the bank "gives credit therefor before midnight of the day of receipt." The term "credit" is then defined in Code 1950, § 6-543.2, as including "payment, remittance, advice of credit, or authorization to charge and, in case where the item is received for deposit as well as for payment, also includes the making of appropriate entries to the receiving bank's general ledger without regard to whether the item is posted to individual customers' ledgers." While the UCC uses different terminology, there are no apparent significant differences as compared with the Virginia statutes.

§ 4-302. **Payor Bank's Responsibility for Late Return of Item.** In the absence of a valid defense such as breach of a presentment warranty (subsection (1) of § 4-207), settlement effected or the like, if an item is presented on and received by a payor bank the bank is accountable for the amount of

(a) a demand item other than a documentary draft whether properly payable or not if the bank, in any case where it is not also the depositary bank, retains the item beyond midnight of the banking day of receipt without settling for it or, regardless of whether it is also the depositary bank, does not pay or return the item or send notice of dishonor until after its midnight deadline; or

(b) any other properly payable item unless within the time allowed for acceptance or payment of that item the bank either accepts or pays the item or returns it and accompanying documents.

COMMENT: **Prior Uniform Statutory Provision:** None; but see American Bankers Association Model Deferred Posting Statute.

Purposes: Under § 4-301, time limits are prescribed within which a payor bank must take action if it receives an item payable by it. § 4-302 states the rights of the customer if the payor bank fails to take the action required within the time limits prescribed.

Cross Reference:

§ 4-301.

Definitional Cross References:

"Acceptance". § 3-410.
"Banking day". § 4-104.
"Customer". § 4-104.
"Depositary bank". § 4-105.
"Documentary draft". § 4-104.
"Item". § 4-104.
"Midnight deadline". § 4-104.
"Notice of dishonor". § 3-508.
"Payor bank". § 4-105.
"Properly payable". § 4-104.
"Settle". § 4-104.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-543.1, 6-543.2, 6-543.3.

Comment: See VIRGINIA ANNOTATIONS to § 4-301.

§ 4-303. **When Items Subject to Notice, Stop-Order, Legal Process or Setoff; Order in Which Items May be Charged or Certified.** (1) Any knowledge, notice or stop-order received by, legal process served upon or setoff exercised by a payor bank, whether or not effective under other rules of law to terminate, suspend or modify the bank's right or duty to pay an item or to charge its customer's account for the item, comes too late to so terminate, suspend or modify such right or duty if the knowledge, notice, stop-order or legal process is received or served and a reasonable time for the bank to act thereon expires or the setoff is exercised after the bank has done any of the following:

(a) accepted or certified the item;

(b) paid the item in cash;

(c) settled for the item without reserving a right to revoke the settlement and without having such right under statute, clearing house rule or agreement;

(d) completed the process of posting the item to the indicated account of the drawer, maker or other person to be charged therewith or otherwise has evidenced by examination of such indicated account and by action its decision to pay the item; or

(e) become accountable for the amount of the item under subsection (1) (d) of § 4-213 and § 4-302 dealing with the payor bank's responsibility for late return of items.

(2) Subject to the provisions of subsection (1) items may be accepted, paid, certified or charged to the indicated account of its customer in any order convenient to the bank.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. The comments to § 4-213 describe the process through which an item passes in the payor bank. Prior to this process or at any time while it is going on, the payor bank may receive knowledge or a legal notice affecting the item, such as knowledge or a notice that the drawer has filed a petition in bankruptcy or made an assignment for the benefit of creditors; may receive an order of the drawer stopping payment on the item; may have served on it an attachment of the account of the drawer; or the bank itself may exercise a right of setoff against the drawer's account. Each of these events affects the account of the drawer and may eliminate or freeze all or part of whatever balance is available to pay the item. Subsection (1) states the rule for determining the relative priorities between these various legal events and the item.

2. The rule is that if any one of several things has been done to the item or if it has reached any one of several stages in its processing at the time the knowledge, notice, stop-order or legal process is received or served and a reasonable time for the bank to act thereon expires or the setoff is exercised, the knowledge, notice, stop-order, legal process or setoff comes too late, the item has priority and a charge to the customer's account may be made and is effective. Certain of the tests determining the priority status of the item are the same as for final payment under § 4-213(1), but additional tests apply in the context of the present section. The first event mentioned, namely, acceptance, means formal acceptance as that term is used and defined in § 3-410. Certification is the type of certification defined in § 3-411. Payment of the item in cash under § 4-213(1)(a), final settlement for the item under § 4-213(1)(b) and completion of the process of posting under § 4-213(1)(c) all constitute final payment of the item and confer priority. After a cash payment, final settlement or the completion of the process of posting, any knowledge, notice, stop-order, legal process or setoff comes too late and cannot interfere with either the payment of the item or a charge to the customer's account based upon such payment.

3. The sixth event conferring priority is stated by the language "or otherwise has evidenced by examination of such indicated account and by action its decision to pay the item." This general "omnibus" language is necessary to pick up other possible types of action impossible to specify particularly but where the bank has examined the account to see if there are sufficient funds and has taken some action indicating an intention to pay. An example is what has sometimes been called "sight posting" where the bookkeeper examines the account and makes a decision to pay but postpones posting. The clause should be interpreted in the light of Ninteenth Ward Bank v. First Nat. Bank of South Weymouth, 184 Mass. 49, 67 N.E. 670 (1903). It is not intended to refer to various preliminary acts in no way close to a true decision of the bank to pay the item, such as receipt of the item over the counter for deposit, entry of a provisional credit in a passbook, or the making of a provisional settlement for the item through the clearing house, by entries in accounts, remittance or otherwise. All actions of this type are provisional and none of them evidences the bank's decision to pay the item. In this Section as in § 4-213 reasoning such as appears in Cohen v. First Nat. Bank of Nogales, 22 Ariz. 394, 400, 198 P. 122, 124, 15 A.L.R. 701 (1921); Briviesca v. Coronado, 19 Cal.2d 244, 120 P.2d 649 (1941); White Brokerage Co. v. Cooperman, 207 Minn. 239, 290 N.W. 790 (1940); Scotts Bluff County v. First Nat. Bank of Gering, 115 Neb. 273, 212 N.W. 617, 618 (1927); Provident Savings Bank & Trust Co. v. Hildebrand, 49 Ohio App. 207, 196 N.E. 790, 791 (1934); Schaer v. First Nat. Bank of Brenham, 132 Tex. 499, 124 S.W.2d 108 (1939) (bill of exchange); Union State Bank of Lancaster v. People's State Bank of Lancaster, 192 Wis. 28, 33, 211 N.W. 931, 933 (1927); 1 Paton's Digest 1067, is rejected.

4. The seventh and last event conferring priority for an item and a charge to the customer's account based upon the item is stated by the language "become accountable for the amount of the item under subsection (1)(d) of § 4-213 and § 4-302 dealing with the payor bank's responsibility for late return of items". Under § 4-213(1)(d) if a payor bank makes a provisional settlement for an item and fails to revoke the settlement in the time and manner permitted by statute, clearing house rule or agreement, such combination of events constitutes final payment of the item. Under § 4-302 a payor bank may also become accountable for the amount of an item in certain other situations even though there has been no provisional settlement for the item or such action as constitutes final payment under § 4-213(1). Expiration of the deadlines under §§ 4-213(1)(d) or 4-302 with resulting accountability by the payor bank for the amount of the item, establish priority of the item over notices, stop-orders, legal process or setoff.

5. In the case of knowledge, notice, stop-orders and legal process the effective time for determining whether they were received too late to affect the payment of an item and a charge to the customer's account by reason of such payment, is receipt plus a reasonable time for the bank to act on any of these communications. Usually a relatively short time is required to communicate to the bookkeeping department advice of one of these events but certainly some time is necessary. Compare §§ 1-201(27) and 4-403. In the case of setoff the effective time is when the setoff is actually made.

6. As between one item and another no priority rule is stated, other than the convenience of the bank. This rule is justified because of the impossibility of stating a rule that would be fair in all cases, having in mind the almost infinite number of combinations of large and small checks in relation to the available balance on hand in the drawer's account; the possible methods of receipt; and other difficulties. Further, where the drawer has drawn all the checks, he should have funds available to meet all of them and has no basis for urging one should be paid before another; and the holders have no direct right against the payor bank in any event, unless of course, the bank has accepted, certified or finally paid a particular item, or has become liable for it under § 4-302. Under subsection (2) the bank obviously has the right to pay items for which it is itself liable ahead of those for which it is not.

Cross References:

§§ 3-410, 3-411, 4-213(1), 4-301, 4-302.

Definitional Cross References:

"Accepted". § 3-410.
"Account". § 4-104.
"Agreement". § 1-201.
"Certified". § 3-411.
"Clearing house". § 4-104.
"Customer". § 4-104.
"Item". § 4-104.
"Notice". § 1-201.
"Payor bank". § 4-105.
"Settle". § 4-104.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: The UCC does not deal with the right of a debtor of a bank to setoff a debt owing by the bank to him, the situation presented in Dickenson v. Charles, 173 Va. 393, 399, 4 S.E.2d 356 (1939).

PART 4

RELATIONSHIP BETWEEN PAYOR BANK AND ITS CUSTOMER

§ 4-401. When Bank May Charge Customer's Account. (1) As against its customer, a bank may charge against his account any item which is otherwise properly payable from that account even though the charge creates an overdraft.

(2) A bank which in good faith makes payment to a holder may charge the indicated account of its customer according to

(a) the original tenor of his altered item; or

(b) the tenor of his completed item, even though the bank knows the item has been completed unless the bank has notice that the completion was improper.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. It is fundamental that upon proper payment of a draft the drawee may charge the account of the drawer. This is true even though the draft is an overdraft since the draft itself authorizes the payment for the drawer's account and carries an implied promise to reimburse the drawee.

2. Subsection (2) parallels the provision which protects a holder in due course against discharge by reason of alteration and permits him to enforce the instrument according to its original tenor. § 3-407(3). It adopts the rule of cases extending the same protection to a drawee who pays in good faith. The subsection also follows the policy of §§ 3-115 and 3-407(3) by protecting the drawee who pays a completed instrument in good faith according to the instrument as completed.

Cross References:

§§ 3-115 and 3-407.

Definitional Cross References:

"Account". § 4-104.
"Bank". § 1-201.
"Customer". § 4-104.
"Good faith". § 1-201.
"Holder". § 1-201.
"Item". § 4-104.
"Properly payable". § 4-104.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: The UCC follows prior law in allowing a bank to charge a customer's account according to the original tenor of an altered item. Nat'l Bank of Virginia v. Nolting, 94 Va. 263, 267, 26 S.E. 826 (1897), held that a bank could not charge the drawer's account for payment of a $500 check, which had been raised from $10, but no particular point was made as to whether the bank could charge the account for $10, the original tenor.

§ 4-402. **Bank's Liability to Customer for Wrongful Dishonor.** A payor bank is liable to its customer for damages proximately caused by the wrongful dishonor of an item. When the dishonor occurs through mistake liability is limited to actual damages proved. If so proximately caused and proved damages may include damages for an arrest or prosecution of the customer or other consequential damages. Whether any consequential damages are proximately caused by the wrongful dishonor is a question of fact to be determined in each case.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. This section is new to the Uniform Laws, although similar statutory provisions are in existence in twenty-three jurisdictions.

2. The liability of the drawee for dishonor has sometimes been stated as one for breach of contract, sometimes as for negligence or other breach of a tort duty, and sometimes as for defamation. This section does not attempt to specify a theory. "Wrongful dishonor" excludes any permitted or justified dishonor, as where the drawer has no credit extended by the drawee, or where the draft lacks a necessary indorsement or is not properly presented.

3. This section rejects decisions which have held that where the dishonored item has been drawn by a merchant, trader or fiduciary he is defamed in his business,

trade or profession by a reflection on his credit and hence that substantial damages may be awarded on the basis of defamation "per se" without proof that damage has occurred. The merchant, trader and fiduciary are placed on the same footing as any other drawer and in all cases of dishonor by mistake damages recoverable are limited to those actually proved.

4. Wrongful dishonor is different from "failure to exercise ordinary care in handling an item", and the measure of damages is that stated in this section, not that stated in § 4-103(5).

5. The fourth sentence of the section rejects decisions holding that as a matter of law the dishonor of a check is not the "proximate cause" of the arrest and prosecution of the customer, and leaves to determination in each case as a question of fact whether the dishonor is or may be the "proximate cause".

Definitional Cross References:

"Bank". § 1-201.
"Customer". § 4-104.
"Item". § 4-104.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-71.

Comment: Although worded differently, the UCC is in accord with Code 1950, § 6-71, regulating a bank's liability to a customer for wrongful dishonor. The Virginia statute limits the liability of a bank for nonmalicious refusal to pay a check of a depositor to proven "actual damages," without specifying what actual damages are. The UCC similarly limits liability to actual damages, but does indicate that damages for an arrest or prosecution are cognizable as consequential actual damages. See also Wood v. American Nat'l Bank, 100 Va. 306, 40 S.E. 931 (1902), holding that exemplary damages may be awarded where a dishonor is wilful and malicious, or the negligence so gross as to evince a culpable indifference to consequences, but only compensatory damages are authorized where no evil motive is proved.

§ 4-403. Customer's Right to Stop Payment; Burden of Proof of Loss. (1) A customer may by order to his bank stop payment of any item payable for his account but the order must be received at such time and in such manner as to afford the bank a reasonable opportunity to act on it prior to any action by the bank with respect to the item described in § 4-303.

(2) An oral order is binding upon the bank only for fourteen calendar days unless confirmed in writing within that period. A written order is effective for only six months unless renewed in writing.

(3) The burden of establishing the fact and amount of loss resulting from the payment of an item contrary to a binding stop payment order is on the customer.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. This section is new. It is intended to replace separate statutes in twenty-nine states which regulate stop-payment orders.

2. The position taken by this section is that stopping payment is a service which depositors expect and are entitled to receive from banks notwithstanding its difficulty, inconvenience and expense. The inevitable occasional losses through failure to stop should be borne by the banks as a cost of the business of banking.

3. Subsection (1) follows the decisions holding that a payee or indorsee has no right to stop payment. This is consistent with the provision governing payment or satisfaction. See § 3-603. The sole exception to this rule is found in § 4-405 on payment after notice of death, by which any person claiming an interest in the account can stop payment.

4. Payment is commonly stopped only on checks; but the right to stop payment is not limited to checks, and extends to any item payable by any bank. Where the maker of a note payable at a bank is in a position analogous to that of a drawer (§ 3-121) he may stop payment of the note. By analogy the rule extends to drawees other than banks.

5. There is no right to stop payment after certification of a check or other acceptance of a draft, and this is true no matter who procures the certification. See §§ 3-411 and 4-303. The acceptance is the drawee's own engagement to pay, and he is not required to impair his credit by refusing payment for the convenience of the drawer.

6. Normally a direction to stop payment is first given by telephone. Notwithstanding statutes which require a written order, banks customarily accept such directions, and have been held to waive the writing. Subsection (2) is intended to protect both parties by making the oral direction effective for only a short time during which the drawer must confirm it in writing, and by eliminating thereafter any claim of waiver by acceptance of the oral direction.

7. The existing statutes all specify a time limit after which any direction to stop payment becomes ineffective unless it is renewed in writing; and the majority of them have specified six months. The purpose of the provision is, of course, to facilitate stopping payment by clearing the records of the drawee of accumulated unrevoked stop orders, as where the drawer has found a lost instrument or has settled his controversy with the payee, but has failed to notify the drawee. The last sentence of subsection (2), together with the second clause in § 4-404, rejects the reasoning of such cases as Goldberg v. Manufacturers Trust Company, 199 Misc. 167, 102 N.Y.S.2d 144 (1951).

8. A payment in violation of an effective direction to stop payment is an improper payment, even though it is made by mistake or inadvertence. Any agreement to the contrary is invalid under § 4-103(1) if in paying the item over the stop payment order the bank has failed to exercise ordinary care. The drawee is, however, entitled to subrogation to prevent unjust enrichment (§ 4-407); retains common-law defenses, e. g., that by conduct in recognizing the payment the customer has ratified the bank's action in paying over a stop payment order (§ 1-103); and retains common-law rights, e. g., to recover money paid under a mistake (§ 1-103) in cases where the payment is not made final by § 3-418. It has sometimes been said that payment cannot be stopped against a holder in due course, but the statement is inaccurate. The payment can be stopped but the drawer remains liable on the instrument to the holder in due course (§§ 3-305, 3-413) and the drawee, if he pays, becomes subrogated to the rights of the holder in due course against the drawer. § 4-407. Any defenses available against a holder in due course remain available to the drawer, but other defenses are cut off to the same extent as if the holder himself were bringing the action.

Cross References:

Point 3: §§ 3-603(1), 4-405.
Point 4: § 3-121.
Point 5: §§ 3-411 and 4-303.
Point 8: §§ 3-305, 3-413, 3-418, 4-103 and 4-407.

Definitional Cross References:

"Account". § 4-104.
"Bank". § 1-201.
"Burden of establishing". § 1-201.
"Customer". § 4-104.
"Item". § 4-104.
"Send". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-73.

Comment: The UCC recognizes the right of a customer to stop payment on any item payable from his account, if the order is received by the bank at such time and in such manner as to afford the bank a reasonable opportunity to act upon it. Oral orders are binding only for fourteen calendar days, unless confirmed in writing within that period. Written orders are effective only for six months, unless renewed in writing. The purposes of the UCC are the same, although the details differ, as those of the Virginia statute, which provides that a stop-payment, initially, shall not be valid for more than one year, but that further renewals, to be effective for not more than one year each, may be made. The Virginia statute requires the renewal to be in writing, but it does not impose this requirement for the original stop-payment order.

§ 4-404. **Bank Not Obligated to Pay Check More Than Six Months Old.** A bank is under no obligation to a customer having a checking account to pay a check, other than a certified check, which is presented more than six months after its date, but it may charge its customer's account for a payment made thereafter in good faith.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: This section incorporates a type of statute adopted in twenty-six jurisdictions. The time limit is set at six months because banking and commercial practice regards a check outstanding for longer than that period as stale, and a bank will normally not pay such a check without consulting the depositor. It is therefore not required to do so, but is given the option to pay because it may be in a position to know, as in the case of dividend checks, that the drawer wants payment made.

Certified checks are excluded from the section because they are the primary obligation of the certifying bank (§§ 3-411 and 3-413), which obligation runs direct to the holder of the check. The customer's account was charged when the check was certified.

Cross References:

§§ 3-411 and 3-413.

Definitional Cross References:

"Account". § 4-104.
"Bank". § 1-201.
"Check". § 3-104.
"Customer". § 4-104.
"Good faith". § 1-201.
"Present". § 3-504.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-72.

Comment: The UCC provides that a bank is under no obligation to pay a stale check presented more than six months after its date. The Virginia statute provides that a bank is under no obligation to pay a "demand" check presented more than one year from its date of issue. Besides being more favorable to the banks, and more exact, the UCC also authorizes the bank to charge its customer's account for good faith payments made after it is no longer obligated to make them.

§ 4-405. **Death or Incompetence of Customer.** (1) A payor or collecting bank's authority to accept, pay or collect an item or to account for proceeds of its collection if otherwise effective is not rendered ineffective by incompetence of a customer of either bank existing at the time the item is issued or its collection is undertaken if the bank does not know of an adjudication of incompetence. Neither death nor incompetence of a customer revokes such authority to accept, pay, collect or account until the bank knows of the fact of death or of an adjudication of incompetence and has reasonable opportunity to act on it.

(2) Even with knowledge a bank may for ten days after the date of death pay or certify checks drawn on or prior to that date unless ordered to stop payment by a person claiming an interest in the account.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. This section is new, although similar statutory provisions are in existence in seven states.

2. Subsection (1) follows existing decisions which hold that a drawee (payor) bank is not liable for the payment of a check before it has notice of the death or incompetence of the drawer. The justice and necessity of the rule are obvious. A check is an order to pay which the bank must obey under penalty of possible liability for disbonor. Further, with the tremendous volume of items handled any rule which required banks to verify the continued life and competency of drawers would be completely unworkable.

One or both of these same reasons apply to other phases of the bank collection and payment process and the rule is made wide enough to apply to these other phases. It applies to all kinds of "items"; to "customers" who own items as well as "customers" who draw or make them; to the function of collecting items as well as the function of accepting or paying them; to the carrying out of instructions to account for proceeds even though these may involve transfers to third parties; to depositary and intermediary banks as well as payor banks; and to incompetency existing at the time of the issuance of an item or the commencement of the collection or payment process as well as to incompetency occurring thereafter. Further, the requirement of actual knowledge makes inapplicable the rule of some cases that an adjudication of incompetency is constructive notice to all the world because obviously it is as impossible for banks to keep posted on such adjudications (in the absence of actual knowledge) as it is to keep posted as to death of immediate or remote customers.

3. Subsection (2) provides a limited period after death during which a bank may continue to pay checks (as distinguished from other items) even though it has notice. The purpose of the provision, as of the existing statutes, is to permit holders of checks drawn and issued shortly before death to cash them without the necessity of filing a claim in probate. The justification is that such checks normally are given in immediate payment of an obligation, that there is almost never any reason why they should not be paid, and that filing in probate is a useless formality, burdensome to the holder, the executor, the court and the bank.

This section does not prevent an executor or administrator from recovering the payment from the holder of the check. It is not intended to affect the validity of any gift causa mortis or other transfer in contemplation of death, but merely to relieve the bank of liability for the payment.

4. Any surviving relative, creditor or other person who claims an interest in the account may give a direction to the bank not to pay checks, or not to pay a particular check. Such notice has the same effect as a direction to stop payment. The bank has no responsibility to determine the validity of the claim or even whether it is "colorable". But obviously anyone who has an interest in the estate, including the person named as executor in a will, even if the will has not yet been admitted to probate, is entitled to claim an interest in the account.

Definitional Cross References:

"Accept". § 3-410.
"Bank". § 1-201.
"Certify". § 3-411.
"Check". § 3-104.
"Customer". § 4-104.
"Depositary bank". § 4-105.
"Item". § 4-104.
"Payor bank". § 4-105.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-540.

Comment: Under the UCC, until a bank has knowledge of the death or an adjudication of incompetency of a customer and a reasonable opportunity to act on it, the authority of the bank to accept, pay, or collect his items is not revoked. Even with knowledge of death the bank for ten days after the date of death may pay or certify checks drawn on or prior to the date of death, although it is not intended to prevent the personal representative from recovering the payment. A person claiming an interest in the account may, however, order the bank to stop payment. Virginia, by an amendment to the NIL, provides in Code 1950, § 6-540, that the authority of a bank to pay checks is not revoked for a period of two weeks, but it is not clear whether the two-week period runs from the date of death of the drawer or from the date the bank has knowledge of the death of the drawer.

§ 4-406. Customer's Duty to Discover and Report Unauthorized Signature or Alteration. (1) When a bank sends to its customer a statement of account accompanied by items paid in good faith in support of the debit entries or holds the statement and items pursuant to a request or instructions of its customer or otherwise in a reasonable manner makes the statement and items available to the customer, the customer must exercise

reasonable care and promptness to examine the statement and items to discover his unauthorized signature or any alteration on an item and must notify the bank promptly after discovery thereof.

(2) If the bank establishes that the customer failed with respect to an item to comply with the duties imposed on the customer by subsection (1) the customer is precluded from asserting against the bank

(a) his unauthorized signature or any alteration on the item if the bank also establishes that it suffered a loss by reason of such failure; and

(b) an unauthorized signature or alteration by the same wrongdoer on any other item paid in good faith by the bank after the first item and statement was available to the customer for a reasonable period not exceeding fourteen calendar days and before the bank receives notification from the customer of any such unauthorized signature or alteration.

(3) The preclusion under subsection (2) does not apply if the customer establishes lack of ordinary care on the part of the bank in paying the item(s).

(4) Without regard to care or lack of care of either the customer or the bank a customer who does not within one year from the time the statemen and items are made available to the customer (subsection (1)) discover and report his unauthorized signature or any alteration on the face or back of the item or does not within three years from that time discover and report any unauthorized indorsement is precluded from asserting against the bank such unauthorized signature or indorsement or such alteration.

(5) If under this section a payor bank has a valid defense against a claim of a customer upon or resulting from payment of an item and waives or fails upon request to assert the defense the bank may not assert against any collecting bank or other prior party presenting or transferring the item a claim based upon the unauthorized signature or alteration giving rise to the customer's claim.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. This section is new to Uniform Laws. It is to replace statutes in forty jurisdictions dealing with the general subject of a depositor's duty to discover and report forgeries and alterations. In these statutes there is substantial variation in rules prescribed as to the following matters: application of the statute to unauthorized signatures, raised checks or altered checks; inclusion of special provisions with respect to fictitious payees; periods of time prescribed for termination of right of customer to assert claims against bank; time when limitation period begins to run; restriction of rights of customer stated in terms of liability for loss, preclusion of rights or limitations on time in which suits may be brought.

2. Subsection (1) states the general duty of a customer to exercise reasonable care and promptness to examine his bank statements and items to discover his unauthorized signature or any alteration and to promptly notify the bank if he discovers an unautborized signature or alteration. This duty becomes operative when the bank does any one of three things with respect to the statement of account and supporting items paid in good faith. The first action is the sending of the statement and items to the customer. The sending may be either by mailing or any other action within the definition of "send" (§ 1-201). The second action is the bolding of such statement and items available for the customer pursuant to a request for instructions of the customer. The third action is stated as "or otherwise in a reasonable manner makes the statement and items available to the customer." Such wider residual language is desirable to cover unusual situations. An example might be where the bank knows a customer has left a former address but does not know any new address to which to send the statement or item or to obtain instructions from the customer. The third residual type of action, however, must be "reasonable" and any court has the power to determine that a particular action or practice of a bank, other than sending statements and items or holding them pursuant to instructions, is not reasonable.

3. Subsection (2) states the effect of a failure of a customer to comply with subsection (1). The first effect stated in subparagraph (a) is that he is precluded from asserting against the bank his unauthorized signature and alteration if the bank establishes that it suffered a loss by reason of the customer's failure. The bank has the burden of establishing that it suffered some loss.

Under subparagraph (b) if, after the first item and statement becomes available plus a reasonable period not exceeding fourteen calendar days, the bank pays in good faith any other item on which there is an unauthorized signature or alteration by the same wrongdoer, which payment is prior to receipt by the bank of notification of such unauthorized signature or alteration on the first item, the customer is precluded from asserting the additional unauthorized signature or alteration. This rule follows substantial case law that payment of an additional item or items bearing an unauthorized signature or alteration by the same wrongdoer is a loss suffered by the bank traceable to the customer's failure to exercise reasonable care in examining his statement and notifying the bank of objections to it. One of the most serious consequences of failure of the customer to comply with the requirements of subsection (1) is the opportunity presented to the wrongdoer to repeat his misdeeds. Conversely, one of the best ways to keep down losses in this type of situation is for the customer to promptly examine his statement and notify the bank of an unauthorized signature or alteration so that the bank will be alerted to stop paying further items. Hence, the rule of subparagraph (b) is prescribed and to avoid dispute a specific time limit for action by the customer is designated, namely fourteen calendar days.

4. The two effects on the customer of his failure to comply with subsection (1) (subparagraphs (a) and (b) of subsection (2)) are stated in terms of preclusion from asserting a claim against the bank. However, these two effects occur only if the customer has failed to exercise reasonable care and promptness in examining his statement and items and notifying the bank and as to this question of fact the burden is upon the bank to establish such failure. Further, even if the bank succeeds in establishing that the customer has failed to exercise ordinary care, if in turn the customer succeeds in establishing that the bank failed to exercise ordinary care in paying the item(s) the preclusion rule does not apply. This distribution of the burden of establishing between the customer and the bank provides reasonable equality of treatment and requires each person asserting the negligence to establish such negligence rather than requiring either person to establish that his entire course of conduct constituted ordinary care.

5. Whether the preclusion rule of subsection (2) operates or does not operate depends upon determinations as to ordinary care of the customer and possibly of the bank. However, subsection (4) places an absolute time limit on the right of a customer to make claim for payment of altered or forged paper without regard to care or lack of care of either the customer or the bank. In the case of alteration or the unauthorized signature of the customer himself the absolute time limit is one year. In the case of unauthorized indorsements it is three years. This recognizes that there is little excuse for a customer not detecting an alteration of his own check or a forgery of his own signature. However, he does not know the signatures of indorsers and may be delayed in learning that indorsements are forged. The three year absolute time limit on the discovery of forged indorsements should be ample, because in the great preponderance of cases the customer will learn of the forged indorsements within this time and if in any exceptional case he does not, the balance in favor of a mechanical termination of the liability of the bank outweighs what few residuary risks the customer may still have. In thirteen of the existing statutes there are limitations on the liability of a bank for payment of items bearing forged indorsements which limitation periods range from thirty days to two years. In the remaining twenty-seven no provision is made for forged indorsements.

6. Nothing in this section is intended to affect any decision holding that a customer who has notice of something wrong with an indorsement must exercise reasonable care to investigate and to notify the bank. It should be noted that under the rules relating to impostors and signatures in the name of the payee (§ 3-405) certain forged indorsements on which the bank has paid the item in good faith may be treated as effective notwithstanding such discovery and notice. If the alteration or forgery results from the drawer's negligence the drawee who pays in good faith is also protected. § 3-406.

7. The forty existing statutes on the subject as well as § 4-406 evidence a public policy in favor of imposing on customers the duty of prompt examination of their bank statements and the notification of banks of forgeries and alterations and in favor of reasonable time limitations on the responsibility of banks for payment

of forged or altered items. In two New York cases, however, it has been held that a payor bank may waive defenses of the kind prescribed by the section and ignore the public policy indicated by these defenses and recover the full amount of a forged or altered item from a collecting bank. Fallick v. Amalgamated Bank of New York, 232 App.Div. 127, 249 N.Y.S. 238 (1st Dep't. 1931); National Surety Corp. v. Federal Reserve Bank of New York, 188 Misc. 207, 70 N.Y.S.2d 636 (1946), affirmed without opinion 188 Misc. 213, 70 N.Y.S.2d 642 (1946). Subsection (5) is intended to reject the holding of these and like cases. Although the principle of subsection (5) might well be applied to other types of claims of customers against banks and defenses to these claims, the rule of the subsection is limited to defenses of a payor bank under this section. No present need is known to give the rule wider effect.

Cross References:

§§ 3-404, 3-405, 3-406, 3-407, 3-417 and 4-207.

Definitional Cross References:

"Alteration". § 3-407.
"Bank". § 1-201.
"Collecting bank". § 4-105.
"Customer". § 4-104.
"Good faith". § 1-201.
"Indorsement". § 3-204.
"Item". § 4-104.
"Payor bank". § 4-105.
"Send". § 1-201.
"Unauthorized signature". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-74, 6-75.

Comment: Under both the UCC and Virginia law a depositor owes a bank the duty of examining statements of account and cancelled checks and to report unauthorized withdrawals from his account. Bank of Occoquan, Inc. v. Bushey, 156 Va. 25, 157 S.E. 764 (1931); Trust Co. of Norfolk v. Snyder, 152 Va. 572, 575-79, 147 S.E. 234 (1929); Trust Co. of Norfolk v. Snyder, 148 Va. 381, 386-87, 138 S.E. 477 (1927); Brown v. Lynchburg Nat'l Bank, 109 Va. 530, 64 S.E. 950 (1909); First Nat'l Bank v. Richmond Electric Co., 106 Va. 347, 56 S.E. 152 (1907). Both the Virginia statutes and the UCC draw some distinctions between the customer's duty as regards his own forged signature and altered items, and his duty as regards forged indorsements, where he cannot be expected to know the indorsers signature. Virginia case law has established that the bank must itself be free from negligence in making an unauthorized payment in order to be relieved from liability. Trust Co. of Norfolk v. Snyder, 152 Va. 572, 147 S.E. 234 (1929); Brown v. Lynchburg Nat'l Bank, 109 Va. 530, 64 S.E. 950 (1909). The UCC is in accord, permitting the customer to recover from the bank if he can establish a lack of ordinary care on the part of the bank in paying the items.

Virginia has recognized that the bank customer owes the duty to the bank, even though it is a bank employee who is perpetrating the fraud. Bank of Occoquan, Inc. v. Bushey, 156 Va. 25, 29-30, 157 S.E. 764 (1931); Brown v. Lynchburg Nat'l Bank, 109 Va. 530, 64 S.E. 950 (1909). The UCC does not expressly cover the point.

The UCC is somewhat broader in its coverage, as regards items, signatures and types of alterations, than the Virginia statutes. The Virginia statutes are strictly statutes of limitations so that a bank would apparently be liable to the customer for unauthorized withdrawals occurring within the statutory period, regardless of how long the customer has been negligent in failing to examine his statements. Under the UCC, however, once the depositor has failed in his duty of examining his statements, he is thereafter precluded from asserting against the bank other unauthorized withdrawals made by the same wrongdoer.

The UCC imposes an absolute one-year statute of limitations as regards unauthorized withdrawals based on the customer's signature or alteration of an item, and a three-year statute of limitations as regards unauthorized indorsements. The comparable periods under the Virginia statutes are ninety days and two years, respectively.

§ 4-407. **Payor Bank's Right to Subrogation on Improper Payment.** If a payor bank has paid an item over the stop payment order of the drawer or maker or otherwise under circumstances giving a basis for objection by the drawer or maker, to prevent unjust enrichment and only to the extent necessary to prevent loss to the bank by reason of its payment of the item, the payor bank shall be subrogated to the rights

(a) of any holder in due course on the item against the drawer or maker; and

(b) of the payee or any other holder of the item against the drawer or maker either on the item or under the transaction out of which the item arose; and

(c) of the drawer or maker against the payee or any other holder of the item with respect to the transaction out of which the item arose.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. § 4-403 states that a stop payment order is binding on a bank. If a bank pays an item over such a stop order it is prima facie liable, but under subsection (3) of § 4-403 the burden of establishing the fact and amount of loss from such payment is on the customer. A defense frequently interposed by a bank in an action against it for wrongful payment over a stop-order is that the drawer or maker suffered no loss because he would have been liable to a holder in due course in any event. On this argument some cases have held that payment cannot be stopped against a holder in due course. Payment can be stopped, but if it is, the drawer or maker is liable and the sound rule is that the bank is subrogated to the rights of the holder in due course. The preamble and subsection (a) of this section state this rule.

2. Subsection (b) also subrogates the bank to the rights of the payee or other holder against the drawer or maker either on the item or under the transaction out of which it arose. It may well be that the payee is not a holder in due course but still has good rights against the drawer. These may be on the check but also may not be as, for example, where the drawer buys goods from the payee and the goods are partially defective so that the payee is not entitled to the full price, but the goods are still worth a portion of the contract price. If the drawer retains the goods he is obligated to pay a part of the agreed price. If the bank has paid the check it should be subrogated to this claim of the payee against the drawer.

3. Subsection (c) subrogates the bank to the rights of the drawer or maker against the payee or other holder with respect to the transaction out of which the item arose. If, for example, the payee was a fraudulent salesman inducing the drawer to issue his check for defective securities, and the bank pays the check over a stop order but reimburses the drawer for such payment, the bank should have a basis for getting the money back from the fraudulent salesman.

4. The limitations of the preamble prevent the bank itself from getting any double recovery or benefits out of its subrogation rights conferred by the section.

5. The spelling out of the affirmative rights of the bank in this section does not destroy other existing rights (§ 1-103). Among others these may include the defense of a payor bank that by conduct in recognizing the payment a customer has ratified the bank's action in paying in disregard of a stop payment order or rights to recover money paid under a mistake.

Cross Reference:

§ 4-403.

Definitional Cross References:

"Holder". § 1-201.
"Holder in due course". § 3-302.
"Item". § 4-104.
"Payor bank". § 4-105.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: The UCC goes somewhat beyond the dictum in McAuley v. Morris Plan Bank, 155 Va. 777, 156 S.E. 418 (1931), to the effect that a payor bank ignoring a stop-payment order would be subrogated as against the drawer to the rights of a holder in due course who had presented the instrument and received payment. In McAuley the precise question was not presented. A depositary bank paid its depositor by a check drawn on another bank. The depositor indorsed the check to a third person and then discovered that the automobile for which the check had been indorsed had been stolen. At the request of the depositor the depositary bank stopped payment on its check. But on learning that another bank had cashed the check in good faith, the bank withdrew the stop-payment order. In an action by the depositor against the depositary bank the court said that the ultimate question in such a case would be whether there was a holder in due course.

PART 5

COLLECTION OF DOCUMENTARY DRAFTS

§ 4-501. Handling of Documentary Drafts; Duty to Send for Presentment and to Notify Customer of Dishonor. A bank which takes a documentary draft for collection must present or send the draft and accompanying documents for presentment and upon learning that the draft has not been paid or accepted in due course must seasonably notify its customer of such fact even though it may have discounted or bought the draft or extended credit available for withdrawal as of right.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: To state the duty of a bank handling a documentary draft for a customer. "Documentary draft" is defined in § 4-104. Notice that the duty stated exists even when the bank has bought the draft. This is because to the customer the draft normally represents an underlying commercial transaction, and if that is not going through as planned he should know it promptly.

Cross References:

In Article 4: §§ 4-201, 4-202, 4-203, 4-204 and 4-210.
In Article 5: §§ 5-110, 5-111, 5-112 and 5-113.

Definitional Cross References:

"Documentary draft". §§ 4-104, 5-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 4-502. Presentment of "On Arrival" Drafts. When a draft or the relevant instructions require presentment "on arrival", "when goods arrive" or the like, the collecting bank need not present until in its judgment a reasonable time for arrival of the goods has expired. Refusal to pay or accept because the goods have not arrived is not dishonor; the bank must notify its transferor of such refusal but need not present the draft again until it is instructed to do so or learns of the arrival of the goods.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: The section is designated to establish a definite rule for "on arrival" drafts. The term includes not only drafts drawn payable "on arrival" but also drafts forwarded with instructions to present "on arrival". The term refers to the arrival of the relevant goods. Unless a bank has actual knowledge of the

arrival of the goods, as for example, when it is the "notify" party on the bill of lading, the section only requires the exercise of such judgment in estimating time as a bank may be expected to have. Commonly the buyer-drawee will want the goods and will therefore call for the documents and take up the draft when they do arrive.

Cross References:

In Article 4: §§ 4-202 and 4-203.
In Article 5: § 5-112.

Definitional Cross References:

"Collecting bank". § 4-105.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 4-503. **Responsibility of Presenting Bank for Documents and Goods; Report of Reasons for Dishonor; Referee in Case of Need.** Unless otherwise instructed and except as provided in Article 5 a bank presenting a documentary draft

(a) must deliver the documents to the drawee on acceptance of the draft if it is payable more than three days after presentment; otherwise, only on payment; and

(b) upon dishonor, either in the case of presentment for acceptance or presentment for payment, may seek and follow instructions from any referee in case of need designated in the draft or if the presenting bank does not choose to utilize his services it must use diligence and good faith to ascertain the reason for dishonor, must notify its transferor of the dishonor and of the results of its effort to ascertain the reasons therefor and must request instructions.

But the presenting bank is under no obligation with respect to goods represented by the documents except to follow any reasonable instructions seasonably received; it has a right to reimbursement for any expense incurred in following instructions and to prepayment of or indemnity for such expenses.

COMMENT: Prior Uniform Statutory Provision: § 131(3), Uniform Negotiable Instruments Law.

Changes: Completely rewritten and enlarged.

Purposes: 1. To state the rules governing, in the absence of instructions, the duty of the presenting bank in case either of honor or of dishonor of a documentary draft. The section should be read in connection with § 2-514 on when documents are delivereable on acceptance, when on payment.

2. If the draft is drawn under a letter of credit, Article 5 controls. See §§ 5-109 through 5-114.

Cross References:

Point 1: § 2-514; see also § 4-504.
Point 2: Article 5, especially §§ 5-109 through 5-114.

Definitional Cross References:

"Documentary draft". §§ 4-104, 5-103.
"Presenting bank". § 4-105.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 4-504. **Privilege of Presenting Bank to Deal With Goods; Security Interest for Expenses.** (1) A presenting bank which, following the dishonor of a documentary draft, has seasonably requested instructions but does not receive them within a reasonable time may store, sell, or otherwise deal with the goods in any reasonable manner.

(2) For its reasonable expenses incurred by action under subsection (1) the presenting bank has a lien upon the goods or their proceeds, which may be foreclosed in the same manner as an unpaid seller's lien.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: To give the presenting bank, after dishonor, a privilege to deal with the goods in any commercially reasonable manner pending instructions from its transferor and, if still unable to communicate with its principal after a reasonable time, a right to realize its expenditures as if foreclosing on an unpaid seller's lien (§ 2-706). The provision includes situations in which storage of goods or other action becomes commercially necessary pending receipt of any requested instructions, even if the requested instructions are later received.

The "reasonable manner" referred to means one reasonable in the light of business factors and the judgment of a business man.

Cross References:

§§ 4-503 and 2-706.

Definitional Cross References:

"Presenting bank". § 4-105.
"Documentary draft". § 4-104, 5-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

ARTICLE 5

LETTERS OF CREDIT

§ 5-101. Short Title. This Article shall be known and may be cited as Uniform Commercial Code—Letters of Credit.

COMMENT: Letters of credit have been known and used for many years, in both international and domestic transactions, and in many forms; but except for a few provisions, like § 135 of the Negotiable Instruments Law, they have not been the subject of statutory enactment, and the law concerning them has been developed in the cases.

This provision of the Negotiable Instruments Law is no longer in the Code. See the contrary rule in § 3-410 on the definition of acceptance. The other source of law respecting letters of credit is the law of contracts with occasional unfortunate excursions into the law of guaranty. This Article is intended within its limited scope (see Comment to § 5-102) to set an independent theoretical frame for the further development of letters of credit.

Cross References:

§§ 5-102, 5-103 and 3-410.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: There are no Virginia statutes and only one Virginia case, Consolidated Sales Co. v. Bank of Hampton Roads, 193 Va. 307, 68 S.E.2d 652 (1952), that is relevant to this Article. The Consolidated case is discussed in Epps and Chappell, Assimilation of the Letter of Credit by the Common Law—A Case of Legal Indigestion, 38 Va. L. Rev. 531 (1952).

Henry Harfield, an authority on letters of credit, has pointed out that: "A letter of credit always serves as a guaranty. This does not mean that it is a guaranty. A letter of credit is a identical twin to a guaranty, but the fact that the two things look alike and may be used for the same purpose and are difficult to distinguish one from the other, does not mean that they are the same thing and does not mean that there are not differences, which, however subtle, are of major importance." Harfield, Code Treatment of Letters of Credit, 48 Cornell L.Q. 92, 93 (1962). It seems rather probable that in the Consolidated Sales case the Supreme Court of Appeals of Virginia mistook a guaranty for its identical twin, a letter of credit.

A Newport News bank wrote a Richmond distributor of electric appliances on behalf of a Newport News retail electric appliance dealer, saying, in part: "Our customer, the Holland Radio Company of this city, has been granted a line of credit of a substantial amount with this bank for the purpose of floor planning their purchases of major appliances . . . If you will draft on the Holland Radio Company at this bank, attaching bill of lading or invoice, drafts will be honored and remittance made on the day received, thus avoiding the necessity of your shipping on an open account . . . This arrangement will remain in effect until you are notified to the contrary." Consolidated made various shipments to Holland. While drafts were attached to the first seven invoices sent to the bank, thereafter, invoices without drafts were sent. Payment was made as respects all invoices, except two that were sent but never received by the bank, and three that were sent and received. In an action by Consolidated against the bank for payment for these five shipments, the bank was held liable for the three for which it had received invoices, but not for the other two.

The arrangement could probably qualify as a letter of credit transaction under UCC 5-102. However, the concept of a letter of credit to be effective until notification has aspects of both irrevocability and revocability that cast doubt on whether the undertaking is a true letter of credit. The UCC recognizes that a credit may be either revocable or irrevocable, but lays down no rules for distinguishing between them, and gives no express recognition to a credit that partakes of both features. In the Consolidated case the court held that the bank had waived the requirement that drafts should be attached to the invoices. The sub-

ject of waiver is not covered in the UCC. Under UCC 5-109 an issuer of a letter of credit is required to use care to ascertain that the documents presented for payment comply with the terms of the credit. The Consolidated case held that vacuum cleaners were major appliances, and so the bank was under a duty to honor documents presented for payment of a shipment of such items.

Consequently, it is rather doubtful if the result in the Consolidated case, treated as a letter of credit transaction, would be the same under the UCC. The result could be more easily sustained on the theory that the case involved a "guaranty" that was not a letter of credit.

§ 5-102. **Scope.** (1) This Article applies

(a) to a credit issued by a bank if the credit requires a documentary draft or a documentary demand for payment; and

(b) to a credit issued by a person other than a bank if the credit requires that the draft or demand for payment be accompanied by a document of title; and

(c) to a credit issued by a bank or other person if the credit is not within subparagraphs (a) or (b) but conspicuously states that it is a letter of credit or is conspicuously so entitled.

(2) Unless the engagement meets the requirements of subsection (1), this Article does not apply to engagements to make advances or to honor drafts or demands for payment, to authorities to pay or purchase, to guarantees or to general agreements.

(3) This Article deals with some but not all of the rules and concepts of letters of credit as such rules or concepts have developed prior to this act or may hereafter develop. The fact that this Article states a rule does not by itself require, imply or negate application of the same or a converse rule to a situation not provided for or to a person not specified by this Article.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: To define the transactions to which this Article applies and to indicate that the rules stated are not intended to be exhaustive of the law applicable to letters of credit.

1. Although letters of credit are commonly thought of as being issued by banks and private bankers, other financing institutions can and do enter into transactions which fit the traditional concept of letters of credit. This is particularly true when the financing institution at the request of a buyer of goods promises the seller of the goods that it will pay or accept drafts or demands for payment on either the buyer or itself if the drafts are accompanied by documents of title covering the goods involved in the sales contract. Banks and private bankers also issue money credits which do not require documents of title to be presented as one of the conditions of honor. So far as these institutions are concerned the accompanying papers can range from a certification that certain building contracts have been performed in whole or in part or a notice that goods have been sent or a notice of default of some kind into the more traditional document of title. Subsection (1) attempts to make clear that automatic application of this Article to the transaction in question depends upon the nature of the issuer. Paragraph (1)(a) is applicable to banks and states that whenever the promise to honor is conditioned on presentation of any piece of paper, the transaction is within this Article whereas paragraph (1)(b) makes automatic application of the Article to transactions involving issuers other than banks dependent upon the requirement of a document of title.

Since banks issue "clean" as well as "documentary" credits and since other persons may desire to bring transactions involving papers other than documents of title within the coverage of this Article, paragraph (1)(c) permits the issuer to do so by conspicuous notation that the paper is a letter of credit. Whether a transaction falls within the mandatory or the permissive paragraphs of subsection (1) is also of importance on the question of payment of funds held by an issuer at the time of its insolvency (See § 5-117).

Subsection (2) states the negative of the rules of applicability of subsection (1) for greater clarity but is not intended to either enlarge or limit the tests of applicability there laid down.

2. Subsection (3) recognizes that in the present state of the law and variety of practices as to letters of credit, no statute can effectively or wisely codify all the possible law of letters of credit without stultifying further development of this useful financing device. The more important areas not covered by this Article revolve around the question of when documents in fact and in law do or do not comply with the terms of the credit. In addition such minor matters as the absence of expiration dates and the effect of extending shipment but not expiration dates are also left untouched for future adjudication. The rules embodied in the Article can be viewed as those expressing the fundamental theories underlying letters of credit. For this reason the second sentence of subsection (3) makes explicit the court's power to apply a particular rule by analogy to cases not within its terms, or to refrain from doing so. Under § 1-102(1) such application is to follow the canon of liberal interpretation to promote underlying purposes and policies. Since the law of letters of credit is still developing, conscious use of that canon and attention to fundamental theory by the court are peculiarly appropriate.

Cross Reference:

§ 1-102.

Definitional Cross References:

"Agreement". § 1-201.
"Bank". § 1-201.
"Conspicuous". § 1-201.
"Credit". § 5-103.
"Documentary draft". § 5-103.
"Document of title". § 1-201.
"Draft". § 3-104.
"Honor". § 1-201.
"Person". § 1-201.

§ 5-103. Definitions. (1) In this Article unless the context otherwise requires

(a) "Credit" or "letter of credit" means an engagement by a bank or other person made at the request of a customer and of a kind within the scope of this Article (§ 5-102) that the issuer will honor drafts or other demands for payment upon compliance with the conditions specified in the credit. A credit may be either revocable or irrevocable. The engagement may be either an agreement to honor or a statement that the bank or other person is authorized to honor.

(b) A "documentary draft" or a "documentary demand for payment" is one honor of which is conditioned upon the presentation of a document or documents. "Document" means any paper including document of title, security, invoice, certificate, notice of default and the like.

(c) An "issuer" is a bank or other person issuing a credit.

(d) A "beneficiary" of a credit is a person who is entitled under its terms to draw or demand payment.

(e) An "advising bank" is a bank which gives notification of the issuance of a credit by another bank.

(f) A "confirming bank" is a bank which engages either that it will itself honor a credit already issued by another bank or that such a credit will be honored by the issuer or a third bank.

(g) A "customer" is a buyer or other person who causes an issuer to issue a credit. The term also includes a bank which procures issuance or confirmation on behalf of that bank's customer.

(2) Other definitions applying to this Article and the sections in which they appear are:

"Notation of Credit". § 5-108.

"Presenter". § 5-112(3).

(3) Definitions in other Articles applying to this Article and the sections in which they appear are:

"Accept" or "Acceptance". § 3-410.

"Contract for sale". § 2-106.

"Draft". § 3-104.

"Holder in due course". § 3-302.

"Midnight deadline". § 4-104.

"Security". § 8-102.

(4) In addition, Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: To define terms used in this Article.

1. Paragraph (a) of subsection (1) in defining a "credit" or "letter of credit" sets forth the requirement that the engagement of the bank or other person to honor drafts or other demands for payment be at the request of another and involve a transaction falling within the scope of this Article (§ 5-102). It then makes clear that the "engagement" may be by way of agreement, that is, a promise to honor, or by way of an authority to honor, thus including within the definition of letter of credit, papers called "authorities to purchase or pay". The definition also makes clear that the engagement may be either revocable or irrevocable, the legal consequences of which are spelled out in § 5-106 on the time and effect of establishment of a credit. Neither the definition nor any other section of this Article deals with the issue of when a credit, not clearly labelled as either revocable or irrevocable falls within the one or the other category although the Code settles this issue with respect to the sales contract (§ 2-325). This issue so far as it affects an issuer under this Article is intentionally left to the courts for decision in the light of the facts and general law (§ 1-103) with due regard to the general provisions of the Code in Article 1 particularly § 1-205 on course of dealing and usage of trade.

2. Paragraph (b) is intended to show that the word "document" is far broader than "document of title" for the purposes of this Article. This is of special importance with respect to the application of the Article to banks under § 5-102(1)(a) and differs from the definition of "document" in Article 9 on secured transactions which is there limited to documents of title. See § 9-105(1)(e).

3. The legal relations between the issuer (1)(c) and the beneficiary (1)(d) and between the issuer and the customer (1)(g) are spelled out in other sections of this Article. The legal relations between the customer and the beneficiary turn on the underlying transaction between them: if that transaction be one of sale of goods, their rights depend upon Article 2; if the transaction involves the sale of investment securities, Article 8 will be applicable; if the transaction involves the transfer of commercial paper, Article 3 will be applicable; if documents of title are transferred, Article 7 will be applicable; and if the transaction is intended to create a security interest, Article 9 will apply. The issuer is not a guarantor of the performance of these underlying transactions. See § 5-109.

4. The definition of a customer in subsection (1)(g) is explicitly made to include a bank which is acting for its customer, so that a particular transaction may well involve a metropolitan issuing bank and two customers, one of whom is the ultimate customer as, e.g., the buyer of goods and the other of whom is the buyer's local bank which has requested the metropolitan bank to issue the credit.

5. The definitions of "advising" and "confirming" banks in subsection (1)(e) and (f) do not include a statement of their legal consequences. These are set out primarily in § 5-107 on advice of credit; confirmation; error in statement.

Cross References:

Point 1: §§ 5-102, 5-106, 1-103, 1-205, 2-325 and Article 1.
Point 2: §§ 5-102, 1-201 and 9-105.
Point 3: Articles 2, 3, 7, 8 and 9; § 5-109.
Point 5: § 5-107.

Definitional Cross References:

"Agreement". § 1-201.
"Bank". § 1-201.
"Document of title". § 1-201.
"Gives notification". § 1-201.
"Honor". § 1-201.
"Person". § 1-201.

§ 5-104. **Formal Requirements; Signing.** (1) Except as otherwise required in subsection (1)(c) of § 5-102 on scope, no particular form of phrasing is required for a credit. A credit must be in writing and signed by the issuer and a confirmation must be in writing and signed by the confirming bank. A modification of the terms of a credit or confirmation must be signed by the issuer or confirming bank.

(2) A telegram may be a sufficient signed writing if it identifies its sender by an authorized authentication. The authentication may be in code and the authorized naming of the issuer in an advice of credit is a sufficient signing.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. Subsection (1) is to make clear that, except for the statement or title required by § 5-102(1)(c) to bring certain transactions within the scope of this Article, no particular form need be followed; it is sufficient that the credit is in writing and signed by the issuer. The subsection also states that any modification is subject to the same requirements of signing and writing. Compare § 2-209(3) on sale of goods. Questions of mistake, waiver or estoppel are left to supplementary principles of law. See § 1-103.

2. Subsection (2), although perhaps unnecessary in view of the definition of "signed" in § 1-201, is inserted here to make certain that code and authorized naming of an issuer is a sufficient signing. These forms of signing are so customary that their explicit inclusion is useful to eliminate all controversy on the point.

Cross References:

Point 1: §§ 5-102, 2-209, 1-103.
Point 2: § 1-201.

Definitional Cross References:

"Confirming bank". § 5-103.
"Credit". § 5-103.
"Issuer". § 5-103.
"Signed". § 1-201.
"Telegram". § 1-201.
"Term". § 1-201.
"Writing". § 1-201.

§ 5-105. **Consideration.** No consideration is necessary to establish a credit or to enlarge or otherwise modify its terms.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: It is not to be expected that a financial institution will engage its credit without some form of expected remuneration. But it is not expected that the beneficiary will know what the issuer's remuneration was, or whether in fact there was any identifiable remuneration in a given case. And it would be extraordinarily difficult for the beneficiary to *prove* the issuer's remuneration. This section dispenses with such proof.

Definitional Cross References:

"Credit". § 5-103.
"Terms". § 1-201.

§ 5-106. **Time and Effect of Establishment of Credit.** (1) Unless otherwise agreed a credit is established

(a) as regards the customer as soon as a letter of credit is sent to him or the letter of credit or an authorized written advice of its issuance is sent to the beneficiary; and

(b) as regards the beneficiary when he receives a letter of credit or an authorized written advice of its issuance.

(2) Unless otherwise agreed once an irrevocable credit is established as regards the customer it can be modified or revoked only with the consent of the customer and once it is established as regards the beneficiary it can be modified or revoked only with his consent.

(3) Unless otherwise agreed after a revocable credit is established it may be modified or revoked by the issuer without notice to or consent from the customer or beneficiary.

(4) Notwithstanding any modification or revocation of a revocable credit any person authorized to honor or negotiate under the terms of the original credit is entitled to reimbursement for or honor of any draft or demand for payment duly honored or negotiated before receipt of notice of the modification or revocation and the issuer in turn is entitled to reimbursement from its customer.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: To define when a letter of credit is established in relation to the customer and the beneficiary, and to set forth for both irrevocable and revocable credits the legal consequences of the fact of establishment.

1. The primary purpose of determining the time of establishment of an irrevocable credit is to determine the point at which the issuer is no longer free to take unilateral action with respect to the cancellation of the credit or modification of its terms. So far as the customer is concerned this point of time is reached when the issuer "sends" (as that term is defined in § 1-201) the credit or when its authorized agent, the advising bank, sends the advice of the credit to the beneficiary. Since the sending is pursuant to an agreement between the issuer and the customer, it is the issuer's performance of the first stage of the contract and under § 5-107(4) the risk of transmission is on the customer. The beneficiary, however, cannot reply upon the credit until and unless he receives it. His right to protest to the issuer in the event of cancellation or modification, therefore, turns on receipt. Nothing in this section affects the beneficiary's right to protest the improper nature of the credit or its cancellation (i.e., its non-receipt) as against the customer, who will normally have agreed to have a letter of credit issued in favor of the beneficiary under some underlying contract. See, e. g., § 2-325(1) on buyer's failure to seasonably furnish an agreed letter of credit pursuant to a sales contract.

2. So far as a revocable letter of credit is concerned, the rules stated in subsections (3) and (4) are intended to show that so far as the customer or beneficiary are concerned establishment of such a credit has no legal significance unless the parties provide otherwise in their contracts with the issuer. The primary significance of the establishment of a revocable letter of credit is the obligation it imposes upon the issuer to innocent third parties who have negotiated or honored drafts drawn under the credit before receiving notice of its cancellation or change. The purpose of this rule is to further the movement of goods which the underlying transaction typically envisages and to preserve the solidity of American credits. As a necessary consequence of the imposition of this duty upon the issuer, a duty of reimbursement of the issuer is placed upon the customer by explicit mention here even though it would fall within the general duty of reimbursement imposed by § 5-114(3).

Cross References:

Point 1: §§ 5-107, 2-325.
Point 2: § 5-114.

Definitional Cross References:

"Beneficiary". § 5-103.
"Credit". § 5-103.
"Customer". § 5-103.
"Draft". § 3-104.
"Honor". § 1-201.
"Issuer". § 5-103.
"Notice". § 1-201.
"Person". § 1-201.
"Receive notice". § 1-201.
"Send". § 1-201.
"Written". § 1-201.

§ 5-107. Advice of Credit; Confirmation; Error in Statement of Terms. (1) Unless otherwise specified an advising bank by advising a credit issued by another bank does not assume any obligation to honor drafts drawn or demands for payment made under the credit but it does assume obligation for the accuracy of its own statement.

(2) A confirming bank by confirming a credit becomes directly obligated on the credit to the extent of its confirmation as though it were its issuer and acquires the rights of an issuer.

(3) Even though an advising bank incorrectly advises the terms of a credit it has been authorized to advise the credit is established as against the issuer to the extent of its original terms.

(4) Unless otherwise specified the customer bears as against the issuer all risks of transmission and reasonable translation or interpretation of any message relating to a credit.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. An "advising bank" is defined in § 5-103. Subsection (1) of this section states its obligations to transmit accurately but not to honor drafts. The advice may of course not be accurate. The advising bank is responsible for its own error; under subsection (3), however, the issuer is bound to honor only in accordance with the original terms of the credit.

2. A "confirming bank" is defined in § 5-103. Subsection (2) of this section states its obligations and rights. The obligation, to the extent of the confirmation, is that of an issuer and so too is the right of reimbursement. The most important aspect of this rule is that a beneficiary who has received a confirmed credit has the independent engagements of both the issuer and the confirming bank. A confirming bank may of course be an advising bank so far as the issuer's engagement is concerned but this is rarely of importance because its own engagement if the terms be improperly advised will be to honor in accordance with those terms.

3. Subsection (4) distributes the risks, as between customer and issuer, of errors in transmission and translation by placing them on the customer in the absence of specific agreement to the contrary. See also § 5-109(1) (b).

Cross References:

§§ 5-103 and 5-109.

Definitional Cross References:

"Advising bank". § 5-103.
"Bank". § 1-201.
"Confirming bank". § 5-103.
"Credit". § 5-103.
"Customer". § 5-103.
"Draft". § 3-104.
"Honor". § 1-201.
"Issuer". § 5-103.

§ 5-108. "Notation Credit"; Exhaustion of Credit. (1) A credit which specifies that any person purchasing or paying drafts or demands

for payment made under it must note the amount of the draft or demand on the letter or advice of credit is a "notation credit".

(2) Under a notation credit

(a) a person paying the beneficiary or purchasing a draft or demand for payment from him acquires a right to honor only if the appropriate notation is made and by transferring or forwarding for honor the documents under the credit such a person warrants to the issuer that the notation has been made; and

(b) unless the credit or a signed statement that an appropriate notation has been made accompanies the draft or demand for payment the issuer may delay honor until evidence of notation has been procured which is satisfactory to it but its obligation and that of its customer continue for a reasonable time not exceeding thirty days to obtain such evidence.

(3) If the credit is not a notation credit

(a) the issuer may honor complying drafts or demands for payment presented to it in the order in which they are presented and is discharged pro tanto by honor of any such draft or demand;

(b) as between competing good faith purchasers of complying drafts or demands the person first purchasing has priority over a subsequent purchaser even though the later purchased draft or demand has been first honored.

COMMENT: **Prior Uniform Statutory Provision: None.**

Purposes: 1. Practice has varied in regard to requiring notation on a letter of credit of the drafts drawn thereunder, and dispute has been rife for more than a century over the effect of failure by a purchaser to make such notations when they are required. The confusion has been due to a failure to distinguish two different types of credit and the different results which flow from each.

Under subsection (3), if an issuer chooses to issue a credit not requiring notation or if the credit is available in portions (see § 5-110) without requirement of notation the issuer avoids all troubles attendant on any purchaser's failure to make notations, but he also imperils the utility of the credit to a beneficiary by reason of its possible exhaustion before any particular purchaser may have discounted drafts under it, so that there may be no market at all for such drafts. Yet this way of operation becomes useful and desirable at least whenever the credit is "domiciled," i.e., when it is explicitly made available only through one particular named correspondent, who will have his own records of prior drafts.

Subsection (3) expressly protects the issuer under such a credit (almost exactly as in the case of drafts drawn in a set under § 3-801) in regard to any drafts which he honors in good faith, even though they are in the hands of a party who as against some other purchaser of drafts is not entitled to their proceeds. Similarly, in the last sentence, the rights of successive good faith purchasers are regulated as with drafts in a set.

2. Under subsection (2), on the other hand, the notation machinery is made available where the credit provides for notation in accordance with subsection (1). This is useful particularly where the credit is intended (as a traveler's letter would be) for roving use, but the responsibility is put upon the purchaser to make the appropriate notation on pain of reimbursing the issuer for any loss occasioned by the failure. The provision in regard to delay of honor while evidence of notation is being procured is novel in the law, but is believed to be a necessary addition first, to protect the issuer, and second, to educate purchasers.

Subsection (2) (a) avoids a difficult question of conflict of laws by making the obligation to note a condition of the credit itself, governed, therefore, by the law which controls the issue of the credit.

Cross References:

§§ 3-801 and 5-110.

Definitional Cross References:

"Beneficiary". § 5-103.
"Credit". § 5-103.
"Customer". § 5-103.
"Document". § 5-103.
"Draft". § 3-104.
"Good faith". § 1-201.
"Honor". § 1-201.
"Issuer". § 5-103.
"Person". § 1-201.
"Purchase". § 1-201.
"Purchaser". § 1-201.
"Rights". § 1-201.
"Signed". § 1-201.

§ 5-109. **Issuer's Obligation to Its Customer.** (1) An issuer's obligation to its customer includes good faith and observance of any general banking usage but unless otherwise agreed does not include liability or responsibility

(a) for performance of the underlying contract for sale or other transaction between the customer and the beneficiary; or

(b) for any act or omission of any person other than itself or its own branch or for loss or destruction of a draft, demand or document in transit or in the possession of others; or

(c) based on knowledge or lack of knowledge of any usage of any particular trade.

(2) An issuer must examine documents with care so as to ascertain that on their face they appear to comply with the terms of the credit but unless otherwise agreed assumes no liability or responsibility for the genuineness, falsification or effect of any document which appears on such examination to be regular on its face.

(3) A non-bank issuer is not bound by any banking usage of which it has no knowledge.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. The extent of the issuer's obligation to its customer is based upon the agreement between the two. Like all agreements within the Code, that agreement is the bargain of the parties in fact as defined in § 1-201(3) and includes the obligation of good faith imposed by § 1-203 and the observance of any course of dealing or usage of trade made applicable by § 1-205. Subsection (1) of this section states, as a particular application of those general rules, the issuer's standard obligation of good faith and observance of general banking usage. Disclaimer of the obligation of good faith in governed by § 1-102(3); conflict between express terms and a usage otherwise applicable is governed by § 1-205(4).

Subsection (1) also clarifies the areas over which the issuer assumes no liability or responsibility except as the agreement of the parties may indicate the contrary. Paragraph (a) rests on the assumptions that the issurer has had no control over the making of the underlying contract or over the selection of the beneficiary, and that the issuer receives compensation for a payment service rather than for a guaranty of performance. The customer will normally have direct recourse against the beneficiary if performance fails, whereas the issuer will have such recourse only by assignment of or in a proper case subrogation to the rights of the customer.

Paragraph (b) also rests in part on the assumption that the issuer has not selected the other persons who may be involved in the transaction. Even though this assumption fails, however, as where the issuer selects the advising bank, the customer by entering the underlying transaction has assumed the risks inherent in it, including the risk of loss or destruction of the papers involved. The allocation of such risks between the parties to the underlying transaction is a proper subject for agreement between them, and the small charge for the issuance

of a letter of credit ordinarily indicates that the issuer assumes minimum risks as against its customer. For comparable reasons § 5-107(4) puts risks of transmission and translation upon the customer.

Paragraph (c) again emphasizes that normally an isssuer performs a banking and not a trade function. This paragraph makes an exception to § 1-205(3), giving effect to usages of which the parties "are or should be aware." The comparable provision for non-bank issuers in subsection (3) of this section is limited to unknown banking usages and is thus merely a definition of a particular type of case not included by the words "should be aware" in § 1-205(3).

2. Subsection (2) states the basic obligation of the issuer to examine with care the documents required under the credit. Under § 1-102(3) this obligation cannot be disclaimed but standards of performance can be determined by agreement if not manifestly unreasonable. There are not infrequent cases in which both parties understand that peculiar circumstances make any check-up on some particular type of document impossible and it is agreed that the issuer may take it "as presented"—so, e.g., export licenses in politically disturbed conditions, or "shipping documents" when no document in standard or regular form can be procured. These agreements will be controlling provided they are not manifestly unreasonable.

The purpose of the examination is to determine whether the documents appear regular on their face. The fact that the documents may be false or fraudulent or lacking in legal effect is not one for which the issuer is bound to examine. His duty is limited to apparent regularity on the face of the documents. The duties, privileges and rights of an issuer who has received documents which are regular on their face but are in fact improper because forged or fraudulent are dealt with in § 5-114.

Cross References:

Point 1: §§ 1-102, 1-201, 1-203, 1-205, 5-107.
Point 2: §§ 1-102, 5-114.

Definitional Cross References:

"Bank". § 1-201.
"Beneficiary". § 5-103.
"Branch". § 1-201.
"Contract". § 1-201.
"Contract for sale". § 2-106.
"Credit". § 5-103.
"Customer". § 5-103.
"Document". § 5-103.
"Draft". § 3-104.
"Genuine". § 1-201.
"Good faith". § 1-201.
"Issuer". § 5-103.
"Knowledge". § 1-201.
"Person". § 1-201.
"Term". § 1-201.

§ 5-110. Availability of Credit in Portions; Presenter's Reservation of Lien or Claim. (1) Unless otherwise specified a credit may be used in portions in the discretion of the beneficiary.

(2) Unless otherwise specified a person by presenting a documentary draft or demand for payment under a credit relinquishes upon its honor all claims to the documents and a person by transferring such draft or demand or causing such presentment authorizes such relinquishment. An explicit reservation of claim makes the draft or demand non-complying.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. The beneficiary may desire to draw more than one draft under the credit, each draft accompanied, for instance, by documents evidencing a single shipment under the underlying sales contract. Subsection (1) makes clear that unless otherwise specified he may do so. Of course, if he does, each draft and its accompanying documents must satisfy the terms of the credit and their total

must not exceed its amount. See comment to § 5-108(3) on exhaustion of a credit on the rule governing the situation in which the total drafts drawn do total more than the maximum amount of the credit.

2. The entire purpose of the usual letter of credit transaction, from the customer's point of view, is to induce the beneficiary to deliver to him through the issuer the documents described in the credit. The buying customer wants the goods, and arranges the transaction in order to get the documents controlling the goods. Therefore, upon honor of the draft, the documents must be delivered free of claims even though the letter of credit is not for the full invoice price and any reservation of claim makes the draft non-complying. A beneficiary who wishes to prevent such delivery must do so by agreement with the customer in the underlying contract and must treat the failure to provide a sufficient letter of credit as a breach of that contract (§ 2-325). So far as the issuer's duty to honor is concerned, the terms of the letter of credit are controlling and the rule of subsection (2) is applicable.

Cross References:

Point 1: § 5-108.
Point 2: §§ 2-325, 5-114.

Definitional Cross References:

"Beneficiary". § 5-103.
"Credit". § 5-103.
"Documentary draft". § 5-103.
"Document". § 5-103.
"Draft". § 3-104.
"Honor". § 1-201.
"Person". § 1-201.

§ 5-111. Warranties on Transfer and Presentment. (1) Unless otherwise agreed the beneficiary by transferring or presenting a documentary draft or demand for payment warrants to all interested parties that the necessary conditions of the credit have been complied with. This is in addition to any warranties arising under Articles 3, 4, 7 and 8.

(2) Unless otherwise agreed a negotiating, advising, confirming, collecting or issuing bank presenting or transferring a draft or demand for payment under a credit warrants only the matters warranted by a collecting bank under Article 4 and any such bank transferring a document warrants only the matters warranted by an intermediary under Articles 7 and 8.

COMMENT: Prior Uniform Statutory Provision: None.

Purpose: The purpose of this section is to state the peculiar warranty of performance made by a beneficiary and to make clear the intermediary character of the persons moving the documents from the beneficiary to the customer. The beneficiary's warranty of compliance with the conditions of the credit in subsection (1) is expressly extended to all interested parties unless agreed to the contrary. So far as the draft or the relevant documents are concerned, the beneficiary's warranties are usually those of an ordinary transferor or indorser for value although varying circumstances may alter this. The usual warranties of an intermediary, listed in subsection (2), are primarily its own good faith and authority. See also Comment to § 5-114(2).

Cross References:

§§ 3-417, 4-207, 7-507, 7-508, 8-306.

Definitional Cross References:

"Advising bank". § 5-103.
"Bank". § 1-201.
"Beneficiary". § 5-103.
"Collecting bank". § 4-105.
"Confirming bank". § 5-103.
"Credit". § 5-103.
"Documentary draft". § 5-103.
"Draft". § 3-104.
"Party". § 1-201.

§ 5-112. **Time Allowed for Honor or Rejection; Withholding Honor or Rejection by Consent; "Presenter".** (1) A bank to which a documentary draft or demand for payment is presented under a credit may without dishonor of the draft, demand or credit

(a) defer honor until the close of the third banking day following receipt of the documents; and

(b) further defer honor if the presenter has expressly or impliedly consented thereto.

Failure to honor within the time here specified constitutes dishonor of the draft or demand and of the credit except as otherwise provided in subsection (4) of § 5-114 on conditional payment.

(2) Upon dishonor the bank may unless otherwise instructed fulfill its duty to return the draft or demand and the documents by holding them at the disposal of the presenter and sending him an advice to that effect.

(3) "Presenter" means any person presenting a draft or demand for payment for honor under a credit even though that person is a confirming bank or other correspondent which is acting under an issuer's authorization.

(VALC Note: The Official Text offers as optional language at the end of subsection (1) the following: "except as otherwise provided in subsection (4) of § 5-114 on conditional payment".)

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. A bank called on to honor drafts under a credit must examine the accompanying documents with care. See § 5-109(2). That may take time. Subsection (1) of this section therefore allows a longer period than in the case of ordinary drafts (§ 3-506) for the decision. The language in the postamble to subsection (1) particularizes for letters of credit the general rule on what constitutes dishonor for negotiable instruments (§ 3-507) and makes it clear that not only the draft but the credit is dishonored. If the particular draft is for a portion of the credit only, its wrongful dishonor is anticipatory repudiation of the entire credit and the beneficiary may proceed under § 5-115(2) as well as § 5-115(1).

2. Many letters of credit involve transactions in international trade and include as required documents the documents of title controlling the possession of goods on their way to the place of issuance of the credit. The ordinary rule requiring physical return of dishonored documentary drafts (§ 4-302) would therefore frequently work commercial hardship on the mercantile parties to the transaction; resale of the goods might be more difficult if the controlling documents of title were not available at the place of arrival of the goods. Subsection (2) therefore expressly permits the issuer to retain the documents as bailee for the presenter if it advises the presenter of its retention for that purpose. Compare §§ 4-202(1) (b), 4-503 and 4-504 on the duties of presenting banks.

3. The definition of "presenter" is to make clear that the term may include a bank which has rights in the documentary draft or which is in one sense the agent of the issuer. Such a bank may nevertheless give consent under subsection (1), and the advice authorized in subsection (2) may be sent to it.

4. Insofar as the banks involved may also be depositary, collecting or paying banks, Article 4 is applicable. Article 3 applies to the extent that a negotiable instrument is involved.

Cross References:

Point 1: §§ 3-506, 3-507, 5-109, 5-114 and 5-115.
Point 2: §§ 4-202, 4-302, 4-503 and 4-504.
Point 4: Articles 3 and 4.

Definitional Cross References:

"Bank". § 1-201.
"Confirming bank". § 5-103.
"Credit". § 5-103.
"Documentary draft". § 5-103.

"Draft". § 8-104.
"Honor". § 1-201.
"Issuer". § 5-103.
"Send". § 1-201.

§ 5-113. Indemnities. (1) A bank seeking to obtain (whether for itself or another) honor, negotiation or reimbursement under a credit may give an indemnity to induce such honor, negotiation or reimbursement.

(2) An indemnity agreement inducing honor, negotiation or reimbursement

(a) unless otherwise explicitly agreed applies to defects in the documents but not in the goods; and

(b) unless a longer time is explicitly agreed expires at the end of ten business days following receipt of the documents by the ultimate customer unless notice of objection is sent before such expiration date. The ultimate customer may send notice of objection to the person from whom he received the documents and any bank receiving such notice is under a duty to send notice to its transferor before its midnight deadline.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. A draft and accompanying documents may almost comply with the terms of the credit, but fail in some particular. The issuer is then not obligated to honor the draft, but it may be willing to do so if properly indemnified against the particular defect. Subsection (1) makes clear that it is proper for a bank seeking payment, acceptance, negotiation or reimbursement under the credit to give such indemnities, and that doing so is a proper part of the business of banking and therefore not ultra vires.

2. Subsection (2) (a) limits the agreed indemnity to defects in the documents, since under § 5-109(1) (a) the issuer is ordinarily not responsible for performance of the underlying transaction. The parties are free to agree further on the scope of the indemnity, but the agreement must be explicit, since an indemnity against defects in the goods would be most unusual.

3. Subsection (2) (b) makes it clear that the indemnity in the absence of explicit agreement for a longer time continues for ten days after the receipt of the document by the ultimate customer, i.e., the customer who is a party to the underlying transaction. This ten day period may not be shortened. If the customer fails to send notice of objection within the period, he loses his right to object and the need for the indemnity disappears. Compare § 2-605(2). Thus indemnitors are free of the possibility of unknown long-continuing contingent liability, a danger under existing law.

4. The question whether a particular banking usage may require honor of documentary drafts accompanied by indemnities for particular defects goes to the meaning of the terms of the credit and is beyond the scope of this section. See, e.g., Dixon, Irmaos & Cia, Ltda., v. Chase Nat. Bank of City of New York, 144 F.2d 759 (2d Cir., 1944). If by virtue of indemnities and usage the credit is complied with, the rights of the customer rest on the implications of the usage rather than on breach of the issuer's duty under this Article. Even so, the policy of this section and its terms require notice before the expiration date.

Cross References:

Point 2: § 5-109.
Point 3: § 2-605.
Point 4: § 1-205.

Definitional Cross References:

"Bank". § 1-201.
"Credit". § 5-103.
"Customer". § 5-103.
"Documents". § 5-103.
"Honor". § 1-201.
"Midnight deadline". § 4-104.
"Person". § 1-201.
"Send". § 1-201.

§ 5-114. **Issuer's Duty and Privilege to Honor; Right to Reimbursement.** (1) An issuer must honor a draft or demand for payment which complies with the terms of the relevant credit regardless of whether the goods or documents conform to the underlying contract for sale or other contract between the customer and the beneficiary. The issuer is not excused from honor of such a draft or demand by reason of an additional general term that all documents must be satisfactory to the issuer, but an issuer may require that specified documents must be satisfactory to it.

(2) Unless otherwise agreed when documents appear on their face to comply with the terms of a credit but a required document does not in fact conform to the warranties made on negotiation or transfer of a document of title (§ 7-507) or of a security (§ 8-306) or is forged or fraudulent or there is fraud in the transaction

(a) the issuer must honor the draft or demand for payment if honor is demanded by a negotiating bank or other holder of the draft or demand which has taken the draft or demand under the credit and under circumstances which would make it a holder in due course (§ 3-302) and in an appropriate case would make it a person to whom a document of title has been duly negotiated (§ 7-502) or a bona fide purchaser of a security (§ 8-302); and

(b) in all other cases as against its customer, an issuer acting in good faith may honor the draft or demand for payment despite notification from the customer of fraud, forgery or other defect not apparent on the face of the documents but a court of appropriate jurisdiction may enjoin such honor.

(3) Unless otherwise agreed an issuer which has duly honored a draft or demand for payment is entitled to immediate reimbursement of any payment made under the credit and to be put in effectively available funds not later than the day before maturity of any acceptance made under the credit.

(VALC Note: The Official Text offers the following optional subsections (4) and (5) to this section:

(4) When a credit provides for payment by the issuer on receipt of notice that the required documents are in the possession of a correspondent or other agent of the issuer

(a) any payment made on receipt of such notice is conditional; and

(b) the issuer may reject documents which do not comply with the credit if it does so within three banking days following its receipt of the documents; and

(c) in the event of such rejection, the issuer is entitled by charge back or otherwise to return of the payment made.

(5) In the case covered by subsection (4) failure to reject documents within the time specified in sub-paragraph (b) constitutes acceptance of the documents and makes the payment final in favor of the beneficiary.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: To define the areas in which the issuer must honor drafts or demands for payment under a credit and those in which he has an option to do so and to make explicit the customer's duty of reimbursement.

1. The letter of credit is essentially a contract between the issuer and the beneficiary and is recognized by this Article as independent of the underlying contract between the customer and the beneficiary (See § 5-109 and Comment thereto). In view of this independent nature of the letter of credit engagement, the issuer is under a duty to honor the drafts or demands for payment which in fact comply with the terms of the credit without reference to their compliance with the terms of the underlying contract. This is stated in subsection (1). Attempts

by the issuer to reserve a right to dishonor by including a clause that all documents must be satisfactory to itself are declared invalid as essentially repugnant to an irrevocable letter of credit. Such a reservation can be made by issuing a revocable credit. See § 5-106. Particular documents, such as bills of lading or inspection or weight certificates can, of course, be required to be satisfactory to the issuer. The duty of the issuer to honor where there is factual compliance with the terms of the credit is also independent of any instructions from its customer once the credit has been issued and received by the beneficiary. See § 5-106.

2. Documents, however, may appear regular on their face and apparently conforming to the credit whereas in fact they are forged or fraudulent or in other respects non-conforming to the warranties which arise under other Articles of the Code on their transfer or negotiation. Since the issuer's duties to its customer are limited to examination of the documents with care (§ 5-109) and since it is important to preserve both the independent character of the issuer's engagement and the reasonable reliance on that engagement of persons dealing with papers regular on their face and in apparent compliance with the terms of the credit, subsection (2) (a) includes as an area in which the issuer's duty to honor exists cases in which persons have acted in a manner which would make them the equivalent of holders in due course under Article 3 or, where relevant, persons to whom documents have been duly negotiated under Article 7 or bona fide purchasers of securities under Article 8. The risk of the original bad faith action of the beneficiary is thus thrown upon the customer who selected him rather than upon innocent third parties or the issuer. So, too, is the risk of fraud in the transaction placed upon the customer.

When, however, no innocent third parties as defined in subsection (a) are involved the issuer is no longer under a duty to honor; but since these matters frequently involve situations in which the determination of the fact of the nonconformance may be difficult or time-consuming, the issuer if he acts in good faith is given the privilege of honoring the draft as against its customer, that is to say, with a right of reimbursement against him. The issuer may, however, refuse honor. In the event of honor, an action by the customer against the beneficiary will lie by virtue of either the underlying contract or § 5-111(1) of this Article. In the event of dishonor, if the presenter is a person who has parted with value, he also may recover against the beneficiary under § 5-111(1).

3. Subsection (3) represents the standard form for reimbursement. The words "duly honored" include not only situations where the issuer has honored because it was his duty to do so but also where he was privileged to do so as in subsection (2) (b) or has done so as under § 5-106(4).

4. Optional subsections (4) and (5) are for the purpose of clarifying a situation which has arisen under the currency restrictions of a few nations and in which payment is required to be made under the credit before opportunity exists to examine the documents. The Article resolves this situation by making clear that the payment is conditional in nature and may be reversed by subsequent timely discovery of defects in the documents.

Cross References:

Point 1: §§ 5-106 and 5-109.
Point 2: §§ 5-106, 5-109, 5-111 and Articles 3, 7 and 8.
Point 3: § 5-106.

Definitional Cross References:

"Bank". § 1-201.
"Beneficiary". § 5-103.
"Contract". § 1-201.
"Contract for sale". § 2-106.
"Credit". § 5-103.
"Customer". § 5-103.
"Document". § 5-103.
"Document of title". § 1-201.
"Draft". § 3-104.
"Good faith". § 1-201.
"Holder". § 1-201.
"Honor". § 1-201.
"Issuer". § 5-103.
"Notification". § 1-201.
"Receives notice". § 1-201.
"Security". § 8-102.
"Term". § 1-201.

COUNCIL COMMENT

Inasmuch as New York, the State which as had the greatest experience with letters of credit, has seen fit to omit the optional language, we feel that Virginia should do likewise.

§ 5-115. Remedy for Improper Dishonor or Anticipatory Repudiation. (1) When an issuer wrongfully dishonors a draft or demand for payment presented under a credit the person entitled to honor has with respect to any documents the rights of a person in the position of a seller (§ 2-707) and may recover from the issuer the face amount of the draft or demand together with incidental damages under § 2-710 on seller's incidental damages and interest but less any amount realized by resale or other use or disposition of the subject matter of the transaction. In the event no resale or other utilization is made the documents, goods or other subject matter involved in the transaction must be turned over to the issuer on payment of judgment.

(2) When an issuer wrongfully cancels or otherwise repudiates a credit before presentment of a draft or demand for payment drawn under it the beneficiary has the rights of a seller after anticipatory repudiation by the buyer under § 2-610 if he learns of the repudiation in time reasonably to avoid procurement of the required documents. Otherwise the beneficiary has an immediate right of action for wrongful dishonor.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. Subsection (1) states the rights of a person entitled to honor, both with respect to any documents and against the issuer, when there is wrongful dishonor. Whether dishonor is wrongful and whether a particular person is entitled to honor depend on the terms of the credit and on the provisions of this Article, particularly § 5-114 on the issuer's duty to honor and § 5-116 on transfer and assignment.

2. Subsection (2) states the rights of the beneficiary upon repudiation of the credit, both against the issuer and with respect to any documents or goods. Note that wrongful dishonor of a draft for a portion of the credit is dishonor of the credit under § 5-112(1), and makes applicable subsection (2) of this section as well as subsection (1).

3. Both subsections are limited to irrevocable credits. Since under § 5-106(3) revocable credits may be modified or revoked without notice to the customer or the beneficiary, rights against the issuer like those here provided can hardly arise under them. The rights of innocent third persons under revocable credits are governed by § 5-106(4) rather than by this section.

Cross References:

Point 1: §§ 2-707, 2-710, 5-114 and 5-116.
Point 2: §§ 2-610, 2-611, 2-703 through 2-706, and 5-112.
Point 3: § 5-106.

Definitional Cross References:

"Action". § 1-201.
"Beneficiary". § 5-103.
"Credit". § 5-103.
"Document". § 5-103.
"Draft". § 3-104.
"Issuer". § 5-103.
"Person". § 1-201.
"Rights". § 1-201.

§ 5-116. Transfer and Assignment. (1) The right to draw under a credit can be transferred or assigned only when the credit is expressly designated as transferable or assignable.

(2) Even though the credit specifically states that it is nontransferable or nonassignable the beneficiary may before performance of the

conditions of the credit assign his right to proceeds. Such an assignment is an assignment of a contract right under Article 9 on Secured Transactions and is governed by that Article except that

(a) the assignment is ineffective until the letter of credit or advice of credit is delivered to the assignee which delivery constitutes perfection of the security interest under Article 9; and

(b) the issuer may honor drafts or demands for payment drawn under the credit until it receives a notification of the assignment signed by the beneficiary which reasonably identifies the credit involved in the assignment and contains a request to pay the assignee; and

(c) after what reasonably appears to be such a notification has been received the issuer may without dishonor refuse to accept or pay even to a person otherwise entitled to honor until the letter of credit or advice of credit is exhibited to the issuer.

(3) Except where the beneficiary has effectively assigned his right to draw or his right to proceeds, nothing in this section limits his right to transfer or negotiate drafts or demands drawn under the credit.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. The situation involved is typified by that of an exporter who has made a contract for sale with a foreign buyer and is beneficiary of a letter of credit initiated by the buyer, especially where the subject matter involves goods still to be manufactured. The exporter is frequently in need of the wherewithal not only to finance payment to his supplier but to assure the latter against cancellation of the order during the process of manufacture. For this purpose assignment of the exporter's rights under the letter of credit is frequently desirable. Since, however, there is general confusion of thought as to the meaning of "assignment or transfer of a credit," the law remains uncertain. If "assignment of the credit" includes delegation of performance of the conditions under the credit then the initiating customer, who in many cases has put his faith in performance or supervision of performance by a beneficiary of established reputation, may be deprived of real and intended security. See Comment to § 2-210 on the comparable situation as to the sales contract. On the other hand, all "negotiation credits" involve a transfer of the rights of the beneficiary by way of negotiation of the draft and such transfer involves no important loss of the initiating party's intended safety. Meanwhile, the exceedingly useful institution of "back to back" credits, in which an American bank issues a credit with the exporter as the initiating customer and the exporter's supplier as the beneficiary is dangerous for the banker unless he can secure in advance an effective assignment from the exporter of the latter's rights under the initial credit issued on behalf of his foreign buyer. Against this background, the section is drawn.

2. Subsection (1) requires the beneficiary's signature on drafts drawn under the credit unless it is expressly designated as assignable or transferable. If it is so designated, the normal rules of assignment apply and both the right to draw and the performance of the beneficiary can be transferred, subject to the beneficiary's continuing liability, if any, for the nature of the performance.

3. Subsection (2) makes clear that to safeguard among other things the letter of credit "back to back" practice, the assignability of proceeds in advance of performance cannot be prohibited in advance of performance. In this respect the letter of credit is treated like any other contract calling for money to be earned. See § 9-318 generally and § 2-210 as to sales contracts. But the special nature of the letter of credit as evidence of the right to proceeds is recognized by the additional requirement of delivery of the letter to the assignee as a condition precedent to the perfection of the assignment. Similiarly, the fact that letters of credit normally require presentation of drafts or demands for payment which are drawn under it and that as a result notice of assignment of proceeds can exist simultaneously with a draft payable by order or indorsement to either the beneficiary or another third person leads to the necessity for permitting an issuer to protect itself against double payment by requiring exhibition of the letter or advice of credit.

4. Subsection (3) makes clear that the section has no application to the normal case of negotiation of a draft or the transfer of a demand for payment unless effective assignment under the section has taken place.

Cross References:

Point 1: § 2-210.
Point 3: §§ 2-210 and 9-318 and Article 9.

Definitional Cross References:

"Accept". § 3-410.
"Beneficiary". § 5-103.
"Contract right". § 9-106.
"Credit". § 5-103.
"Draft". § 3-104.
"Honor". § 1-201.
"Issuer". § 5-103.
"Receive notification". § 1-201.

§ 5-117. **Insolvency of Bank Holding Funds for Documentary Credit.** (1) Where an issuer or an advising or confirming bank or a bank which has for a customer procured issuance of a credit by another bank becomes insolvent before final payment under the credit and the credit is one to which this Article is made applicable by paragraphs (a) or (b) of § 5-102 (1) on scope, the receipt or allocation of funds or collateral to secure or meet obligations under the credit shall have the following results:

(a) to the extent of any funds or collateral turned over after or before the insolvency as indemnity against or specifically for the purpose of payment of drafts or demands for payment drawn under the designated credit, the drafts or demands are entitled to payment in preference over depositors or other general creditors of the issuer or bank; and

(b) on expiration of the credit or surrender of the beneficiary's rights under it unused any person who has given such funds or collateral is similarly entitled to return thereof; and

(c) a change to a general or current account with a bank if specifically consented to for the purpose of indemnity against or payment of drafts or demands for payment drawn under the designated credit falls under the same rules as if the funds had been drawn out in cash and then turned over with specific instructions.

(2) After honor or reimbursement under this section the customer or other person for whose account the insolvent bank has acted is entitled to receive the documents involved.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: A bank which issues a letter of credit acts as a principal, not as agent for its customer, and engages its own credit. But the resulting liability is not like that to its depositors, and the security and indemnity furnished by the customer against it and the documents which it receives on honor of complying drafts are not like its own investments.

The typical letter of credit transaction facilitates the movement of goods. The bank's credit is engaged, but it expects to be put in funds by its customer before it makes disbursements, or to be reimbursed immediately afterwards. And everybody understands that the documents received upon honor of complying drafts are to be turned over to the customer at once when he makes reimbursement or signs trust receipts. Only the bank's commission, if the transaction is completed, will enter the bank's general assets and join the other backing of its deposit liabilities.

It is therefore proper, when insolvency occurs before the letter of credit transaction is completed, to regard both the outstanding liabilities, the security held and funds provided to indemnify against those liabilities, and the related drafts

and documents, as separate from deposit liabilities and from general assets, and to deal with them as separate. To do so carries out the original purpose, which is to facilitate the underlying mercantile transaction, and does no wrong to the bank's depositors and other general creditors.

This section states appropriate rules to carry out these principles. The section is limited to transactions under § 5-102(1) (a) and (b) to prevent abuse in situations where the commercial purpose of facilitating the movement of goods, securities or the like may be lacking.

Cross Reference:

Compare § 4-214, and the Comment thereto.

Definitional Cross References:

"Advising Bank". § 5-103.
"Bank". § 1-201.
"Beneficiary". § 5-103.
"Confirming Bank". § 5-103.
"Credit". § 5-103.
"Customer". § 5-103.
"Document". § 5-103.
"Draft". § 3-104.
"Honor". § 1-201.
"Insolvent". § 1-201.
"Issuer". § 5-103.
"Person". § 1-201.

ARTICLE 6

BULK TRANSFERS

§ 6-101. **Short Title.** This Article shall be known and may be cited as Uniform Commercial Code—Bulk Transfers.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. This Article attempts to simplify and make uniform the bulk sales laws of the states that adopt this Act.

2. Many states have bulk sales laws, of varying type and coverage. Their central purpose is to deal with two common forms of commercial fraud, namely:

(a) The merchant, owing debts, who sells out his stock in trade to a friend for less than it is worth, pays his creditors less than he owes them, and hopes to come back into the business through the back door some time in the future.

(b) The merchant, owing debts, who sells out his stock in trade to any one for any price, pockets the proceeds, and disappears leaving his creditors unpaid.

3. The first is one form of fraudulent conveyance. The substantive law concerning it has been codified by the Commissioners in the Uniform Fradulent Conveyance Act. No change in that Act is proposed. The contribution of the bulk sales laws to the problem is in the requirement that creditors receive advance notice of bulk sales. Having such notice, they can investigate the price and other circumstances of the sale before it occurs, and determine then instead of later whether they should try to stop it. This is a valuable policing measure, and is continued. To be effective, it requires a longer notice than five days. This Article therefore follows in this respect those laws which require a longer notice (§§ 6-105, 6-108).

4. The second form of fraud suggested above represents the major bulk sales risk, and its prevention is the central purpose of the existing bulk sales laws and of this Article. Advance notice to the seller's creditors of the impending sale is an important protection against it, since with notice the creditors can take steps to impound the proceeds if they think it necessary. In many states, typified for instance by New York, such notice is substantially the only protection which bulk sales statutes give. Other states, typified for instance by Pennsylvania, give additional protection, by imposing on the buyer an obligation to ensure that the money that he pays to his indebted seller is in fact applied to pay the seller's debts. This Article requires notice to creditors (§ 6-105) and if bracketed § 6-106 is enacted it imposes the other obligation also.

5. These are the affirmative reasons for a law such as this Article. The objections are chiefly delay and red tape on legitimate transactions, and the possibility of a trap for the unwary buyer. It is hard to avoid the latter danger. But to minimize both it and the former the transactions subject to the Article are identified as clearly as possible and are limited to those which carry the dangers to be guarded against (§ 6-102 and 6-103), and the sanctions are such as to permit honest and solvent buyers and sellers to put through transactions promptly without undue risk. §§ 6-104 through 6-108.

Cross References:

Point 3: §§ 6-105 and 6-108.
Point 4: §§ 6-105 and 6-106.
Point 5: §§ 6-102, 6-103, 6-104 through 6-108.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 55-83, 55-84, 55-85, 55-86.

Comment: For a discussion of this Article in relation to Virginia law see: Clark, Bulk Sales and Article 6, 20 Wash. & Lee L. Rev. (Fall 1963).

Virginia has the New York type statute, which requires the giving of notice to creditors, but which does not require the buyer to see to the application of the proceeds.

§ 6-102. "Bulk Transfer"; Transfers of Equipment; Enterprises Subject to This Article; Bulk Transfers Subject to This Article. (1) A "bulk transfer" is any transfer in bulk and not in the ordinary course of the transferor's business of a major part of the materials, supplies, merchandise or other inventory (§ 9-109) of an enterprise subject to this Article.

(2) A transfer of a substantial part of the equipment (§ 9-109) of such an enterprise is a bulk transfer if it is made in connection with a bulk transfer of inventory, but not otherwise.

(3) The enterprises subject to this Article are all those whose principal business is the sale of merchandise from stock, including those who manufacture what they sell.

(4) Except as limited by the following section all bulk transfers of goods located within this state are subject to this Article.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. Much of the litigation under the existing laws has dealt with the kinds of businesses and the kinds of transfers covered. This section defines these matters.

2. The businesses covered are defined in subsection (3). Notice that they do not include farming nor contracting nor professional services, nor such things as cleaning shops, barber shops, pool halls, hotels, restaurants, and the like whose principal business is the sale not of merchandise but of services. While some bulk sales risk exists in the excluded businesses, they have in common the fact that unsecured credit is not commonly extended on the faith of a stock of merchandise.

3. The transfers included are of "materials, supplies, merchandise or other inventory" that is, of goods. Transfers of investment securities are not covered by the Article, nor are transfers of money, accounts receivable, chattel paper, contract rights, negotiable instruments, nor things in action generally. Such transfers are dealt with in other Articles, and are not believed to carry any major bulk sales risk.

4. The kinds of transfers covered are identified in paragraph (1). They are believed to be those that carry the major bulk sales risks. They are further limited by the section following.

Cross References:

Point 3: Articles 3, 4, 8 and 9
Point 4: § 6-103.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 55-83.

Comment: The UCC covers "any transfer in bulk," while the Virginia statute covers "the sale, transfer or assignment in bulk." While verbally the Virginia statute is broader, the coverage is probably the same. The transaction in Canada v. Beasley & Bros., Inc., 132 Va. 166, 111 S.E. 251 (1922), found not to be a sale under the Virginia statute would likewise not be a bulk transfer under the UCC. The UCC covers transfer of "a major part," while the Virginia statute is somewhat broader covering the transfer of "any part or the whole."

The UCC covers a transfer of "a substantial part of the equipment . . . made in connection with a bulk transfer of inventory," while the Virginia statute covers a transfer of "the fixtures pertaining to the conduct of a business of selling merchandise." The term "equipment," as defined in UCC 9-109, is somewhat broader than the term "fixtures" in the Virginia statute. However, the Virginia statute does cover a transfer of "fixtures" alone, while the UCC covers a transfer of equipment only if it is made in connection with a transfer of inventory. The UCC Comment, Point 2, states that the UCC does not cover restaurants. This is in accord with O'Connor v. Smith, 188 Va. 214, 49 S.E. 2d 310 (1948), Note, 35 Va. L. Rev. 123 (1949), which held that the Virginia Bulk Sales Act does not cover the sale of the fixtures and equipment of a restaurant, since they do not pertain to the business of selling merchandise.

The UCC covers transfers of "materials, supplies, merchandise or other inventory of an enterprise," while the Virginia statute only covers transfers of "a stock of merchandise or the fixtures pertaining to the conduct of a business of selling merchandise." Since inventory, as defined in UCC 9-109, includes materials used or consumed in a business, the coverage of the UCC is somewhat broader than the Virginia statute.

The UCC covers transfers out of the ordinary course of the transferor's business, while the Virginia statute requires that the transfer be both out of the regular course of the transferor's business and also out of the ordinary course of trade of such businesses generally.

§ 6-103. **Transfers Excepted From This Article.** The following transfers are not subject to this Article:

(1) Those made to give security for the performance of an obligation;

(2) General assignments for the benefit of all the creditors of the transferor, and subsequent transfers by the assignee thereunder;

(3) Transfers in settlement or realization of a lien or other security interest;

(4) Sales by executors, administrators, receivers, trustees in bankruptcy, or any public officer under judicial process;

(5) Sales made in the course of judicial or administrative proceedings for the dissolution or reorganization of a corporation and of which notice is sent to the creditors of the corporation pursuant to order of the court or administrative agency;

(6) Transfers to a person maintaining a known place of business in this State who becomes bound to pay the debts of the transferor in full and gives public notice of that fact, and who is solvent after becoming so bound;

(7) A transfer to a new business enterprise organized to take over and continue the business, if public notice of the transaction is given and the new enterprise assumes the debts of the transferor and he receives nothing from the transaction except an interest in the new enterprise junior to the claims of creditors;

(8) Transfers of property which is exempt from execution.

Public notice under subsection (6) or subsection (7) may be given by publishing once a week for two consecutive weeks in a newspaper of general circulation where the transferor had its principal place of business in this state an advertisement including the names and addresses of the transferor and transferee and the effective date of the transfer.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. The section defines the transfers which although within the general definition of the previous section ought not to be subjected to the requirements of this Article.

2. Some of the existing Bulk Sales laws cover "bulk mortgages" as well as outright sales. In this Code security interests of all kinds in personal property are regulated by Article 9, Secured Transactions. Subsection (1) of this section therefore excludes all transfers for security from the operation of this Article. See also § 9-111.

3. The exclusions described in subsections (2), (3), (4), (5) and (8) are believed to explain themselves.

4. Subsection (6) will exclude a great many transactions from the requirements of this Article. It is believed the exclusion is justified, and that it removes many of the objections to a law of this character. The transactions excluded are outright sales, since that is the only kind of a transaction in which the transferee

is likely to bind himself to pay the transferor's debts. The purpose of this Article on outright sales is to give the seller's creditors a reasonable chance to collect their debts. (See §§ 6-104 through 6-108). If the buyer is willing to assume personal liability for those debts, and is himself solvent after such assumption, there is no reason to subject the transaction to the delay and red tape which this Article imposes.

5. Subsection (7) deals with certain changes in the ownership of a business, as by incorporation, change of membership of a firm, or transfer from a sole proprietor to a firm. The exclusion is believed to be justified within the limits stated in the subsection. Notice that in all the transactions to which the subsection applies (a) both the original debtor and the new enterprise are personally bound to pay the debts, (b) the property subject to the debts before the transfer is still subject to them, and (c) the original debtor has taken nothing out of the transaction except an interest (shares in a corporation, an interest in a firm, or a subordinated obligation) which is junior to the debts.

Cross References:

Point 1: § 6-102.
Point 2: § 9-111 and Article 9 generally.
Point 4: §§ 6-104 through 6-108.

Definitional Cross References:

"Creditors". §§ 1-201 and 6-109.
"Person". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 55-83.

Comment: Subsection 6-103(1) is in accord with United States v. Lankford, 3 F.2d 52, 53-54 (E.D. Va. 1924), which held that the Virginia Bulk Sales Act does not cover a transaction that involves the giving of a deed of trust or chattel mortgage to secure a pre-existing indebtedness.

While not exactly in point, subsection 6-103(6) is in accord with Barker v. Stant, 3 F.2d 918, 920 (4th Cir. 1925), which held that a creditor who has dealt with the transferee as his debtor is barred from attacking the transfer for noncompliance with statutory requirements.

Subsection 6-103(8) is in accord with Canada v. Beasley & Bros., Inc., 132 Va. 166, 172-73, 111 S.E. 251 (1922), holding that the Virginia Bulk Sales Act does not cover transfers of property that is exempt from execution.

§ 6-104. **Schedule of Property, List of Creditors.** (1) Except as provided with respect to auction sales (§ 6-108), a bulk transfer subject to this Article is ineffective against any creditor of the transferor unless:

(a) The transferee requires the transferor to furnish a list of his existing creditors prepared as stated in this section; and

(b) The parties prepare a schedule of the property transferred sufficient to identify it; and

(c) The transferee preserves the list and schedule for six months next following the transfer and permits inspection of either or both and copying therefrom at all reasonable hours by any creditor of the transferor, or files the list and schedule in (a public office to be here identified).

(2) The list of creditors must be signed and sworn to or affirmed by the transferor or his agent. It must contain the names and business addresses of all creditors of the transferor, with the amounts when known, and also the names of all persons who are known to the transferor to assert claims against him even though such claims are disputed. If the transferor is the obligor of an outstanding issue of bonds, debentures or the like as to which there is an indenture trustee, the list of creditors need include only the name and address of the indenture trustee and the aggregate outstanding principal amount of the issue.

(3) Responsibility for the completeness and accuracy of the list of creditors rests on the transferor, and the transfer is not rendered ineffective by errors or omissions therein unless the transferee is shown to have had knowledge.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. The section describes the information that must be compiled and kept available to creditors on all bulk transfers subject to this Article except those made by sale at auction. Additional requirements for particular kinds of transfers are stated in the succeeding sections (§§ 6-105 through 6-107). The section on auction sales (§ 6-108) imposes similar requirements, but on different people and with a different sanction.

2. Except for the accuracy of the list of creditors, the sanction for noncompliance with the present section is that the transfer is ineffective against creditors of the transferor. The creditors referred to are those holding claims based on transactions or events occurring before the transfer (§ 6-109). Any such creditor or creditors may therefore disregard the transfer and levy on the goods as still belonging to the transferor, or a receiver representing them can take them by whatever procedure the local law provides. But it follows also that if the debts of the transferor are paid as they mature disregard of the requirements of the section creates no liability. And a defect can always be cured by paying off the unpaid creditors.

3. The sanction for the accuracy of the list of creditors is the criminal law of the state relative to false swearing, made applicable by subsection (2).

Cross References:

Point 1: §§ 6-105 through 6-108.
Point 2: § 6-109.

Definitional Cross References:

"Bulk transfer". § 6-102.
"Creditor". §§ 1-201 and 6-109.
"Party". § 1-201.
"Person". § 1-201.
"Signed" §§ 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 55-83, 55-84.

Comment: Transfers made without compliance with the UCC are "ineffective" as against creditors. The Virginia statute says that such transfers shall be "void." The consequence of noncompliance under both the UCC and the Virginia statute is that a creditor may disregard the transfer and levy on the goods as though they still belonged to the transferor. Neither the UCC nor the Virginia statute requires that the transfer be fraudulent. Thomas Andrews & Co., v. Robinson, 155 Va. 362, 365-66, 154 S.E. 514 (1930), held that a noncomplying bulk a bulk transfer made by parties who were ignorant of the statutory requirements and who had no intent to defraud. Isaac Eberly Co. v. Gibson, 107 Va. 315, 58 S.E. 591 (1907), is to the same effect. Thomas Andrews & Co., v. Robinson, 155 Va. 362, 365-66, 154 S.E. 514 (1930), held that a noncomplying bulk transfer could be attacked both in law and in equity.

§ 6-105. Notice to Creditors. In addition to the requirements of the preceding section, any bulk transfer subject to this Article except one made by auction sale (§ 6-108) is ineffective against any creditor of the transferor unless at least ten days before he takes possession of the goods or pays for them, whichever happens first, the transferee gives notice of the transfer in the manner and to the persons hereafter provided (§ 6-107).

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. This section is the heart of the Article. It requires notice to creditors of all bulk transfers subject to the Article, except those made by auction sale. The contents of the notice, the persons to whom it must be given, and the manner of giving it are stated in § 6-107. The section on auction sales (6-108) also calls for notice, but by a different person and with a different sanction.

2. The notice in all cases must be given ten days in advance. See Points 3 and 4 to § 6-101.

3. The sanction for noncompliance with the section is that the transfer is ineffective against creditors. Comment 2 to § 6-104 applies.

Cross References:

Point 1: §§ 6-107 and 6-108.
Point 2: Points 3 and 4 to § 6-101.
Point 3: Comment 2 to § 6-104.

Definitional Cross References:

"Bulk transfer". § 6-102.
"Creditor". §§ 1-201 and 6-109.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 55-83.

Comment: The UCC is in substantial agreement with the Virginia statute, both providing for the giving of notice to creditors ten days before the buyer takes possession of the goods.

§ 6-106. Omitted

(VALC Note: The Official Text offers § 6-106 as an optional section as follows:

[§ 6-106. Application of the Proceeds. In addition to the requirements of the two preceding sections:

(1) Upon every bulk transfer subject to this Article for which new consideration becomes payable except those made by sale at auction it is the duty of the transferee to assure that such consideration is applied so far as necessary to pay those debts of the transferor which are either shown on the list furnished by the transferor (§ 6-104) or filed in writing in the place stated in the notice (§ 6-107) within thirty days after the mailing of such notice. This duty of the transferee runs to all the holders of such debts, and may be enforced by any of them for the benefit of all.

(2) If any of said debts are in dispute the necessary sum may be withheld from distribution until the dispute is settled or adjudicated.

(3) If the consideration payable is not enough to pay all of the said debts in full distribution shall be made pro rata.]

Note: This section is bracketed to indicate division of opinion as to whether or not it is a wise provision, and to suggest that this is a point on which State enactments may differ without serious damage to the principle of uniformity.

In any State where this section is omitted, the following parts of sections, also bracketed in the text, should also be omitted, namely:

§ 6-107(2)(e).
§ 6-108(3)(c).
§ 6-109(2).

In any State where this section is enacted, these other provisions should be also.

Optional Subsection (4)

[(4) The transferee may within ten days after he takes possession of the goods pay the consideration into the (specify court) in the county where the transferor had its principal place of business in this state and thereafter may discharge his duty under this section by giving notice by registered or certified mail to all the persons to whom the duty runs that the consideration has been paid into that court and that they should file their claims there. On motion of any interested party, the court may order the distribution of the consideration to the persons entitled to it.]

Note: Optional subsection (4) is recommended for those states which do not have a general statute providing for payment of money into court.)

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. This section applies only to transfers "for which new consideration becomes payable". It applies only if something, which of course need not be money,

becomes payable in consideration of the transfer. The purpose of the section is to give the transferor's creditors direct protection against improper dissipation by the transferor of the consideration which he receives for the transfer. See Comment 4 to § 6-101.

2. Subsections (6) and (7) of § 6-103 remove many outright transfers from the operation of this Article and therefore of course of this section. In addition it is clear from the section itself that in any case in which the seller's debts are to be paid as they mature the buyer can disregard the section without danger of added liability except that his seller will disappoint him. And in case of trouble the buyer is entitled under § 6-109(2) to credit for sums honestly paid to particular creditors.

3. The methods by which the buyer may perform the duty stated in the section are various. He may, for instance, by agreement with the seller hold the consideration in his own hands until the debts are ascertained, or deposit it in an account subject to checks bearing his counter-signature, or deposit it in escrow with an independent agency. If the affairs of the seller are so involved that nothing else is practical the buyer will no doubt pay the consideration into the registry of an appropriate court and interplead the seller's creditors. If optional subsection (4) is enacted, specific provision is made for such a procedure. But notice that the transferee's obligation runs, not to all possible creditors of the transferor who may appear at any time in the future, but only to existing creditors whom the transferee has a chance to identify in one of the ways provided in subsection (1).

Cross References:

Point 1: §§ 6-108, Comment 4 to § 6-101.
Point 2: §§ 6-103(6) and (7), 6-109(2).
Point 3: § 6-109.

Definitional Cross References:

"Bulk transfer". § 6-102.
"Creditor". § 6-109.
"Writing". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: This is an optional section, to be adopted only if Virginia wants to adopt an application of the proceeds type statute.

COUNCIL COMMENT

The inclusion of this section would, we believe, introduce an unnecessary and undesirable complication into our law.

§ 6-107. **The Notice.** (1) The notice to creditors (§ 6-105) shall state:

(a) that a bulk transfer is about to be made; and

(b) the names and business addresses of the transferor and transferee, and all other business names and addresses used by the transferor within three years last past so far as known to the transferee; and

(c) whether or not all the debts of the transferor are to be paid in full as they fall due as a result of the transaction, and if so, the address to which creditors should send their bills.

(2) If the debts of the transferor are not to be paid in full as they fall due or if the transferee is in doubt on that point then the notice shall state further:

(a) the location and general description of the property to be transferred and the estimated total of the transferor's debts;

(b) the address where the schedule of property and list of creditors (§ 6-104) may be inspected;

(c) whether the transfer is to pay existing debts and if so the amount of such debts and to whom owing;

(d) whether the transfer is for new consideration and if so the amount of such consideration and the time and place of payment;

(3) The notice in any case shall be delivered personally or sent by registered or certified mail to all the persons shown on the list of creditors furnished by the transferor (§ 6-104) and to all other persons who are known to the transferee to hold or assert claims against the transferor.

(VALC Note: The Official Text offers an optional paragraph (2)(e) as follows:

(e) if for new consideration the time and place where creditors of the transferor are to file their claims.)

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. This section specifies the contents of the notice to be given on all the transfers covered by § 6-105 (that is, all transfers subject to the Article except those made by auction sale) and the manner in which it is to be given.

2. Under the section, if the debts of the transferor are to be paid in full as they fall due, a short form of notice is provided. This facilitates honest and solvent transactions.

3. If the transfer is by auction sale § 6-108 applies.

4. Subsection (2) (e) is a corollary of § 6-106 and should be omitted if that section is. See note to § 6-106.

Cross References:

Point 1: § 6-105.
Point 3: § 6-108.
Point 4: Note to § 6-106.

Definitional Cross References:

"Bulk transfer". § 6-102.
"Creditor". §§ 1-201 and 6-109.
"Person". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 55-83.

Comment: The UCC provides for a short-form notice where the debts of the transferor are to be paid in full, otherwise for a long-form notice. The Virginia statute requires the same type of notice in either case.

COUNCIL COMMENT

The optional language is omitted to conform to the action taken on § 6-106.

§ 6-108. **Auction Sales; "Auctioneer".** (1) A bulk transfer is subject to this Article even though it is by sale at auction, but only in the manner and with the results stated in this section.

(2) The transferor shall furnish a list of his creditors and assist in the preparation of a schedule of the property to be sold, both prepared as before stated (§ 6-104).

(3) The person or persons other than the transferor who direct, control or are responsible for the auction are collectively called the "auctioneer". The auctioneer shall:

(a) receive and retain the list of creditors and prepare and retain the schedule of property for the period stated in this Article (§ 6-104);

(b) give notice of the auction personally or by registered or certified mail at least ten days before it occurs to all persons shown on the list of

creditors and to all other persons who are known to him to hold or assert claims against the transferor;

(4) Failure of the auctioneer to perform any of these duties does not affect the validity of the sale or the title of the purchasers, but if the auctioneer knows that the auction constitutes a bulk transfer such failure renders the auctioneer liable to the creditors of the transferor as a class for the sums owing to them from the transferor up to but not exceeding the net proceeds of the auction. If the auctioneer consists of several persons their liability is joint and several.

(VALC Note: The Official Text offers an optional paragraph (3)(c) as follows:

(c) assure that the net proceeds of the auction are applied as provided in this Article (§ 6-106).)

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. The section is intended to make appropriate application of the requirements of this Article to auction sales. It is clear that the provisions of the four previous sections in their literal form cannot be applied directly to an auction, since neither the price nor the identity of the purchaser or purchasers can be known until the sale occurs. But it is equally clear that if auctions were excluded entirely from the transfers covered by this Article the way would be open to a debtor to carry out a bulk transfer of his property without notice to his creditors and without any duty upon anyone to see to the application of the proceeds. The section attempts to meet this situation by imposing the obligations stated in the section upon the persons there described.

2. Since the obligation to give advance notice, etc., cannot rest upon bidders at an auction it is clear that the sale must be effective so far as they are concerned whether or not the section is complied with. Subsection (4) therefore states a sanction which does not affect the purchasers. Notice that the sanction applies only "if the auctioneer knows that the auction constitutes a bulk transfer." No doubt in some cases, as for instance when goods are simply received on consignment for sale, he may not know.

3. Subsection (3) (c) is a corollary of § 6-106 and should be omitted if that section is. See note to that section.

Cross References:

Point 1: §§ 6-104 through 6-107.
Point 2: §§ 6-104 through 6-107.
Point 3: § 6-106 and Note thereto.

Definitional Cross References:

"Bulk transfer". § 6-102.
"Creditor". §§ 1-201 and 6-109.
"Person". § 1-201.
"Purchaser". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: The Virginia statute does not apply to auction sales.

COUNCIL COMMENT

The optional language is omitted to conform to action taken on § 6-106.

§ 6-109. What Creditors Protected. The creditors of the transferor mentioned in this Article are those holding claims based on transactions or events occurring before the bulk transfer, but creditors who become such after notice to creditors is given (§§ 6-105 and 6-107) are not entitled to notice.

(VALC Note: The Official Text offers an optional paragraph (2) as follows:

(2) Against the aggregate obligation imposed by the provisions of this Article concerning the application of the proceeds (§ 6-106 and subsection (3)(c) of § 6-108) the transferee or auctioneer is entitled to credit for sums paid to particular creditors of the transferor, not exceeding the sums believed in good faith at the time of the payment to be properly payable to such creditors.)

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. Subsection (1) identifies the creditors who may have rights under the various provisions of this Article. The claims referred to of course include unliquidated claims.

2. Subsection (2) gives the transferee or auctioneer appropriate credit for honest payments to particular creditors. If § 6-106 is omitted this subsection should be also. See note to that section.

Cross References:

Point 1: §§ 6-104 through 6-108.
Point 2: § 6-106 and Note thereto.

Definitional Cross References:

"Auctioneer". § 6-108.
"Bulk transfer". § 6-102.
"Creditor". § 1-201.
"Good faith". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 55-83.

Comment: This section is in accord with Canada v. Beasley & Bros., Inc., 132 Va. 166, 167-68, 173, 111 S.E. 251 (1922), in holding that only creditors having claims based on transactions before the transfer are covered by the legislation. The section also appears to be consistent with Trimble v. Covington Grocery Co., 112 Va. 826, 72 S.E. 724 (1911). Covington Grocery was a creditor of Whitaker. Whitaker made a bulk sale to Rose. On November 20, Rose made a bulk sale, without complying with the statute, to Trimble. Thereafter, Trimble made an assignment for the benefit of creditors. Meanwhile, on November 11, an attachment was served on Rose by Covington Grocery, who was trying to reach the purchase money owed by Rose to Whitaker. It was held that on November 20, when Rose made the bulk transfer to Trimble, the Covington Grocery Company was not a creditor of Rose, and so the Grocery Company had no standing to attack the transfer from Rose to Trimble.

COUNCIL COMMENT

The optional language is omitted to conform to action taken on § 6-106.

§ 6-110. Subsequent Transfers. When the title of a transferee to property is subject to a defect by reason of his non-compliance with the requirements of this Article, then:

(1) a purchaser of any of such property from such transferee who pays no value or who takes with notice of such noncompliance takes subject to such defect, but

(2) a purchaser for value in good faith and without such notice takes free of such defect.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. The section deals with subsequent transfers by the transferee.

2. The second transfer may of course itself be a "bulk transfer" subject to this Article. Whether it is or not will depend on its own character under §§ 6-102 and 6-103.

Cross References:

Point 2: §§ 6-102 and 6-103.

Definitional Cross References:

"Good faith". § 1-201.
"Notice". § 1-201.
"Purchaser". § 1-201.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 55-83.

Comment: See VIRGINIA ANNOTATIONS to UCC 6-109 for a discussion of Trimble v. Covington Grocery Co., 112 Va. 826, 72 S.E. 724 (1911).

§ 6-111. Limitation of Actions and Levies. No action under this Article shall be brought nor levy made more than six months after the date on which the transferee took possession of the goods unless the transfer has been concealed. If the transfer has been concealed, actions may be brought or levies made within six months after its discovery.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. This Article imposes unusual obligations on buyers of property. A short statute of limitations is therefore appropriate.

2. The main sanction for noncompliance with the Article is that the transfer "is ineffective against any creditor of the transferor." §§ 6-104, 6-105. This means, e.g., that a judgment creditor of the transferor may levy execution on the property. See Comment 2 to § 6-104.

In such a case, which may be expected to be frequent, no "action under this Article" will be necessary. The action will have been brought and prosecuted to judgment on whatever the claim was. The only thing done "under this Article" will be the levy and resulting sale.

The short statute of limitations is therefore made applicable to levies as well as actions. "Levy", which is not a defined term in the Code, should be read broadly as including not only levies of execution proper but also attachment, garnishment, trustee process, receivership, or whatever proceeding, under the state's practice, is used to apply a debtor's property to payment of his debts.

Definitional Cross References:

"Action". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 55-85, 55-86.

Comment: The UCC provides a six months statute of limitations. The Virginia statutes on this subject are conflicting and confusing, § 55-85 provides a six months limitation period while § 55-86 provides a twelve months period.
The history of the Virginia statutes shows the reason for the conflict. § 5187 of the Code of 1919 contained the present provision for the preservation of the list of creditors and inventory for six months and then provided that after six months no suit should be brought to invalidate a bulk sale. In Barker v. Stant, 3 F.2d 918, 920 (4th Cir. 1925), this section was construed as imposing a six months statute of limitations. However, in 1930 the statute was amended by adding the paragraph which is now Code 1950, § 55-86. After this amendment the statute, read as a whole, imposed a six months statute of limitations where the list of creditors and inventory had been preserved, although no notice had been given to creditors, and a twelve months statute of limitations where there had been no compliance whatsoever with the statute. A slight change of wording was made in the 1950 codification, with the result that both statutes of limitations now presumably cover all bulk sales.

Note to Article 6: *§ 6-106 is bracketed to indicate division of opinion as to whether or not it is a wise provision, and to suggest that this is a point on which State enactments may differ without serious damage to the principle of uniformity.*

In any State where § 6-106 is not enacted, the following parts of sections, also bracketed in the text, should also be omitted, namely:

§ 6-107(2)(e).
6-108(3)(c).
6-109(2).

In any State where § 6-106 is enacted, these other provisions should be also.

ARTICLE 7

WAREHOUSE RECEIPTS, BILLS OF LADING AND OTHER DOCUMENTS OF TITLE

PART 1

GENERAL

§ 7-101. Short Title. This Article shall be known and may be cited as Uniform Commercial Code—Documents of Title.

COMMENT: This Article is a consolidation and revision of the Uniform Warehouse Receipts Act and the Uniform Bills of Lading Act, and embraces also the provisions of the Uniform Sales Act relating to negotiation of documents of title. The only substantial omissions of material covered in the previous uniform acts are the criminal provisions found in the Warehouse Receipts and Bills of Lading acts. These criminal provisions are inappropriate to a Commercial Code, and for the most part duplicate portions of the ordinary criminal law relating to frauds. The Article does not attempt to define the tort liability of bailees, except to hold certain classes of bailees to a minimum standard of reasonable care. For important classes of bailees, liabilities in case of loss, damage or destruction, as well as other legal questions associated with particular documents of title, are governed by federal statutes, international treaties, and in some cases regulatory state laws, which supersede the provisions of this Article in case of inconsistency. See § 7-103.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 61-1 through 61-58; 56-119, 56-120, 56-121.

Comment: This Article replaces the Uniform Warehouse Receipts Act, adopted in Virginia in 1908, and now set forth in the Code as §§ 61-1 through 61-58. The UCC does not cover the criminal aspects of this act, now contained in §§ 61-53 through 61-58.

The UCC also replaces the Uniform Sales Act and the Uniform Bills of Lading Act, neither of which was ever adopted in Virginia.

This Article does not replace other regulatory statutes as the Cold Storage Warehouses Act, Code 1950, §§ 61-57 through 61-77, the Refrigerated Locker Plants Act, Code 1950, §§ 61-78 through 61-94; the Acts regulating Tobacco Warehouses and the handling and sale of tobacco, Code 1950, §§ 61-95 through 61-160; and the several Acts relating to Public Service Companies set forth in Title 56.

§ 7-102. Definitions and Index of Definitions. (1) In this Article, unless the context otherwise requires:

(a) "Bailee" means the person who by a warehouse receipt, bill of lading or other document of title acknowledges possession of goods and contracts to deliver them.

(b) "Consignee" means the person named in a bill to whom or to whose order the bill promises delivery.

(c) "Consignor" means the person named in a bill as the person from whom the goods have been received for shipment.

(d) "Delivery order" means a written order to deliver goods directed to a warehouseman, carrier or other person who in the ordinary course of business issues warehouse receipts or bills of lading.

(e) "Document" means document of title as defined in the general definitions in Article 1 (§ 1-201).

(f) "Goods" means all things which are treated as movable for the purposes of a contract of storage or transportation.

(g) "Issuer" means a bailee who issues a document except that in relation to an unaccepted delivery order it means the person who orders the possessor of goods to deliver. Issuer includes any person for whom an agent or employee purports to act in issuing a document if the agent or employee has real or apparent authority to issue documents, notwithstanding that the issuer received no goods or that the goods were misdescribed or that in any other respect the agent or employee violated his instructions.

(h) "Warehouseman" is a person engaged in the business of storing goods for hire.

(2) Other definitions applying to this Article or to specified Parts thereof, and the sections in which they appear are:

"Duly negotiate". § 7-501.
"Person entitled under the document". § 7-403(4).

(3) Definitions in other Articles applying to this Article and the sections in which they appear are:

"Contract for sale". § 2-106.
"Overseas". § 2-323.
"Receipt" of goods. § 2-103.

(4) In addition Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

COMMENT: **Prior Uniform Statutory Provision:** § 76, Uniform Sales Act; § 58, Uniform Warehouse Receipts Act; §§ 1 and 53, Uniform Bills of Lading Act.

Changes: Applicable definitions from the uniform acts have been consolidated and revised; definition of delivery order is new.

Purposes of Changes and New Matter: 1. "Bailee" was not defined in the old uniform acts. It is used in this Article as a blanket term to designate carriers, warehousemen and others who normally issue documents of title on the basis of goods which they have received. The definition does not, however, require actual possession of the goods. If a bailee acknowledges possession when he does not have it he is bound by sections of this Article which declare the "bailee's" obligations. (See definition of "Issuer" in this section and §§ 7-203 and 7-301 on liability in case of non-receipt.)

2. The definition of warehouse receipt contained in the general definitions section of this Act (§ 1-201) eliminates the requirement of the Uniform Warehouse Receipts Act that the issuing warehouseman be "lawfully engaged" in business. The warehouseman's compliance with applicable state regulations such as the filing of a bond has no bearing on the substantive issues dealt with in this Article. Certainly the issuer's violations of law should not diminish his responsibility on documents he has put in commercial circulation. The Uniform Warehouse Receipts Act requirement that the warehouseman be engaged "for profit" has also been eliminated in view of the existence of state operated and co-operative warehouses. But it is still essential that the business be storing goods "for hire" (§ 1-201 and this section). A person does not become a warehouseman by storing his own goods.

3. Delivery orders, which were included without qualification in the Uniform Sales Act definition of document of title, must be treated differently in this consolidation of provisions from the three uniform acts. When a delivery order has been accepted by the bailee it is for practical purposes indistinguishable from a warehouse receipt. Prior to such acceptance there is no basis for imposing obligations on the bailee other than the ordinary obligation of contract which the bailee may have assumed to the depositor of the goods.

Cross References:

Point 1: §§ 7-203 and 7-301.
Point 2: §§ 1-201 and 7-203.
See general comment to document of title in § 1-201.

Definitional Cross References:

"Bill of lading". § 1-201.
"Contract". § 1-201.
"Contract of sale". § 2-106.
"Delivery". § 1-201.
"Document of title". § 1-201.
"Person". § 1-201.
"Purchase". § 1-201.
"Receipt of goods". § 2-103.
"Right". § 1-201.
"Warehouse receipt". § 1-201.
"Written". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 61-1.

§ 7-103. **Relation of Article to Treaty, Statute, Tariff, Classification or Regulation.** To the extent that any treaty or statute of the United States, regulatory statute of this State or tariff classification or regulation filed or issued pursuant thereto is applicable, the provisions of this Article are subject thereto.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. To make clear what would of course be true without the section, that applicable Federal law is paramount.

2. To make clear also that *regulatory* state statutes (such as those fixing or authorizing a commission to fix rates and prescribe services, authorizing different charges for goods of different values, and limiting liability for loss to the declared value on which the charge was based) are not affected by the Article and are controlling on the matters which they cover. Notice that the reference is not only to such statutes, but to tariffs, classifications and regulations filed or issued pursuant to them.

Cross References:

§§ 7-201, 7-202, 7-204, 7-206, 7-309, 7-401, 7-403.

Definitional Cross References:

"Bill of lading". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 7-104. **Negotiable and Non-Negotiable Warehouse Receipt, Bill of Lading or Other Document of Title.** (1) A warehouse receipt, bill of lading or other document of title is negotiable

(a) if by its terms the goods are to be delivered to bearer or to the order of a named person; or

(b) where recognized in overseas trade, if it runs to a named person or assigns.

(2) Any other document is non-negotiable. A bill of lading in which it is stated that the goods are consigned to a named person is not made negotiable by a provision that the goods are to be delivered only against a written order signed by the same or another named person.

COMMENT: Prior Uniform Statutory Provision: §§ 27 and 76, Uniform Sales Act; §§ 2, 3, 4, 5 and 59, Uniform Warehouse Receipts Act; §§ 2, 3, 4, 5 and 53, Uniform Bills of Lading Act.

Changes: Consolidated and rewritten.

Purposes of Changes: This Article deals with a class of commercial paper representing commodities in storage or transportation. This "commodity paper" is to be distinguished from what might be called "money paper" dealt with in the

Article of this Act on Commercial Paper (Article 3) and "investment paper" dealt with in the Article of this Act on Investment Securties (Article 8). The class of "commodity paper" is designated "document of title" following the terminology of the Uniform Sales Act § 76. § 1-201. The distinctions between negotiable and nonnegotiable documents in this section makes the most important subclassification employed in the Article, in that the holder of negotiable documents may acquire more rights than his transferor had (See § 7-502).
A document of title is negotiable only if it satisfies this section. "Deliverable on proper indorsement and surrender of this receipt" will not render a document negotiable. Bailees often include such provisions as a means of insuring return of nonnegotiable receipts for record purposes. Such language may be regarded as insistence by the bailee upon a particular kind of receipt in connection with delivery of the goods. Subsections (1) (a) and (2) make it clear that a document is not negotiable which provides for delivery to order or bearer only if written instructions to that effect are given by a named person.

Cross Reference:

§ 7-502.

Definitional Cross References:

"Bearer". § 1-201.
"Bill of lading". § 1-201.
"Delivery". § 1-201.
"Document of title". § 1-201.
"Overseas". § 2-323.
"Person". § 1-201.
"Warehouse receipt". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 61-5, 61-6, 61-7, 61-8.

§ 7-105. Construction Against Negative Implication. The omission from either Part 2 or Part 3 of this Article of a provision corresponding to a provision made in the other Part does not imply that a corresponding rule of law is not applicable.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: To avoid any impairment, for example, of any common-law right of indemnity a warehouseman may have corresponding to § 7-301(5), or of any contractual security interest a carrier might have corresponding to § 7-209(2).

Cross References:

Parts 2 and 3 of Article 7.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

PART 2

WAREHOUSE RECEIPTS: SPECIAL PROVISIONS

§ 7-201. Who May Issue a Warehouse Receipt; Storage Under Government Bond. (1) A warehouse receipt may be issued by any warehouseman.

(2) Where goods including distilled spirits and agricultural commodities are stored under a statute requiring a bond against withdrawal or a license for the issuance of receipts in the nature of warehouse receipts, a receipt issued for the goods has like effect as a warehouse receipt even though issued by a person who is the owner of the goods and is not a warehouseman.

COMMENT: Prior Uniform Statutory Provision: § 1, Uniform Warehouse Receipts Act.

Changes: Provision added to cover storage under government bond or under licensing statute.

Purposes: It is not intended by reenactment of subsection (1) to repeal any provisions of special licensing or other statutes regulating who may become a warehouseman. See § 10-103. Subsection (2) covers receipts issued by the owner for whiskey or other goods stored in bonded warehouses under such statutes as 26 U.S.C. Chapter 26. Limitations on the transfer of the receipts and criminal sanctions for violation of such limitations are not impaired. § 7-103. Compare § 7-104(d) on the liability of the issuer in such cases.

Cross References:

§§ 7-103, 7-401, 10-103.

Definitional Cross References:

"Warehouse receipt". § 1-201.
"Warehouseman". § 7-102.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 61-4.

§ 7-202. Form of Warehouse Receipt; Essential Terms; Optional Terms. (1) A warehouse receipt need not be in any particular form.

(2) Unless a warehouse receipt embodies within its written or printed terms each of the following, the warehouseman is liable for damages caused by the omission to a person injured thereby:

(a) the location of the warehouse where the goods are stored;

(b) the date of issue of the receipt;

(c) the consecutive number of the receipt;

(d) a statement whether the goods received will be delivered to the bearer, to a specified person, or to a specified person or his order;

(e) the rate of storage and handling charges, except that where goods are stored under a field warehousing arrangement a statement of that fact is sufficient on a nonnegotiable receipt;

(f) a description of the goods or of the packages containing them;

(g) the signature of the warehouseman, which may be made by his authorized agent;

(h) if the receipt is issued for goods of which the warehouseman is owner, either solely or jointly or in common with others, the fact of such ownership; and

(i) a statement of the amount of advances made and of liabilities incurred for which the warehouseman claims a lien or security interest (§ 7-209). If the precise amount of such advances made or of such liabilities incurred is, at the time of the issue of the receipt, unknown to the warehouseman or to his agent who issues it, a statement of the fact that advances have been made or liabilities incurred and the purpose thereof is sufficient.

(3) A warehouseman may insert in his receipt any other terms which are not contrary to the provisions of this Act and do not impair his obligation of delivery (§ 7-403) or his duty of care (§ 7-204). Any contrary provisions shall be ineffective.

COMMENT: **Prior Uniform Statutory Provision:** §2, Uniform Warehouse Receipts Act.

Changes: Exemption for field warehouse receipts added in subsection (2) (e).

Purposes: To make clear that the formal requirements of the Uniform Warehouse Receipts Act are continued but not to displace particular legislation requiring other or different specifications of form, see §§ 7-103 and 10-103. This section does not require that a receipt be issued but states formal requirements for those which are issued.

Cross References:

§§ 7-103 and 10-103.

Definitional Cross References:

"Bearer". § 1-201.
"Delivery". § 1-201.
"Goods". § 7-102.
"Person". § 1-201.
"Security interest". § 1-201.
"Term". § 1-201.
"Warehouse receipt". § 1-201.
"Warehouseman". § 7-102.
"Written". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 61-5.

§ 7-203. Liability for Non-Receipt or Misdescription. A party to or purchaser for value in good faith of a document of title other than a bill of lading relying in either case upon the description therein of the goods may recover from the issuer damages caused by the non-receipt or misdescription of the goods, except to the extent that the document conspicuously indicates that the issuer does not know whether any part or all of the goods in fact were received or conform to the description, as where the description is in terms of marks or labels or kind, quantity or condition, or the receipt or description is qualified by "contents, condition and quality unknown", "said to contain" or the like, if such indication be true, or the party or purchaser otherwise has notice.

COMMENT: **Prior Uniform Statutory Provision:** § 20, Uniform Warehouse Receipts Act.

Changes: New section confined to problem of non-receipt and misdescription.

Purposes of Changes and New Matter: This section is a simplified restatement of existing law as to the method by which a bailee may avoid responsibility for the accuracy of descriptions which are made by or in reliance upon information furnished by the depositor. The issuer is liable on documents issued by an agent, contrary to instructions of his principal, without receiving goods. No disclaimer of the latter liability is permitted.

Cross References:

§§ 7-301 and 7-203.

Definitional Cross References:

"Conspicuous". § 1-201.
"Document". § 7-102.
"Document of title". § 1-201.
"Goods". § 7-102.
"Issuer". § 7-102.
"Notice". § 1-201.
"Party". § 1-201.
"Purchaser". § 1-201.
"Receipt of goods". § 2-103.
"Value". § 1-201.

Prior Statutes: Code 1950, § 61-23.

Comment: Under the original § 20 of the Uniform Warehouse Receipts Act a principal was not bound by the act of his agent in issuing a warehouse receipt for goods which had not actually been received. A substitute § 20 was proposed by the National Conference of Commissioners on Uniform State Laws in 1922, which would have imposed liability in such circumstances, but this substitute amendment was not adopted in Virginia. Consequently, this section changes Virginia law as it relates to the liability of a warehouseman for his agent's fraudulent issue of warehouse receipts when no goods have been received.

§ 7-204. Duty of Care; Contractual Limitation of Warehouseman's Liability. (1) A warehouseman is liable for damages for loss of or injury to the goods caused by his failure to exercise such care in regard to them as a reasonably careful man would exercise under like circumstances but unless otherwise agreed he is not liable for damages which could not have been avoided by the exercise of such care.

(2) Damages may be limited by a term in the warehouse receipt or storage agreement limiting the amount of liability in case of loss or damage, and setting forth a specific liability per article or item, or value per unit of weight, beyond which the warehouseman shall not be liable; provided, however, that such liability may on written request of the bailor at the time of signing such storage agreement or within a reasonable time after receipt of the warehouse receipt be increased on part or all of the goods thereunder, in which event increased rates may be charged based on such increased valuation, but that no such increase shall be permitted contrary to a lawful limitation of liability contained in the warehouseman's tariff, if any. No such limitation is effective with respect to the warehouseman's liability for conversion to his own use.

(3) Reasonable provisions as to the time and manner of presenting claims and instituting actions based on the bailment may be included in the warehouse receipt or tariff.

(VALC Note: The Official Text contains the following subsection (4): "(4) This section does not impair or repeal . . .".)

COMMENT: Prior Uniform Statutory Provision: §§ 3 and 21, Uniform Warehouse Receipts Act.

Changes: Consolidated and rewritten; material on limitation of remedy is new.

Purposes of Changes: The old uniform acts provided that receipts could not contain terms impairing the obligation of reasonable care. Whether this is violated by a stipulation that in case of loss the bailee's liability is limited to stated amounts has been much controverted. The section is intended to eliminate that controversy by setting forth the conditions under which liability is so limited. However, as subsection (4) makes clear, the states as well as the federal government may supplement this section with more rigid standards of responsibility for some or all bailees.

Cross References:
§§ 7-103 and 10-103.

Definitional Cross References:
"Action". § 1-201.
"Agreed". § 1-201.
"Goods". § 7-102.
"Reasonable time". § 1-204.
"Sign". § 1-201.
"Term". § 1-201.
"Value". § 1-201.
"Warehouse receipt". § 1-201.
"Warehouseman". § 7-102.
"Written". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 61-6, 61-24.

Comment: The duty of due care imposed by this section is in accord with Marsh v. Pennsylvania Railroad Co., 159 Va. 694, 699, 167 S.E. 274 (1933).

COUNCIL COMMENT

There appears to be no Virginia statute which "imposes a higher responsibility upon the warehouseman or invalidates contractual limitations which would be permissible under this Article".

§ 7-205. **Title Under Warehouse Receipt Defeated in Certain Cases.** A buyer in the ordinary course of business of fungible goods sold and delivered by a warehouseman who is also in the business of buying and selling such goods takes free of any claim under a warehouse receipt even though it has been duly negotiated.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: The typical case covered by this section is that of the warehouseman-dealer in grain, and the substantive question at issue is whether in case the warehouseman becomes insolvent the receipt holders shall be able to trace and recover grain shipped to farmers and other purchasers from the elevator. This was possible under the old acts, although courts were eager to find estoppels to prevent it. The practical difficulty of tracing fungible grain means that the preservation of this theoretical right adds little to the commercial acceptability of negotiable grain receipts, which really circulate on the credit of the warehouseman. Moreover, on default of the warehouseman, the receipt holders at least share in what grain remains, whereas retaking the grain from a good faith cash purchaser reduces him completely to the status of general creditor in a situation where there was very little he could do to guard against the loss. Compare 15 U.S.C. § 714p, enacted in 1955.

Cross References:

§§ 2-403 and 9-307.

Definitional Cross References:

"Buyer in ordinary course of business". § 1-201.
"Delivery". § 1-201.
"Duly negotiate". § 7-501.
"Fungible" goods. § 1-201.
"Goods". § 7-102.
"Value". § 1-201.
"Warehouse receipt". § 1-201.
"Warehouseman". § 7-102.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 7-206. **Termination of Storage at Warehouseman's Option.** (1) A warehouseman may on notifying the person on whose account the goods are held and any other person known to claim an interest in the goods require payment of any charges and removal of the goods from the warehouse at the termination of the period of storage fixed by the document, or, if no period is fixed, within a stated period not less than thirty days after the notification. If the goods are not removed before the date specified in the notification, the warehouseman may sell them in accordance with the provisions of the section on enforcement of a warehouseman's lien (§ 7-210).

(2) If a warehouseman in good faith believes that the goods are about to deteriorate or decline in value to less than the amount of his lien within the time prescribed in subsection (1) for notification, advertisement and sale, the warehouseman may specify in the notification any reasonable shorter time for removal of the goods and in case the goods are not removed, may sell them at public sale held not less than one week after a single advertisement or posting.

(3) If as a result of a quality or condition of the goods of which the warehouseman had no notice at the time of deposit the goods are a hazard to other property or to the warehouse or to persons, the warehouseman may sell the goods at public or private sale without advertisement on reasonable notification to all persons known to claim an interest in the goods. If the warehouseman after a reasonable effort is unable to sell the goods he may dispose of them in any lawful manner and shall incur no liability by reason of such disposition.

(4) The warehouseman must deliver the goods to any person entitled to them under this Article upon due demand made at any time prior to sale or other disposition under this section.

(5) The warehouseman may satisfy his lien from the proceeds of any sale or disposition under this section but must hold the balance for delivery on the demand of any person to whom he would have been bound to deliver the goods.

COMMENT: **Prior Uniform Statutory Provision:** § 34, Uniform Warehouse Receipts Act.

Changes: Rewritten and expanded to define the warehouseman's right to terminate the storage not only where the goods are perishable or hazardous as in Uniform Warehouse Receipts Act, § 34, but also for any other reason including decline in value of the goods imperilling the warehouseman's security for charges.

Purposes of Changes: 1. Most warehousing is for an indefinite term, the bailor being entitled to delivery on reasonable demand. It is necessary to define the warehouseman's power to terminate the bailment, since it would be commercially intolerable to allow warehousemen to order removal of the goods on short notice. The thirty day period provided where the document does not carry its own period of termination corresponds to commercial practice of computing rates on a monthly basis. The right to terminate under subsection (1) includes a right to require payment of "any charges", but does not depend on the existence of unpaid charges.

2. In permitting expeditious disposition of perishable and hazardous goods Uniform Warehouse Receipts Act, § 34, made no distinction between cases where the warehouseman knowingly undertook to store such goods and cases where the goods were discovered to be of that character subsequent to storage. The former situation presents no such emergency as justifies the summary power of removal and sale. Subsections (2) and (3) distinguish between the two situations.

3. Protection of his lien is the only interest which the warehouseman has to justify summary sale of perishable goods which are not hazardous. This same interest must be recognized when the stored goods, although not perishable, decline in market value to a point which threatens the warehouseman's security.

4. The right to order removal of stored goods is subject to provisions of the public warehousing laws of some states forbidding warehousemen from discriminating among customers. Nor does the section relieve the warehouseman of any obligation under the state laws to secure the approval of a public official before disposing of deteriorating goods. Such *regulatory* statutes and the regulations under them remain in force and operative. §§ 7-103, 10-103.

Cross References:

§§ 7-103, 7-403, 10-103.

Definitional Cross References:

"Delivery". § 1-201.
"Document". § 7-102.
"Good faith". § 1-201.
"Goods". § 7-102.
"Notice". § 1-201.
"Notification". § 1-201.
"Person". § 1 201.
"Reasonable time". § 1-204.
"Value". § 1-201.
"Warehouseman". § 7-102.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 61-37.

§ 7-207. **Goods Must Be Kept Separate; Fungible Goods.** (1) Unless the warehouse receipt otherwise provides, a warehouseman must keep separate the goods covered by each receipt so as to permit at all times identification and delivery of those goods except that different lots of fungible goods may be commingled.

(2) Fungible goods so commingled are owned in common by the persons entitled thereto and the warehouseman is severally liable to each owner for that owner's share. Where because of overissue a mass of fungible goods is insufficient to meet all the receipts which the warehouseman has issued against it, the persons entitled include all holders to whom overissued receipts have been duly negotiated.

COMMENT: **Prior Uniform Statutory Provision:** §§ 22 and 23, Uniform Warehouse Receipts Act.

Changes: Consolidated and revised; holders of overissued receipts permitted to share in mass of fungible goods.

Purposes of Changes: No change of substance is made other than the explicit statement that holders to whom overissued receipts have been duly negotiated shall share in a mass of fungible goods. Where individual ownership interests are merged into claims on a common fund, as is necessarily the case with fungible goods, there is no policy reason for discriminating between successive purchasers of similar claims.

Definitional Cross References:
"Delivery". § 1-201.
"Duly negotiate". § 7-501.
"Fungible" goods. § 1-201.
"Goods". § 7-102.
"Holder". § 1-201.
"Person". § 1-201.
"Warehouse receipt". § 1-201.
"Warehouseman". § 7-102.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 61-25, 61-26.

§ 7-208. **Altered Warehouse Receipts.** Where a blank in a negotiable warehouse receipt has been filled in without authority, a purchaser for value and without notice of the want of authority may treat the insertion as authorized. Any other unauthorized alteration leaves any receipt enforceable against the issuer according to its original tenor.

COMMENT: **Prior Uniform Statutory Provision:** § 13, Uniform Warehouse Receipts Act.

Changes: Generally revised and simplified; explicit treatment of the situation where a blank in an executed document is filled without authority.

Purposes of Changes: 1. The execution of warehouse receipts in blank is a dangerous practice. As between the issuer and an innocent purchaser the risks should clearly fall on the former.

2. An unauthorized alteration whether made with or without fraudulent intent does not relieve the issuer of his liability on the warehouse receipt as originally executed. The unauthorized alteration itself is of course ineffective against the warehouseman.

Definitional Cross References:
"Issuer". § 7-102.
"Notice". § 1-201.
"Purchaser". § 1-201.
"Value". § 1-201.
"Warehouse receipt". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 61-16.

§ 7-209. **Lien of Warehouseman.** (1) A warehouseman has a lien against the bailor on the goods covered by a warehouse receipt or on the proceeds thereof in his possession for charges for storage or transportation (including demurrage and terminal charges), insurance, labor, or charges present or future in relation to the goods, and for expenses necessary for preservation of the goods or reasonably incurred in their sale pursuant to law. If the person on whose account the goods are held is liable for like charges or expenses in relation to other goods whenever deposited and it is stated in the receipt that a lien is claimed for charges and expenses in relation to other goods, the warehouseman also has a lien against him for such charges and expenses whether or not the other goods have been delivered by the warehouseman. But against a person to whom a negotiable warehouse receipt is duly negotiated a warehouseman's lien is limited to charges in an amount or at a rate specified on the receipt or if no charges are so specified then to a reasonable charge for storage of the goods covered by the receipt subsequent to the date of the receipt.

(2) The warehouseman may also reserve a security interest against the bailor for a maximum amount specified on the receipt for charges other than those specified in subsection (1), such as for money advanced and interest. Such a security interest is governed by the Article on Secured Transactions (Article 9).

(3) A warehouseman's lien for charges and expenses under subsection (1) or a security interest under subsection (2) is also effective against any person who so entrusted the bailor with possession of the goods that a pledge of them by him to a good faith purchaser for value would have been valid but is not effective against a person as to whom the document confers no right in the goods covered by it under § 7-503.

(4) A warehouseman loses his lien on any goods which he voluntarily delivers or which he unjustifiably refuses to deliver.

COMMENT: **Prior Uniform Statutory Provision:** §§ 27 through 32, Uniform Warehouse Receipts Act.

Changes: Rewritten.

Purposes of Changes: 1. Subsection (1) defines the warehouseman's statutory lien. A specific lien attaches automatically, without express notation on the receipt, to goods stored under a nonnegotiable receipt. That lien is limited to the usual charges arising out of a storage transaction; by notation on the receipt it can be made a general lien extending to like charges in relation to other goods. The same rules apply where the receipt is negotiable, except that as against a holder by due negotiation the lien is limited to the amount or rate specified on the receipt, or, if none is specified, to a reasonable charge for storage of the specific goods after the date of the receipt.

2. Subsection (2) provides for a security interest based upon agreement. Such a security interest arises out of relations between the parties other than bailment for storage or transportation, as where the bailee assumes the role of financer or performs a manufacturing operation, extending credit in reliance upon the goods covered by the receipt. Such a security interest is not a statutory lien. Compare §§ 9-102(2) and 9-310. It is governed in all respects by Article 9, except that subsection (2) requires that the receipt specify a maximum amount and limits the security interest to the amount specified.

3. Subsections (1) and (2) validate the lien and security interest "against the bailor." As against third parties, subsection (3) continues the rule under the prior uniform statutory provision that to validate the lien the owner must have entrusted the goods to the depositor, and that the circumstances must be such that a pledge by the depositor to a good faith purchaser for value would have been valid. Thus the owner's interest will not be subjected to a lien or security interest arising out of a deposit of his goods by a thief. The warehouseman may be protected because of the actual, implied or apparent authority of the depositor, because of a Factor's Act, or because of other circumstances which would protect a bona fide pledgee, unless those circumstances are denied effect under

§ 7-503. Where the third party is the holder of a security interest, the rights of the warehouseman depend on the priority given to a hypothetical bona fide pledgee by Article 9, particularly § 9-312. Thus the special priority granted to statutory liens by § 9-310 does not apply to liens under subsection (1) of this section, since subsection (3) "expressly provides otherwise" within the meaning of § 9-310.

4. It is unnecessary to state here, as in Uniform Warehouse Receipts Act 31, that a bailee with a valid lien need not deliver until the lien is satisfied. § 7-403 provides that a person demanding delivery under a document must be prepared to satisfy the bailee's lien.

5. Where goods have been stored under a nonnegotiable warehouse receipt and are sold by the person to whom the receipt has been issued, frequently the goods are not withdrawn by the new owner. The obligations of the seller of the goods in this situation are set forth in § 2-503(4) on tender of delivery and include procurement of an acknowledgment by the bailee of the buyer's right to possession of the goods. If a new receipt is requested, such an acknowledgment can be withheld until storage charges have been paid or provided for. The statutory lien for charges on the goods sold, granted by the first sentence of subsection (1), continues valid unless the bailee gives it up. But once a new receipt is issued to the buyer, the buyer becomes "the person on whose account the goods are held" under the second sentence of subsection (1); unless he undertakes liability for charges in relation to other goods stored by the seller, there is no general lien against the buyer for such charges. Of course, the bailee may preserve the general lien in such a case either by an arrangement by which the buyer "is liable for" such charges, or by reserving a security interest under subsection (2).

Cross References:

Point 2: §§ 9-102(2) and 9-310.
Point 3: §§ 7-503, 9-310 and 9-312.
Point 4: § 7-403.
Point 5: § 2-503.

Definitional Cross References:

"Deliver". § 1-201.
"Document". § 7-102.
"Goods". § 7-102.
"Money". § 1-201.
"Person". § 1-201.
"Purchaser". § 1-201.
"Right". § 1-201.
"Security interest". § 1-201.
"Value". § 1-201.
"Warehouse receipt". § 1-201.
"Warehouseman". § 7-102.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 61-30 through 61-35.

§ 7-210. Enforcement of Warehouseman's Lien. (1) Except as provided in subsection (2), a warehouseman's lien may be enforced by public or private sale of the goods in bloc or in parcels, at any time or place and on any terms which are commercially reasonable, after notifying all persons known to claim an interest in the goods. Such notification must include a statement of the amount due, the nature of the proposed sale and the time and place of any public sale. The fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the warehouseman is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. If the warehouseman either sells the goods in the usual manner in any recognized market therefor, or if he sells at the price current in such market at the time of his sale, or if he has otherwise sold in conformity with commercially reasonable practices among dealers in the type of goods sold, he has sold in a commercially reasonable manner. A sale of more goods than apparently necessary to be offered to insure satisfaction of the obligation is not commercially reasonable except in cases covered by the preceding sentence.

(2) A warehouseman's lien on goods other than goods stored by a merchant in the course of his business may be enforced only as follows:

(a) All persons known to claim an interest in the goods must be notified.

(b) The notification must be delivered in person or sent by registered or certified letter to the last known address of any person to be notified.

(c) The notification must include an itemized statement of the claim, a description of the goods subject to the lien, a demand for payment within a specified time not less than ten days after receipt of the notification, and a conspicuous statement that unless the claim is paid within that time the goods will be advertised for sale and sold by auction at a specified time and place.

(d) The sale must conform to the terms of the notification.

(e) The sale must be held at the nearest suitable place to that where the goods are held or stored.

(f) After the expiration of the time given in the notification, an advertisement of the sale must be published once a week for two weeks consecutively in a newspaper of general circulation where the sale is to be held. The advertisement must include a description of the goods, the name of the person on whose account they are being held, and the time and place of the sale. The sale must take place at least fifteen days after the first publication. If there is no newspaper of general circulation where the sale is to be held, the advertisement must be posted at least ten days before the sale in not less than six conspicuous places in the neighborhood of the proposed sale.

(3) Before any sale pursuant to this section any person claiming a right in the goods may pay the amount necessary to satisfy the lien and the reasonable expenses incurred under this section. In that event the goods must not be sold, but must be retained by the warehouseman subject to the terms of the receipt and this Article.

(4) The warehouseman may buy at any public sale pursuant to this section.

(5) A purchaser in good faith of goods sold to enforce a warehouseman's lien takes the goods free of any rights of persons against whom the lien was valid, despite noncompliance by the warehouseman with the requirements of this section.

(6) The warehouseman may satisfy his lien from the proceeds of any sale pursuant to this section but must hold the balance, if any, for delivery on demand to any person to whom he would have been bound to deliver the goods.

(7) The rights provided by this section shall be in addition to all other rights allowed by law to a creditor against his debtor.

(8) Where a lien is on good stored by a merchant in the course of his business the lien may be enforced in accordance with either subsection (1) or (2).

(9) The warehouseman is liable for damages caused by failure to comply with the requirements for sale under this section and in case of willful violation is liable for conversion.

COMMENT: Prior Uniform Statutory Provision: § 33, Uniform Warehouse Receipts Act.

Changes: Rewritten; simplified foreclosure proceeding provided for all liens other than warehousemen's lien in noncommercial storage.

Purposes of Changes: 1. Subsection (1) makes "commercial reasonableness" the standard for foreclosure proceedings in all cases except noncommercial storage with a warehouseman. The latter category embraces principally storage of household goods by private owners; and for such cases the detailed provisions as to notification, publication and public sale, found in § 33 of the Uniform Warehouse Receipts Act, are retained in subsection (2). The swifter, more flexible procedure of subsection (1) is appropriate to commercial storage. Compare seller's power of resale on breach by buyer under the provisions of the Article on Sales (§ 2-706).

2. The provisions of subsections (4) and (5) permitting the bailee to bid at public sales and confirming the title of purchasers at foreclosure sales are designed to secure more bidding and better prices.

Cross References:

§ 7-403.

Definitional Cross References:

"Bill of lading". § 1-201.
"Conspicuous". § 1-201.
"Creditor". § 1-201.
"Delivery". § 1-201.
"Document". § 7-102.
"Good faith". § 1-201.
"Goods". § 7-102.
"Notification". § 1-201.
"Notifies". § 1-201.
"Person". § 1-201.
"Purchaser". § 1-201.
"Rights". § 1-201.
"Term". § 1-201.
"Warehouseman". § 7-102.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 61-36.

Comment: While the point was not directly involved, Bell Storage Co. v. Harrison, 164 Va. 278, 288, 180 S.E. 320 (1935), indicated that an invalid sale to enforce a lien would constitute a conversion. Under the UCC there is a conversion only if the violation is wiiful.

PART 3

BILLS OF LADING: SPECIAL PROVISIONS

§ 7-301. Liability for Non-Receipt or Misdescription; "Said to Contain"; "Shipper's Load and Count"; Improper Handling. (1) A consignee of a nonnegotiable bill who has given value in good faith or a holder to whom a negotiable bill has been duly negotiated relying in either case upon the description therein of the goods, or upon the date therein shown, may recover from the issuer damages caused by the misdating of the bill or the nonreceipt or misdescription of the goods, except to the extent that the document indicates that the issuer does not know whether any part or all of the goods in fact were received or conform to the description, as where the description is in terms of marks or labels or kind, quantity, or condition or the receipt or description is qualified by "contents or condition of contents of packages unknown", "said to contain", "shipper's weight, load and count" or the like, if such indication be true.

(2) When goods are loaded by an issuer who is a common carrier, the issuer must count the packages of goods if package freight and ascertain the kind and quantity if bulk freight. In such cases "shipper's

weight, load and count" or other words indicating that the description was made by the shipper are ineffective except as to freight concealed by packages.

(3) When bulk freight is loaded by a shipper who makes available to the issuer adequate facilities for weighing such freight, an issuer who is a common carrier must ascertain the kind and quantity within a reasonable time after receiving the written request of the shipper to do so. In such cases "shipper's weight" or other words of like purport are ineffective.

(4) The issuer may by inserting in the bill the words "shipper's weight, load and count" or other words of like purport indicate that the goods were loaded by the shipper; and if such statement be true the issuer shall not be liable for damages caused by the improper loading. But their omission does not imply liability for such damages.

(5) The shipper shall be deemed to have guaranteed to the issuer the accuracy at the time of shipment of the description, marks, labels, number, kind, quantity, condition and weight, as furnished by him; and the shipper shall indemnify the issuer against damage caused by inaccuracies in such particulars. The right of the issuer to such indemnity shall in no way limit his responsibility and liability under the contract of carriage to any person other than the shipper.

COMMENT: **Prior Uniform Statutory Provision:** § 23, Uniform Bills of Lading Act.

Changes: Rewritten in part.

Purposes of Changes: 1. The provision as to misdating in subsection (1) conforms to the policy of the amendment to the Federal Bills of Lading Act by 44 Stat. 1450 (1927), as amended 49 U.S.C. § 102, after the holding in Browne v. Union Pac. R. Co., 113 Kan. 726, 216 P. 299 (1923), affirmed on other grounds 267 U.S. 255, 45 S.Ct. 315, 69 L.Ed. 601 (1925). Subsections (2) and (3) conform to the policy of the Federal Bills of Lading Act, 49 U.S.C. §§ 100, 101, and the laws of several states. See, e.g., N.Y.Pers.Prop. Law § 209; Report of N. Y. Law Revision Commission, N.Y.Leg.Doc. (1941) No. 65(F).

2. The language of the old Uniform Act suggested that a carrier is ordinarily liable for damage caused by improper loading, but may relieve himself of liability by disclosing on the bill that shipper actually loaded. A more accurate statement of the law is that the carrier is not liable for losses caused by act or default of the shipper, which would include improper loading. There is some question whether under present law a carrier is liable even to a good faith purchaser of a negotiable bill for such losses, if the shipper's faulty loading in fact caused the loss. It is this doubtful liability which subsection (4) permits the carrier to bar by disclosure of shipper's loading. There is no implication that decisions such as Modern Tool Corp. v. Pennsylvania R. Co., 100 F.Supp. 595 (D.N.J.1951), are disapproved.

3. This section is a simplified restatement of existing law as to the method by which a bailee may avoid responsibility for the accuracy of descriptions which are made by or in reliance upon information furnished by the depositor or shipper.

The issuer is liable on documents issued by an agent, contrary to instructions of his principal, without receiving goods. No disclaimer of this liability is permitted since it is not a matter either of the care of the goods or their description.

4. The shipper's erroneous report to the carrier concerning the goods may cause damage to the carrier. Subsection (5) therefore provides appropriate indemnity.

Cross References:

§§ 7-203 and 7-309.

Definitional Cross References:

"Bill of lading". § 1-201.
"Consignee". § 7-102.
"Document". § 7-102.
"Duly negotiate". § 7-501.

"Good faith". § 1-201.
"Goods". § 7-102.
"Holder". § 1-201.
"Issuer". § 7-102.
"Notice". § 1-201.
"Party". § 1-201.
"Purchaser". § 1-201.
"Receipt of goods". § 2-103.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: For a Virginia case involving interstate commerce see Director-General of Railroads v. Chandler, 129 Va. 418, 420-22, 106 S.E. 226 (1921).

§ 7-302. **Through Bills of Lading and Similar Documents.** (1) The issuer of a through bill of lading or other document embodying an undertaking to be performed in part by persons acting as its agents or by connecting carriers is liable to anyone entitled to recover on the document for any breach by such other persons or by a connecting carrier of its obligation under the document but to the extent that the bill covers an undertaking to be performed overseas or in territory not contiguous to the continental United States or an undertaking including matters other than transportation this liability may be varied by agreement of the parties.

(2) Where goods covered by a through bill of lading or other document embodying an undertaking to be performed in part by persons other than the issuer are received by any such person, he is subject with respect to his own performance while the goods are in his possession to the obligation of the issuer. His obligation is discharged by delivery of the goods to another such person pursuant to the document, and does not include liability for breach by any other such persons or by the issuer.

(3) The issuer of such through bill of lading or other document shall be entitled to recover from the connecting carrier or such other person in possession of the goods when the breach of the obligation under the document occurred, the amount it may be required to pay to anyone entitled to recover on the document therefor, as may be evidenced by any receipt, judgment, or transcript thereof, and the amount of any expense reasonably incurred by it in defending any action brought by anyone entitled to recover on the document therefor.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. The purpose of this section is to subject the initial carrier under a through bill to suit for breach of the contract of carriage by any connecting carrier and to make it clear that any such connecting carrier holds the goods on terms which are defined by the document of title even though such connecting carrier did not issue the document. Since the connecting carrier does hold on the terms of the document, it must honor a proper demand for delivery or a diversion order just as the original bailee would have to. Similarly it has the benefits of the excuses for nondelivery and limitations for liability provided for the original bailee. Unlike the original bailee-issuer, the connecting carrier's responsibility is limited to the period while the goods are in its possession. The section is patterned generally after the Interstate Commerce Act, but does not impose any obligation to issue through bills.

2. The reference to documents other than through bills looks to the possibility that multi-purpose documents may come into use, e.g., combination warehouse receipts and bills of lading.

3. Where the obligations or standards applicable to different parties bound by a document of title are different, the initial carrier's responsibility for portions of the journey not on its own lines will be determined by the standards appropriate to the connecting carrier. Thus a land carrier issuing a through bill of lading involving water carriage at a later stage will have the benefit of the water

carrier's immunity from liability for negligence of its servants in navigating the vessel, where the law provides such an immunity for water carriers and the loss occurred while the goods were in the water carrier's possession.

4. Under subsection (1) the issuer of a through bill of lading may become liable for the fault of another person. Subsection (3) gives it appropriate rights of recourse.

Definitional Cross References:

"Agreement". § 1-201.
"Bailee". § 7-102.
"Bill of lading". § 1-201.
"Delivery". § 1-201.
"Document". § 7-102.
"Goods". § 7-102.
"Issuer". § 7-102.
"Overseas". § 2-323.
"Party". § 1-201.
"Person". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 56-120, 56-121.

Comment: This section imposes liability on the issuer of a through bill of lading for damages caused by connecting carriers, with a right over by the initial carrier against the connecting carrier who is primarily liable. This represents some change in Virginia law, to the extent that Virginia statutes are applicable to bills of lading. Under Code 1950, §§ 56-120 and 56-121, the initial carrier is prima facie liable, but it will be relieved of liability if it can establish that some other party caused the loss. Big Sandy and Cumberland Railroad Co. v. Ball, 133 Va. 431, 438-39, 113 S.E. 722 (1922) (failure to deliver); Southern Express Co. v. Jacobs, 109 Va. 27, 33, 63 S.E. 17 (1908) (injury to a horse); Norfolk and Western Railway Co. v. Wilkinson, 106 Va. 775, 780-81, 56 S.E. 808 (1907) (delay in delivery).

The Virginia statute, § 56-120, by its terms is not applicable where the shipment originates outside the state. Southern Railway Co. v. Russell, 133 Va. 292, 294-95, 112 S.E. 700 (1922). The constitutionality of the Virginia statutes was upheld, as not being in conflict with the power of Congress to regulate interstate commerce, in Richmond and Alleghany Railroad Co. v. Patterson Tobacco Co., 169 U.S. 311 (1898), aff'g. 92 Va. 670, 24 S.E. 261 (1896). In light of the Carmack Amendment, though, the statutes are now limited to intrastate commerce. Chesapeake and Ohio Railway Co. v. National Bank of Commerce of Norfolk, 122 Va. 471, 488, 95 S.E. 454 (1918); Old Dominion Steamship Co. v. Flanary & Co., 111 Va. 816, 819, 60 S.E. 1107 (1911); Radford-Portsmouth Veneer Co. v. Norfolk & Western Ry. Co., 1 Va. Law Reg. (N.S.) 598, 602 (Radford Corp. Ct. 1915).

The UCC is in accord with Vaughn Machine Co. v. Staunton Tanning Co., 106 Va. 445, 451-52, 56 S.E. 140 (1907), in recognizing that the consignee is entitled to sue for damages to goods consigned to him.

§ 7-303. Diversion; Reconsignment; Change of Instructions. (1) Unless the bill of lading otherwise provides, the carrier may deliver the goods to a person or destination other than that stated in the bill or may otherwise dispose of the goods on instructions from

(a) the holder of a negotiable bill; or

(b) the consignor on a nonnegotiable bill notwithstanding contrary instructions from the consignee; or

(c) the consignee on a nonnegotiable bill in the absence of contrary instructions from the consignor, if the goods have arrived at the billed destination or if the consignee is in posession of the bill; or

(d) the consignee on a nonnegotiable bill if he is entitled as against the consignor to dispose of them.

(2) Unless such instructions are noted on a negotiable bill of lading, a person to whom the bill is duly negotiated can hold the bailee according to the original terms.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. The old Acts contained no reference to diversion, a very common commercial practice which defeats delivery to the consignee originally named in a bill of lading. The carrier was protected under the heading of "justified delivery" if the substituted consignee who received delivery was "a person lawfully entitled to possession of the goods." Cf. subsection (1) (d). This in turn depended on whether the person ordering the diversion was the owner of the goods or empowered to dispose of them, which again might depend upon whether under sales law title had passed from the consignor-seller to the consignee-buyer. The carrier is plainly not in a position to decide such questions when directed by the person with whom it has contracted for transportation to change the destination of the goods in transit. Carriers may as a business matter be willing to accept instructions from consignees in which case, as under the old uniform acts, the carrier will be liable for misdelivery if the consignee was not the owner or otherwise empowered to dispose of the goods. The section imposes no duty on carriers to undertake diversion; it is of course subject to the provisions of filed tariffs. § 7-103.

2. It should be noted that the section provides only an immunity for carriers against liability for "misdelivery." It does not, for example, defeat the title to the goods which the consignee-buyer may have acquired from the consignor-seller upon delivery of the goods to the carrier under a nonnegotiable bill of lading. Thus if the carrier, upon instructions from the consignor, returns the goods to him, the consignee may recover the goods from the consignor or his insolvent estate. However, under certain circumstances, the consignee's title may be defeated by diversion of the goods in transit to a different consignee.

Cross References:

Point 2: §§ 7-403 and 7-504(3).

Definitional Cross References:

"Bailee". § 7-102.
"Bill of lading". § 1-201.
"Consignee". § 7-102.
"Consignor". § 7-102.
"Delivery". § 1-201.
"Goods". § 7-102.
"Holder". § 1-201.
"Notice". § 1-201.
"Person". § 1-201.
"Purchaser". § 1-201.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 7-304. Bills of Lading in a Set. (1) Except where customary in overseas transportation, a bill of lading must not be issued in a set of parts. The issuer is liable for damages caused by violation of this subsection.

(2) Where a bill of lading is lawfully drawn in a set of parts, each of which is numbered and expressed to be valid only if the goods have not been delivered against any other part, the whole of the parts constitute one bill.

(3) Where a bill of lading is lawfully issued in a set of parts and different parts are negotiated to different persons, the title of the holder to whom the first due negotiation is made prevails as to both the document and the goods even though any later holder may have received the goods from the carrier in good faith and discharged the carrier's obligation by surrender of his part.

(4) Any person who negotiates or transfers a single part of a bill of lading drawn in a set is liable to holders of that part as if it were the whole set.

(5) The bailee is obliged to deliver in accordance with Part 4 of this Article against the first presented part of a bill of lading lawfully drawn in a set. Such delivery discharges the bailee's obligation on the whole bill.

COMMENT: Prior Uniform Statutory Provision: § 6, Uniform Bills of Lading Act.

Changes: This section adds to existing legislation, which merely prohibits bills in a set in ordinary domestic trade, a statement of the legal effect of a lawfully issued set.

Purposes of Changes: The statement of the legal effect of a lawfully issued set is in accord with existing commercial law relating to maritime and other overseas bills. This law has been codified in the Hague and Warsaw Conventions and in the Carriage of Goods by Sea Act, the provisions of which would ordinarily govern in situations where bills in a set are recognized by this Article.

Cross Reference:

§ 10-103.

Definitional Cross References:

"Bailee". § 7-102.
"Bill of lading". § 7-102.
"Delivery". § 1-201.
"Document". § 7-102.
"Duly negotiate". § 7-501.
"Good faith". § 1-201.
"Goods". § 7-102.
"Holder". § 1-201.
"Issuer". § 7-102.
"Overseas". § 2-323.
"Person". § 1-201.
"Receipt of goods". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 7-305. **Destination Bills.** (1) Instead of issuing a bill of lading to the consignor at the place of shipment a carrier may at the request of the consignor procure the bill to be issued at destination or at any other place designated in the request.

(2) Upon request of anyone entitled as against the carrier to control the goods while in transit and on surrender of any outstanding bill of lading or other receipt covering such goods, the issuer may procure a substitute bill to be issued at any place designated in the request.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: This proposal is designed to facilitate the use of order bills in connection with fast shipments. Use of order bills on high speed shipments is impeded by the fact that the goods may arrive at destination before the documents, so that no one is ready to take delivery from the carrier. This is especially inconvenient for carriers by truck and air, who do not have terminal facilities where shipments can be held to await consignee's appearance. Order bills would be useful to take advantage of bank collection. This may be preferable to C.O.D. shipment in which the carrier, e.g., a truck driver, is the collecting and remitting agent. Financing of shipments under this plan would be handled as follows: seller at San Francisco delivers the goods to an airline with instructions to issue a bill in New York to a named bank. Seller receives a receipt embodying this undertaking to issue a destination bill. Airline wires its New York freight agent to issue the bill as instructed by the seller. Seller wires the New York bank a draft on buyer. New York bank indorses the bill to buyer when he honors the draft. Normally seller would act through his own bank in San Francisco, which would extend him credit in reliance on the airline's contract to deliver a bill to

the order of its New York correspondent. This section is entirely permissive; it imposes no duty to issue such bills. Whether a connecting carrier will act as issuing agent is left to agreement between carriers.

Definitional Cross References:

"Bill of lading". § 1-201.
"Consignor". § 7-102.
"Goods". § 7-102.
"Issuer". § 7-102.
"Receipt of goods". § 2-103.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 7-306. **Altered Bills of Lading.** An unauthorized alteration or filling in of a blank in a bill of lading leaves the bill enforceable according to its original tenor.

COMMENT: Prior Uniform Statutory Provision: § 16, Uniform Bills of Lading Act.

Changes: Generally revised and simplified; explicit treatment of the situation where a blank in an executed document is filled without authority.

Purposes of Changes: An unauthorized alteration whether made with or without fraudulent intent does not relieve the issuer of his liability on the document as originally executed. Uniform Warehouse Receipts Act 13 excused the issuer from any liability to a fraudulent alterer, other than the liability to deliver the goods according to the terms of the original document. It is difficult to conceive what liability the draftsman intended to excuse. Uniform Bills of Lading Act 16 contains no such excuse provision, and is followed in this respect in the present section. Uniform Bills of Lading Act 16 characterizes an unauthorized alteration as "void" but apparently nothing more was intended than that the alteration did not change the obligation of the issuer. This is sufficiently covered by the terms of this section. Moreover cases are conceivable in which an alteration would not be "void"; for example, an alteration made by common consent of a transferor and transferee of a document might evidence an enforceable contract between them. The same rule is made applicable to the filling in of blanks, a matter on which the prior Acts were silent.

Definitional Cross References:

"Bill of lading". § 1-201.
"Issuer". § 7-102.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 7-307. **Lien of Carrier.** (1) A carrier has a lien on the goods covered by a bill of lading for charges subsequent to the date of its receipt of the goods for storage or transportation (including demurrage and terminal charges) and for expenses necessary for preservation of the goods incident to their transportation or reasonably incurred in their sale pursuant to law. But against a purchaser for value of a negotiable bill of lading a carrier's lien is limited to charges stated in the bill or the applicable tariffs, or if no charges are stated then to a reasonable charge.

(2) A lien for charges and expenses under subsection (1) on goods which the carrier was required by law to receive for transportation is effective against the consignor or any person entitled to the goods unless the carrier had notice that the consignor lacked authority to subject the goods to such charges and expenses. Any other lien under subsection (1) is effective against the consignor and any person who permitted the bailor to have control or possession of the goods unless the carrier had notice that the bailor lacked such authority.

(3) A carrier loses his lien on any goods which he voluntarily delivers or which he unjustifiably refuses to deliver.

COMMENT: Prior Uniform Statutory Provision: §§ 27 through 32, Uniform Warehouse Receipts Act.

Changes: Rewritten; lien extended to carrier. Lien of common carrier validated unless carrier had notice that consignor lacked authority to subject the goods to charges and expenses. Where the carrier is not required by law to receive the goods for transportation, lien validated against anyone who permitted the bailor to have possession even if he had no real or apparent authority.

Purposes of Changes: The section is intended to give carriers a specific statutory lien for charges and expenses similar to that given to warehousemen by the first sentence of § 7-209. But since carriers do not commonly claim a lien for charges in relation to other goods or lend money on the security of goods in their hands, provisions for a general lien or a security interest similar to those in § 7-209(1) and (2) are omitted. See Comment to § 7-105. Since the lien given by this section is specific, and the storage or transportation often preserves or increases the value of the goods, subsection (2) validates the lien against anyone who permitted the bailor to have possession of the goods. Where the carrier is required to receive the goods for transportation, the owner's interest may be subjected to charges and expenses arising out of deposit of his goods by a thief. Cf. § 9-310. The crucial mental element is the carrier's knowledge or reason to know of the bailor's lack of authority.

Cross References:

§§ 7-209, 9-102(2) and 9-310.

Definitional Cross References:

"Bill of lading". § 1-201.
"Consignor". § 7-102.
"Delivery". § 1-201.
"Goods". § 7-102.
"Person". § 1-201.
"Purchaser". § 1-201.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 61-30 through 61-35.

§ 7-308. **Enforcement of Carrier's Lien.** (1) A carrier's lien may be enforced by public or private sale of the goods, in bloc or in parcels, at any time or place and on any terms which are commercially reasonable, after notifying all persons known to claim an interest in the goods. Such notification must include a statement of the amount due, the nature of the proposed sale and the time and place of any public sale. The fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the carrier is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. If the carrier either sells the goods in the usual manner in any recognized market therefor or if he sells at the price current in such market at the time of his sale or if he has otherwise sold in conformity with commercially reasonable practices among dealers in the type of goods sold he has sold in a commercially reasonable manner. A sale of more goods than apparently necessary to be offered to ensure satisfaction of the obligation is not commercially reasonable except in cases covered by the preceding sentence.

(2) Before any sale pursuant to this section any person claiming a right in the goods may pay the amount necessary to satisfy the lien and the reasonable expenses incurred under this section. In that event the goods must not be sold, but must be retained by the carrier subject to the terms of the bill and this Article.

(3) The carrier may buy at any public sale pursuant to this section.

(4) A purchaser in good faith of goods sold to enforce a carrier's lien takes the goods free of any rights of persons against whom the lien was valid, despite noncompliance by the carrier with the requirements of this section.

(5) The carrier may satisfy his lien from the proceeds of any sale pursuant to this section but must hold the balance, if any, for delivery on demand to any person to whom he would have been bound to deliver the goods.

(6) The rights provided by this section shall be in addition to all other rights allowed by law to a creditor against his debtor.

(7) A carrier's lien may be enforced in accordance with either subsection (1) or the procedure set forth in subsection (2) of § 7-210.

(8) The carrier is liable for damages caused by failure to comply with the requirements for sale under this section and in case of willful violation is liable for conversion.

COMMENT: **Prior Uniform Statutory Provision:** § 33, Uniform Warehouse Receipts Act.

Changes: Rewritten; provisions extended to carriers' liens; simplified foreclosure proceeding provided.

Purposes of Changes: This section is intended to give the carrier an enforcement procedure of his lien coextensive with that given the warehousemen in cases other than those covering noncommercial storage by him. See Comment to § 7-210.

Cross Reference:
§ 7-210.

Definitional Cross References:
"Bill of lading". § 1-201.
"Creditor". § 1-201.
"Delivery". § 1-201.
"Good faith". § 1-201.
"Goods". § 7-102.
"Notification". § 1-201.
"Notifies". § 1-201.
"Person". § 1-201.
"Purchaser". § 1-201.
"Rights". § 1-201.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 61-36, 56-126, 56-127.

Comment: The Virginia statutes, §§ 56-126 and 56-127, only apply to "unclaimed articles" and so are not affected by this section of the U.C.C.

§ 7-309. Duty of Care; Contractual Limitation of Carrier's Liability. (1) A carrier who issues a bill of lading whether negotiable or nonnegotiable must exercise the degree of care in relation to the goods which a reasonably careful man would exercise under like circumstances. This subsection does not repeal or change any law or rule of law which imposes liability upon a common carrier for damages not caused by its negligence.

(2) Damages may be limited by a provision that the carrier's liability shall not exceed a value stated in the document if the carrier's rates are dependent upon value and the consignor by the carrier's tariff is afforded an opportunity to declare a higher value or a value as lawfully provided in the tariff, or where no tariff is filed he is otherwise advised of such opportunity; but no such limitation is effective with respect to the carrier's liability for conversion to its own use.

(3) Reasonable provisions as to the time and manner of presenting claims and instituting actions based on the shipment may be included in a bill of lading or tariff.

COMMENT: **Prior Uniform Statutory Provision:** § 3, Uniform Bills of Lading Act.

Changes: Consolidated and rewritten.

Purposes of Changes: The old uniform act provided that bills of lading could not contain terms impairing the obligation of reasonable care. Whether this is violated by a stipulation that in case of loss the bailee's liability is limited to stated amounts has been much controverted. For interstate rail transportation the matter is settled by the Carmack Amendment to the Interstate Commerce Act (See 49 U.S.C.A. § 20(11)). The present section is a generalized version of the Interstate Commerce Act provisions. The obligation of due care is radically qualified, in the case of maritime bills and international air bills, by federal legislation and treaty. All this special legislation would remain in effect even if Congress enacts this Code, including the present Article. See § 7-103.

Subsection (1) does not impair any rule of law imposing the liability of an insurer on a common carrier in intrastate commerce. Subsection (2), however, applies to such liability as well as to liability based on negligence. The entire section is subject under § 7-103 to applicable provisions in filed tariffs, such as the common disclaimer of responsibility for undeclared articles of extraordinary value, hidden from view. Tariffs which lawfully provide a maximum unit value beyond which goods are not taken fall within the same principle, and are expressly covered by the words "value as lawfully provided in the tariff."

Cross Reference:

§ 7-103.

Definitional Cross References:

"Action". § 1-201.
"Bill of lading". § 1-201.
"Consignor". § 7-102.
"Document". § 7-102.
"Goods". § 7-102.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 56-119.

Comment: The last sentence of subsection 7-309(1) saves Code 1950, § 56-119, which invalidates contractual provisions purporting to exempt transportation companies from their liability as common carriers. The Supreme Court of Appeals in Chesapeake & Ohio Railway Co. v. Osborne, 154 Va. 477, 494, 153 S.E. 865 (1930), discussed this liability in these terms: "The liability of the carrier is practically that of an insurer of the property to the full amount of its value against all loss or damage of whatever kind, due to whatever cause, with the exception of loss or damage caused by the act of God or the public enemy, to which exception in modern times there have been added loss or damage from the inherent nature of the property. In case of loss or destruction of the property for which the carrier is liable, it is liable for the full value of the property, and in event of injury or damage to the property for which the carrier is liable, it is liable for the full amount of the damage thereto." See also Adams Express Co. v. Allen, 125 Va. 530, 544-45, 100 S.E. 473 (1919); Southern Express Co. v. Keeler, 109 Va. 459, 468-69, 64 S.E. 38 (1909); Chesapeake and Ohio Railway Co. v. Pew, 109 Va. 288, 294, 64 S.E. 35 (1909).

Subsection 7-309(2) permits the carrier to limit the amount of damages on the basis of declared values. The Virginia statute does not cover this, but the Virginia cases have recognized that a shipper who knowingly misrepresents the value of goods is estopped, after the goods have been lost or damaged, to assert that the value was different from what he had represented it to be. Chesapeake & Ohio Railway Co. v. Osborne, 154 Va. 477, 503-06, 153 S.E. 865 (1930); Adams Express Co. v. Green, 112 Va. 527, 533-35, 72 S.E. 102 (1911); Southern Express Co. v. Keeler, 109 Va. 459, 469, 64 S.E. 38 (1909).

The Virginia statute does not expressly cover the effect of provisions in bills of lading relating to the time and manner of presenting claims and instituting actions. Apparently, the question has never been presented in Virginia as regards an intrastate shipment, but the Supreme Court of Appeals, applying federal law,

has several times given effect to such provisions in bills of lading covering interstate shipments. Chesapeake and Ohio Railway Co. v. National Fruit Products Co., 155 Va. 438, 447-48, 155 S.E. 630, 72 A.L.R. 878 (1930); Chesapeake and Ohio Railway Co. v. Martin, 154 Va. 1, 143 S.E. 629, 152 S.E. 335 (1928), rev'd, 283 U.S. 209 (1931); Old Dominion Steamship Co. v. Flanary & Co., 111 Va. 816, 820-22, 69 S.E. 1107 (1911); Liquid Carbonic Co. v. Norfolk and Western Railway Co., 107 Va. 323, 330, 58 S.E. 569 (1907).

Although not covered, the UCC is consistent with the holding in Norfolk and Western Railway Co. v. Stuart's Draft Milling Co., 109 Va. 184, 189-90, 63 S.E. 415 (1909), that the liability of a carrier is converted into the liability of a warehouseman when the consignee refuses to receive the goods.

PART 4

WAREHOUSE RECEIPTS AND BILLS OF LADING: GENERAL OBLIGATIONS

§ 7-401. Irregularities in Issue of Receipt or Bill or Conduct of Issuer. The obligations imposed by this Article on an issuer apply to a document of title regardless of the fact that

(a) the document may not comply with the requirements of this Article or of any other law or regulation regarding its issue, form or content; or

(b) the issuer may have violated laws regulating the conduct of his business; or

(c) the goods covered by the document were owned by the bailee at the time the document was issued; or

(d) the person issuing the document does not come within the definition of warehouseman if it purports to be a warehouse receipt.

COMMENT: **Prior Uniform Statutory Provision:** § 20, Uniform Warehouse Receipts Act; § 23, Uniform Bills of Lading Act.

Changes: Most of the material is new; the uniform act sections cited deal only with nonreceipt and misdescription.

Purposes of Changes and New Matter: The bailee's liability on his document despite nonreceipt or misdescription of the goods is affirmed in §§ 7-203 and 7-301. The purpose of this section is to make it clear that regardless of irregularities a document which falls within the definition of document of title imposes on the issuer the obligations stated in this Article. For example, a bailee will not be permitted to avoid his obligation to deliver the goods (§ 7-403) or his obligation of due care with respect to them (§§ 7-204 and 7-309) by taking the position that no valid "document" was issued because he failed to file a statutory bond or did not pay stamp taxes or did not disclose the place of storage in the document. Sanctions against violations of statutory or administrative duties with respect to documents should be limited to revocation of license or other measures prescribed by the regulation imposing the duty. As to the continuing vitality of regulations, in addition to those found in this Article, of documents of title, see §§ 7-103 and 10-103.

Cross References:

§§ 7-103, 7-203, 7-204, 7-301, 7-309 and 10-103.

Definitional Cross References:

"Bailee". § 7-102.
"Document". § 7-102.
"Document of title". § 1-201.
"Goods". § 7-102.
"Issuer". § 7-102.
"Person". § 1-201.
"Warehouse receipt". § 1-201.
"Warehouseman". § 7-102.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 61-23.

§ 7-402. **Duplicate Receipt or Bill; Overissue.** Neither a duplicate nor any other document of title purporting to cover goods already represented by an outstanding document of the same issuer confers any right in the goods, except as provided in the case of bills in a set, overissue of documents for fungible goods and substitutes for lost, stolen or destroyed documents. But the issuer is liable for damages caused by his overissue or failure to identify a duplicate document as such by conspicuous notation on its face.

COMMENT: **Prior Uniform Statutory Provision:** § 6, Uniform Warehouse Receipts Act; § 7, Uniform Bills of Lading Act.

Changes: Consolidated and rewritten.

Purposes of Changes: 1. This section treats a duplicate which is not properly identified as such like any other overissue of documents: a purchaser of such a document acquires no title but only a cause of action for damages against the person who made his deception possible, except in the cases noted in the section. But parts of a bill lawfully issued in a set of parts are not "overissue" (§ 7-304). Of course, if the issuer has clearly indicated that a document is a duplicate so that no one can be deceived by it, and in fact the duplicate is a correct copy of the original, the warehouseman is not liable for preparing and delivering such a duplicate copy.

2. The section applies to nonnegotiable documents to the extent of providing an action for damages for one who acquires an unmarked duplicate from a transferor who knew the facts and would therefore himself have had no cause of action against the issuer of the duplicate. Ordinarily the transferee of a nonnegotiable document acquires only the rights of his transferor.

3. Overissue is defined so as to exclude the common situation where two valid documents of different issuers are outstanding for the same goods at the same time. Thus freight forwarders commonly issue bills of lading to their customers for small shipments to be combined into carload shipments for which the railroad will issue a bill of lading to the forwarder. So also a warehouse receipt may be outstanding against goods, and the holder of the receipt may issue delivery orders against the same goods. In these cases dealings with the subsequently issued documents may be effective to transfer title; e.g. negotiation of a delivery order will effectively transfer title in the ordinary case where no dishonesty has occurred and the goods are available to satisfy the orders. § 7-503 provides for cases of conflict between documents of different issuers.

Cross References:

Point 1: §§ 7-207, 7-304, and 7-601.
Point 3: § 7-503.

Definitional Cross References:

"Bill of lading". § 1-201.
"Conspicuous". § 1-201.
"Document". § 7-102.
"Document of title". § 1-201.
"Fungible" goods. § 1-201.
"Goods". § 7-102.
"Issuer". § 7-102.
"Right". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 61-9.

§ 7-403. **Obligation of Warehouseman or Carrier to Deliver; Excuse.** (1) The bailee must deliver the goods to a person entitled under the document who complies with subsections (2) and (3), unless and to the extent that the bailee establishes any of the following:

(a) delivery of the goods to a person whose receipt was rightful as against the claimant;

(b) damage to or delay, loss or destruction of the goods for which the bailee is not liable;

(c) previous sale or other disposition of the goods in lawful enforcement of a lien or on warehouseman's lawful termination of storage;

(d) the exercise by a seller of his right to stop delivery pursuant to the provisions of the Article on Sales (§ 2-705);

(e) a diversion, reconsignment or other disposition pursuant to the provisions of this Article (§ 7-303) or tariff regulating such right;

(f) release, satisfaction or any other fact affording a personal defense against the claimant;

(g) any other lawful excuse.

(2) A person claiming goods covered by a document of title must satisfy the bailee's lien where the bailee so requests or where the bailee is prohibited by law from delivering the goods until the charges are paid.

(3) Unless the person claiming is one against whom the document confers no right under § 7-503 (1), he must surrender for cancellation or notation of partial deliveries any outstanding negotiable document covering the goods, and the bailee must cancel the document or conspicuously note the partial delivery thereon or be liable to any person to whom the document is duly negotiated.

(4) "Person entitled under the document" means holder in the case of a negotiable document, or the person to whom delivery is to be made by the terms of or pursuant to written instructions under a nonnegotiable document.

(VALC Note: The Official Text offers as optional language at the end of subsection (1)(b) of the section, the following: ", but the burden of establishing negligence in such cases is on the person entitled under the document".)

COMMENT: Prior Uniform Statutory Provision: §§ 8 through 12, 16 and 19, Uniform Warehouse Receipts Act; §§ 11 through 15, 19 and 22, Uniform Bills of Lading Act.

Changes: Consolidated and rewritten.

Purposes of Changes: 1. The general and primary purpose of this revision is to simplify the statement of the bailee's obligation on the document. The interrelations of the separate sections of the old uniform acts dealing with "obligation to deliver," "justification in delivering," and "liability for misdelivery" are obscure. The present section is constructed on the basis of stating what previous deliveries or other circumstances operate to excuse the bailee's normal obligation on the document. Accordingly, "justified" deliveries under the old uniform acts now find their place as "excuse" under subsection (1). Unjustified deliveries, i.e., "misdeliveries" under the old acts, are simply omitted from the list of excuses, thus permitting the normal obligation on the document to be asserted.

2. The principal case covered by subsection (1) (a) is delivery to a person whose title is paramount to the rights represented by the document. For example, if a thief deposits stolen goods in a warehouse and takes a negotiable receipt, the warehouseman is not liable on the receipt if he has surrendered the goods to the true owner, even though the receipt is held by a good faith purchaser. See § 7-503(1). However, if the owner entrusted the goods to a person with power of disposition, and that person deposited the goods and took a negotiable document, the owner's receipt would not be rightful as against a holder to whom the negotiable document was duly negotiated, and delivery to the owner would not give the bailee a defense against such a holder. See §§ 7-502(1)(b), 7-503(1)(a).

3. Subsection (1) (b) amounts to a cross reference to all the tort law that determines the varying responsibilities and standards of care applicable to commercial bailees. A restatement of this tort law would be beyond the scope of this Act. Much of the applicable law as to responsibility of bailees for the preservation of the goods and limitation of liability in case of loss has been codified for particular classes of bailees in interstate and foreign commerce by federal legislation and treaty and for intrastate carriers, and other bailees by the regulatory

state laws preserved by § 7-103. In the absence of governing legislation the common law will prevail subject to the minimum standard of reasonable care prescribed by §§ 7-204 and 7-309 of this Article. The optional language in subsection (1)(b) states the rule laid down for interstate carriers in many federal cases. State decisions are in conflict as to both carriers and warehousemen. Particular states may prefer to adopt the federal rule.

4. Subsection (2) eliminates the implication of the old uniform acts that a request for delivery must be accompanied by a formal tender of the amount of the charges due. Rather, the bailee must request payment of the amount of his lien when asked to deliver, and only in case this request is refused is he justified in declining to deliver because of nonpayment of charges. Where delivery without payment is forbidden by law, the request is treated as implicit. Such a prohibition reflects a policy of uniformity to prevent discrimination by failure to request payment in particular cases.

5. Subsection (3) states the obvious duty of a bailee to take up a negotiable document or note partial deliveries conspicuously thereon, and the result of failure in that duty. It is subject to only one exception, that stated in subsection 1(a) of this section and in § 7-503(1). It is limited to cases of delivery to a claimant; it has no application, for example, where goods held under a negotiable document are lawfully sold to enforce the bailee's lien.

Cross References:

Point 2: §§ 7-502 and 7-503.
Point 3: §§ 7-103, 7-204, 7-309 and 10-103.
Point 5: § 7-503(1).

Definitional Cross References:

"Bailee". § 7-102.
"Conspicuous". § 1-201.
"Delivery". § 1-201.
"Document". § 7-102.
"Document of title". § 1-201.
"Duly negotiate". § 7-501.
"Goods". § 7-102.
"Person". § 1-201.
"Receipt of goods". § 2-103.
"Right". § 1-201.
"Terms". § 1-201.
"Warehouseman". § 7-102.
"Written". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 61-11 through 61-15, 61-19, 61-22.

Comment: This section is in accord with Bell Storage Co. v. Harrison, 164 Va. 278, 285-86, 180 S.E. 320 (1935), which recognized that the bailee must make delivery of the goods to the party entitled to them under the document of title, unless it can establish some lawful excuse for not doing so, such as delivery to the rightful owner or dispossession by legal process. The section is also consistent with Railway Express Agency v. Kessler, 189 Va. 301, 308, 52 S.E. 2d. 102 (1949), in which it was said that there is an absolute duty on the carrier to deliver the goods only to a person authorized to receive them, and that reasonable care in making a delivery is not sufficient.

The adoption of subsection 7-403(1)(b) without the optional language leaves unchanged the Virginia rule as regards the burden of proof in fixing the liability of a warehouseman. John Nix & Co. v. Herbert, 149 Va. 131, 134-35, 140 S.E. 121 (1927), held that the bailor must prove by a preponderance of the evidence that he delivered the goods in good condition to the bailee and that they were returned in a damaged condition. Thereupon, the bailee must prove by a preponderance of the evidence that he exercised due care in order to be relieved from liability.

Subsection 7-403(3) makes a bailee liable to a person to whom a negotiable document of title has been "duly negotiated," when the bailee has delivered the goods without cancelling the document. The application of the UCC to the fact situation in Norfolk and Western Railway Co. v. Aylor, 153 Va. 575, 150 S.E.

252 (1929), which actually involved interstate commerce, is not entirely clear. A seller shipped a carload of flour to a buyer, taking a bill of lading to his own order, and forwarded the bill of lading with a draft. The carrier delivered the flour, without requiring surrender of the bill of lading, to the buyer, who had not paid the draft. Under these circumstances the carrier was held liable for conversion. UCC 7-501 (2)(b) says that when a document running to the order of a named person is delivered to him the effect is the same as if the document had been negotiated. The same result would be reached under the UCC as in this case if "duly negotiated" under UCC 7-403(3) includes a transaction the effect of which is the same "as if the document had been negotiated."

COUNCIL COMMENT

The optional language is omitted to accord with Virginia law as noted in the Virginia Annotations.

§ 7-404. No Liability for Good Faith Delivery Pursuant to Receipt or Bill. A bailee who in good faith including observance of reasonable commercial standards has received goods and delivered or otherwise disposed of them according to the terms of the document of title or pursuant to this Article is not liable therefor. This rule applies even though the person from whom he received the goods had no authority to procure the document or to dispose of the goods and even though the person to whom he delivered the goods had no authority to receive them.

COMMENT: **Prior Uniform Statutory Provision:** § 10, Uniform Warehouse Receipts Act; § 13, Uniform Bills of Lading Act.

Changes: Consolidated and rewritten.

Purposes of Changes: The generalized test of good faith and observance of reasonable commercial standards is substituted for the attempts to particularize what constitutes good faith in the cited sections of the old uniform acts. The section states explicitly what is perhaps an implication from the old acts that the common law rule of "innocent conversion" by unauthorized "intermeddling" with another's property is inapplicable to the operations of commercial carriers and warehousemen, who in good faith and with reasonable observance of commercial standards perform obligations which they have assumed and which generally they are under a legal compulsion to assume. The section applies to delivery to a fraudulent holder of a valid document as well as to delivery to the holder of an invalid document.

Definitional Cross References:

"Bailee". § 7-102.
"Delivery". § 1-201.
"Document of title". § 1-201.
"Good faith". § 1-201.
"Goods". § 7-102.
"Person". § 1-201.
"Receipt of goods". § 2-103.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 61-13.

PART 5

WAREHOUSE RECEIPTS AND BILLS OF LADING: NEGOTIATION AND TRANSFER

§ 7-501. Form of Negotiation and Requirements of "Due Negotiation". (1) A negotiable document of title running to the order of a named person is negotiated by his indorsement and delivery. After his indorsement in blank or to bearer any person can negotiate it by delivery alone.

(2) (a) A negotiable document of title is also negotiated by delivery alone when by its original terms it runs to bearer.

(b) When a document running to the order of a named person is delivered to him the effect is the same as if the document had been negotiated.

(3) Negotiation of a negotiable document of title after it has been indorsed to a specified person requires indorsement by the special indorsee as well as delivery.

(4) A negotiable document of title is "duly negotiated" when it is negotiated in the manner stated in this section to a holder who purchases it in good faith without notice of any defense against or claim to it on the part of any person and for value, unless it is established that the negotiation is not in the regular course of business or financing or involves receiving the document in settlement or payment of a money obligation.

(5) Indorsement of a nonnegotiable document neither makes it negotiable nor adds to the transferee's rights.

(6) The naming in a negotiable bill of a person to be notified of the arrival of the goods does not limit the negotiability of the bill nor constitute notice to a purchaser thereof of any interest of such person in the goods.

COMMENT: **Prior Uniform Statutory Provision:** §§ 28, 29, 31, 32 and 38, Uniform Sales Act; §§ 37, 38, 39, 40 and 47, Uniform Warehouse Receipts Act; §§ 28, 29, 30, 31 and 38, Uniform Bills of Lading Act.

Changes: Consolidated and rewritten.

Purposes of Changes: 1. In general this section is intended to clarify the language of the old acts and to restate the effect of the better decisions thereunder. An important new concept is added, however, in the requirement of "regular course of business or financing" to effect the "due negotiation" which will transfer greater rights than those held by the person negotiating. The foundation of the mercantile doctrine of good faith purchase for value has always been, as shown by the case situations, the furtherance and protection of the regular course of trade. The reason for allowing a person, in bad faith or in error, to convey away rights which are not his own has from the beginning been to make possible the speedy handling of that great run of commercial transactions which are patently usual and normal.

There are two aspects to the usual and normal course of mercantile dealings, namely, the person making the transfer and the nature of the transaction itself. The first question which arises is: Is the transferor a person with whom it is reasonable to deal as having full powers? In regard to documents of title the only holder whose possession appears, commercially, to be in order is almost invariably a person in the trade. No commercial purpose is served by allowing a tramp or a professor to "duly negotiate" an order bill of lading for hides or cotton not his own, and since such a transfer is obviously not in the regular course of business, it is excluded from the scope of the protection of subsection (4).

The second question posed by the "regular course" qualification is: Is the transaction one which is normally proper to pass full rights without inquiry, even though the transferor himself may not have such rights to pass, and even though he may be acting in breach of duty? In raising this question the "regular course" criterion has the further advantage of limiting the effective wrongful disposition

to transactions whose protection will really further trade. Obviously, the snapping up of goods for quick resale at a price suspiciously below the market deserves no protection as a matter of policy: it is also clearly outside the range of regular course.

Any notice from the face of the document sufficient to put a merchant on inquiry as to the "regular course" quality of the transaction will frustrate a "due negotiation". Thus irregularity of the document on its face or unexplained staleness of a bill of lading may appropriately be recognized as negating a negotiation in "regular" course.

A pre-existing claim constitutes value, and "due negotiation" does not require "new value." A usual and ordinary transaction in which documents are received as security for credit previously extended may be in "regular" course, even though there is a demand for additional collateral because the creditor "deems himself insecure." But the matter has moved out of the regular course of financing if the debtor is thought to be insolvent, the credit previously extended is in effect cancelled, and the creditor snatches a plank in the shipwreck under the guise of a demand for additional collateral. Where a money debt is "paid" in commodity paper, any question of "regular" course disappears, as the case is explicitly excepted from "due negotiation".

2. Negotiation under this section may be made by any holder no matter how he acquired possession of the document. The present section follows in this respect the Uniform Bills of Lading Act and amendments of the original Uniform Sales Act and Uniform Warehouse Receipts Act proposed by the Commissioners on Uniform State Laws in 1922.

3. Subsection (2) (b) makes explicit a matter upon which the intent of the old acts was clear but the language somewhat obscure: a negotiation results from a delivery to a banker or buyer to whose order the document has been taken by the person making the bailment. There is no presumption of irregularity in such a negotiation; it may very well be in "regular course".

4. This Article does not contain any provision creating a presumption of due negotiation to, and full rights in, a holder of a document of title akin to that created by §§ 16, 24 and 59 of the Negotiable Instruments Law. But the reason of the provisions of this Act (§ 1-202) on the prima facie authenticity and accuracy of third party documents, joins with the reason of the present section to work such a presumption in favor of any person who has power to make a due negotiation. It would not make sense for this Act to authorize a purchaser to indulge the presumption of regularity if the courts were not also called upon to do so.

Cross References:

Point 1: §§ 7-502 and 7-503.
Point 2: § 7-502.

Definitional Cross References:

"Bearer". § 1-201.
"Delivery". § 1-201.
"Document". § 7-102.
"Document of title". § 1-201.
"Good faith". § 1-201.
"Holder". § 1-201.
"Notice". § 1-201.
"Person". § 1-201.
"Purchase". § 1-201.
"Rights". § 1-201.
"Terms". § 1-201.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 61-40 through 61-43, 61-50.

Comment: Under the original §§ 40 and 47 of the Uniform Warehouse Receipts Act, a warehouse receipt can only be negotiated by the owner or by a person to whom the possession or custody of the receipt has been entrusted by the owner, so that a person who obtained the receipt by trespass or by finding could not negotiate the document. In 1922 the National Conference of Commissioners on Uniform State Laws proposed substitute sections, under which a person within the tenor of the document and in possession, "however such possession may have

been acquired," could negotiate the document. Virginia never adopted these substitute sections. Since the UCC follows the substitute sections, the UCC changes Virginia law as regards warehouse receipts in this respect.

For a discussion of the application of subsection 7-501(2)(b) to the fact situation in Norfolk and Western Railway Co. v. Aylor, 153 Va. 575, 150 S.E. 252 (1929), see VIRGINIA ANNOTATIONS to UCC 7-403.

§ 7-502. **Rights Acquired by Due Negotiation.** (1) Subject to the following section and to the provisions of § 7-205 on fungible goods, a holder to whom a negotiable document of title has been duly negotiated acquires thereby:

(a) title to the document;

(b) title to the goods;

(c) all rights accruing under the law of agency or estoppel, including rights to goods delivered to the bailee after the document was issued; and

(d) the direct obligation of the issuer to hold or deliver the goods according to the terms of the document free of any defense or claim by him except those arising under the terms of the document or under this Article. In the case of a delivery order the bailee's obligation accrues only upon acceptance and the obligation acquired by the holder is that the issuer and any indorser will procure the acceptance of the bailee.

(2) Subject to the following section, title and rights so acquired are not defeated by any stoppage of the goods represented by the document or by surrender of such goods by the bailee, and are not impaired even though the negotiation or any prior negotiation constituted a breach of duty or even though any person has been deprived of possession of the document by misrepresentation, fraud, accident, mistake, duress, loss, theft or conversion, or even though a previous sale or other transfer of the goods or document has been made to a third person.

COMMENT: **Prior Uniform Statutory Provision:** §§ 20(4), 25, 33, 38 and 62, Uniform Sales Act; §§ 41, 47, 48 and 49, Uniform Warehouse Receipts Act; §§ 32, 38, 39, 40 and 42, Uniform Bills of Lading Act.

Changes: Rewritten.

Purposes of Changes: 1. The several necessary qualifications of the broad principle that the holder of a document acquired in a due negotiation is the owner of the document and the goods have been brought together in the next section.

2. Subsection (1) (c) covers the case of "feeding" of a duly negotiated document by subsequent delivery to the bailee of such goods as the document falsely purported to cover; the bailee in such case is estopped as against the holder of the document.

3. The explicit statement in subsection (1) (d) of the bailee's direct obligation to the holder precludes the defense, sometimes successfully asserted under the old acts, that the document in question was "spent" after the carrier had delivered the goods to a previous holder. But the holder is subject to such defenses as non-negligent destruction even though not apparent on the face of the document, and the bailee's obligation is of course subject to lawful provisions in filed classifications and tariffs. See §§ 7-103, 7-403. The sentence on delivery orders applies only to delivery orders in negotiable form which have been duly negotiated. On delivery orders, see also § 7-503(2) and Comment.

4. Subsection (2) condenses and continues the law of a number of sections of the prior acts which gave full effect to the issuance or due negotiation of a negotiable document. The subsection adds nothing to the effect of the rules stated in subsection (1), but it has been included since such explicit references were relied upon under the prior acts to preserve the rights of a purchaser by due negotiation unimpaired. The listing is not exhaustive. Only those matters have been repeated in this subsection which were explicitly reserved in the prior acts except in the

case of stoppage in transit. Here, the language has been broadened to include "any stoppage" lest an inference be drawn that a stoppage of the goods before or after transit might cut off or otherwise impair the purchaser's rights.

Cross References:

§§ 7-103, 7-205, 7-403 and 7-503.

Definitional Cross References:

"Bailee". § 7-102.
"Delivery". § 1-201.
"Delivery order". § 7-102.
"Document". § 7-102.
"Document of title". § 1-201.
"Duly negotiate". § 7-501.
"Fungible". § 1-201.
"Goods". § 7-102.
"Holder". § 1-201.
"Issuer". § 7-102.
"Person". § 1-201.
"Rights". § 1-201.
"Term". § 1-201.
"Warehouse receipt". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 61-44, 61-50, 61-51, 61-52.

Comment: This section is in accord with Virginia cases holding that the transferee of a document of title is entitled to the goods. Seward and Co. v. Miller & Higdon, 106 Va. 309, 312-13, 55 S.E. 681 (1906) (bill of lading); Millhiser Manufacturing Co. v. Gallego Mills Co., 101 Va. 579, 589-94, 44 S.E. 760 (1903) (warehouse receipt).

§ 7-503. Document of Title to Goods Defeated in Certain Cases. (1) A document of title confers no right in goods against a person who before issuance of the document had a legal interest or a perfected security interest in them and who neither

(a) delivered or entrusted them or any document of title covering them to the bailor or his nominee with actual or apparent authority to ship, store or sell or with power to obtain delivery under this Article (§ 7-403) or with power of disposition under this Act (§§ 2-403 and 9-307) or other statute or rule of law; nor

(b) acquiesced in the procurement by the bailor or his nominee of any document of title.

(2) Title to goods based upon an unaccepted delivery order is subject to the rights of anyone to whom a negotiable warehouse receipt or bill of lading covering the goods has been duly negotiated. Such a title may be defeated under the next section to the same extent as the rights of the issuer or a transferee from the issuer.

(3) Title to goods based upon a bill of lading issued to a freight forwarder is subject to the rights of anyone to whom a bill issued by the freight forwarder is duly negotiated; but delivery by the carrier in accordance with Part 4 of this Article pursuant to its own bill of lading discharges the carrier's obligation to deliver.

COMMENT: Prior Uniform Statutory Provision: § 33, Uniform Sales Act; § 41, Uniform Warehouse Receipts Act; § 32, Uniform Bills of Lading Act.

Changes: Subsection (1) narrows, as compared to the cited sections, the occasions for defeating the document holder's title.

Purposes of Changes: 1. In general it may be said that the title of a purchaser by due negotiation prevails over almost any interest in the goods which existed

prior to the procurement of the document of title if the possession of the goods by the person obtaining the document derived from any action by the prior claimant which introduced the goods into the stream of commerce or carried them along that stream. A thief of the goods cannot indeed by shipping or storing them to his own order acquire power to transfer them to a good faith purchaser. Nor can a tenant or mortgagor defeat any rights of a landlord or mortgagee which have been perfected under the local law merely by wrongfully shipping or storing a portion of the crop or other goods. However, "acquiescence" by the landlord or tenant does not require active consent under subsection (1) (b) and knowledge of the likelihood of storage or shipment with no objection or effort to control it is sufficient to defeat his rights as against one who takes by "due" negotiation of a negotiable document.

On the other hand, where goods are delivered to a factor for sale, even though the factor has made no advances and is limited in his duty to sell for cash, the goods are "entrusted" to him "with actual . . . authority . . . to sell" under subsection (1) (a), and if he procures a negotiable document of title he can transfer the owner's interest to a purchaser by due negotiation. Further, where the factor is in the business of selling, goods entrusted to him simply for safekeeping or storage may be entrusted under circumstances which give him "apparent authority to ship, store or sell" under subsection (1) (a), or power of disposition under §§ 2-403, 7-205 or 9-307, or under a statute such as the earlier Factors Acts, or under a rule of law giving effect to apparent ownership. See § 1-103.

Persons having an interest in goods also frequently deliver or entrust them to agents or servants other than factors for the purpose of shipping or warehousing or under circumstances reasonably contemplating such action. Rounding out the case law development under the prior Acts, this Act is clear that such persons assume full risk that the agent to whom the goods are so delivered may ship or store in breach of duty, take a document to his own order and then proceed to misappropriate it. This Act makes no distinction between possession or mere custody in such situations and finds no exception in the case of larceny by a bailee or the like. The safeguard in such situations lies in the requirement that a due negotiation can occur only "in the regular course of business or financing" and that the purchase be in good faith and without notice. See § 7-501. Documents of title have no market among the commercially inexperienced and the commercially experienced do not take them without inquiry from persons known to be truck drivers or petty clerks even though such persons purport to be operating in their own names.

Again, where the seller allows a buyer to receive goods under a contract for sale, though as a "conditional delivery" or under "cash sale" terms and on explicit agreement for immediate payment, the buyer thereby acquires power to defeat the seller's interest by transfer of the goods to certain good faith purchasers. See § 2-403. Both in policy and under the language of subsection (1) (a) that same power must be extended to accomplish the same result if the buyer procures a negotiable document of title to the goods and duly negotiates it.

2. Under subsection (1) a delivery order issued by a person having no right in or power over the goods is ineffective unless the owner acts as provided in subsection (1) (a) or (b). Thus the rights of a transferee of a nonnegotiable warehouse receipt can be defeated by a delivery order subsequently issued by the transferor only if the transferee "delivers or entrusts" to the "person procuring" the delivery order or "acquiesces" in his procurement. Similarly, a second delivery order issued by the same issuer for the same goods will ordinarily be subject to the first, both under this section and under § 7-402. After a delivery order is validly issued but before it is accepted, it may nevertheless be defeated under subsection (2) in much the same way that the rights of a transferee may be defeated under § 7-504. For example, a buyer in ordinary course from the issuer may defeat the rights of the holder of a prior delivery order if the bailee receives notification of the buyer's rights before notification of the holder's rights. § 7-504(2) (b). But an accepted delivery order has the same effect as a document issued by the bailee.

3. Under subsection (3) a bill of lading issued to a freight forwarder is subordinated to the freight forwarder's certificate, since the bill on its face gives notice of the fact that a freight forwarder is in the picture and has in all probability issued a certificate. But the carrier is protected in following the terms of its own bill of lading.

Cross References:

Point 1: §§ 2-403, 7-205, 7-501, 9-307, and 9-309.
Point 2: §§ 7-402 and 7-504.
Point 3: §§ 7-402, 7-403 and 7-404.

Definitional Cross References:

"Bill of lading". § 1-201.
"Contract for sale". § 2-106.
"Delivery". § 1-201.
"Delivery order". § 7-102.
"Document". § 7-102.
"Document of title". § 1-201.
"Duly negotiate". § 7-501.
"Goods". § 7-102.
"Person". § 1-201.
"Right". § 1-201.
"Warehouse receipt". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 61-44.

§ 7-504. Rights Acquired in the Absence of Due Negotiation; Effect of Diversion; Seller's Stoppage of Delivery. (1) A transferee of a document, whether negotiable or non-negotiable, to whom the document has been delivered but not duly negotiated, acquires the title and rights which his transferor had or had actual authority to convey.

(2) In the case of a nonnegotiable document, until but not after the bailee receives notification of the transfer, the rights of the transferee may be defeated

(a) by those creditors of the transferor who could treat the sale as void under § 2-402; or

(b) by a buyer from the transferor in ordinary course of business if the bailee has delivered the goods to the buyer or received notification of his rights; or

(c) as against the bailee by good faith dealings of the bailee with the transferor.

(3) A diversion or other change of shipping instructions by the consignor in a nonnegotiable bill of lading which causes the bailee not to deliver to the consignee defeats the consignee's title to the goods if they have been delivered to a buyer in ordinary course of business and in any event defeats the consignee's rights against the bailee.

(4) Delivery pursuant to a nonnegotiable document may be stopped by a seller under § 2-705, and subject to the requirement of due notification there provided. A bailee honoring the seller's instructions is entitled to be indemnified by the seller against any resulting loss or expense.

COMMENT: Prior Uniform Statutory Provision: § 34, Uniform Sales Act; §§ 41(b) and 42, Uniform Warehouse Receipts Act; §§ 32(b) and 33, Uniform Bills of Lading Act.

Changes: Generally rewritten; Subsection (3) is new.

Purposes of Changes and New Matter: 1. Under the general principles controlling negotiable documents, it is clear that in the absence of due negotiation a transferor cannot convey greater rights than he himself has, even when the negotiation is formally perfect. This section recognizes the transferor's power to transfer rights which he himself has or has "actual authority to convey." Thus, where a negotiable document of title is being transferred the operation of the principle of estoppel is not recognized, as contrasted with situations involving the transfer of the goods themselves. (Compare § 2-403 on good faith purchase of goods.)

A necessary part of the price for the protection of regular dealings with negotiable documents of title is an insistence that no dealing which is in any way irregular shall be recognized as a good faith purchase of the document or of any rights pertaining to it. So, where the transfer of a negotiable document fails as a negotiation because a requisite indorsement is forged or otherwise missing, the purchaser in good faith and for value may be in the anomalous position of having less rights, in part, than if he had purchased the goods themselves. True, his rights are not subject to defeat by attachment of the goods or surrender of them to his transferor [Contrast subsection (2)]; but on the other hand, he cannot acquire enforceable rights to control or receive the goods over the bailee's objection merely by giving notice to the bailee. Similarly, a consignee who makes payment to his consignor against a straight bill of lading can thereby acquire the position of a good faith purchaser of goods under provisions of the Article of this Act on Sales (§ 2-403), whereas the same payment made in good faith against an unindorsed order bill would not have such effect. The appropriate remedy of a purchaser in such a situation is to regularize his status by compelling indorsement of the document (see § 7-506).

2. As in the case of transfer—as opposed to "due negotiation"—of negotiable documents, subsection (1) empowers the transferor of a nonnegotiable document to transfer only such rights as he himself has or has "actual authority" to convey. In contrast to situations involving the goods themselves the operation of estoppel or agency principles is not here recognized to enable the transferor to convey greater rights than he actually has. Subsection (2) makes it clear, however, that the transferee of a nonnegotiable document may acquire rights greater in some respects than those of his transferor by giving notice of the transfer to the bailee.

3. Subsection (3) is in part a reiteration of the carrier's immunity from liability if it honors instructions of the consignor to divert, but there is added a provision protecting the title of the substituted consignee if the latter is a buyer in ordinary course of business. A typical situation would be where a manufacturer, having shipped a lot of standardized goods to A on nonnegotiable bill of lading, diverts the goods to customer B who pays for them. Under orthodox passage-of-title-by-appropriation doctrine A might reclaim the goods from B. However, no consideration of commercial policy supports this involvement of an innocent third party in the default of the manufacturer on his contract to A; and the common commercial practice of diverting goods in transit suggests a trade understanding in accordance with this subsection.

4. Subsection (4) gives the carrier an express right to indemnity where he honors a seller's request to stop delivery.

5. § 1-201(27) gives the bailee protection, if due diligence is exercised, similar to that found in the third paragraph of § 33, Uniform Bills of Lading Act, where the bailee's organization has not had time to act on a notification.

Cross References:

Point 1: §§ 2-403 and 7-506.
Point 2: § 2-403.
Point 3: §§ 7-303 and 7-403(1) (e).
Point 4: §§ 2-705 and 7-403(1) (d).

Definitional Cross References:

"Bailee". § 7-102.
"Bill of lading". § 1-201.
"Buyer in ordinary course of business". § 1-201.
"Consignee". § 7-102.
"Consignor". § 7-102.
"Creditor". § 1-201.
"Delivery". § 1-201.
"Document". § 7-102.
"Duly negotiate". § 7-501.
"Good faith". § 1-201.
"Goods". § 7-102.
"Honor". § 1-201.
"Notification". § 1-201.
"Purchaser". § 1-201.
"Rights". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 61-44(b), 61-45.

§ 7-505. **Indorser Not a Guarantor for Other Parties.** The indorsement of a document of title issued by a bailee does not make the indorser liable for any default by the bailee or by previous indorsers.

COMMENT: **Prior Uniform Statutory Provision:** § 37, Uniform Sales Act; § 45, Uniform Warehouse Receipts Act; § 36, Uniform Bills of Lading Act.

Changes: No substantial change.

Purposes of Changes: The indorsement of a document of title is generally understood to be directed towards perfecting the transferee's rights rather than towards assuming additional obligations. The language of the present section, however, does not preclude the one case in which an indorsement given for value guarantees future action, namely, that in which the bailee has not yet become liable upon the document at the time of the indorsement. Under such circumstances the indorser, of course, engages that appropriate honor of the document by the bailee will occur. See § 7-502(1) (d) as to negotiable delivery orders. However, even in such a case, once the bailee attorns to the transferee, the indorser's obligation has been fulfilled and the policy of this section excludes any continuing obligation on the part of the indorser for the bailee's ultimate actual performance.

Cross Reference:
§ 7-502.

Definitional Cross References:
"Bailee". § 7-102.
"Document of title". § 1-201.
"Party". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 61-48.

§ 7-506. **Delivery Without Indorsement: Right to Compel Indorsement.** The transferee of a negotiable document of title has a specifically enforceable right to have his transferor supply any necessary indorsement but the transfer becomes a negotiation only as of the time the indorsement is supplied.

COMMENT: **Prior Uniform Statutory Provision:** § 35, Uniform Sales Act; § 43, Uniform Warehouse Receipts Act; § 34, Uniform Bills of Lading Act.

Changes: Consolidated and rewritten; former requirement that transfer be "for value" eliminated.

Purposes of Changes: 1. From a commercial point of view the intention to transfer a negotiable document of title which requires an indorsement for its transfer, is incompatible with an intention to withhold such indorsement and so defeat the effective use of the document. This position is sustained by the absence of any reported case applying the prior provisions in almost forty years of decisions. Further, the preceding section and the Comment thereto make it clear that an indorsement generally imposes no responsibility on the indorser.

2. Although this section provides that delivery of a document of title without the necessary indorsement is effective as a transfer, the transferee, of course, has not regularized his position until such indorsement is supplied. Until this is done he cannot claim rights under due negotiation within the requirements of this Article (subsection (4) of § 7-501) on "due negotiation." Similarly, despite the transfer to him of his transferor's title, he cannot demand the goods from the bailee until the negotiation has been completed and the document is in proper form for surrender. See § 7-403(2).

Cross References:
Point 1: § 7-505.
Point 2: §§ 7-501(4) and 7-403(2).

Definitional Cross References:
"Document of title". § 1-201.
"Rights". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 61-46.

§ 7-507. **Warranties on Negotiation or Transfer of Receipt or Bill.** Where a person negotiates or transfers a document of title for value otherwise than as a mere intermediary under the next following section, then unless otherwise agreed he warrants to his immediate purchaser only in addition to any warranty made in selling the goods

(a) that the document is genuine; and

(b) that he has no knowledge of any fact which would impair its validity or worth; and

(c) that his negotiation or transfer is rightful and fully effective with respect to the title to the document and the goods it represents.

COMMENT: **Prior Uniform Statutory Provision:** § 36, Uniform Sales Act; § 44, Uniform Warehouse Receipts Act; § 35, Uniform Bills of Lading Act.

Changes: Consolidated and rewritten without change in policy.

Purposes of Changes: 1. This section omits provisions of the prior acts on warranties as to the goods as unnecessary and incomplete. It is unnecessary because such warranties derive from the contract of sale and not from the transfer of the documents. The fact that transfer of control occurs by way of a document of title does not limit or displace the ordinary obligations of a seller. The former provision, moreover, was incomplete because it did not expressly include all of the warranties which might rest upon a seller under such circumstances. This Act handles the problem by means of the precautionary reference to "any warranty made in selling the goods." If the transfer of documents attends or follows the making of a contract for the sale of goods, the general obligations on warranties as to the goods (§§ 2-312 through 2-318) are brought to bear as well as the special warranties under this section.

2. The limited warranties of a delivering or collecting intermediary are stated in § 7-508.

Cross References:
Point 1: §§ 2-312 through 2-318.
Point 2: § 7-508.

Definitional Cross References:
"Document". § 7-102.
"Document of title". § 1-201.
"Genuine". § 1-201.
"Goods". § 7-102.
"Person". § 1-201.
"Purchaser". § 1-201.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 61-47.

§ 7-508. **Warranties of Collecting Bank as to Documents.** A collecting bank or other intermediary known to be entrusted with documents on behalf of another or with collection of a draft or other claim against delivery of documents warrants by such delivery of the documents only its own good faith and authority. This rule applies even though the intermediary has purchased or made advances against the claim or draft to be collected.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. To state the limited warranties given with respect to the documents accompanying a documentary draft.

2. In warranting its authority a bank only warrants its authority from its transferor. See § 4-203. It does not warrant the genuineness or effectiveness of the document. Compare § 7-507.

3. Other duties and rights of banks handling documentary drafts for collection are stated in Article 4, Part 5.

Cross References:
§§ 4-203 and 7-507, 4-501 through 4-504.

Definitional Cross References:
"Collecting bank". § 4-105.
"Delivery". § 1-201.
"Document". § 7-102.
"Draft". § 5-103.
"Good faith". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 7-509. Receipt or Bill: When Adequate Compliance With Commercial Contract. The question whether a document is adequate to fulfill the obligations of a contract for sale or the conditions of a credit is governed by the Articles on Sales (Article 2) and on Letters of Credit (Article 5).

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: To cross-refer to the Articles of this Act which deal with the substantive issues of the type of document of title required under the contract entered into by the parties.

Cross References:
Articles 2 and 5.

Definitional Cross References:
"Contract for sale". § 2-106.
"Document". § 7-102.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

PART 6

WAREHOUSE RECEIPTS AND BILLS OF LADING: MISCELLANEOUS PROVISIONS

§ 7-601. Lost and Missing Documents. (1) If a document has been lost, stolen or destroyed, a court may order delivery of the goods or issuance of a substitute document and the bailee may without liability to any person comply with such order. If the document was negotiable the claimant must post security approved by the court to indemnify any person who may suffer loss as a result of nonsurrender of the document. If the document was not negotiable, such security may be required at the discretion of the court. The court may also in its discretion order payment of the bailee's reasonable costs and counsel fees.

(2) A bailee who without court order delivers goods to a person claiming under a missing negotiable document is liable to any person injured thereby, and if the delivery is not in good faith becomes liable for conversion. Delivery in good faith is not conversion if made in accordance with a filed classification or tariff or, where no classification or tariff is filed, if the claimant posts security with the bailee in an amount at least double the value of the goods at the time of posting to indemnify any person injured by the delivery who files a notice of claim within one year after the delivery.

COMMENT: Prior Uniform Statutory Provision: § 14, Uniform Warehouse Receipts Act; § 17, Uniform Bills of Lading Act.

Changes: General Revision. Principal innovations include: affirmation of bailee's privilege to deliver to claimant without resort to judicial proceedings if the bailee acts in good faith and is willing to take the full risk of loss in case the lost document turns up in the hands of an innocent purchaser; explicit authorization to

the court to order bailee to issue a substitute document rather than make physical delivery of the goods; inclusion of "stolen" as well as lost documents; extension of section to nonnegotiable documents.

Purposes of Changes: The purposes of the changes insofar as they are not self-evident are as follows:

1. As to bailee's privilege to deliver without court order, doubt had arisen as to the propriety of such action under § 54 of the Uniform Warehouse Receipts Act, which made it a crime to deliver goods covered by negotiable receipts without taking up the receipts "except in the cases provided for in § 14" (the lost receipts section). This has been interpreted by one court as exempting from criminal liability only if the judicial procedure of § 14 was followed. Dahl v. Winter-Truesdell-Diercks Co., 61 N.D. 84, 237 N.W. 202 (1931). Although the criminal provisions are not being re-enacted in this Act (and the Uniform Bills of Lading Act never did include such a criminal provision), it seems advisable to clarify the legality of the well established commercial practice of bailees to make delivery where they are satisfied that the claimant is the person entitled under a lost document. Since the bailee remains liable on the document in such cases, he will usually insist that the claimant provide an indemnity bond.

2. The old acts provide only for compulsory delivery of goods; this section provides also for compulsory issuance of a substitute document. If continuance of the bailment is desirable there is no reason to require the goods to be withdrawn and redeposited in order to secure a negotiable document. The present acts would probably be so interpreted. § 20 of the Federal Warehouse Act and some state laws expressly require issuance of a new receipt on proof of loss and posting of bond.

3. Claimants on nonnegotiable instruments are permitted to avail themselves of this procedure because straight bills of lading sometimes contain provisions that the goods shall not be delivered except upon production of the bill. If the carrier should choose to insist upon production of the bill, the consignee should have some means of compelling delivery on satisfactory proof of entitlement.

Ordinarily no security would be necessary to indemnify a bailee in delivering to the person named in a nonnegotiable document. But disputes as to negotiability may arise, in which case if there is a reasonable doubt on the point the bailee should be protected against the possibility that the missing document would, in the hands of an innocent purchaser for value, be held negotiable.

4. It seems unnecessary to to state, as do the present acts, that the court shall act "on satisfactory proof of such loss or destruction." The right of action created by the section is conditioned on a document being lost, stolen or destroyed. Plaintiff must of course bring himself within the section. There is nothing in the language of the old acts to suggest that they intended to impose anything but the normal burden of proof on the plaintiff in such proceedings.

5. Subsection (2) makes it clear that after delivery without court order the bailee remains liable for actual damages. Liability for conversion is provided where the delivery is dishonest, but excluded where a filed classification or tariff is followed in good faith, or where the described bond is posted in good faith and no classification or tariff is filed. Liability for conversion in other cases is left to judicial decision.

Definitional Cross References:

"Bailee". § 7-102.
"Bill of lading". § 1-201.
"Delivery". § 1-201.
"Document". § 7-102.
"Good faith". § 1-201.
"Goods". § 7-102.
"Person". § 1-201.
"Warehouse receipt". § 1-201.
"Warehouseman". § 7-102.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 61-17.

§ 7-602. Attachment of Goods Covered by a Negotiable Document. Except where the document was originally issued upon delivery of the goods by a person who had no power to dispose of them, no lien attaches by virtue of any judicial process to goods in the possession of a bailee for

which a negotiable document of title is outstanding unless the document be first surrendered to the bailee or its negotiation enjoined, and the bailee shall not be compelled to deliver the goods pursuant to process until the document is surrendered to him or impounded by the court. One who purchases the document for value without notice of the process or injunction takes free of the lien imposed by judicial process.

COMMENT: **Prior Uniform Statutory Provisions:** § 25, Uniform Warehouse Receipts Act; § 24, Uniform Bills of Lading Act.

Changes: Consolidated and rewritten.

Purposes of Changes: 1. The purpose of the section is to protect the bailee from conflicting claims of the document holder and the judgment creditors of the person who deposited the goods. The rights of the former prevail unless, in effect, the judgment creditors immobilize the negotiable document. However, if the document was issued upon deposit of the goods by a person who had no power to dispose of the goods so that the document is ineffective to pass title, judgment liens are valid to the extent of the debtor's interest in the goods.

2. The last sentence covers the possibility that the holder of a document who has been enjoined from negotiating it will violate the injunction by negotiating to an innocent purchaser for value. In such case the lien will be defeated.

Cross Reference:
Point 1: § 7-503.

Definitional Cross References:
"Bailee". § 7-102.
"Delivery". § 1-201.
"Document". § 7-102.
"Goods". § 7-102.
"Notice". § 1-201.
"Person". § 1-201.
"Purchase". § 1-201.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 61-28.

§ 7-603. Conflicting Claims; Interpleader. If more than one person claims title or possession of the goods, the bailee is excused from delivery until he has had a reasonable time to ascertain the validity of the adverse claims or to bring an action to compel all claimants to interplead and may compel such interpleader, either in defending an action for nondelivery of the goods, or by original action, whichever is appropriate.

COMMENT: **Prior Uniform Statutory Provision:** §§ 16 and 17, Uniform Warehouse Receipts Act; §§ 20 and 21, Uniform Bills of Lading Act.

Changes: Consolidation without substantial change.

Purposes of Changes: The section enables a bailee faced with conflicting claims to the goods to compel the claimants to litigate their claims with each other rather than with him.

Definitional Cross References:
"Action". § 1-201.
"Bailee". § 7-102.
"Delivery". § 1-201.
"Goods". § 7-102.
"Person". § 1-201.
"Reasonable time". § 1-204.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 61-19, 61-20.

Comment: This section does not directly affect the result in Bell Storage Co. v. Harrison, 164 Va. 278, 286-89, 180 S.E. 320 (1935), in which a warehouseman, who had wrongfully sold the goods, was denied the right to bring a bill of interpleader since it did not stand indifferent as between the adverse claimants.

ARTICLE 8

INVESTMENT SECURITIES

PART 1

SHORT TITLE AND GENERAL MATTERS

§ 8-101. **Short Title.** This Article shall be known and may be cited as Uniform Commercial Code—Investment Securities.

COMMENT: The Article is neither a Blue Sky Law nor a corporation code. It may be likened rather to a negotiable instruments law dealing with securities. The instruments covered are those included in the definition of "security" in § 8-102.

Thus the Article deals with bearer bonds, formerly covered by the Uniform Negotiable Instruments Law, and with registered bonds, not previously covered by any Uniform Law. It also covers certificates of stock, formerly provided for by the Uniform Stock Transfer Act, and additional types of investment paper not now covered by any Uniform Act.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, Title 6, Chapter 10, and Title 13, Chapter 4.

Comment: This Article replaces the Uniform Negotiable Instruments Law, which was proposed for adoption in 1896, and adopted in Virginia in 1897, to the extent that act covered bonds as investment securities. The Article replaces the Uniform Stock Transfer Act, which was proposed for adoption in 1909, and adopted in Virginia in 1924. Article 8 does not replace the Uniform Act for the Simplification of Fiduciary Security Transfers, proposed for adoption in 1958, and adopted in Virginia in 1960, Code of 1950, Title 13.1, Chapter 4.1.

§ 8-102. **Definitions and Index of Definitions.** (1) In this Article unless the context otherwise requires

(a) A "security" is an instrument which

(i) is issued in bearer or registered form; and

(ii) is of a type commonly dealt in upon securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment; and

(iii) is either one of a class or series or by its terms is divisible into a class or series of instruments; and

(iv) evidences a share, participation or other interest in property or in an enterprise or evidences an obligation of the issuer.

(b) A writing which is a security is governed by this Article and not by Uniform Commerical Code—Commercial Paper even though it also meets the requirements of that Article. This Article does not apply to money.

(c) A security is in "registered form" when it specifies a person entitled to the security or to the rights it evidences and when its transfer may be registered upon books maintained for that purpose by or on behalf of an issuer or the security so states.

(d) A security is in "bearer form" when it runs to bearer according to its terms and not by reason of any indorsement.

(2) A "subsequent purchaser" is a person who takes other than by original issue.

(3) A "clearing corporation" is a corporation all of the capital stock of which is held by or for a national securities exchange or association registered under a statute of the United States such as the Securities Exchange Act of 1934.

(4) A "custodian bank" is any bank or trust company which is supervised and examined by state or federal authority having supervision over banks and which is acting as custodian for a clearing corporation.

(5) Other definitions applying to this Article or to specified Parts thereof and the sections in which they appear are:

"Adverse claim". § 8-301.
"Bona fide purchaser". § 8-302.
"Broker". § 8-303.
"Guarantee of the signature". § 8-402.
"Intermediary Bank". § 4-105.
"Issuer". § 8-201.
"Overissue". § 8-104.

(6) In addition Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: To define the basic term of this Article, "security" and so to identify the instruments to which this Article applies. Notice that if an instrument is a "security" as here defined it is governed by this Article and not by Article 3. See also § 3-103(1). Money (§ 1-201) is not a security. Nor is it commercial paper (§ 3-103).

This section also defines certain other terms, and lists other sections containing other definitions.

The definition of "security" is functional rather than formal, and it is believed will cover anything which securities markets, including not only the organized exchanges but as well as the "over-the-counter" markets, are likely to regard as suitable for trading. For example, transferable warrants evidencing rights to subscribe for shares in a corporation will normally be "securities" within the definition, since they (a) are issued in bearer or registered form, (b) are of a type commonly dealt in on securities markets, (c) constitute a class or series of instruments, and (d) evidence an obligation of the issuer, namely the obligation to honor the warrant upon its due exercise and issue shares accordingly.

On the other hand the definition does not cover anything (whether it is a "security" or not under regulatory statutes like the Securities Act of 1933 or a state Blue Sky law) which is not either "of a type commonly dealt in upon securities exchanges or markets," or "commonly recognized . . . as a medium for investment."

Cross Reference:

§ 3-103.

Definitional Cross References:

"Bearer". § 1-201.
"Issuer". § 8-201.
"Money". § 1-201.
"Person". § 1-201.
"Rights". § 1-201.
"Term". § 1-201.
"Writing". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Upon a finding that the instrument in Wall v. Fairfax, 180 Va. 421, 23 S.E.2d 130 (1942), was an instrument commonly recognized as a medium of investment in the area in which it was issued or dealt in, it would apparently qualify as "a security" under this Article. See VIRGINIA ANNOTATIONS to UCC 3-104.

The section is in accord with Stuart Court Realty Corp. v. Gillespie, 150 Va. 515, 525, 143 S.E. 741, 59 A.L.R. 334 (1928), that a corporate bearer coupon bond is a negotiable instrument.

§ 8-103. **Issuer's Lien.** A lien upon a security in favor of an issuer thereof is valid against a purchaser only if the right of the issuer to such lien is noted conspicuously on the security.

COMMENT: Prior Uniform Statutory Provision: Uniform Stock Transfer Act, § 15.

Purposes: The rule of § 15 of the former Act is made applicable to all "securities" covered by the Article. A corresponding rule as to restrictions on transfer imposed by the issuer appears at § 8-204.

"Noted" makes clear that the text of the lien provision need not be set forth in full. However, this would not override a provision of an applicable corporation code requiring statement *in haec verba*.

Cross Reference:

§ 8-204.

Definitional Cross References:

"Conspicuous". § 1-201.
"Issuer". § 8-201.
"Security". § 8-102.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 13.1-415.

§ 8-104. **Effect of Overissue; "Overissue."** (1) The provisions of this Article which validate a security or compel its issue or reissue do not apply to the extent that validation, issue or reissue would result in overissue; but

(a) if an identical security which does not constitute an overissue is reasonably available for purchase, the person entitled to issue or validation may compel the issuer to purchase and deliver such a security to him against surrender of the security, if any, which he holds; or

(b) if a security is not so available for purchase, the person entitled to issue or validation may recover from the issuer the price he or the last purchaser for value paid for it with interest from the date of his demand.

(2) "Overissue" means the issue of securities in excess of the amount which the issuer has corporate power to issue.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. Deeply embedded in corporation law is the conception that "corporate power" to issue securities stems from the statute, either general or special, under which the corporation is organized. Corporation codes universally require that the charter or articles of incorporation state, at least as to capital shares, maximum limits in terms of number of shares or total dollar capital. Historically, special incorporation statutes are similarly drawn and sometimes similarly limit the face amount of authorized debt securities. The theory is that issue of securities in excess of the authorized amounts is prohibited. See, for example, McWilliams v. Geddes and Moss Undertaking Co., 169 So. 894 (1936, La.); Crawford v. Twin City Oil Co., 216 Ala. 216, 113 So. 61 (1927); New York

and New Haven R. R. Co. v. Schuyler, 34 N.Y. 30 (1865). This conception persists despite modern corporation codes under which, by action of directors and stockholders, additional shares can be authorized by charter amendment and thereafter issued. This section does not give a person entitled to validation, issue or reissue of a security, the right to compel amendment of the charter to authorize additional shares. Therefore, in a case where issue of an additional security would require charter amendment, the plaintiff is limited to the two alternate remedies set forth in paragraphs (a) and (b) of subsection (1).

2. Where an identical security is reasonably available for purchase, whether because traded on an organized market, or because one or more holders may be willing to sell at a not unreasonable price, the issuer, although unable to issue additional shares, will be able to purchase them and may be compelled to follow that procedure. West v. Tintic Standard Mining Co., 71 Utah 158, 263 P. 490, 56 A.L.R. 1190 (1928).

3. The right to recover damages from an issuer who has permitted an overissue to occur is well settled. New York v. Schuyler, 34 N.Y. 30 (1865). The measure of such damages, however, has been open to question, some courts basing them upon the value of the stock at the time registration is refused; some upon the value at the time of trial; and some upon the highest value between the time of refusal and the time of trial. Allen v. South Boston R. Co., 150 Mass. 200, 22 N.E. 917, 5 L.R.A. 716, 15 Am.St.Rep. 185 (1889); Commercial Bank v. Kortright, 22 Wend. (N.Y.) 348 (1839). The purchase price of the security to the last holder who gave value for it is here adopted as being the fairest means of reducing the possibility of speculation by the purchaser. Interest may be recovered as the best available measure of compensation for delay.

4. This section modifies and controls the rules otherwise laid down in this Article as to the validation and issue of securities. The particular sections so modified are listed in the cross-references.

Cross References:

Point 4: See §§ 8-202, 8-205, 8-206, 8-208, 8-311 and Part 4 of this Article.

Definitional Cross References:

"Issuer". § 8-201.
"Person". § 1-201.
"Purchase". § 1-201.
"Purchaser". § 1-201.
"Security". § 8-102.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 8-105. Securities Negotiable and Fungible; Presumptions. (1) Securities governed by this Article are negotiable instruments and are fungible.

(2) In any action on a security

(a) unless specifically denied in the pleadings, each signature on the security or in a necessary indorsement is admitted;

(b) when the effectiveness of a signature is put in issue the burden of establishing it is on the party claiming under the signature but the signature is presumed to be genuine or authorized;

(c) when signatures are admitted or established production of the instrument entitles a holder to recover on it unless the defendant establishes a defense or a defect going to the validity of the security; and

(d) after it is shown that a defense or defect exists the plaintiff has the burden of establishing that he or some person under whom he claims is a person against whom the defense or defect is ineffective (§ 8-202).

(VALC Note: The caption and subsection (1) of § 8-105 are contained in the Official Text as follows:

§ 8-105. Securities Negotiable; Presumptions. (1) Securities governed by this Article are negotiable instruments.)

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. This Article gives to bona fide purchasers of securities rights greater than those they would have if the things bought were chattels or simple contracts. See e. g. §§ 8-202, 8-301. Subsection (1) of this section states the conclusion: Securities are negotiable instruments. It remains true that the particular kinds of negotiable instruments defined in this Article as "securities" are governed by this Article and not by Article 3. See §§ 8-102(1)(b) and 3-103(1). But by subsection (2) of this section the particular rules stated in § 3-307 for the negotiable instruments governed by Article 3 are adapted to securities.

2. "Any action on a security" includes any action or proceeding brought against the issuer to enforce a right or interest represented by the security, e. g., to collect principal or interest or a dividend, or to establish a right to vote or to receive a new security under an exchange offer or plan of reorganization.

Cross Reference:

§§ 3-103, 3-307, 8-202, 8-301.

Definitional Cross Reference:

"Security". § 8-102.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: The UCC expressly declares that securities governed by this Article are negotiable, which accords with the holdings in Stuart Court Realty Corp. v. Gillespie, 150 Va. 515, 525, 143 S.E. 741, 59 A.L.R. 334 (1928); and Supervisors of Cumberland County v. Randolph, 89 Va. 614, 619, 16 S.E. 722 (1893), holding that corporate bearer coupon bonds are negotiable.

COUNCIL COMMENT

We feel that the language which we recommend is clearer and less complicated than that of the Official Text.

§ 8-106. Applicability. The validity of a security and the rights and duties of the issuer with respect to registration of transfer are governed by the law (including the conflict of laws rules) of the jurisdiction of organization of the issuer.

COMMENT: Prior Uniform Statutory Provision: None.

Purpose: To state, in accordance with the prevailing case law, a specific conflicts rule applicable in the securities field. Other conflicts rules applicable generally and under this Article are stated in § 1-105.

Cross References:

§§ 1-105 and 8-202 and Part 4 of this Article.

Definitional Cross Reference:

"Issuer". § 8-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 8-107. Action for Price. Where, pursuant to a contract to sell or a sale, a security has been delivered or tendered to the purchaser, and the purchaser wrongfully fails to pay for the security according to the terms of the contract or the sale, the seller may in addition to any other remedy recover the agreed price of the security. This provision does not affect the remedy of a seller if the security has not been delivered or tendered.

(VALC Note: § 8-107 is contained in the Official Text as follows:

§ 8-107. Securities Deliverable; Action for Price. (1) Unless otherwise agreed and subject to any applicable law or regulation respecting short sales, a person obligated to deliver securities may deliver any security of the specified issue in bearer form or registered in the name of the transferee or indorsed to him or in blank.

(2) When the buyer fails to pay the price as it comes due under a contract of sale the seller may recover the price

(a) of securities accepted by the buyer; and

(b) of other securities if efforts at their resale would be unduly burdensome or if there is no readily available market for their resale.

COMMENT: Prior Uniform Statutory Provision: None.

Purpose: 1. The rights and interests represented by securities of the same issue are "fungible". § 1-201(17). To the extent that instruments representing such rights and interests (securities) are available in form to be further transferred by the person to whom they are deliverable, the securities themselves are fungible. Subsection (1) states the generally accepted legal consequences of such fungibility. "Unless otherwise agreed", the seller, bailee, broker or other "person obligated to deliver securities" need not deliver any specific instrument, but may select (e. g., from "a fungible bulk" (§ 8-313(2)) any security of the proper issue, in bearer form or appropriately registered or indorsed.

Rules of the organized markets limiting the forms of registration in which securities are deliverable in transactions on such markets are matters "otherwise agreed". Cases such as Parsons v. Martin, 77 Mass. (11 Gray) 111 (1858) and Rumery v. Brooks, 205 App.Div. 283, 199 N.Y.Supp. 517 (1st Dept. 1923) holding a broker liable for conversion if he registers transfer of a customer's securities held in "cash account" out of the customer's name or tenders on demand for delivery a different though equivalent security are rejected. However, this Act does not enlarge the rights of a broker as to such securities so as to permit him without the customer's consent to pledge them for his own indebtedness as he may properly do with securities held in a "margin account" and upon which he has acquired a lien for advances. The distinction is carefully preserved in Statute (e. g., N.Y. Penal Law § 956) and case law. In re Mills, 125 App.Div. 730, 110 N.Y.Supp. 314 (1st Dept. 1908).

2. Subsection (2) is designed to follow the dictum in Agar v. Orda, 264 N.Y. 248, 190 N.E. 479 (1934) in this context. Paragraph (b) is applicable where for example (i) the securities are those of a "closely-held" corporation not dealt in on any organized market; or (ii) because of the necessity for compliance with the registration requirements of the Securities Act of 1933 or other regulatory provisions or procedures prior to offering the particular securities on the market substantial delay and expense would be involved. The approval of these particular remedies does not constitute disapproval of other remedies that may exist under other rules of law. § 1-103.

Cross References:

§§ 1-103; 2-708; 2-709; 8-313(2).

Definitional Cross References:

"Action". § 1-201(1).
"Contract". § 1-201(11).
"Person". § 1-201(30).
"Security". § 8-102.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: The UCC does not cover the buyer's remedies for a breach of a contract to sell stock. See Lynch v. Highfield, 146 Va. 488, 131 S.E. 810 (1926).

COUNCIL COMMENT

The language which we recommend offers the broker a clear and more certain remedy than the provisions requiring him to establish whether resale would be "unduly burdensome" or there is no "readily available market" for the securities.

PART 2

ISSUE—ISSUER

§ 8-201. "Issuer." (1) With respect to obligations on or defenses to a security "issuer" includes a person who

(a) places or authorizes the placing of his name on a security (otherwise than as authenticating trustee, registrar, transfer agent or the like) to evidence that it represents a share, participation or other interest in his property or in an enterprise or to evidence his duty to perform an obligation evidenced by the security; or

(b) directly or indirectly creates fractional interests in his rights or property which fractional interests are evidenced by securities; or

(c) becomes responsible for or in place of any other person described as an issuer in this section.

(2) With respect to obligations on or defenses to a security a guarantor is an issuer to the extent of his guaranty whether or not his obligation is noted on the security.

(3) With respect to registration of transfer (Part 4 of this Article) "issuer" means a person on whose behalf transfer books are maintained.

COMMENT: **Prior Uniform Statutory Provision:** §§ 29, 60, 61 and 62, Uniform Negotiable Instruments Law.

Changes: Definition of person liable on instrument adapted to investment securities.

Purposes of Changes: 1. This Article includes many types of securities not covered by the Uniform Negotiable Instruments Law (§ 8-102). The term "issuer" is here defined as a word of art, applicable to the various kinds of securities covered.

2. This definition is for purposes of this Article only and has no implications with respect to other statutes using the same term in a different sense. Thus as defined in the Securities Exchange Act of 1934, the term issuer expressly excludes trustees under equipment-trust certificates. In those common forms of equipment trust certificates where the payments of principal and interest are the direct obligation of the indenture trustee, such trustee is an "issuer" within subparagraph (a) of this section.

Subsection (2) distinguishes the obligations of a guarantor as issuer from those of the principal obligor. However, it does not exempt the guarantor from the impact of subsection (4) of § 8-202. Whether or not the obligation of the guarantor is noted on the security is immaterial. Typically, guarantors are parent corporations, or stand in some similar relationship to the principal obligor. If that relationship existed at the time the security was originally issued the guaranty would probably have been noted on the security. However, if the relationship arose afterward, e. g., through a purchase of stock or properties, or through merger or consolidation, probably the notation would not have been made. Nonetheless, the holder of the security is entitled to the benefit of the obligation of the guarantor.

3. Subsection (3) narrows the definition of "issuer" for purposes of Part 4 of this Article (registration of transfer). It is supplemented by § 8-406.

Cross References:

Point 1: § 8-102.
Point 2: § 8-202.
Point 3: Part 4 of this Article.

Definitional Cross References:

"Person". § 1-201.
"Rights". § 1-201.
"Security". § 8-102.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-381, 6-412, 6-413, 6-414.

§ 8-202. **Issuer's Responsibility and Defenses; Notice of Defect or Defense.** (1) Even against a purchaser for value and without notice, the terms of a security include those stated on the security and those made part of the security by reference to another instrument, indenture or document or to a constitution, statute, ordinance, rule, regulation, order or the like to the extent that the terms so referred to do not conflict with the stated terms. Such a reference does not of itself charge a purchaser for value with notice of a defect going to the validity of the security even though the security expressly states that a person accepting it admits such notice.

(2) (a) A security other than one issued by a government or governmental agency or unit even though issued with a defect going to its validity is valid in the hands of a purchaser for value and without notice of the particular defect unless the defect involves a violation of constitutional provisions in which case the security is valid in the hands of a subsequent purchaser for value and without notice of the defect.

(b) The rule of subparagraph (a) applies to an issuer which is a government or governmental agency or unit only if either there has been substantial compliance with the legal requirements governing the issue or the issuer has received a substantial consideration for the issue as a whole or for the particular security and a stated purpose of the issue is one for which the issuer has power to borrow money or issue the security.

(3) Except as otherwise provided in the case of certain unauthorized signatures on issue (§ 8-205), lack of genuineness of a security is a complete defense even against a purchaser for value and without notice.

(4) All other defenses of the issuer including nondelivery and conditional delivery of the security are ineffective against a purchaser for value who has taken without notice of the particular defense.

(5) Nothing in this section shall be construed to affect the right of a party to a "when, as and if issued" or a "when distributed" contract to cancel the contract in the event of a material change in the character of the security which is the subject of the contract or in the plan or arrangement pursuant to which such security is to be issued or distributed.

COMMENT: Prior Uniform Statutory Provisions: §§ 16, 23, 28, 56, 57, 60, 61, 62, Uniform Negotiable Instruments Law.

Changes: Rules as to notice of defects or defenses, rights of purchasers, and the liability of primary parties applied to securities.

Purposes: In this Article the rights of the purchaser for value without notice are divided into two aspects, those against the issuer, and those against other claimants to the security. Part 2 of this Article, and especially this section, deal with rights against the issuer.

1. Subsection (1) states, in accordance with the prevailing case law, the right of the issuer (who prepares the text of the security) to include terms incorporated by adequate reference to an extrinsic source, so long as the terms so incorporated do not conflict with the stated terms. Thus, the standard practice of referring in a bond or debenture to the trust indenture under which it is issued without spelling out its necessarily complex and lengthy provisions is approved. Every stock certificate refers in some manner to the charter or articles of incorporation of the issuer. At least where there is more than one class of stock authorized applicable corporation codes specifically require a statement or summary as to preferences, voting powers and the like. References to constitutions, statutes, ordinances, rules, regulations or orders are not so common, except in the obligations of governments or governmental agencies or units; but where appropriate they fit into the rule here stated.

The last sentence of subsection (1) distinguishes between the right of the issuer to incorporate by reference and the effect of that procedure as notice to a pur-

chaser for value of a defect going to the validity of the security. Here the underlying concept is that it is for the issuer, not for the purchaser, to make sure that the issuer's security complies with the law governing its issue, and the rules as to defenses available to the issuer are stated in the following subsections.

2. By subsection (2) a security "is valid" in the hands of a purchaser for value without notice of a particular defect even if the defect is so serious as to be described as one "going to the validity" of the security. The few exceptions to this proposition are noted later. Notice that "purchaser" includes a person taking from the company on original issue (§ 1-201) whereas a "subsequent purchaser" does not (§ 8-102).

3. Subsection (2) does not touch the relationship between the issuer and a purchaser who takes on original issue when the defect in issue consists of the violation of a constitutional provision. That situation is not covered by this Article but is left to the law of the particular state.

Following the basic principles of the Negotiable Instruments Law the cases have generally held that an issuer is estopped from denying representations made in the text of a security. Delaware-New Jersey Ferry Co. v. Leeds, 21 Del.Ch. 279, 186 A. 913 (1936). Nor is a defect in form or the invalidity of a security normally available to the issuer as a defense. Bonini v. Family Theatre Corporation, 327 Pa. 273, 194 A. 498 (1937); First National Bank of Fairbanks v. Alaska Automotive, 119 F.2d 267 (C.C.A.Alaska 1941).

This general rule of estoppel is here adopted in favor of purchasers, with the exception noted above.

The genuineness of an instrument, on the other hand, has always been subject to attack and this rule is continued in subsection (3) with the stated exception provided for in the case of certain unauthorized signatures (§ 8-205).

Instead of allowing damages against the issuer, subsection (2) validates most defective securities in the hands of innocent purchasers, thus refusing to prefer such a purchaser over other investors of the same class while keeping the benefit of the investment available to him.

4. Many jurisdictions have constitutional and statutory requirements that unless substantial value is received by the issuer for the security it shall be void. This Article follows the better case law and validates securities in the hands of bona fide purchasers where the provisions are statutory and bona fide subsequent purchasers where the provisions are constitutional, even where this type of defect exists. See as to constitutional provisions, Kisterbock's Appeal, 127 Pa. 601, 18 A. 381, 14 Am.St.Rep. 868 (1889); Clark v. Freeling, 196 Ark. 907, 120 S.W.2d 375 (1938); People's State Bank v. Jacksonian Hotel Co., 261 Ky. 166, 87 S.W.2d 111 (1935); O'Brien v. Turner, 174 Wash. 266, 24 P.2d 641 (1933); and as to statutory requirements, Westminster National Bank v. New England Electrical Works, 73 N.H. 465, 62 A. 971, 3 L.R.A.,N.S., 551, 111 Am.St.Rep. 637 (1906); Bankers Trust Co. v. Rood, 211 Iowa 289, 233 N.W. 794, 73 A.L.R. 1421 (1930). Lesser defects in issue a fortiori received the same treatment.

5. Although generally regarded as a defect going to the validity of the security overissue is an exception to the rule of subsection (2) (§ 8-104) and an issuer cannot be required to recognize a security which constitutes an overissue. The provisions of the section on overissue (§ 8-104) require, however, that if a similar security is reasonably available for purchase, the issuer must purchase and deliver it to the purchaser in place of the invalid one.

6. Governmental issuers are distinguished in subsection (2) from other issuers as a matter of public policy and additional safeguards are imposed before governmental issues are validated. Governmental issuers are estopped from asserting defenses only if there has been substantial compliance with the legal requirements governing the issue or if substantial consideration has been received and a stated purpose of the issue is one for which the issuer has power to borrow money or issue the security. The purpose of the substantial compliance requirement is to make certain that a mere technicality as, e. g., in the manner of publishing election notices, shall not be a ground for depriving an innocent purchaser of his rights in the security. The policy is here adopted of such cases as Tommie v. City of Gadsden, 229 Ala. 521, 158 So. 763 (1935), in which minor discrepancies in the form of the election ballot used were overlooked and the bonds were declared valid since there had been substantial compliance with the statute. A long and well established line of Federal cases recognizes the principle of estoppel in favor of bona fide purchasers where municipalities issue bonds con-

taining recitals of compliance with governing constitutional and statutory provisions, made by the municipal authorities entrusted with determining such compliance. Chaffee County v. Potter, 142 U.S. 355, 12 S.Ct. 216, 35 L.Ed. 1040 (1892); Oregon v. Jennings, 119 U.S. 74, 7 S.Ct. 124, 30 L.Ed. 323 (1886); Gunnison County Commissioners v. Rollins, 173 U.S. 255, 19 S.Ct. 390, 43 L.Ed. 689 (1898). This rule has been qualified, however, by requiring that the municipality have power to issue the security. Anthony v. County of Jasper, 101 U.S. 693, 25 L.Ed. 1005 (1879); Town of South Ottawa v. Perkins, 94 U.S. 260, 24 L.Ed. 154 (1876). This section follows the case law trend, simplifying the rule by setting up two conditions for an estoppel against a governmental issuer: (1) substantial consideration given, and (2) power in the issuer to borrow money or issue the security for the stated purpose. As a practical matter the problem of policing governmental issuers has been alleviated by the present practice of requiring legal opinions as to the validity of the issue. The bulk of the case law on this point is nearly 50 years old and it may be assumed that the question now seldom arises.

7. Subsection (5) is included to make clear that this section does not affect the presently recognized right of either party to a "when, as and if" or "when distributed" contract to cancel the contract on substantial change.

Cross References:

Point 1: §§ 1-201, 8-203.
Point 2: §§ 1-201, 8-102.
Point 3: § 8-205.
Point 5: §8-104.
See §§ 8-104, 8-203, 8-205 and 8-206.

Definitional Cross References:

"Delivery". § 1-201.
"Genuine". § 1-201.
"Issuer". § 8-201.
"Money". § 1-201.
"Notice". § 1-201.
"Organization". § 1-201.
"Person". § 1-201.
"Proper form". § 8-102.
"Purchaser". § 1-201.
"Security". § 8-102.
"Subsequent purchaser". § 8-102.
"Term". § 1-201.
"Unauthorized signature". § 1-201.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-368, 6-375, 6-380, 6-408, 6-409, 6-412, 6-413, 6-414.

Comment: In Supervisors of Cumberland County v. Randolph, 89 Va. 614, 620, 16 S.E. 722 (1893), the Supreme Court of Appeals held that the purchaser of a negotiable security issued by a municipal corporation, which had authority to issue such securities, could rely upon statements in the securities, and that such a purchaser "is not bound to ascertain the truth or falsity of such recital, or to look further than to see whether the requisite legislative authority has been conferred". This approach is consistent with that set forth in subsection 8-202(2)(b) relating to government securities.

§ 8-203. Staleness as Notice of Defects or Defenses. (1) After an act or event which creates a right to immediate performance of the principal obligation evidenced by the security or which sets a date on or after which the security is to be presented or surrendered for redemption or exchange, a purchaser is charged with notice of any defect in its issue or defense of the issuer

(a) if the act or event is one requiring the payment of money or the delivery of securities or both on presentation or surrender of the security and such funds or securities are available on the date set for payment or exchange and he takes the security more than one year after that date; and

(b) if the act or event is not covered by paragraph (a) and he takes the security more than two years after the date set for surrender or presentation or the date on which such performance became due.

(2) A call which has been revoked is not within subsection (1).

COMMENT: Prior Uniform Statutory Provision: §§ 52 (2), 53, Uniform Negotiable Instruments Law.

Changes: Extensive modification of policy that a holder in due course must take before maturity of the instrument.

Purposes of Changes: 1. The problem of matured or called securities is here dealt with in terms of the effect of such events in giving notice of the issuer's defenses and not in terms of "negotiability". The fact that a security is in circulation long after it has been called for redemption or exchange must give rise to the question in a purchaser's mind as to why it has not been surrendered. After the lapse of a reasonable period of time he can no longer claim that he had "no reason to know" of any defects or irregularities in its issue. Where funds are available for the redemption of the security it is normally turned in more promptly and a shorter time is set as the "reasonable period", subsection (1)(a), than is set where funds are not available.

It is true that defaulted securities are frequently traded on financial markets in the same manner as unmatured and undefaulted instruments and a purchaser might not be placed upon notice of irregularity by the mere fact of default. An issuer, however, should at some point be placed in a position to determine definitely its liability on an invalid or improper issue, and for this purpose a security under this section becomes "stale" two years after the default. But notice that a different rule applies when the question is notice not of issuer's defenses but of claims of ownership. § 8-305 and comment.

2. Nothing in this section is designed to extend the life of preferred stocks called for redemption as "shares of stock" beyond the redemption date. After such a call, the security represents only a right to the funds set aside for redemption.

Cross References:

See §§ 8-104(1), 8-202 and 8-305.

Definitional Cross References:

"Delivery". § 1-201.
"Issuer". § 8-201.
"Money". § 1-201.
"Notice". § 1-201.
"Purchaser". § 1-201.
"Right". § 1-201.
"Security". § 8-102.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-404(2), 6-405.

§ 8-204. **Effect of Issuer's Restrictions on Transfer.** Unless noted conspicuously on the security a restriction on transfer imposed by the issuer even though otherwise lawful is ineffective except against a person with actual knowledge of it.

COMMENT: Prior Uniform Statutory Provision: § 15, Uniform Stock Transfer Act.

Changes: Rephrased.

Purposes of Changes: 1. "Noted" removes an ambiguity under the former Act and makes clear that the restriction need not be set forth in full text. See Allen v. Biltmore Tissue Corporation, 2 N.Y.2d 534, 141 N.E.2d 812 (1957).

Securities dealt in on financial markets are generally assumed to be free of adverse claims (§ 8-301). That assumption should not be lightly negated. Therefore a strict rule as to notice of a restriction on transfer is here imposed. Since by hypothesis the issuer imposed the restriction, the refusal of an issuer to register a transfer on the basis of an unnoted restriction constitutes a conversion

and the issuer can be compelled to register the transfer under the policy of Part 4 of this Article. Hulse v. Consolidated Quicksilver Mining Corporation, 65 Idaho 768, 154 P.2d 149 (1944); Mancini v. Patrizi, 110 Cal.App. 42, 293 P. 828 (1930). Conversely, the issuer to whom a security with proper notation of a restriction is presented thereby receives timely notification of an adverse claim and is under a duty to inquire (§ 8-403).

A purchaser with actual knowledge of an unnoted restriction certainly has notice of an adverse claim (§ 8-304 and Comment). In that situation this section adopts the reasoning of Baumohl v. Goldstein, 95 N.J.Eq. 597, 124 A. 118 (1924), and Tomoser v. Kamphausen, 307 N.Y. 797, 121 N.E.2d 622 (1954), rejecting the contrary holding of such cases as Costello v. Farrell, 234 Minn. 453, 48 N.W.2d 557, 29 A.L.R.2d 890 (1951).

2. Most jurisdictions recognize the right of issuers to impose restrictions giving either the issuer itself or other stockholders the option to purchase the security at an ascertained price before it is offered to third parties. Vannucci v. Peduni, 217 Cal. 138, 17 P.2d 706 (1932); People ex rel. Rudaitis v. Galskis, 233 Ill.App. 414 (1924); Bloomingdale v. Bloomingdale, 107 Misc. 646, 177 N.Y.S. 873 (1919). This is the type of restriction contemplated by the present section. Mere notation on the security cannot, of course, validate an otherwise unlawful restriction. The present section in no way alters the prevailing case law which recognizes free alienability as an inherent attribute of securities and holds invalid unreasonable restraints on alienation such as those requiring consents of directors without establishing criteria for the granting or witholding of such consents and those giving the directors an option of purchase at a price to be fixed in their sole discretion. Howe v. Roberts, 209 Ala. 80, 95 So. 344 (1923); People ex rel. Malcom v. Lake Sand Corporation, 251 Ill.App. 499 (1929); Morris v. Hussong Dyeing Machine Co., 81 N.J.Eq. 256, 86 A. 1026 (1913); New England Trust Co. v. Abbott, 162 Mass. 148, 38 N.E. 432, 27 L.R.A. 271.

Nor is interference intended with such statutory provisions as typified by § 66 of the New York Stock Corporation Law (which permits the directors to refuse to transfer the shares of a stockholder indebted to the corporation when such restriction is printed on the certificate) or by Chapter 276, § 14, of the New Hampshire Revised Laws of 1942 (which prohibits any corporation from making any by-law restraining the free sale of shares of its stock).

No interference is intended with the common practice of closing books for proper corporate purposes.

3. Cooperative associations and ventures, as well as private clubs are generally considered an exception to the rules against restrictions on transfer as unreasonable restraints on alienation and are permitted for example to require the consents of governing bodies such as a board of directors. Penthouse Properties, Inc. v. 1158 Fifth Avenue, Inc., 256 App. Div. 685, 11 N.Y.S. 2d 417 (1939).

Historically restrictions on transfer were most commonly imposed by the so-called "closely-held" issuers (including cooperatives and the like) in an attempt to restrict control if not total membership to a homogeneous security holder group. They are being increasingly resorted to today by issuers with publicly held securities seeking to police enforcement of the registration requirements of the Securities Act of 1933 against persons purchasing their securities in a transaction exempt from those requirements (e. g., one "not involving any public offering" [Securities Act of 1933, § 4 (1)], or against persons in a "control" relationship to the issuer. [Securities Act of 1933, § 2(11) and see Rule 405 of the Rules and Regulations of the Securities and Exchange Commission under that Act.] Particularly in the latter context where notation of the restriction on all affected certificates may not be practical the issuer enforces it by notifying the holders of such certificates and refusing requests to register transfer out of the name of the "controlling person" either for purposes of sale or for delivery after sale, relying on the stated exception as to a person "with actual knowledge" of the restriction.

4. This section deals only with restrictions imposed by the issuer and restrictions imposed by statute are not affected. See Quiner v. Marblehead Social Co., 10 Mass. 476 (1813); Madison Bank v. Price, 79 Kan. 289, 100 P. 280 (1909); Healey v. Steele Center Creamery Ass'n., 115 Minn. 451, 133 N.W. 69 (1911). Nor does it deal with private agreements between stockholders containing restrictive covenants as to the sale of the security as in In re Consolidated Factors Corporation, 46 F.2d 561 (D.C.N.Y.1931).

5. A corresponding provision concerning issuer's liens appears at § 8-103.

Cross References:

Point 5: § 8-103.
See Part 4 of this Article.

Definitional Cross References:

"Conspicuous". § 1-201.
"Issuer". § 8-201.
"Security". § 8-102.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 13.1-415.

Comment: The UCC only deals with restrictions on transfer "imposed by the issuer." It does not undertake to cover restrictions on transfer imposed by private agreement, as in Colonial Coal and Coke Co. v. Ream, 114 Va. 800, 77 S.E. 508 (1913); Carnegie Trust Co. v. Security Life Ins. Co., 111 Va. 1, 68 S.E. 412 (1910); or by other statutes.

§ 8-205. **Effect of Unauthorized Signature on Issue.** An unauthorized signature placed on a security prior to or in the course of issue is ineffective except that the signature is effective in favor of a purchaser for value and without notice of the lack of authority if the signing has been done by

(a) an authenticating trustee, registrar, transfer agent or other person entrusted by the issuer with the signing of the security or of similar securities or their immediate preparation for signing; or

(b) an employee of the issuer or of any of the foregoing entrusted with responsible handling of the security.

COMMENT: **Prior Uniform Statutory Provision:** § 23, Uniform Negotiable Instruments Law.

Changes: Rephrased; circumstances under which an issuer is precluded from setting up a forgery as a defense made explicit.

Purposes of Changes: 1. In current practice the problem of forged or unauthorized signatures arises most frequently where an employee of the issuer, transfer agent or registrar has access to securities which he is required to prepare for issue by affixing the corporate seal or by adding a signature necessary for issue. This section is based upon the issuer's duty to avoid the negligent entrusting of securities to such persons. Issuers have long been held responsible for signatures placed upon securities by parties whom they held out to the public as authorized to prepare such securities. See Fifth Avenue Bank of New York v. The Forty-Second and Grand Street Ferry Railroad Co., 137 N.Y. 231, 33 N.E. 378, 19 L.R.A. 331, 33 Am.St.Rep. 712 (1893); Jarvis v. Manhattan Beach Co., 148 N.Y. 652, 43 N.E. 68, 31 L.R.A. 776, 51 Am.St.Rep. 727 (1896). The "apparent authority" concept of some of the case-law, however, is here extended and this section expressly rejects the technical distinction, made by courts reluctant to recognize forged signatures, between cases where the forger signs a signature he is authorized to sign under proper circumstances and those in which he signs a signature he is never authorized to sign. Citizens' & Southern National Bank v. Trust Co. of Georgia, 50 Ga.App. 681, 179 S.E. 278 (1935). Normally the purchaser is not in a position to determine which signature a forger, entrusted with the preparation of securities, has "apparent authority" to sign and which he has not. The issuer, on the other hand, can protect himself against such fraud by the careful selection and bonding of agents and employees, or by action over against transfer agents and registrars who in turn may bond their personnel.

2. The issuer cannot be held liable for the honesty of employees not entrusted, directly or indirectly, with the signing, preparation, or responsible handling of similar securities and whose possible commission of forgery it has no reason to anticipate. The result in such cases as Hudson Trust Co. v. American Linseed Co., 232 N.Y. 350, 134 N.E. 178 (1922), and Dollar Savings Fund & Trust Co. v. Pittsburgh Plate Glass Co., 213 Pa. 307, 62 A. 916, 5 Ann.Cas. 248 (1906) is here adopted.

3. The present section deals only with signatures placed upon securities prior to or in the course of issue and is not concerned with forged or unauthorized indorsements (§ 8-311).

4. The protection here stated is available to all purchasers for value without notice and not merely to subsequent purchasers.

Cross References:

Point 3: § 8-311.
See § 8-202(3).

Definitional Cross References:

"Issuer". § 8-201.
"Notice". § 1-201.
"Person". § 1-201.
"Purchaser". § 1-201.
"Security". § 8-102.
"Sign". § 1-201.
"Unauthorized signature". § 1-201.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-375.

§ 8-206. **Completion or Alteration of Instrument.** (1) Where a security contains the signatures necessary to its issue or transfer but is incomplete in any other respect

(a) any person may complete it by filling in the blanks as authorized; and

(b) even though the blanks are incorrectly filled in, the security as completed is enforceable by a purchaser who took it for value and without notice of such incorrectness.

(2) A complete security which has been improperly altered even though fraudulently remains enforceable but only according to its original terms.

COMMENT: Prior Uniform Statutory Provision: §§ 14, 15 and 124, Uniform Negotiable Instruments Law; § 16, Uniform Stock Transfer Act.

Changes: 1. Non-delivery of an incomplete instrument is no longer available as a defense against a purchaser for value without notice.

2. An altered security may now be enforced according to its original terms by any holder.

Purposes of Changes: 1. The problem of forged or unauthorized signatures necessary for the issue or transfer of a security is not involved here and a person in possession of a security is not, by this section, given authority to fill in blanks with such signatures.

2. Blanks left upon the issue of a security are the only blanks dealt with here and a purchaser for value without notice is protected. Blanks on assignments or powers of attorney during the transfer of a security and the holding in Meier v. Continental Nat. Bank, 83 Ind.App. 109, 143 N.E. 377 (1924) giving the transferee implied power to fill in such blanks are covered by provisions of this Article on indorsement, § 8-308. The problem in those cases is one of claims of ownership rather than of issuer's defenses, and the rights of a purchaser are determined under the provisions of this Article on bona fide purchase (§ 8-301).

3. The defense of non-delivery is not available to an issuer against a purchaser for value without notice (subsection (4) of § 8-202). Normally undelivered securities containing blanks can be appropriated and filled up only by employees and agents of the issuer who have access to such unissued securities. As in the case of forged or unauthorized signatures on issue, the issuer must bear the responsibility for trusting such persons.

4. The protection granted a purchaser for value without notice under this section is modified to the extent that an overissue may result where an incorrect amount is filled in a blank (§ 8-104).

5. The nature of securities and the investment normally involved necessitates that any purchaser of an altered security be permitted to enforce it according to its original terms whether or not he be a purchaser for value without notice.

Cross References:

Point 2: §§ 8-301 and 8-308.
Point 3: § 8-202(4).
Point 4: § 8-104.
See §§ 8-205 and 8-311.

Definitional Cross References:

"Notice". § 1-201.
"Person". § 1-201.
"Purchaser". § 1-201.
"Security". § 8-102.
"Term". § 1-201.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-366, 6-367, 6-477, 13.1-416.

§ 8-207. **Rights of Issuer With Respect to Registered Owners.** (1) Prior to due presentment for registration of transfer of a security in registered form the issuer or indenture trustee may treat the registered owner as the person exclusively entitled to vote, to receive notifications and otherwise to exercise all the rights and powers of an owner.

(2) Nothing in this Article shall be construed to affect the liability of the registered owner of a security for calls, assessments or the like.

COMMENT: Prior Uniform Statutory Provision: § 3, Uniform Stock Transfer Act.

Changes: Issuer's rights with respect to registered holders now stated affirmatively and express protection given until the security is duly presented for registration of transfer.

Purposes of Changes: 1. The protection of this section operates until due presentment of the security for registration of transfer; what constitutes such "due presentment" is determined generally by Part 4 of this Article dealing with Registration. The rule of such cases as Turnbull v. Longacre Bank, 249 N.Y. 159, 163 N.E. 135 (1928), which held the issuer liable for paying out dividends to the record holder after the transferee had given notice of the transfer and demanded that a new certificate be issued to him, is left unchanged. However, such cases as Morrison v. Gulf Oil Corporation, 189 Miss. 212, 196 So. 247 (1940), holding that § 3 of the Uniform Stock Transfer Act did not change the common law as to the issuer's liability for dealing with the record holder after a mere notice of a pledge, are expressly rejected. Mere notice is not enough under this section to impose upon the issuer the duty of dealing with the pledgee although it may constitute notice to the issuer of a claim of ownership under Part 4.

2. Subsection (1) is permissive and does not require that the issuer deal exclusively with the registered owner. It is free to require proof of ownership before paying out dividends or the like if it chooses to. Barbato v. Breeze Corporation, 128 N.J.L. 309, 26 A.2d 58 (1942).

3. This section does not operate to determine who is finally entitled to exercise voting and other rights or to receive payments and distributions. The parties are still free to incorporate their own arrangements as to these matters in seller-purchaser agreements which will be definitive as between them.

4. No change in existing state laws as to the liability of registered owners for calls and assessments is here intended; nor is anything in this section designed to estop a record holder from denying ownership when assessments are levied if he is otherwise entitled to do so under state law. See State ex rel. Squire v. Murfey, Blosson & Co., 131 Ohio St. 289, 2 N.E.2d 866 (1936); Willing v. Delaplaine, 23 F.Supp. 579 (1937).

5. No interference is intended with the common practice of closing the transfer books or taking a record date for dividend, voting and other purposes, as provided for in by-laws, charters and statutes.

Cross Reference:

See Part 4 of this Article.

Definitional Cross References:

"Issuer". § 8-201.
"Notification". § 1-201.
"Person". § 1-201.
"Registered form". § 8-102.
"Right". § 1-201.
"Security". § 8-102.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 13.1-403.

§ 8-208. **Effect of Signature of Authenticating Trustee, Registrar or Transfer Agent.** (1) A person placing his signature upon a security as authenticating trustee, registrar, transfer agent or the like warrants to a purchaser for value without notice of the particular defect that

(a) the security is genuine; and

(b) his own participation in the issue of the security is within his capacity and within the scope of the authorization received by him from the issuer; and

(c) he has reasonable grounds to believe that the security is in the form and within the amount the issuer is authorized to issue.

(2) Unless otherwise agreed, a person by so placing his signature does not assume responsibility for the validity of the security in other respects.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. The warranties here stated express the current understanding and prevailing case law as to the effect of the signatures of authenticating trustees, transfer agents, and registrars. See Jarvis v. Manhattan Beach Co., 148 N.Y. 652, 43 N.E. 68, 31 L.R.A. 776, 51 Am.St.Rep. 727 (1896). Although it has generally been regarded as the particular obligation of the transfer agent to determine whether securities are in proper form as provided by the by-laws and Articles of Incorporation, neither a registrar nor an authenticating trustee should properly place a signature upon a security without determining whether it is at least regular on its face. The obligations of these parties in this respect have therefore been made explicit in terms of due care. See Feldmeier v. Mortgage Securities, Inc., 34 Cal.App.2d 201, 93 P.2d 593 (1939).

2. Those cases which hold that an authenticating trustee is not liable for any defect in the mortgage or property which secures the bond or for any fraudulent misrepresentations made by the issuer are not here affected since these matters do not involve the genuineness or proper form of the security. Ainsa v. Mercantile Trust Co., 174 Cal. 504, 163 P. 898 (1917); Tschetinian v. City Trust Co., 186 N.Y. 432, 79 N.E. 401 (1906); Davidge v. Guardian Trust Co. of New York, 203 N.Y. 331, 96 N.E. 751 (1911).

3. The charter or an applicable statute may affect the capacity of a bank or other corporation undertaking to act as an authenticating trustee, registrar or transfer agent. See, for example, the Federal Reserve Act (U.S.C.A., Title 12, Banks and Banking, § 248) under which the Board of Governors of the Federal Reserve Bank is authorized to grant special permits to National Banks permitting them to act as trustees. Such corporations are therefore held to certify as to their legal capacity to act as well as to their authority.

4. Authenticating trustees, registrars and transfer agents have normally been held liable for an issue in excess of the authorized amount. Jarvis v. Manhattan Beach Co., supra; Mullen v. Eastern Trust & Banking Co., 108 Me. 498, 81 A. 948 (1911). In imposing upon these parties a duty of due care with respect to the amount they are authorized to help issue, this section does not necessarily validate the security, but merely holds persons responsible for the excess issue liable in damages for any loss suffered by the purchaser.

5. Aside from the question of excess issue these parties are not held to certify as to the validity of the security unless they specifically undertake to do so. The case law which has recognized a unique responsibility on the transfer agent's part to testify as to the validity of any security which it countersigns is rejected. See Fifth Ave. Bank v. Forty-Second Street & Grand Street Ferry R. Co., 137 N.Y. 231, 240, 33 N.E. 378, 380, 19 L.R.A. 331, 33 Am.St.Rep. 712 (1893).

6. This provision does not prevent a transfer agent or issuer agreeing with a registrar of stock to protect the registrar in respect of the genuineness and proper form of a security signed by the issuer or the transfer agent or both. Nor does it interfere with proper indemnity arrangements between the issuer and trustees, transfer agents, registrars and the like.

Cross Reference:

Point 1: § 8-102.

Definitional Cross References:

"Agreed". § 1-201.
"Genuine". § 1-201.
"Issuer". § 8-201.
"Notice". § 1-201.
"Person". § 1-201.
"Proper form". § 8-102.
"Purchaser". § 1-201.
"Security". § 8-102.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

PART 3

PURCHASE

§ 8-301. Rights Acquired by Purchaser; "Adverse Claim"; Title Acquired by Bona Fide Purchaser. (1) Upon delivery of a security the purchaser acquires the rights in the security which his transferor had or had actual authority to convey except that a purchaser who has himself been a party to any fraud or illegality affecting the security or who as a prior holder had notice of an adverse claim cannot improve his position by taking from a later bona fide purchaser. "Adverse claim" includes a claim that a transfer was or would be wrongful or that a particular adverse person is the owner of or has an interest in the security.

(2) A bona fide purchaser in addition to acquiring the rights of a purchaser also acquires the security free of any adverse claim.

(3) A purchaser of a limited interest acquires rights only to the extent of the interest purchased.

COMMENT: Prior Uniform Statutory Provision: §§ 52, 57, 58 and 59, Uniform Negotiable Instruments Law; § 7, Uniform Stock Transfer Act.

Changes: Rephrased; policy made uniform for all investment securities.

Purposes of Changes: 1. This Article views the concept of negotiability from two aspects: issuer's defenses and adverse claims. Any purchaser for value of a security without notice of a particular defect may take free of the issuer's defense based on that defect, but only a purchaser taking by a formally perfect transfer, for value and without notice of any adverse claim, may take free of adverse claims. The "bona fide purchaser" here dealt with is the person taking free of adverse claims. His rights against the issuer are determined by Part 2 of this Article and his rights to registration are determined by Part 4.

2. Protection is extended to bona fide purchasers of all investment securities, whether such securities were considered negotiable or non-negotiable under the

prior law. This is the result sought by many cases which have resolved doubts in favor of negotiability despite terms in bonds which militated against their negotiability under the provisions of the Negotiable Instruments Law. See Paxton v. Miller, 102 Ind.App. 511, 200 N.E. 87 (1936); Scott v. Platt, 171 Or. 379, 135 P.2d 769 (1943). Such cases as U. S. Gypsum v. Faroll, 296 Ill.App. 47, 15 N.E.2d 888 (1938), protecting bona fide purchasers of stock certificates under the provisions of the Stock Transfer Act are adopted and approved.

3. Subsection (1) states the so-called shelter provision of the Negotiable Instruments Law as well as the exception to it in the case of a person participating in the fraud or illegality. These provisions are applicable throughout this Article and any reference to the rights of purchasers must be read as including the shelter provision and its exception. See Gruntal v. U. S. Fidelity & Guaranty Co., 254 N.Y. 468, 173 N.E. 682 (1930).

4. An adverse claim may be either legal or equitable, e. g., that the claimant is the beneficial owner of a security, though not the legal owner of it, or that it has been or is proposed to be transferred in breach of trust or a valid restriction on transfer (See § 8-204 and Comment).

Cross References:

Point 1: Parts 2 and 4 of this Article.
Point 4: § 8-204 and Comment.

Definitional Cross References:

"Bona fide purchaser". § 8-302.
"Delivery". § 1-201.
"Holder". § 1-201.
"Notice". § 1-201.
"Party". § 1-201.
"Person". § 1-201.
"Purchase". § 1-201.
"Purchaser". § 1-201.
"Rights". § 1-201.
"Security". § 8-102.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-404, 6-409, 6-410, 6-411, 13.1-407.

Comment: The holding in Stuart Court Realty Corp. v. Gillespie, 150 Va. 515, 526, 143 S.E. 741, 59 A.L.R. 334 (1928), that the holder of a corporate bearer coupon bond can sue in his own name is implicit in the UCC. Similarly, the UCC is in accord with Supervisors of Cumberland County v. Randolph, 89 Va. 614, 619, 16 S.E. 722 (1893), holding that the holder of such an instrument is presumed a bona fide holder for value before maturity, unless fraud or illegality in the inception of the paper is shown.

§ 8-302. "Bona Fide Purchaser." A "bona fide purchaser" is a purchaser for value in good faith and without notice of any adverse claim who takes delivery of a security in bearer form or of one in registered form issued to him or indorsed to him or in blank.

COMMENT: Prior Uniform Statutory Provision: § 52, Negotiable Instruments Law.

Purposes: To define the bona fide purchaser who has the rights stated in the preceding section. Note that there may be claims of ownership which are not "adverse", e.g., the claim of a principal against his agent including that of a customer against his broker (§ 8-303). The agent's knowledge of his principal's claim thus annot defeat the agent's right to be a bona fide purchaser under this section.

Definitional Cross References:

"Adverse claim". § 8-301.
"Bearer form". § 8-102.
"Delivery". § 1-201.
"Good faith". § 1-201.
"Indorsed". § 8-308.
"Notice". § 1-201.

"Purchaser". § 1-201.
"Registered form". § 8-102.
"Security". § 8-102.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-404.

§ 8-303. "Broker." "Broker" means a person engaged for all or part of his time in the business of buying and selling securities, who in the transaction concerned acts for, or buys a security from or sells a security to a customer. Nothing in this Article determines the capacity in which a person acts for purposes of any other statute or rule to which such person is subject.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purpose: To define "broker" for purposes of this Article in terms of function in the particular transaction. The term is applicable to the person performing the function. The differentiation under the Securities Exchange Act of 1934 between "broker" and "dealer" is of no significance under this Article. This and similar distinctions are preserved for other purposes by the last sentence of the section.

Definitional Cross Reference:

"Security". § 8-102.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 8-304. **Notice to Purchaser of Adverse Claims.** (1) A purchaser (including a broker for the seller or buyer but excluding an intermediary bank) of a security is charged with notice of adverse claims if

(a) the security whether in bearer or registered form has been indorsed "for collection" or "for surrender" or for some other purpose not involving transfer; or

(b) the security is in bearer form and has on it an unambiguous statement that it is the property of a person other than the transferor. The mere writing of a name on a security is not such a statement.

(2) The fact that the purchaser (including a broker for the seller or buyer) has notice that the security is held for a third person or is registered in the name of or indorsed by a fiduciary does not create a duty of inquiry into the rightfulness of the transfer or constitute notice of adverse claims. If, however, the purchaser (excluding an intermediary bank) has knowledge that the proceeds are being used or that the transaction is for the individual benefit of the fiduciary or otherwise in breach of duty, the purchaser is charged with notice of adverse claims.

COMMENT: **Prior Uniform Statutory Provision:** §§ 37, 56, Uniform Negotiable Instruments Law.

Changes: Statement of certain special circumstances in which a purchaser other than an intermediary bank (§ 4-105) is charged as a matter of law with notice of adverse claims.

Purposes of Changes: 1. § 8-302 defines "bona fide purchaser" in terms of three distinct elements, "value", "good faith", and lack of "notice of any adverse claim". This section deals only with notice and presents three specific situations in which a purchaser is charged with notice of adverse claims as a matter of law. The listing is not exhaustive and does not exclude other situations in which the trier of the facts may determine that similar notice has been given. For example, receipt of notification that the particular security has been lost or stolen raises the question of notice "forgotten" in good faith. Kentucky Rock Asphalt v.

Mazza's Admr., 264 Ky. 158, 94 S.W.2d 316 (1936); Graham v. White-Phillips Co., 296 U.S. 27, 56 S.Ct. 21, 80 L.Ed. 20, 102 A.L.R. 24 (1935) but cf., First National Bank of Oedessa v. Fazzari, 10 N.Y.2d 394, 179 N.E.2d 493 (1961). Also suspicious characteristics of the transaction may give a purchaser (particularly a commercially sophisticated purchaser such as a broker) "reason to know". U. S. F. & G. Co. v. Goetz, 285 N.Y. 74, 32 N.E.2d 798 (1941), Morris v. Muir, 111 Misc. 739, 180 N.Y.S. 913 (1920).

2. Subsection (1)(a) refers to situations where a security indorsed "for collection" or "for surrender" is being offered for transfer and follows in effect § 37 of the Negotiable Instruments Law, which provides that subsequent indorsees acquire only the title of the first indorsee under a restrictive indorsement.

3. In subsection (2) some situations involving purchase from one described or identifiable as a fiduciary are explicitly provided for, again imposing an objective standard, while leaving the door open to other circumstances which may constitute notice of adverse claims. Mere notice of the existence of the fiduciary relation is not enough in itself to prevent bona fide purchase, and the purchaser is free to take the security on the assumption that the fiduciary is acting properly. The fact that the security may be transferred to the individual account of the fiduciary or that the proceeds of the transaction are paid into that account in cash would not be sufficient to charge the purchaser with notice of potential breach of fiduciary obligation but as in State Bank of Binghamton v. Bache, 162 Misc. 128, 293 N.Y.S. 667 (1937) knowledge that the proceeds are being applied to the personal indebtedness of the fiduciary will charge the purchaser with such notice.

4. The notice here involved is to purchasers. A broker acting as such (§ 8-303) is treated in this section as a purchaser though he may not be a purchaser under the definitions of that term (§ 1-201 (33)). On the other hand, a bank, stockbroker or other intermediary who, in the particular transaction acts purely in that capacity, is not a purchaser. Cf. subsections (3) and (4) of § 8-306 and Comments 3 and 4 to that Section. The notice to the issuer is covered by Part 4 of this Article. Subsection (2) follows the policy of § 4 of the Uniform Fiduciaries Act and of § 3-304(2) with respect to commercial paper. Compare § 7(a) of the Uniform Act for Simplification of Fiduciary Security Transfers.

The fact that the broker is expressly mentioned in this section carries no negative implication in other sections where merely the word "purchaser" is used. An issuer is not a purchaser. His duty of inquiry is limited and spelled out in Part 4.

Cross References:

Point 4: Part 4 of this Article.
See §§ 8-104, 8-302, 8-305 and 8-308.

Definitional Cross References:

"Adverse claim". § 8-301.
"Bearer form". § 8-102.
"Broker". § 8-303.
"Intermediary bank". § 4-105.
"Notice". § 1-201.
"Notification". § 1-201.
"Person". § 1-201.
"Purchase". § 1-201.
"Purchaser". § 1-201.
"Registered form". § 8-102.
"Security". § 8-102.
"Writing". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-389, 6-408.

§ 8-305. Staleness as Notice of Adverse Claims. An act or event which creates a right to immediate performance of the principal obligation evidenced by the security or which sets a date on or after which the security is to be presented or surrendered for redemption or exchange does not of itself constitute any notice of adverse claims except in the case of a purchase.

(a) after one year from any date set for such presentment or surrender for redemption or exchange; or

(b) after six months from any date set for payment of money against presentation or surrender of the security if funds are available for payment on that date.

COMMENT: Prior Uniform Statutory Provision: §§ 52(2), 53, Uniform Negotiable Instruments Law.

Changes: Under given circumstances there may now be a bona fide purchaser of a matured instrument.

Purposes of Changes: 1. In the case of adverse claims the fact of "staleness" is viewed as notice of certain defects after the lapse of stated periods but the maturity of the security does not operate automatically to affect holders' rights. The periods of time here stated are shorter than those appearing in the provisions of this Article on staleness as notice of defects or defenses (§ 8-203) since a purchaser who takes a security after funds or other securities are available for its redemption has more reason to suspect claims of ownership than issuer's defenses. An owner will normally turn in his security rather than transfer it at such a time.

Of itself, a default never constitutes notice of a possible adverse claim. To provide otherwise would not tend to drive defaulted securities home and would serve only to disrupt current financial markets where many defaulted securities are actively traded.

2. The owner is provided with a means of protecting himself while his security is being sent in for redemption or exchange. He may endorse it "for collection" or for "surrender," and this constitutes notice of his claims (§ 8-304). The present section does not come into operation unless the time period here stated has elapsed.

3. Unpaid or overdue coupons attached to a bond do not bring it within the operation of this section, although under some circumstances they may give the purchaser "reason to know" of claims of ownership. Georgia Granite R. Co. v. Miller, 144 Ga. 665, 87 S.E. 897 (1916).

Cross References:

Point 1: § 8-203.
Point 2: § 8-304.
See § 8-103.

Definitional Cross References:

"Adverse claim". § 8-301.
"Money". § 1-201.
"Notice". § 1-201.
"Purchase". § 1-201.
"Right". § 1-201.
"Security". § 8-102.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-404(2), 6-405.

§ 8-306. Warranties on Presentment and Transfer. (1) A person who presents a security for registration of transfer or for payment or exchange warrants to the issuer that he is entitled to the registration, payment or exchange. But a purchaser for value without notice of adverse claims who receives a new, reissued or re-registered security on registration of transfer warrants only that he has no knowledge of any unauthorized signature (§ 8-311) in a necessary indorsement.

(2) A person by transferring a security to a purchaser for value warrants only that

(a) his transfer is effective and rightful; and

(b) the security is genuine and has not been materially altered; and

(c) he knows no fact which might impair the validity of the security.

(3) Where a security is delivered by an intermediary known to be entrusted with delivery of the security on behalf of another or with collection of a draft or other claim against such delivery, the intermediary by such delivery warrants only his own good faith and authority even though he has purchased or made advances against the claim to be collected against the delivery.

(4) A pledgee or other holder for security who redelivers the security received, or after payment and on order of the debtor delivers that security to a third person makes only the warranties of an intermediary under subsection (3).

(5) A broker gives to his customer and to the issuer and a purchaser the warranties provided in this section and has the rights and privileges of a purchaser under this section. The warranties of and in favor of the broker acting as an agent are in addition to applicable warranties given by and in favor of his customer.

COMMENT: Prior Uniform Statutory Provision: §§ 65, 66, 67, 69, Uniform Negotiable Instruments Law; §§ 11, 12, Uniform Stock Transfer Act.

Changes: Rephrased, and warranties extended under appropriate circumstances to the issuer.

Purposes of Changes: 1. The warranties here stated have been recognized by the prevailing case law as well as by the prior Acts cited. See Boston Towboat Co. v. Medford Nat. Bank, 232 Mass. 38, 121 N.E. 491 (1919); Burtch v. Child, Hulswit & Co., 207 Mich. 205, 174 N.W. 170 (1919). Usual estoppel principles apply where the purchaser has knowledge of the defect and these warranties will not be effective in such a case. In addition, under § 1-102(3) these provisions apply only "unless otherwise agreed" and the parties are free to enter into any express agreement they desire where both are aware of possible defects.

2. The second sentence of subsection (1) limits the warranties made by the presenter of a security who is a purchaser for value without notice of adverse claims and who receives a new, re-issued or re-registered security, in accordance with the basic change in the law made by this Act, protecting such a person against a claim based on the forgery of an indorsement. (§ 8-311 and Comment, § 8-405).

3. Subsections (3) and (4) are designed to eliminate all substantive warranties in the case of deliveries by intermediaries and pledgees. Such parties deal primarily with the draft or other claim and, having no access to direct knowledge about the security, they cannot be held to warrant its genuineness or validity.

Further, following Appenzellar v. McCall, 150 Misc. 897, 270 N.Y.S. 748 (1934), although the so-called "stock-broker" normally functions as a broker (see definition of "broker", § 8-303) and on a few occasions another institution such as a bank may function as a broker, e. g. for a standard broker's commission or similar compensation, nevertheless both the so-called "stock-broker" and the bank can qualify for the protection given by subsections (3) and (4) to an "intermediary" where in the particular transaction it does not function as a broker, e. g. delivering securities on a customer's instructions, either without charge or for a nominal handling charge.

4. In those cases where the so-called "stock-broker" or another person genuinely acts as such (§ 8-303) the warranties, rights and privileges of the broker are spelled out in subsection (5).

Cross References:

See §§ 1-102(3), 8-103, 8-301, 8-311 and 8-405.

Definitional Cross References:

"Broker". § 8-303.
"Delivery". § 1-201.
"Genuine". § 1-201.
"Good faith". § 1-201.
"Person". § 1-201.

"Purchase". § 1-201.
"Purchaser". § 1-201.
"Security". § 8-102.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-417, 6-418, 6-419, 6-421, 13.1-411, 13.1-412.

§ 8-307. Effect of Delivery Without Indorsement; Right to Compel Indorsement. Where a security in registered form has been delivered to a purchaser without a necessary indorsement he may become a bona fide purchaser only as of the time the indorsement is supplied, but against the transferor the transfer is complete upon delivery and the purchaser has a specifically enforceable right to have any necessary indorsement supplied.

COMMENT: **Prior Uniform Statutory Provision:** § 49, Uniform Negotiable Instruments Law; § 9, Uniform Stock Transfer Act.

Changes: Stock Transfer Act rule altered; as between the parties transfer now complete upon delivery of security.

Purposes of Changes: 1. As between the parties the transfer is made complete upon delivery, but the transferee cannot become a bona fide purchaser of the security until indorsement is made. The indorsement does not operate retroactively and such notice may intervene between delivery and indorsement as will prevent the transferee from becoming a bona fide purchaser. This Article rejects such cases as Bethea v. Floyd, 177 S.C. 521, 181 S.E. 721 (1935), certiorari denied 296 U.S. 622, 56 S.Ct. 143, 80 L.Ed. 442, holding that the indorsement of a note delivered prior to maturity but indorsed thereafter took effect as of the date of delivery to permit the purchaser to become a holder in due course. Although a purchaser taking without a necessary indorsement may be subject to claims of ownership, any issuer's defense of which he had no notice at the time of delivery will be cut off since the provisions of this Article protect all purchasers for value without notice (§ 8-202).

2. The transferee's right to compel an indorsement where a security has been delivered with intent to transfer is recognized in the case law and the Article of this Act on Documents of Title. See Coates v. Guaranty Bank & Trust Co., 170 La. 871, 129 So. 513 (1930), and § 7-506 of this Act.

3. A proper indorsement is one of the requisites of transfer which a purchaser has a right to obtain (§ 8-316). A purchaser may not only compel an indorsement under that section but may also recover for any reasonable expense incurred by the transferor's failure to respond to the demand for an indorsement.

Cross References:

Point 1: § 8-202.
Point 2: § 7-506.
Point 3: § 8-316.
See §§ 8-302, 8-308 and 8-309.

Definitional Cross References:

"Bona fide purchaser". § 8-302.
"Delivery". § 1-201.
"Purchaser". § 1-201.
"Registered form". § 8-102.
"Right". § 1-201.
"Security". § 8-102.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-401, 13.1-409.

Comment: The UCC does not explicitly deal with the situation presented in J. G. Wilson Corp. v. Cahill, 152 Va. 108, 146 S.E. 274 (1929). In this case a stockholder, who was indebted to the corporation, transferred certificates of stock without a necessary indorsement, and later died. The corporation endeavored to set-off the stockholder's indebtness to the corporation against dividends which had been declared. Deciding the case under the common law, the Supreme Court

of Appeals held that the set-off was not available to the corporation, the transferee of the certificates being entitled to the dividends. Even if a right of set-off is considered a defense, under UCC 8-202(4), a purchaser for value without notice of the facts takes free of the issuer's defenses. A bona fide purchaser, as distinguished from a purchaser for value, under the UCC takes free of adverse claims.

§ 8-308. Indorsement, How Made; Special Indorsement; Indorser Not a Guarantor; Partial Assignment. (1) An indorsement of a security in registered form is made when an appropriate person signs on it or on a separate document an assignment or transfer of the security or a power to assign or transfer it or when the signature of such person is written without more upon the back of the security.

(2) An indorsement may be in blank or special. An indorsement in blank includes an indorsement to bearer. A special indorsement specifies the person to whom the security is to be transferred, or who has power to transfer it. A holder may convert a blank indorsement into a special indorsement.

(3) "An appropriate person" in subsection (1) means

(a) the person specified by the security or by special indorsement to be entitled to the security; or

(b) where the person so specified is described as a fiduciary but is no longer serving in the described capacity,—either that person or his successor; or

(c) where the security or indorsement so specifies more than one person as fiduciaries and one or more are no longer serving in the described capacity,—the remaining fiduciary or fiduciaries, whether or not a successor has been appointed or qualified; or

(d) where the person so specified is an individual and is without capacity to act by virtue of death, incompetence, infancy or otherwise,—his executor, administrator, guardian or like fiduciary; or

(e) where the security or indorsement so specifies more than one person as tenants by the entirety or with right of survivorship and by reason of death all cannot sign,—the survivor or survivors; or

(f) a person having power to sign under applicable law or controlling instrument; or

(g) to the extent that any of the foregoing persons may act through an agent,—his authorized agent.

(4) Unless otherwise agreed the indorser by his indorsement assumes no obligation that the security will be honored by the issuer.

(5) An indorsement purporting to be only of part of a security representing units intended by the issuer to be separately transferable is effective to the extent of the indorsement.

(6) Whether the person signing is appropriate is determined as of the date of signing and an indorsement by such a person does not become unauthorized for the purposes of this Article by virtue of any subsequent change of circumstances.

(7) Failure of a fiduciary to comply with a controlling instrument or with the law of the state having jurisdiction of the fiduciary relationship, including any law requiring the fiduciary to obtain court approval of the transfer, does not render his indorsement unauthorized for the purposes of this Article.

COMMENT: Prior Uniform Statutory Provision: §§ 31 through 37, 64 through 69, Uniform Negotiable Instruments Law; § 20, Uniform Stock Transfer Act.

Changes: Rephrased and expanded; liability of indorser for issuer's obligations negated.

Purposes of Changes: 1. The simplified method of indorsement of securities set forth in the Uniform Stock Transfer Act is here continued. The indorser of a security is relieved from liability insofar as honor of the instrument by the issuer is concerned. In view of the nature of investment securities and the circumstances under which they are normally transferred an indorser cannot be held to warrant as to the issuer's actions. As a transferor he, of course, remains liable for breach of the warranties set forth in this Article (§ 8-306).

2. Although more than one special indorsement on a given security is here made possible the desire for dividends or interest, as the case may be, should operate to bring the security home for registration of transfer within a reasonable period of time. The usual form of assignment which appears on the back of a stock certificate or in a separate "power" may be filled up either in the form of an assignment, a power of attorney to transfer, or both. If it is not filled up at all but merely signed, the indorsement is in blank; if filled up either as an assignment or as a power of attorney to transfer, the indorsement is special.

3. As under the Uniform Stock Transfer Act, indorsement is one of two distinct steps necessary to a transfer, the other step being delivery of the security (§§ 8-301, 8-302, 8-309). Therefore, subsection (6) of this section makes the indorsement speak as of the date of signing. § 8-312 on guaranty of signature and § 8-402 on assurance that indorsements are effective apply the same reasoning. Thus, the signatures on a security indorsed by A during his lifetime or on behalf of X corporation by Y as president during his incumbency do not become "unauthorized" (§ 8-311) because A dies or Y is replaced as president by Z. Authority to deliver and thus to complete the transfer is not covered by this section. Subsection (7) supplements § 8-403(3)(b) by making it clear that certain matters go to rightfulness of the transfer rather than to the validity of the indorsement. An example is the failure of a duly appointed guardian to obtain a required court approval of the transfer. Such a guardian is an "appropriate person" under subsection (3)(d) of this section, and his indorsement may be effective even though, e. g., a required court order is not obtained.

4. Subsection (3) defines, in paragraphs (b) through (g), the various types of situations in which the signatures of persons other than the registered owner or special indorsee will be appropriate. The paragraphs are not mutually exclusive; for example, the same security may be effectively indorsed either by the registered owner under (a) or by his agent under (g). Paragraph (b) is made explicitly alternative to make it clear that there is no conflict with subsection (3)(a) of § 8-403, permitting the issuer to rely on the continued power of a fiduciary to act where he is the registered owner and the issuer has not received written notice to the contrary. Similar protection is given to other persons dealing with the security. See also the Comment to § 8-404.

Paragraphs (f) and (g) in particular are comprehensive. For example, where a "small estate statute" permits a widow to transfer a decedent's securities without administration proceedings, she would be "a person having power to sign under applicable law". Similarly, in the usual partnership case, the signature of a partner would be that of "a person having power to sign under . . . [a] . . . controlling instrument".

Indorsement by "an appropriate person" is included in the scope of the guarantee of signature (§ 8-312). It is prerequisite to the issuer's duty to register a transfer (§ 8-401) and to his exoneration from liability for improper registration (§ 8-404).

5. Subsection (5) recognizes, in contradistinction to the rule under the Uniform Negotiable Instruments Law, the validity of a "partial" indorsement of a security, e. g., as to fifty shares of the one hundred represented by a single certificate. The rights of a transferee under a partial indorsement to the status of a bona fide purchaser are left to the case law.

Cross References:

Point 1: § 8-306.
Point 3: §§ 8-301, 8-302, 8-307, 8-309 and 8-312.
Point 4: § 8-312 and Part 4 of this Article.

Definitional Cross References:

"Bearer". § 1-201.
"Delivery". § 1-201.
"Holder". § 1-201.
"Honor". § 1-201.
"Issuer". § 8-201.
"Person". § 1-201.
"Registered form". § 8-102.
"Security". § 8-102.
"Sign". § 1-201.
"Written". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-383 through 6-389, 6-416 through 6-421; 13.1-420.

§ 8-309. **Effect of Indorsement Without Delivery.** An indorsement of a security whether special or in blank does not constitute a transfer until delivery of the security on which it appears or if the indorsement is on a separate document until delivery of both the document and the security.

COMMENT: **Prior Uniform Statutory Provision:** § 30, Uniform Negotiable Instruments Law; §§ 1, 10, Uniform Stock Transfer Act.

Changes: Rephrased; provisions of Stock Transfer Act as to effect of attempted transfer without delivery omitted.

Purposes of Changes: 1. There must be a voluntary parting with control in order to effect a valid transfer of an investment security as between the parties. Levey v. Nason, 279 Mass. 268, 181 N.E. 193 (1932), and National Surety Co. v. Indemnity Insurance Co. of North America, 237 App.Div. 485, 261 N.Y.S. 605 (1933).

2. The provision in § 10 of the Uniform Stock Transfer Act that an attempted transfer without delivery amounts to a promise to transfer is here omitted. Even under the prior Act the effect of such a promise was left to the applicable law of contracts and this Article by making no reference to such situations intends to achieve a similar result. There is no counterpart in the case of delivery to § 8-307 on right to compel indorsement, such as is envisaged in Johnson v. Johnson, 300 Mass. 24, 13 N.E.2d 788 (1938), where the transferee under a written assignment was given the right to compel a transfer of the certificate.

Cross References:

Point 2: § 8-307.
See §§ 8-202(4) and 8-313.

Definitional Cross References:

"Delivery". § 1-201.
"Security". § 8-102.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-382; 13.1-401, 13.1-410.

§ 8-310. **Indorsement of Security in Bearer Form.** An indorsement of a security in bearer form may give notice of adverse claims (§ 8-304) but does not otherwise affect any right to registration the holder may possess.

COMMENT: **Prior Uniform Statutory Provision:** § 40, Uniform Negotiable Instruments Law.

Changes: Qualification of special indorser's liability omitted.

Purposes of Changes: 1. The concept of indorsement applies only to registered securities and a purported indorsement of bearer paper is normally of no effect. An indorsement "for collection," "for surrender" or the like, charges a purchaser with notice of adverse claims (§ 8-304(1)(a)) but does not operate beyond this to interfere with any right the holder may otherwise possess to have the security registered in his name.

2. The provisions of § 40 of the Negotiable Instruments Law as to the liability of special indorsers of bearer instruments have no applicability here since this Article negates the liability of indorsers as such (§ 8-308).

Cross References:

See §§ 8-304 and 8-308.

Definitional Cross References:

"Bearer form". § 1-201.
"Holder". § 1-201.
"Notice". § 1-201.
"Right". § 1-201.
"Security". § 8-102.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-392.

§ 8-311. Effect of Unauthorized Indorsement. Unless the owner has ratified an unauthorized indorsement or is otherwise precluded from asserting its ineffectiveness

(a) he may assert its ineffectiveness against the issuer or any purchaser other than a purchaser for value and without notice of adverse claims who has in good faith received a new, reissued or re-registered security on registration of transfer; and

(b) an issuer who registers the transfer of a security upon the unauthorized indorsement is subject to liability for improper registration (§ 8-404).

COMMENT: Prior Uniform Statutory Provision: § 23, Uniform Negotiable Instruments Law.

Changes: Modification of rule as to the ineffectiveness of forged signatures where a bona fide purchaser has received a new, reissued or re-registered security on registration of transfer.

Purposes of Changes: 1. Since the bulk of present day security purchases is made through brokers, the purchaser who normally receives and sees only a certificate registered in his own name cannot realistically be held to have notice or to have relied upon a forged or unauthorized indorsement on the original security transferred. A bona fide purchaser holding a new, re-issued or re-registered certificate is therefore protected. Compare Telegraph Co. v. Davenport, 97 U.S. 369, 24 L.Ed. 1047 (1878). That line of cases which has refused to apply this rule where the new security is still in the hands of the party to whom it was issued is expressly rejected. See Weniger v. Success Mining Co., 227 F. 548 (C.C.A.Utah 1915); Hambleton v. Central Ohio R. R. Co., 44 Md. 551 (1876).

2. The original owner of a security which has been transferred on the basis of a forged indorsement is protected by the issuer's liability for wrongful registration of transfer (§ 8-404). The issuer's duty to issue a similar security to the owner unless an overissue would result is made explicit in Part 4 of this Article as in his obligation to purchase available securities on the open market for delivery to the owner where such overissue is involved (see § 8-104). Compare Prince v. Childs Co., 23 F.2d 605 (1928); West v. Tintic Standard Mining Co., 71 Utah 158, 263 P. 490, 56 A.L.R. 1190 (1928). The issuer's recourse is against the forger and the guarantor of the latter's signature, if any, but where the issuer has a right to require a guarantee of signature, a bona fide purchaser of the forged security presenting the security to the issuer should not be held liable on any implied warranty of title theory unless he knew of the forgery (§ 8-306).

3. A bond which has been registered as to principal and subsequently returned to bearer form is, at that point, a "new security" within the meaning of this section.

Cross References:

Point 2: §§ 8-104, 8-306(1), 8-312, and Part 4 of this Article.

Definitional Cross References:

"Good faith". § 1-201.
"Issuer". § 8-201.
"Notice". § 1-201.
"Purchaser". § 1-201.
"Security". § 8-102.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-375.

§ 8-312. **Effect of Guaranteeing Signature or Indorsement.** (1) Any person guaranteeing a signature of an indorser of a security warrants that at the time of signing

(a) the signature was genuine; and

(b) the signer was an appropriate person to indorse (§ 8-308); and

(c) the signer had legal capacity to sign.

But the guarantor does not otherwise warrant the rightfulness of the particular transfer.

(2) Any person may guarantee an indorsement of a security and by so doing warrants not only the signature (subsection 1) but also the rightfulness of the particular transfer in all respects. But no issuer may require a guarantee of indorsement as a condition to registration of transfer.

(3) The foregoing warranties are made to any person taking or dealing with the security in reliance on the guarantee and the guarantor is liable to such person for any loss resulting from breach of the warranties.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. The commonly accepted liability of the signature guarantor, which includes a warranty of the authority of the signer to sign for the holder as well as of the capacity of the signer to sign, is here made express so that issuers and their agents may have a clear understanding of the extent to which they may rely upon such guarantees. See The Jennie Clarkson Home for Children v. Missouri, K. & T. R. Co., 182 N.Y. 47, 74 N.E. 571, 70 A.L.R. 787 (1905); New York Stock Exchange Rules for Delivery, Rule 198; New York Curb Exchange Rule S.R.-50; Rules 43 and 155 of the New York Stock Transfer Association.

2. Consistently with the coordinate provisions of §§ 8-308, 8-401 and 8-404, this section recites the warranty of the guarantor that the signature is that of a person who "at the time of signing" was "an appropriate person" to indorse. The postamble to subsection (1) specifically negates a warranty as to the rightfulness of a transfer as such. Thus the signature guarantor does not warrant that the delivery was rightful or authorized. See the Comment to § 8-308.

3. An "indorsement guarantee", covering also the rightfulness of the proposed transfer, is now made available to those parties who wish to use it. In connection with any request to register a transfer, an issuer may properly require a guarantee of signature by a responsible guarantor (§ 8-402). He may not require a guarantee of indorsement, but the voluntary furnishing of such a guarantee and its acceptance by the issuer may save the time and expense of an inquiry into possible adverse claims (cf. § 8-403).

4. Subsection (3) is expressly designed to encourage issuers and their agents to rely upon signature guarantees and to avoid needless waste of time and duplication of effort in ascertaining the facts so guaranteed.

Cross Reference:

Point 1: § 8-308.
See Part 4 of this Article.

Definitional Cross References:

"Appropriate person". § 8-308.
"Holder". § 1-201.
"Issuer". § 8-201.
"Person". § 1-201.
"Security". § 8-102.
"Sign". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 8-313. When Delivery to the Purchaser Occurs; Purchaser's Broker as Holder. (1) Delivery to a purchaser occurs when

(a) he or a person designated by him acquires possession of a security; or

(b) his broker acquires possession of a security specially indorsed to or issued in the name of the purchaser; or

(c) his broker sends him confirmation of the purchase and also by book entry or otherwise identifies a specific security in the broker's possession as belonging to the purchaser; or

(d) with respect to an identified security to be delivered while still in the possession of a third person when that person acknowledges that he holds for the purchaser; or

(e) appropriate entries on the books of a clearing corporation are made under § 8-320.

(2) The purchaser is the owner of a security held for him by his broker, but is not the holder except as specified in subsections (b), (c) and (e) of subsection (1). Where a security is part of a fungible bulk, the purchaser is the owner of a proportionate property interest in the fungible bulk and is a bona fide purchaser if when the broker takes delivery as a holder neither he nor the purchaser has notice of any adverse claim and the purchaser takes his interest for value.

(3) Notice of an adverse claim to the broker or to the purchaser after the broker takes delivery as a holder without notice of any adverse claim is not notice of the adverse claim to either the broker or the purchaser.

(VALC Note: Subsections (2) and (3) of § 8-313 are contained in the Official Text as follow:

(2) The purchaser is the owner of a security held for him by his broker, but is not the holder except as specified in subparagraphs (b), (c) and (e) of subsection (1). Where a security is part of a fungible bulk the purchaser is the owner of a proportionate property interest in the fungible bulk.

(3) Notice of an adverse claim received by the broker or by the purchaser after the broker takes delivery as a holder for value is not effective either as to the broker or as to the purchaser. However, as between the broker and the purchaser the purchaser may demand delivery of an equivalent security as to which no notice of an adverse claim has been received.)

COMMENT: Prior Uniform Statutory Provision: § 191, Uniform Negotiable Instruments Law; § 22, Uniform Stock Transfer Act.

Changes: General modification of prior delivery rules in cases involving brokers.

Purposes of Changes: 1. Subsection 1(a) states the concept of the prior Acts which contemplated an actual transfer of possession of the original instrument as the essential element of delivery. That concept is here broadened to conform to modern conditions under which the bulk of securities transactions are handled by brokers and on organized markets. Subsections (b), (c) and (d) apply in the

relationship of the buying broker to his customer. That relationship is unique, partaking of various aspects of an agency, bailment, trust and pledge. In re Rosenbaum Grain Corp., 103 F.2d 656 (1939); In re Ellis' Estate, 24 Del.Ch. 393, 6 A.2d 602 (1939); Parsons v. Third National Co., 230 Mo.App. 1114, 94 S.W.2d 1057 (1936). The final effect of this relationship and the rights and liabilities of the parties are here stated in terms of the actual practice and understanding in financial circles. Thus, delivery may be completed while the security is still in the hands of the broker. When the factual situations described in subsections (1) (b), (c) and (d) occur delivery to the purchaser is complete, and no intervening notice of adverse claims before he takes actual physical possession of the security can divest him of his rights.

2. The provisions of subsection (1) (d) as to delivery by acknowledgment are directed primarily toward margin trading, where the securities are pledged by the broker to secure funds for the remainder of the purchase price not advanced by the customer, but, of course, apply also to any other situation where the security is in the possession of a third party.

3. A single completed sale of a security may involve a transfer of several different instruments, that is, from seller to selling broker, from selling broker to buying broker, from buying broker to purchaser; and a security delivered to a broker in response to a customer's order to buy will not in the normal instance be the same security later delivered by him to the customer. Therefore, despite any bookkeeping entries made by him, the broker is regarded as the holder of any securities which are not specifically identified as belonging to a particular customer.

Subsection (2) recognizes the difference between the status of "holder" which is important for various purposes under Article 8 (subsection (20) of § 1-201; subsection (2) of § 8-301; § 8-302) and that of "owner". The affirmative statement that a purchaser is the "owner" of a security held for him by his broker or constituting part of a fungible bulk provides protection to the customer in the event of the broker's insolvency, to the extent such protection may be provided by State law. See In re Mills, 125 App.Div. 730, 110 N.Y.Supp. 314 (1st Dept. 1908).

Subsection (3) provides protection to both broker and customer where notice of an adverse claim is received after the broker takes delivery as a holder for value, but also states the principle that as between the broker and his customer, the latter is entitled to delivery of a "clean" security, i.e., one which is genuine and free of any notice of adverse claim. Isham v. Post, 141 N.Y. 100, 35 N.E. 1084, 23 L.R.A., 90 (1894), which permitted a broker acting as agent to deliver to his customer a security as to which a claim of forgery was made after its receipt by the broker, is rejected. The broker is in the business of handling securities. He is better equipped to clear up any questions of genuineness or adverse claim, and even though acting in whole or in part as agent for his customer is not permitted to pass such problems on to his customer. However if the problem arises because of the customer's own act or omission to act he is estopped to rely on it as a basis for rejecting delivery. § 1-103.

4. The fact that the broker is viewed as a holder and therefore a person who himself can be viewed as a bona fide purchaser of a security is intended to repeal by implication the cases holding the broker liable for "innocent" conversion where no forgery of a necessary indorsement is involved or may be asserted under the provisions of this Article dealing with the effect of forged indorsement. (§ 8-311). He is viewed as standing on an independent bona fide purchaser basis.

5. Subsection (1) (e) has reference to the prevalent practice of brokers (subject to their varying obligations to their customers depending on the type of account in which the securities are held (Subsection (1) of § 8-107 and Comment) to treat securities as fungible. That practice has been further emphasized by the introduction of clearing procedures on the organized markets. § 8-320 equates a transfer or pledge effected by appropriate entries on the books of a clearing corporation to "a delivery of a security in bearer form or duly indorsed in blank (§ 8-301) representing the amount of the obligation or the number of shares or rights transfered or pledged". Normally such transactions are between brokers or banks, and unless both transferor and transferee are in account with the clearing corporation, subsection (1) (e) does not apply.

Cross References:

Point 4: § 8-311.
See §§ 8-104, 8-301, 8-314 and 8-315.

Definitional Cross References:

"Delivery". § 1-201.
"Fungible". § 1-201.
"Holder". § 1-201.
"Person". § 1-201.
"Purchase". § 1-201.
"Purchaser". § 1-201.
"Security". § 8-102.
"Send". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-544, 13.1-422.

Comment: The UCC leaves unchanged the result in Putnam v. Ford, 155 Va. 625, 155 S.E. 823, 71 A.L.R. 1217 (1930), in which Virginia adopted the majority rule that a customer buying on margin becomes the owner of the stock, although the broker can hold it as a pledge, so that the customer is the owner for purposes of taxation. See also Miller & Co., v. Lyons, 113 Va. 275, 74 S.E. 194 (1912).

COUNCIL COMMENT

The provisions of these subsections as they appear in the Official Text of the UCC would impose on a broker the obligation to give his customer a "clean" equivalent security even if an adverse claim arose, or notice of such claim was received, after the broker took delivery of the security. Better protection for both the customer and the broker would appear to result from giving both bona fide purchaser status under these circumstances.

§ 8-314. Duty to Deliver, When Completed. (1) Unless otherwise agreed where a sale of a security is made on an exchange or otherwise through brokers

(a) the selling customer fulfills his duty to deliver when he places such a security in the possession of the selling broker or of a person designated by the broker or if requested causes an acknowledgment to be made to the selling broker that it is held for him; and

(b) the selling broker including a correspondent broker acting for a selling customer fulfills his duty to deliver by placing the security or a like security in the possession of the buying broker or a person designated by him or by effecting clearance of the sale in accordance with the rules of the exchange on which the transaction took place.

(2) Except as otherwise provided in this section and unless otherwise agreed, a transferor's duty to deliver a security under a contract of purchase is not fulfilled until he places the security in form to be negotiated by the purchaser in the possession of the purchaser or of a person designated by him or at the purchaser's request causes an acknowledgment to be made to the purchaser that it is held for him. Unless made on an exchange a sale to a broker purchasing for his own account is within this subsection and not within subsection (1).

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. This section, together with the section on warranties to the purchaser (§ 8-306) and the section on delivery to the purchaser (§ 8-313), states the rights and duties of the parties involved in the transfer of a security from the original transferor to the ultimate purchaser. Particular emphasis has been placed upon transactions on organized exchanges or through brokers or dealers since they account for the great bulk of security sales. Normally the sale of a security on such an exchange or through brokers involves at least three intermediate transactions, and perhaps more, depending upon the number of correspondent brokers concerned. Rarely does the same security travel through the entire transaction and the duty of each intermediate party in the chain of transfer must therefore be stated. The increased use of clearing houses is also recognized

and a selling broker is specifically permitted to make delivery by clearing the sale through such a clearing agency.

2. Under subsection (2), absent agreement or request, one delivering a security to a purchaser in a transaction not consummated on an exchange or through brokers must make physical delivery. He cannot, for example, just put the security in transit and impose the risk of loss upon the recipient. The last sentence covers the situation where one in business as a broker is, in the particular transaction, his own customer. When he buys or sells for a customer other than himself, whether as agent or as principal he is a "broker" under this Article (§ 8-303) and the transaction is within subsection (1) of this section.

Cross References:

§§ 8-303, 8-306 and 8-313.

Definitional Cross References:

"Agreed". § 1-201.
"Agreement". § 1-201.
"Broker". § 8-303.
"Contract". § 1-201.
"Delivery". § 1-201.
"Person". § 1-201.
"Purchase". § 1-201.
"Purchaser". § 1-201.
"Security". § 8-102.
"Send". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 8-315. Action Against Purchaser Based Upon Wrongful Transfer. (1) Any person against whom the transfer of a security is wrongful for any reason, including his incapacity, may against anyone except a bona fide purchaser reclaim possession of the security or obtain possession of any new security evidencing all or part of the same rights or have damages.

(2) If the transfer is wrongful because of an unauthorized indorsement, the owner may also reclaim or obtain possession of the security or new security even from a bona fide purchaser if the ineffectiveness of the purported indorsement can be asserted against him under the provisions of this Article on unauthorized indorsements (§ 8-311).

(3) The right to obtain or reclaim possession of a security may be specifically enforced and its transfer enjoined and the security impounded pending the litigation.

COMMENT: Prior Uniform Statutory Provision: § 7, Uniform Stock Transfer Act.

Changes: Rephrased; statement of rule in case of forged or unauthorized indorsements added.

Purposes of Changes and New Matter: 1. The general rule permitting an owner to reclaim possession of a security wrongfully transferred is here continued. An exception is made, as in the prior law, in favor of bona fide purchasers. Where the transfer is based upon a forged or unauthorized indorsement the exception operates in favor only of a bona fide purchaser who has received a new security upon registration of transfer. See § 8-311 and the comments thereto.

2. This section deals only with the owner's right to reclaim possession of the security and is not intended to exclude any rights he may have to damages for conversion under the case law. But see § 8-318, which protects innocent brokers and other agents and bailees from liability for conversion.

Cross References:

§§ 8-311 and 8-318.

Definitional Cross References:

"Action". § 1-201.
"Bona fide purchaser". § 8-302.
"Person". § 1-201.
"Right". § 1-201.
"Security". § 8-102.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 13.1-407.

§ 8-316. Purchaser's Right to Requisites for Registration of Transfer on Books. Unless otherwise agreed the transferor must on due demand supply his purchaser with any proof of his authority to transfer or with any other requisite which may be necessary to obtain registration of the transfer of the security but if the transfer is not for value a transferor need not do so unless the purchaser furnishes the necessary expenses. Failure to comply with a demand made within a reasonable time gives the purchaser the right to reject or rescind the transfer.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. The registration of the transfer of a security is a matter of vital importance to a purchaser and he is here provided with the means of obtaining such formal requirements for registration as signature guarantees, proof of authority, transfer tax stamps and the like. In practice, it is the custom for the transferor to register transfer out of his own name and into that of the transferee, or into "street name" before delivery of the security. If he does not do this, he is the one in a position to supply most conveniently whatever documentation may be requisite for registration of transfer and his duty to do so upon demand within a reasonable time is here stated affirmatively. But if the transfer is not for value the transferee should pay expenses.

2. If the transferor's duty is not performed the transferee may reject or rescind the transfer. He is not bound to do so; he may prefer his action for damages for breach of contract; and if an essential item is peculiarly within the province of the transferor so that he is the only one who can obtain it, the purchaser may specifically enforce his right. Compare § 8-307.

Cross Reference:

§ 8-307.

Definitional Cross References:

"Purchaser". § 1-201.
"Reasonable time". § 1-204.
"Right". § 1-201.
"Security". § 8-102.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 8-317. Attachment or Levy Upon Security. (1) No attachment or levy upon a security or any share or other interest evidenced thereby which is outstanding shall be valid until the security is actually seized by the officer making the attachment or levy but a security which has been surrendered to the issuer may be attached or levied upon at the source.

(2) A creditor whose debtor is the owner of a security shall be entitled to such aid from courts of appropriate jurisdiction, by injunction or otherwise, in reaching such security or in satisfying the claim by means thereof as is allowed at law or in equity in regard to property which cannot readily be attached or levied upon by ordinary legal process.

COMMENT: Prior Uniform Statutory Provision: §§ 13, 14, Uniform Stock Transfer Act.

Changes: Rephrased for clarity.

Purposes of Changes: 1. In dealing with investment securities the instrument itself is the vital thing and therefore a valid levy cannot be made unless all possibility of the security finding its way into a transferee's hands has been removed. This can be accomplished only when the security has been reduced to possession by a public officer or by the issuer. A holder who has been enjoined can still transfer the security in contempt of court. See Overlock v. Jerome Portland Copper Mining Co., 29 Ariz. 560, 243 P. 400 (1926). Therefore, although injunctive relief is provided in subsection (2) so that creditors may use this method to gain control of the security, the security itself must be reached to constitute a proper levy. The method used in Hodes v. Hodes, 176 Or. 102, 155 P.2d 564 (1945), where the Oregon court enjoined the transfer of a security in a safe deposit box in the state of Washington, directing a copy of the writ to be served upon the issuer, although not operative as an effective levy, is a method of reaching the security approved by the section.

2. An attachment filed at the issuer's office against the shares represented by the security on the books is ineffective unless the security itself has been surrendered to the issuer. The case law holdings that priority in time of transfer or attachment governed the validity of the levy are rejected under this Article as under the Stock Transfer Act. See for example, National Bank of Pacific v. Western Pac. R. Co., 157 Cal. 573, 108 P. 676, 27 L.R.A., N.S., 987, 21 Ann.Cas. 1391 (1910).

3. This section deals with the problems of attaching or levying creditors and prevents such persons from securing rights paramount to those of purchasers who have actual possession of the security. It does not apply in cases where a governmental agency, for reasons of public safety or the like, seeks to confiscate securities. See, for example, the situation in Silesian American Corp. v. Clark, 332 U.S. 469, 68 S.Ct. 179, 92 L.Ed. 81 (1947), upon which this section has no bearing.

Definitional Cross References:

"Creditor". § 1-201.
"Issuer". § 8-201.
"Security". § 8-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 13.1-413, 13.1-414.

Comment: The UCC continues the basic provision of the Uniform Stock Transfer Act that an attachment or levy on a security can only be made by actually seizing or possessing the security so it can no longer be transferred. Code 1950, § 13.1-413, provides that an attachment or levy will be effective only if further transfer of the share by the holder is enjoined. In Iron City Savings Bank v. Isaacsen, 158 Va. 609, 632, 164 S.E. 520 (1932), this provision was interpreted to mean that the holder must be before the court. See also Mills v. Jacobs, 333 Pa. 231, 4 A.2d 152, 122 A.L.R. 33 (1939), involving the attachment of shares in a Virginia corporation, Virginia having adopted the Uniform Stock Transfer Act.

§ 8-318. **No Conversion by Good Faith Delivery.** An agent or bailee who in good faith (including observance of reasonable commercial standards if he is in the business of buying, selling or otherwise dealing with securities) has received securities and sold, pledged or delivered them according to the instructions of his principal is not liable for conversion or for participation in breach of fiduciary duty although the principal had no right to dispose of them.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: To negate the liability of agents, including brokers, and of bailees, for innocent conversion or participation in breach of fiduciary duty. Gruntal v. U. S. Fidelity and Guaranty Co., 254 N.Y. 468, 173 N.E. 682 (1930) followed. Compare § 7(a) of the Uniform Act for Simplification of Fiduciary Security Transfers.

Cross Reference:

§ 7-404.

Definitional Cross References:

"Delivery". § 1-201.
"Good faith". § 1-201.
"Security". § 8-102.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 8-319. Statute of Frauds. A contract for the sale of securities is not enforceable by way of action or defense unless

(a) there is some writing signed by the party against whom enforcement is sought or by his authorized agent or broker sufficient to indicate that a contract has been made for sale of a stated quantity of described securities at a defined or stated price; or

(b) delivery of the security has been accepted or payment has been made but the contract is enforceable under this provision only to the extent of such delivery or payment; or

(c) within a reasonable time a writing in confirmation of the sale or purchase and sufficient against the sender under paragraph (a) has been received by the party against whom enforcement is sought and he has failed to send written objection to its contents within ten days after its receipt; or

(d) the party against whom enforcement is sought admits in his pleading, testimony or otherwise in court that a contract was made for sale of a stated quantity of described securities at a defined or stated price.

COMMENT: Prior Uniform Statutory Provision: § 4, Uniform Sales Act (which was based on § 17 of the Statute of 29 Charles II).

Changes: Completely rephrased.

Purposes of Changes: To conform the statute of frauds provisions with regard to securities to the policy of the provisions in the Article on Sales (Article 2) on sale of goods. Requirements for minimum specification of quantity and price consistent with business practice in the securities field are added.

1. What will be sufficient specification will vary with the circumstances. Where the transaction is on an exchange or an over-the-counter market where daily quotations of the security are available "100 shares X. Corp. comm. @ market" should suffice. If there is no readily available standard to interpret "@ market" there is no "defined or stated price."

2. Paragraph (c) is particularly important in the relationship of broker (§ 8-303) and customer. Normally a great volume of such business is done over the telephone. Orders are executed almost immediately and confirmed on the same or the next business day, usually on standard forms which as to the broker more than meet the minimal requirements of paragraph (a). It is reasonable to require the customer to raise his objection, if any, within ten days after the confirmation has been received (§ 1-201).

Cross Reference:

See § 2-201 and Comment thereto.

Definitional Cross References:

"Action". § 1-201.
"Delivery". § 1-201.
"Party". § 1-201.
"Purchase". § 1-201.
"Security". § 8-103.
"Send". § 1-201.
"Sign". § 1-201.
"Written" and "writing". § 1-201.

Prior Statutes: None.

Comment: Since Virginia has not had a Statute of Frauds relating to contracts for the sale of securities, this section changes Virginia law by providing a Statute of Frauds for such contracts.

§ 8-320. **Transfer or Pledge within a Central Depository System.** (1) If a security

(a) is in the custody of a clearing corporation or of a custodian bank or a nominee of either subject to the instructions of the clearing corporation; and

(b) is in bearer form or indorsed in blank by an appropriate person or registered in the name of the clearing corporation or custodian bank or a nominee of either; and

(c) is shown on the account of a transferor or pledgor on the books of the clearing corporation;

then, in addition to other methods, a transfer or pledge of the security or any interest therein may be effected by the making of appropriate entries on the books of the clearing corporation reducing the account of the transferor or pledgor and increasing the account of the transferee or pledgee by the amount of the obligation or the number of shares or rights transferred or pledged.

(2) Under this section entries may be with respect to like securities or interests therein as a part of a fungible bulk and may refer merely to a quantity of a particular security without reference to the name of the registered owner, certificate or bond number or the like and, in appropriate cases, may be on a net basis taking into account other transfers or pledges of the same security.

(3) A transfer or pledge under this section has the effect of a delivery of a security in bearer form or duly indorsed in blank (§ 8-301) representing the amount of the obligation or the number of shares or rights transferred or pledged. If a pledge or the creation of a security interest is intended, the making of entries has the effect of a taking of delivery by the pledgee or a secured party (§§ 9-304 and 9-305). A transferee or pledgee under this section is a holder.

(4) A transfer or pledge under this section does not constitute a registration of transfer under Part 4 of this Article.

(5) That entries made on the books of the clearing corporation as provided in subsection (1) are not appropriate does not affect the validity or effect of the entries nor the liabilities or obligations of the clearing corporation to any person adversely affected thereby.

COMMENT: Prior Uniform Statutory Provision: None.

Purpose: Consistent with the underlying purposes and policies of this Act "to permit the continued expansion of commercial practices through custom, usage and agreement of the parties"—subsection (2) (b) of § 1-102—this section expressly authorizes a newly developing and commercially useful method of transferring or pledging securities on the organized securities markets, particularly among brokers and banks but not necessarily so limited.

The key provision in subsection (3) gives the procedures authorized in subsections (1) and (2) "the effect of a delivery of a security in bearer form or duly indorsed in blank". See subsection (1) (e) of § 8-313.

Subsection (4) makes clear that transfer or pledge under this Section does not change the registered ownership of the affected security and subsection (5) states

the accountability of a clearing corporation to persons adversely affected by entries made on its books which "are not appropriate".

Cross References:

§§ 1-102(2)(b); 8-301; 8-302; 8-308; 8-313; Part 4 of Article 8; §§ 9-304; 9-305.

Definitional Cross References:

"Appropriate person". § 8-308(3).
"Clearing corporation". § 8-102.
"Custodian bank". § 8-102.
"Delivery". §§ 1-201(14); 8-313(1).
"Fungible". § 1-201(17).
"Security". § 8-102.
"Security interest". § 1-201(37).
"Secured party". § 9-105(1) (i).

VIRGINIA ANNOTATIONS

Prior Statutes: None.

PART 4

REGISTRATION

§ 8-401. Duty of Issuer to Register Transfer. (1) Where a security in registered form is presented to the issuer with a request to register transfer, the issuer is under a duty to register the transfer as requested if

(a) the security is indorsed by the appropriate person or persons (§ 8-308); and

(b) reasonable assurance is given that those indorsements are genuine and effective (§ 8-402); and

(c) the issuer has no duty to inquire into adverse claims or has discharged any such duty (§ 8-403); and

(d) any applicable law relating to the collection of taxes has been complied with; and

(e) the transfer is in fact rightful or is to a bona fide purchaser.

(2) Where an issuer is under a duty to register a transfer of a security the issuer is also liable to the person presenting it for registration or his principal for loss resulting from any unreasonable delay in registration or from failure or refusal to register the transfer.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. § 8-201(3) defines "issuer" as used in this Part 4 as the person on whose behalf transfer books are maintained. Transfer agents, registrars or the like have rights and duties under this Part within the scope of their respective functions, similar to those of the issuer (§ 8-406).

2. There is a substantial and heterogenous body of case law as to the issuer's duty to register a transfer and as to his liability for improper registration, e.g., on an unauthorized signature (§ 8-311), or where the indorsement is not that of an appropriate person (§ 8-308), and generally under circumstances where the issuer is deemed to have had notice of an adverse claim (§ 8-301) and thus of the possible wrongfulness of the transfer.

In general this section and those which follow it continue the well-settled rules found in the case law as to duty to register and as to liability for improper registration on an unauthorized signature, or where the indorsement is not that of an appropriate person. They clarify the application of those rules in accordance with the fact patterns found in the usual business situations.

In all other areas, the issuer's potential liability for wrongful registration of transfer has been substantially reduced. The rules found in the case law are drastically modified in furtherance of a considered policy to speed up the registration process by narrowing the field in which the issuer historically has first sought to assure itself that it cannot be held to be on notice of an adverse claim, and, failing that assurance, has imposed rigorous requirements of proof that there is no possible impropriety.

3. This section states the basic duty of the issuer to register transfers. It states that a duty exists but only if certain preconditions exist. If any of the preconditions do not exist, there is no duty to register transfer. If the indorsement on a security is a forgery, there is no duty. If there has not been compliance with applicable tax laws, there is no duty. If the security is properly indorsed but nevertheless the transfer is in fact wrongful, there is no duty unless the transfer is to a bona fide purchaser (and the other preconditions exist). Cf. Kaiser-Frazer Corp. v. Otis & Co., 195 F.2d 838 (2d Cir. 1952), certiorari denied 73 S.Ct. 89, 344 U.S. 856, 97 L.Ed. 664.

This section does not constitute a mandate that all preconditions must be met before the issuer registers a transfer. Conversely, it is not a prohibition upon transfers when not all the preconditions are met. If it so desires, the issuer can waive the reasonable assurances specified in subparagraph (b). If it has confidence in the responsibility of the persons requesting transfer, it can ignore questions of compliance with tax laws. If it has no notice of or duty to inquire into adverse claims, it can and it should register transfer without inquiry as to the rightfulness of a transfer. This section is not a check list of steps the issuer must take before registering a transfer. §§ 8-402 and 8-403 are the sections dealing with mechanics and § 8-402 imposes limits on assurances that may be requested. § 8-401 recognizes the duty to register transfer clearly established by case law but then states limitations on this duty.

By subsection (2) the person entitled to registration may not only compel it but may hold the issuer liable in damages for unreasonable delay.

Cross References:

Point 1: §§ 8-201(3) and 8-406.
Point 2: §§ 8-204, 8-301, 8-308 and 8-311.

Definitional Cross References:

"Adverse claim". § 8-301.
"Appropriate person". § 8-308.
"Bona fide purchaser". § 8-302.
"Indorsement". § 8-308.
"Issuer". § 8-201(3).
"Person". § 1-201.
"Registered form". § 8-102.
"Security". § 8-102.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: The UCC is in accord with Steindler v. Virginia Public Service Co., 163 Va. 462, 175 S.E. 888 (1934). In this case the owners of stock certificates were induced through fraud to indorse and deliver the certificates to swindlers, who obtained signature guarantees of the indorsements, and then secured the transfer of new certificates to them. These certificates were sold to a security dealer, who sought to have them transferred to him, but the transfer was stopped, the transfer agent having been notified of the swindle. The dealer brought an action to compel the transfer and also seeking damages caused by the delay. It was held that the action lay, the issuer being required to make the transfer and also to respond in damages. See also Colonial Coal & Coke Co. v. Ream, 114 Va. 800, 77 S.E. 508 (1913).

§ 8-402. Assurance that Indorsements Are Effective. (1) The issuer may require the following assurance that each necessary indorsement (§ 8-308) is genuine and effective

(a) in all cases, a guarantee of the signature (subsection (1) of §8-312) of the person indorsing; and

(b) where the indorsement is by an agent, appropriate assurance of authority to sign;

(c) where the endorsement is by a fiduciary, appropriate evidence of appointment or incumbency;

(d) where there is more than one fiduciary, reasonable assurance that all who are required to sign have done so;

(e) where the indorsement is by a person not covered by any of the foregoing, assurance appropriate to the case corresponding as nearly as may be to the foregoing.

(2) A "guarantee of the signature" in subsection (1) means a guarantee signed by or on behalf of a person reasonably believed by the issuer to be responsible. The issuer may adopt standards with respect to responsibility provided such standards are not manifestly unreasonable.

(3) "Appropriate evidence of appointment or incumbency" in subsection (1) means

(a) in the case of a fiduciary appointed or qualified by a court, a certificate issued by or under the direction or supervision of that court or an officer thereof and dated within sixty days before the date of presentation for transfer; or

(b) in any other case, a copy of a document showing the appointment or a certificate issued by or on behalf of a person reasonably believed by the issuer to be responsible or, in the absence of such a document or certificate, other evidence reasonably deemed by the issuer to be appropriate. The issuer may adopt standards with respect to such evidence provided such standards are not manifestly unreasonable. The issuer is not charged with notice of the contents of any document obtained pursuant to this paragraph (b) except to the extent that the contents relate directly to the appointment or incumbency.

(4) The issuer may elect to require reasonable assurance beyond that specified in this section but if it does so and for a purpose other than that specified in subsection 3(b) both requires and obtains a copy of a will, trust, indenture, articles of co-partnership, by-laws or other controlling instrument it is charged with notice of all matters contained therein affecting the transfer.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. As noted (See the Comment to § 8-401) the issuer's absolute liability, stated in the cases, for wrongful registration of transfer where the signature of the indorser is unauthorized (§ 8-311) or is not that of an appropriate person (§ 8-308) is continued. Under the circumstances, the issuer is entitled to require reasonable assurance that all necessary indorsements are effective, and thus to minimize its risk. This section establishes the requirements the issuer may make in terms of documentation which, except in the rarest of instances, should be easily furnished. If a demand for further assurance is reasonable under the circumstances, subsection (4) applies.

2. Under subsection (1) (a) the issuer may require in all cases a guarantee of signature (§ 8-312). Under subsection (2) the guarantor must be one reasonably believed to be responsible, and the issuer may adopt standards of responsibility which are not manifestly unreasonable. In this aspect, this section approves the practice of the organized securities markets.

3. § 8-312(3) gives the issuer an action over against the guarantor of signature for breach of the warranties stated in that section. Both the indorsement and the guarantee of signature speak as of the "date of signing" or "time of signing." See §§ 8-308(6), 8-312(1). This section, by paragraphs (b) through (e) of subsection (1), permits the issuer to seek confirmation of the effectiveness of the

indorsement. The permitted methods act as a double check on matters which are within the warranties of the guarantor of signature. See § 8-312(3). In addition, to some extent, they act also as a check on the right to transfer (i.e. to deliver the security). Thus, an agent may be required to submit his power of attorney, a corporation to submit a certified resolution evidencing the authority of its signing officer to sign, an executor or administrator to submit the usual "short-form certificate", etc. But failure of a fiduciary to obtain court approval of the transfer or to comply with other requirements does not make his indorsement unauthorized. § 8-308(7). Hence court orders and other controlling instruments are omitted from subsection (1).

Manifestly, it is impossible to check incumbency as of the moment when the security was delivered if presentment is made by the purchaser, or as of the moment of presentation in the more usual case of presentment by the seller. Therefore, subsection (1) (c) authorizes the issuer only to require "appropriate evidence" of appointment or incumbency, and subsection (3) indicates what evidence will be "appropriate". In the case of a fiduciary appointed or qualified by a court, that evidence will be a court certificate dated within sixty days before the date of presentation; where the fiduciary is not appointed or qualified by a court, as in the case of a successor trustee, subsection (3) (b) applies. Compare § 4 of the Uniform Act for Simplification of Fiduciary Security Transfers. If the security is registered in the name of the indorsing fiduciary, the issuer may under § 8-403(3) (a) assume without inquiry that the fiduciary status continues until written notice to the contrary is received; hence no evidence of appointment or incumbency is needed unless such a notice has been received. Compare § 2 of the Uniform Act for Simplification of Fiduciary Security Transfers.

Where subsection (3) (b) applies, the issuer may require a copy of a trust instrument or other document showing the appointment, or it may require the certificate of a responsible person. In the absence of such a document or certificate, it may require other appropriate evidence. If a document is obtained solely as "appropriate evidence of appointment or incumbency" under subsection (3) (b), the issuer is not charged with notice of its contents except to the extent that the contents relate directly to the appointment or incumbency. But if the document is obtained for any other purpose, the issuer may be so charged under subsection (4). See Point 6 below.

4. There are many other types of situations where, under the case law, the issuer would be deemed to have notice of possible adverse claims, and therefore would register transfer at its peril. Typical are: knowledge that the registered owner is dead, the fact that he is described or identifiable as a fiduciary, etc. Perhaps the most ubiquitous is where a will, trust indenture or other controlling instrument is on file with the issuer or transfer agent for some other purpose (e.g., in the banking as distinct from the corporation agency department of a trust company), but, unless specifically asked for, would not come to the attention of the officers responsible for the registration of security transfers. Here, under the cases, there is an area of liability based upon notice of possible adverse claims affecting the right to deliver the security, an area to which the warranties of the guarantor of signature specifically do not extend. See § 8-312(3). Also, it is the area in which in the past issurers and their agents, fearing possible lawsuits based upon unauthorized transfers by fiduciaries and the like, have made it a practice to demand complete and convincing evidence that the transfer is proper in all of its aspects. §§ 8-403 and 8-404 strictly circumscribed the issuer's liability in such cases, and this section therefore makes no provision for assurances to cover them.

5. Circumstances may indicate that a necessary signature was unauthorized or was not that of an appropriate person. Such circumstances would be ignored at risk of absolute liability and to minimize that risk the issuer may properly exercise the option given by subsection (4) to require assurance beyond that specified in subsection (1). On the other hand, the facts at hand may reflect only on the rightfulness of the transfer. Such facts do not operate, as they did under the prior law, automatically to create a duty of inquiry, unless there is timely notification of the existence of an adverse claim. See § 8-403(1) (a). If there is a duty of inquiry under § 8-403, the issuer may follow the procedure provided in § 8-403(2), or it may discharge the duty of inquiry "by any reasonable means". The same is true if the issuer's overriding duty to conduct its functions in good faith (§ 1-203) comes into play, e.g., where the security is indorsed by a person known to the employee handling the transaction for the issuer to be wanted by the police.

6. Specifically to implement the policy of this Act to discourage issuers from requiring excessive documentation, subsection (4) provides that if the issuer elects to require additional documentation for any purpose other than to obtain

"appropriate evidence of appointment or incumbency" under subsection (3) (b), and both requires and obtains a copy of a will, trust, indenture, articles of copartnership, by-laws or other controlling instrument, it is charged with notice of all matters contained therein affecting the transfer. It follows that an instrument voluntarily submitted, without having been "required" by the issuer, may be returned without examination. But if the issuer has no duty to inquire and demands more than reasonable assurance that necessary indorsements are genuine and effective, the presenter of a security may refuse the demand and sue for improper refusal to register. § 8-401.

Cross References:

Point 1: §§ 8-308, 8-311.
Point 2: § 8-312.
Point 3: §§ 8-308, 8-312.
Point 4: §§ 8-312, 8-403, 8-404.
Point 5: §§ 1-203, 8-403.
Point 6: § 8-401.

Definitional Cross References:

"Adverse claim". § 8-301.
"Issuer". § 8-201.
"Notice". § 1-201.
"Person". § 1-201.
"Security". § 8-102.
"Sign". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Under the UCC the issuer may require a guarantee of the signature of a person indorsing a security. As applied in a case like Steindler v. Virginia Public Service Co., 163 Va. 462, 175 S.E. 888 (1934), discussed in VIRGINIA ANNOTATIONS to UCC 8-401, this would mean a guarantee of the indorsement of the swindler who obtained possession of the certificate. This section apparently changes this aspect of the Steindler case, since Virginia required the issuer to transfer the security to a bona fide purchaser, without requiring a guarantee of the swindler's signature.

§ 8-403. Limited Duty of Inquiry. (1) An issuer to whom a security is presented for registration is under a duty to inquire into adverse claims if

(a) a written notification of an adverse claim is received at a time and in a manner which affords the issuer a reasonable opportunity to act on it prior to the issuance of a new, reissued or re-registered security and the notification identifies the claimant, the registered owner and the issue of which the security is a part and provides an address for communications directed to the claimant; or

(b) the issuer is charged with notice of an adverse claim from a controlling instrument which it has elected to require under subsection (4) of § 8-402.

(2) The issuer may discharge any duty of inquiry by any reasonable means, including notifying an adverse claimant by registered or certified mail at the address furnished by him or if there be no such address at his residence or regular place of business that the security has been presented for registration of transfer by a named person, and that the transfer will be registered unless within thirty days from the date of mailing the notification, either

(a) an appropriate restraining order, injunction or other process issues from a court of competent jurisdiction; or

(b) an indemnity bond sufficient in the issuer's judgment to protect the issuer and any transfer agent, registrar or other agent of the issuer

involved, from any loss which it or they may suffer by complying with the adverse claim is filed with the issuer.

(3) Unless an issuer is charged with notice of an adverse claim from a controlling instrument which it has elected to require under subsection (4) of § 8-402 or receives notification of an adverse claim under subsection (1) of this section, where a security presented for registration is indorsed by the appropriate person or persons the issuer is under no duty to inquire into adverse claims. In particular

(a) an issuer registering a security in the name of a person who is a fiduciary or who is described as a fiduciary is not bound to inquire into the existence, extent, or correct description of the fiduciary relationship and thereafter the issuer may assume without inquiry that the newly registered owner continues to be the fiduciary until the issuer receives written notice that the fiduciary is no longer acting as such with respect to the particular security;

(b) an issuer registering transfer on an indorsement by a fiduciary is not bound to inquire whether the transfer is made in compliance with a controlling instrument or with the law of the state having jurisdiction of the fiduciary relationship, including any law requiring the fiduciary to obtain court approval of the transfer; and

(c) the issuer is not charged with notice of the contents of any court record or file or other recorded or unrecorded document even though the document is in its possession and even though the transfer is made on the indorsement of a fiduciary to the fiduciary himself or to his nominee.

COMMENT: Prior Uniform Statutory Provision: § 3, Uniform Fiduciaries Act.

Changes: Scope of exoneration broadened; duty of inquiry limited to defined situations.

In consonance with the general policy of this Part 4 (See the Comments to §§ 8-401 and 8-402), and subject always to the overriding duty of good faith in the performance of its functions (§ 1-203) this section limits the issuer's duty to inquire into adverse claims to the two specific situations stated in subsection (1).

Purposes of Changes: 1. Paragraph (a) of subsection (1) is the ordinary "stop transfer" notice commonly resorted to by the owner of a lost or stolen security or in a situation where breach of trust, disregard of a valid restriction on transfer, or other improper action is feared to have occurred or to be about to occur.

Notification under paragraph (a) of subsection (1) (a) must be "written" within § 1-201(46) and must be "received" under § 1-201(26) "at a time and in a manner which affords the issuer a reasonable opportunity to act on it prior to the issuance of a new, reissued or re-registered security". Cf. § 1-201(27). Its contents must be such as to make reasonably clear who makes the claim and with respect to what security, and where communications may be addressed to him. Compare § 5(a) of the Uniform Act for Simplification of Fiduciary Security Transfers.

A notification once so received is easily keyed to the appropriate records. Therefore, no defense of "forgotten notice", possibly relevant on the issue of bona fide purchase as to bearer form securities, is available under this section.

As to paragraph (b) see the Comment to § 8-402.

2. Subsection (2) does not limit the issuer to any specific method of discharging a duty of inquiry. It may use "any reasonable means" including the procedure spelled out in the subsection. That procedure, based on a New York statute respecting adverse claims to bank deposits and on commercial practice, should be effective in the large majority of cases to protect the rights of all interested parties and relieve the issuer of further responsibility. No delay during the thirty day period will be "unreasonable" under § 8-401(2).

3. Subsection (3) is the converse of subsection (1) and spells out some specific situations in which under prior law a duty to inquire existed or may have existed. Compare §§ 2 and 3 of the Uniform Act for Simplification of Fiduciary Security

Transfers. As to the effect of subsection (3) (a) on the effectiveness of an indorsement, see the Comment to § 8-404.

Cross References:

§§ 1-203, 8-304, 8-401, 8-402, 8-404, and 8-405.

Definitional Cross References:

"Adverse claim". § 8-301.
"Issuer". § 8-201.
"Notice". § 1-201.
"Notification". § 1-201.
"Person". § 1-201.
"Purchase". § 1-201.
"Security". § 8-102.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 8-404. **Liability and Non-Liability for Registration.** (1) Except as otherwise provided in any law relating to the collection of taxes, the issuer is not liable to the owner or any other person suffering loss as a result of the registration of a transfer of a security if

(a) there were on or with the security the necessary indorsements (§ 8-308); and

(b) the issuer had no duty to inquire into adverse claims or has discharged any such duty (§ 8-403).

(2) Where an issuer has registered a transfer of a security to a person not entitled to it the issuer on demand must deliver a like security to the true owner unless

(a) the registration was pursuant to subsection (1); or

(b) the owner is precluded from asserting any claim for registering the transfer under subsection (1) of the following section; or

(c) such delivery would result in overissue, in which case the issuer's liability is governed by § 8-104.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. This section states the basic exonerative policy of this Article where the security is appropriately indorsed (§ 8-308) and there is no duty to inquire into adverse claims (§ 8-403).

Note that under subsection (1)(a) exoneration depends on whether or not the necessary indorsements were in fact on or with the security. The issuer cannot, for example, defend a suit based on its having registered a transfer on a forged indorsement on the ground that it received the assurances listed in § 8-402 and was under no duty to go further. It has that option under § 8-402 (4).

Note, however, that this Act excludes from the category of "unauthorized indorsement" (§ 8-311) certain situations which might have been included in that category under prior law, e. g., where there has been a change of circumstances subsequent to the signature (subsection (6) of § 8-308); and where the signature is that of a fiduciary who has failed to obtain court approval of the transfer (subsection (7) of § 8-308). Similarly, when an issuer acts on the assumption permitted by subsection (3)(a) of § 8-403, that a fiduciary registered owner continues to act as such, the "necessary indorsement" under subsection (1)(a) of this section is that of the registered owner under § 8-308(3)(b), even though a successor has in fact been appointed. In these and other cases, where the question is one affecting only the rightfulness of the transfer, the issuer need only establish that it had no duty under § 8-403 to inquire into adverse claims or that it has discharged any such duty.

2. The registered owner's right to receive a new security where the issuer has wrongfully registered a transfer is established but the cases have also recognized

his right to elect between an equitable action to compel issue of a new security and an action for damages. Cf. Casper v. Kait-Zimmers Mfg. Co., 159 Wis. 517, 149 N.W. 754 (1914). Such election of remedies is no longer available and the owner is now required to take a new security except where an overissue would result and a similar security is not reasonably available for purchase. See § 8-104.

Cross References:

Point 1: §§ 8-308, 8-402, 8-403.
Point 2: §§ 8-104 and 8-405.

Definitional Cross References:

"Adverse claim". § 8-301.
"Deliver". § 1-201.
"Issuer". § 8-201.
"Notify". § 1-201.
"Overissue". § 8-104.
"Person". § 1-201.
"Security". § 8-102.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 8-405. **Lost, Destroyed and Stolen Securities.** (1) Where a security has been lost, apparently destroyed or wrongfully taken and the owner fails to notify the issuer of that fact within a reasonable time after he has notice of it and the issuer registers a transfer of the security before receiving such a notification, the owner is precluded from asserting against the issuer any claim for registering the transfer under the preceding section or any claim to a new security under this section.

(2) Where the owner of a security claims that the security has been lost, destroyed or wrongfully taken, the issuer must issue a new security in place of the original security if the owner

(a) so requests before the issuer has notice that the security has been acquired by a bona fide purchaser; and

(b) files with the issuer a sufficient indemnity bond; and

(c) satisfies any other reasonable requirements imposed by the issuer.

(3) If, after the issue of the new security, a bona fide purchaser of the original security presents it for registration of transfer, the issuer must register the transfer unless registration would result in overissue, in which event the issuer's liability is governed by § 8-104. In addition to any rights on the indemnity bond, the issuer may recover the new security from the person to whom it was issued or any person taking under him except a bona fide purchaser.

COMMENT: Prior Uniform Statutory Provision: § 17, Uniform Stock Transfer Act.

Changes: In appropriate circumstances the issuer is now required to issue a new security in place of a lost, destroyed or stolen one without a court order.

Purposes of Changes: 1. Subsection (1) applies explicitly the general rule of this Article on forged or unauthorized indorsements (§ 8-311). By failing to notify the issuer within a reasonable time after he knows or has reason to know of the loss or theft of his security, the owner is estopped from asserting the ineffectiveness of a forged or unauthorized indorsement and the wrongfulness of the registration of the transfer. If the lost security was indorsed by the owner then the registration of the transfer was not wrongful under § 8-404 unless notice had been given to the issuer.

2. The long standing corporate practice of voluntary issuing new securities to replace lost, destroyed or stolen ones is now incorporated into law. Where rea-

sonable requirements are satisfied and a sufficient indemnity bond supplied, a court order is no longer necessary but, of course, the court may compel a recalcitrant issuer to take action.

3. Where an "original" security has reached the hands of a bona fide purchaser, the registered owner who was in the best position to prevent the loss, destruction or theft of his security is now deprived of the new security issued to him as a replacement. This changes the prior law under which the original security was ineffective after the issue of a replacement except insofar as it might represent an action for damages in the hands of a bona fide purchaser. Keller v. Eureka Brick Mach. Mfg. Co., 43 Mo.App. 84, 11 L.R.A. 472 (1890). Where both the original and the new security have reached bona fide purchasers the issuer is now required to honor both securities unless an overissue would result and the security is not reasonably available for purchase. See § 8-104. In the latter case alone, the bona fide purchaser of the original security is relegated to an action for damages. In either case, the issuer itself may recover on the indemnity bond.

Cross References:

§§ 8-104, 8-311, 8-312, 8-402, 8-403 and 8-404.

Definitional Cross References:

"Bona fide purchaser". § 8-302.
"Issuer". § 8-201.
"Notice". § 1-201.
"Person". § 1-201.
"Reasonable time". § 1-204.
"Security". § 8-102.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 13.1-417.

§ 8-406. Duty of Authenticating Trustee, Transfer Agent or Registrar. (1) Where a person acts as authenticating trustee, transfer agent, registrar, or other agent for an issuer in the registration of transfers of its securities or in the issue of new securities or in the cancellation of surrendered securities

(a) he is under a duty to the issuer to exercise good faith and due diligence in performing his functions; and

(b) he has with regard to the particular functions he performs the same obligation to the holder or owner of the security and has the same rights and privileges as the issuer has in regard to those functions.

(2) Notice to an authenticating trustee, transfer agent, registrar or other such agent is notice to the issuer with respect to the functions performed by the agent.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. Transfer agents, registrars and the like are here expressly held liable to both the issuer and the owner for wrongful refusal to register a transfer as well as wrongful registration of a transfer in any case within the scope of their respective functions where the issuer would itself be liable. Those cases which have regarded these parties solely as agents of the issuer and have therefore refused to recognize their liability to the owner for mere non-feasance, i.e., refusal to register a transfer, are now rejected. Hulse v. Consolidated Quicksilver Mining Corp., 65 Idaho 768, 154 P.2d 149 (1944); Nicholson v. Morgan, 119 Misc. 309, 196 N.Y.Supp. 147 (1922); Lewis v. Hargadine-McKittrick Dry Goods Co., 305 Mo. 396, 274 S.W. 1041 (1924).

2. The practice frequently followed by authenticating trustees issuing certificates of indebtedness rather than authenticating duplicate certificates where securities have been lost or stolen now becomes obsolete in view of the provisions of the preceding section of this Article, which makes express provision for the issue of substitute securities. It can no longer be considered a breach of trust or lack of

due diligence for trustees to authenticate such instruments. Cf. Switzerland General Ins. Co. v. New York Cent. & H. R. R. Co., 152 App.Div. 70, 136 N.Y.S. 726 (1912).

3. "Good faith and due diligence" require the use of reasonable care and the observance of "reasonable" commercial standards, and preclude arbitrary, capricious, over-cautious and super-technical objections and requirements. See Powers v. Universal Film Mfg. Co., 162 App.Div. 806, 148 N.Y.S. 114 (1914). Compliance with the provisions of this Article as to the documents which an issuer may properly require before registering a transfer in cases where there has been no notice of adverse claims (§ 8-402) constitutes due diligence on the part of these agents and insisting upon more would incur liability for wrongful refusal to register a transfer.

Cross References:

Point 3: §§ 8-401, 8-402, 8-403 and 8-404.
See §§ 1-201, 8-208, 8-312, 8-401, 8-402, 8-403 and 8-405.

Definitional Cross References:

"Good faith". § 1-201.
"Holder". § 1-201.
"Issuer". § 8-201.
"Notice". § 1-201.
"Person". § 1-201.
"Security". § 8-102.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

ARTICLE 9

SECURED TRANSACTIONS; SALES OF ACCOUNTS, CONTRACT RIGHTS AND CHATTEL PAPER

PART 1

SHORT TITLE, APPLICABILITY AND DEFINITIONS

§ 9-101. Short Title. This Article shall be known and may be cited as Uniform Commercial Code—Secured Transactions.

COMMENT: This Article sets out a comprehensive scheme for the regulation of security interests in personal property and fixtures. It supersedes existing legislation dealing with such security devices as chattel mortgages, conditional sales, trust receipts, factor's liens and assignments of accounts receivable (see Note to § 9-102).

Consumer instalment sales and consumer loans present special problems of a nature which makes special regulation of them inappropriate in a general commercial codification. Many states now regulate such loans and sales under small loan acts, retail instalment selling acts and the like. While this Article applies generally to security interests in consumer goods, it is not designed to supersede such regulatory legislation (see Notes to §§ 9-102 and 9-203). Nor is this Article designed as a substitute for small loan acts or retail instalment selling acts in any state which does not presently have such legislation.

Existing law recognizes a wide variety of security devices, which came into use at various times to make possible different types of secured financing. Differences between one device and another persist, in formal requisites, in the secured party's rights against the debtor and third parties, in the debtor's rights against the secured party, and in filing requirements, despite the fact that today many of those differences no longer serve any useful function. Thus an unfiled chattel mortgage is by the law of many states "void" against creditors generally; a conditional sale, often available as a substitute for the chattel mortgage, is in some states valid against all creditors without filing, and in states where filing is required is, if unfiled, void only against lien creditors. The recognition of so many separate security devices has the result that half a dozen filing systems covering chattel security devices may be maintained within a state, some on a county basis, others on a state-wide basis, each of which must be separately checked to determine a debtor's status.

Nevertheless, despite the great number of security devices there remain gaps in the structure. In many states, for example, a security interest cannot be taken in inventory or a stock in trade although there is a real need for such financing. It is often baffling to try to maintain a technically valid security interest when financing a manufacturing process, where the collateral starts out as raw materials, becomes work in process and ends as finished goods. Furthermore, it is by no means clear, even to specialists, how under present law a security interest may be taken in many kinds of intangible property—such as television or motion picture rights—which have come to be an important source of commercial collateral.

While the chattel mortgage is adaptable for use in almost any situation where goods are collateral, there are limitations, sometimes highly technical, on the use of other devices, such as the conditional sale and particularly the trust receipt. The cases are many in which a security transaction described by the parties as a conditional sale or a trust receipt has been later determined by a court to be something else, usually a chattel mortgage. The consequence of such a determination is typically to void the security interest against creditors because the security agreement was not filed *as a chattel mortgage* (even though it may have been filed as a conditional sale or a trust receipt). In recent years our security law has grown in complexity at an alarming rate. The already

mentioned difficulty of financing on the security of inventory has been got around to some extent by the device known as "field warehousing" as well as by the use of the trust receipt. Since 1940 a number of states have generally authorized inventory financing by enacting statutes, similar although not uniform, known as "factor's lien" acts. Also in the period since 1940 the increasingly important business of lending against accounts receivable has inspired new statutes in that field in more than thirty states.

The growing complexity of financing transactions forces us to keep piling new statutory provisions on top of our inadequate and already sufficiently complicated nineteenth-century structure of security law. The results of this continuing development are, and will be, increasing costs to both parties and increasing uncertainty as to their rights and the rights of third parties dealing with them. The aim of this Article is to provide a simple and unified structure within which the immense variety of present-day secured financing transactions can go forward with less cost and with greater certainty.

Under this Article the traditional distinctions among security devices, based largely on form, are not retained; the Article applies to all transactions intended to create security interests in personal property and fixtures, and the single term "security interest" substitutes for the variety of descriptive terms which has grown up at common law and under a hundred-year accretion of statutes. This does not mean that the old forms may not be used, and § 9-102(2) makes it clear that they may be.

This Article does not determine whether "title" to collateral is in the secured party or in the debtor and adopts neither a "title theory" nor a "lien theory" of security interests. Rights, obligations and remedies under the Article do not depend on the location of title (§ 9-202). The location of title may become important for other purposes—as, for example, in determining the incidence of taxation—and in such a case the parties are left free to contract as they will. In this connection the use of a form which has traditionally been regarded as determinative of title (e. g., the conditional sale) could reasonably be regarded as evidencing the parties' intention with respect to title to the collateral.

Under the Article distinctions based on form (except as between pledge and nonpossessory interests) are no longer controlling. For some purposes there are distinctions based on the type of property which constitutes the collateral—industrial and commercial equipment, business inventory, farm products, consumer goods, accounts receivable, documents of title and other intangibles—and, where appropriate, the Article states special rules applicable to financing transactions involving a particular type of property. Despite the statutory simplification a greater degree of flexibility in the financing transaction is allowed than is possible under existing law.

The scheme of the Article is to make distinctions, where distinctions are necessary, along functional rather than formal lines.

This has made possible a radical simplification in the formal requisites for creation of a security interest.

A more rational filing system replaces the present system of different files for each security device which is subject to filing requirements. Thus not only is the information contained in the files made more accessible but the cost of procuring credit information, and, incidentally, of maintaining the files, is greatly reduced.

The Article's flexibility and simplified formalities should make it possible for new forms of secured financing, as they develop, to fit comfortably under its provisions, thus avoiding the necessity, so apparent in recent years, of year by year passing new statutes and tinkering with the old ones to allow legitimate business transactions to go forward.

The rules set out in this Article are principally concerned with the limits of the secured party's protection against purchasers from and creditors of the debtor. Except for procedure on default, freedom of contract prevails between the immediate parties to the security transaction.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: For discussions of this Article in relation to Virginia law see: Partington, Conditional Sales and Article 9, 20 Wash. & Lee L. Rev. (Fall 1963), and Burton, Factor's Lien and Accounts Receivable Financing and Article 9, 20 Wash. & Lee L. Rev. (Fall 1963).

§ 9-102. Policy and Scope of Article. (1) Except as otherwise provided in § 9-103 on multiple state transactions and in § 9-104 on excluded transactions, this Article applies so far as concerns any personal property and fixtures within the jurisdiction of this state

(a) to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper, accounts or contract rights; and also

(b) to any sale of accounts, contract rights or chattel paper.

(2) This Article applies to security interests created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, conditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security. This Article does not apply to statutory liens except as provided in § 9-310.

(3) The application of this Article to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this Article does not apply.

Note: *The adoption of this Article should be accompanied by the repeal of existing statutes dealing with conditional sales, trust receipts, factor's liens where the factor is given a non-possessory lien, chattel mortgages, crop mortgages, mortgages on railroad equipment, assignment of accounts and generally statutes regulating security interests in personal property.*

Where the state has a retail installment selling act or small loan act, that legislation should be carefully examined to determine what changes in those acts are needed to conform them to this Article. This Article primarily sets out rules defining rights of a secured party against persons dealing with the debtor; it does not prescribe regulations and controls which may be necessary to curb abuses arising in the small loan business or in the financing of consumer purchases on credit. Accordingly there is no intention to repeal existing regulatory acts in those fields. See § 9-203 (2) and the Note thereto.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: The purpose of this Section is to bring all consensual security interests in personal property and fixtures, with the exception of certain types of transactions excluded by §§ 9-103 and 9-104, under this Article, as well as sales of accounts, contract rights and chattel paper whether intended for security or not unless excluded by § 9-104(f). As to security interests in fixtures created under the law applicable to real estate, see § 9-313(1).

1. Except for sales of accounts, contract rights and chattel paper, the principal test whether a transaction comes under this Article is: is the transaction intended to have effect as security? For example, § 9-104 excludes certain transactions where the security interest (such as an artisan's lien) arises under statute or common law by reason of status and not by consent of the parties. Transactions in the form of consignments or leases are subject to this Article if the understanding of the parties or the effect of the arrangement shows that a security interest was intended. (As to consignments the provisions of § 2-326 of Article 2 (Sales) should be consulted.) When it is found that a security interest as defined in § 1-201(37) was intended, this Article applies regardless of the form of the transaction or the name by which the parties may have christened it. The list of traditional security devices in subsection (2) is illustrative only; other old devices, as well as any new ones which the ingenuity of lawyers may invent, are included, so long as the requisite intent is found. The controlling definition is that contained in subsection (1). In connection with the inclusion of "equipment trust" in the subsection (2) list, it should be noted that § 9-104(e) excludes from the Article equipment trusts on railway rolling stock.

2. The Article does not in terms abolish existing security devices. The conditional sale or bailment-lease for example is not prohibited; but even though it is used, the rules of this Article govern.

3. In general this Article adopts the position, implicit in prior law, that the law of the state where the collateral is located should be the governing law, without regard to possible contacts in other jurisdictions. Thus the applicability of the Article is by this Section stated to extend to transactions concerning "personal property and fixtures within the jurisdiction of this state". This "narrow" approach, appropriate in the field of security transactions, should be contrasted with the "broad" approach stated in § 1-105 with reference to the applicability of the Act as a whole. § 9-103 states special rules relating to the applicability of this Article where the collateral consists of certain types of intangibles or mobile equipment, or property which is brought into this state subject to a security interest which attached in another jurisdiction.

4. An illustration of subsection (3) is as follows:

The owner of Blackacre borrows $10,000 from his neighbor, and secures his note by a mortgage on Blackacre. This Article is not applicable to the creation of the real estate mortgage. However, when the mortgagee in turn pledges this note and mortgage to secure his own obligation to X, this Article is applicable to the security interest thus created in the note and the mortgage. Whether the transfer of the collateral for the note, i. e., the mortgagee's interest in Blackacre, requires further action (such as recording an assignment of the mortgagee's interest) is left to real estate law. See § 9-104(j).

5. While most sections of this Article apply to a security interest without regard to the nature of the collateral or its use, some sections state special rules with reference to particular types of collateral. An index of sections where such special rules are stated follows:

ACCOUNTS AND CONTRACT RIGHTS

Section	
9-102(1) (b)	Sale of accounts and contract rights subject to Article
9-103(1)	When Article applies; conflict of laws rules
9-104(f)	Certain sales of accounts and contract rights excluded from Article
9-106	Definitions
9-204(2) (c) and (d)	When debtor acquires rights
9-205	Permissible for debtor to make collections
9-206(1)	Agreement not to assert defenses against assignee
9-301(1) (d)	Unperfected security interest subordinate to certain transferees
9-302(1) (e)	What assignments need not be filed
9-306(5)	Rule when goods whose sale gave rise to an account return to seller's possession
9-318(1)	Rights of assignee subject to defenses
9-318(2)	Modification of contract after assignment of contract right
9-318(3)	When account debtor may pay assignor
9-318(4)	Term prohibiting assignment ineffective
9-401	Place of filing
9-502	Collection rights of secured party
9-504(2)	Rights on default where underlying transaction was sale of accounts or contract rights

CHATTEL PAPER

9-102(1) (b)	Sale subject to Article
9-104(f)	Certain sales excluded from Article
9-105(1) (b)	Definition
9-205	Permissible for debtor to make collections
9-206(1)	Agreement not to assert defenses against assignee
9-207(1)	Duty of secured party in possession to preserve rights against prior parties

Section	
9-301(1) (c)	Unperfected security interest subordinate to certain transferees
9-304(1)	Perfection by filing
9-305	When possession by secured party perfects security interest
9-306(5)	Rule when goods whose sale results in chattel paper return to seller's possession
9-308	When purchasers of chattel paper have priority over security interest
9-318(1)	Rights of assignee subject to defenses
9-318(3)	When account debtor may pay assignor
9-502	Collection rights of secured party
9-504(2)	Rights on default where underlying transaction was sale

DOCUMENTS AND INSTRUMENTS

9-105(1) (e)	Definition of document (and see 1-201)
9-105(1) (g)	Definition of instrument
9-206(1)	Rule where buyer of goods signs both negotiable instrument and security agreement
9-207(1)	Duty of secured party in possession of instrument to preserve rights against prior parties
9-301(1) (c)	Unperfected security interest subordinate to certain transferees
9-302(1) (b) and (f)	What interests need not be filed
9-304(1)	How security interest can be perfected
9-304(2, 3)	Perfection of security interest in goods in possession of issuer of negotiable document or of other bailee
9-304(4, 5)	Perfection of security interest in instruments or negotiable documents without filing or transfer of possession
9-305	When possession by secured party perfects security interest
9-308	When purchasers of non-negotiable instruments have priority over security interest
9-309	When purchasers of negotiable instruments or negotiable documents have priority over security interest
9-501(1)	Rights on default where collateral is documents
9-502	Collection rights of secured party

GENERAL INTANGIBLES

9-103(2)	When Article applies; conflict of laws rules
9-105	Obligor is "account debtor"
9-106	Definition
9-301(1) (d)	Unperfected security interest subordinate to certain transferees
9-318(1)	Rights of assignee subject to defenses
9-318(3)	When account debtor may pay assignor
9-502	Collection rights of secured party

GOODS

(See also Consumer Goods, Equipment, Farm Products, Inventory)

9-103(2)	When Article applies with regard to goods of a type normally used in more than one jurisdiction; conflict of laws rules
9-105(1) (f)	Definition
9-109	Classification of goods as consumer goods, equipment, farm products and inventory
9-203	Formal requisites of security agreement covering certain types of goods (crops, oil, gas, minerals or timber)

Section	
9-204(2) (b)	When debtor acquires rights in certain types of goods (crops, fish, timber, oil, gas, minerals)
9-204(4)	Validity of after-acquired property clause covering certain types of goods (crops, consumer goods)
9-205	Permissible for debtor to accept returned goods
9-206(2)	When security agreement can limit or modify warranties on sale
9-301(1) (c)	Unperfected security interest subordinate to certain transferees
9-304(2, 3)	Perfection of security interest in goods in possession of issuer of negotiable document or of other bailee
9-304(5)	Perfection of security interest without filing or transfer of possession where goods in possession of certain bailees
9-305	When possession by secured party perfects security interest
9-306(5)	Rule when goods whose sale gave rise to account or chattel paper return to seller's possession
9-307	When buyers of goods from debtor take free of security interest
9-313	Goods which are or become fixtures
9-314	Goods affixed to other goods
9-315	Goods commingled in a product
9-401(1) (c)	Place of filing for fixtures
9-402	Form of financing statement covering fixtures
9-504(1)	Sale of goods by secured party after default subject to Article 2 (Sales)

CONSUMER GOODS

9-109(1)	Definition
9-203(2)	Transaction, althongh subject to this Article, may also be subject to certain regulatory statutes
9-204(4) (b)	Validity of after-acquired property clause
9-206(1)	Buyer's agreement not to assert defenses against an assignee subject to statute or decision which establishes rule for buyers of consumer goods
9-302(1) (d)	When filing not required
9-307(2)	When buyers from debtor take free of security interest
9-401(1) (a)	Place of filing
9-505(1)	Secured party's duty to dispose of repossessed consumer goods
9-507(1)	Secured party's liability for improper disposition of consumer goods after default

EQUIPMENT

9-103(2)	When Article applies with regard to certain types of equipment normally used in more than one jurisdiction; conflict of laws rules
9-109(2)	Definition
9-302(1) (c)	When filing not required to perfect security interest in certain farm equipment
9-307(2)	When buyers of certain farm equipment from debtor take free of security interest
9-401(1)	Place of filing for equipment used in farming operation
9-503	Secured party's right after default to remove or to render equipment unusable

FARM PRODUCTS

Section	
9-109(3)	Definition
9-203(1) (b)	Formal requisites of security agreement covering crops
9-204(2) (a)	When debtor acquires rights in crops
9-204(4) (a)	Validity of after-acquired property clause in crops
9-307	When a buyer of farm products takes free of security interest
9-312(2)	Priority of secured party who gives new value to enable debtor to produce crops
9-401(1) (b)	Place of filing
9-402(1) and (3)	Form of financing statement covering crops

INVENTORY

9-103(2)	When Article applies with regard to certain types of inventory normally used in more than one jurisdiction; conflict of laws rules
9-109(4)	Definition
9-306(5)	Rule where goods whose sale gave rise to account or chattel paper return to seller's possession
9-307(1)	When buyers from debtor take free of security interest
9-312(3)	When purchase money security interest takes priority over conflicting security interest

Cross References:

§§ 9-103 and 9-104.
Point 1: § 2-326.
Point 2: § 1-105.

Definitional Cross References:

"Account". § 9-106.
"Chattel paper". § 9-105.
"Contract". § 1-201.
"Contract right". § 9-106.
"Document". § 9-105.
"General intangibles". § 9-106.
"Goods". § 9-105.
"Instrument". § 9-105.
"Security interest". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-550 - 568 (trust receipts); 11-5 - 7 (assignments of accounts receivable); 43-27 - 28 (crop liens); 43-41 - 43 (liens on offspring of certain animals); 43-44 - 61 (agricultural chattel deeds of trust); 43-62 (lien for farm products consigned to commission merchants); 55-58 - 63, 55-95 - 105 (deeds of trust, chattel mortgages, bailment leases); 55-88 - 94 (conditional sales); 55-143 - 150 (factor's liens); 55-156 - 160 (assignments for benefit of creditors).

Comment: This Article covers, with certain stated exceptions, all consensual security interests in personal property and fixtures. Since the Virginia law has not developed in exactly the same way, it is not possible to state categorically every aspect of Virginia law that is superseded by the UCC. For example, while many of the Virginia statutes relating to deeds of trust either expressly or by implication cover personal property, the statutes have been drafted and are oriented primarily towards real property, and almost all the cases have dealt with real property. While literally within the coverage of Article 9, statutes such as those giving liens on the offspring of stallions, jackasses, and bulls might be excluded from the UCC on the theory that there no "commercial" transaction is involved.

The following are the principal security arrangements recognized in Virginia that are within the scope of Article 9:

1. Conditional Sales. A conditional sale is defined in Code 1950, § 55-88, as: "Every sale or contract for the sale of goods and chattels, wherein the title thereto or a lien thereon is reserved until the same be paid for, in whole or in

part, or the transfer of title is made to depend on any condition, when possession is delivered to the vendee." Code 1950, § 55-89, covers conditional sales of railroad equipment.

2. Deeds of Trust and Chattel Mortgages. Code 1950, § 55-96, requires recordation of "every deed of gift, or deed of trust, or mortgage conveying . . . goods and chattels and every such bill of sale, or contract for the sale of goods and chattels, when the possession is allowed to remain with the grantor."

3. Bailment Leases. Code 1950, § 55-88, provides for the recordation of a bailment lease as any other lease.

4. Agricultural Chattel Deeds of Trust. Code 1950, §§ 43-44 through 43-61, give special statutory treatment to these security arrangements.

5. Crop Liens. Code 1950, §§ 43-27 through 43-28, give special statutory treatment to these security transactions, involving advances made to farmers by persons other than landlords.

6. Security Instruments Relating to Property Used in the Business of a Contractor, Logger, or Sawmiller. Code 1950, §§ 55-88.1 and 55-96.1, give special statutory treatment to these security transactions.

7. Security Interests in Civil Aircraft. Code 1950, § 55-100, provides for recordation of any "instrument which affects the title to or interest in any civil aircraft of the United States."

8. Pledges. There is no statutory coverage of the common law pledge.

9. Field Warehousing. There is no statutory coverage of this form of security transaction, other than as provided for in the Uniform Warehouse Receipts Act, Code 1950, §§ 61-1 through 61-58.

10. Trust Receipts. Virginia has adopted the Uniform Trust Receipts Act, Code 1950, §§ 6-550 through 6-568.

11. Factor's Liens. Virginia has adopted, Code 1950, §§ 55-143 through 55-150, the Factor's Lien Act, which covers the financing of a manufacturer in his purchases, manufacture and sale of goods and merchandise, and consignees and pledgees. The validity of a factor's lien was upheld in In the Matter of Lincoln Industries, Inc., 166 F. Supp. 200, 243 (W.D. Va. 1958).

12. Assignments of Accounts Receivable. Code 1950, §§ 11-5 through 11-7, validates assignments of accounts receivable.

13. Farm Products Consigned to Commission Merchant. Code 1950, § 43-62, provides that the consignor or owner of farm products consigned to a commission merchant, and sold by the merchant, has a lien on the estate of the merchant if he becomes insolvent or dies, subject only to liens recorded before insolvency or death. If the consignor leaves the proceeds at interest or if he permits them to remain with the commission merchant thirty days after being informed of the sale, he is not entitled to the lien.

The purpose of the UCC, as set forth in UCC 9-101 and 9-202, is to abolish in security transactions the traditional formal distinctions, and, instead, to draw functional distinctions. This approach is, therefore, different from that previously followed in Virginia. In Mullins v. Sutherland, 131 Va. 547, 555, 109 S.E. 420 (1921), the Virginia Supreme Court of Appeals quoted with approval the following extract from 24 R.C.L. § 744, which sets forth the traditional approach to personal property security: "Courts have frequently, without regard to the designation of the contract by the parties as a conditional sale and the reservation of the title until the price is paid, construed the contract as in effect an absolute sale with mortgage back as a security for the price and not a conditional sale, where the contract read as a whole and the special circumstances surrounding the transaction justified the conclusion that such was the ruling intention of the parties and the proper construction of the instrument as a whole . . . Conditional sales are not favored in law, and where it is doubtful from the face of the instrument whether the contract is a conditional sale or a mortgage, the courts generally treat it as a mortgage, for the reason that such a construction will be most apt to attain the ends of justice and prevent fraud and oppression, because an error which converts a conditional sale into a mortgage is less injurious than an error which changes a mortgage into a conditional sale."

Robert's Adm'r v. Cocke, Ex'r, 22 Va. (1 Rand.) 121 (1822), shows the difficulty of distinguishing between the different traditional forms of security transactions.

This case involved a writing executed in 1797, which provided: "William Thompson . . . borrows of Daniel Roberts . . . the sum of one hundred pounds to be repaid on or before the first day of March next. The said William Thompson, in order to pay the interest thereon and to secure the payment of the principal at the time stipulated, doth deliver to the said Daniel Roberts, a negro man named Jerry. The labor of the said Jerry, to be for the interest of the money; and if the said William Thompson, shall fail to re-pay the said one hundred pounds, on or before the first day of March next, then the said Daniel Roberts is to have a good title in fee simple to the said negro. If the said negro shall die before the said first day of March, it is to be the loss of the said William Thompson . . ." One member of a three-judge court considered this a mortgage, one a conditional sale, and one a mortgage on its face but rendered a conditional sale by the attendant circumstances.

The distinction between a chattel mortgage and a deed of trust is discussed in Ambler v. D. Warwick & Co., 28 Va. (1 Leigh) 194, 212-13 (1829). The distinction between a chattel mortgage and a conditional sale is discussed in Virginia Fire and Marine Insurance Co. v. Lennon, 140 Va. 766, 777-89, 125 S.E. 801, 38 A.L.R. 186 (1924). For a discussion of conditional sales see also Franklin Fire Insurance Co. v. Bolling, 173 Va. 228, 234-35, 3 S.E. 2d 182 (1939).

The UCC approach of abolishing formal distinctions between security arrangements bearing traditional names may have some effect on some cases applying Virginia law, but it is not possible to evaluate the effect. Corbett v. Riddle, 209 Fed. 811, 814-15 (4th Cir. 1913) (bailment lease treated as a conditional sale); *The Henry S.*, 4 F. Supp. 953, 954 (E. D. Va. 1933) (conditional sale treated as a chattel mortgage).

The UCC in Article 9 only covers transactions "intended to create a security interest in personal property." Consequently, the section is in accord with Southern Dairies, Inc. v. Cooper, 35 F.2d 439, 440 (4th Cir. 1929), in its holding that a true lease, not a bailment lease, is not a security transaction, and so it would not be within the scope of Article 9. Similarly, successive assignments of the same deposit of money, such as those involved in Evans v. Joyner, 195 Va. 85, 77 S.E.2d 420 (1953), which are not intended to create security interests are not within the scope of Article 9.

Under subsection 9-102(2) all security interests created by contract are within the scope of Article 9. In accordance with this provision, choses in action may be used for security, but this approach does not affect the Virginia holdings that choses in action are not goods or chattels. First Nat'l Bank of Richmond v. Holland, 99 Va. 495, 503-07, 39 S.E. 126 (1901); Kirkland, Chase & Co. v. Brune, 72 Va. (31 Gratt.) 126, 130-32 (1878).

Goods which may become fixtures are within the Article. Virginia has recognized that such items may be the subject of conditional sales contracts. Holt v. Henley, 232 U.S. 637 (1914) (sprinkler system); Monarch Laundry v. Westbrook, 109 Va. 382, 63 S.E. 1070 (1909) (engines, boilers, and machinery).

For the exclusion of common law and statutory possessory liens see VIRGINIA ANNOTATIONS to UCC 9-104.

§ 9-103. Accounts, Contract Rights, General Intangibles and Equipment Relating to Another Jurisdiction; and Incoming Goods Already Subject to a Security Interest. (1) If the office where the assignor of accounts or contract rights keeps his records concerning them is in this State, the validity and perfection of a security interest therein and the possibility and effect of proper filing is governed by this Article; otherwise by the law (including the conflict of laws rules) of the jurisdiction where such office is located.

(2) If the chief place of business of a debtor is in this State, this Article governs the validity and perfection of a security interest and the possibility and effect of proper filing with regard to general intangibles or with regard to goods of a type which are normally used in more than one jurisdiction (such as automotive equipment, rolling stock, airplanes, road building equipment, commercial harvesting equipment, construction machinery and the like) if such goods are classified as equipment or classified as inventory by reason of their being leased by the debtor to others. Otherwise, the law (including the conflict of laws rules) of the jurisdiction

where such chief place of business is located shall govern. If the chief place of business is located in a jurisdiction which does not provide for perfection of the security interest by filing or recording in that jurisdiction, then the security interest may be perfected by filing in this State. For the purpose of determining the validity and perfection of a security interest in an airplane, and chief place of business of a debtor who is a foreign air carrier under the Federal Aviation Act of 1958, as amended, is the designated office of the agent upon whom service of process may be made on behalf of the debtor.

(3) If personal property other than that governed by subsections (1) and (2) is already subject to a security interest when it is brought into this State, the validity of the security interest in this State is to be determined by the law (including the conflict of laws rules) of the jurisdiction where the property was when the security interest attached. However, if the parties to the transaction understood at the time that the security interest attached that the property would be kept in this State and it was brought into this State within 30 days after the security interest attached for purposes other than transportation through this State, then the validity of the security interest in this State is to be determined by the law of this State. If the security interest was already perfected under the law of the jurisdiction where the property was when the security interest attached and before being brought into this State, the security interest continues perfected in this State for four months and also thereafter if within the four month period it is perfected in this State. The security interest may also be perfected in this State after the expiration of the four month period: in such case perfection dates from the time of perfection in this State. If the security interest was not perfected under the law of the jurisdiction where the property was when the security interest attached and before being brought into this State, it may be perfected in this State; in such case perfection dates from the time of perfection in this State.

(4) Notwithstanding subsections (2) and (3), if personal property is covered by a certificate of title issued under a statute of this State or any other jurisdiction which requires indication on a certificate of title of any security interest in the property as a condition of perfection, then the perfection is governed by the law of the jurisdiction which issued the certificate.

(5) Notwithstanding subsection (1) and § 9-302, if the office where the assignor of accounts or contract rights keeps his records concerning them is not located in a jurisdiction which is a part of the United States, its territories or possessions, and the accounts or contract rights are within the jurisdiction of this State or the transaction which creates the security interest otherwise bears an appropriate relation to this State, this Article governs the validity and perfection of the security interest and the security interest may only be perfected by notification to the account debtor.

Note: *The last sentence of subsection (2) and subsection (5) are bracketed to indicate optional enactment. In states engaging in financing of airplanes of foreign carriers and of international open accounts receivable, bracketed language will be of value. In other states not engaging in financing of this type, the bracketed language may not be considered necessary.*

(VALC Note: The last sentence of subsection (2) and all of subsection (5) are optional in the Official Text.)

COMMENT: Prior Uniform Statutory Provision: Subsection (3)—§ 14, Uniform Conditional Sales Act.

Changes: Completely rewritten.

Purposes of Changes: 1. Under § 9-102 this Article applies to the transactions described in that Section "so far as concerns any personal property and fixtures within the jurisdiction of this state". That is equivalent to saying, in most cases, that the Article applies when the collateral is physically located in this state. This Section amplifies that general principle and states special rules in three situations which have given difficulty under earlier statutes. Subsections (1) and (2) in effect state when this state claims jurisdiction over accounts and contract rights (subsection (1)) and over mobile equipment and general intangibles (subsection (2)). Subsection (3) deals with the problem of collateral brought into this state subject to a security interest which attached elsewhere.

2. The general rule of § 9-102 is difficult of application with respect to certain types of intangible collateral. This Article classifies intangible property as instruments (defined in § 9-105 to include investment securities as well as conventional negotiable instruments), documents (defined in §§ 9-105 and 1-201 to include bills of lading, warehouse receipts and the like), chattel paper (defined in § 9-105), accounts, contract rights and general intangibles (defined in § 9-106). The general rule is appropriate and applies to instruments, documents and chattel paper: in contemplation of law and by common understanding and practice the property right or claim evidenced by an instrument, document or chattel paper is thought of as being merged in or symbolically represented by the piece of paper, whose indorsement or delivery is a prerequisite to a transfer of the underlying claim or right. This Article therefore applies to security interests in instruments, documents, and chattel paper when the relevant pieces of paper are in this State.

Accounts, contract rights and general intangibles do not fit that simple pattern. As to them there is no indispensable or symbolic document which represents the underlying claim, whose indorsement or delivery is the one effectual means of transfer.

There is a considerable body of case law dealing with the situs of choses in action. This case law is in the highest degree confused, contradictory and uncertain; it affords no base on which to build a statutory rule.

An account receivable arises typically out of a sale; the contract of sale may be executed in State A, the goods shipped from a warehouse in State B to the buyer (account debtor) in State C. The account may then be assigned to an assignee in State D. The seller-assignor may keep his principal records in State E. Under the non-notification system of accounts receivable financing, the seller-assignor, despite the assignment, bills and collects from the account debtor; under notification financing the account debtor makes payment to the assignee, but the bills may be prepared and sent out by either assignor or assignee. The contracts of the transaction are with many jurisdictions: to which one is it appropriate to look for the governing law?

All this applies with equal force to contract rights. Even more complicated situations may be anticipated when the collateral consists of novel or uncommon types of personal property, which fall within the definition of general intangibles.

If we bear in mind that one of the principal questions involved is where certain financing statements shall be filed, two things become clear. *First:* since the purpose of filing is to allow subsequent creditors of the *debtor-assignor* to determine the true status of his affairs, the place chosen must be one which such creditors would normally associate with the assignor; thus the place of business of the assignee and the places of business or residences of the various account debtors must be rejected. *Second:* since the validity of the assignment against third parties may depend on the filing of a financing statement in the proper place, it is vital that the place chosen be one which can be determined with the least possible risk of error.

Subsection (1), following some of the existing state statutes, adopts the rule that security interests in accounts or contract rights are covered when the office of the assignor where he keeps his records concerning them is in this state. Since general intangibles are not closely associated with particular records, a different rule (subsection (2) and Comment 5) is adopted for them.

In a state in which under this Article filing with reference to assignments of accounts and contract rights is generally in a state and not a county office, no problem arises under the subsection (1) rule if all the assignor's places of business are in this state. As to the optional provision for county filing, see § 9-401 and Comment. For the multi-state business there is no easy solution. The office where the assignor keeps his records of accounts or contract rights will be

typically the principal financial office of the enterprise. Frequently records of an account may be kept in several offices: for example, in the branch office where the account debtor placed his order and in the warehouse from which the goods were shipped as well as in the principal financial office: in such a case, it is the internal practice of the assignor—i. e., which of the various records is controlling for general accounting purposes of the enterprise—that determines whether the law of this state or of some other jurisdiction shall apply. In the great majority of cases the test of subsection (1) is easy to apply; some situations remain, which will have to be worked out on a case by case basis, and which neither this nor any other statutory formula can settle in advance beyond the possibility of a doubt. There is, however, one easy answer: if there might be more than one state in which it could be claimed that the assignor keeps his records, let the assignee file in all such states. Filing is simple and inexpensive, and the entire problem can thereby be avoided.

If the record-keeping office is moved into "this state" after a security interest has been perfected under the law of another jurisdiction, the secured party should file in this state, since § 9-401(3) is inapplicable.

3. Another class of collateral for which a special rule is stated (subsection (2)) is mobile goods which are normally moved for use from one jurisdiction to another. Such goods are generally classified as equipment; occasionally they may be classified as inventory, for example, autos owned by a car rental agency. Under many present chattel mortgage and conditional sales acts the mortgagee or conditional vendor must file in each filing district in which such mobile equipment is used—which is possible although onerous in some cases, but not even possible in the case, for example, of non-scheduled trucking operations. Subsection (2) provides that a security interest in such equipment or inventory is subject to this Article when the debtor's chief place of business is in this state. "Chief place of business" does not mean the place of incorporation; it means the place from which in fact the debtor manages the main part of his business operations. That is the place where persons dealing with the debtor would normally look for credit information, and is the appropriate place for filing. The term "chief place of business" is not defined in this Section or elsewhere in this Act. Doubt may arise as to which is the "chief place of business" of a multi-state enterprise with decentralized, autonomous regional offices. A secured party in such a case may easily protect himself at no great additional burden by filing in each of several places. Although under this formula, as under the accounts receivable rule stated in subsection (1), there will be doubtful situations, the subsection states a rule which will be simple to apply in most cases, which will make it possible to dispense with much burdensome and useless filing, and which will operate to preserve a security interest in the case of non-scheduled operations.

Similarly, if the chief place of business of the debtor is moved into "this state" after a security interest has been perfected in another jurisdiction, the secured party should file in this state, since § 9-401(3) is inapplicable.

§ 9-302(3) should be consulted for certain transactions to which the filing provisions of this Article do not apply. Where property is covered by a certificate of title, the governing rule is stated in subsection (4) of this section.

4. Notice that the rule of subsection (2) applies to goods of a type "normally used" in more than one jurisdiction; there is no requirement that particular goods be in fact used out of state. Thus if an enterprise whose chief place of business is in State X keeps in this state goods of the type covered by subsection (2), this rule of the subsection applies even though the goods never cross a state line. The definitions of "equipment" and "inventory" (§ 9-109) should be consulted.

5. General intangibles present the same problem as accounts and contract rights, but with an added difficulty. The "office where records are kept" rule which subsection (1) applies to accounts and contract rights is not available here since no records will be kept with respect to many types of property which would be "general intangibles". The "chief place of business" rule of subsection (2) is adopted as providing a convenient filing place. If the debtor's chief place of business is moved into "this state" after a security interest has been perfected in another jurisdiction, the secured party should file in this state, since § 9-401(3) is inapplicable.

6. Under subsection (1) this state in effect disclaims jurisdiction over certain accounts and contract rights and under subsection (2) over general intangibles which, by common law rules, might be held to be within the state's jurisdiction;

In case of delay beyond the four-month period, there is no "relation back"; and this is also true where, in this state, the security interest is perfected for the first time.

Note that even after the four-month period, it is the law of the jurisdiction where the security interest attached which determines its validity. That is to say, such matters as formal requisites continue to be tested by the law with reference to which the parties originally contracted; other matters (rights of third parties, rights on default and so on) are governed by this Article.

Subsection (3) does not apply to the case of goods removed from one filing district to another within this state (see subsection (3) of § 9-401), but only to property brought into this state from another jurisdiction (i. e., from another state, from a foreign country, or from Federal territory).

8. Optional subsection (5) makes an exception to subsection (1) and to § 9-302 on the requirement of filing. Where subsection (1) refers to the law of a foreign nation for the validity and perfection of a security interest in accounts or contract rights, the governing law may be difficult or impossible to ascertain. Subsection (5) therefore provides a substitute rule for such cases, if the transaction is one which bears an appropriate relation to this state. Compare §§ 1-105, 9-102. If a buyer of goods in this state (account debtor) owes money to a foreign seller (assignor) who keeps his records abroad, and an assignment of the account to an assignee in this state is executed here, subsection (5) makes the Article applicable and makes notification to the account debtor the exclusive method of perfecting the assignment. Where there are points of contact with other states as well as this state, the question whether the relation to this state is "appropriate" is left to judicial decision.

Cross References:

§§ 1-105, 9-102 and 9-401.
Point 3: § 9-302.
Point 7: §§ 9-301, 9-312 and 9-402.

Definitional Cross References:

"Account". § 9-106.
"Contract right". § 9-106.
"Debtor". § 9-105.
"Equipment". § 9-109.
"General intangibles". § 9-106.
"Goods". § 9-105.
"Inventory". § 9-109.
"Security interest". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 46.1-71, 55-99.

Comment: Code 1950, § 55-99, requires recordation in Virginia of a "mortgage, deed of trust or other encumbrance created upon personal property" which is "removed into this State." See also Corbett v. Riddle, 209 Fed. 811, 815 (4th Cir. 1913), requiring recordation of a Pennsylvania bailment lease without citation of the Virginia statute. The cases arising under the Virginia statute, with one exception, have involved motor vehicles and it has been generally found that the vehicle has not been removed to Virginia within the meaning of the statute. Universal C.I.T. Credit Corp. v. Kaplan, 198 Va. 67, 71-73, 92 S.E.2d 359 (1956); P.R. Smith Motor Sales, Inc. v. Lay, 173 Va. 117, 121-24, 3 S.E.2d 190 (1939); C.I.T. Corp. v. Guy, 170 Va. 16, 24-26, 195 S.E. 659 (1938). This requirement of a "removal" to Virginia is described in Universal C.I.T. Credit Corp. v. Kaplan, 198 Va. 67, 72, 92 S.E.2d 359 (1956), in the following language: "It is therefore settled that before recordation is required under Code, § 55-99, the property brought into Virginia must come to rest and be located here to the extent of acquiring a new situs. The acquisition of a new situs signifies something more than the temporary or transient presence of the property in this state. It implies some degree of permanency and unless this requirement is established it cannot be said that the property has been 'removed into' and 'located in' Virginia as contemplated by the statute."

A Virginia trial court has held that a conditional sales contract is not an encumbrance within the meaning of Code 1950, § 55-99. Osmond-Barringer Co. v. Hey, 7 Va. Law Reg. (N.S.) 175, 177-80 (Law and Equity Court of Richmond, 1921). The Virginia Supreme Court of Appeals has never passed on the point,

except where motor vehicles are involved and so other statutes are also applicable. In C.I.T. Corp. v. Crosby & Co., 175 Va. 16, 23-26, 7 S.E.2d 107 (1940), an attaching creditor prevailed over the holder of a duly recorded out-of-state conditional sale contract, which had not been re-recorded in Virginia under § 55-99, where the motor vehicle, by virtue of Code 1950, § 46.1-134, should have been registered in Virginia but was not so registered. As to motor vehicles registered in Virginia, Code 1950, § 46.1-71, provides that liens are to be noted on the certificate of title and that local recording is not required, but this section of the Motor Vehicle Code does not exclude the operation of Code 1950, § 55-99, requiring re-recording where the chattel has been removed to Virginia. In Universal C.I.T. Credit Corp. v. Kaplan, 198 Va. 67, 70-76, 92 S.E.2d 359 (1956), the motor vehicle had not been operated in Virginia so as to require registration in the state and it had not been removed to Virginia so that re-recordation under Code 1950, § 55-99, was required. Although theoretically Code 1950, § 55-99, has some application to motor vehicles, as a practical matter it would seem that when a motor vehicle has been "removed" to Virginia so as to be subject to the re-recording requirement of § 55-99, the vehicle has also become so associated with Virginia as to require its registration in the state, and, if so, the certificate of title laws become operative so that local recording is no longer required.

In American Agricultural Chemical Co. v. J. W. Perry Co., 152 Va. 598, 601, 148 S.E. 806 (1929), it was said that a statutory crop lien created under North Carolina law would not follow the crop into Virginia, without a new recording in Virginia, but the court did not discuss the requirement that the crop must be "removed" to Virginia in order for Code 1950, § 55-99, to be applicable.

The UCC changes Virginia law in that a four-month period is given in which to record in Virginia a security interest validly created outside of the state, whereas under the present statute there is no grace period if it is found that the property has been "removed" to Virginia. However, the present "removal" requirement and the operation of the Motor Vehicle Code minimizes the significance of the change.

COUNCIL COMMENT

The optional language appears unobjectional and we recommend its adoption.

§ 9-104. Transactions Excluded From Article. This Article does not apply

(a) to a security interest subject to any statute of the United States such as the Ship Mortgage Act, 1920, to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property; or

(b) to a landlord's lien; or

(c) to a lien given by statute or other rule of law for services or materials except as provided in § 9-310 on priority of such liens; or

(d) to a transfer of a claim for wages, salary or other compensation of an employee; or

(e) to an equipment trust covering railway rolling stock; or

(f) to a sale of accounts, contract rights or chattel paper as part of a sale of the business out of which they arose, or an assignment of accounts, contract rights or chattel paper which is for the purpose of collection only, or a transfer of a contract right to an assignee who is also to do the performance under the contract; or

(g) to a transfer of an interest or claim in or under any policy of insurance or contract for an annuity, including a variable annuity; or

(h) to a right represented by a judgment; or

(i) to any right of set-off; or

(j) except to the extent that provision is made for fixtures in § 9-313, to the creation or transfer of an interest in or lien on real estate, including a lease or rents thereunder; or

(k) to a transfer in whole or in part of any of the following: any claim arising out of tort; any deposit, savings, passbook or like account maintained with a bank, savings and loan association, credit union or like organization.

(VALC Note: Subsection (g) of § 9-104 is contained in the Official Text as follows:

(g) to a transfer of an interest or claim in or under any policy of insurance; or.)

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: To exclude certain security transactions from this Article.

1. Where a federal statute regulates the incidents of security interests in particular types of property, those security interests are of course governed by the federal statute and excluded from this Article. The Ship Mortgage Act, 1920, is an example of such a federal act. Legislation covering aircraft financing has been proposed to the Congress, and, if enacted, would displace this Article in that field. The present provisions of the Civil Aeronautics Act (49 U.S.C.A. § 523) call for registration of title to and liens upon aircraft with the Civil Aeronautics Administrator and such registration is recognized as equivalent to filing under this Article (§ 9-302(3)); but to the extent that the Civil Aeronautics Act does not regulate the rights of parties to and third parties affected by such transactions, security interests in aircraft remain subject to this Article, pending passage of federal legislation.

Although the Federal Copyright Act contains provisions permitting the mortgage of a copyright and for the recording of an assignment of a copyright (17 U.S.C. §§ 28, 30) such a statute would not seem to contain sufficient provisions regulating the rights of the parties and third parties to exclude security interests in copyrights from the provisions of this Article. Compare Republic Pictures Corp. v. Security-First National Bank of Los Angeles, 197 F.2d 767 (9th Cir. 1952). Compare also with respect to patents, 35 U.S.C. § 47. The filing provisions under these Acts, like the filing provisions of the Aeronautics Act, are recognized as the equivalent to filing under this Article. § 9-302(3).

Even such a statute as the Ship Mortgage Act is far from a comprehensive regulation of all aspects of ship mortgage financing. That Act contains provisions on formal requisites, on recordation and on foreclosure but not much more. If problems arise under a ship mortgage which are not covered by the Act, the federal admiralty court must decide whether to improvise an answer under "federal law" or to follow the law of some state with which the mortgage transaction has appropriate contacts. The exclusionary language in paragraph (a) is that this Article does not apply to such security interest "to the extent" that the federal statute governs the rights of the parties. Thus if the federal statute contained no relevant provision, this Article could be looked to for an answer.

2. Except for fixtures (§ 9-313), the Article applies only to security interests in personal property. The exclusion of landlord's liens by paragraph (b) and of leases and other interests in or liens on real estate by paragraph (j) merely reiterates the limitations on coverage already made explicit in § 9-102(3). See Comment 4 to that section.

3. In all jurisdictions liens are given suppliers of many types of services and materials either by statute or by common law. It was thought to be both inappropriate and unnecessary for this Article to attempt a general codification of that lien structure which is in considerable part determined by local conditions and which is far removed from ordinary commercial financing. Paragraph (c) therefore excludes such liens from the Article. § 9-310 states a rule for determining priorities between such liens and the consensual security interests covered by this Article.

4. In many states assignments of wage claims and the like are regulated by statute. Such assignments present important social problems whose solution should be a matter of local regulation. Paragraph (d) therefore excludes them from this Article.

5. The exclusion of (e) is made because the persons chiefly interested in railroad equipment trusts have insisted that their rights and obligations are better governed by existing law. Notice that the exclusion applies only to equipment trusts covering railway rolling stock. Equipment trusts on other kinds of property (e. g. trucks, busses, contractors' equipment) are therefore covered by the Article, and so are security arrangements on railway rolling stock which are not equipment

trusts. Further, the exclusion of (e) does not affect the question of the extent to which § 20c of the Interstate Commerce Act (49 U.S.C. § 20c) overrides state law. See exclusion (a), Comment 1 and § 9-302(3) (a).

6. In general sales as well as security transfers of accounts, contract rights and chattel paper are within the Article (see § 9-102). Paragraph (f) excludes from the Article certain transfers of such intangibles which, by their nature, have nothing to do with commercial financing transactions.

7. Rights under life insurance and other policies, and deposit accounts, are often put up as collateral. Such transactions are often quite special, do not fit easily under a general commercial statute and are adequately covered by existing law. Paragraphs (g) and (k) make appropriate exclusions.

8. The remaining exclusions go to other types of claims which do not customarily serve as commercial collateral: judgments under paragraph (h), set-offs under paragraph (i) and tort claims under paragraph (k).

Cross References:

Point 1: § 9-302(3).
Point 2: §§ 9-102(3) and 9-313.
Point 3: §§ 9-102(2) and 9-310.
Point 5: § 9-302(3).
Point 6: § 9-102.

Definitional Cross References:

"Account". § 9-106.
"Bank". § 1-201.
"Chattel paper". § 9-105.
"Contract". § 1-201.
"Contract right". § 9-106.
"Party". § 1-201.
"Rights". § 1-201.
"Security interest". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 43-29 - 30 (landlord's lien); 43-31 - 40, 43-63 (artisan's liens); 43-1 - 26 (mechanics' and materialmen's liens, and liens of employees and suppliers); 55-161 - 167 (wage assignments).

Comment: This section excludes certain transactions from the coverage of Article 9. As a result the Article does not cover: the lien of landlords and farmers for advances to tenants and laborers, Code 1950, §§ 43-29 through 43-30; the liens of innkeepers, livery stable keepers, agisters, garagemen, mechanics, and laundries and dry cleaners, Code 1950, §§ 43-31 through 43-40 and 43-63; mechanics' and materialmen's liens and liens on franchises and property of transportation and similar companies, Code 1950, §§ 43-1 through 43-26; and wage assignments, Code 1950, §§ 55-161 through 55-167.

Although not explicit on the point, subsection 9-104(c) is broad enough so as to exclude maritime liens from the Article. See *The Henry S.*, 4 F. Supp. 953, 954 (E.D. Va. 1933), which noted the possibility of a conflict between a valid conditional sale and a maritime lien, but found that the conditional sale had not been properly created, and so it was not necessary to decide the point.

COUNCIL COMMENT

The language which we recommend will prevent an unfortunate or improvident person from losing or dissipating rights in an annuity contract which he may have spent years in accumulating against the needs of his old age.

§ 9-105. Definitions and Index of Definitions. (1) In this Article unless the context otherwise requires:

(a) "Account debtor" means the person who is obligated on an account, chattel paper, contract right or general intangible;

(b) "Chattel paper" means a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods. When a transaction is evidenced both by such a security agreement or a

lease and by an instrument or a series of instruments, the group of writings taken together constitutes chattel paper;

(c) "Collateral" means the property subject to a security interest, and includes accounts, contract rights and chattel paper which have been sold;

(d) "Debtor" means the person who owes payment or other performance of the obligation secured, whether or not he owns or has rights in the collateral, and includes the seller of accounts, contract rights or chattel paper. Where the debtor and the owner of the collateral are not the same person, the term "debtor" means the owner of the collateral in any provision of the Article dealing with the collateral, the obligor in any provision dealing with the obligation, and may include both where the context so requires;

(e) "Document" means document of title as defined in the general definitions of Article 1 (§ 1-201);

(f) "Goods" includes all things which are movable at the time the security interest attaches or which are fixtures (§ 9-313), but does not include money, documents, instruments, accounts, chattel paper, general intangibles, contract rights and other things in action. "Goods" also include the unborn young of animals and growing crops;

(g) "Instrument" means a negotiable instrument (defined in § 3-104), or a security (defined in § 8-102) or any other writing which evidences a right to the payment of money and is not itself a security agreement or lease and is of a type which is in ordinary course of business transferred by delivery with any necessary indorsement or assignment;

(h) "Security agreement" means an agreement which creates or provides for a security interest;

(i) "Secured party" means a lender, seller or other person in whose favor there is a security interest, including a person to whom accounts, contract rights or chattel paper have been sold. When the holders of obligations issued under an indenture of trust, equipment trust agreement or the like are represented by a trustee or other person, the representative is the secured party.

(2) Other definitions applying to this Article and the sections in which they appear are:

"Account". § 9-106.
"Consumer goods". § 9-109(1).
"Contract right". § 9-106.
"Equipment". § 9-109(2).
"Farm products". § 9-109(3).
"General intangibles". § 9-106.
"Inventory". § 9-109(4).
"Lien creditor". § 9-301(3).
"Proceeds". § 9-306(1).
"Purchase money security interest". § 9-107.

(3) The following definitions in other Articles apply to this Article:

"Check". § 3-104.
"Contract for sale". § 2-106.
"Holder in due course". § 3-302.
"Note". § 3-104.
"Sale". § 2-106.

(4) In addition Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

COMMENT: **Prior Uniform Statutory Provisions:** Various.

Purposes: To state the sense in which certain words are used in this Article.

1. **General.** It is necessary to have a set of terms to describe the parties to a secured transaction, the agreement itself, and the property involved therein; but the selection of the set of terms applicable to any one of the existing forms (e. g., mortgagor and mortgagee) might carry to some extent the implication that the existing law referable to that form was to be used for the construction and interpretation of this Article. Since it is desired to avoid any such implication, a set of terms has been chosen which have no common law or statutory roots tying them to a particular form.

In place of such terms as "chattel mortgage," "conditional sale," "assignment of accounts receivable," "trust receipt," etc., this Article substitutes the general term "security agreement", defined in subsection (1) (h). In place of "mortgagor," "mortgagee," "conditional vendee," "conditional vendor," etc., this Article substitutes "debtor", defined in subsection (1) (d), and "secured party", defined in subsection (1) (i). The property subject to the security agreement is "collateral", defined in subsection (1) (c). The interest in the collateral which is conveyed by the debtor to the secured party is a "security interest", defined in § 1-201(37).

2. **Parties.** The parties to the security agreement are the "debtor" and the "secured party."

"Debtor": In all but a few cases the person who owes the debt and the person whose property secures the debt will be the same. Occasionally, one person furnishes security for another's debt, and sometimes property is transferred subject to a secured debt of the transferor which the transferee does not assume; in such cases, under the second sentence of the definition, the term "debtor" may, depending upon the context, include either or both such persons. § 9-112 sets out special rules which are applicable where collateral is owned by a person who does not owe a debt.

"Secured Party": The term includes any person in whose favor there is a security interest (defined in § 1-201). The term is used equally to refer to a person who as a seller retains a lien on or title to goods sold, to a person whose interest arises initially from a loan transaction, and to an assignee of either. Note that a seller is a "secured party" in relation to his customer; the seller becomes a "debtor" if he assigns the chattel paper as collateral. This is also true of a lender who assigns the debt as collateral. With the exceptions stated in § 9-104(f) the Article applies to any sale of accounts, contract rights or chattel paper; the term "secured party" includes an assignee of such intangibles whether by sale or for security, to distinguish him from the payee of the account, for example, who becomes a "debtor" by pledging the account as security for a loan.

"Account debtor": Where the collateral is an account, contract right, chattel paper or general intangible the original obligor is called the "account debtor", defined in subsection (1) (a).

3. **Property subject to the security agreement.** "Collateral", defined in subsection (1) (c), is a general term for the tangible and intangible property subject to a security interest. For some purposes the Code makes distinctions between different types of collateral and therefore further classification of collateral is necessary. Collateral which consists of tangible property is "goods", defined in subsection (1) (f); and "goods" are again subdivided in § 9-109. For purposes of this Article all intangible collateral fits one of six categories, three of which, "accounts", "contract rights" and "general intangibles", are defined in the following § 9-106; the other three, "documents", "instruments" and "chattel paper", are defined in subsections (1) (e), (1) (g) and (1) (b) of this Section.

"Goods": The definition in subsection (1) (f) is similar to that contained in § 2-105 except that the Sales Article definition refers to "time of identification to the contract for sale", while this definition refers to "the time the security interest attaches".

For the treatment of fixtures, § 9-313 should be consulted. It will be noted that the treatment of fixtures under § 9-313 does not at all points conform to their treatment under § 2-107 (goods to be severed from realty). § 2-107 relates to sale of such goods; § 9-313 to security interests in them. The discrepancies between the two sections arise from the differences in the types of interest covered.

For the purpose of this Article, goods are classified as "consumer goods", "equipment", "farm products", and "inventory"; those terms are defined in § 9-109. When the general term "goods" is used in this Article, it includes, as may be appropriate in the context, the subclasses of goods defined in § 9-109.

"Instrument": The term as defined in subsection (1) (g) includes not only negotiable instruments and investment securities but also any other intangibles evidenced by writings which are in ordinary course of business transferred by delivery. As in the case of chattel paper "delivery" is only the minimum stated and may be accompanied by other steps.

If a writing is itself a security agreement or lease with respect to specific goods it is not an instrument although it otherwise meets the term of the definition. See Comment below on "chattel paper".

"Documents": See the Comment under § 1-201(15).

"Chattel paper": To secure his own financing a secured party may wish to borrow against or sell the security agreement itself along with his interest in the collateral which he has received from his debtor. Since the refinancing of paper secured by specific goods presents some problems of its own, the term "chattel paper" is used to describe this kind of collateral. The comments under § 9-308 further describe this concept.

4. The following transactions illustrate the use of the term "chattel paper" and some of the other terms defined in this Section.

A dealer sells a tractor to a farmer on conditional sales contract. The conditional sales contract is a "security agreement", the farmer is the "debtor", the dealer is the "secured party" and the tractor is the type of "collateral" defined in § 9-109 as "equipment". But now the dealer transfers the contract to his bank, either by outright sale or to secure a loan. Since the conditional sales contract is a security agreement relating to specific equipment the conditional sales contract is now the type of collateral called "chattel paper". In this transaction between the dealer and his bank, the bank is the "secured party", the dealer is the "debtor", and the farmer is the "account debtor".

Under the definition of "security interest" in § 1-201(37) a lease does not create a security interest unless intended as security. Whether or not the lease itself is a security agreement, it is chattel paper when transferred if it relates to specific goods. Thus, if the dealer enters into a straight lease of the tractor to the farmer (not intended as security), and then arranges to borrow money on the security of the lease, the lease is chattel paper.

Chattel mortgages and conditional sales contracts are frequently executed in connection with a negotiable note or a series of such notes. Under the definitions in subsections (1) (b) and (1) (g) the rules applicable to chattel paper, rather than those relating to instruments, are applicable to the group of writings (contract plus note) taken together.

5. Comments to the definitions indexed in subsections (2) and (3) follow the sections in which the definitions are contained.

Cross References:

Point 2: §§ 9-104(f) and 9-112.
Point 3: §§ 2-105, 2-107, 9-106, 9-109, 9-308 and 9-313.

Definitional Cross References:

"Account". § 9-106.
"Agreement". § 1-201.
"Contract right". § 9-106.
"Document of title". § 1-201.
"General intangibles". § 9-106.
"Holder". § 1-201.
"Money". § 1-201.
"Negotiable instrument". § 3-104.
"Person". § 1-201.
"Representative". § 1-201.
"Rights". § 1-201.
"Security". § 8-102.
"Security interest". § 1-201.
"Writing". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 9-106. **Definitions: "Account"; "Contract Right"; "General Intangibles".** "Account" means any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper. "Contract right" means any right to payment under a contract not yet earned by performance and not evidenced by an instrument or chattel paper. "General intangibles" means any personal property (including things in action) other than goods, accounts, contract rights, chattel paper, documents and instruments.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: The terms defined in this Section rounded out the classification of intangibles: see the definitions of "document of title" (§ 1-201), "chattel paper" (§ 9-105) and "instrument" (§ 9-105). Those three terms cover the various categories of commercial paper which are either negotiable or to a greater or less extent dealt with as if negotiable: the closely related terms "account" and "contract right" cover those choses in action which may be the subject of commercial financing transactions but which are not evidenced by an indispensable writing. The term "general intangibles" brings under this Article miscellaneous types of contractual rights and other personal property which are used or may become customarily used as commercial security. Examples are goodwill, literary rights and rights to performance. Other examples are copyrights, trade-marks and patents, except to the extent that they may be excluded by § 9-104(a). This Article solves the problems of filing of security interests in these types of intangibles (§§9-103(2) and 9-401). Note that this catch-all definition does not apply to types of intangibles which are specifically excluded from the coverage of the Article (§ 9-104) and note also that under § 9-302(2) (a) filing under a federal statute may satisfy the filing requirements of this Article.

"Account" as defined is a right to payment for goods sold or leased or services rendered: that is to say, a right earned by performance, whether or not due and payable, the ordinary commercial account receivable. "Contract right" is a right to be earned by future performance under an existing contract: for example, rights to arise when deliveries are made under an installment contract or as work is completed under a building contract. Contract rights may be regarded as potential accounts: they become accounts as performance is made under the contract.

It has been found advisable to distinguish rights earned from rights not yet earned for several reasons. The recognition of the "contract right" as collateral in a security transaction makes clear that this Article rejects any lingering common law notion that only rights already earned can be assigned. Furthermore in the triangular arrangement following assignment, there is reason to allow the original parties—assignor and account debtor—more flexibility in modifying the underlying contract before performance than after performance (see § 9-318). It will, however, be found that in most situations the same rules apply to both accounts and contract rights.

Cross References:

§§ 9-103(2), 9-104, 9-302(2) (a), 9-318 and 9-401.

Definitional Cross References:

"Chattel paper". § 9-105.
"Contract". § 1-201.
"Document". § 9-105.
"Goods". § 9-105.
"Instrument". § 9-105.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 9-107. **Definitions: "Purchase Money Security Interest".** A security interest is a "purchase money security interest" to the extent that it is

(a) taken or retained by seller of the collateral to secure all or part of its price; or

(b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. Under existing rules of law and under this Article purchase money obligations often have priority over other obligations. Thus a purchase money obligation has priority over an interest acquired under an after-acquired property clause (§ 9-312(3) and (4)), where filing is required a grace period of ten days is allowed against creditors and transferees in bulk (§ 9-301(2)); and in some instances filing may not be necessary (§ 9-302(1) (c) and (d)).

Under this Section a seller has a purchase money security interest if he retains a security interest in the goods; a financing agency has a purchase money security interest when it advances money to the seller, taking back an assignment of chattel paper, and also when it makes advances to the buyer (e. g., on chattel mortgage) to enable him to buy, and he uses the money for that purpose.

2. When a purchase money interest is claimed by a secured party who is not a seller, he must of course have given present consideratian. This Section therefore provides that the purchase money party must be one who gives value "by making advances or incurring an obligation": the quoted language excludes from the purchase money category any security interest taken as security for or in satisfaction of a preexisting claim or antecedent debt.

Cross References:

Point 1: §§ 9-301, 9-302 and 9-312.
Point 2: § 9-108.

Definitional Cross References:

"Collateral". § 9-105.
"Debtor". § 9-105.
"Person". § 1-201.
"Rights". § 1-201.
"Security interest". § 1-201.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 55-60.

Comment: The definition is in accord with the definition of "deferred purchase money" in a deed of trust, as given in Code 1950, § 55-60.

§ 9-108. When After-Acquired Collateral Not Security for Antecedent Debt. Where a secured party makes an advance, incurs an obligation, releases a perfected security interest, or otherwise gives new value which is to be secured in whole or in part by after-acquired property his security interest in the after-acquired collateral shall be deemed to be taken for new value and not as security for an antecedent debt if the debtor acquires his rights in such collateral either in the ordinary course of his business or under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. Many financing transactions contemplate that the collateral will include both the debtor's existing assets and also assets thereafter acquired by him in the operation of his business. This Article generally validates such after-acquired property interests (see § 9-204 and Comment) although they may be subordinated to later purchase money interests under § 9-312(3) and (4).

Interests in after-acquired property have never been considered as involving transfers of property for antecedent debt merely because of the after-acquired feature, nor should they be so considered. The section makes explicit what has been true under the case law: an after-acquired property interest is not, by virtue of that fact alone, security for a pre-existing claim. This rule is of importance principally in insolvency proceedings under the federal Bankruptcy Act or state statutes which make certain transfers for antecedent debt voidable

as preferences. The determination of when a transfer is for antecedent debt is largely left by the Bankruptcy Act to state law.

Two tests must be met under this section for an interest in after-acquired property to be one not taken for an antecedent debt. *First*: the secured party must, at the inception of the transaction, have given new value in some form. *Second*: the after-acquired property must come in either in the ordinary course of the debtor's business or as an acquisition which is made under a contract of purchase entered into within a reasonable time after the giving of new value pursuant to the security agreement. The reason for the first test needs no comment. The second is in line with limitations which judicial construction has placed on the operation of after-acquired property clauses. Their coverage has been in many cases restricted to subsequent ordinary course acquisitions: this Article does not go so far (see § 9-204 and Comment), but it does deny present value status to out of ordinary course acquisitions not made pursuant to the original loan agreement. This solution gives the secured party full protection as to the collateral which he may be reasonably thought to have contracted for; it gives other creditors the possibility, under the law of preferences, of subjecting to their claims windfall or uncontemplated acquisitions shortly before bankruptcy.

2. The term "value" is defined in § 1-201(44) and discussed in the accompanying Comment. In this Section and in other sections of this Article the term "new value" is used but is left without statutory definition. The several illustrations of "new value" given in the text of this Section (making an advance, incurring an obligation, releasing a perfected security interest) as well as the "purchase money security interest" definition in § 9-107 indicate the nature of the concept. In other situations it is left to the courts to distinguish between "new" and "old" value, between present considerations and antecedent debt.

Cross References:

Point 1: §§ 9-204 and 9-312.
Point 2: § 9-107.

Definitional Cross References:

"Collateral". § 9-105.
"Contract". § 1-201.
"Debtor". § 9-105.
"Purchase". § 1-201.
"Rights". § 1-201.
"Secured party". § 9-105.
"Security agreement". § 9-105.
"Security interest". § 1-201.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 9-109. Classification of Goods; "Consumer Goods"; "Equipment"; "Farm Products"; "Inventory". Goods are

(1) "consumer goods" if they are used or bought for use primarily for personal, family or household purposes;

(2) "equipment" if they are used or bought for use primarily in business (including farming or a profession) or by a debtor who is a non-profit organization or a governmental subdivision or agency or if the goods are not included in the definitions of inventory, farm products or consumer goods;

(3) "farm products" if they are crops or livestock or supplies used or produced in farming operations or if they are products of crops or livestock in their unmanufactured states (such as ginned cotton, wool-clip, maple syrup, milk and eggs), and if they are in the possession of a debtor engaged in raising, fattening, grazing or other farming operations. If goods are farm products they are neither equipment nor inventory;

(4) "inventory" if they are held by a person who holds them for sale or lease or to be furnished under contracts of service or if he has so fur-

nished them, or if they are raw materials, work in process or materials used or consumed in a business. Inventory of a person is not to be classified as his equipment.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. This Section classifies goods as consumer goods, equipment, farm products and inventory. The classification is important in many situations: it is relevant, for example, in determining the rights of persons who buy from a debtor goods subject to a security interest (§ 9-307), in certain questions of priority (§ 9-312), in determining the place of filing (§ 9-401) and in working out rights after default (Part 5). Comment 5 to § 9-102 contains an index of the special rules applicable to different classes of collateral.

2. The classes of goods are mutually exclusive; the same property cannot at the same time and as to the same person be both equipment and inventory, for example. In borderline cases—a physician's car or a farmer's jeep which might be either consumer goods or equipment—the principal use to which the property is put should be considered as determinative. Goods can fall into different classes at different times; a radio is inventory in the hands of a dealer and consumer goods in the hands of a householder.

3. The principal test to determine whether goods are inventory is that they are held for immediate or ultimate sale. Implicit in the definition is the criterion that the prospective sale is in the ordinary course of business. Machinery used in manufacturing, for example, is equipment and not inventory even though it is the continuing policy of the enterprise to sell machinery when it becomes obsolete. Goods to be furnished under a contract of service are inventory even though the arrangement under which they are furnished is not technically a sale. When an enterprise is engaged in the business of leasing a stock of products to users (for example, the fleet of cars owned by a car rental agency), that stock is also included within the definition of "inventory". It should be noted that one class of goods which is not held for disposition to a purchaser or user is included in inventory: "Materials used or consumed in a business". Examples of this class of inventory are fuel to be used in operations, scrap metal produced in the course of manufacture, and containers to be used to package the goods. In general it may be said that goods used in a business are equipment when they are fixed assets or have, as identifiable units, a relatively long period of use; but are inventory, even though not held for sale, if they are used up or consumed in a short period of time in the production of some end product.

4. Goods are "farm products" only if they are in the possession of a debtor engaged in farming operations. Animals in a herd of livestock are covered whether they are acquired by purchase or result from natural increase. Products of crops or livestock remain farm products so long as they are in the possession of a debtor engaged in farming operations and have not been subjected to a manufacturing process. The terms "crops", "livestock" and "farming operations" are not defined; however, it is obvious from the text that "farming operations" includes raising livestock as well as crops; similarly, since eggs are products of livestock, livestock includes fowl.

When crops or livestock or their products come into the possession of a person not engaged in farming operations they cease to be "farm products". If they come into the possession of a marketing agency for sale or distribution or of a manufacturer or processor as raw materials, they become inventory.

Products of crops or livestock, even though they remain in the possession of a person engaged in farming operations, lose their status as farm products if they are subjected to a manufacturing process. What is and what is not a manufacturing operation is not determined by this Article. At one end of the scale some processes are so closely connected with farming—such as pasteurizing milk or boiling sap to produce maple syrup or maple sugar—that they would not rank as manufacturing. On the other hand an extensive canning operation would be manufacturing. The line is one for the courts to draw. After farm products have been subjected to a manufacturing operation, they become inventory if held for sale.

Note that the buyer in ordinary course who under § 9-307 takes free of a security interest in goods held for sale does not include one who buys farm products from a person engaged in farming operations.

5. The principal definition of equipment is a negative one: goods used in a business (including farming or a profession) which are not inventory and not farm products. Trucks, rolling stock, tools, machinery are typical. It will be noted furthermore

that any goods which are not covered by one of the other definitions in this section are to be treated as equipment.

Cross References:

Point 1: §§ 9-102, 9-307, 9-312, 9-401 and Part 5.
Point 3: § 9-307.
Point 4: § 9-307.

Definitional Cross References:

"Contract". § 1-201.
"Debtor". § 9-105.
"Goods". § 9-105.
"Organization". § 1-201.
"Person". § 1-201.
"Sale". §§ 2-106 and 9-105.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 9-110. Sufficiency of Description. For the purpose of this Article any description of personal property or real estate is sufficient whether or not it is specific if it reasonably identifies what is described.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: The requirement of description of collateral (see § 9-203 and Comment thereto) is evidentiary. The test of sufficiency of a description laid down by this Section is that the description do the job assigned to it—that it make possible the identification of the thing described. Under this rule courts should refuse to follow the holdings, often found in the older chattel mortgage cases, that descriptions are insufficient unless they are of the most exact and detailed nature, the so-called "serial number" test. The same test of reasonable identification applies where a description of real estate is required in a financing statement. See § 9-402.

Cross References:

§§ 9-203 and 9-402.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: For comment see VIRGINIA ANNOTATIONS to UCC 9-402.

§ 9-111. Applicability of Bulk Transfer Laws. The creation of a security interest is not a bulk transfer under Article 6 (see § 6-103).

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: The bulk transfer laws, which have been almost everywhere enacted, were designed to prevent a once prevalent type of fraud which seems to have flourished particularly in the retail field: the owner of a debt-burdened enterprise would sell it to an unwary purchaser and then remove himself, with the purchase price and his other assets, beyond the reach of process. The creditors would find themselves with no recourse unless they could establish that the purchaser assumed existing debts. The bulk transfer laws, which require advance notice of sale to all known creditors, seem to have been successful in preventing such frauds.

There has been disagreement whether the bulk transfer laws should be applied to security as well as to sale transactions. In most states security transactions have not been covered; in a few states the opposite result has been reached either by judicial construction or by express statutory provision. Whatever the reasons may be, it seems to be true that the bulk transfer type of fraud has not often made its appearance in the security field: it may be that lenders of money are more inclined to investigate a potential borrower than are purchasers of retail stores to determine the true state of their vendor's affairs. Since compliance with the bulk transfer laws is onerous and expensive, legitimate financing transactions should not be required to comply when there is no reason to believe that other creditors will be prejudiced.

This Section merely reiterates the provisions of Article 6 on Bulk Transfers which provides in § 6-103(1) that transfers "made to give security for the performance of an obligation" are not subject to that Article.

Cross Reference:

§ 6-103(1).

Definitional Cross Reference:

"Security interest". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 9-112. **Where Collateral Is Not Owned by Debtor.** Unless otherwise agreed, when a secured party knows that collateral is owned by a person who is not the debtor, the owner of the collateral is entitled to receive from the secured party any surplus under § 9-502(2) or under § 9-504(1), and is not liable for the debt or for any deficiency after resale, and he has the same right as the debtor

(a) to receive statements under § 9-208;

(b) to receive notice of and to object to a secured party's proposal to retain the collateral in satisfaction of the indebtedness under § 9-505;

(c) to redeem the collateral under § 9-506;

(d) to obtain injunctive or other relief under § 9-507(1); and

(e) to recover losses caused to him under § 9-208(2).

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: Under the definition of § 9-105, in any provisions of the Article dealing with the collateral the term "debtor" means the owner of the collateral even though he is not the person who owes payment or performance of the obligation secured. This Section covers several situations in which the implications of this definition are specifically set out.

The duties which this Section imposes on a secured party toward such an owner of collateral are conditioned on the secured party's knowledge of the true state of facts. Short of such knowledge he may continue to deal exclusively with the person who owes the obligation. Nor does the Section suggest that the secured party is under any duty of inquiry. It does not purport to cut across the law of conversion or of ultra vires. Whether a person who does not own property has authority to encumber it for his own debts and whether a person is free to encumber his property as collateral for the debts of another, are matters to be decided under other rules of law and are not covered by this Section.

The Section does not purport to be an exhaustive treatment of the subject. It isolates certain problems which may be expected to arise and states rules as to them. Others will no doubt arise: their solution is left to the courts.

Cross References:

§§ 9-105, 9-208 and Part 5.

Definitional Cross References:

"Collateral". § 9-105.
"Debtor". § 9-105.
"Notice". § 1-201.
"Person". § 1-201.
"Receive notice". § 1-201.
"Right". § 1-201.
"Secured party". § 9-105.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 9-113. **Security Interests Arising Under Article on Sales.** A security interest arising solely under the Article on Sales (Article 2) is subject to the provisions of this Article except that to the extent that and so long as the debtor does not have or does not lawfully obtain possession of the goods

(a) no security agreement is necessary to make the security interest enforceable; and

(b) no filing is required to perfect the security interest; and

(c) the rights of the secured party on default by the debtor are governed by the Article on Sales (Article 2).

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. Under the provisions of Article 2 on Sales, a seller of goods may reserve a security interest (see, e. g., §§ 2-401 and 2-505); and in certain circumstances, whether or not a security interest is reserved, the seller has rights of resale and stoppage under §§ 2-703, 2-705 and 2-706 which are similar to the rights of a secured party. Similarly, under such sections as §§ 2-506, 2-707 and 2-711, a financing agency, an agent, a buyer or another person may have a security interest or other right in goods similar to that of a seller. The use of the term "security interest" in the Sales Article is meant to bring the interests so designated within this Article. This Section makes it clear, however, that such security interests are exempted from certain provisions of this Article. Compare § 4-208(3), making similar special provisions for security interests arising in the bank collection process.

2. The security interests to which this Section applies commonly arise by operation of law in the course of a sale transaction. Since the circumstances under which they arise are defined in the Sales Article, there is no need for the "security agreement" defined in § 9-105(1)(h) and required by §§ 9-203(1)(b) and 9-204(1), and paragraph (a) dispenses with such requirements. The requirement of filing may be inapplicable under §§ 9-302(1)(a) and (b), 9-304 and 9-305, where the goods are in the possession of the secured party or of a bailee other than the debtor. To avoid difficulty in the residual cases, as for example where a bailee does not receive notification of the secured party's interest until after the security interest arises, paragraph (b) dispenses with any filing requirement. Finally, paragraph (c) makes inapplicable the default provisions of Part 5 of this Article, since the Sales Article contains detailed provisions governing stoppage of delivery and resale after breach. See §§ 2-705, 2-706, 2-707(2) and 2-711(3).

3. These limitations on the applicability of this Article to security interests arising under the Sales Article are appropriate only so long as the debtor does not have or lawfully obtain possession of the goods. Compare § 56(b) of the Uniform Sales Act. A secured party who wishes to retain a security interest after the debtor lawfully obtains possession must comply fully with all the provisions of this Article and ordinarily must file a financing statement to perfect his interest. This is the effect of the "except" clause in the preamble to this Section. Note that in the case of a buyer who has a security interest in rejected goods under § 2-711(3), the buyer is the "secured party" and the seller is the "debtor".

4. This Section applies only to a "security interest". The definition of "security interest" in § 1-201(37) expressly excludes the special property interest of a buyer of goods on identification under § 2-401(1). The seller's interest after identification and before delivery may be more than a security interest by virtue of explicit agreement under §§ 2-401(1) or 2-501(1), by virtue of the provisions of § 2-401(2), (3) or (4), or by virtue of substitution pursuant to § 2-501(2). In such cases, Article 9 is inapplicable by the terms of § 9-102(1)(a).

5. Where there is a "security interest", this Section applies only if the security interest arises "solely" under the Sales Article. Thus § 1-201(37) permits a buyer to acquire by agreement a security interest in goods not in his possession or control; such a security interest does not impair his rights under the Sales Article, but any rights based on the security agreement are fully subject to this Article without regard to the limitations of this Section. Similarly, a seller who reserves a security interest by agreement does not lose his rights under the Sales Article, but rights other than those conferred by the Sales Article depend on full compliance with this Article.

Cross References:

Point 1: §§ 2-401, 2-505, 2-506, 2-705, 2-706, 2-707, 2-711(3), 4-208(3).
Point 2: §§ 2-705, 2-706, 2-707(2), 2-711(3), 9-203(1)(b), 9-204(1), 9-302(1)(a) and (b), 9-304, 9-305 and Part 5.
Point 3: § 2-711(3).
Point 4: §§ 2-401, 2-501 and 9-102(1)(a).

Definitional Cross References:

"Debtor". § 9-105.
"Goods". § 9-105.
"Rights". § 1-201.
"Secured party". § 9-105.
"Security agreement". § 9-105.
"Security interest". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

PART 2

VALIDITY OF SECURITY AGREEMENT AND RIGHTS OF PARTIES THERETO

§ 9-201. General Validity of Security Agreement. Except as otherwise provided by this Act a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors. Nothing in this Article validates any charge or practice illegal under any statute or regulation thereunder governing usury, small loans, retail installment sales, or the like, or extends the application of any such statute or regulation to any transaction not otherwise subject thereto.

COMMENT: Prior Uniform Statutory Provisions: § 4, Uniform Conditional Sales Act; § 3, Uniform Trust Receipts Act.

Changes: Rewritten; no change in substance.

Purposes of Changes: This section states the general validity of a security agreement. In general the security agreement is effective between the parties; it is likewise effective against third parties. Exceptions to this general rule arise where there is a specific provision in any Article of this Act, for example, where Article 1 invalidates a disclaimer of the obligations of good faith, etc. (§ 1-102(3)), or this Article subordinates the security interest because it has not been perfected (§ 9-301) or for other reasons (see § 9-312 on priorities) or defeats the security interest where certain types of claimants are involved (for example § 9-307 on buyers of goods). As pointed out in the Note to § 9-102, there is no intention that the enactment of this Article should repeal retail installment selling acts or small loan acts. Nor of course are the usury laws of any state repealed. These are mentioned in the text of § 9-201 as examples of applicable laws, outside this Code entirely, which might invalidate the terms of a security agreement.

Cross References:

§§ 1-102(3), 9-301, 9-307 and 9-312.

Definitional Cross References:

"Collateral". § 9-105.
"Creditor". § 1-201.
"Party". § 1-201.
"Purchaser". § 1-201.
"Security agreement". § 9-105.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-552 (trust receipts).

Comment: The UCC is in accord with Virginia law in recognizing that as between the parties a security agreement is effective in accordance with its terms. The Virginia Supreme Court of Appeals said in Universal Credit Co. v. Taylor, 164 Va. 624, 628, 180 S.E. 277 (1935), that "their rights and liabilities depend upon the intention of the parties as expressed in the contract by which they have bound themselves." In New Jersey Fidelity and Plate Glass Insurance Co. v. General Electric Co., 160 Va. 342, 347-48, 168 S.E. 425 (1933), the court pointed out that a conditional sales contract was valid without recordation as between all of the original parties—the conditional vendor who supplied electrical equipment for a ferry, the conditional vendee who built the ferry, and the ferry owner who had notice of the lien. Stickney v. General Electric Co., 44 F.2d 362, 365 (4th Cir. 1930), involves the same transaction and is to the same effect. See also Newcomb v. Guthrie, 145 Va. 627, 632, 134 S.E. 585 (1926) and Janney v. Bell, 111 F.2d 103, 104-05 (4th Cir. 1940). In accordance with the contract between the parties it has been held that the seller can take out insurance and add the premium to the buyer's debt. Fisch v. Steingold, 79 F.2d 448, 450-51 (4th Cir. 1935).

This section does not explicitly cover the situation presented in B-W Acceptance Corp. v. Benjamin T. Crump Co., 199 Va. 312, 99 S.E.2d 606 (1957), in which the debtor, who had not complied with a trust receipt financing arrangement, was held liable to a creditor, who had not perfected his security interest by filing. The basic holding of the case appears to be that a creditor is under no duty to perfect his security interest in order to protect a debtor, who has not complied with the agreement between the parties, from loss.

The UCC does not validate any agreement otherwise illegal under state law. In Levy v. Davis, 115 Va. 814, 816-21, 81 S.E. 791 (1914), Virginia refused to enforce a conditional sale contract on chattels knowingly sold for use in a house of prostitution.

§ 9-202. Title to Collateral Immaterial. Each provision of this Article with regards to rights, obligations and remedies applies whether title to collateral is in the secured party or in the debtor.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: The rights and duties of the parties to a security transaction and of third parties are stated in this Article without reference to the location of "title" to the collateral. Thus the incidents of a security interest which secures the purchase price of goods are the same under this Article whether the secured party appears to have retained title or the debtor appears to have obtained title and then conveyed it or a lien to the secured party. This Article in no way determines which line of interpretation (title theory v. lien theory or retained title v. conveyed title) should be followed in cases where the applicability of some other rule of law depends upon who has title. Thus if a revenue law imposes a tax on the "legal" owner of goods or if a corporation law makes a vote of the stockholders prerequisite to a corporation "giving" a security interest but not if it acquires property "subject" to a security interest, this Article does not attempt to define whether the secured party is a "legal" owner or whether the transaction "gives" a security interest for the purpose of such laws. Other rules of law or the agreement of the parties determine the location of "title" for such purposes. Petitions for reclamation brought by a secured party in his debtor's insolvency proceedings have often been granted or denied on a title theory: where the secured party has title, reclamation will be granted; where he has "merely a lien", reclamation may be denied. For the treatment of such petitions under this Article, see Point 1 of Comment to § 9-507.

Cross References:

§§ 2-401 and 2-507.

Definitional Cross References:

"Collateral". § 9-105.
"Debtor". § 9-105.
"Remedy". § 1-201.
"Rights". § 1-201.
"Secured party". § 9-105.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 9-203. **Enforceability of Security Interest; Proceeds, Formal Requisites.** (1) Subject to the provisions of § 4-208 on the security interest of a collecting bank and § 9-113 on a security interest arising under Article on Sales, a security interest is not enforceable against the debtor or third parties unless

(a) the collateral is in the possession of the secured party; or

(b) the debtor has signed a security agreement which contains a description of the collateral and in addition, when the security interest covers crops or oil, gas or minerals to be extracted or timber to be cut, a description of the land concerned. In describing collateral, the word "proceeds" is sufficient without further description to cover proceeds of any character.

(2) A transaction, although subject to this Article, is also subject to §§ 6-274 through 6-338, § 11-4, and § 46.1-545 of the Code of Virginia, and in the case of conflict between the provisions of this Article and any such statute, the provisions of such statute control. Failure to comply with any applicable statute has only the effect which is specified therein.

(VALC Note: Blanks have been filled in with references to appropriate statutes, as indicated in the Virginia Annotations.)

Note: *At * in subsection (2) insert reference to any local statute regulating small loans, retail installment sales and the like.*

The foregoing subsection (2) is designed to make it clear that certain transactions, although subject to this Article, must also comply with other applicable legislation.

This Article is designed to regulate all the "security" aspects of transactions within its scope. There is, however, much regulatory legislation, particularly in the consumer field, which supplements this Article and should not be repealed by its enactment. Examples are small loan acts, retail installment selling acts and the like. Such acts may provide for licensing and rate regulation and may prescribe particular forms of contract. Such provisions should remain in force despite the enactment of this Article. On the other hand if a Retail Installment Selling Act contains provisions on filing, rights on default, etc., such provisions should be repealed as inconsistent with this Article.

COMMENT: Prior Uniform Statutory Provision: § 2, Uniform Trust Receipts Act.

Changes: Adapted to fit the scheme of this Article.

Purposes of Changes: 1. Here as elsewhere in this Article, following the policy of the Uniform Trust Receipts Act, formal requisites are reduced to a minimum. The technical requirements of acknowledgment, accompanying affidavits, etc., common to much chattel mortgage legislation, are abandoned. The only requirements for the enforceability of non-possessory security interests in cases not involving land are (a) a writing; (b) the debtor's signature; and (c) a description of the collateral or kinds of collateral. (Typically, of course, the agreement will contain much more.) As to the type of description which will satisfy the requirements of this Section, see § 9-110 and Comment thereto.

2. In the case of crops, or timber growing on land, or of gas or oil or minerals to be extracted, the best identification is by describing the land and subsection (1)(b) requires such a description.

3. One purpose of the formal requisites stated in subsection (1) (b) is evidentiary. The requirement of written record minimizes the possibility of future dispute as to the terms of a security agreement and as to what property stands as collateral for the obligation secured. Where the collateral is in the possession of the secured party, the evidentiary need for a written record is much less than where the collateral is in the debtor's possession; customarily, of course, as a

matter of business practice the written record will be kept, but, in this Article as at common law, the writing is not a formal requisite. Subsection (1) (a), therefore, dispenses with the written agreement—and thus with signature and description—if the collateral is in the secured party's possession.

4. The definition of "security agreement" (§ 9-105) is "an agreement which creates or provides for a security interest". Under that definition the requirement of this Section that the debtor sign a security agreement is not intended to reject, and does not reject, the deeply rooted doctrine that a bill of sale although absolute in form may be shown to have been in fact given as security. Under this Article as under prior law a debtor may show by parol evidence that a transfer purporting to be absolute was in fact for security and may then, on payment of the debt, assert his fundamental right to return of the collateral and execution of an acknowledgment of satisfaction.

5. The formal requisites stated in this Section are not only conditions to the enforceability of a security interest against third parties. They are in the nature of a Statute of Frauds. Unless the secured party is in possession of the collateral, his security interest, absent a writing which satisfies subsection (1) (b), is not enforceable even against the debtor, and cannot be made so on any theory of equitable mortgage or the like. If he has advanced money, he is of course a creditor and, like any creditor, is entitled after judgment to appropriate process to enforce his claim against his debtor's assets; he will not, however, have against his debtor the rights given a secured party by Part 5 of this Article on Default. The theory of equitable mortgage, insofar as it has operated to allow creditors to enforce informal security agreements against debtors, may well have developed as a necessary escape from the elaborate requirements of execution, acknowledgment and the like which the nineteenth century chattel mortgage acts vainly relied on as a deterrent to fraud. Since this Article reduces formal requisites to a minimum, the doctrine is no longer necessary or useful. More harm than good would result from allowing creditors to establish a secured status by parol evidence after they have neglected the simple formality of obtaining a signed writing.

6. Subsection (2) states that the provisions of regulatory statutes covering the field of consumer finance prevail over the provisions of this Article in case of conflict. The second sentence of the subsection is added to make clear that no doctrine of total voidness for illegality is intended: failure to comply with the applicable regulatory statute has whatever effect may be specified in that statute, but no more.

Cross References:

§§ 4-208 and 9-113.
Point 1: § 9-110.
Point 5: Part 5.

Definitional Cross References:

"Collateral". § 9-105.
"Debtor". § 9-105.
"Party". § 1-201.
"Proceeds". § 9-306.
"Secured party". § 9-105.
"Security agreement". § 9-105.
"Security interest". § 1-201.
"Signed". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-274 - 338 (Small Loan Act); 6-551 (Trust Receipts Act); 11-4 (Act Regulating the Size of Type); 46.1-545 (Instalment Sales of Automobiles); 55-144 (Factor's Lien Act).

Comment: Subsection 9-203(1)(b), in effect, establishes a statute of frauds for security transactions. In order for the security agreement to be enforceable against the debtor, there must be a written security agreement signed by the debtor. This presumably changes Virginia law on the point, although the prevalence of recording requirements minimizes the significance of the change.

This section expressly reserves and makes applicable to security transactions the requirements set forth in the Small Loan Act, §§ 6-274 - 338; the Size of Type Act, § 11-4; and the Automobile Instalment Sales Act, § 46.1-545.

The Act Regulating the Size of Type in Contracts only applies to contracts for "the sale and future delivery" of goods and chattels. Jones v. Franklin, 160 Va. 266, 272-74, 166 S.E. 753 (1933), held that the statute does not apply to a present conditional sale of personal property. Garrett v. International Motor Truck, Inc. 151 Va. 795, 799-800, 145 S.E. 252 (1928), held the statute does not apply to a promissory note containing a statement that it is secured by a conditional sale contract.

§ 9-204. **When Security Interest Attaches; After-Acquired Property; Future Advances.** (1) A security interest cannot attach until there is agreement (subsection (3) of § 1-201) that it attach and value is given and the debtor has rights in the collateral. It attaches as soon as all of the events in the preceding sentence have taken place unless explicit agreement postpones the time of attaching.

(2) For the purposes of this section the debtor has no rights

(a) in crops until they are planted or otherwise become growing crops, in the young of livestock until they are conceived;

(b) in fish until caught, in oil, gas or minerals until they are extracted, in timber until it is cut;

(c) in a contract right until the contract has been made;

(d) in an account until it comes into existence.

(3) Except as provided in subsection (4) a security agreement may provide that collateral, whenever acquired, shall secure all obligations covered by the security agreement.

(4) No security interest attaches under an after-acquired property clause

(a) to crops which become such more than one year after the security agreement is executed except that a security interest in crops which is given in conjunction with a lease or a land purchase or improvement transaction evidenced by a contract, mortgage or deed of trust may if so agreed attach to crops to be grown on the land concerned during the period of such real estate transaction;

(b) to consumer goods other than accessions (§ 9-314) when given as additional security unless the debtor acquires rights in them within ten days after the secured party gives value.

(5) Obligations covered by a security agreement may include future advances or other value whether or not the advances or value are given pursuant to commitment.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. Subsection (1) states three basic prerequisites to the existence of a security interest: agreement, value, and collateral. When these three coexist a security interest may, in the terminology adopted in this Article, attach. Perfection of a security interest will in many cases depend on the additional step of filing a financing statement (see § 9-302); § 9-301 states who will take priority over a security interest which has attached but which has not been perfected. The second sentence of the subsection states a rule of construction under which the security interest, unless postponed by explicit agreement, attaches automatically when the three stated events have occurred.

2. Subsections (1) and (3) read together make clear that a security interest arising by virtue of an after-acquired property clause has equal status with a security interest in collateral in which the debtor has rights at the time value is given under the security agreement. (To this general rule subsection (4) states two exceptions.) That is to say: the security interest in after-acquired property

is not merely an "equitable" interest; no further action by the secured party—such as the taking of a supplemental agreement covering the new collateral—is required. This does not however mean that the interest is proof against subordination or defeat: § 9-108 should be consulted on when a security interest in after-acquired collateral is not security for antecedent debt, and § 9-312(3) and (4) on when such a security interest may be subordinated to a conflicting purchase money security interest in the same collateral.

3. This Article accepts the principle of a "continuing general lien" which is stated in § 45 of the New York Personal Property Law and other similar statutes applicable to "factor's lien". It rejects the doctrine—of which the judicial attitude toward after-acquired property interests was one expression—that there is reason to invalidate as a matter of law what has been variously called the floating charge, the free-handed mortgage and the lien on a shifting stock. This Article validates a security interest in the debtor's existing and future assets, even though (see § 9-205) the debtor has liberty to use or dispose of collateral without being required to account for proceeds or substitute new collateral. (See further, however, § 9-306 on Proceeds and Comment thereto.)

The widespread nineteenth century prejudice against the floating charge was based on a feeling, often inarticulate in the opinions, that a commercial borrower should not be allowed to encumber all his assets present and future, and that for the protection not only of the borrower but of his other creditors a cushion of free assets should be preserved. That inarticulate premise has much to recommend it. This Article decisively rejects it not on the ground that it was wrong in policy but on the ground that it has not been effective. In the past fifty years there has been a multiplication of security devices designed to avoid the policy: field warehousing, trust receipts, "factor's lien" acts and so on. The cushion of free assets has not been preserved. In almost every state it is now possible for the borrower to give a lien on everything he has or will have. There have no doubt been sufficient economic reasons for the change. This Article, in expressly validating the floating charge, merely recognizes an existing state of things.

The substantive rules of law set forth in the balance of the Article are designed to achieve the protection of the debtor and the equitable resolution of the conflicting claims of creditors which the old rules no longer give.

4. Subsection (2) states the time at which debtor has rights in collateral in specified cases. A security agreement may be executed and value given before the debtor acquires rights: the security interest will then attach under subsection (1), as to after-acquired property, when he does. Subsection (2) states when that is in several controversial cases. Notice that the vexed question of assignment of future accounts is treated like any other case of after-acquired property: no periodic list of accounts is required by this Act. Where less than all accounts are assigned such a list may of course be necessary to permit identification of the particular accounts assigned.

5. Subsection (3) has been already referred to in connection with after-acquired property. It also serves to validate the so-called "cross-security" clause under which collateral acquired at any time may secure advances whenever made.

6. Subsection (4) (a) follows many state statutes which invalidate long-term security arrangements designed to cover future crops. Under existing statutes varying time limits are stated, the most frequent being one year, the period adopted by this section. The "except" clause permits a security interest in future crops in favor of a real estate lessor, mortgagee, conditional vendor or other encumbrancer during the continuance of his interest in the realty—this provision, again, is in accord with many existing statutes. Note that the real estate transaction involved must be one of lease or purchase or improvement of the land. § 9-312(2) should be consulted on the subordination of such an interest to a later interest arising from a current crop production loan.

7. Subsection (4) (b) limits the operation of the after-acquired property clause against consumers. No such interest can be claimed as additional security in consumer goods (defined in § 9-109), except accessions (see § 9-314), acquired more than ten days after the giving of value.

8. Under subsection (5) collateral may secure future as well as present advances when the security agreement so provides. At common law and under chattel mortgage statutes there seems to have been a vaguely articulated prejudice against future advance agreements comparable to the prejudice against after-acquired property interests. Although only a very few jurisdictions went to the

length of invalidating interests claimed by virtue of future advances, judicial limitations severely restricted the usefulness of such arrangements. A common limitation was that an interest claimed in collateral existing at the time the security transaction was entered into for advances made thereafter was good only to the extent that the original security agreement specified the amount of such later advances and even the times at which they should be made. In line with the policy of this Article toward after-acquired property interests this subsection validates the future advance interest, provided only that the obligation be covered by the security agreement. This is a special case of the more general provision of subsection (3).

As in the case of interests in after-acquired collateral, a security interest based on future advances may be subordinated to conflicting interests in the same collateral. See § 9-312(3) and (4).

Cross References:

Point 1: §§ 9-301 and 9-302.
Point 2: §§ 9-108 and 9-312.
Point 3: §§ 9-205 and 9-306.
Point 4: §§ 9-110 and 9-203(1)(b).
Point 6: § 9-312(2).
Point 7: §§ 9-109 and 9-314.
Point 8: § 9-312(3) and (4).

Definitional Cross References:

"Account". § 9-106.
"Agreement". § 1-201.
"Collateral". § 9-105.
"Consumer goods". § 9-109.
"Contract". § 1-201.
"Contract right". § 9-106.
"Debtor". § 9-105.
"Purchase". § 1-201.
"Rights". § 1-201.
"Secured party". § 9-105.
"Security agreement". § 9-105.
"Security interest". § 1-201.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 43-27 (crop liens); 43-41, 43-43 (liens on offspring of certain animals); 43-46 (agricultural chattel deeds of trust); 55-144 (factor's liens).

Comment: In stating that a security interest cannot attach until the debtor has rights in the property, subsection 9-204(1) is consistent with Henry's Ex'x v. Payne, 126 Va. 1, 7, 100 S.E. 845 (1919), which held that a person taking a chattel mortgage on property he knew the mortgagor did not own did not acquire an interest therein.

Virginia statutes and decisions recognize that a security interest may cover crops to be grown in the future and the future increase of livestock. Code 1950, § 43-27 (crop liens); §§ 43-41, 43-43 (liens on offspring of certain animals); § 43-46 (agricultural chattel deeds of trust); Gannaway v. Tate, 98 Va. 789, 37 S.E. 768 (1900); United States v. George H. Meyer Sons, 162 F. Supp. 619, 621 (E.D. Va. 1958). See also Brockenbrough's Ex'x v. Brockenbrough's Adm'r, 72 Va. (31 Gratt.) 580, 591-94 (1879), discussing, but without deciding, the validity of a clause in a deed of trust, which covered future crops and after-acquired livestock.

Subsection 9-204(3) is in accord with Virginia law in recognizing the validity of a clause in a security agreement covering after-acquired property. First Nat. Bank of Alexandria v. Turnbull & Co., 73 Va. (32 Gratt.) 695, 701-06 (1885). This subsection also recognizes the validity of a floating lien on a shifting stock of merchandise. For the change this makes in Virginia law see comment in VIRGINIA ANNOTATIONS to UCC 9-205.

Subsection 9-204(5) is in accord with Didied v. Patterson, 93 Va. 534, 536-37, 25 S.E. 661 (1896), in recognizing the validity of clauses in security agreements that cover future advances by the lender.

§ 9-205. **Use or Disposition of Collateral Without Accounting Permissible.** A security interest is not invalid or fraudulent against creditors by reason of liberty in the debtor to use, commingle or dispose of all or part of the collateral (including returned or repossessed goods) or to collect or compromise accounts, contract rights or chattel paper, or to accept the return of goods or make repossessions, or to use, commingle or dispose of proceeds, or by reason of the failure of the secured party to require the debtor to account for proceeds or replace collateral. This section does not relax the requirements of possession where perfection of a security interest depends upon possession of the collateral by the secured party or by a bailee.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. This Article expressly validates the floating charge or lien on a shifting stock. (See §§ 9-201, 9-204, and Comment to § 9-204.) This Section provides that a security interest is not invalid or fraudulent by reason of liberty in the debtor to dispose of the collateral without being required to account for proceeds or substitute new collateral. It repeals the rule of Benedict v. Ratner, 268 U.S. 353, 45 S.Ct. 566, 69 L.Ed. 991 (1925), and other cases which held such arrangements void as a matter of law because the debtor was given unfettered dominion or control over the collateral. The principal effect of the Benedict rule has been, not to discourage or eliminate security transactions in inventory and accounts receivable—on the contrary such transactions have vastly increased in volume—but rather to force financing arrangements in this field toward a self-liquidating basis. Furthermore several Circuit Court cases drew implications from Justice Brandeis' opinion in Benedict v. Ratner which have required lenders operating in this field to observe a number of needless and costly formalities: for example it has been thought necessary for the debtor to make daily remittances to the lender of all collections received, even though the amount remitted is immediately returned to the debtor in order to keep the loan at an agreed level.

2. The Benedict rule has, in the accounts receivable field, been repealed in many of the state accounts receivable statutes which have been enacted since 1943, and, in the inventory field, by some of the factor's lien statutes. (Benedict v. Ratner purported to state the law of New York and not a rule of federal bankruptcy law. Since its acceptance is a matter of state law, it can of course be rejected by state statute.)

3. The requirement of "policing" is the substance of the Benedict rule. While this Section repeals Benedict in matters of form, the filing requirements (§ 9-302) give other creditors the opportunity to ascertain from public sources whether property of their debtor or prospective debtor is subject to secured claims, and the provisions about proceeds (§ 9-306(4)) enable creditors to claim collections which were made by the debtor more than 10 days before insolvency proceedings and commingled or deposited in a bank account before institution of the insolvency proceedings. The repeal of the Benedict rule under this Section must be read in the light of these provisions.

4. Other decisions reaching results like that in the Benedict case, but relating to other aspects of dominion (of which Lee v. State Bank & Trust Co., 54 F.2d 518 (2d Cir. 1931), is an example) are likewise rejected.

5. Nothing in § 9-205 prevents such "policing" or dominion as the secured party and the debtor may agree upon; business and not legal reasons will determine the extent to which strict accountability, segregation of collections, daily reports and the like will be employed.

6. The last sentence is added to make clear that the Section does not mean that the holder of an unfiled security interest, whose perfection depends on possession of the collateral by the secured party or by a bailee (such as a field warehouseman), can allow the debtor access to and control over the goods without thereby losing his perfected interest. The common law rules on the degree and extent of possession which are necessary to perfect a pledge interest or to constitute a valid field warehouse are not relaxed by this or any other section of this Article.

Cross References:

Point 1: §§ 9-201 and 9-204.
Point 3: §§ 9-302 and 9-306(4).
Point 6: §§ 9-304 and 9-305.

Definitional Cross References:

"Account". § 9-106.
"Chattel paper". § 9-105.
"Collateral". § 9-105.
"Contract right". § 9-106.
"Creditor". § 1-201.
"Debtor". § 9-105.
"Goods". § 9-105.
"Proceeds". § 9-306.
"Secured party". § 9-105.
"Security interest". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 55-144 (factor's liens).

Comment: Since 1825, when Lang v. Lee, 24 Va. (3 Rand.) 410, 417-33 (1825), was decided, Virginia had held that a floating lien on a shifting stock of goods is invalid as a matter of law. This section changes this rule, expressly validating such security arrangements. The Virginia law is discussed in Brasfield, Reservation of Dominion over Property Given as Security—The Virginia Rule, 49 Va. L. Rev. 192 (1963). The effect of the UCC on Virginia law is discussed in Burton, Factor's Lien and Accounts Receivable Financing and Article 9, 20 Wash. & Lee L. Rev. (Fall 1963).

The rule of Lang v. Lee was stated in Consolidated Tramway Co. v. Germania Bank, 121 Va. 331, 334, 93 S.E. 572 (1917), to be: "A deed of trust made by the debtor professedly for the indemnity of certain preferred creditors, reserving to the grantor a power over the property conveyed, inconsistent with the avowed purposes of the trust, and adequate to the defeat thereof, is, because of such reservation, void as to any creditor thereby postponed, and as to purchasers." The power reserved to the grantor that is inconsistent with the purpose of the conveyance is the power to exercise dominion over the property by selling it and using the proceeds. The retention of such a power of sale may be by an express provision of the security instrument. Consolidated Tramway Co. v. Germania Bank, 121 Va. 331, 93 S.E. 572 (1917) (debtor agreed to reinvest proceeds of property sold in other property, which would be subject to the deed of trust); Wray v. Davenport, 79 Va. 19, 20-24 (1884) (debtor agreed to reinvest proceeds of property sold in other property, which would be subject to the deed of trust); Addington v. Etheridge, 53 Va. (12 Gratt.) 436, 437-39 (1855) (retail merchant had express power to sell stock of goods).

The Lang v. Lee rule also applies if the power of sale can be implied, as where the debtor is permitted to remain in possession and to enjoy the profits, there being no profits unless the goods are sold. Newcomb v. Guthrie, 145 Va. 627, 634-35, 134 S.E. 585 (1926); Gray v. Atlantic Trust & Deposit Co., 113 Va. 580, 583-87, 25 S.E. 226 (1912); Hughes, Effinger & Co. v. Epling, 93 Va. 424, 424-26, 25 S.E. 105 (1896); Saunders v. Waggoner & Co., 82 Va. 316, 320-23 (1886); McCormick v. Atkinson, 78 Va. 8, 9-12 (1883); Perry v. Shenandoah Nat'l Bank, 68 Va. (27 Gratt.) 755, 756-60 (1876); Sheppards v. Turpin, 44 Va. (3 Gratt.) 373, 397-403 (1847); United States v. Lankford, 3 F.2d 52, 54 (E.D. Va. 1924).

The Lang v. Lee rule does not apply to the "operating mortgage", such as that involved in Mathews v. Bond, 146 Va. 158, 163-69, 135 S.E. 689 (1926). In this case a deed of trust allowing the debtor, a sawmill operator, to sell lumber and railroad ties was upheld. Similarly, Hagan v. Richmond Trust Co., 148 Va. 528, 548-52, 139 S.E. 317 (1927), sustained a deed of trust of timber lands, the debtor retaining the right to cut and sell timber.

The Lang v. Lee rule also applies to assignments of accounts receivable. Didier v. Patterson, 93 Va. 534, 538-41, 25 S.E. 661 (1896), upheld an assignment of accounts as against the claim that the power of the assignor over the proceeds violated the Lang v. Lee rule. Parker v. Meyer, 37 F.2d 556, 556-57 (4th Cir. 1930), upheld an assignment of amounts due under leases and conditional sales contracts where the assignor was to make the collections and pay them over at sixty-day intervals. However, Mount v. Norfolk Savings & Loan Corp., 192 F.2d 286, 287-91 (4th Cir. 1951), invalidated an arrangement under which the assignor not only made collections, but used them for his own purposes. The court said that under Virginia law the validity of the security arrangement depended "upon the extent to which the parties intended that the borrower should keep or

relinquish control of the proceeds of the accounts and the extent to which the right of the assignee to control the collateral has been enforced or abandoned." In the case it was found that the assignor's control of the accounts assigned was "substantially unrestricted and free."

§ 9-206. **Agreement Not to Assert Defenses Against Assignee; Modification of Sales Warranties Where Security Agreement Exists.** (1) Subject to any statute or decision which establishes a different rule for buyers or lessees of consumer goods, an agreement by a buyer or lessee that he will not assert against an assignee any claim or defense which he may have against the seller or lessor is enforceable by an assignee who takes his assignment for value, in good faith and without notice of a claim or defense, except as to defenses of a type which may be asserted against a holder in due course of a negotiable instrument under the Article on Commercial Paper (Article 3). A buyer who as part of one transaction signs both a negotiable instrument and a security agreement makes such an agreement.

(2) When a seller retains a purchase money security interest in goods the Article on Sales (Article 2) governs the sale and any disclaimer, limitation or modification of the seller's warranties.

COMMENT: Prior Uniform Statutory Provision: § 2, Uniform Conditional Sales Act.

Changes: Rewritten and new material added.

Purposes of Changes and New Matter: 1. Clauses are frequently inserted in conditional sale contracts under which the conditional vendee agrees not to assert defenses against an assignee of the contract. These clauses have led to litigation and their present status under the case law is in confusion. In some jurisdictions they have been held void as attempts to create negotiable instruments outside the framework of the Negotiable Instruments Law or on grounds of public policy; in others they have been allowed to operate to cut off at least defenses based on breach of warranty. Under subsection (1) such clauses in a security agreement are validated outside the consumer field, but only as to defenses which could be cut off if a negotiable instrument were used. This limitation is important since if the clauses were allowed to have full effect as typically drafted they would operate to cut off real as well as personal defenses. The execution of a negotiable note in connection with a security agreement is given like effect as the execution of an agreement containing a waiver of defense clause. The same rules are made applicable to leases as to security agreements, whether or not the lease is intended as security.

2. This Article takes no position on the controversial question whether a buyer of consumer goods may effectively waive defenses by contractual clause or by execution of a negotiable note. In some states such waivers have been invalidated by statute. In other states the course of judicial decision has rendered them ineffective or unreliable—courts have found that the assignee is not protected against the buyer's defense by a clause in the contract or that the holder of a note, by reason of his too close connection with the underlying transaction, does not have the rights of a holder in due course. This Article neither adopts nor rejects the approach taken in such statutes and decisions, except that the validation of waivers in subsection (1) is expressly made "subject to any statute or decision" which may restrict the waiver's effectiveness in the case of a buyer of consumer goods.

3. Subsection (2) makes clear, as did § 2 of the Uniform Conditional Sales Act, that purchase money security transactions are sales, and warranty rules for sales are applicable. It also prevents a buyer from inadvertently abandoning his warranties by a "no warranties" term in the security agreement when warranties have already been created under the sales arrangement. Where the sales arrangement and the purchase money security transaction are evidenced by only one writing, that writing may disclaim, limit or modify warranties to the extent permitted by Article 2.

Cross References:

Point 1: § 3-305.
Point 2: § 9-203(2).
Point 3: §§ 2-102 and 2-316.

Definitional Cross References:

"Agreement". § 1-201.
"Consumer goods". § 9-109.
"Good faith". § 1-201.
"Goods". § 9-105.
"Holder". § 1-201.
"Holder in due course". §§ 3-302 and 9-105.
"Negotiable instrument". § 3-104.
"Notice". § 1-201.
"Purchase money security interest". § 9-107.
"Sale". §§ 2-106 and 9-105.
"Security agreement". § 9-105.
"Security interest". § 1-201.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Subsection 9-206(2) is in accord with Transit Corporation of Norfolk v. Four Wheel Drive Auto Co., 151 Va. 865, 873-75, 145 S.E. 331 (1828), in which it was held that the written order, not the conditional sale contract, determined whether express warranties had been made by the seller.

§ 9-207. Rights and Duties When Collateral Is in Secured Party's Possession. (1) A secured party must use reasonable care in the custody and preservation of collateral in his possession. In the case of an instrument or chattel paper reasonable care includes taking necessary steps to preserve rights against prior parties unless otherwise agreed.

(2) Unless otherwise agreed, when collateral is in the secured party's possession

(a) reasonable expenses (including the cost of any insurance and payment of taxes or other charges) incurred in the custody, preservation, use or operation of the collateral are chargeable to the debtor and are secured by the collateral;

(b) the risk of accidental loss or damage is on the debtor to the extent of any deficiency in any effective insurance coverage;

(c) the secured party may hold as additional security any increase or profits (except money) received from the collateral, but money so received, unless remitted to the debtor, shall be applied in reduction of the secured obligation;

(d) the secured party must keep the collateral identifiable but fungible collateral may be commingled;

(e) the secured party may repledge the collateral upon terms which do not impair the debtor's right to redeem it.

(3) A secured party is liable for any loss caused by his failure to meet any obligation imposed by the preceding subsections but does not lose his security interest.

(4) A secured party may use or operate the collateral for the purpose of preserving the collateral or its value or pursuant to the order of a court of appropriate jurisdiction or, except in the case of consumer goods, in the manner and to the extent provided in the security agreement.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. Subsection (1) states the duty to preserve collateral imposed on a pledgee at common law. See Restatement of Security, §§ 17, 18. In many cases a secured party having collateral in his possession may satisfy this duty by notify-

ing the debtor of any act which must be taken and allowing the debtor to perform such act himself. If the secured party himself takes action, his reasonable expenses may be added to the secured obligation.

Under § 1-102(3) the duty to exercise reasonable care may not be disclaimed by agreement, although under that Section the parties remain free to determine by agreement, in any manner not manifestly unreasonable, what shall constitute reasonable care in a particular case.

2. Subsection (2) states rules, which follow common law precedents, and which apply, unless there is agreement otherwise, in typical situations during the period while the secured party is in possession of the collateral.

3. The right of a secured party holding instruments or documents to have them indorsed or transferred to him or his order is dealt with in the relevant sections of Articles 3 (Commercial Paper), 7 (Warehouse Receipts, Bills of Lading and Other Documents) and 8 (Investment Securities). (§§ 3-201, 7-506, 8-307.)

4. This Section applies when the secured party has possession of the collateral before default, as a pledgee, and also when he has taken possession of the collateral after default. See § 9-501(1) and (2). Subsection (4) permits operation of the collateral in the circumstances stated, and subsection (2)(a) authorizes payment of or provision for expenses of such operation. Agreements providing for such operation are common in trust indentures securing corporate bonds and are particularly important when the collateral is a going business. Such an agreement cannot of course disclaim the duty of care established by subsection (1), nor can it waive or modify the rights of the debtor contrary to § 9-501(3).

Cross References:

Point 1: § 1-102(3).
Point 3: §§ 3-201, 7-506 and 8-307.
Point 4: § 9-501(2) and Part 5.

Definitional Cross References:

"Chattel paper". § 9-105.
"Collateral". § 9-105.
"Debtor". § 9-105.
"Instrument". § 9-105.
"Money". § 1-201.
"Party". § 1-201.
"Secured party". § 9-105.
"Security interest". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Subsection 9-207(2)(a) is consistent with Fisch v. Steingold, 79 F.2d 448, 450-50 (4th Cir. 1935), in which the seller insured the goods and added the amount of the premium to the debt owed by the buyer.

Subsection 9-207(2)(b) is in accord with Exposition Arcade Corp. v. Lit Bros., 113 Va. 574, 575-77, 75 S.E. 117 (1912), holding that in a conditional sale contract the risk of loss is on the buyer.

§ 9-208. Request for Statement of Account or List of Collateral. (1) A debtor may sign a statement indicating what he believes to be the aggregate amount of unpaid indebtedness as of a specified date and may send it to the secured party with a request that the statement be approved or corrected and returned to the debtor. When the security agreement or any other record kept by the secured party identifies the collateral a debtor may similarly request the secured party to approve or correct a list of the collateral.

(2) The secured party must comply with such a request within two weeks after receipt by sending a written correction or approval. If the secured party claims a security interest in all of a particular type of collateral owned by the debtor he may indicate that fact in his reply and

need not approve or correct an itemized list of such collateral. If the secured party without reasonable excuse fails to comply he is liable for any loss caused to the debtor thereby; and if the debtor has properly included in his request a good faith statement of the obligation or a list of the collateral or both the secured party may claim a security interest only as shown in the statement against persons misled by his failure to comply. If he no longer has an interest in the obligation or collateral at the time the request is received he must disclose the name and address of any successor in interest known to him and he is liable for any loss caused to the debtor as a result of failure to disclose. A successor in interest is not subject to this section until a request is received by him.

(3) A debtor is entitled to such a statement once every six months without charge. The secured party may require payment of a charge not exceeding $10 for each additional statement furnished.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. To provide a procedure whereby a debtor may obtain from the secured party a statement of the amount due on the obligation and in some cases a statement of the collateral.

2. The financing statement required to be filed under this Article (see § 9-402) may disclose only that a secured party may have a security interest in specified types of collateral owned by the debtor. Unless a copy of the security agreement itself is filed as the financing statement third parties are told neither the amount of the obligation secured nor which particular assets are covered. Since subsequent creditors and purchasers may legitimately need more detailed information, it is necessary to provide a procedure under which the secured party will be required to make disclosure. On the other hand, the secured party should not be under a duty to disclose details of business operations to any casual inquirer or competitor who asks for them. This Section gives the right to demand disclosure only to the debtor, who will typically request a statement in connection with negotiations with subsequent creditors and purchasers, or for the purpose of establishing his credit standing and proving which of his assets are free of the security interest. The secured party is further protected against onerous requests by the provisions that he need furnish a statement of collateral only when his own records identify the collateral and that if he claims all of a particular type of collateral owned by the debtor he is not required to approve an itemized list.

Cross Reference:

Point 2: § 9-402.

Definitional Cross References:

"Collateral". § 9-105.
"Debtor". § 9-105.
"Good faith". § 1-201.
"Know". § 1-201.
"Person". § 1-201.
"Receive". § 1-201.
"Secured party". § 9-105.
"Security agreement". § 9-105.
"Security interest". § 1-201.
"Send". § 1-201.
"Written". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

PART 3

RIGHTS OF THIRD PARTIES; PERFECTED AND UNPERFECTED SECURITY INTERESTS; RULES OF PRIORITY

§ 9-301. Persons Who Take Priority Over Unperfected Security Interests; "Lien Creditor". (1) Except as otherwise provided in subsection (2), an unperfected security interest is subordinate to the rights of

(a) persons entitled to priority under § 9-312;

(b) a person who becomes a lien creditor without knowledge of the security interest and before it is perfected;

(c) in the case of goods, instruments, documents, and chattel paper, a person who is not a secured party and who is a transferee in bulk or other buyer not in ordinary course of business to the extent that he gives value and receives delivery of the collateral without knowledge of the security interest and before it is perfected;

(d) in the case of accounts, contract rights, and general intangibles, a person who is not a secured party and who is a transferee to the extent that he gives value without knowledge of the security interest and before it is perfected.

(2) If the secured party files with respect to a purchase money security interest before or within ten days after the collateral comes into possession of the debtor, he takes priority over the rights of a transferee in bulk or of a lien creditor which arise between the time the security interest attaches and the time of filing.

(3) A "lien creditor" means a creditor who has acquired a lien on the property involved by attachment, levy or the like and includes an assignee for benefit of creditors from the time of assignment, and a trustee in bankruptcy from the date of the filing of the petition or a receiver in equity from the time of appointment. Unless all the creditors represented had knowledge of the security interest such a representative of creditors is a lien creditor without knowledge even though he personally has knowledge of the security interest.

COMMENT: Prior Uniform Statutory Provision: §§ 8(2) and 9(2)(b), Uniform Trust Receipts Act; § 5, Uniform Conditional Sales Act.

Changes: Changed in substance.

Purposes of Changes: 1. This Section lists the classes of persons who take priority over an unperfected security interest. As in § 60 of the Federal Bankruptcy Act, the term "perfected" is used to describe a security interest in personal property which cannot be defeated in insolvency proceedings or in general by creditors. A security interest is "perfected" when the secured party has taken whatever steps are necessary to give him such an interest. These steps are explained in the five following sections (§§ 9-302 through 9-306).

2. § 9-312 states general rules for the determination of priorities among conflicting security interests and in addition contains a list of other sections which state special rules of priority in a variety of situations. The interests given priority under § 9-312 and the other sections therein listed take such priority in general even over a perfected security interest. *A fortiori* they take priority over an unperfected security interest, and subsection (1)(a) of this Section so states.

3. Subsection (1)(b) follows the Uniform Trust Receipts Act and Uniform Conditional Sales Act and the rule under some chattel mortgage legislation. It provides that an unperfected security interest is subordinate to the rights of lien

creditors who acquire their liens without knowledge of the prior security interest and before it is perfected. The section rejects the rule, applied in many jurisdictions to chattel mortgages and in a few to conditional sales, that an unperfected security interest is subordinated to all creditors . The section subordinates the unperfected security interest but does not subordinate the debt.

4. Subsections (1)(c) and (1)(d) deal with purchasers (other than secured parties) of collateral who would take subject to a perfected security interest but who are by these subsections given priority over an unperfected security interest. In the cases of goods and of intangibles of the type whose transfer is effected by physical delivery of the representative piece of paper (instruments, documents and chattel paper) the purchaser who takes priority must both give value and receive delivery of the collateral without knowledge of the existing security interest and before perfection (subsection (1)(c)). Thus even if the purchaser gave value without knowledge and before perfection, he would take subject to the security interest if perfection occurred before physical delivery of the collateral to him. The subsection (1)(c) rule is obviously not appropriate where the collateral consists of intangibles and there is no representative piece of paper whose physical delivery is the only or the customary method of transfer. Therefore with respect to such intangibles (accounts, contract rights and general intangibles), subsection (1)(d) gives priority to any transferee who has given value without knowledge and before perfection of the security interest.

The term "buyer in ordinary course of business" referred to in subsection (1)(c) is defined in § 1-201(9).

Other secured parties are excluded from subsections (1)(c) and (1)(d) because their priorities are covered in § 9-312 (see point 2 of this Comment).

5. Except to the extent provided in subsection (2) this Article does not permit a secured party to file or take possession after another interest has received priority under subsection (1) and thereby protect himself against the intervening interest.

A few chattel mortgage statutes did have grace periods, i. e., a filing within x days after the mortgage was given related back to the day the mortgage was given. The Uniform Conditional Sales Act had a ten-day period which cut off all intervening interests. The Uniform Trust Receipts Act had a thirty-day period but did not cut off the interest of a purchaser who took delivery before the filing.

Subsection (2) gives a grace period for perfection by filing as to purchase money security interests only (that term is defined in § 9-107). The grace period runs for ten days after the collateral comes into possession of the debtor but operates to cut off only the interests of intervening lien creditors or bulk purchasers.

6. Subsection (3) defines "lien creditor", following in substance the provisions of the Uniform Trust Receipts Act.

Cross References:

§ 9-312.
Point 1: §§ 9-302 through 9-306.

Definitional Cross References:

"Account". § 9-106.
"Buyer in ordinary course of business". § 1-201.
"Chattel paper". § 9-105.
"Collateral". § 9-105.
"Contract right". § 9-106.
"Creditor". § 1-201.
"Delivery". § 1-201.
"Document". § 9-105.
"General intangibles". § 9-106.
"Goods". § 9-105.
"Instrument". § 9-105.
"Knowledge". § 1-201.
"Person". § 1-201.
"Purchase money security interest". § 9-107.
"Representative". § 1-201.
"Rights". § 1-201.
"Secured party". § 9-105.
"Security interest". § 1-201.
"Value". § 1-201.

Prior Statutes: Code 1950, §§ 6-557 - 558 (trust receipts); 11-5 (accounts receivable); 43-28 (crop liens); 43-53 (agricultural chattel deeds of trust); 55-88, 55-88.1, 55-89 (conditional sales); 55-96, 55-96.1 (chattel deeds of trust, mortgages, and bailment leases); 55-146 (factor's liens).

Comment: Subsection 9-301(1) is consistent with Virginia holdings that security agreements are valid without recordation as against creditors, other than lien creditors. F. D. Cummer and Son Co. v. R. M. Hudson Co., 141 Va. 271, 277-79, 127 S.E.171 (1925) (unrecorded deed of trust); Henry's Ex'x v. Payne, 126 Va. 1, 7, 100 S.E. 845 (1919) (unrecorded chattel mortgage). In this latter case the court said, "A creditor without a lien stands on no higher footing than his debtor" and cannot successfully invoke the benefits of a statute designed to protect lien creditors and purchasers.

By implication this subsection recognizes that a party claiming under a perfected security interest will prevail over a subsequent lien creditor. This is in accord with the holdings applying Virginia law. First Nat. Bank of Alexandria v. Turnbull & Co., 73 Va. (32 Gratt.) 695, 705-06 (1885), held that a secured party under a duly recorded deed of trust prevailed over a subsequent execution creditor. Coin Machine Acceptance Corp. v. O'Donnell, 192 F.2d 773, 777 (4th Cir. 1951), held that a secured party under a perfected trust receipt would prevail over a lien creditor and a trustee in bankruptcy. In the Matter of Lincoln Industries, Inc., 166 F. Supp. 240, 245 (W.D. Va. 1958), upheld the validity of a lien perfected under the factor's lien statute. By implication, although not expressly covered, this subsection is in accord with Bird v. Wilkinson, 31 Va. (4 Leigh) 266, 270-75 (1833), holding that a bona fide purchaser of a slave from a mortgagor prevailed over a mortgagee who had not recorded the mortgage. For comment on the rights of buyers of goods see VIRGINIA ANNOTATIONS to UCC 9-307.

Subsection 9-301(1)(b) is consistent with the Virginia decisions holding that an unrecorded security interest is subordinate to the rights of lien creditors. Jennings v. Attorney-General, 14 Va. (4 Hen. & M.) 424, 425 (1809) (judgment creditor prevailed over holder of an improperly recorded mortgage on slaves); Moore's Ex'r v. The Auditor, 13 Va. (3 Hen. & M.) 232, 236-37 (1808) (judgment creditor prevailed over secured party under an improperly recorded deed of trust of personality); Chesapeake Shoe Co. v. Seidner, 122 Fed. 593, 594-96 (4th Cir. 1903) (trustee in bankruptcy, with rights of a lien creditor, prevailed over conditional vendor under an unrecorded conditional sale contract).

Subsection 9-301(1)(b) changes Virginia law by requiring the lien creditor to be without notice in order to obtain rights superior to an unperfected security interest. Guerrant v. Anderson, 25 Va. (4 Rand.) 208, 211-12 (1826), held that a lien creditor would prevail over the holder of an unrecorded mortgage even though the creditor had notice of the prior security interest. (The same rule has been applied in Virginia to an unrecorded deed of trust of realty, which is subordinate to the rights of a judgment creditor, whether or not he has notice of the deed of trust. Neff v. Newman, 150 Va. 203, 211-12, 142 S.E. 389 (1928).

Under subsection 9-301(3) a lien creditor is defined so as to include an assignee for the benefit of creditors. This definition changes Virginia law under which such an assignee, or trustee in a deed of trust, has been defined as a purchaser for value. Liquid Carbonic Co. v. Whitehead, 115 Va. 586, 592-96, 80 S.E. 104 (1913); Arbuckle Bros. v. Gates, 95 Va. 802, 812-14, 30 S.E. 496 (1898); Janney v. Bell, 111 F.2d 103, 105 (4th Cir. 1940); Corbett v. Riddle, 209 Fed. 811, 815 (4th Cir. 1913). (See also Rhea v. Preston, 75 Va. 757, 768 (1881), involving real property, which held that a trustee in a deed of trust to secure a debt and the creditor so secured are purchasers for value within the meaning of the registration laws.) As purchasers, such parties under Virginia law have been affected by notice of prior unperfected security interests. In Liquid Carbonic Co. v. Whitehead, 115 Va. 586, 592-96, 80 S.E. 104 (1913), the debtor made an assignment for the benefit of creditors, the trustee in the deed of assignment having actual knowledge of a conditional vendor's rights, but the conditional sales contract had not been properly recorded. The trustee sold the property to a purchaser who also had notice. It was held that both the trustee and the purchaser were liable to the conditional vendor since they could not qualify as purchasers without notice. Although under the UCC the trustee in this case would be defined as a lien creditor instead of a purchaser, the result would be the same since the UCC requires that a lien creditor must be without notice in order to obtain rights superior to an unperfected security interest.

These two changes the UCC makes in Virginia law—reclassification of an assignee for benefit of creditors as a lien creditor and the addition of a requirement that

he be without notice tend to cancel each other—so as to leave the results reached under the UCC the same as under Virginia law.

The definition of a lien creditor as a creditor who has acquired a lien by attachment, levy or the like is consistent with the Virginia statutes which give the creditor a lien from the time of the levying of an attachment, Code 1950, § 8-545, and from the time of delivering a writ of fieri facias to an officer for the purpose of execution, Code 1950, § 8-411.

Subsection 9-301(2) gives the secured party under a purchase money security interest ten days to file after the collateral comes into the possession of the debtor. Code 1950, § 55-88, has given the conditional vendor five days to file. Norfolk Stationery Co. v. Royster Inv. Corp., 23 F.2d 586, 587-88 (4th Cir. 1928), held that the grace period runs from the delivery of individual items and not from the delivery of the last of a series.

§ 9-302. When Filing Is Required to Perfect Security Interest; Security Interests to Which Filing Provisions of This Article Do Not Apply. (1) A financing statement must be filed to perfect all security interests except the following:

(a) a security interest in collateral in possession of the secured party under § 9-305;

(b) a security interest temporarily perfected in instruments or documents without delivery under § 9-304 or in proceeds for a 10 day period under § 9-306;

(c) a purchase money security interest in farm equipment having a purchase price not in excess of $500; but filing is required for a fixture under § 9-313;

(d) a purchase money security interest in consumer goods; but filing is required for a fixture under § 9-313;

(e) an assignment of accounts or contract rights which does not alone or in conjunction with other assignments to the same assignee transfer a significant part of the outstanding accounts or contract rights of the assignor;

(f) a security interest of a collecting bank (§ 4-208) or arising under the Article on Sales (see § 9-113) or covered in subsection (3) of this section.

(2) If a secured party assigns a perfected security interest, no filing under this Article is required in order to continue the perfected status of the security interest against creditors of and transferees from the original debtor.

(3) The filing provisions of this Article do not apply to a security interest in property subject to a statute

(a) of the United States which provides for a national registration or filing of all security interests in such property; or

(b) of this state which provides for central filing of, or which requires indication on a certificate of title of, such security interests in such property.

(4) A security interest in property covered by a statute described in subsection (3) can be perfected only by registration or filing under that statute or by indication of the security interest on a certificate of title or a duplicate thereof by a public official.

(VALC Note: Subsections (1)(c) and (1)(d) of § 9-302 are contained in the Official Text as follows:

(c) a purchase money security interest in farm equipment having a purchase price not in excess of $2500; but filing is required for a fixture under § 9-313 or for a motor vehicle required to be licensed;

(d) a purchase money security interest in consumer goods; but filing is required for a fixture under § 9-313 or for a motor vehicle required to be licensed;

The Official Text also offers an optional form of subsection (3) (b) as follows:

(b) of this state which provides for central filing of security interests in such property, or in a motor vehicle which is not inventory held for sale for which a certificate of title is required under the statutes of this state if a notation of such a security interest can be indicated by a public official on a certificate or a duplicate thereof.)

COMMENT: Prior Uniform Statutory Provision: § 5, Uniform Conditional Sales Act; § 8, Uniform Trust Receipts Act.

Purpose of Changes: Modified to conform to the scheme of this Article.

1. Subsection (1) states the general rule that to perfect a security interest under this Article a financing statement must be filed. Subsections (1)(a) through (1)(f) exempt from the filing requirement the transactions described. Subsection (3) further sets out certain transactions to which the filing provisions of this Article do not apply: these are cases where alternative systems for giving public notice of a security interest are available. § 9-303 states the time when a security interest is perfected by filing or otherwise. Part 4 of the Article deals with the mechanics of filing: place of filing, form of financing statement and so on.

2. As at common law, there is no requirement of filing when the secured party has possession of the collateral in a pledge transaction (subsection (1)(a)). § 9-305 should be consulted on what collateral may be pledged and on the requirements of possession.

3. Under this Article, as under the Uniform Trust Receipts Act, filing is not effective to perfect a security interest in instruments. See § 9-304(1).

4. Where goods subject to a security interest are left in the debtor's possession, the only exceptions from the general filing requirement are those stated in subsections (1)(c) and (1)(d): purchase money security interests in consumer goods and in certain farm equipment, other than fixtures and motor vehicles. In many jurisdictions under prior law security interests in consumer goods under conditional sale or bailment lease have not been subject to filing requirements. Subsections (1)(c) and (1)(d) follow the policy of those jurisdictions. The subsections change prior law in jurisdictions where all conditional sales and bailment leases have been subject to filing requirements.

Although the security interests described in subsections (1)(c) and (1)(d) are perfected without filing, § 9-307(2) provides that unless a financing statement is filed certain buyers may take free of the security interest even though perfected. See that Section and the Comment thereto.

On filing for security interests in motor vehicles, see subsection (3)(b) of this Section.

5. A financing statement must be filed to perfect a security interest in accounts or contract rights, except for the transactions described in subsection (1)(e). It should be noted that this Article applies to sales of accounts, contract rights or chattel paper as well as to transfers of such intangibles for security (§ 9-102(1)(b)); the filing requirement of this Section applies both to sales and to transfers for security. In this respect this Article follows many of the state statutes regulating assignments of accounts receivable.

Over forty jurisdictions have enacted accounts receivable statutes. About half of these statutes require filing to protect or perfect assignments; of the remainder, one is a so-called "book-marking" statute and the others validate assignments without filing. This Article adopts the filing requirement, on the theory that there is no valid reason why public notice is less appropriate for assignments of accounts and contract rights than for any other type of non-possessory interest. § 9-305, furthermore, excludes accounts and contract rights from the types of collateral which may be the subject of a possessory security interest: filing is thus the only means of perfection contemplated by this Article.

The purpose of the subsection (1)(e) exemptions is to save from *ex post facto* invalidation casual or isolated assignments: some accounts receivable statutes have been so broadly drafted that all assignments, whatever their character or

purpose, fall within their filing provisions. Under such statutes many assignments which no one would think of filing may be subject to invalidation. The subsection (1)(e) exemptions go to that type of assignment. Any person who regularly takes assignments of any debtor's accounts should file. In this connection § 9-104(f) which excludes certain transfers of accounts and contract rights from the Article should be consulted.

6. With respect to the subsection (1)(f) exemptions, see the sections referred to and Comments thereto.

7. The following example will explain the operation of subsection (2): Buyer buys goods from seller who retains a security interest in them which he perfects. Seller assigns the perfected security interest to X. The security interest, in X's hands and without further steps on his part, continues perfected against *Buyer's* transferees and creditors. If, however, the assignment from Seller to X was itself intended for security (or was a sale of accounts, contract rights or chattel paper), X must take whatever steps may be required for perfection in order to be protected against *Seller's* transferees and creditors.

8. Subsection (3) exempts from the filing provisions of this Article transactions as to which an adequate system of filing, state or federal, has been set up outside this Article and subsection (4) makes clear that when such a system exists perfection of a relevant security interest can be had only through compliance with that system (i. e., filing under this Article is not a permissible alternative).

Examples of the type of federal statute referred to in subsection (3)(a) are the provisions of 17 U.S.C. §§ 28, 30 (copyrights), 49 U.S.C. § 523 (aircraft), 49 U.S.C. § 20(c) (railroads). The Assignment of Claims Act of 1940, as amended, provides for notice to contracting and disbursing officers and to sureties on bonds but does not establish a national filing system and therefore is not within the scope of subsection (3)(a). An assignee of a claim against the United States, who must of course comply with the Assignment of Claims Act, must also file under this Article in order to perfect his security interest against creditors and transferees of his assignor.

Some states have enacted central filing statutes with respect to security transactions in kinds of property which are of special importance in the local economy. Subsection (3)(b) adopts such statutes as the appropriate filing system for such property.

In addition to such central filing statutes many states have enacted certificate of title laws covering motor vehicles and the like. If a certificate of title law requires the indication of all security interests on the certificate, subsection (3)(b) exempts transactions covered by the law from the filing requirements of this Article. (Alternative A.) If a certificate of title law requires a certificate to be issued and a notation of all security interests affecting the property can be indicated on the certificate by a public official (even though the law does not require the indication to be made), subsection (3)(b) exempts transactions covered by the law from the filing requirements of this Article (Alternative B).

9. Perfection of a security interest under a state or federal statute of the type referred to in subsection (3) has all the consequences of perfection under the provisions of this Article.

Cross References:

Point 1: § 9-303 and Part 4.
Point 2: § 9-305.
Point 3: § 9-304(1).
Point 4: § 9-307(2).
Point 5: §§ 9-102(1)(b), 9-104(f) and 9-305.
Point 6: §§ 4-208 and 9-113.

Definitional Cross References:

"Account". § 9-106.
"Collateral". § 9-105.
"Consumer goods". § 9-109.
"Contract right". § 9-106.
"Creditor". § 1-201.
"Debtor". § 9-105.
"Delivery". § 1-201.
"Document". § 9-105.
"Equipment". § 9-109.

"Instrument". § 9-105.
"Inventory". § 9-109.
"Proceeds". § 9-306.
"Purchase". § 1-201.
"Purchase money security interest". § 9-107.
"Sale". §§ 2-106 and 9-105.
"Secured party". § 9-105.
"Security interest". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-557 - 558 (trust receipts); 11-5 (accounts receivable); 43-28 (crop liens); 43-42 - 43 (liens on offspring of certain animals); 43-53 (agricultural chattel deeds of trust); 46.1-68 - 98 (motor vehicle certificates of title); 55-88 - 89 (conditional sales); 55-96 - 96.1 (chattel deeds of trust, mortgages, and bailment leases); 55-100 (civil aircraft); 55-144 (factor's liens).

Comment: Virginia law requires that most nonpossessory chattel liens be recorded in order to protect the secured party's rights. Under the UCC some security arrangements are perfected without recording. The principal change is in the perfection without recording of purchase money security interests in consumer goods and farm equipment having a purchase price of less than $2,500. To some extent this represents a return to the common law, when conditional sales contracts were perfected without recording. McComb v. Donald's Adm'r, 82 Va. 903, 906-08, 5 S.E. 558 (1886). The statute requiring recordation of conditional sales contracts was adopted in 1884. Va. Acts 1883-4, ch. 31 and ch. 189. See also Note, Rights of Conditional Vendor and Vendee Upon Default in Virginia, 26 Va. L. Rev. 232 (1939).

Subsection 9-302(e) changes Virginia law by requiring filing of financing statements covering the assignment of accounts receivable. This changes the approach taken in Kirkland, Chase & Co. v. Brune, 72 Va. (31 Gratt.) 126, 131-33 (1878), which held that assignments of choses in action did not have to be recorded, but it cannot be determined with certainty whether the assignment involved in the case would have had to be recorded under the UCC. The UCC changes Code 1950, § 11-5, under which assignments of accounts receivable are valid without recording. The UCC does not cover the situation involved in Darden v. George G. Lee Co., 204 Va. 108, 129 S.E.2d 897 (1963).

The adoption of 9-302(3)(b) Alternative A preserves the Virginia system of recording liens on motor vehicles on the certificate of title, as set forth in Code 1950, §§ 46.1-68 - 98.

Subsection 9-302(3)(a) excludes from the operation of the Article, Code 1950, § 55-100, providing for national recordation of instruments affecting title to civil aircraft.

COUNCIL COMMENT

There is an apparent inconsistency between subsections (1)(c) and (1) (d) of these sections and subsection (3) (b). We recommend the elimination of the reference to motor vehicles in subsections (1)(c) and (1)(d) and adoption of the first alternative version of subsection (3) (b) to preserve the Virginia system of recording liens on motor vehicles on the certificate of title, as provided in §§ 46.1-68 through 46.1-98 of the Virginia Code.

We further recommend changing the figures $2500 to $500 to conform to changes in § 9-307.

§ 9-303. When Security Interest Is Perfected; Continuity of Perfection. (1) A security interest is perfected when it has attached and when all of the applicable steps required for perfection have been taken. Such steps are specified in §§ 9-302, 9-304, 9-305 and 9-306. If such steps are taken before the security interest attaches, it is perfected at the time when it attaches.

(2) If a security interest is originally perfected in any way permitted under this Article and is subsequently perfected in some other way under this Article, without an intermediate period when it was unperfected, the

security interest shall be deemed to be perfected continuously for the purposes of this Article.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. The term "attach" is used in this Article to describe the point at which property becomes subject to a security interest. The requisites for attachment are stated in § 9-204. When it attaches a security interest may be either perfected or unperfected: "Perfected" means that the secured party has taken all the steps required by this Article as specified in the several sections listed in subsection (1). A perfected security interest may still be or become subordinate to other interests (see § 9-312) but in general after perfection the secured party is protected against creditors and transferees of the debtor and in particular against any representative of creditors in insolvency proceedings instituted by or against the debtor. Subsection (1) states the truism that the time of perfection is when the security interest has attached and any necessary steps for perfection (such as taking possession or filing) have been taken. If the steps for perfection have been taken in advance (as when the secured party files a financing statement before giving value or before the debtor acquires rights in the collateral), then the interest is perfected automatically when it attaches.

2. The following example will illustrate the operation of subsection (2): A bank which has issued a letter of credit honors drafts drawn under the credit and receives possession of the negotiable bill of lading covering the goods shipped. Under §§ 9-304(2) and 9-305 the bank now has a perfected security interest in the document and the goods. The bank releases the bill of lading to the debtor for the purpose of procuring the goods from the carrier and selling them. Under § 9-304(5) the bank continues to have a perfected security interest in the document and goods for 21 days. The bank files before the expiration of the 21 day period. Its security interest now continues perfected for as long as the filing is good. The goods are sold by the debtor. The bank continues to have a security interest in the proceeds of sale to the extent stated in § 9-306(3).

If the successive stages of the bank's security interest succeed each other without an intervening gap, the security interest is "continuously perfected" and the date of perfection is when the interest first became perfected (i. e., in the example given, when the bank received possession of the bill of lading against honor of the drafts). If, however, there is a gap between stages—for example, if the bank does not file until after the expiration of the 21 day period specified in § 9-304(5), the collateral still being in the debtor's possession—then, the chain being broken, the perfection is no longer continuous. The date of perfection would now be the date of filing (after expiration of the 21 day period); the bank's interest might now become subject to attack under § 60 of the Federal Bankruptcy Act and would be subject to any interests arising during the gap period which under § 9-301 take priority over an unperfected security interest.

The rule of subsection (2) would also apply to the case of collateral brought into this state subject to a security interest which became perfected in another state or jurisdiction. See § 9-103(3).

Cross References:

§§ 9-302, 9-304, 9-305 and 9-306.
Point 1: §§ 9-204 and 9-312.
Point 2: §§ 9-103(3) and 9-301.

Definitional Cross Reference:

"Security interest". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 55-144 (factor's lien).

§ 9-304. Perfection of Security Interest in Instruments, Documents, and Goods Covered by Documents; Perfection by Permissive Filing; Temporary Perfection Without Filing or Transfer of Possession. (1) A security interest in chattel paper or negotiable documents may be perfected by filing. A security interest in instruments (other than instruments which constitute part of chattel paper) can be perfected only by the secured party's taking possession, except as provided in subsections (4) and (5).

(2) During the period that goods are in the possession of the issuer of a negotiable document therefor, a security interest in the goods is perfected by perfecting a security interest in the document, and any security interest in the goods otherwise perfected during such period is subject thereto.

(3) A security interest in goods in the possession of a bailee other than one who has issued a negotiable document therefor is perfected by issuance of a document in the name of the secured party or by the bailee's receipt of notification of the secured party's interest or by filing as to the goods.

(4) A security interest in instruments or negotiable documents is perfected without filing or the taking of possession for a period of 21 days from the time it attaches to the extent that it arises for new value given under a written security agreement.

(5) A security interest remains perfected for a period of 21 days without filing where a secured party having a perfected security interest in an instrument, a negotiable document or goods in possession of a bailee other than one who has issued a negotiable document therefor

(a) makes available to the debtor the goods or documents representing the goods for the purpose of ultimate sale or exchange or for the purpose of loading, unloading, storing, shipping, transshipping, manufacturing, processing or otherwise dealing with them in a manner preliminary to their sale or exchange; or

(b) delivers the instrument to the debtor for the purpose of ultimate sale or exchange or of presentation, collection, renewal or registration of transfer.

(6) After the 21 day period in subsections (4) and (5) perfection depends upon compliance with applicable provisions of this Article.

COMMENT: Prior Uniform Statutory Provision: §§ 3 and 8(1), Uniform Trust Receipts Act.

Changes: Revised to conform to the scheme of this Article.

Purposes: 1. For most types of property, filing and taking possession are alternative methods of perfection. For some types of intangibles (i. e., accounts, contract rights and general intangibles) filing is the only available method (see § 9-305 and point 1 of Comment thereto). With respect to instruments subsection (1) provides that, except for the cases of "temporary perfection" covered in subsections (4) and (5), taking possession is the only available method; this provision follows the Uniform Trust Receipts Act. The rule is based on the thought that where the collateral consists of instruments, it is universal practice for the secured party to take possession of them in pledge; any surrender of possession to the debtor is for a short time; therefore it would be unwise to provide the alternative of perfection for a long period by filing which, since it in no way corresponds with commercial practice, would serve no useful purpose. Subsection (1) further provides that filing is available as a method of perfection for security interests in chattel paper and negotiable documents, which also come within § 9-305 on perfection by possession. Chattel paper is sometimes delivered to the assignee, sometimes left in the hands of the assignor for collection; subsection (1) allows the assignee to perfect his interest by filing in the latter case. Negotiable documents may be, and usually are, delivered to the secured party; subsection (1) follows the Uniform Trust Receipts Act in allowing filing as an alternative method of perfection. Perfection of an interest in a non-negotiable document is covered in subsection (3).

2. Subsection (2), following prior law and consistently with the provisions of Article 7, takes the position that, so long as a negotiable document covering goods is outstanding, title to the goods is, so to say, locked up in the document and the proper way of dealing with such goods is through the document. Perfection therefore is to be made with respect to the document and, when made, auto-

matically carries over to the goods. Any interest perfected directly in the goods while the document is outstanding (for example, a chattel mortgage on goods in a warehouse) is subordinated to an outstanding negotiable document.

3. Subsection (3) takes a different approach to the problem of goods covered by a non-negotiable document or otherwise in the possession of a bailee who has not issued a negotiable document. Here title to the goods is not looked on as being locked up in the document and the secured party may perfect his interest directly in the goods by filing as to them. The subsection states two other methods of perfection: issuance of the document in the secured party's name (as consignee of a straight bill of lading or the person to whom delivery would be made under a non-negotiable warehouse receipt) and receipt of notification of the secured party's interest by the bailee which, under § 9-305, is looked on as equivalent to taking possession by the secured party.

4. Subsections (4) and (5) follow the Uniform Trust Receipts Act in giving perfected status to security interests in instruments and documents for a short period although there has been no filing and the collateral is in the debtor's possession. The period of 21 days is chosen to conform to the provisions of § 60 of the Federal Bankruptcy Act. There are a variety of legitimate reasons—some of them are described in subsections (5)(a) and (5)(b)—why such collateral has to be temporarily released to a debtor and no useful purpose would be served by cluttering the files with records of such exceedingly short term transactions. Under subsection (4) the 21 day perfection runs from the date of attachment; there is no limitation on the purpose for which the debtor is in possession but the secured party must have given new value under a written security agreement. Under subsection (5) the 21 day perfection runs from the date a secured party who already has a perfected security interest turns over the collateral to the debtor (an example is a bank which has acquired a bill of lading by honoring drafts drawn under a letter of credit and subsequently turns over the bill of lading to its customer); there is no new value requirement but the turnover must be for one or more of the purposes stated in subsections (5)(a) and (5)(b). Note that while subsection (4) is restricted to instruments and *negotiable* documents, subsection (5) extends to goods covered by non-negotiable documents as well. Thus the letter of credit bank referred to in the example could make a subsection (5) turn-over without regard to the form of the bill of lading, provided that, in the case of a non-negotiable document, it had previously perfected its interest under one of the methods stated in subsection (3).

Cross References:

Article 7 and §§ 9-303 and 9-305.

Definitional Cross References:

"Chattel paper". § 9-105.
"Debtor". § 9-105.
"Document". § 9-105.
"Goods". § 9-105.
"Instrument". § 9-105.
"Receives notification". § 1-201.
"Sale". §§ 2-106 and 9-105.
"Secured party". § 9-105.
"Security agreement". § 9-105.
"Security interest". § 1-201.
"Value". § 1-201.
"Written". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-552, 6-557 (trust receipts); 55-146 (factor's liens).

§ 9-305. When Possession by Secured Party Perfects Security Interest Without Filing. A security interest in letters of credit and advices of credit (subsection (2)(a) of § 5-116), goods, instruments, negotiable documents or chattel paper may be perfected by the secured party's taking possession of the collateral. If such collateral other than goods covered by a negotiable document is held by a bailee, the secured party is deemed to have possession from the time the bailee receives notification of the secured party's interest. A security interest is perfected by possession from the time possession is taken without relation back and continues only

so long as possession is retained, unless otherwise specified in this Article. The security interest may be otherwise perfected as provided in this Article before or after the period of possession by the secured party.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. As under the common law of pledge, no filing is required by this Article to perfect a security interest where the secured party has possession of the collateral. Compare § 9-302(1)(a). This Section permits a security interest to be perfected by transfer of possession only when the collateral is goods, instruments, documents or chattel paper: that is to say, accounts, contract rights and general intangibles are excluded. See § 5-116 for the special case of assignments of letters and advices of credit. A security interest in accounts, contract rights and general intangibles—property not ordinarily represented by any writing whose delivery operates to transfer the claim—may under this Article be perfected only by filing, and this rule would not be affected by the fact that a security agreement or other writing described the assignment of such collateral as a "pledge". § 9-302(1)(e) exempts from filing certain assignments of accounts or contract rights which are out of the ordinary course of financing: such exempted assignments are perfected when they attach under § 9-303(1); they do not fall within this Section.

2. Possession may be by the secured party himself or by an agent on his behalf: it is of course clear, however, that the debtor or a person controlled by him cannot qualify as such an agent for the secured party. See also the last sentence of § 9-205. Where the collateral (except for goods covered by a negotiable document) is held by a bailee, the time of perfection of the security interest, under the second sentence of the Section, is when the bailee receives notification of the secured party's interest: this rule rejects the common law doctrine that it is necessary for the bailee to attorn to the secured party or acknowledge that he now holds on his behalf.

3. The third sentence of the Section rejects the "equitable pledge" theory of relation back, under which the taking possession was deemed to relate back to the date of the original security agreement. The relation back theory has had little vitality since the 1938 revision of the Federal Bankruptcy Act, which introduced in § 60(a) provisions designed to make such interests voidable as preferences in bankruptcy proceedings. This Section now brings state law into conformity with the overriding federal policy: where a pledge transaction is contemplated, perfection dates only from the time possession is taken, although a security interest may attach, unperfected, before that under the rules stated in § 9-204. The only exception to this rule is the short twenty-one day period of perfection provided in § 9-304(4) and (5), during which a debtor may have possession of specified collateral in which there is a perfected security interest.

Cross References:

§§ 5-116, 9-204, 9-302, 9-303 and 9-304.

Definitional Cross References:

"Chattel paper". § 9-105.
"Collateral". § 9-105.
"Documents". § 9-105.
"Goods". § 9-105.
"Instruments". § 9-105.
"Receives notification". § 1-201.
"Secured party". § 9-105.
"Security interest". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: This section is in accord with Moore v. Hermitage Realty Corp., 145 Va. 199, 204-06, 133 S.E. 881 (1926), in recognizing that a secured party may perfect a security interest by taking possession of collateral without any filing. In this case a pledgee in possession, who entered in to a new agreement with the pledgor, prevailed over another secured party, who claimed rights in the chattel acquired between the initial pledge and the second agreement, but who did not notify the pledgee of these rights.

The section validates, without filing, security interests in goods arising from field warehousing arrangements, provided the person supposedly in possession has suf-

ficient control over the goods. Hamilton Ridge Lumber Sales Corp., v. Wilson, 25 F.2d 592, 593-96 (4th Cir. 1928), held a field warehousing arrangement to be invalid as against the trustee in bankruptcy. Fidelity Insurance, Trust & Safe Deposit Co. v. Roanoke Iron Co., 81 Fed. 439, 443-47 (W.D. Va. 1896), held a secured party's rights under a field warehousing arrangement to be subordinate to the rights of suppliers, who had a statutory lien on the same property under a now-repealed statute.

§ 9-306. **"Proceeds"; Secured Party's Rights on Disposition of Collateral.** (1) "Proceeds" includes whatever is received when collateral or proceeds is sold, exchanged, collected or otherwise disposed of. The term also includes the account arising when the right to payment is earned under a contract right. Money, checks and the like are "cash proceeds". All other proceeds are "non-cash proceeds".

(2) Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition therefore by the debtor unless his action was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor.

(3) The security interest in proceeds is a continuously perfected security interest if the interest in the original collateral was perfected but it ceases to be a perfected security interest and becomes unperfected ten days after receipt of the proceeds by the debtor unless

(a) a filed financing statement covering the original collateral also covers proceeds; or

(b) the security interest in the proceeds is perfected before the expiration of the ten day period.

(4) In the event of insolvency proceedings instituted by or against a debtor, a secured party with a perfected security interest in proceeds has a perfected security interest

(a) in identifiable non-cash proceeds;

(b) in identifiable cash proceeds in the form of money which is not commingled with other money or deposited in a bank account prior to the insolvency proceedings;

(c) in identifiable cash proceeds in the form of checks and the like which are not deposited in a bank account prior to the insolvency proceedings; and

(d) in all cash and bank accounts of the debtor, if other cash proceeds have been commingled or deposited in a bank account, but the perfected security interest under this paragraph (d) is

(i) subject to any right of set-off; and

(ii) limited to an amount not greater than the amount of any cash proceeds received by the debtor within ten days before the institution of the insolvency proceedings and commingled or deposited in a bank account prior to the insolvency proceedings less the amount of cash proceeds received by the debtor and paid over to the secured party during the ten day period.

(5) If a sale of goods results in an account or chattel paper which is transferred by the seller to a secured party, and if the goods are returned to or are repossessed by the seller or the secured party, the following rules determine priorities:

(a) If the goods were collateral at the time of sale for an indebtedness of the seller which is still unpaid, the original security interest attaches again to the goods and continues as a perfected security interest if it was perfected at the time when the goods were sold. If the security interest was originally perfected by a filing which is still effective, nothing further is required to continue the perfected status; in any other case, the secured party must take possession of the returned or repossessed goods or must file.

(b) An unpaid transferee of the chattel paper has a security interest in the goods against the transferor. Such security interest is prior to a security interest asserted under paragraph (a) to the extent that the transferee of the chattel paper was entitled to priority under § 9-308.

(c) An unpaid transferee of the account has a security interest in the goods against the transferor. Such security interest is subordinate to a security interest asserted under paragraph (a).

(d) A security interest of an unpaid transferee asserted under paragraph (b) or (c) must be perfected for protection against creditors of the transferor and purchasers of the returned or repossessed goods.

COMMENT: Prior Uniform Statutory Provision: § 10, Uniform Trust Receipts Act.

Changes: Modified and rewritten.

Purposes of Changes: 1. To state a secured party's right to the proceeds received by a debtor on disposition of collateral and to state when his interest in such proceeds is perfected.

2. Changes from Prior Law:

(a) Whether a debtor's sale of collateral was authorized or unauthorized, prior law generally gave the secured party a claim to the proceeds. Sometimes it was said that the security interest attached to the "property" received in substitution; sometimes it was said the debtor held the proceeds as "trustee" or "agent" for the secured party. Whatever the formulation of the rule, the secured party, if he could trace the proceeds, could reclaim them or their equivalent from the debtor or his trustee in bankruptcy. The change in existing law made by this Section relates to non-identifiable cash proceeds; the secured party has, under conditions stated in subsection (4)(d), a security interest in the debtor's cash and bank accounts equal to the amount of cash proceeds received and commingled or deposited within the 10 days before insolvency proceedings were instituted less the amount of cash proceeds received by the debtor and paid over to the secured party during that period, without regard to whether or not the funds are identifiable as cash proceeds of the collateral.

(b) Subsections (2) and (3) make clear that the four-month period for calculating a voidable preference in bankruptcy begins with the date of the secured party's obtaining the security interest in the original collateral and not with the date of his obtaining control of the proceeds. The interest in the proceeds "continues" as a perfected interest if the original interest was perfected; but the interest ceases to be perfected after the expiration of ten days unless the financing statement covering the original collateral covered the proceeds or unless the secured party perfects his interest in the proceeds themselves—i. e., by filing a financing statement covering them or by taking possession.

(c) Where cash proceeds are covered into the debtor's checking account and paid out in the operation of the debtor's business, recipients of the funds of course take free of any claim which the secured party may have in them as proceeds. What has been said relates to payments and transfers in ordinary course. The law of fraudulent conveyances would no doubt in appropriate cases support recovery of proceeds by a secured party from a transferee out of ordinary course or otherwise in collusion with the debtor to defraud the secured party.

3. In most cases when a debtor makes an unauthorized disposition of collateral, the security interest, under prior law and under this Article, continues in the original collateral in the hands of the purchaser or other transferee. That is to say, since the transferee takes subject to the security interest, the secured party may

repossess the collateral from him or in an appropriate case maintain an action for conversion. Subsection (2) codifies this rule. The secured party may claim both proceeds and collateral, but may of course have only one satisfaction.

In many cases a purchaser or other transferee of collateral will take free of a security interest: in such cases the secured party's only right will be to proceeds. The transferee will take free whenever the disposition was authorized; the authorization may be contained in the security agreement or otherwise given. A claim to proceeds in a filed financing statement might be considered as impliedly authorizing sale or other disposition of the collateral, depending upon the circumstances of the parties, the nature of the collateral, the course of dealing of the parties and the usage of trade (see § 1-205). § 9-301 states when transferees take free of unperfected security interests. §§ 9-307 on goods, 9-308 on chattel paper and non-negotiable instruments and 9-309 on negotiable instruments, negotiable documents and securities state when purchasers of such collateral take free of a security interest even though perfected and even though the disposition was not authorized.

4. Subsection (5) states rules to determine priorities when collateral which has been sold is returned to the debtor: for example goods returned to a department store by a dissatisfied customer. The most typical problems involve sale and return of inventory, but the subsection can also apply to equipment. Under the rule of Benedict v. Ratner, failure to segregate such returned goods sometimes led to invalidation of the entire security arrangement. This Article rejects the Benedict v. Ratner line of cases (see § 9-205 and Comment). Subsection (5)(a) of this Section reinforces the rule of § 9-205: as between secured party and debtor (and debtor's trustee in bankruptcy) the original security interest continues on the returned goods. Whether or not the security interest in the returned goods is perfected depends upon factors stated in the text.

Subsections (5)(b), (c) and (d) deal with a different aspect of the returned goods situation. Assume that a dealer has sold an automobile and transferred the chattel paper or the account arising on the sale to Bank X (which had not previously financed the car as inventory). Thereafter the buyer of the automobile rightfully rescinds the sale, say for breach of warranty, and the car is returned to the dealer. Subsection (5)(b) gives the bank as transferee of the chattel paper or the account a security interest in the car against the dealer. For protection against the dealer's creditors or purchasers from him (other than buyers in the ordinary course of business, see § 9-307), Bank X as the transferee, under subsection (5)(d), must perfect its interest by taking possession of the car or by filing as to it. Perfection of his original interest in the chattel paper or the account does not automatically carry over to the returned car, as it does under subsection (5)(a) where the secured party originally financed the dealer's inventory.

In the situation covered by (5)(b) and (5)(c) a secured party who financed the inventory and a secured party to whom the chattel paper or the account was transferred may both claim the returned goods—the inventory financer under subsection (5)(a), the transferee under subsections (5)(b) and (5)(c). With respect to chattel paper, § 9-308 regulates the priorities. With respect to an account, subsection (5)(c) subordinates the security interest of the transferee of the account to that of the inventory financer. However, if the inventory security interest was unperfected, the transferee's interest could become entitled to priority under the rules stated in § 9-312(5).

In cases of repossession by the dealer and also in cases where the chattel was returned to the dealer by the voluntary act of the account debtor, the dealer's position may be that of a mere custodian; he may be an agent for resale, but without any other obligation to the holder of the chattel paper; he may be obligated to repurchase the chattel, the chattel paper or the account from the secured party or to hold it as collateral for a loan secured by a transfer of the chattel paper or the account.

If the dealer thereafter sells the chattel to a buyer in ordinary course of business in any of the foregoing cases, the buyer is fully protected under § 2-403(2) as well as under § 9-307(1), whichever is technically applicable.

Cross References:

§§ 9-307, 9-308 and 9-309.
Point 3: §§ 1-205 and 9-301.
Point 4: §§ 2-403(2), 9-205 and 9-312.

Definitional Cross References:

"Account". § 9-106.
"Bank". § 1-201.
"Chattel paper". § 9-105.
"Check". §§ 3-104 and 9-105.
"Collateral". § 9-105.
"Contract right". § 9-106.
"Creditors". § 1-201.
"Debtor". § 9-105.
"Goods". § 9-105.
"Insolvency proceedings". § 1-201.
"Money". § 1-201.
"Purchaser". § 1-201.
"Sale". §§ 2-106 and 9-105.
"Secured party". § 9-105.
"Security agreement". § 9-105.
"Security interest". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-559 (trust receipts); 55-146 (factor's liens).

§ 9-307. Protection of Buyers of Goods. (1) A buyer in ordinary course of business (subsection (9) of § 1-201) other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence.

(2) In the case of consumer goods and in the case of farm equipment having an original purchase price not in excess of $500 (other than fixtures, see § 9-313), a buyer takes free of a security interest even though perfected if he buys without knowledge of the security interest, for value and for his own personal, family or household purposes or his own farming operations unless prior to the purchase the secured party has filed a financing statement covering such goods.

(VALC Note: Subsection (2) appears in the Official Text as follows:

(2) In the case of consumer goods and in the case of farm equipment having an original purchase price not in excess of $2500 (other than fixtures, see § 9-313), a buyer takes free of a security interest even though perfected if he buys without knowledge of the security interest, for value and for his own personal, family or household purposes or his own farming operations unless prior to the purchase the secured party has filed a financing statement covering such goods.)

COMMENT: Prior Uniform Statutory Provision: § 9, Uniform Conditional Sales Act; § 9(2), Uniform Trust Receipts Act.

Changes: Policy of prior acts continued (subsection (1)).

Purposes of Changes: 1. This Section states when buyers of goods take free of a security interest even though perfected. A buyer who takes free of a perfected security interest of course takes free of an unperfected one. § 9-301 should be consulted to determine what purchasers, in addition to the buyers covered in this Section, take free of an unperfected security interest.

Article 2 (Sales) states general rules on purchase of goods from a seller with defective or voidable title (§ 2-403).

2. The definition of "buyer in ordinary course of business" in § 1-201(9) restricts the application of subsection (1) to buyers (except pawnbrokers) "from a person in the business of selling goods of that kind": thus the subsection applies, in the terminology of this Article, primarily to inventory. Subsection (1) further excludes from its operation buyers of "farm products", defined in § 9-109(3), from a person engaged in farming operations. The buyer in ordinary course of business is defined as one who buys "in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party." This Section provides that such a buyer takes free of a security interest, even though perfected, and although he knows the security interest exists. Reading

the two provisions together, it results that the buyer takes free if he merely knows that there is a security interest which covers the goods but takes subject if he knows, in addition, that the sale is in violation of some term in the security agreement not waived by the words or conduct of the secured party.

The limitations which this Section imposes on the persons who may take free of a security interest apply of course only to unauthorized sales by the debtor. If the secured party has authorized the sale in the security agreement or otherwise, the buyer takes free without regard to the limitations of this Section. § 9-306 states the right of a secured party to the proceeds of a sale, authorized or unauthorized.

3. Subsection (2) deals with buyers of "consumer goods" (defined in § 9-109) and with buyers of farm equipment having an original purchase price not in excess of $2500. (If the consumer goods or farm equipment are fixtures, the rule of the subsection does not apply.). Under § 9-302(1)(c) and (1)(d) no filing is required to perfect a purchase money interest in the consumer goods or farm equipment subject to this subsection except motor vehicles required to be licensed; filing is required to perfect security interests in such goods or equipment other than purchase money interests and, for motor vehicles, even in the case of purchase money interests.

Under subsection (2) a buyer of consumer goods or farm equipment takes free of a security interest even though perfected (a) if he buys without knowledge of the security interest, (b) for value, (c) for his own personal, family, or household purposes (or in the case of farm equipment for his own farming operations), and (d) before a financing statement is filed.

As to purchase money security interests which are perfected without filing under § 9-302(1)(c) and (d): A secured party may file a financing statement (although filing is not required for perfection). If he does file, all buyers take subject to the security interest. If he does not file, a buyer who meets the qualifications stated in the preceding pargraph takes free of the security interest.

As to security interests which can be perfected only by filing under § 9-302: This category includes all non-purchase money interests, and all interests, whether or not purchase money, in motor vehicles, as well as interests which may be and are filed, though filing was not required for perfection under § 9-302. (Note that under § 9-302(3) the filing provisions of this Article do not apply when a state has enacted a certain type of certificate of title law. Thus where motor vehicles are concerned, in a state having such a certificate of title law, perfection will be under that law.) So long as the security interest remains unperfected, not only the buyers described in subsection (2) but the purchasers described in § 9-301 will take free of the interest. After a financing statement has been filed or after compliance with the certificate of title law all subsequent buyers, under the rule of subsection (2), are subject to the security interest.

As to security interests in consumer goods or farm equipment which have become fixtures: Since the rule of subsection (2) does not apply, the normal rules govern. § 9-313 states rules of priority between a claimant of a chattel security interest in fixtures and persons who claim an interest in the fixtures as realty.

Cross References:

Point 1: §§ 2-403 and 9-301.
Point 2: § 9-306.
Point 3: §§ 9-301, 9-302 and 9-313.

Definitional Cross References:

"Buyer in ordinary course of business". § 1-201.
"Consumer goods". § 9-109.
"Equipment". § 9-109.
"Farm products". § 9-109.
"Goods". § 9-105.
"Knows" and "Knowledge". § 1-201.
"Person". § 1-201.
"Purchase". § 1-201.
"Secured party". § 9-105.
"Security interest". § 1-201.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-558 (trust receipts); 55-146 (factor's liens).

Comment: This section is in close accord with Virginia law. It is elementary that a buyer in ordinary course of business, or a bona fide purchaser, as he is called in the Virginia cases, will prevail over an unperfected, or unrecorded, security interest. General Motors Acceptance Corp. v. Vicars, 153 Va. 149, 153-55, 149 S.E. 476 (1929) (bona fide purchaser of refrigerator takes priority over vendor under unrecorded conditional sales contract); American Agricultural Chemical Co. v. J. W. Perry Co., 152 Va. 598, 601-03, 148 S.E. 806 (1929) (bona fide purchaser prevails over lienor under unrecorded crop lien); Bird v. Wilkinson, 31 Va. (4 Leigh) 266, 270-75 (1833) (bona fide purchaser of slave prevails over mortgagee under unrecorded chattel mortgage).

The UCC adopts and goes beyond the familiar rule of Boice v. Finance and Guaranty Corp., 127 Va. 563, 102 S.E. 591, 10 A.L.R. 654 (1920). The rule of this case is summarized in 127 Va. at 570-71 as follows: "It is true that, as a rule, the seller of personal chattels cannot confer upon a purchaser any better title than he himself has, but if the owner stands by and permits a seller, who is a licensed dealer in such goods to hold himself out to the world as owner, to treat the goods as his own, place them with other similar goods of his own in a public showroom, and offer the same indiscriminately with his own to the public, he will be estopped by his conduct from asserting his ownership against a purchaser for value without notice of his title. The constructive notice furnished by a recorded mortgage or deed of trust in such cases is not sufficient. The act of knowingly permitting the goods to be so handled and used by the seller in the ordinary and usual conduct of his business is just as destructive of the rights of the creditor as if such permission had been expressly granted in the mortgage or deed of trust." The same rule was applied the same day in O'Neil v. Cheatwood, 127 Va. 96, 99-100, 102 S.E. 596 (1920), and later in General Credit, Inc. v. Winchester, Inc., 196 Va. 711, 714-19, 85 S.E.2d 201 (1955).

In Gump Investment Co. v. Jackson, 142 Va. 190, 193-96, 128 S.E. 506, 47 A.L.R. 82 (1925), Virginia extended the rule to cover the situation in which the secured party does not know that the dealer is offering the chattel to the public. The court said in 142 Va. at 195: "One conclusion is that some duty, at least, rests upon an individual, corporate or otherwise, who finances a retail dealer, to see to it that cars upon which he has a lien are not left under the domain and control of such dealer on his sales room floor, to be offered to the public. The business of the Gump Investment Company was to finance retail automobile dealers, and it did finance them for a profit. It assumed some risk both as to the moral and financial standing of every dealer it financed. It took a risk as to the hazard for a profit." This extension of the Boice rule was repudiated in McQuay v. Mount Vernon Bank & Trust Co., 200 Va. 776, 782-83, 108 S.E.2d 251 (1959), commented upon in Rodriguez, Assignments of Security Interests in Dealers' Stocks of Automobiles, 17 Wash. & Lee L. Rev. 173 (1960). The case held that the lienor under a lien noted on the certificate of title would prevail over a bona fide purchaser, where the secured party did not know that the automobile was to be placed in a stock of cars and offered for sale. The UCC eliminates the McQuay limitation on the Boice doctrine and returns Virginia law to the broad principles stated in the Gump case, that is, the buyer in ordinary course of business from a dealer in goods of that kind prevails over a secured party. Under the UCC this is true even though the buyer knows of the security interest. This extension also changes Virginia law, which has required the buyer to be without notice of the secured party's rights in order to prevail under the Boice rule. Garrett v. Rahily & Martin, 132 Va. 226, 227-28, 111 S.E. 110 (1922).

It would seem that the same result would be reached under the UCC as in Rudolph v. Farmers' Supply Co., Inc., 131 Va. 305, 312-15, 108 S.E. 638 (1921). In this case Farmers' Supply sold Garman a car under a conditional sale contract, which was duly recorded. Garman sold the car to Davis, a second-hand car dealer, who in turn sold it to Rudolph, a bona fide purchaser. The conditional vendor, Farmers' Supply, was held to be entitled to the car, as against Rudolph, the bona fide purchaser. Rudolph would not be able to rely on subsection 9-307(1) because the security interest of Farmers' Supply was not one "created by his seller," as is required under this subsection. Since the car in the hands of Garman would be "consumer goods" and since the security interest was perfected by recording, the secured party would prevail under subsection 9-307(2) even as against a bona fide purchaser.

Subsection 9-307(1) is in accord with O'Connor v. Smith, 188 Va. 214, 219, 49 S.E. 2d 310 (1948), in its holding that the Boice rule does not apply to equipment and fixtures, since these are not sold in the ordinary course of business.

COUNCIL COMMENT

We feel that the $2500 figure below which certain purchasers of farm equipment can prevail over a security interest is much too high and recommend lowering it to $500.

§ 9-308. **Purchase of Chattel Paper and Non-Negotiable Instruments.** A purchaser of chattel paper or a non-negotiable instrument who gives new value and takes possession of it in the ordinary course of his business and without knowledge that the specific paper or instrument is subject to a security interest has priority over a security interest which is perfected under § 9-304 (permissive filing and temporary perfection). A purchaser of chattel paper who gives new value and takes possession of it in the ordinary course of his business has priority over a security interest in chattel paper which is claimed merely as proceeds of inventory subject to a security interest (§ 9-306), even though he knows that the specific paper is subject to the security interest.

COMMENT: **Prior Uniform Statutory Provision:** §§ 9(a) and 10 of Uniform Trust Receipts Act.

Changes: Important changes in substance.

Purposes of Changes: 1. Chattel paper is defined (§ 9-105) as "a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods". In terms of existing security devices the definition covers, for example, the conditional sale contract, the bailment lease and the chattel mortgage. Such paper has become an important class of collateral in financing arrangements, which may—as in the automobile and some other fields—follow an earlier financing arrangement covering inventory or which may begin with the chattel paper itself.

Arrangements where the chattel paper is delivered to the secured party who then makes collections, as well as arrangements where the debtor, whether or not he is left in possession of the paper, makes the collections, are both widely used, and are known respectively as notification (or "direct collection") and non-notification (or "indirect collection") arrangements. In the automobile field, for example, when a car is sold to a consumer buyer under an installment purchase agreement and the resulting chattel paper is assigned, the assignee usually takes possession, the obligor is notified of the assignment and is directed to make payments to the assignee. In the furniture field, for an example on the other hand, the chattel paper may be left in the dealer's hands or delivered to the assignee; in either case the obligor is usually not notified, and payments are made to the dealer-assignor who receives them under a duty to remit to his assignee. The widespread use of both methods of dealing with chattel paper is recognized by the provisions of this Article which permit perfection of a chattel paper security interest either by filing or by taking possession.

2. Although perfection by filing is permitted as to chattel paper, certain purchasers of chattel paper allowed to remain in the debtor's possession take free of the security interest despite the filing. The second sentence of the Section deals with the case where the security interest in the chattel paper is claimed merely as proceeds—i. e. in favor of an inventory financer, whether or not his filed financing statement claimed proceeds, who has not by some new transaction with the debtor acquired a specific interest in the chattel paper. In that case a purchaser, even though he knows of the inventory financer's proceeds interest, takes priority provided he gives new value and takes possession of the paper in the ordinary course of his business. The first sentence deals with the case where the non-possessory security interest in the chattel paper is more than a mere claim to proceeds—i. e. exists in favor of a secured party who has given value against the paper, whether or not he financed the inventory whose sale gave rise to it. In this case the purchaser, to take priority, must not only give new value and take possession in the ordinary course of his business; he must also take without knowledge of the existing security interest. Thus a secured party, who has a specific interest in the chattel paper and not merely a claim to proceeds, and who wishes to leave the paper in the debtor's possession can, because of the knowledge requirement, protect himself against purchasers by stamping or noting on the paper the fact that it has been assigned to him.

3. The rule of the first sentence of the Section also applies to non-negotiable instruments. Note that the term "non-negotiable instrument" is by no means as

broad as the common law concept of "chose in action": accounts, contract rights and general intangibles (all defined in § 9-106) are not included. It should also be noted that under § 9-304(1) a security interest in an instrument, negotiable or non-negotiable, cannot be perfected by filing. Thus the only type of perfected non-possessory security interest that can arise in an instrument is the temporary 21 day perfection provided for in § 9-304(4) and (5). Where such a perfected interest exists in a non-negotiable instrument, purchasers will take free if they qualify under the first sentence of the Section. Since the second sentence applies only to chattel paper, knowledge of the existing security interest would defeat the purchaser of a non-negotiable instrument even though that interest was claimed merely as proceeds.

Cross References:

Point 1: §§ 9-304(1) and 9-305(1).
Point 2: § 9-306.
Point 3: § 9-304.

Definitional Cross References:

"Chattel paper". § 9-105.
"Instrument". § 9-105.
"Inventory". § 9-109.
"Knowledge". § 1-201.
"Proceeds". § 9-306.
"Purchaser". § 1-201.
"Security interest". § 1-201.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-558 - 559 (trust receipts).

§ 9-309. Protection of Purchasers of Instruments and Documents. Nothing in this Article limits the rights of a holder in due course of a negotiable instrument (§ 3-302) or a holder to whom a negotiable document of title has been duly negotiated (§ 7-501) or a bona fide purchaser of a security (§ 8-301) and such holders or purchasers take priority over an earlier security interest even though perfected. Filing under this Article does not constitute notice of the security interest to such holders or purchasers.

COMMENT: Prior Uniform Statutory Provision: § 9(a), Uniform Trust Receipts Act.

Changes: No changes in substance.

Purposes: 1. Under this Article as at common law and under prior statutes the rights of purchasers of negotiable paper, including negotiable documents of title and investment securities, are determined by the rules of holding in due course and the like which are applicable to the type of paper concerned. (Articles 3, 7, and 8.) This Section, as did § 9(a) of the Uniform Trust Receipts Act, makes explicit the rule which was implicitly but universally recognized under earlier statutes.

2. Under § 9-304(1) filing is ineffective to perfect a security interest in instruments (including securities) and of course is ineffective to constitute notice to subsequent purchasers. Although filing is permissible as a method of perfection for a security interest in documents, this Section follows the policy of the Uniform Trust Receipts Act in providing that the filing does not constitute notice to purchasers.

Cross References:

Articles 3, 7, and 8 and § 9-304(1).

Definitional Cross References:

"Bona fide purchaser". § 8-302.
"Document of title". § 1-201.
"Duly negotiated". § 7-501.
"Holder". § 1-201.
"Holder in due course". §§ 3-302 and 9-105.

"Negotiable instrument". §§ 3-104 and 9-105.
"Notice". § 1-201.
"Purchaser". § 1-201.
"Security". §§ 8-102 and 9-105.
"Security interest". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 6-558 (trust receipts).

§ 9-310. **Priority of Certain Liens Arising by Operation of Law.** When a person in the ordinary course of his business furnishes services or materials with respect to goods subject to a security interest, a lien upon goods in the possession of such person given by statute or rule of law for such materials or services takes priority over a perfected security interest unless the lien is statutory and the statute expressly provides otherwise.

COMMENT: **Prior Uniform Statutory Provision:** § 11, Uniform Trust Receipts Act.

Changes: None in substance.

Purposes: 1. To provide that liens securing claims arising from work intended to enhance or preserve the value of the collateral take priority over an earlier security interest even though perfected.

2. Apart from the Uniform Trust Receipts Act which had a section similar to this one, there was generally no specific statutory rule as to priority between security devices and liens for services or materials. Under chattel mortgage or conditional sales law many decisions made the priority of such liens turn on whether the secured party did or did not have "title". This Section changes such rules and makes the lien for services or materials prior in all cases where they are furnished in the ordinary course of the lienor's business and the goods involved are in the lienor's possession. Some of the statutes creating such liens expressly make the lien subordinate to a prior security interest. This Section does not repeal such statutory provisions. If the statute creating the lien is silent, even though it has been construed by decision to make the lien subordinate to the security interest, this Section provides a rule of interpretation that the lien should take priority over the security interest.

Cross References:

§§ 9-102(2), 9-104(c) and 9-312(1).

Definitional Cross References:

"Goods". § 9-105.
"Person". § 1-201.
"Security interest". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-560 (trust receipts); 43-32 - 33 (artisan's liens); 55-146 (factor's liens).

Comment: Code 1950, § 43-33 gives a mechanic a possessory lien for his repairs. However, the Virginia statute further states that where the property is subject to a prior encumbrance the mechanic shall have a lien for only $50.00. The UCC gives the possessory lienor (mechanic) a priority over the prior security interest without limitation as to amount "unless (the mechanic's) lien is statutory and the statute expressly provides otherwise." It would seem that the UCC does not supercede the existing scheme of Virginia statutory priority between prior encumbrancers and mechanics because by simultaneously creating and limiting the mechanic's lien (where a prior encumbrance is involved) in the amount of $50.00, the Virginia statute, by indirect but forceful means, has accomplished the same purpose as if it had "expressly provided otherwise" as required by the UCC. The Virginia statute giving a garageman a lien, Code 1950, § 43-32, does not contain any provision regarding priorities, and so the UCC operates to give the garageman a priority without limitation in regard to other secured parties.

§ 9-311. **Alienability of Debtor's Rights: Judicial Process.** The debtor's rights in collateral may be voluntarily or involuntarily transferred (by way

of sale, creation of a security interest, attachment, levy, garnishment or other judicial process) notwithstanding a provision in the security agreement prohibiting any transfer or making the transfer constitute a default.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. To make clear that in all security transactions under this Article, the debtor has an interest (whether legal title or an equity) which he can dispose of and which his creditors can reach.

2. Some jurisdictions have held that when a mortgagee or conditional seller has "title" to the collateral, creditors may not proceed against the mortgagor's or vendee's interest by levy, attachment or other judicial process. This Section changes those rules by providing that in all security interests the debtor's interest in the collateral remains subject to claims of creditors who take appropriate action. It is left to the law of each state to determine the form of "appropriate process".

3. Where the security interest is in inventory, difficult problems arise with reference to attachment and levy. Assume that a debt of $100,000 is secured by inventory worth twice that amount. If by attachment or levy certain units of the inventory are seized, the determination of the debtor's equity in the units seized is not a simple matter. The Section leaves the solution of this problem to the courts. Procedures such as marshalling may be appropriate.

Definitional Cross References:

"Collateral". § 9-105.
"Debtor". § 9-105.
"Rights". § 1-201.
"Sale". §§ 2-106 and 9-105.
"Security agreement". § 9-105.
"Security interest". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Ashworsh v. Fleenor, 178 Va. 104, 110-12, 16 S.E. 2d 309 (1941) recognized that an assignee of the debtor-vendee succeeds to the rights of his assignor. The UCC goes beyond the principle recognized by the Ashworth case and makes it clear that a contractual provision prohibiting transfer or making the transfer a default does not invalidate the transfer.

§ 9-312. **Priorities Among Conflicting Security Interests in the Same Collateral.** (1) The rules of priority stated in the following sections shall govern where applicable: § 4-208 with respect to the security interest of collecting banks in items being collected, accompanying documents and proceeds; § 9-301 on certain priorities; § 9-304 on goods covered by documents; § 9-306 on proceeds and repossessions; § 9-307 on buyers of goods; § 9-308 on possessory against non-possessory interests in chattel paper or non-negotiable instruments; 9-309 on security interests in negotiable instruments, documents or securities; § 9-310 on priorities between perfected security interests and liens by operation of law; § 9-313 on security interests in fixtures as against interests in real estate; § 9-314 on security interests in accessions as against interest in goods; § 9-310 on conflicting security interests where goods lose their identity or become part of a product; and § 9-316 on contractual subordination.

(2) A perfected security interest in crops for new value given to enable the debtor to produce the crops during the production season and given not more than three months before the crops become growing crops by planting or otherwise takes priority over an earlier perfected security interest to the extent that such earlier interest secures obligations due more than six months before the crops become growing crops by planting or otherwise, even though the person giving new value had knowledge of the earlier security interest.

(3) A purchase money security interest in inventory collateral has priority over a conflicting security interest in the same collateral if

(a) the purchase money security interest is perfected at the time the debtor receives possession of the collateral; and

(b) any secured party whose security interest is known to the holder of the purchase money security interest or who, prior to the date of the filing made by the holder of the purchase money security interest, had filed a financing statement covering the same items or type of inventory, has received notification of the purchase money security interest before the debtor receives possession of the collateral covered by the purchase money security interest; and

(c) such notification states that the person giving the notice has or expects to acquire a purchase money security interest in inventory of the debtor, describing such inventory by item or type.

(4) A purchase money security interest in collateral other than inventory has priority over a conflicting security interest in the same collateral if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within ten days thereafter.

(5) In all cases not governed by other rules stated in this section (including cases of purchase money security interests which do not qualify for the special priorities set forth in subsections (3) and (4) of this section), priority between conflicting security interests in the same collateral shall be determined as follows:

(a) in the order of filing if both are perfected by filing, regardless of which security interest attached first under § 9-204(1) and whether it attached before or after filing;

(b) in the order of perfection unless both are perfected by filing, regardless of which security interest attached first under § 9-204(1) and, in the case of a filed security interest, whether it attached before or after filing; and

(c) in the order of attachment under § 9-204(1) so long as neither is perfected.

(6) For the purpose of the priority rules of the immediately preceding subsection, a continuously perfected security interest shall be treated at all times as if perfected by filing if it was originally so perfected and it shall be treated at all times as if perfected otherwise than by filing if it was originally perfected otherwise than by filing.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. In a variety of situations two or more people may claim an interest in the same property. The several sections listed in subsection (1) state rules for determining priorities between security interests and such other claims in the situations covered in those sections. For cases not covered in those sections this Section states general rules of priority between conflicting security interests.

2. Subsection (2) gives priority to a new value security interest in crops based on a current crop production loan over an earlier security interest in the crop which secured obligations (such as rent, interest or mortgage principal amortization) due more than six months before the crops become growing crops. This priority is not affected by the fact that the person making the crop loan knew of the earlier security interest. § 9-204(4)(a) should be consulted on the extent to which this Article permits a security interest to attach to crops planted after the execution of the security agreement.

3. Subsections (3) and (4) give priority to a purchase money security interest (defined in § 9-107) under certain conditions over non-purchase money interests,

which in this context will usually be interests asserted under after-acquired property clauses. See § 9-204(3) and (4) on the extent to which after-acquired property interests are validated and § 9-108 on when a security interest in after-acquired property is deemed taken for new value.

Prior law, under one or another theory, usually contrived to protect purchase money interests over after-acquired property interests (to the extent to which the after-acquired property interest was recognized at all). For example, in the field of industrial equipment financing it was possible, by manipulation of title theory, for the purchase money financer of new equipment (under conditional sale or equipment trust) to protect himself against the claims of prior mortgagees or bondholders under an after-acquired clause in the mortgage or trust indenture: the result was arrived at on the theory that since "title" to the equipment was never in the vendee or lessee there was nothing for the lien of the mortgage to attach to. While this Article broadly validates the after-acquired property interest, it also recognizes as sound the preference which prior law gave to the purchase money interest. That policy is carried out in subsections (3) and (4).

Subsection (4) states a general rule applicable to all types of collateral except inventory: the purchase money interest takes priority provided only that it is perfected when the debtor receives possession of the collateral or within ten days thereafter. As to the ten day grace period, compare § 9-301(2).The perfection requirement means that the purchase money secured party either has filed a financing statement before that time or has a temporarily perfected interest in goods covered by documents under § 9-304(4) and (5) (which is continued in a perfected status by filing before the expiration of the 21 day period specified in that section). There is no requirement that the purchase money secured party be without notice or knowledge of the other interest; he takes priority although he knows of it or it has been filed.

Under subsection (3) the same rule of priority, but without the ten day grace period for filing, applies to a purchase money security interest in inventory with the additional requirement that the purchase money secured party give notification, as stated in subsections (3)(b) and (3)(c), to any other secured party of whom he knows or who was the first to file and who is also interested in the same item or type of inventory. The reason for the additional requirement of notification is that typically the arrangement between an inventory secured party and his debtor will require the secured party to make periodic advances against incoming inventory or periodic releases of old inventory as new inventory is received. A fraudulent debtor may apply to the secured party for advances even though he has already given a security interest in the inventory to another secured party. The notification requirement protects the inventory financer in such a situation: if he has received notification, he will presumably not make an advance; if he has not received notification (or if the other interest does not qualify as a purchase money interest), any advance he may make will have priority. Since an arrangement for periodic advances against incoming property is unusual outside the inventory field, no notification requirement is included in subsection (4).

4. Subsection (5) states rules for determining priority between conflicting security interests in cases not covered in the sections listed in subsection (1) or in subsections (2), (3) and (4) of this section. Note that subsection (5) applies to cases of purchase money security interests which do not qualify for the special priorities set forth in subsections (3) and (4).

The operation of subsections (5) and (6) is illustrated by the following examples.

Example 1. A files against X (debtor) on February 1. B files against X on March 1. B makes a non-purchase money advance against certain collateral on April 1. A makes an advance against the same collateral on May 1. A has priority even though B's advance was made earlier and was perfected when made. It makes no difference whether or not A knew of B's interest when he made his advance.

The problem stated in the example is peculiar to a notice filing system under which filing may be made before the security interest attaches (see § 9-402). The Uniform Trust Receipts Act, which first introduced such a filing system, contained no hint of a solution and case law under it has been unpredictable. This Article follows several of the accounts receivable statutes in determining priority by order of filing. The justification for the rule lies in the necessity of protecting the filing system—that is, of allowing the secured party who has first filed to make subsequent advances without each time having, as a condition of protection, to check for filings later than his. Note, however, that his protection is not absolute: if, in the example, B's advance creates a purchase money security interest, he has priority under subsection (4), or, in the case of inventory, under subsection (3) provided he has properly notified A. (See further Example 3 below.)

Example 2. A and B make non-purchase money advances against the same collateral. The collateral is in the debtor's possession and neither interest is perfected when the second advance is made. Whichever secured party first perfects his interest (by taking possession of the collateral or by filing) takes priority and it makes no difference whether or not he knows of the other interest at the time he perfects his own.

Subsections (5)(a) and (5)(b) both lead to this result. It may be regarded as an adoption, in this type of situation, of the idea, deeply rooted at common law, of a race of diligence among creditors. Subsection (5)(c) adds the thought that so long as neither of the interests is perfected, the one which first attached (i. e. under the advance first made) has priority. The last mentioned rule may be thought to be of merely theoretical interest, since it is hard to imagine a situation where the case would come into litigation without either A or B having perfected his interest. If neither interest had been perfected at the time of the filing of a petition in bankruptcy, of course neither would be good against the trustee in bankruptcy.

Example 3. A has a temporarily perfected (21 day) security interest, unfiled, in a negotiable document in the debtor's possession under § 9-304(4) or (5). On the fifth day B files and thus perfects a security interest in the same document. On the tenth day A files. A has priority, whether or not he knows of B's interest when he files.

The result follows from subsection (6) which classifies security interests according to the manner of their initial perfection. The case therefore falls under subsection (5)(b) and not under (5)(a); A prevails because his interest was first perfected although B was first to file.

Example 4. On February 1 A makes an advance against machinery in the debtor's possession and files his financing statement. On March 1 B makes an advance against the same machinery and files his financing statement. On April 1 A makes a further advance, under the original security agreement, against the same machinery (which is covered by the original financing statement and thus perfected when made). A has priority over B both as to the February 1 and as to the April 1 advance and it makes no difference whether or not A knows of B's intervening advance when he makes his second advance.

The case falls under subsection (5)(a), since both interests are perfected by filing. A wins, as to the April 1 advance, because he first filed, even though B's interest attached, and indeed was perfected, first. § 9-204(5) and the Comment thereto should be consulted for the validation of future advances. § 9-313 provides for cases involving fixtures.

Example 5. On February 1 A makes advances to X under a security agreement which covers "all the machinery in X's plant" and contains an after-acquired property clause. A promptly files his financing statement. On March 1 X acquires a new machine, B makes an advance against it and files his financing statement. On April 1 A, under the original security agreement, makes an advance against the machine acquired March 1. If B's advance creates a purchase money security interest, he has priority under subsection (4) (provided he filed before X received possession of the machine or within ten days thereafter). If B's advance, although he gave new value, did not create a purchase money interest, A has priority for the reasons stated under Example 4.

Cross References:

§§ 9-204(1) and 9-303.
Point 1: §§ 4-208, 9-301, 9-304, 9-306, 9-307, 9-308, 9-309, 9-310, 9-313, 9-314, 9-315 and 9-316.
Point 2: § 9-204(4) (a).
Point 3: §§ 9-108, 9-204(3) and (4), 9-304(4) and (5).
Point 4: §§ 9-204(5), 9-304(4) and (5) and 9-402(1).

Definitional Cross References:

"Bank". § 1-201.
"Chattel paper". § 9-105.
"Collateral". § 9-105.
"Debtor". § 9-105.
"Documents". § 9-105.
"Give notice". § 1-201.
"Goods". § 9-105.
"Instruments". § 9-105.
"Inventory". § 9-109.

"Knowledge". § 1-201.
"Person". § 1-201.
"Proceeds". § 9-306.
"Purchase money security interest". § 9-107.
"Receives" notification. § 1-201.
"Secured party". § 9-105.
"Security". §§ 8-102 and 9-105.
"Security interest". § 1-201.
"Value". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 43-27 - 30 (crop liens).

Comment: Subsection 9-312(2) appears to change Virginia law as stated in McCormick v. Terry, 147 Va. 448, 453-59, 137 S.E. 452 (1927), in which the Supreme Court of Appeals said, "It may be conceded that it was competent for the legislature to provide that the lien for advances on crops seeded after the execution of a deed of trust on land should have priority over a prior recorded lien on the premises, yet it has not been seen fit to do so. The party making the advances was chargeable with knowledge of the existence of the prior mortgage, and if he desired to make the advances, or intended to secure them, he had but to get the consent of the mortgagee that the crops should be removed before sale, or that as to crops he should have priority." However, this case is not squarely in point with the UCC since the action was brought by the party making the crop advances against the purchaser of the land at the judicial sale to enjoin him from taking the crops in accordance with the terms of the sale.

§ 9-313. Priority of Security Interests in Fixtures. (1) The rules of this section do not apply to goods incorporated into a structure in the manner of lumber, bricks, tile, cement, glass, metal work and the like and no security interest in them exists under this Article unless the structure remains personal property under applicable law. The law of this State other than this Act determines whether and when other goods become fixtures. This Act does not prevent creation of an encumbrance upon fixtures or real estate pursuant to the law applicable to real estate.

(2) A security interest which attaches to goods before they become fixtures takes priority as to the goods over the claims of all persons who have an interest in the real estate except as stated in subsection (4).

(3) A security interest which attaches to goods after they become fixtures is valid against all persons subsequently acquiring interests in the real estate except as stated in subsection (4) but is invalid against any person with an interest in the real estate at the time the security interest attaches to the goods who has not in writing consented to the security interest or disclaimed an interest in the goods as fixtures.

(4) The security interests described in subsections (2) and (3) do not take priority over

(a) a subsequent purchaser for value of any interest in the real estate; or

(b) a creditor with a lien on the real estate subsequently obtained by judicial proceedings; or

(c) a creditor with a prior encumbrance of record on the real estate to the extent that he makes subsequent advances

if the subsequent purchase is made, the lien by judicial proceedings is obtained, or the subsequent advance under the prior encumbrance is made or contracted for without knowledge of the security interest and before it is perfected. A purchaser of the real estate at a foreclosure sale other than an encumbrancer purchasing at his own foreclosure sale is a subsequent purchaser within this section.

(5) When under subsections (2) or (3) and (4) a secured party has priority over the claims of all persons who have interests in the real estate, he may, on default, subject to the provisions of Part 5, remove his collateral from the real estate but he must reimburse any encumbrancer or owner of the real estate who is not the debtor and who has not otherwise agreed for the cost of repair of any physical injury, but not for any diminution in value of the real estate caused by the absence of the goods removed or by any necessity for replacing them. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate security for the performance of this obligation.

COMMENT: **Prior Uniform Statutory Provision:** § 7, Uniform Conditional Sales Act.

Changes: Changed in substance.

Purposes of Changes: 1. To state when a secured party claiming an interest in goods as fixtures under this Act is entitled to priority over a person claiming an interest in the same goods by reason of the law applicable to real estate.

2. This Section, like § 7 of the Uniform Conditional Sales Act, leaves it to other law to determine when chattels become realty by affixation except to the extent that the first sentence of subsection (1) makes clear that the Section does not apply to structural materials.

3. Where a security interest in the goods as chattels has attached before affixation, subsection (2) gives the secured party priority over all prior claims based on an interest in the realty. If the secured party perfects his interest by filing, which he may do in advance of affixation, he takes priority over subsequent realty claims as well. So long as he fails to perfect his interest he may, however, be subordinated to subsequent claimants described in subsections (4) (a), (b) and (c). The last sentence of subsection (4) on purchasers at foreclosure sales clarifies a point on which prior decisions have been in conflict.

4. Subsection (3) permits a chattel interest to be taken in goods after they have become fixtures. In this case the secured party has the same rights against *subsequent* real estate interests as when his interest was taken before affixation. However the post-affixation security interest is invalid against *prior* real estate claims unless they agree in writing to a subordinate status. The reason for the distinction taken, as to prior real estate claims, between the pre-affixation and post-affixation security interest is that in the former case the value of the real estate is presumably being increased by the addition of the fixture, while in the latter case value, on which the real estate encumbrancer may have counted. is being in a sense deducted from the real estate by the separate financing of a part of it as a fixture.

5. Subsection (5) is an important departure from § 7 of the Uniform Conditional Sales Act and from much other conditional sales legislation. Under the Uniform Conditional Sales Act a conditional vendor could not sever and remove the affixed chattel if a "material injury to the freehold" would result. The courts of various jurisdictions were in sharp disagreement on the meaning of "material injury": some held that only physical injury was meant; others adopted the so-called "institutional theory" and denied removal whenever the "going value" of the structure would be materially diminished by the removal. Under these rules the conditional vendor either could not remove at all, or, if he could, could damage the structure on removal without becoming accountable to the real estate claimant. The situation was complicated by the fact that it became increasingly difficult to predict what types of goods the courts in a given jurisdiction would hold not subject to removal.

Subsection (5) abandons the "material injury to the freehold" rule. Instead a secured party entitled to priority may in all cases sever and remove his collateral, subject, however, to a duty to reimburse any real estate claimant (other than the debtor himself) for any physical injury caused by the removal. The right to reimbursement is implemented by the last sentence of subsection (5) which gives the real estate claimant a statutory right to security or indemnity, failing which he may refuse permission to remove. The subsection (5) rule thus accomplishes two things: it puts an end to the uncertainty which has grown up under the "material injury" rule, while at the same time it protects the real estate claimant under the reimbursement provisions.

6. Under this Article as under the Uniform Conditional Sales Act the place of filing with respect to goods affixed or to be affixed to realty is with the real estate

records and not with the chattel records. See § 9-401 on the place of filing and § 9-402 on the form of financing statement.

Cross References:

§§ 9-102(1), 9-104(j) and 9-312(1).
Point 3: §§ 9-204(1), 9-303 and 9-402(1).
Point 5: Part 5.
Point 6: §§ 9-401(1) (b) and 9-402.

Definitional Cross References:

"Collateral". § 9-105.
"Contract". § 1-201.
"Creditor." § 1-201.
"Debtor". § 9-105.
"Goods". § 9-105.
"Knowledge". § 1-201.
"Person". § 1-201.
"Purchase". § 1-201.
"Purchaser". § 1-201.
"Secured party". § 9-105.
"Security interest". § 1-201.
"Value". § 1-201.
"Writing". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: This section is consistent with the approach taken in Holt v. Henley, 232 U.S. 637 (1914), which involved the relative rights of a mortgagee of a plant and the conditional vendor of a sprinkling system subsequently placed in the plant under an unrecorded conditional sale contract. The conditional vendor prevailed over the mortgagee, the U.S. Supreme Court in 232 U.S. at 641 saying: "We believe the better rule in a case like this, and the one consistent with the Virginia decisions so far as they have gone, is that 'the mortgagees take just such an interest in the property as the mortgagor acquired; no more no less.'" Furthermore, the Court said: "Removal would not affect the integrity of the structure on which the mortgagees advanced. To hold that the mere fact of annexing the system to the freeholder overrode the agreement that it should remain personalty and still belong to Holt would be to give a mystic importance to attachments by bolts and screws."

This section incorporates the "other" law of the state to determine what are fixtures. The test of what constitutes fixtures in Virginia is discussed in Danville Holding Corp. v. Clement, 178 Va. 223, 16 S.E.2d 345 (1941).

§ 9-314. Accessions. (1) A security interest in goods which attaches before they are installed in or affixed to other goods takes priority as to the goods installed or affixed (called in this section "accessions") over the claims of all persons to the whole except as stated in subsection (3) and subject to § 9-315(1).

(2) A security interest which attaches to goods after they become part of a whole is valid against all persons subsequently acquiring interests in the whole except as stated in subsection (3) but is invalid against any person with an interest in the whole at the time the security interest attaches to the goods who has not in writing consented to the security interest or disclaimed an interest in the goods as part of the whole.

(3) The security interests described in subsections (1) and (2) do not take priority over

(a) a subsequent purchaser for value of any interest in the whole; or

(b) a creditor with a lien on the whole subsequently obtained by judicial proceedings; or

(c) a creditor with a prior perfected security interest in the whole to the extent that he makes subsequent advances

if the subsequent purchase is made, the lien by judicial proceedings obtained or the subsequent advance under the prior perfected security interest is made or contracted for without knowledge of the security interest and before it is perfected. A purchaser of the whole at a foreclosure sale other than the holder of a perfected security interest purchasing at his own foreclosure sale is a subsequent purchaser within this section.

(4) When under subsections (1) or (2) and (3) a secured party has an interest in accessions which has priority over the claims of all persons who have interests in the whole, he may on default subject to the provisions of Part 5 removed his collateral from the whole but he must reimburse any encumbrancer or owner of the whole who is not the debtor and who has not otherwise agreed for the cost of repair of any physical injury but not for any diminution in value of the whole caused by the absence of the goods removed or by any necessity for replacing them. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate security for the performance of this obligation.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. To state when a secured party claiming an interest in goods installed in or affixed to other goods is entitled to priority over a party with a security interest in the whole.

2. This Section changes prior law in that the secured party claiming an interest in a part (e. g., a new motor in an old car) is entitled to priority and has a right to remove even though under other rules of law the part now belongs to the whole. The Section adopts the same policy as that stated in § 9-313 for fixtures.

3. This Section does not apply to goods which, for example, are so commingled in a manufacturing process that their original identity is lost. That type of situation is covered in § 9-315. § 9-315 should also be consulted for the effect of a financing statement which claims both component parts and the resulting product.

Cross References:

§§ 9-204(1), 9-303 and 9-312(1) and Part 5.
Point 2: § 9-313.
Point 3: § 9-315.

Definitional Cross References:

"Collateral". § 9-105.
"Creditor". § 1-201.
"Debtor". § 9-105.
"Goods". § 9-105.
"Knowledge". § 1-201.
"Person". § 1-201.
"Purchaser". § 1-201.
"Secured party". § 9-105.
"Security interest". § 1-201.
"Value". § 1-201.
"Writing". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 9-315. Priority When Goods Are Commingled or Processed. (1) If a security interest in goods was perfected and subsequently the goods or a part thereof have become part of a product or mass, the security interest continues in the product or mass if

(a) the goods are so manufactured, processed, assembled or commingled that their identity is lost in the product or mass; or

(b) a financing statement covering the original goods also covers the product into which the goods have been manufactured, processed or assembled.

In a case to which paragraph (b) applies, no separate security interest in that part of the original goods which has been manufactured, processed or assembled into the product may be claimed under § 9-314.

(2) When under subsection (1) more than one security interest attaches to the product or mass, they rank equally according to the ratio that the cost of the goods to which each interest originally attached bears to the cost of the total product or mass.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. To state when a secured party whose collateral contributes to a product has priority over others who have conflicting claims in the same product.

2. This Section changes the law in some jurisdictions where a security interest in goods (e. g., raw materials) was lost when the goods lost their identity by being commingled or processed. Under this Section the security interest continues in the resulting mass or product in the cases stated in subsection (1).

3. This section applies not only to cases where flour, sugar and eggs are commingled into cake mix or cake, but also to cases where components are assembled into a machine. In the latter case a secured party is put to an election at the time of filing, by the last sentence of subsection (1), whether to claim under this section or to claim a security interest in one component under § 9-314.

4. Subsection (2) is new and is needed because under subsection (1) it is possible to have more than one secured party claiming an interest in a product. The rule stated treats all such interests as being of equal priority entitled to share ratably in the product.

Cross References:

§§ 9-204(1), 9-303, 9-312(1) and 9-314.

Definitional Cross References:

"Goods". § 9-105.
"Security interest". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 9-316. Priority Subject to Subordination. Nothing in this Article prevents subordination by agreement by any person entitled to priority.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: The several preceding sections deal elaborately with questions of priority. This Section is inserted to make it entirely clear that a person entitled to priority may effectively agree to subordinate his claim. Only the person entitled to priority may make such an agreement: his rights cannot be adversely affected by an agreement to which he is not a party.

Cross References:

§§ 1-102 and 9-312(1).

Definitional Cross References:

"Agreement". § 1-201.
"Person". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 9-317. Secured Party Not Obligated on Contract of Debtor. The mere existence of a security interest or authority given to the debtor to dispose of or use collateral does not impose contract or tort liability upon the secured party for the debtor's acts or omissions.

COMMENT: Prior Uniform Statutory Provision: § 12, Uniform Trust Receipts Act.

Changes: Rewritten; no changes in substance.

Purposes of Changes: There were a few common law decisions, mostly in cases involving trust receipts, which suggested, if they did not hold, that a secured party who gave his debtor liberty of sale might be liable (for example, for breach of warranty) on the debtor's contracts of sale. The theory was grounded on the law of agency; the debtor being regarded as selling agent for the secured party as principal. This section rejects that theory. § 12 of the Uniform Trust Receipts Act provided that the entruster was not subject to liability, merely because of his status as entruster, on sale of the goods subject to trust receipt. This Section adopts the policy of the prior act and states it in general terms.

Cross Reference:

§ 2-210(4).

Definitional Cross References:

"Collateral". § 9-105.
"Contract". § 1-201.
"Debtor". § 9-105.
"Secured party". § 9-105.
"Security interest". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 9-318. **Defenses Against Assignee; Modification of Contract After Notification of Assignment; Term Prohibiting Assignment Ineffective; Identification and Proof of Assignment.** (1) Unless an account debtor has made an enforceable agreement not to assert defenses or claims arising out of a sale as provided in § 9-206 the rights of an assignee are subject to

(a) all the terms of the contract between the account debtor and assignor and any defense or claim arising therefrom; and

(b) any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives notification of the assignment.

(2) So far as the right to payment under an assigned contract right has not already become an account, and notwithstanding notification of the assignment, any modification of or substitution for the contract made in good faith and in accordance with reasonable commercial standards is effective against an assignee unless the account debtor has otherwise agreed but the assignee acquires corresponding rights under the modified or substituted contract. The assignment may provide that such modification or substitution is a breach by the assignor.

(3) The account debtor is authorized to pay the assignor until the account debtor receives notification that the account has been assigned and that payment is to be made to the assignee. A notification which does not reasonably identify the rights assigned is ineffective. If requested by the account debtor, the assignee must seasonably furnish reasonable proof that the assignment has been made and unless he does so the account debtor may pay the assignor.

(4) A term in any contract between an account debtor and an assignor which prohibits assignment of an account or contract right to which they are parties is ineffective.

COMMENT: Prior Uniform Statutory Provision: § 9(3), Uniform Trust Receipts Act.

Purposes: 1. Subsection (1) makes no substantial change in prior law. An assignee has traditionally been subject to defenses or set-offs existing before an account debtor is notified of the assignment. When the account debtor's defenses on an assigned account, chattel paper or a contract right arise from the contract between him and the assignor it makes no difference whether the breach giving rise to the defense occurs before or after the account debtor is notified of the assignment (subsection (1) (a)). The account debtor may also have claims against the assignor which arise independently of that contract: an assignee is subject to all such claims which accrue before, and free of all those which accrue after, the account debtor is notified (subsection (1) (b)). The account debtor may waive his right to assert claims or defenses against an assignee to the extent provided in § 9-206.

2. "Contract rights" as defined in § 9-106 are in general rights to payments of money to be earned under an existing contract. Prior law was in confusion as to whether modification of an executory contract by account debtor and assignor without the assignee's consent was possible after notification of an assignment. Subsection (2) makes good faith modifications by assignor and account debtor without the assignee's consent effective against the assignee even after notification. This rule may do some violence to accepted doctrines of contract law. Nevertheless it is a sound and indeed a necessary rule in view of the realities of large scale procurement. When for example it becomes necessary for a government agency to cut back or modify existing contracts, comparable arrangements must be made promptly in hundreds and even thousands of subcontracts lying in many tiers below the prime contract. Typically the right to payments under these subcontracts will have been assigned. The government, as sovereign, might have the right to amend or terminate existing contracts apart from statute. This subsection gives the prime contractor (the account debtor) the right to make the required arrangements directly with his subcontractors without undertaking the task of procuring assents from the many banks to whom rights under the contracts may have been assigned. Assignees are protected by the provision which gives them automatically corresponding rights under the modified or substituted contract. Notice that subsection (2) applies only "so far as the right to payment under an assigned contract right has not already become an account," and therefore its application ends entirely when the work is done or the goods furnished.

3. Subsection (3) clarifies the right of an account debtor to make payment to his seller-assignor in an "indirect collection" situation (see Comment to § 9-308). So long as the assignee permits the assignor to collect accounts or leaves him in possession of chattel paper which does not indicate that payment is to be made at some place other than the assignor's place of business, the account debtor may pay the assignor even though he may know of the assignment. In such a situation an assignee who wants to take over collections must notify the account debtor to make further payments to him.

4. Subsection (4) breaks sharply with the older contract doctrines by denying effectiveness to contractual terms prohibiting assignment of accounts and contract rights—that is, sums due and to become due under contracts of sale, construction contracts and the like. Under the rule as stated an assignment would be effective even if made to an assignee who took with full knowledge that the account debtor had sought to prohibit or restrict assignment of the account or of the money to be earned under the contract.

It is only for the past hundred years that our law has recognized the possibility of assigning choses in action. The history of this development, at law and equity, is in broad outline well known. Lingering traces of the absolute common law prohibition have survived almost to our own day.

There can be no doubt that a term prohibiting assignment of proceeds was effective against an assignee with notice through the nineteenth century and well into the twentieth. § 151 of the Restatement of Contracts (1932) so states the law without qualification.

That rule of law has been progressively undermined by a process of erosion which began much earlier than the cited section of the Restatement of Contracts would suggest. The cases are legion in which courts have construed the heart out of prohibitory or restrictive terms and held the assignment good. The cases are not lacking where courts have flatly held assignments valid without bothering to construe away the prohibition. See 4 Corbin on Contracts (1951) §§ 872, 873. Such cases as Allhusen v. Caristo Const. Corp., 303 N.Y. 446, 103 N.E.2d 891 (1952), would be rejected by this subsection.

This gradual and largely unacknowledged shift in legal doctrine has taken place in response to economic need: as accounts and contract rights have become the collateral which secures an ever increasing number of financing transactions, it has been necessary to reshape the law so that these intangibles, like negotiable instruments and negotiable documents of title, can be freely assigned.

Subsection (4) thus states a rule of law which is widely recognized in the cases and which corresponds to current business practices. It can be regarded as a revolutionary departure only by those who still cherish the hope that we may yet return to the views entertained some two hundred years ago by the Court of King's Bench.

5. The Federal Assignment of Claims Act of 1940—to which of course this section is subject—requires that assignments of claims against the United States be filed as provided in that Act. Many large business enterprises, situated like the United States in that claims against them are held by hundreds or thousands of subcontractors or suppliers, often require in their contract or purchase order forms that assignments against them be filed in a prescribed way. Subsection (3) requires reasonable identification of the account or contract right assigned and recognizes the right of an account debtor to require reasonable proof of the making of the assignment and to that extent validates such requirements in contracts or purchase order forms. If the notification does not contain such reasonable identification or if such reasonable proof is not furnished on request the account debtor may disregard the assignment and make payment to the assignor. What is "reasonable" is not left to the arbitrary decision of the account debtor; if there is doubt as to the adequacy either of a notification or of proof submitted after request, the account debtor may not be safe in disregarding it unless he has notified the assignee with commercial promptness as to the respects in which identification or proof is considered defective.

6. If the thing to be assigned is the beneficiary's right under a letter of credit, § 5-116 should be consulted.

Cross References:

Point 1: § 9-206.
Point 3: §§ 9-205 and 9-308.
Point 4: § 2-210(2) and (3).
Point 6: § 5-116.

Definitional Cross References:

"Account". § 9-106.
"Account debtor". § 9-105.
"Agreement". § 1-201.
"Contract". § 1-201.
"Contract right". § 9-106.
"Good faith". § 1-201.
"Party". § 1-201.
"Receives" notification. § 1-201.
"Rights". § 1-201.
"Sale". §§ 2-106 and 9-105.
"Seasonably". § 1-204.
"Term". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-558 (trust receipts); 43-65 (crop liens).

Comment: Subsection 9-318(1) is in accord with the statement in Hartford Fire Ins. Co. v. Mut. Savings and Loan Co., Inc., 193 Va. 269, 277, 68 S.E.2d 541 (1952), that: "An assignee or pledgee of a non-negotiable paper, steps into the shoes of an assignor, or pledgor, and takes the assignment subject to all defenses of the obligor against the assignor, or pledgor, existing before notice of assignment."

PART 4

FILING

§ 9-401. Place of Filing; Erroneous Filing; Removal of Collateral. (1) The proper place to file in order to perfect a security interest is as follows:

(a) when the collateral is equipment used in farming operations, or farm products, or accounts, contract rights or general intangibles arising from or relating to the sale of farm products by a farmer, or consumer goods, then in the office of the clerk of the court in which deeds are admitted to record in the county or city of the debtor's residence or if the debtor is not a resident of this State then in the office of such clerk in the county or city where goods are kept, and in addition when the collateral is crops in the office of such clerk in the county or city where the land on which the crops are growing or to be grown is located;

(b) when the collateral is goods which at the time the security interest attaches are or are to become fixtures, then in the office where a mortgage on the real estate concerned would be filed or recorded;

(c) in all other cases, in the office of the State Corporation Commission and in addition, if the debtor has a place of business in only one county or city of this State, also in the office of the clerk of the court in which deeds are admitted to record of such county or city, or, if the debtor has no place of business in this State, but resides in the State, also in the office of such clerk of the county or city in which he resides.

(2) A filing which is made in good faith in an improper place or not in all of the places required by this section is nevertheless effective with regard to any collateral as to which the filing complied with the requirements of this Article and is also effective with regard to collateral covered by the financing statement against any person who has knowledge of the contents of such financing statement.

(3) A filing which is made in the proper place in this State continues effective even though the debtor's residence or place of business or the location of the collateral or its use, whichever controlled the original filing, is thereafter changed.

(4) If collateral is brought into this State from another jurisdiction, the rules stated in § 9-103 determine whether filing is necessary in this State.

(VALC Note: The Official Text offers Alternative Subsections as follows:

First Alternative Subsection (1)

(1) The proper place to file in order to perfect a security interest is as follows:

(a) when the collateral is goods which at the time the security interest attaches are or are to become fixtures, then in the office where a mortgage on the real estate concerned would be filed or recorded;

(b) in all other cases, in the office of the (Secretary of State).

Second Alternative Subsection (1)

(1) The proper place to file in order to perfect a security interest is as follows:

(a) when the collateral is equipment used in farming operations, or farm products, or accounts, contract rights or general intangibles arising from or re-

lating to the sale of farm products by a farmer, or consumer goods, then in the office of the . . . in the county of the debtor's residence or if the debtor is not a resident of this state then in the office of the . . . in the county where the goods are kept, and in addition when the collateral is crops in the office of the . . . in the county where the land on which the crops are growing or to be grown is located;

(b) when the collateral is goods which at the time the security interest attaches are or are to become fixtures, then in the office where a mortgage on the real estate concerned would be filed or recorded;

(c) in all other cases, in the office of the (Secretary of State).

Alternative Subsection (3).

(3) A filing which is made in the proper county continues effective for four months after a change to another county of the debtor's residence or place of business or the location of the collateral, whichever controlled the original filing. It becomes ineffective thereafter unless a copy of the financing statement signed by the secured party is filed in the new county within said period. The security interest may also be perfected in the new county after the expiration of the four-month period; in such case perfection dates from the time of perfection in the new county. A change in the use of the collateral does not impair the effectiveness of the original filing.)

COMMENT: **Prior Uniform Statutory Provision:** § 4, Uniform Trust Receipts Act; §§ 6 and 7, Uniform Conditional Sales Act.

Purposes: 1. Under chattel mortgage acts, the Uniform Conditional Sales Act and other conditional sales legislation the geographical unit for filing or recording was local: the county or township in which the mortgagor or vendee resided or in which the goods sold or mortgaged were kept. The Uniform Trust Receipts Act used the state as the geographical filing unit: under that Act statements of trust receipt financing were filed with an official in the state capital and were not filed locally. The state-wide filing system of the Trust Receipts Act has been followed in many accounts receivable and factor's lien acts.

Both systems have their advocates and both their own advantages and drawbacks. The principal advantage of state-wide filing is ease of access to the credit information which the files exist to provide. Consider for example the national distributor who wishes to have current information about the credit standing of the thousands of persons he sells to on credit. The more completely the files are centralized on a state-wide basis, the easier and cheaper it becomes to procure credit information; the more the files are scattered in local filing units, the more burdensome and costly. On the other hand, it can be said that most credit inquiries about local businesses, farmers and consumers come from local sources; convenience is served by having the files locally available and there is no great advantage in centralized filing.

This Section does not attempt to resolve the controversy between the advocates of a completely centralized state-wide filing system and those of a large degree of local autonomy. Instead the Section is drafted in a series of alternatives; local considerations of policy will determine the choice to be made.

2. Fortunately there is general agreement that the proper filing place for security interests in fixtures is in the office where a mortgage on the real estate concerned would be filed or recorded, and subsection (1) (a) in the First Alternative and subsection (1) (b) in the Second and Third Alternatives so provide. This provision follows the Uniform Conditional Sales Act. Note that there is no requirement for an additional filing with the chattel records.

3. In states where it is felt wise to preserve local filing for transactions of essentially local interest, either the Second or Third Alternatives of subsection (1) should be adopted. Subsection (1) (a) in both alternatives provides county (township, etc.) filing for consumer goods transactions and for agricultural transactions (farm equipment, farm products, farm accounts and crops). Note that the subsection departs from § 6 of the Uniform Conditional Sales Act and adopts instead the policy of many chattel mortgage acts in selecting the county of the debtor's residence, rather than the county where the goods are located, as the normal filing place. Where, however, the debtor is an out-of-state resident the filing must of necessity be in the county where the goods are, and the subsection so provides. Though not expressly stated, it is evident that filing for an assignment of accounts arising from the sale of farm products by a farmer who is not a resident must be in the county where the debtor keeps his farm products. In the case of crops, where the land is in one county and the debtor's residence in another, filing must

be made in both counties. The policy of the subsection is to require filing in the place or places where a creditor would normally look for information concerning interests created by a debtor.

4. It is thought that sound policy requires a state-wide filing system for all transactions except the essentially local ones covered in subsection (1) (a) of the Second and Third Alternatives and transactions involving fixtures covered in subsection (1) (b) of the Second and Third Alternatives. Subsection (1) (c) so provides in both alternatives, as does subsection (1) (b) in the First Alternative. In a state which has adopted either the Second or Third Alternative, central filing would be required when the collateral was any kind of goods except consumer goods, farm equipment or farm products (including crops); documents; chattel paper; and accounts, contract rights and general intangibles, unless related to a farm. Note that the filing provisions of this article do not apply to instruments (see § 9-304).

If the Third Alternative subsection (1) is adopted, then local filing, in addition to the central filing, is required in all the cases stated in the preceding paragraph, with respect to any debtor whose places of business within the state are all within a single county (township, etc.) or a debtor who is not engaged in business.

In states where the arguments for a completely centralized set of files (except for fixtures) prevail, the First Alternative subsection (1) should be adopted. That alternative provides for exclusive central filing of all security interests except those in fixtures.

5. When a secured party has in good faith attempted to comply with the filing requirements but has not done so correctly, subsection (2) makes his filing effective in so far as it was proper, and also makes it good for all collateral covered by the financing statement against any person who actually knows the contents of the improperly filed statement. The subsection rejects the occasional decisions that an improperly filed record is ineffective to give notice even to a person who knows of it. But if the Third Alternative subsection (1) is adopted, the requirements of subsection (1) (c) are not complied with unless there is filing in both offices specified; filing in only one of two required places is not effective except as against one with actual knowledge.

6. Subsection (3) deals with change of residence or place of business or the location or use of the goods *after* a proper filing has been made. The subsection is important only when local filing is required, and covers only changes between local filing units in the State. For changes of location between states see § 9-103(3).

Subsection (3) is presented in alternative forms. Under the first no new filing is required in the county to which the collateral has been removed. Under alternative subsection (3) the original filing lapses four months after the change in location; this is the same rule that is applied by § 9-103(3) to the case of collateral brought into the state subject to a security interest which attached elsewhere.

Cross References:

§§ 9-302, 9-304 and 9-307(2).
Point 2: § 9-313.
Point 6: § 9-103(3).

Definitional Cross References:

"Account". § 9-106.
"Collateral". § 9-105.
"Consumer goods". § 9-109.
"Debtor". § 9-105.
"Equipment". § 9-109.
"Farm products". § 9-109.
"Financing statement". § 9-402.
"Good faith". § 1-201.
"Goods". § 9-105.
"Knowledge". § 1-201.
"Person". § 1-201.
"Secured party". § 9-105.
"Security interest". § 1-201.
"Signed". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-562 (trust receipts); 11-5 (assignments of accounts receivable); 43-27 (crop liens); 43-42 - 43 (liens on offspring of certain animals); 43-52 - 53 (agricultural chattel deeds of trust); 55-88 - 89 (conditional sales); 55-96 (chattel mortgages, deeds of trust, and bailment leases); 55-96.1 (property used in business of contractor, logger, or sawmiller); 55-97 (property in more than one

locality); 55-98 (property removed from one locality to another); 55-99 (property brought into Virginia from outside the State); 55-100 (civil aircraft); 55-101 (recording in county or corporation); 55-145 (factor's lien).

Comment: Virginia statutes provide for central filing, local filing, and both central and local filing, but for the most part only local filing is required. Conditional sales of railroad equipment, under Code 1950, § 55-89, are filed only in the office of the State Corporation Commission. Instruments affecting the title or interest in civil aircraft, under Code 1950, § 55-100, are filed only in an office designated by the laws of the United States. Statements concerning trust receipt financing are filed centrally, in the office of the State Corporation Commission, and locally, in the county or city of the trustee's residence or principal place of business. Other security instruments are filed locally only.

Under the UCC central filing would be required in the following cases, where under present law only local filing is required, with the possibility of also having local filing if alternative three is adopted: Newcomb v. Guthrie, 145 Va. 627, 629-30, 134 S.E. 585 (1926) (conditional sale of scales, showcases, refrigerator, slicing machine, register, adding machine); National Cash Register Co. v. Norfolk City Realty Co., 110 Va. 791, 792, 67 S.E. 372 (1910) (conditional sale of cash registers sold to a hotel); National Cash Register Co. v. Burrow, 110 Va. 785, 792, 67 S.E. 370 (1910) (cash registers sold to a hotel); Monarch Laundry v. Westbrook, 109 Va. 382, 383-84, 63 S.E. 1070 (1909) (conditional sale contract covering engines, boilers, and machinery for a laundry); Williamson v. Payne, 103 Va. 551, 554-55, 49 S.E. 660 (1905) (deed of trust on horses, mules, oxen, and wagons used with a sawmill); Lucado v. Tutwiler's Adm'x, 69 Va. (28 Gratt.) 39, 39-40 (1877) (mortgage on a canal boat); Groner v. Babcock Printing Press Co., 267 Fed. 822, 822-23 (4th Cir. 1920) (conditional sale of printing press sold to printing company).

Subsection 9-401(2) gives some validity to a filing even in the wrong place. This changes Virginia law as stated in Code 1950, § 55-97, wherein such filings are declared to be void. Lane v. Mason, 32 Va. (5 Leigh) 520, 521-22 (1834), held that a deed of trust of slaves recorded in the county of the debtor's residence was ineffective where the slaves were kept in another county. Tokheim Oil Tank & Pump Co., 33 F.2d 730, 733 (4th Cir. 1929), held that a trustee in bankruptcy would prevail over a conditional vendor where the conditional sales contract had been filed in the wrong place, but there were also other defects in the conditional sales contract so as to render the recordation ineffective.

Under 9-401(3) a proper filing continues to be effective despite a change in the locations of the property or the debtor, and despite a change in the use made of the property. This represents a change in Virginia law: Code 1950, § 55-98 required a new recordation within one year after the goods had been removed to another county.

Under the UCC the existing practice of noting the security interest on the title certificate of motor vehicles continues; no additional filing or recording is required to perfect a security interest in motor vehicles either under the UCC or previous Virginia law.

COUNCIL COMMENT

In selecting the alternative chosen, we have sought to change the pattern of present Virginia recording statutes as little as possible.

§ 9-402. Formal Requisites of Financing Statement; Amendments. (1) A financing statement is sufficient if it is signed by the debtor and the secured party, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral. A financing statement may be filed before a security agreement is made or a security interest otherwise attaches. When the financing statement covers crops growing or to be grown or goods which are or are to become fixtures, the statement must also contain a description of the real estate concerned. A copy of the security agreement is sufficient as a financing statement if it contains the above information and is signed by both parties.

(2) A financing statement which otherwise complies with subsection (1) is sufficient although it is signed only by the secured party when it is filed to perfect a security interest in

(a) collateral already subject to a security interest in another jurisdiction when it is brought into this State. Such a financing statement must state that the collateral was brought into this State under such circumstances.

(b) proceeds under § 9-306 if the security interest in the original collateral was perfected. Such a financing statement must describe the original collateral.

(3) A form substantially as follows is sufficient to comply with subsection (1):

Name of debtor (or assignor) .....

Address .....

Name of secured party (or assignee) .....

Address .....

1. This financing statement covers the following types (or items) of property:

(Describe) .....

2. (If collateral is crops) The above described crops are growing or are to be grown on:

(Describe Real Estate) .....

3. (If collateral is goods which are or are to become fixtures) The above described goods are affixed or to be affixed to:

(Describe Real Estate) .....

4. (If proceeds or products of collateral are claimed) Proceeds—Products of the collateral are also covered.

Signature of Debtor (or Assignor) .....

Signature of Secured Party (or Assignee) .....

(4) The term "financing statement" as used in this Article means the original financing statement and any amendments but if any amendment adds collateral, it is effective as to the added collateral only from the filing date of the amendment.

(5) A financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading.

COMMENT: **Prior Uniform Statutory Provision:** §§ 13(3), 13(4), Uniform Trust Receipts Act.

Purposes: 1. Subsection (1) sets out the simple formal requisites of a financing statement under this Article. These requirements are: (1) signatures and addresses of both parties; (2) a description of the collateral by type or item. Where the collateral is growing crops or fixtures, the financing statement must also contain a description of the land concerned. § 9-110 provides that "any description of personal property or real estate is sufficient whether or not it is specific if it reasonably identifies what is described". Subsection (3) suggests a form which complies with the statutory requirements. A copy of the security agreement may be filed in place of a separate financing statement, if it is signed by both parties and contains the required information.

2. This Section adopts the system of "notice filing" which has proved successful under the Uniform Trust Receipts Act. What is required to be filed is not, as under chattel mortgage and conditional sales acts, the security agreement itself, but only a simple notice which may be filed before the security interest attaches

or thereafter. The notice itself indicates merely that the secured party who has filed may have a security interest in the collateral described. Further inquiry from the parties concerned will be necessary to disclose the complete state of affairs. § 9-208 provides a statutory procedure under which the secured party, at the debtor's request, may be required to make disclosure. Notice filing has proved to be of great use in financing transactions involving inventory, accounts and chattel paper, since it obviates the necessity of refiling on each of a series of transactions in a continuing arrangement where the collateral changes from day to day. Where other types of collateral are involved, the alternative procedure of filing a signed copy of the security agreement may prove to be the simplest solution.

3. This Section departs from the requirements of many chattel mortgage statutes that the instrument filed be acknowledged or witnessed or accompanied by affidavits of good faith. Those requirements do not seem to have been successful as a deterrent to fraud; their principal effect has been to penalize good faith mortgagees who have inadvertently failed to comply with the statutory niceties. They are here abandoned in the interest of a simplified and workable filing system.

4. Subsection (2) allows the secured party to file a financing statement signed only by himself where the filing is with reference to collateral already subject to a security interest in another jurisdiction when brought into this State or with reference to proceeds when his security interest in the original collateral was perfected. (§ 9-103 states when a financing statement must be filed when collateral is brought into this State; § 9-306 defines proceeds and states when refiling is necessary to continue a perfected security interest in them.) § 9-401(3), alternative provision, contains similar permission on removal between counties in this State. The reason for dispensing with the debtor's signature in the two cases covered by subsection (2) and in the case covered by § 9-401(3), is that the necessity for refiling arises from actions of the debtor (in moving his place of business or residence, or the collateral, or disposing of it), which may have been unauthorized or fraudulent. The secured party should not be penalized for failure to make a timely filing by reason of difficulty in procuring the signature of a possibly reluctant or hostile debtor. Financing statements filed under this subsection must explain the circumstances under which they are filed (e. g., that the collateral was brought here from another state where a security interest attached, or has been moved from one county to another in this state, or, in the case of proceeds, describing the original collateral).

5. Subsection (5) is in line with the policy of this Article to simplify formal requisites and filing requirements and is designed to discourage the fanatical and impossibly refined reading of such statutory requirements in which courts have occasionally indulged themselves. As an example of the sort of reasoning which this subsection rejects, see General Motors Acceptance Corporation v. Haley, 329 Mass. 559, 109 N.E.2d 143 (1952).

Cross References:

Point 1: § 9-110.
Point 2: § 9-208.
Point 4: §§ 9-103, 9-306 and 9-401(3).

Definitional Cross References:

"Collateral". § 9-105.
"Debtor". § 9-105.
"Goods". § 9-105.
"Party". § 1-201.
"Proceeds". § 9-306.
"Secured party". § 9-105.
"Security agreement". § 9-105.
"Security interest". § 1-201.
"Signed". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-562 (trust receipts); 43-27 (crop liens); 43-42 - 43 (liens on the offspring of certain animals); 43-48 (agricultural chattel deeds of trust); 55-58, 55-96, 55-96.1 (chattel mortgages, deeds of trust, and bailment leases); 55-88 - 89 (conditional sales); 55-100 (civil aircraft); 55-144 (factor's lien).

Comment: This section adopts a single form of financing statement that is sufficient for all filings, in place of the varying requirements found in the Virginia statutes, depending upon the type of security instrument.

The UCC adopts the system of "notice filing" in the Uniform Trust Receipts Act to replace the present Virginia system under which some instruments are recorded

in full, other are docketed only, and some are simply filed, with indexing in each instance. See Callahan v. Young, 90 Va. 574, 576-77, 19 S.E. 163 (1894), for the difference between recording in full and docketing or indexing a memorandum. Chattel mortgages, deeds of trust, bailment leases, and factor's liens are recorded in full. Code 1950, §§ 55-96, 55-96.1, 55-145, 17-59. Crop liens and liens on offspring of certain animals are docketed. Code 1950, §§ 43-27, 43-42 - 43. Agricultural chattel deeds of trust may be recorded in full or docketed, at the option of the beneficiary. Code 1950, § 43-53. Statements of trust receipt financing and conditional sales contracts are filed. Code 1950, §§ 6-562, 55-88 - 89.

A failure to comply with any of the formal requisites set forth in the Virginia statutes means that the instrument has not been validly recorded, docketed or filed and so it fails to accomplish the purpose of recordation—perfecting a security interest. Virginia has adopted a rule of strict compliance with formal requisites for recordation, so that recorded instruments have frequently failed of their purpose. See In re Adkins, 197 F. Supp. 287, 288 (E.D. Va. 1961).

In Mack International Truck Corp. v. Jones, 153 Va. 183, 185-87, 149 S.E. 544 (1929), a recorded conditional sales contract was held ineffective because of the failure of the seller to sign. The same result was reached in In re Adkins, 197 F. Supp. 287 (E.D. Va. 1961), in which the seller had not signed the contract, although the seller's printed name appeared at the bottom of the contract and the credit manager had signed on a line reserved for witnesses. See also Callahan v. Young, 90 Va. 574, 575-77, 19 S.E. 163 (1894), which arose under an earlier version of the statute, holding recordation to be ineffective where the seller had not acknowledged the writing or proved it by two witnesses.

Newcomb v. Guthrie, 145 Va. 627, 632-33, 134 S.E. 585 (1926), held that a conditional sales contract was sufficiently definite as to the amount due when it provided that notes were payable a specified number of days after date, and the date was given. Similarly, Fisch v. Steingold, 79 F.2d 448, 449-51 (4th Cir. 1935), upheld as sufficiently definite a provision that the seller might add an additional charge for insurance premiums to the amount of the debt. However, in Tokheim Oil Tank & Pump Co., Inc. v. Fentress, 33 F.2d 730, 732-33 (4th Cir. 1929), the conditional sales contract was found to be ineffective in that it failed to show the time when deferred payments were due.

The large majority of the cases have involved questions relating to the sufficiency of the description of the goods that were the subject of the security interest.

The sufficiency of the description required in a deed of trust was described in Williamson v. Payne, 103 Va. 551, 555-56, 49 S.E. 660 (1905), in the following terms: "The recordation of a deed which furnishes a stranger with the obvious means of identifying the property which these deeds afford, does give constructive notice . . . . The written description of personal property in mortgages, taken alone, rarely furnishes strangers adequate means of identifying the property, and information thus imparted must usually be supplemented or aided by extraneous inquiry." In this case the conveyance of horses, mules, oxen and wagons along with a definitely described sawmill was held to be a sufficient description. Klingstein v. Vaughan, 149 Va. 147, 153-55, 140 S.E. 275 (1927), held the description in a deed of trust of an automobile as being in the possession of a particular individual was a sufficient description. Elgin v. Dehart, 144 Va. 311, 312-19, 132 S.E. 323 (1926), held that the description in a deed of trust of personal property on a specific farm was a sufficient description. However, Hardaway v. Jones, 100 Va. 481, 483-85, 41 S.E. 957 (1902), held that a description in a deed of trust of "four mules" was not sufficient.

The description in a conditional sale contract, according to National Cash Register Co. v. Burrow, 110 Va. 785, 790, 67 S.E. 370 (1910), "must afford to subsequent purchasers or encumbrancers the means of not only ascertaining with accuracy what property is conveyed or affected by the instrument registered or recorded and where it is, but the language must be such that, if a subsequent purchaser or incumbrancer should examine the instrument itself he would obtain thereby actual notice of all the rights which were intended to be created or conferred by it; and if it contained these essential requisites the registry or recordation thereof operates as constructive notice to subsequent purchasers and incumbrancers; otherwise not." By this test, the description in this case was found to be insufficient. Similarly, National Cash Register Co. v. Norfolk City Realty Co., 110 Va. 791, 795-97, 67 S.E. 372 (1910), held the description insufficient. In Monarch Laundry v. Westbrook, 109 Va. 382, 390-91, 63 S.E. 1070 (1909), the description in a conditional sales contract of "additional shafting, piping, connections, etc." was held to be insufficient. Tokheim Oil Tank & Pump Co. v. Fentress, 33 F.2d 730, 732 (4th Cir. 1929), found the description of oil tanks and pumps to be insufficient, and Tilton v. H. M. Wade Mfg. Co., 2 F.2d 358, 356-60 (4th Cir. 1924), found the description

to be sufficient as to some chattels but not as to others. In the Matter of Fineman, 150 F. Supp. 875, 877-78 (E.D. Va. 1957), held that parol evidence was admissible to establish the significance of certain words and figures in the description.

United States v. George H. Meyer Sons, 162 F. Supp. 619, 621 (E.D. Va. 1958), involved an agricultural chattel deed of trust, the docketing of which did not give a sufficient description, but the full deed, which was filed, did contain a sufficient description. The filing of the instrument gave constructive notice of its entire contents.

Subsection 9-402(5), which provides for the filing of financial statements substantially complying with the requirements of the section, probably changes the strict approach taken in Callahan v. Young, 90 Va. 574, 575-77, 19 S.E. 163 (1894). This case denied recordation to a conditional sale contract because the instrument had not been authenticated as then required by the statute. Code 1950, § 55-88, no longer requires that conditional sales be acknowledged or proved by witnesses so that the instrument would be sufficient under present Virginia law or under the UCC.

The UCC eliminates all requirements of acknowledgments, witnesses, and affidavits and so to the extent these are required by Virginia statutes, the law of Virginia is changed.

§ 9-403. What Constitutes Filing; Duration of Filing; Effect of Lapsed Filing; Duties of Filing Officer. (1) Presentation for filing of a financing statement and tender of the filing fee or acceptance of the statement by the filing officer constitutes filing under this Article.

(2) A filed financing statement which states a maturity date of the obligation secured of five years or less is effective until such maturity date and thereafter for a period of sixty days. Any other filed financing statement is effective for a period of five years from the date of filing. The effectiveness of a filed financing statement lapses on the expiration of such sixty day period after a stated maturity date or on the expiration of such five year period, as the case may be, unless a continuation statement is filed prior to the lapse. Upon such lapse the security interest becomes unperfected. A filed financing statement which states that the obligation secured is payable on demand is effective for five years from the date of filing.

(3) A continuation statement may be filed by the secured party (i) within six months before and sixty days after a stated maturity date of five years or less, and (ii) otherwise within six months prior to the expiration of the five year period specified in subsection (2). Any such continuation statement must be signed by the secured party, identify the original statement by file number and state that the original statement is still effective. Upon timely filing of the continuation statement, the effectiveness of the original statement is continued for five years after the last date to which the filing was effective whereupon it lapses in the same manner as provided in subsection (2) unless another continuation statement is filed prior to such lapse. Succeeding continuation statements may be filed in the same manner to continue the effectiveness of the original statement. Unless a statute on disposition of public records provides otherwise, the filing officer may remove a lapsed statement from the files and destroy it.

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

(5) The uniform fee for filing, indexing and furnishing filing data for an original or a continuation statement shall be one dollar.

COMMENT: Prior Uniform Statutory Provision: §§ 13(3), 13(4), Uniform Trust Receipts Act; § 10, Uniform Conditional Sales Act.

Changes: Changed in substance.

Purposes of Changes: 1. Prior law was not always clear whether a mortgage filed for record gave constuctive notice from the time of presentation to the filing officer or only from the time of indexing. Subsection (1) adopts the former position.

2. Prior statutes have usually limited the effectiveness of a filing to a specified period of time after which refiling is necessary. Subsection (2) follows the same policy, establishing a maximum length of five years as the filing period. If the financing statement states a maturity date of five years or less, there is added a sixty-day grace period within which the original filing may be continued without lapse. A financing statement which states that the obligation secured is payable on demand is treated as one which does not state a maturity date. The five year maximum period is substantially longer than that accorded under most prior statutes. Subsection (3) provides for the filiug of one or more continuation statements (which need be signed only by the secured party) if it is desired to continue the effectiveness of the original filing.

3. Under the fourth sentence of subsection (2) the security interest becomes unperfected when filing lapses. Thereafter, the interest of the secured party is subject to defeat by those persons who take priority over an unperfected security interest (see § 9-301), and under § 9-312(5) the holder of a perfected conflicting security interest is such a person even though before lapse the conflicting interest was junior. Compare the situation arising under § 9-103(3) when a perfected security interest under the law of another jurisdiction is not perfected in this state within four months after the property is brought into this state.

Thus if A and B both make non-purchase money advances against the same collateral, and both perfect security interests by filing, A who files first is entitled to priority under § 9-312(5)(a). But if no continuation statement is filed, A's filing may lapse first. So long as B's interest remains perfected thereafter, he is entitled to priority over A's unperfected interest. This rule avoids the circular priority which arose under some prior statutes, under which A was subordinate to the debtor's trustee in bankruptcy, A retained priority over B, and B's interest was valid against the trustee in bankruptcy. In re Andrews, 172 F.2d 996 (7th Cir. 1949).

Cross References:

Point 3: §§ 9-103(3), 9-301 and 9-312(5).

Definitional Cross References:

"Debtor". § 9-105.
"Financing statement". § 9-402.
"Secured party". § 9-105.
"Security interest". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-562 (trust receipts); 43-27 (crop liens); 43-42 - 43 (lien on offspring of certain animals); 43-53 (agricultural chattel deeds of trust); 55-38 - 90 (conditional sales); 55-96, 55-96.1, 55-106 (chattel mortgages, deeds of trust, and bailment leases); 55-100 (civil aircraft); 55-145 (factor's liens); 17-59, 17-61, 43-4.1 (recording).

Comment: The approach set forth in subsection 9-403(1) follows that taken in Virginia, the filing alone perfecting the recordation and being sufficient to constitute constructive notice. Jones v. Folkes, 149 Va. 140, 143-46, 140 S.E. 126 (1927), is a square holding that a deed of trust covering real property is effective to give constructive notice when it is admitted to record, even though it is not spread in extenso on the deed book or indexed. The section is in accord with Fooshee v. Snavely, 58 F.2d 772, 776-77 (4th Cir. 1932), which involved the mailing to the clerk of a deed to real estate, but which was not accompanied with sufficient money to cover the fees. It was held that unless sufficient fees are tendered with the instrument, it is not admitted to record until the clerk accepts the instrument and thereby personally obligates himself to pay the fees. The subsection is consistent with Code 1950, § 55-101, which gives the priority, where on the same day two or more instruments are admitted to record, to the instrument first admitted to record. (This statute changes the rule laid down in the case of Naylor v. Throckmorton, 34 Va. (7 Leigh) 98, 106 (1836), interpreting an earlier statute as giving priority to the instrument first executed.)

In accordance with the policy of eliminating formal distinctions the UCC provides for a single file and a single index for all financing statements. This eliminates the possibility of erroneously recording one form of security instrument as some other type and so rendering the recordation ineffective. Peoples Bank of Southampton v. Merchants and Farmers Bank, 152 Va. 520, 524, 147 S.E. 220 (1929), held that the recordation of a mortgage in a conditional sale book was ineffective and did not give constructive notice.

This single file under the UCC replaces the several Virginia procedures for recordation. Code 1950, § 43-4.1 (Supp. 1962), requires that instruments filed after July 1, 1960, and previously recorded in the Miscellaneous Lien Book are to be recorded in the deed books and indexed in the general index of deeds, the index to show the type of lien involved. This statute changed the method of recording the following: chattel mortgages, chattel deeds of trust, and bailment leases, Code 1950, §§ 17-61, 17-79, 55-96, 55-96.1; liens on offspring of certain animals, Code 1950, §§ 43-42 - 43; agricultural chattel deeds of trust, Code 1950, § 43-53; and factor's liens, Code 1950, § 55-145. Crop liens are recorded in a Crop Lien Book and indexed therein, Code 1950, § 43-28(2). Agricultural chattel deeds of trust may be docketed in an Agricultural Chattel Deed of Trust Book and separately indexed, Code 1950, § 43-53. Conditional sales contracts are filed and indexed separately, Code 1950, § 55-90. Conditional sales of railroad equipment are filed with the State Corporation Commission and indexed separately, Code 1950, § 55-89. Statements of trust receipt financing are filed both with the State Corporation Commission and locally, and indexed separately, Code 1950, § 6-562.

The UCC requires each financing statement to be indexed in the name of the debtor, the index showing the file number and the address of the debtor. Harris, Woodson, Barbee Co., Inc. v. Gwathmey, 130 Va. 277, 280-81, 107 S.E. 658 (1921), held that where the vendee was a partnership, indexing in the name of the partnership was sufficient. While the UCC does not expressly cover the point, the same result would doubtless be reached under the UCC policy of eliminating technicalities.

The details regarding filing are essentially the same as for trust receipts, under Code 1950, § 6-562. It is not necessary to index the statement in the name of the secured party, a change from the present requirement of Code 1950, § 55-90, that a conditional sale contract must be indexed in the name of the vendor as well as in the name of the vendee. The Virginia conditional sales contract statute does not require that the index show any addresses, while the UCC does require the index to show the address of the debtor.

Subsection 9-403(5) establishes a single uniform fee for filing. This replaces the various fees required in Virginia: for admitting to record, 50 cents, and for recording, 3 cents per 20 words, with a minimum of $2.50 at the election of the clerk, Code 1950, § 14-123(1)(4)(5); liens on offspring of stallions and jackasses, 30 cents, Code 1950, § 43-42, and liens on offspring of bulls, 25 cents, Code 1950, § 43-43; agricultural chattel deeds of trust, $1.00, Code 1950, § 43-54; crop liens, 25 cents, Code 1950, § 43-27; conditional sales contracts, 50 cents, Code 1950, § 55-90; trust receipts, $1.00, Code 1950, § 6-562.

§ 9-404. Termination Statement. (1) Whenever there is no outstanding secured obligation and no commitment to make advances, incur obligations or otherwise give value, the secured party must on written demand by the debtor send the debtor a statement that he no longer claims a security interest under the financing statement, which shall be identified by file number. A termination statement signed by a person other than the secured party of record must include or be accompanied by the assignment or a statement by the secured party of record that he has assigned the security interest to the signer of the termination statement. The uniform fee for filing and indexing such an assignment or statement thereof shall be one dollar. If the affected secured party fails to send such a termination statement within ten days after proper demand therefor he shall be liable to the debtor for one hundred dollars, and in addition for any loss caused to the debtor by such failure.

(2) On presentation to the filing officer of such termination statement he must note it in the index. The filing officer shall remove from the files, mark "terminated" and send or deliver to the secured party the financ-

ing statement and any continuation statement, statement of assignment or statement of release pertaining thereto.

(3) The uniform fee for filing and indexing a termination statement including sending or delivering the financing statement shall be one dollar.

COMMENT: **Prior Uniform Statutory Provision:** § 12, Uniform Conditional Sales Act.

Changes: Modified to conform to the scheme of this Article.

Purposes of Changes: 1. To provide a procedure for noting discharge of the secured obligation on the records and for noting that a financing arrangement has been terminated.

2. This Section makes only formal changes, if any, in discharge procedures under prior law. It adds to the usual provisions one covering the problem which arises because a secured party under a notice filing system may file notice of an intention to make advances which may never be made. Under this Section a debtor may require a secured party to send a termination statement when there is no outstanding obligation and no commitment to make future advances.

Cross Reference:

Point 2: § 9-402(1).

Definitional Cross References:

"Debtor". § 9-105.
"Financing statement". § 9-402.
"Person". § 1-201.
"Secured party". § 9-105.
"Security interest". § 1-201.
"Send". § 1-201.
"Value". § 1-201.
"Written". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 43-56 (agricultural chattel deeds of trust); 55-66.7, 55-97 (chattel mortgages, deeds of trust, and bailment leases); 55-92 (conditional sales); 55-147 (factor's liens).

Comment: This section provides a simplified method of terminating financing statements, to replace the varying provisions now contained in the Virginia statutes. It establishes a uniform fee for filing termination statements, replacing the present varying fees: agricultural chattel deeds of trust, 25 cents, Code 1950, § 43-56; chattel mortgages, deeds of trust, bailment leases, 50 cents, Code 1950, § 55-66.7; conditional sales, 25 cents, Code 1950, § 55-92; and factor's liens, 50 cents, Code 1950, § 55-147.

§ 9-405. Assignment of Security Interest; Duties of Filing Officer; Fees. (1) A financing statement may disclose an assignment of a security interest in the collateral described in the statement by indication in the statement of the name and address of the assignee or by an assignment itself or a copy thereof on the face or back of the statement. Either the original secured party or the assignee may sign this statement as the secured party. On presentation to the filing officer of such a financing statement the filing officer shall mark the same as provided in § 9-403(4). The uniform fee for filing, indexing and furnishing filing data for a financing statement so indicating an assignment shall be one dollar.

(2) A secured party may assign of record all or a part of his rights under a financing statement by the filing of a separate written statement of assignment signed by the secured party of record and setting forth the name of the secured party of record and the debtor, the file number and the date of filing of the financing statement and the name and address of the assignee and containing a description of the collateral assigned. A copy of the assignment is sufficient as a separate statement if it complies

with the preceding sentence. On presentation to the filing officer of such a separate statement, the filing officer shall mark such separate statement with the date and hour of the filing. He shall note the assignment on the index of the financing statement. The uniform fee for filing, indexing and furnishing filing data about such a separate statement of assignment shall be one dollar.

(3) After the disclosure or filing of an assignment under this section, the assignee is the secured party of record.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: This Section provides a permissive device whereby a secured party who has assigned all or part of his interest may have the assignment noted of record. Note that under § 9-302(2) no filing of such an assignment is required as a condition of continuing the perfected status of the security interest against creditors and transferees of the original debtor. A secured party who has assigned his interest might wish to have the fact noted of record, so that inquiries concerning the transaction would be addressed not to him but to the assignee (see Point 2 of Comment to § 9-402). After a secured party has assigned his rights of record, the assignee becomes the "secured party of record" and may file a continuation statement under § 9-403, a termination statement under § 9-404, or a statement of release under § 9-406.

Cross References:

§§ 9-302(2) and 9-402 through 9-406.

Definitional Cross References:

"Collateral". § 9-105.
"Debtor". § 9-105.
"Financing statement". § 9-402.
"Rights". § 1-201.
"Secured party". § 9-105.
"Signed". § 1-201.
"Written". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 43-55 (agricultural chattel deeds of trust); 43-65 (crop liens).

Comment: This section recognizes that a secured party may assign his security interest, conveying to the assignee his rights. This is in accord with *The Henry S.*, 4 F. Supp. 953, 954 (E.D. Va. 1933).

The section provides a uniform fee for filing assignments. The fee in Virginia for filing an assignment of an agricultural chattel deed of trust is 75 cents, Code 1950, § 43-54.

§ 9-406. Release of Collateral; Duties of Filing Officer; Fees. A secured party of record may by his signed statement release all or a part of any collateral described in a filed financing statement. The statement of release is sufficient if it contains a description of the collateral being released, the name and address of the debtor, the name and address of the secured party, and the file number of the financing statement. Upon presentation of such a statement to the filing officer he shall mark the statement with the hour and date of filing and shall note the same upon the margin of the index of the filing of the financing statement. The uniform fee for filing and noting such a statement of release shall be one dollar.

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: Like the preceding Section, this Section provides a permissive device for noting of record any release of collateral. There is no requirement that such a statement be filed when collateral is released. (cf. § 9-404 on Termination Statements). It is merely a method of making the record reflect the true state of affairs so that fewer inquiries will have to be made by persons who consult the files.

Cross Reference:

§ 9-404.

Definitional Cross References:

"Collateral". § 9-105.
"Debtor". § 9-105.
"Financing statement". § 9-402.
"Secured party". § 9-105.
"Signed". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 9-407. Omitted

(**VALC Note:** The Official Text offers § 9-407 as an optional section as follows:

§ 9-407. Information From Filing Officer.

(1) If the person filing any financing statement, termination statement, statement of assignment, or statement of release, furnishes the filing officer a copy thereof, the filing officer shall upon request note upon the copy the file number and date and hour of the filing of the original and deliver or send the copy to such person.

(2) Upon request of any person, the filing officer shall issue his certificate showing whether there is on file on the date and hour stated therein, any presently effective financing statement naming a particular debtor and any statement of assignmeut thereof and if there is, giving the date and hour of filing of each such statement and the names and addresses of each secured party therein. The uniform fee for such a certificate shall be $..... plus $..... for each financing statement and for each statement of assignment reported therein. Upon request the filing officer shall furnish a copy of any filed financing statement or statement of assignment for a uniform fee of $..... per page.)

COMMENT: Prior Uniform Statutory Provision: None.

Purposes: 1. Subsection (1) requires the filing officer upon request to return to the secured party a copy of the financing statement on which the material data concerning the filing are noted. Receipt of such a copy will assure the secured party that the mechanics of filing have been complied with. Note, however, that under § 9-403(1) the secured party does not bear the risk that the filing officer will not properly perform his duties: under that Section the secured party has complied with the filing requirements when he presents his financing statement for filing and the filing fee has been tendered or the statement accepted by the filing officer.

2. Subsection (2) requires the filing officer on request to issue to any person who has tendered the proper fee his certificate as to what filings have been made against any particular debtor and to furnish copies of such filed financing statements. In view of the centralized filing system adopted by this Article (see § 9-401 and Comment thereto), this provision is of obvious convenience to a person who wishes to know what the files contain but who cannot conveniently consult files located in the state capital.

Cross References:

Point 1: § 9-403(1)
Point 2: § 9-401.

Definitional Cross References:

"Debtor". § 9-105.
"Financing statement". § 9-402.
"Person". § 1-201.
"Secured party". § 9-105.
"Send". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

COUNCIL COMMENT

In the light of Virginia practice, we feel this section is unnecessary.

PART 5

DEFAULT

§ 9-501. Default; Procedure When Security Agreement Covers Both Real and Personal Property. (1) When a debtor is in default under a security agreement, a secured party has the rights and remedies provided in this Part, and except as limited by subsection (3) those provided in the security agreement. He may reduce his claim to judgment, foreclose or otherwise enforce the security interest by any available judicial procedure. If the collateral is documents the secured party may proceed either as to the documents or as to the goods covered thereby. A secured party in possession has the rights, remedies and duties provided in § 9-207. The rights and remedies referred to in this subsection are cumulative.

(2) After default, the debtor has the rights and remedies provided in this Part, those provided in the security agreement and those provided in § 9-207.

(3) To the extent that they give rights to the debtor and impose duties on the secured party, the rules stated in the subsections referred to below may not be waived or varied except as provided with respect to compulsory disposition of collateral (subsection (1) of § 9-505) and with respect to redemption of collateral (§ 9-506) but the parties may by agreement determine the standards by which the fulfillment of these rights and duties is to be measured if such standards are not manifestly unreasonable:

(a) subsection (2) of § 9-502 and subsection (2) of § 9-504 insofar as they require accounting for surplus proceeds of collateral;

(b) subsection (3) of § 9-504 and subsection (1) of § 9-505 which deal with disposition of collateral;

(c) subsection (2) of § 9-505 which deals with acceptance of collateral as discharge of obligation;

(d) § 9-506 which deals with redemption of collateral; and

(e) subsection (1) of § 9-507 which deals with the secured party's liability for failure to comply with this Part.

(4) If the security agreement covers both real and personal property, the secured party may proceed under this Part as to the personal property or he may proceed as to both the real and the personal property in accordance with his rights and remedies in respect of the real property in which case the provisions of this Part do not apply.

(5) When a secured party has reduced his claim to judgment the lien of any levy which may be made upon his collateral by virtue of any execution based upon the judgment shall relate back to the date of the perfection of the security interest in such collateral. A judicial sale, pursuant to such execution, is a foreclosure of the security interest by judicial procedure within the meaning of this section, and the secured party may purchase at the sale and thereafter hold the collateral free of any other requirements of this Article.

COMMENT: **Prior Uniform Statutory Provision:** § 6, Uniform Trust Receipts Act; §§ 16 through 26, Uniform Conditional Sales Act.

Changes: Modified to conform to the scheme of this Article.

Purposes of Changes: 1. The rights of the secured party in the collateral after the debtor's default are of the essence of a security transaction. These are the rights which distinguish the secured from the unsecured lender. This Section and the following six sections state those rights as well as the limitations on their free exercise which legislative policy requires for the protection not only of the defaulting debtor but of other creditors. But subsections (1) and (2) make it clear that the statement of rights and remedies in this Part does not exclude other remedies provided by agreement.

2. Following default and the taking possession of the collateral by the secured party, there is no longer any distinction between the security interest which before default was non-possessory and that which was possessory under a pledge. Therefore no general distinction is taken in this Part between the rights of a non-possessory secured party and those of a pledgee; the latter, being in possession of the collateral at default, will of course not have to avail himself of the right to take possession under § 9-503.

3. § 9-207 states rights, remedies and duties with respect to collateral in the secured party's possession. That section applies not only to the situation where he is in possession before default, as a pledgee, but also, by subsections (1) and (2) of this Section, to the secured party in possession after default. Nevertheless the relations of the parties have been changed by default, and § 9-207 as it applies after default must be read together with this Part. In particular, agreements permitted under § 9-207 cannot waive or modify the rights of the debtor contrary to subsection (3) of this Section.

4. § 1-102(3) states rules to determine which provisions of this Act are mandatory and which may be varied by agreement. In general, provisions which relate to matters which come up between immediate parties may be varied by agreement. In the area of rights after default our legal system has traditionally looked with suspicion on agreements designed to cut down the debtor's rights and free the secured party of his duties: no mortgage clause has ever been allowed to clog the equity of redemption. The default situation offers great scope for overreaching; the suspicious attitude of the courts has been grounded in common sense.

Subsection (3) of this Section contains a codification of this long-standing and deeply rooted attitude: the specified rights of the debtor and duties of the secured party may not be waived or varied except as stated. Provisions not specified in subsection (3) are subject to the general rules stated in § 1-102(3).

5. The collateral for many corporate security issues consists of both real and personal property. In the interest of simplicity and speed subsection (4) permits, although it does not require, the secured party to proceed as to both real and personal property in accordance with his rights and remedies in respect of the real property. Except for the permission so granted, this Act leaves to other state law all questions of procedure with respect to real property. For example, this Act does not determine whether the secured party can proceed against the real estate alone and later proceed in a separate action against the personal property in accordance with his rights and remedies against the real estate. By such separate actions the secured party "proceeds as to both," and this Part does not apply in either action. But subsection (4) does give him an option to proceed under this Part as to the personal property.

6. Under subsection (1) a secured party is entitled to reduce his claim to judgment or to foreclose his interest by any available procedure, outside this Article, which state law may provide. The first sentence of subsection (5) makes clear that any judgment lien which the secured party may acquire against the collateral is, so to say, a continuation of his original interest (if perfected) and not the acquisition of a new interest or a transfer of property to satisfy an antecedent debt. The judgment lien is therefore stated to relate back to the date of perfection of the security interest. The second sentence of the subsection makes clear that a judicial sale following judgment, execution and levy is one of the methods of foreclosure contemplated by subsection (1); such a sale is governed by other law and not by this Article and the restrictions which this Article imposes on the right of a secured party to buy in the collateral at a sale under § 9-504 do not apply.

Cross References:

Point 2: § 9-503.
Point 3: § 9-207.
Point 4: § 1-102(3).
Point 5: §§ 9-102(1) and 9-104(j).
Point 6: § 9-504.

Definitional Cross References:

"Agreement". § 1-201.
"Collateral". § 9-105.
"Debtor". § 9-105.
"Documents". § 9-105.
"Goods". § 9-105.
"Remedy". § 1-201.
"Rights". § 1-201.
"Secured party". § 9-105.
"Security agreement". § 9-105.
"Security interest". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-555 (trust receipts); 43-28 (crop liens); 43-59 - 60 (agricultural chattel deeds of trust); 55-59 - 63 (deeds of trust); 55-91, 55-93, 55-94 (conditional sales); 8-586 - 596 (detinue).

Comment: The remedies available to the secured party upon the debtor's default under Virginia law, depend, to some extent, on the form of the security arrangement. The UCC approaches the subject from the functional standpoint rather than from the standpoint of form.

Conditional Sales. For a discussion of the Virginia law see Snead, Retail Instalment Sales v. Virginia Remedies on Default, 16 Wash. & Lee L. Rev. 1 (1959). The conditional vendor, upon default, may take peaceable possession, which then involves four alternative procedures, or he may follow a judicial remedy, with four alternative procedures available, so that the conditional vendor has available a total of eight different remedies.

If the conditional vendor takes peaceable possession he has four alternative rights:

(1) He may retain the property as his own, but if be does so, it would appear that he must account to the vendee for the difference between the fair market value of the property at the time and place of repossession and the unpaid purchase price with interest. Ashworth v. Fleenor, 178 Va. 104, 111-12, 16 S.E.2d 309 (1941). It may be, though, that this case turns on its peculiar facts, and does not stand for as broad a proposition as has been stated. See Snead, Retail Instalment Sales: Virginia Remedies on Default, 16 Wash. & Lee L. Rev. 1, 10-14 (1959).

(2) The conditional vendor may repossess the property peaceably and sell at a private sale. If he does so, he cannot obtain a deficiency judgment, since Code 1950, § 55-93, provides that such a private sale cancels the unpaid purchase price, notwithstanding any clause in the contract to the contrary. Federal Motor Truck Co. v. Kellenberger, 193 Va. 882, 886-90, 71 S.E.2d 177 (1952). This statute was adopted to reverse the result in Universal Credit Co. v. Taylor, 164 Va. 624, 627-31, 80 S.E. 104 (1935), in which a conditional vendor was allowed to recover a deficiency judgment after peaceably repossessing a chattel and making a private sale. The Taylor case and the effect of the statute are discussed in Note, Rights of Conditional Vendor and Vendee upon Default in Virginia, 26 Va. L. Rev. 232 (1939). It is not clear whether a conditional vendor who peaceably repossesses and sells at private sale is accountable to the vendee for any surplus he may realize. The statute, § 55-93, is silent on this point, and the two cases that have indicated that the vendor is liable for the surplus have involved contract provisions to that effect. Universal Credit Co. v. Taylor, 164 Va. 624, 625-27, 80 S.E. 104 (1935); Lynchburg Motor Co. v. Thomasson, 141 Va: 153, 162-63, 126 S.E. 64 (1925).

(3) The conditional vendor may, under Code 1950, § 55-93, after default, enter into a new contract in writing with the vendee, which provides for a private resale, with the buyer to be liable for any deficiency.

(4) The conditional vendor may repossess the goods in a peaceable manner, and by following the provisions of Code 1950, § 55-93, regarding a public sale, become entitled to a deficiency judgment. The statute requires that the public auction must be held in the county or city where the vendor has his principal place of business or where the vendee resides, after ten days written notice of the time, place, and terms of sale, served upon or sent hy registered mail to the last known address of the vendee, and after publication in a newspaper or by posting for five days at three or more public places. Associates Discount Corp. v. Lunsford, 204 Va. 1, 2-3, 128 S.E. 2d 924 (1963), held that it is not necessary to have a licensed auctioneer conduct the public sale in order to comply with the statute.

The conditional vendor has the following four judicial remedies:

(1) The situation with respect to actions of detinue where conditional sales contracts are involved is not clear. Code 1950, § 8-593, provides that where contracts made to secure the payment of money are involved the judgment for the plaintiff shall be for the amount due or for the specific property and costs, with the defendant to have the election of paying the amount of the judgment or surrendering the specific property. Under this statute the conditional vendor is not entitled to both the goods and a deficiency judgment, but only to one or the other, with the vendee having the election as to which it shall be. Lloyd v. Federal Motor Truck Co., 168 Va. 72, 77-80, 190 S.E. 257 (1937); Osmond-Barringer Co. v. Hey, 7 Va. Law Reg. (N.S.) 175, 180 (Law and Equity Court of City of Richmond 1921). In Universal Credit Co. v. Botetourt Motor Co., Inc., 180 Va. 159, 176, 21 S.E.2d 800 (1942), in an action of detinue the seller repossessed the cars and sold them without giving the buyer an election, and the court held it proper to decree the surplus to the buyer.

Code 1950, § 55-94, added in 1946, also relates to the action of detinue by conditional vendors, and provides that the court may order all or some of the property sold to satisfy the vendor's claim or order all or some of the property returned to the vendor to satisfy his claim. It is not clear whether § 55-94 was intended to supersede or supplement § 8-593, or what its purpose is. If § 55-94 supersedes § 8-593 the vendor has been deprived of his election to pay the judgment or return the property. If the two statutes are to be construed together it is difficult to determine when the one or the other applies. Neither statute in terms authorizes the entry of a deficiency judgment in favor of the conditional vendor.

See also Douglas v. United Co., 183 Va. 263, 31 S.E.2d 889 (1944), for a case involving use of the action of detinue.

(2) The conditional vendor may use the statutory remedy provided by Code 1950, § 55-91, by proceeding by petition to a trial justice or by a bill in equity in a court of equity jurisdiction, depending upon the amount involved. In such a proceeding the court may order the property sold, possession delivered to the vendor, or make such other disposition as seems proper, and in a proper case a personal judgment may be entered against the vendee. Bolling v. General Motors Acceptance Corp., 204 Va. 4, 5, 129 S.E.2d 54 (1963); Mitchell Transparent Ice Co. v. Triumph Electric Co., 116 Va. 725, 726, 82 S.E. 730 (1914); Liquid Carbonic Co. v. Whitehead, 115 Va. 586, 596-99, 80 S.E. 104 (1913).

(3) The conditional vendor may bring an action at law for the amount of the unpaid purchase price. Southern Manufacturing and Supply Co. v. Klavan, 125 Va. 438, 439-41, 99 S.E. 566 (1919); Victor Products Corp. v. Yates-American Mach. Co., 54 F.2d 1062, 1065 (4th Cir. 1932).

(4) The conditional vendor may bring a suit in equity to foreclose the lien, according to dictum in several cases. Lloyd v. Federal Motor Truck Co., 168 Va. 72, 77, 190 S.E. 257 (1937); Universal Credit Co. v. Taylor, 164 Va. 624, 626, 180 S.E. 277 (1935); Mitchell Transparent Ice Co. v. Triumph Electric Co., 116 Va. 725, 726, 82 S.E. 730 (1914).

The Virginia law is in accord with the UCC in that the rights and remedies given to the conditional vendor are cumulative. Universal Credit Co. v. Taylor, 164 Va. 624, 630, 180 S.E. 277 (1935); Southern Manufacturing and Supply Co. v. Klavan, 125 Va. 438, 440-41, 99 S.E. 566 (1919); Mitchell Transparent Ice Co. v. Triumph Electric Co., 116 Va. 725, 726, 82 S.E. 730 (1914); Levy v. Davis, 115 Va. 814, 820-21, 80 S.E. 791 (1914).

The UCC does not cover the situation presented in Wheeler v. City Savings and Loan Corp., 156 Va. 402, 404-06, 157 S.E. 726 (1931), involving the proper remedy to be followed by a conditional vendor, who seeks to hold a city sergeant liable on his bond for wrongfully paying over to a judgment creditor the proceeds of an execution sale of collateral.

Chattel Deeds of Trust. The Virginia statutes relating to deeds of trust in some instances cover both real and personal property (e. g., Code 1950, §§ 55-52, 55-61), while other statutes are limited to real estate (e. g., Code 1950, §§ 55-49, 55-64), and still others do not make any express reference to the type of property covered (e. g., §§ 55-48, 55-51). Consequently, there is no comprehensive and well-defined law relating to this form of personal property security.

The creditor's rights under a chattel deed of trust are generally governed by the terms of the deed. In Turk v. Clark, 193 Va. 744, 748-51, 71 S.E.2d 172 (1952), the provisions of the deed were not complied with by the trustee in making a sale of an automobile after the debtor had defaulted. The creditor bought in the auto-

mobile at the sale at a price less than the amount of the indebtedness and then brought an action for the deficiency. The court discussed whether such an action could be maintained after a conversion, pointing out a conflict in the authorities, but did not lay down a rule for Virginia, since a recovery could be denied on the ground that the evidence supported the jury verdict of no deficiency.

Upon refusal of the debtor under a deed of trust to deliver the goods upon demand of the trustee, the trustee may bring an action of detinue. Hardaway v. Jones, 100 Va. 481, 483, 485-86, 41 S.E. 957 (1902), held that in such an action the trustee was entitled to a judgment that included an amount for the use and hire of mules from the time he had demanded possession. In McClure Grocery Co. v. Watson, 148 Va. 601, 139 S.E. 288 (1927), the purchaser under a sale under a deed of trust used detinue to seek to obtain possession of the property.

Where a deed of trust covers both real and personal property, it is not clear from the Virginia cases whether there is any difference in the remedies available as respects the different types of property. See e. g., Williamson v. Payne, 103 Va. 551, 555, 49 S.E. 660 (1905) (deed of trust covered sawmill and personal property). To the extent that remedies relating to real property have been used where the deed of trust has covered both real and personal property, subsection 9-501(4) authorizes continued use of the same procedures.

Agricultural Chattel Deeds of Trust. Code 1950, §§ 43-59 and 43-60, provide that upon default the trustee may take possession and may foreclose in any manner provided by law for the foreclosure of liens, and foreclosure may be by sale after such advertisement and in such manner as provided in the deed of trust or by the laws relating to sales by trustees in deeds of trust on real property, provided only that the sale is by public auction.

Chattel Mortgages. A chattel mortgagee may use detinue to enforce his security interest. Code 1950, § 8-593; Universal Credit Co. v. Botetourt Motor Co., Inc., 180 Va. 159, 174-75, 21 S.E.2d 800 (1942); Ashworth v. Fleenor, 178 Va. 104, 109, 16 S.E.2d 309 (1941) (dictum).

In the old case of Moore's Ex'r v. Aylett's Ex'r, 11 Va. (1 Hen. & M.) 29, 32 (1806), the mortgagee in possession of slaves who had sold them, in accordance with the terms of the mortgage, was required to account in equity to the mortgagor for the surplus over the amount of the debt. Dabney v. Green, 14 Va. (4 Hen. & M.) 101, 109-13 (1809), recognized that a bill of sale of a slave, absolute on its face, given for a loan of money would nevertheless be deemed a mortgage, and that the mortgagor has an equity of redemption upon payment of the mortgage, although in this case the mortgagor was denied any right to redeem because of his fraudulent conduct. Dust v. Conrod, 19 Va. (5 Munf.) 411, 415 (1817), recognized the right of a purchaser from the mortgagor to exercise the mortgagor's right of redemption of a slave by payment of the mortgage debt.

Trust Receipts. The remedies of the entruster, upon the trustee's default, are set forth in Code 1950, § 6-555.

Crop Liens. Code 1950, § 43-28, gives the secured party the remedy of injunction to protect a crop lien.

§ 9-502. Collection Rights of Secured Party. (1) When so agreed and in any event on default the secured party is entitled to notify an account debtor or the obligor on an instrument to make payment to him whether or not the assignor was theretofore making collections on the collateral, and also to take control of any proceeds to which he is entitled under § 9-306.

(2) A secured party who by agreement is entitled to charge back uncollected collateral or otherwise to full or limited recourse against the debtor and who undertakes to collect from the account debtors or obligors must proceed in a commercially reasonable manner and may deduct his reasonable expenses of realization from the collections. If the security agreement secures an indebtedness, the secured party must account to the debtor for any surplus, and unless otherwise agreed, the debtor is liable for any deficiency. But, if the underlying transaction was a sale of accounts, contract rights, or chattel paper, the debtor is entitled to any surplus or is liable for any deficiency only if the security agreement so provides.

COMMENT: **Prior Uniform Statutory Provision: None.**

Purposes: 1. The assignee of accounts, chattel paper, contract rights or instruments holds as collateral property which is not only the most liquid asset of the debtor's business but also property which may be collected without any interruption of the business, assuming it to continue after default. The situation is far different from that where the collateral is inventory or equipment, whose removal may bring the business to a halt. Furthermore the problems of valuation and identification, present where the collateral is tangible chattels, do not arise so sharply on the assignment of intangibles. Considerations, similar although not identical, apply to assignments of general intangibles, which are also covered by the rule of the Section. Consequently, this Section recognizes the fact that financing by assignment of intangibles lacks many of the complexities which arise after default in other types of financing, and allows the assignee to liquidate in the regular course of business by collecting whatever may become due on the collateral, whether or not the method of collection contemplated by the security arrangement before default was direct (i. e., payment by the account debtor to the assignee, "notification" financing) or indirect (i. e., payment by the account debtor to the assignor, "non-notification" financing). By agreement, of course, the secured party may have the right to give notice and to make collections before default.

2. In one form of accounts receivable financing, which is found in the "factoring" arrangements which are common in the textile industry, the assignee assumes the credit risk—that is, he buys the account under an agreement which does not provide for recourse or charge-back against the assignor in the event the account proves uncollectible. Under such an arrangement, neither the debtor nor his creditors have any legitimate concern with the disposition which the assignee makes of the accounts. Under another form of accounts receivable financing, however, the assignee does not assume the credit risk and retains a right of full or limited recourse or charge-back for uncollectible accounts. In such a case both debtor and creditors have a right that the assignee not dump the accounts, if the result will be to increase a possible deficiency claim or to reduce a possible surplus.

3. Where an assignee has a right of charge-back or a right of recourse, subsection (2) provides that liquidation must be made with due regard to the interest of the assignor and of his other creditors—"in a commercially reasonable manner" (compare § 9-504 and see § 9-507(2))—and the proceeds allocated to the expenses of realization and to the indebtedness. If the "charge-back" provisions of the assignment arrangement provide only for "charge-back" of bad accounts against a reserve, the debtor's claim to surplus and his liability for a deficiency are limited to the amount of the reserve.

4. Financing arrangements of the type dealt with by this section are between business men. The last sentence of subsection (2) therefore preserves freedom of contract, and the subsection recognizes that there may be a true sale of accounts, chattel paper, or contract rights although recourse exists. The determination whether a particular assignment constitutes a sale or a transfer for security is left to the courts. Note that, under § 9-102, this Article applies both to sales and to security transfers of such intangibles.

Cross References:

§§ 9-205 and 9-306.
Point 3: §§ 9-504 and 9-507(2).
Point 4: §§ 9-102(1) (b) and 9-104(f).

Definitional Cross References:

"Account". § 9-106.
"Account debtor". § 9-105.
"Agreement". § 1-201.
"Chattel paper". § 9-105.
"Collateral". § 9-105.
"Contract right". § 9-106.
"Debtor". § 9-105.
"Instrument". § 9-105.
"Notify". § 1-201.
"Proceeds". § 9-306.
"Secured party". § 9-105.
"Security agreement". § 9-105.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

§ 9-503. Secured Party's Right to Take Possession After Default. Unless otherwise agreed a secured party has on default the right to take possession of the collateral. In taking possession a secured party may proceed without judicial process if this can be done without breach of the peace or may proceed by action. If the security agreement so provides the secured party may require the debtor to assemble the collateral and make it available to the secured party at a place to be designated by the secured party which is reasonably convenient to both parties. Without removal a secured party may render equipment unusable, and may dispose of collateral on the debtor's premises under § 9-504.

COMMENT: **Prior Uniform Statutory Provision:** § 6, Uniform Trust Receipts Act; §§ 16 and 17, Uniform Conditional Sales Act.

Changes: Modified to conform to the scheme of this Article.

Purposes of Changes: Under this Article the secured party's right to possession of the collateral (if he is not already in possession as pledgee) accrues on default unless otherwise agreed in the security agreement. This Article follows the provisions of the earlier uniform legislation in allowing the secured party in most cases to take possession without the issuance of judicial process. In the case of collateral such as heavy equipment, the physical removal from the debtor's plant and the storage of the equipment pending resale may be exceedingly expensive and in some cases impractical. The Section therefore provides that in lieu of removal the lender may render equipment unusable or dispose of collateral on the debtor's premises. The authorization to render equipment unusable or to dispose of collaeral without removal would not justify unreasonable action by the secured party, since, under § 9-504(3), all his actions in connection with disposition must be taken in a "commercially reasonable manner".

Cross Reference:

§ 9-504.

Definitional Cross References:

"Action". § 1-201.
"Collateral". § 9-105.
"Debtor". § 9-105.
"Equipment". § 9-109.
"Party". § 1-201.
"Rights". § 1-201.
"Secured party". § 9-105.
"Security agreement". § 9-105.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-555 (trust receipts); 43-59 (agricultural chattel deeds of trust); 55-59 (chattel deeds of trust); 55-93 - 94 (conditional sales); 8-586 - 596 (detinue).

Comment: The UCC recognizes the right of a secured party, after default, to take possession of the collateral. This may be done without judicial process, if it can be done without breach of the peace. Virginia similarly recognizes this right of repossessing peaceably. Ashworth v. Fleenor, 178 Va. 104, 111-12, 16 S.E.2d 309 (1941); Universal Credit Co. v. Taylor, 164 Va. 624, 630-31, 180 S.E. 277 (1935). Repossession may be obtained by legal action, which in Virginia ordinarily means by an action of detinue. Code 1950, §§ 8-586 - 596; Lloyd v. Federal Motor Truck Co., 168 Va. 72, 190 S.E. 257 (1937). See also VIRGINIA ANNOTATIONS to UCC 9-501.

§ 9-504. Secured Party's Right to Dispose of Collateral After Default; Effect of Disposition. (1) A secured party after default may sell, lease or otherwise dispose of any or all of the collateral in its then condition or following any commercially reasonable preparation or processing. Any sale of goods is subject to the Article on Sales (Article 2). The proceeds of disposition shall be applied in the order following to

(a) the reasonable expenses of retaking, holding, preparing for sale, selling and the like and, to the extent provided for in the agreement and

not prohibited by law, the reasonable attorneys' fees and legal expenses incurred by the secured party;

(b) the satisfaction of indebtedness secured by the security interest under which the disposition is made;

(c) the satisfaction of indebtedness secured by any subordinate security interest in the collateral if written notification of demand therefor is received before distribution of the proceeds is completed. If requested by the secured party, the holder of a subordinate security interest must seasonably furnish reasonable proof of his interest, and unless he does so, the secured party need not comply with his demand.

(2) If the security interest secures an indebtedness, the secured party must account to the debtor for any surplus, and, unless otherwise agreed, the debtor is liable for any deficiency. But if the underlying transaction was a sale of accounts, contract rights, or chattel paper, the debtor is entitled to any surplus or is liable for any deficiency only if the security agreement so provides.

(3) Disposition of the collateral may be by public or private proceedings and may be made by way of one or more contracts. Sale or other disposition may be as a unit or in parcels and at any time and place and on any terms but every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable. Unless collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, reasonable notification of the time and place of any public sale or reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor, and except in the case of consumer goods to any other person who has a security interest in the collateral and who has duly filed a financing statement indexed in the name of the debtor in this State or who is known by the secured party to have a security interest in the collateral. The secured party may buy at any public sale and if the collateral is of a type customarily sold in a recognized market or is of a type which is the subject of widely distributed standard price quotations he may buy at private sale.

(4) When collateral is disposed of by a secured party after default, the disposition transfers to a purchaser for value all of the debtor's rights therein, discharges the security interest under which it is made and any security interest or lien subordinate thereto. The purchaser takes free of all such rights and interests even though the secured party fails to comply with the requirements of this Part or of any judicial proceedings

(a) in the case of a public sale, if the purchaser has no knowledge of any defects in the sale and if he does not buy in collusion with the secured party, other bidders or the person conducting the sale; or

(b) in any other case, if the purchaser acts in good faith.

(5) A person who is liable to a secured party under a guaranty, indorsement, repurchase agreement or the like and who receives a transfer of collateral from the secured party or is subrogated to his rights has thereafter the rights and duties of the secured party. Such a transfer of collateral is not a sale or disposition of the collateral under this Article.

COMMENT: **Prior Uniform Statutory Provision:** § 6, Uniform Trust Receipts Act; §§ 19, 20, 21, and 22, Uniform Conditional Sales Act.

Changes: Modified to conform to the scheme of this Article.

Purposes of Changes: 1. The Uniform Trust Receipts Act provides that an entruster in possession after default holds the collateral with the rights and duties

of a pledgee, and, in particular, that he may sell such collateral at public or private sale with a right to claim deficiency and a duty to account for any surplus. The Uniform Conditional Sales Act insisted on a sale at public auction with elaborate provisions for the giving of notice of sale. This Section follows the more liberal provisions of the Trust Receipts Act. Although public sale is recognized, it is hoped that private sale will be encouraged where, as is frequently the case, private sale through commercial channels will result in higher realization on collateral for the benefit of all parties. The only restriction placed on the secured party's method of disposition is that it must be commercially reasonable. In this respect this Section follows the provisions of the Section on resale by a seller following a buyer's rejection of goods (§ 2-706). Subsection (1) does not restrict disposition to sale: the collateral may be sold, leased, or otherwise disposed of—subject of course to the general requirement of subsection (2) that all aspects of the disposition be "commercially reasonable". § 9-507(2) states some tests as to what is "commercially reasonable".

2. Subsection (1) in general follows prior law in its provisions for the application of proceeds and for the debtor's right to surplus and liability for deficiency. Under subsection (1) (c) the secured party, after paying expenses of retaking and disposition and his own debt, is required to pay over remaining proceeds to the extent necessary to satisfy the holder of any junior security interest in the same collateral if the holder of the junior interest has made a written demand and furnished on request reasonable proof of his interest: this provision is necessary in view of the fact that under subsection (4) the junior interest is discharged by the disposition. Since the requirement is conditioned on written demand it should not result in undue burden on the secured party making the disposition. It should be noted also that under § 9-112 where the secured party knows that the collateral is owned by a person who is not the debtor, the owner of the collateral and not the debtor is entitled to any surplus.

3. In any security transaction the debtor (or the owner of the collateral if other than the debtor: see § 9-112) is entitled to any surplus which results from realization on the collateral; the debtor will also, unless otherwise agreed, be liable for any deficiency. Subsection (2) so provides. Since this Article covers sales of certain intangibles as well as transfers for security, the subsection also provides that apart from agreement the right to surplus or liability for deficiency does not accrue where the transaction between debtor and secured party was a sale and not a security transaction.

4. Subsection (4) provides that a purchaser for value from a secured party after default takes free of any rights of the debtor and of the holders of junior security interests and liens, even though the secured party has not complied with the requirements of this Part or of any judicial proceedings. This subsection follows a similar provision in the Uniform Trust Receipts Act and in the Section of this Act on resale by a seller (§ 2-706). Where the purchaser for value has bought at a public sale he is protected under paragraph (a) if he has no knowledge of any defects in the sale and was not guilty of collusive practices. Where the purchaser for value has bought at a private sale he must, to receive the protection of paragraph (b), qualify in all respects as a purchaser in good faith. Thus while the purchaser at a private sale is required to proceed in the exercise of good faith, the purchaser at public sale is protected so long as he is not actively in bad faith, and is put under no duty to inquire into the circumstances of the sale.

5. Both the Uniform Trust Receipts Act and the Uniform Conditional Sales Act required a waiting period after repossession and before sale (five days in the Trust Receipts Act, ten days in the Conditional Sales Act). Under subsection (3) the secured party in most cases is required to give reasonable notification of disposition both to the debtor and (except for consumer goods) to other secured parties who have filed in this state or are known to him. Except for the requirement of notification there is no statutory period during which the collateral must be held before disposition. "Reasonable notification" is not defined in this Article; at a minimum it must be sent in such time that persons entitled to receive it will have sufficient time to take appropriate steps to protect their interests by taking part in the sale or other disposition if they so desire.

6. § 19 of the Uniform Conditional Sales Act required that sale be made not more than thirty days after possession taken by the conditional vendor. The Uniform Trust Receipts Act contained no comparable provision. Here again this Article follows the Trust Receipts Act, and no period is set within which the disposition must be made, except in the case of consumer goods which under § 9-505(1) must in certain instances be sold within ninety days after the secured party has taken possession. The failure to prescribe a statutory period during which disposition must be made is in line with the policy adopted in this Article to encourage dispo-

sition by private sale through regular commercial channels. It may, for example, be wise not to dispose of goods when the market has collapsed, or to sell a large inventory in parcels over a period of time instead of in bulk. Note, however, that under subsection (3) every aspect of the sale or other disposition of the collateral must be commercially reasonable; this specifically includes method, manner, time, place and terms. See § 9-507(2). Under that provision a secured party who without proceeding under § 9-505(2) held collateral a long time without disposing of it, thus running up large storage charges against the debtor, where no reason existed for not making a prompt sale, might well be found not to have acted in a "commercially reasonable" manner. See also § 1-203 on the general obligation of good faith.

Cross References:

Point 1: §§ 2-706 and 9-507(2).
Point 2: § 9-112.
Point 3: §§ 9-102 (1) (b) and 9-112.
Point 4: § 2-706.
Point 6: §§ 9-505 and 9-507(2).

Definitional Cross References:

"Account". § 9-106.
"Agreement". § 1-201.
"Chattel paper". § 9-105.
"Collateral". § 9-105.
"Consumer goods". § 9-109.
"Contract". § 1-201.
"Contract right". § 9-106.
"Debtor". § 9-105.
"Financing statement". § 9-402.
"Gives notification". § 1-201.
"Good faith". § 1-201.
"Goods". § 9-105.
"Knowledge". § 1-201.
"Person". § 1-201.
"Proceeds". § 9-306.
"Purchaser". § 1-201.
"Receives" notification. § 1-201.
"Rights". § 1-201.
"Sale". §§ 2-106 and 9-105.
"Secured party". § 9-105.
"Security agreement". § 9-105.
"Security interest". § 1-201.
"Send". § 1-201.
"Term". § 1-201.
"Value". § 1-201.
"Written". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, §§ 6-555 (trust receipts); 43-59 - 60 (agricultural chattel deeds of trust); 55-59 - 63 (chattel deeds of trust); 55-93 (conditional sales).

Comment: The UCC is in accord with Virginia law in recognizing the right of the pledgee to sell collateral after default by the pledgor. Parksley Nat'l Bank v. Parks, 172 Va. 169, 185, 200 S.E. 629 (1939); Reid v. Windsor, 111 Va. 825, 831, 69 S.E. 1101 (1911); Richardson v. Insurance Co. of Valley of Virginia, 68 Va. (27 Gratt.) 749, 752-54 (1876); Alex., Loud., & Hamp. R.R. Co. v. Burke, 63 Va. (22 Gratt.) 254, 261-63 (1872).

Ordinarily under both the UCC and Virginia law reasonable notice of a sale of collateral must be given to the debtor. Alex., Loud., & Hamp. R.R. Co. v. Burke, 63 Va. (22 Gratt.) 254, 263-65 (1872). Reid v. Windsor, 111 Va. 825, 831, 69 S.E. 1101 (1911), recognized that the parties could agree to give the pledgee a power of sale without making demand upon the debtor or giving him notice.

In Richardson v. Insurance Co. of Valley of Virginia, 68 Va. (27 Gratt.) 749, 752-54 (1876), the court rejected a contention that there was a duty on the pledgee to sell stock which had lost its value. The pledgor, if he wanted the stock sold, should have requested the pledgee to do so or have redeemed it and made a sale himself.

Universal Credit Co. v. Botetourt Motor Co., Inc., 180 Va. 159, 174-75, 21 S.E.2d 800 (1942), involved an action of detinue in which a chattel mortgagee who went ahead and sold goods without giving the debtor his detinue election was required to pay the surplus to the debtor. McClure Grocery Co. v. Watson, 148 Va. 601, 608-09, 139 S.E. 288 (1927), indicated that a sale under a deed of trust could be set aside as a fraud on creditors if it was shown to be a sham transaction known to the purchaser.

Code 1950, §§ 55-59 through 55-63, provides for a secured party's rights upon default under a chattel deed of trust, in the absence of any different provisions in the deed of trust.

UCC 9-504(5) discards the principle employed by the Virginia court in Federal Motor Truck Co. v. Kellenberger, 193 Va. 882, 71 S.E.2d 177 (1952). There, although reaching a correct result, the court rested its decision on the principle that an automobile dealer who was compelled by contract to repurchase an automobile from a financing agency was not continuing a secured transaction but was "buying" the automobile and hence was not entitled to the remedies of a secured party. Under the UCC the repurchasing dealer has all of the rights of a secured party.

§ 9-505. **Compulsory Disposition of Collateral; Acceptance of the Collateral as Discharge of Obligation.** (1) If the debtor has paid sixty per cent of the cash price in the case of a purchase money security interest in consumer goods or sixty percent of the loan in the case of another security interest in consumer goods, and has not signed after default a statement renouncing or modifying his rights under this Part a secured party who has taken possession of collateral must dispose of it under § 9-504 and if he fails to do so within ninety days after he takes possession the debtor at his option may recover in conversion or under § 9-507(1) on secured partys' liability.

(2) In any other case involving consumer goods or any other collateral a secured party in possession may, after default, propose to retain the collateral in satisfaction of the obligation. Written notice of such proposal shall be sent to the debtor and except in the case of consumer goods to any other secured party who has a security interest in the collateral and who has duly filed a financing statement indexed in the name of the debtor in this State or is known by the secured party in possession to have a security interest in it. If the debtor or other person entitled to receive notification objects in writing within thirty days from the receipt of the notification or if any other secured party objects in writing within thirty days after the secured party obtains possession the secured party must dispose of the collateral under § 9-504. In the absence of such written objection the secured party may retain the collateral in satisfaction of the debtor's obligation.

COMMENT: **Prior Uniform Statutory Provision:** § 23, Uniform Conditional Sales Act.

Changes: Modified to conform to the scheme of this Article.

Purposes of Changes: 1. Experience has shown that the parties are frequently better off without a resale of the collateral; hence this section sanctions an alternative arrangement. In lieu of resale or other disposition, the secured party may propose under subsection (2) that he keep the collateral as his own, thus discharging the obligation and abandoning any claim for a deficiency. This right may not be exercised in the case of consumer goods where the debtor has paid 60% of the price or obligation and thus has a substantial equity, and may be exercised in other cases only on notification to the debtor and other secured parties who have filed in this state or are otherwise known to the secured party exercising the right, and on failure of anyone receiving notification to object within thirty days.

2. When an objection is received by the secured party he must then proceed to dispose of the collateral in accordance with § 9-504, and on failure to do so would incur the liabilities set out in § 9-507. In the case of consumer goods where 60% of the price or obligation has been paid the disposition must be made within 90 days

after possession taken. For failure to make the sale within the 90 day period the secured party is liable in conversion or alternatively may incur the liabilities set out in § 9-507.

3. After default (but not before) a consumer-debtor who has paid 60% of the cash price may sign a written renunciation of his rights to require resale of the collateral.

Cross References:

§§ 9-504 and 9-507(1).

Definitional Cross References:

"Collateral". § 9-105.
"Consumer goods". § 9-109.
"Debtor". § 9-105.
"Knows". § 1-201.
"Notice". § 1-201.
"Person". § 1-201.
"Purchase money security interest". § 9-107.
"Receives" notification. § 1-201.
"Rights". § 1-201.
"Secured party". § 9-105.
"Security interest". § 1-201.
"Send". § 1-201.
"Signed". § 1-201.
"Written". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: Code 1950, § 55-93 (conditional sales).

Comment: This subsection changes Virginia law by requiring the secured party to sell the collateral, where it is consumer goods on which the buyer has paid 60 per cent of the cash price or loan. Virginia law does not provide for such compulsory disposition in any instance. See VIRGINIA ANNOTATIONS to UCC 9-501. The subsection, though, does follow the present proviso of Code 1950, § 55-93, covering conditional sales under which the compulsory disposition requirement is eliminated if the debtor signs a statement after default under which he renounces these rights. Subsection 9-505(2) also changes Virginia law by requiring a secured party who proposes to retain collateral, which is consumer goods, in satisfaction of the obligation, to notify the debtor to this effect, and upon objection the creditor is required to sell the goods. See Ashworth v. Fleenor, 178 Va. 104, 109-13, 16 S.E.2d 309 (1941).

§ 9-506. Debtor's Right to Redeem Collateral. At any time before the secured party has disposed of collateral or entered into a contract for its disposition under § 9-504 or before the obligation has been discharged under § 9-505(2) the debtor or any other secured party may unless otherwise agreed in writing after default redeem the collateral by tendering fulfillment of all obligations secured by the collateral as well as the expenses reasonably incurred by the secured party in retaking, holding and preparing the collateral for disposition, in arranging for the sale, and to the extent provided in the agreement and not prohibited by law, his reasonable attorneys' fees and legal expenses.

COMMENT: Prior Uniform Statutory Provision: § 18, Uniform Conditional Sales Act.

Changes: Modified to conform to the scheme of this Article.

Purposes of Changes: Except in the case stated in § 9-505(1) (consumer goods) the secured party is not required to dispose of collateral within any stated period of time. Under this Section so long as the secured party has not disposed of collateral in his possession or contracted for its disposition and so long as his right to retain it has not become fixed under § 9-505(2), the debtor or another secured party may redeem. The debtor must tender fulfillment of all obligations secured, plus certain expenses: if the agreement contains a clause accelerating the entire balance due on default in one installment, the entire balance would have to be tendered. "Tendering fulfillment" obviously means more than a new promise to

perform the existing promise; it requires payment in full of all monetary obligations then due and performance in full of all other obligations then matured. If unmatured obligations remain, the security interest continues to secure them as if there had been no default.

Under § 9-504 the secured party may make successive sales of parts of the collateral in his possession. The fact that he may have sold or contracted to sell part of the collateral would not affect the debtor's right under this Section to redeem what was left. In such a case, of course, in calculating the amount required to be tendered the debtor would receive credit for net proceeds of the collateral sold.

Cross References:

§§ 9-504 and 9-505.

Definitional Cross References:

"Agreement". § 1-201.
"Collateral". § 9-105.
"Contract". § 1-201.
"Debtor". § 9-105.
"Secured party". § 9-105.
"Writing". § 1-201.

VIRGINIA ANNOTATIONS

Prior Statutes: None.

Comment: Dabney v. Green, 14 Va. (4 Hen. & M.) 101, 109-13 (1809), recognized that a bill of sale of a slave, absolute on its face, given for a loan of money would nevertheless be deemed a mortgage, and that the mortgagor has an equity of redemption upon payment of the mortgage, although in this case the mortgagor was denied any right to redeem because of his own fraudulent conduct. Dust v. Conrod, 19 Va. (5 Munf.) 411, 415 (1817), recognized that the purchaser from a mortgagor of a slave had a right to pay the mortgage debt and exercise the mortgagor's right to redeem the slave.

§ 9-507. Secured Party's Liability for Failure to Comply With This Part. (1) If it is established that the secured party is not proceeding in accordance with the provisions of this Part disposition may be ordered or restrained on appropriate terms and conditions. If the disposition has occurred the debtor or any person entitled to notification or whose security interest has been made known to the secured party prior to the disposition has a right to recover from the secured party any loss caused by a failure to comply with the provisions of this Part. If the collateral is consumer goods, the debtor has a right to recover in any event an amount not less than the credit service charge plus ten per cent of the principal amount of the debt or the time price difference plus ten per cent of the cash price.

(2) The fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the secured party is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. If the secured party either sells the collateral in the usual manner in any recognized market therefor or if he sells at the price current in such market at the time of his sale or if he has otherwise sold in conformity with reasonable commercial practices among dealers in the type of property sold he has sold in a commercially reasonable manner. The principles stated in the two preceding sentences with respect to sales also apply as may be appropriate to other types of disposition. A disposition which has been approved in any judicial proceeding or by any bona fide creditors' committee or representative of creditors shall conclusively be deemed to be commercially reasonable, but this sentence does not indicate that any such approval must be obtained in any case nor does it indicate that any disposition not so approved is not commercially reasonable.

COMMENT: **Prior Uniform Statutory Provision:** None.

Purposes: 1. The principal limitation on the secured party's right to dispose of collateral is the requirement that he proceed in good faith (§ 1-203) and in a commercially reasonable manner. See § 9-504. In the case where he proceeds, or is about to proceed, in a contrary manner, it is vital both to the debtor and other creditors to provide a remedy for the failure to comply with the statutory duty. This remedy will be of particular importance when it is applied prospectively before the unreasonable disposition has been concluded. This Section therefore provides that a secured party proposing to dispose of collateral in an unreasonable manner, may, by court order, be restrained from doing so, and such an order might appropriately provide either that he proceed with the sale or other disposition under specified terms and conditions, or that the sale be made by a representative of creditors where insolvency proceedings have been instituted. The Section further provides for damages where the unreasonable disposition has been concluded, and, in the case of consumer goods, states a minimum recovery.

A case may be put in which the liquidation value of an insolvent estate would be enhanced by disposing of all the debtor's property (including that subject to a security interest) in the liquidation proceeding and in which, if a secured party repossesses and sells that part of the property which he holds as collateral, the remainder will have little or no resale value. In such a case the question may arise whether a particular court has the power to control the manner of disposition, although reasonable in other respects, in order to preserve the estate for the benefit of creditors. Such a power is no doubt inherent in a Federal bankruptcy court, and perhaps also in other courts of equity administering insolvent estates. Traditionally it has not been exercised where the secured party claimed under a title retention device, such as conditional sale or trust receipt. See In re Lake's Laundry, Inc., 79 F.2d 326 (2d Cir. 1935) and the remarks of Clark, J., concurring, in In re White Plains Ice Service, Inc., 109 F.2d 913 (2d Cir. 1940). But since this Article adopts neither a "title" nor a "lien" theory of security interests (see § 9-202 and Comment thereto), the granting or denying of, for example, petitions of reclamation in bankruptcy proceedings should not be influenced by speculations as to whether the secured party had "title" to the collateral or "merely a lien".

2. In view of the remedies provided the debtor and other creditors in subsection (1) when a secured party does not dispose of collateral in a commercially reasonable manner, it is of great importance to make clear what types of disposition are to be considered commercially reasonable, and in an appropriate case to give the secured party means of getting, by court order or negotiation with a creditors' committee or a representative of creditors, approval of a proposed method of disposition as a commercially reasonable one. Subsection (2) states rules to assist in the determination, and provides for such advance approval in appropriate situations. One recognized method of disposing of repossessed collateral is for the secured party to sell the collateral to or through a dealer—a method which in the long run may realize better average returns since the secured party does not usually maintain his own facilities for making such sales. Such a method of sale, fairly conducted, is recognized as commercially reasonable under the second sentence of subsection (2). However, none of the specific methods of disposition set forth in subsection (2) is to be regarded as either required or exclusive, provided only that the disposition made or about to be made by the secured party is commercially reasonable.

Cross References:

Point 1: §§ 1-203, 9-202 and 9-504.

Definitional Cross References:

"Collateral". § 9-105.
"Consumer goods". § 9-109.
"Creditor". § 1-201.
"Debtor". § 9-105.
"Knows". § 1-201.
"Notification". § 1-201.
"Person". § 1-201.
"Representative". § 1-201.
"Rights". § 1-201.
"Secured party". § 9-105.
"Security interest". § 1-201.

Prior Statutes: None.

Comment: For discussion of secured party's liability under Virginia law see VIRGINIA ANNOTATIONS to UCC 9-501. The UCC does not cover the point decided in Jones v. Morris Plan Bank of Portsmouth, 168 Va. 284, 290-93, 191 S.E. 608 (1937), in which the creditor sued and obtained judgment for only two past due installments on notes given for the purchase of an automobile under a conditional sales contract, although because of an acceleration clause the entire amount was due. When the creditor sought to collect another installment he was met with a plea of res judicata, and took a nonsuit. The creditor later obtained possession of the car without the debtor's consent. In a suit by the debtor for conversion, the creditor was held liable on the ground that he could not split the cause of action, and having sued for two installments he was barred from suing again, and the title to the car had passed to the debtor.

ARTICLE 10

EFFECTIVE DATE—TRANSITIONAL PROVISIONS

§ 10-101. Effective Date. This Act shall become effective at midnight on January one, nineteen hundred sixty-six. It applies to transactions entered into and events occurring after that date.

COMMENT: This effective date is suggested so that there may be ample time for all those who will be affected by the provisions of the Code to become familiar with them.

VIRGINIA ANNOTATIONS

Comment: Making the Code effective January 1, 1966 will coincide with a calendar year and in many cases with a business fiscal year; it will also have several other beneficial results: Everyone will have had opportunity to become familiar with the Code. Attorneys and others who will use the Code will be forced to an examination of it in November and December of 1965. If imperfections are found, the General Assembly of 1966 will be at hand to correct them.

§ 10-102. Provision for Transition. Transactions validly entered into before the effective date specified in § 10-101 and the rights, duties and interests flowing from them remain valid thereafter and may be terminated, completed, consummated or enforced as required or permitted by any statute or other law amended or repealed by this Act as though such repeal or amendment had not occurred.

COMMENT: Subsection (1) provides for the repeal of present uniform and other acts superseded by this Act. Subsection (2) provides for the transition to the Code.

VIRGINIA ANNOTATIONS

Comment: In accordance with Virginia practice the sections repealed are set forth in a separate repeal clause, which is not a part of the text of the Code.

§ 10-103. General Repealer. Except as provided in the following section, all acts and parts of acts inconsistent with this Act are hereby repealed.

COMMENT: This section provides for the repeal of all other legislation inconsistent with this Act.

§ 10-104. Laws Not Repealed. (1) The Article on Documents of Title (Article 7) does not repeal or modify any laws prescribing the form or contents of documents of title or the services or facilities to be afforded by bailees, or otherwise regulating bailees' businesses in respects not specifically dealt with herein; but the fact that such laws are violated does not affect the status of a document of title which otherwise complies with the definition of a document of title (§ 1-201).

(2) This Act does not repeal §§ 13.1-424 through 13.1-443 of the Code of Virginia, cited as the Uniform Act for the Simplification of Fiduciary Security Transfers, and if in any respect there is any inconsistency between that Act and the Article of this Act on investment securities (Article 8) the provisions of §§ 13.1-424 through 13.1-443 shall control.

COMMENT: This section subordinates the Article of this Act on Documents of Title (Article 7) to the more specialized regulations of particular classes of bailees under other legislation and international treaties. Particularly, the provisions of that Article are superseded by applicable inconsistent provisions regarding the obligation of carriers and the limitation of their liability found in federal legislation dealing with transportation by water (including the Harter Act, Act of February 13, 1893, 27 Stat. 445, and the Carriage of Goods by Sea Act, Act of April 16, 1936, 49 Stat. 1207); the Warsaw Convention on International Air Transportation, 49 Stat. 3000, and § 20(11) of the Interstate Commerce Act, Act of February 20, 1887, 24 Stat. 386, as amended. The Documents of Title provisions of this Act supplement such legislation largely in matters other than obligation of the bailee, e. g., form and effects of negotiation, procedure in the case of lost documents, effect of overissue, possibility of rapid transmission.

Cross Reference:

§ 7-103.

VIRGINIA ANNOTATIONS

Comment: Virginia has adopted the Uniform Act for the Simplification of Fiduciary Transfers, to which Article 8 is subjected by the section.

Be it further enacted by the General Assembly of Virginia:

2. That §§ 6-341, 8-13, 8-94, 8-114 as amended, 8-223, 8-517 as amended, and 8-593 of the Code of Virginia, be amended and reenacted as follows:

§ 6-341. In any suit for a sum of money expressed in any foreign currency or otherwise than in the money of account of this State, the jury, if there be one impaneled for any other purpose, and if not, the court, shall ascertain the value in the money of account of the sum so expressed, making such allowance for the difference of exchange as shall be just; and the judgment or decree may either be for what may be so ascertained, or for the sum of money expressed as aforesaid to be discharged by the sum so ascertained; *provided, that as to any such suit involving an instrument to which § 3-107 of the Uniform Commercial Code is applicable, the provisions of that section shall apply.*

§ 8-13. Every action to recover money which is founded upon an award, or on any contract, other than a judgment or recognizance, shall be brought within the following number of years next after the right to bring the same shall have first accrued, that is to say:

If the case be upon any contract by writing under seal, whether made by a public officer, a fiduciary or private person within ten years;

If it be upon an award or upon a contract in writing signed by the party to be charged thereby, or by his agent, but not under seal, within five years; and

If it be upon any other contract express or implied within three years, unless it be an action by one partner against his co-partner for a settlement of the partnership account, or upon accounts concerning the trade of merchandise between merchant and merchant, their factors, or servants, in either of which cases the action may be brought until the expiration of five years from the cessation of the dealings in which they are interested together, but not after;

Provided that the right of action against the estate of any person hereafter dying, or upon any such award or contract, which shall have accrued at the time of his death, or the right to prove any such claim against his estate in any suit or proceeding, shall not in any case continue longer than five years from the qualification of his personal representative, or if the right of action shall not have accrued at the time of the decedent's death,

it shall not continue longer than five years after the same shall have so accrued; and

Provided further that the limitation to an action or other proceeding for money on deposit with a bank or any person or corporation doing a banking business shall not begin to run until a request in writing be made therefor, by check, order, or otherwise.

And provided further, that as to any action to which § 2-275 of the Uniform Commercial Code is applicable, the provisions of that section shall be controlling.

§ 8-94. The assignee or beneficial owner of any bond, note, writing or other chose in action, not negotiable *and not covered by the provisions of § 3-805 of the Uniform Commercial Code,* may maintain thereon in his own name any action which the original obligee, payee, or contracting party might have brought, but shall allow all just discounts, not only against himself, but against such obligee, payee, or contracting party, before the defendant had notice of the assignment or transfer by such obligee, payee, or contracting party, and shall also allow all such discounts against any intermediate assignor or transferrer, the right to which was acquired on the faith of the assignment or transfer to him and before the defendant had notice of the assignment or transfer by such assignor or transferrer to another.

§ 8-114. *Except as otherwise provided by § 3-307 of the Uniform Commercial Code,* when any pleading alleges that any person made, indorsed, assigned, or accepted any writing, no proof of the handwriting shall be required, unless it be denied by an affidavit accompanying the plea putting it in issue.

§ 8-223. *Except as otherwise provided in § 3-122 of the Uniform Commercial Code,* in any action whether on contract or for tort, the jury may allow interest on the sum found by the verdict, or any part thereof, and fix the period at which the interest shall commence. If a verdict be rendered which does not allow interest, the sum thereby found shall bear interest from its date, and judgment shall be entered accordingly. In any suit in equity, or in an action or motion founded on contract, when no jury is impaneled, decree or judgment may be rendered for interest on the principal sum recovered, until such decree or judgment be paid; and when there is a jury, which allows interest, the judgment shall, in like manner, be for such interest until payment.

§ 8-517. A civil action may be maintained on any past due lost bond, note, or other written evidence of debt, and if judgment be rendered for the plaintiff, there shall be entered as a part of the judgment that the plaintiff is not to have the benefit thereof, nor be allowed to enforce it by execution or otherwise, unless and until he shall have first entered into bond before the court or the clerk therein in such penalty as is prescribed in the order awarding the judgment, and with condition to indemnify and save harmless the defendant or defendants from all loss or damage he or they may sustain or incur by reason of having to pay in whole or in part such past due lost bond, note, or other written evidence of debt to some other person than the plaintiff. The indemnifying bond hereinbefore required shall be payable to the defendant or defendants, and shall be filed in the clerk's office of the court in which the judgment is rendered.

In the event of any inconsistency between this section and any applicable provisions of § 3-804 of the Uniform Commercial Code, the provisions of that section shall control.

§ 8-593. When final judgment is rendered on the trial of such action or warrant, the court or * *judge* shall dispose of the property or proceeds according to the rights of those entitled; and when in any such action or warrant the plaintiff shall prevail under a contract which, regardless of its form or express terms, was in fact made to secure the payment of money to the plaintiff or his assignor, judgment shall be for the recovery of the amount due the plaintiff thereunder, or else the specific property, and costs, and the defendant shall have the election of paying the amount of such judgment or surrendering the specific property. And the court or * *judge* may grant the defendant a reasonable time not exceeding thirty days, within which to discharge such judgment upon such security being given as the court or * *judge* may deem sufficient.

In the event of any inconsistency between this section and any applicable provisions of Article 9 of the Uniform Commercial Code, the provisions of that Article shall control.

Be it further enacted by the General Assembly of Virginia:

3. That §§ 6-63; 6-71 through 6-75; 6-353 through 6-421; 6-423 through 6-426; 6-426.1; 6-427 through 6-543; 6-543.1 through 6-543.3; 6-544 through 6-549; 6-550 through 6-558; 8-654.3; 11-5 through 11-7; 13.1-401 through 13.1-423; 43-27; 43-28; 43-44 through 43-61; 55-83 through 55-86; 55-88 through 55-94; 55-98; 55-99; 55-143 through 55-151; 56-120; 56-121; 56-126; 56-127; 61-1 through 61-52, of the Code of Virginia and all amendments thereof, are hereby repealed.

APPENDIX III

STATES WHICH HAVE ADOPTED THE UNIFORM COMMERCIAL CODE

State	*Adoption Date*	*Effective Date*
Pennsylvania	1953	Original version—July 1, 1954
Pennsylvania	1959	1958 Official Text—January 1, 1960
Massachusetts	1957	October 1, 1958
Kentucky	1958	July 1, 1960
Connecticut	1959	October 1, 1961
New Hampshire	1959	July 1, 1961
Rhode Island	1960	January 2, 1962
Wyoming	1961	January 1, 1962
Arkansas	1961	January 1, 1962
New Mexico	1961	January 1, 1962
Ohio	1961	July 1, 1962
Oregon	1961	September 1, 1963
Oklahoma	1961	December 1, 1962
Illinois	1961	July 2, 1962
New Jersey	1961	January 1, 1963
Georgia	1962	January 1, 1964
Alaska	1962	December 31, 1962
New York	1962	September 30, 1964
Michigan	1962	January 1, 1964
Indiana	1963	July 1, 1964
Tennessee	1963	July 1, 1964
West Virginia	1963	July 1, 1964
Montana	1963	January 1, 1965
Maryland	1963	February 1, 1964
California	1963	January 1, 1965
Wisconsin	1963	July 1, 1965
Maine	1963	January 1, 1965
Nebraska	1963	March 1, 1965
Missouri	1963	July 1, 1965

APPENDIX IV

A BILL to amend and reenact § 2-232, as amended, of the Code of Virginia, relating to the printing and distribution of Acts of Assembly.

Be it enacted by the General Assembly of Virginia:

1. That § 2-232, as amended, of the Code of Virginia, be amended and reenacted as follows:

§ 2-232. The * *Director* shall cause to be printed, as soon as approved by the Governor, * *not in excess of five* thousand copies of the acts and joint resolutions of the General Assembly. *The Act of Assembly enacting for Virginia the Uniform Commercial Code and making consequential changes in other statutes shall be printed and bound as a single volume separate from the other Acts of Assembly of nineteen hundred sixty-four, but the provisions of this section except as to the maximum number which may be printed shall otherwise apply thereto.* As printing progresses a sufficient number, approximately nine hundred copies, shall be stapled in sections of approximately two hundred pages each for distribution as advance sheets of the Acts of Assembly and shall be distributed promptly as follows:

Two copies to each member of the General Assembly;

Five copies to the clerk of each house;

One copy to each head of a department;

Six copies to the Division of Statutory Research and Drafting;

Six copies to the Attorney General;

One copy to each judge of a county or municipal court, and one copy to each judge, attorney for the Commonwealth, clerk of a court of record of this State, and clerk of the council of a city in this State; and

Five copies to the State Corporation Commission.

The remainder he shall have bound in ordinary half binding, with the index and tables required by law to be printed with the acts and joint resolutions of the General Assembly, and as soon as practicable after the close of each session of the General Assembly, shall deliver:

One copy to the Governor;

One copy to each head of department; and

Ten copies for the use of the Division of Statutory Research and Drafting plus the number required for exchange with other states;

And he shall forward by mail, express, or otherwise:

Five copies to each member of the General Assembly;

Two copies to each judge;

Five copies to the State Corporation Commission;

Six copies to the Attorney General;

One copy to each mayor, clerk of any court, attorney for the Commonwealth, sheriff, sergeant, treasurer, commissioner of the revenue, judge of a county or a municipal court, board of supervisors and school board, the Reporter of the Supreme Court of Appeals, the library of each educational institution in this State that maintains a library, each public library, each judge and clerk of any court held in this State under the laws of the United States and each attorney and marshal in this State holding office under the United States;

Five copies to the State Library;

Five copies to the State Law Library;

One copy to each university and college in this State;

One copy to each member of the State Hospital Board;

One copy to the School for the Deaf and the Blind;

Ten copies to the Clerk of the Senate for the use of the Senate;

Fifteen copies to the Clerk of the House of Delegates for the use of the House; *and*

Three copies to the Auditor of Public Accounts.

(VALC Note: This section was amended twice in 1958. This bill embodies the provisions of both amendments. The italicized words in the first two and last two lines, accordingly, do not represent a change in existing law.)