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Juan Javier
del Granado

Universidad Nacional Autónoma de México
Instituto de Investigaciones Jurídicas

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Juan Javier del Granado

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ÍNDICE

INTRODUCCIÓN ……………………………………..3

I. Artículo 1 sobre los principios generales 5
A. LA APLICACIÓN SUPLETORIA DEL COMMON LAW Y DE LA EQUITY...5
B. LA BUENA FE...9
II. Artículo 2 sobre la compraventa 25
A. SU APLICACIÓN EN NEGOCIOS JURÍDICOS MIXTOS..................25
EL ELEMENTO PREDOMINANTE DEL NEGOCIO..................25
B. EL PERFECCIONAMIENTO DE LOS CONTRATOS..................51
C. LA DOCTRINA DE LA CAUSA EN LOS CONTRATOS TÍPICOS NOMINADOS..................51
D. EL REQUISITO FORMAL DE UNA ESCRITURA EN EL NEGOCIO COMERCIAL..................69
E. LA OFERTA Y LA ACCEPTACIÓN..................88
F. LA INTERPRETACIÓN CONTRACTUAL..................124
G. LOS USOS COMERCIALES..................124
H. EL PAROLE EVIDENCE RULE SE AFLOJA..................124
I. LAS ESTIPULACIONES CONTRACTUALES..................146
J. EL RIESGO DE PÉRDIDA..................162
K. LAS GARANTÍAS EN EL NEGOCIO COMERCIAL..................169
L. EL CUMPLIMIENTO DEL CONTRATO COMERCIAL..................298
III. Artículo 2A sobre el arrendamiento.................... 326
A. EL CASO INSÓLITO DEL ARRENDAMIENTO FINANCIERO.......326
IV. Artículo 3 sobre las obligaciones negociables..... 353
A. LOS REQUISITOS FORMALES DE LA NEGOCIABILIDAD Y EL TENEDOR DE BUENA FE..................353
V. Artículo 4 sobre depósitos bancarios 372
A. LA LEGISLACIÓN COMERCIAL VIGENTE Y EL CONTRATO CELEBRADO ENTRE EL DEUDOR Y EL ACREEDOR..................372
VI. Artículo 4A sobre la trasferencia de fondos 383
A. LA TRANSFERENCIA ELECTRÓNICA DE FONDOS..................383
B. LA OPERACIÓN ELECTRÓNICA CON TARJETA DE CRÉDITO..395
VII. Artículo 9 sobre la prenda mobiliaria 416
A. LA CONSTITUCIÓN Y LA PERFECCIÓN DE LA PRENDA............416
B. LA PRIORIDAD EN EL PAGO A LOS ACREEDORES PRIVILEGIADOS..................426
TABLA DE LOS CASOS 503

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INTRODUCCIÓN

El presente libro nace del trabajo conjunto de dos profesores de derecho privado que, en los últimos años, se han dedicado a enseñar, en Estados Unidos y en México —en la maestría de Derecho Estadounidense impartido conjuntamente por el Instituto de Investigaciones Jurídicas de la UNAM y el Ilustre y Nacional Colegio de Abogados de México—, la materia de Derecho Comercial.

El propósito del libro es muy preciso: contar con un número relevante de fallos de los tribunales de Estados Unidos, debidamente seleccionados, que permita a los profesores explicar la materia y a los alumnos acceder a un material que no es fácil de conseguir en México.

Algunas precisiones son necesarias:

- Todos los casos han sido tomados de las fuentes directas tal como se publican en EE. UU. No hay, por tanto, una uniformidad en la forma cómo son transcritos los fallos porque las publicaciones originales no son uniformes. No se olvide que la materia de Derecho Coimercial en EE. UU., al igual que en México, es una materia que depende de la codificación local del Código Comercial Uniforme y jurisprudencia de cada Estado de la Unión Americana.
- El material ha sido ordenado siguiendo lo que suelen ser los manuales con los que se enseña esta materia en Estados Unidos (los llamados *case books*). En ellos se suelen colocar casos de jurisprudencia que implementan las normas de los artículos (en nuestro lenguaje jurídico, los llamaríamos libros) del Código Comercial Uniforme.
- El Código Comercial Uniforme es un trasplante jurídico del *Bürgerliches Gesetzbuch* alemán, cuyo redactor principal, Karl Llewellyn, logró que se

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adopte en casi todo el territorio estadounidense, con la única excepción del Estado de Louisiana.

- Para lograr la aceptación del proyecto entre los abogados, jueces y juristas estadounidenses, Llewellyn esgrimió la argucia de querer hacer más uniforme el Derecho Comercial a lo ancho y largo del país del Norte. En realidad, lo que se buscaba este jurista era modernizar dicho ordenamiento. En el régimen de obligaciones del *common law*, toda contratación era atípica, por la ingerencia directa de la acción de *causa fidei laesionis seu perjurii* del derecho canónico en el *writ of assumpsit*.
- Louisiana ya poseía la figura de los contratos típicos nominados por la vigencia del derecho civil en dicha jurisdicción, a través del *Code civil* luisiano.
- La arquitectura jurídica del Código Comercial Uniforme no trasplanta las figuras del derecho civil de manera ramplona al ordenamiento estadounidense, sino los recrea a partir de los lineamientos jurídicos propios del common law.
- Dicha codificacón se asienta como una *lex specialis* sobre la lex generlis no codificada del *common law* y la *equity*.
- El Artículo 1 es la parte general o *Allgemeiner Teil* del Código Comercial Uniforme; los Artículos 2, 2A, y 9 introducen en el ordenamiento privado estadounidense las formas contractuales típicas nominadas de la compraventa, el arrendemiento y la prenda, respectivamente.
- En Estados Unidos, ha quedado poco del *common law* en el ordenamiento privado de las jurisdicciones de cada estado de la Unión, pasando gran parte de las materias del derecho privado al terreno del Derecho Comercial en ese país.

El autor

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Artículo 1 sobre los principios generales

A. LA APLICACIÓN SUPLETORIA DEL COMMON LAW Y DE LA EQUITY

THE FRENCH LUMBER CO., INC. & others, v. COMMERCIAL REALTY & FINANCE CO., INC. & another SUPREME JUDICIAL COURT OF MASSACHUSETTS 346 Mass. 716; 2 U. C. C. Rep. Serv. 3 December 3, 1963, Argued January 15, 1964, Decided

OPINION BY: SPALDING [*716] [**508] This bill in equity seeks to determine the ownership of certain funds derived from the sale of an automobile at a public auction.

The judge made findings of the material facts. The findings and evidence establish these facts: On February 9, 1959, The French Lumber Co., Inc. (French), purchased a 1959 Cadillac automobile and financed this purchase through the Ware Trust Company (Ware). French received $4,600 [*717] which together with a finance charge of $460 resulted in a total indebtedness by it to Ware in the amount of $5,060 which was to be repaid in twenty-three successive monthly instalments of $207 each."French entered into a Uniform Commercial Code security agreement as security for its note," and this agreement was duly recorded.

On July 10, 1959, French pledged its existing equity in the Cadillac to the defendant Commercial Realty and Finance Co., Inc. (Commercial), as collateral security for funds advanced by Commercial. Commercial's security interest was duly recorded. The note to Commercial was in the sum of $8,040 and was payable in sixty monthly instalments of $134. In addition to the equity in the Cadillac this note was secured by a real estate mortgage, a chattel mortgage and assignments of life insurance. The

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note was signed by French, Arthur T. Winters and Charles W. Proctor.

French failed to make payments under its agreement with Ware and in the latter part of July, 1959, Ware turned over the French chattel mortgage and note to its attorney, Mr. Schlosstein, for the purpose of foreclosure. Arrangements to refinance the mortgage having come to naught, Mr. Schlosstein ordered repossession of the Cadillac on August 15, 1959. In September, 1959, Winters and Proctor on behalf of French conferred with Associates Discount Corporation (Associates) about refinancing the Cadillac then in Ware's possession. As a result of these negotiations Winters and Proctor entered into a security agreement with Associates, which was duly recorded, covering the refinancing [**509] of the Cadillac for the total amount of $5,022. Upon receiving a note in this amount signed by Winters and Proctor, Associates issued its check in the sum of $4,256 payable to Ware, Winters, and Proctor. This check was turned over by Winters to Mr. Schlosstein on September 4, 1959, and he made a notation on the French note that it was paid in full. Subsequently the Ware security agreement and discharge were sent to Associates. On the check given by Associates was a notation over the indorsements of Winters, Proctor, and Ware that it was in payment in full for the Cadillac.

[*718] On August 30, 1960, Associates repossessed the Cadillac because of defaults in payments. A public auction followed and the present controversy has to do with the ownership of the proceeds ($3,200) of the foreclosure sale. Commercial asserts that it is entitled to the proceeds. Associates asserts that it is subrogated to the rights of Ware and is therefore entitled to the proceeds. After finding the foregoing facts the judge concluded: "There was nothing to indicate that French, Winters or Proctor ever informed Associates that Commercial held any security interest in the

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Cadillac over and above the interest held by [Ware] I infer from the evidence that Associates had no knowledge of this situation. It is incredible that Associates would not have taken appropriate protective steps by way of an assignment from the bank. If the assumption is made that Associates was negligent in failing to check the records, this negligent act will not necessarily bar Associates from obtaining the relief it seeks through subrogation. Such negligence was as to its own interests and did not affect prejudically the interests of Commercial. There has been no change of position by Commercial. It is left exactly in the position it originally was in. It had a claim known by it to be subordinated to [Ware] . [Ware] was paid by Associates. If Associates had taken an assignment from [Ware], Commercial would have had no cause for complaint."

The judge ordered the entry of a decree declaring that Associates is entitled to the $3,200 arising from the proceeds of the auction sale. From a decree accordingly Commercial appealed.

Commercial seeks to establish rights in the proceeds prior to the rights of Associates. That part of the Uniform Commercial Code (*G. L. c. 106, § 9-312 [5] [a]*), here pertinent, provides that the order of filing determines the order of priorities among conflicting interests in the same collateral. Under this provision the order of priorities would be: Ware, Commercial, and Associates. This establishes Commercial's priority over Associates unless Associates can establish a right to succeed to Ware's priority.

[*719] A security interest can be "assigned" to another creditor without loss of its priority even if no filing is made. G. *L. c. 106, § 9-302 (2)*. Thus Ware could have made an assignment of its security interest to Associates, and Associates would then have acquired Ware's priority over Commercial. But no such assignment was made.

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Associates could also acquire Ware's priority through the doctrine of subrogation. For cases analogous to the present where this doctrine has been applied, see *Hill v. Wiley, 295 Mass. 396*; *Worcester No. Sav. Inst. v. Farwell, 292 Mass. 568*; *Home Owners' Loan Corp. v. Baker, 299 Mass. 158*.

In *Home Owners' Loan Corp. v. Baker, supra,* where the doctrine of subrogation was discussed, it was said at pages 161-162, "The plaintiff, having paid the debts of the defendant out of its funds and taken its mortgage in the mistaken belief that it would have a first lien on the premises, was not officious. In such circumstances equity has given relief by way of subrogation when the interest of intervening [**510] lienors were not prejudicially affected."

The trial judge, having found that the conduct of Associates did not prejudice Commercial or cause it to change its position, was of opinion that the principle of the cases cited above was applicable and accorded Associates priority over Commercial. Commercial argues that Associates has elected to stand on its own later security interest and should have no rights to Ware's interest. We are of opinion that this argument lacks merit. Associates was seeking to collect its own claim. This was not inconsistent with its present claim for subrogation to Ware's rights.

The decisions on subrogation discussed above are not superseded by the Uniform Commercial Code. Section 1-103 of the Code provides in part, "Unless displaced by the particular provisions of this chapter, the principles of law and equity shall supplement its provisions." No provision of the Code purports to affect the fundamental equitable doctrine of subrogation.

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Commercial argues that even if Associates is entitled to subrogation its rights can rise no higher than Ware's. [*720] This, of course, is true. H*ome Owners' Loan Corp. v. Baker, 299 Mass. 158, 162*. The facts establish that Ware received $4,256 from Associates in payment of the balance due on French's debt to Ware. They also show that Associates received $1,297.50 in payments by French on its debt to Associates. Commercial argues that the $1,297.50 in payments made to Associates by French should be allocated as payment on the $4,256 balance owed to Ware at the time Associates paid off the debt to Ware. This could limit Associates' subrogation rights to $2,958.50. We do not agree. Associates had a right to enforce its own claim without displacing its right to subrogation to Ware's security. Associates is entitled to be subrogated to the full $3,200 of the proceeds.

Contrary to the contention of Commercial, the failure of French to disclose to Associates the existence of Commercial's security interest would have no effect on Associates' rights to subrogation.

The decrees are affirmed with costs of appeal.

So ordered.

¿Este caso supone un ejemplo en el derecho privado de Estados Unidos de la aplicación del principio *lex generalis derogat lex specialis*?

B. LA BUENA FE

LA SARA GRAIN COMPANY, et al., Petitioners v. FIRST NATIONAL BANK OF MERCEDES, TEXAS, Respondent SUPREME COURT OF TEXAS 673 S. W.2d 558; 38 U. C. C. Rep. Serv. 963 May 23, 1984, Decided

OPINION BY: SPEARS [*561] This action concerns a bank's liability for honoring checks with fewer than the

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required number of signatures, failing to follow a restrictive endorsement, and other alleged wrongful acts and deceptive trade practices which allowed an employee to embezzle funds from his employer. After a non-jury trial, the district court rendered judgment against the bank for $911,329.66; that figure included actual damages, additional damages under the Deceptive Trade Practices Act (DTPA), interest, and attorney's fees. The court of appeals reversed the judgment of the trial court and rendered judgment that plaintiff La Sara take nothing.*646 S. W.2d 246*. We affirm that portion of the judgment of the court of appeals that removed the award of DTPA additional damages. We reverse the judgment of the court of appeals in all other regards, and affirm the trial court judgment for actual damages. We remand the cause for the consideration of a factual insufficiency point and for the recalculation of prejudgment interest.

La [**2] Sara Grain Company, a corporation, hired Harold Jones as general manager and opened a checking account with First National Bank of Mercedes in 1975. La Sara filed with the bank a corporate resolution naming the four officers of the corporation as authorized signatories and providing that any two of them could sign checks for the corporation. Jones was one of the officers named in this resolution. The bank also provided La Sara with a signature card; however, during its circulation among the four officers, the card was altered to require only one signature rather than two. From the spring of 1975 to the fall of 1978, the bank honored checks drawn on La Sara's account bearing the signature of only one officer, ordinarily Jones, the officer in charge of La Sara's day-to-day affairs. During this period, La Sara received monthly statements of its account with the bank.

In the fall of 1978, La Sara fired Jones. An audit subsequently revealed that Jones had embezzled over

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$300,000. In July of 1979, La Sara filed suit against Jones to recover the amounts embezzled. La Sara thereafter amended its petition to join as defendants Fidelity & Deposit Company of Maryland and the First National [**3] Bank of Mercedes. Prior to trial, La Sara settled its claims against Jones and Fidelity. Jones agreed to make restitution; Fidelity paid $90,000 to settle La Sara's claim on a fidelity bond and then intervened in La Sara's suit against the bank, claiming a right to subrogation.[1]

1 Although La Sara and Fidelity have filed separate applications for writ of error their arguments are the same and will hereafter be attributed only to La Sara.

I. Application of TEX. UCC § 4.406(d)

La Sara's primary complaint at trial was that the bank had breached the depository contract by paying checks signed only by Jones without the second signature required by the corporate resolution. The bank denied liability. The basis of the bank's defense was that it had sent La Sara monthly statements accompanied by all checks paid, but that La Sara had failed to examine the statements and report the unauthorized signature within the one-year period prescribed by *section 4.406(d)*. T*ex. Bus. & Com. Code Ann. § 4.406(d)* (Tex. [**4] UCC) (Vernon 1968).

Section 4.406 places a duty upon the depositor to promptly examine his bank statement and report to the bank the discovery of any "unauthorized signature or any alteration." [2] *Id. § 4.406(a)*. If the depositor [*562] fails to comply with this duty, the bank is protected from loss so long as it has exercised ordinary care and paid the item in good faith. I*d. § 4.406(b)*, *(c)*. If a depositor does not report an unauthorized signature within one year from the time the statement and items are made available to him, the bank's care or lack thereof becomes irrelevant, *id. § 4.406(d)*; at

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that point, the customer's only claim is that the item was not paid in good faith. I*d. § 4.406(d)*.

2*Tex. Bus. & Com. Code Ann. section 4.406* provides:

§ 4.406. Customer's Duty to Discover and Report Unauthorized Signature or Alteration

(a) 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 instruction 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.

(b) If the bank establishes that the customer failed with respect to an item to comply with the duties imposed on the customer by Subsection (a) the customer is precluded from asserting against the bank

(1) 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

(2) 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.

(c) The preclusion under Subsection (b) does not apply if the customer establishes lack of ordinary care on the part of the bank in paying the item(s).

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(d) 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 statement and items are made available to the customer (Subsection (a)) 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] *A. La Sara's Checks*

The courts below interpreted the term "unauthorized signature" differently and therefore disagreed on the application of *section 4.406*. The trial court rejected the bank's defense under *section 4.406*. It found that, because Jones's signature was one of four authorized in La Sara's corporate resolution, the checks were not paid on an "unauthorized" signature. The court of appeals, on the other hand, concluded that the bank was entitled to rely on *section 4.406*, saying "when a bank honors a check or withdrawal on less that the required number of signatures, the signature is an unauthorized signature within the meaning of 4.406(d)." *646 S. W.2d at 252*.

The initial issue is whether the checks drawn on La Sara's account were paid on unauthorized signatures. La Sara contends that, because no signatures were forged and the signature of Jones was authorized, *section 4.406(d)* does not protect the bank. We do not agree.

An unauthorized signature includes more than just a forgery. P*ine Bluff National Bank v. Kesterson, 257 Ark. 813, 520 S. W.2d 253, 258 (1975)*. An unauthorized signature is defined as "one made without actual, implied or apparent authority [**6] and includes a forgery", *Tex. Bus. & Com. Code Ann. § 1.201(43)* (Tex. UCC) (Vernon 1968), and includes a signature made by an agent in excess

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of his authority. I*d.* *§ 3.404*, comment 1. La Sara's argument that *section 4.406* does not apply focuses on Jones's signature rather than that of La Sara, the bank's customer. La Sara's signature required the joint signatures of two officers. Although Jones was one of four authorized to sign, his signature alone was not La Sara's. When the bank paid the checks bearing only one of two required signatures, it paid on an unauthorized signature within the meaning of *section 4.406(d)*.

La Sara also argues that the checks were not paid in good faith. If so, the bank cannot claim the protection of *section 4.406*. The time limits of that section apply only to items paid in good faith. I*d.*, [*563] *§ 4.406(a)*. Moreover, an obligation of good faith is imposed on the performance of every contract or duty within the Code. I*d.* *§ 1.203*. Good faith is defined as "honesty in fact in the conduct or transaction concerned." *Id.* *§ 1.201(19)*. The test for good faith is the actual belief of the party in question, not the reasonableness [**7] of that belief. R*iley v. First State Bank, 469 S. W.2d 812* (Tex. Civ. App. -- Amarillo 1971, writ ref'd n. R. E.).

La Sara contends that the bank actually knew Jones's signature alone was insufficient, yet paid the checks anyway, and therefore did not exercise good faith. The trial court agreed, finding that the bank had actual knowledge of the unauthorized change of the signature card from a dual to a single-signature requirement. The court of appeals, however, held that there was no evidence to support this finding. At trial, the evidence showed that La Sara's corporate resolution, which the bank required, was in the bank's files; the corporate resolution specified that two signatures were necessary. The bank president testified that the bank would know of anything that was in the files. The bank,a corporation, is bound by the knowledge of one of its agents if that knowledge came to him in the course of the

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agent's employment. *City of Fort Worth v. Pippen, 439 S. W.2d 660 (Tex. 1969)*; *Wellington Oil Co. of Delaware v. Maffi, 136 Tex. 201, 150 S. W.2d 60 (1941)*. The bank does not contend that the corporate resolution was filed outside the normal course of business. [**8] Moreover, the checks were paid pursuant to an obviously altered signature card, and many were deposited into Jones's personal account. The trial court found that, under these facts, the bank knew that Jones's signature alone was not the authorized signature of La Sara. There is evidence supporting that finding. La Sara is entitled to recover for the checks paid on Jones's signature alone, less a credit for the funds from which La Sara benefited.[3]

3 The trial court made this calculation in its judgment for actual damages. The bank has not contended that the trial court's figures were inaccurate.

B. La Sara's other claims

In addition to the unauthorized payment of its checks, La Sara complains that the bank failed to follow a restrictive endorsement, allowed Jones to orally transfer money from its account, and paid Jones the proceeds of loans made in La Sara's name. These complaints concern four separate transactions:

1. On July 15, 1977, the Holland Farms check made payable to La Sara and [**9] endorsed "For Deposit Only" was split with $40,000 deposited to Jones's personal account and $22,600 deposited to La Sara's account.

2. On May 12, 1977, the bank transferred $14,000 from La Sara's account to Jones's personal account at Jones's oral request.

3. On June 8, 1976, a $19,506 loan was made to La Sara at Jones's request. Proceeds of the loan were used by

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Jones to purchase a cashier's check payable to the McCrabb Brothers.

4. On July 22, 1977, a $35,000 loan was made to La Sara at Jones's request. The proceeds were split with $12,000 deposited to Jones's personal account and $23,000 deposited to La Sara's account.

The court of appeals did not expressly address these claims but implicitly held that *section 4.406(d)* barred La Sara's right to recovery. La Sara argues that *section 4.406(d)* does not shield the bank from liability. We agree.

In *Fultz v. First National Bank, 388 S. W.2d 405 (Tex. 1965)*, we held that a bank breached its depository contract when it failed to follow its depositor's restrictive endorsement, "For Deposit Only." Although *Fultz* predates the adoption of the Uniform Commercial Code, the rule remains unchanged. Under the Code, a depositary [**10] bank is liable for paying an instrument other than in accordance with the terms of a restrictive endorsement. *Tex. Bus. & Com. Code Ann. §§ 3.206(c)*, *(d)*, *3.419(c)*, *(d)* (Tex. UCC) (Vernon 1968).

[*564] The bank also breached its contract by transferring $14,000 from La Sara's account at Jones's oral request. When a customer deposits funds with a bank, the bank impliedly agrees to disburse those funds only in accordance with the depositor's instructions. M*esquite State Bank v. Professional Investment Co., 488 S. W.2d 73, 75 (Tex. 1973)*; *Tex. Bus. & Com. Code Ann. §§ 3.404(a)*, *4.401(a)* (Tex. UCC) (Vernon 1968). La Sara did not authorize the bank to disburse funds from La Sara's account at the oral request of Jones. S*ection 4.406(d)* provides no defense to the bank because no unauthorized signature was used to obtain the $14,000 withdrawal.

Finally, the bank does not assert *section 4.406(d)* as a defense to the loans in dispute. Instead, the bank argues that

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Jones had the authority to borrow money in La Sara's name and that La Sara is estopped to the extent it has gained the use and benefit of these loans. The record shows, however, that La Sara did not have the use and [**11] benefit of all funds borrowed in its name. La Sara established that the first loan was used by Jones to purchase a cashier's check payable to a third party, and that a portion of the second loan was deposited directly into Jones's personal account.

We hold that La Sara is entitled to judgment against the bank for the $40,000 loss caused by the bank's failure to follow La Sara's restrictive endorsement, for the $14,000 withdrawal from La Sara's account made without proper authorization and for $31,506 representing the sum the bank delivered to Jones but charged to La Sara as proceeds from two loans.

II. La Sara's DTPA Claim

La Sara also contends that the bank has violated the Deceptive Trade Practices -- Consumer Protection Act. T*ex. Bus. & Com. Code Ann. §§ 17.41 -.63*.(Vernon Supp. 1984). La Sara claims that as part of the depository contract the bank impliedly warranted the dual-signature requirement adopted in La Sara's corporate resolution. La Sara alleges that the bank breached this warranty when it paid checks signed only by Jones and is therefore liable for treble damages under *section 17.50(a)(2)*. In addition to the checks, La Sara contends that the bank's practice [**12] of splitting items payable to La Sara between the accounts of Jones and La Sara, of making loans in La Sara's name without proper authorization, and of allowing Jones to orally withdraw money from La Sara's account violated the general prohibition against "(f)alse, misleading or deceptive acts or practices in the conduct of any trade or commerce" contained in the 1977 act. I*d. §§ 17.46(a)*, *17.50(a)(1)*. The trial court agreed.

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The court of appeals reversed the judgment of the trial court and rendered judgment that La Sara take nothing on its DTPA claim. The court of appeals found no evidence of a false, misleading, or deceptive act or practice in violation of *sections 17.46(a)* and *17.50(a)(1)*. The court did agree that the bank had breached an implied warranty in paying La Sara's checks on only one signature, but held that La Sara's cause of action for breach of warranty accrued in 1975 when the checking account was first opened. The court of appeals reasoned that La Sara was not a consumer then because the 1975 version of the DTPA defined services as "work, labor, or services purchased or leased for use for other than commercial or business use." *See Farmers & Merchants* [**13] *State Bank v. Ferguson, 617 S. W.2d 918, 920 (Tex. 1981)*.

A. DTPA § 17.50(a)(2) -- Breach of Warranty

Section 17.50(a)(2) provides that a consumer may maintain an action if he has been adversely affected by the breach of an express or implied warranty. A consumer is defined as an "individual, partnership or corporation, or governmental entity who seeks or acquires by purchase or lease any goods or services." *Tex. Bus. & Com. Code Ann. § 17.45(4)* (Vernon Supp. 1984). The services provided by a bank in connection with a checking account are within the scope of the DTPA. F*armers & Merchants State Bank v. Ferguson, 605 S. W.2d 320, 324* (Tex. Civ. App. -- Fort Worth [*565] 1980), *aff'd on other grounds*, *617 S. W.2d 918 (Tex. 1981)*.

The court of appeals erred in applying the 1975 act to all of La Sara's checks. The applicable version of the DTPA is determined by the date the deceptive act or practice occurs. W*oods v. Littleton, 554 S. W.2d 662, 666 (Tex. 1977)*. If the bank breached a warranty by honoring La Sara's checks on an unauthorized signature, La Sara's cause

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of action accrued under the version of the DTPA in force at the time the checks were [**14] paid. The 1977 Act would therefore apply to those checks paid after May 23, 1977, the effective date of the amendment which deleted the phrase "for other than commercial or business use" from the definition of services. Because La Sara qualifies as a consumer under the 1977 act, we must determine whether the bank breached an implied warranty by paying checks contrary to La Sara's instructions.

The DTPA does not define the term "warranty." [4] Furthermore, the act does not create any warranties; therefore any warranty must be established independently of the act. C*heney v. Parks, 605 S. W.2d 640, 642* (Tex. Civ. App. -- Houston [1st Dist.] 1980, writ ref'd n. R. E.); D. Bragg, P. Maxwell, & J. Longley, *Texas Consumer Litigation* § 5.01 (2d ed. 1983). While express warranties are imposed by agreement of the parties to the contract, *Rinehart v. Sonitrol of Dallas, Inc., 620 S. W.2d 660, 662-3* (Tex. Civ. App. -- Dallas 1981, writ ref'd n. R. E.); *Tex. Bus. & Com. Code Ann. § 2.313* (Tex. UCC) (Vernon 1968), implied warranties are created by operation of law and are grounded more in tort than in contract. H*umber v. Morton, 426 S. W.2d 554 (Tex. 1968)*. Implied warranties [**15] are derived primarily from statute, although some have their origin at common law. S*ee Kamarath v. Bennett, 568 S. W.2d 658 (Tex. 1978)*; *Jacob E. Decker & Sons, Inc. v. Capps, 139 Tex. 609, 164 S. W.2d 828 (1942)*.

4 This is unfortunate because the word's meaning at common law is ambiguous. S*ee* 5 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 673 (3d ed. 1961). Karl Llewellyn, the father of the Uniform Commercial Code, complained that, "To say warranty is to say nothing definite as to legal effect." K. LLEWELLYN, CASES AND MATERIALS ON THE LAW OF SALES 211 (1930).

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One statutory source of implied warranties is the Uniform Commercial Code. S*ee, e. G.*, *Tex. Bus. & Com. Code Ann. §§ 2.314*, *2.315* (Tex. UCC) (Vernon 1968). Although the UCC imposes a number of warranties on customers and collecting banks in the payment process, *see id.* § 4.207, there is no mention of a warranty by a payor bank in favor of its customer. All of the warranties created in section 4.207 concern either the item [**16] itself (for instance, that it has not been materially altered) or the holder's relationship to it (that he has good title, for example). Each of these warranties goes to a present fact. On the other hand, when section 4.207 speaks of a promise to accept the return of a dishonored item, it speaks of an "engagement."Generally, courts are to construe statutes so as to harmonize with other relevant laws, if possible. S*tate v. Standard Oil Co., 130 Tex. 313, 107 S. W.2d 550 (1937)*. We hold that the bank's implied promise that it will not pay checks on an unauthorized signature is not a warranty, but only an implied term of the contract. A mere breach of contract is not a violation of the DTPA. A*shford Development, Inc. v. USLife Real Estate Services Corp., 661 S. W.2d 933, 935 (Tex. 1983)*.

B. DTPA §§ 17.46(a) & 17.50(a)(1) -- Deceptive Trade Practice

La Sara next contends that the bank's practice of paying its checks on an unauthorized signature violated the 1977 act's general prohibition against "(f)alse, misleading or deceptive acts or practices in the conduct of any trade or commerce." *Tex. Bus. & Com. Code Ann. §§ 17.46(a)*, *17.50(a)(1)* (Vernon Supp. 1984). We, [**17] however, like the court of appeals find no evidence that the bank's payment of La Sara's checks on only one signature was a deceptive [*566] trade practice. La Sara was fully informed of the bank's practice; each month the bank returned La Sara's cancelled checks with a statement of its account.

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Before 1979, it was an open question whether the failure to disclose material facts was a violation of 17.46(a). S*ee Robinson v. Preston Chrysler-Plymouth, 633 S. W.2d 500 (Tex. 1982)* (failure to disclose an unknown material fact not a deceptive trade practice). This case, however, does not even involve a failure to disclose; the bank sent La Sara notice of all transactions. Although the bank's conduct may have been in bad faith under the UCC, it was not false, misleading, or deceptive.

In addition to the checks, the trial court found the $14,000 oral withdrawal and the two unauthorized loans to be deceptive trade practices. La Sara argues the court of appeals has erred in failing to address and affirm these findings. The first loan and the oral withdrawal, however, provide no basis for a DTPA claim because both occurred during the period governed by the 1975 act when La Sara [**18] did not qualify as a consumer of services. Only the second loan originated after the 1977 amendment to the DTPA which expanded the definition of services to include business and commercial uses. [5] La Sara maintains that this loan was a deceptive trade practice under *sections 17.46(a)* and *17.50(a)(1)* because it was made without proper authorization and the proceeds were split between the accounts of La Sara and Jones.

5 Although the split deposit of the Holland Farms check occurred after the 1977 amendment, it was not found to be a deceptive trade practice by the trial court.

We first considered whether a loan might provide the basis for a DTPA claim in *Riverside National Bank v. Lewis, 603 S. W.2d 169 (Tex. 1980)*. In *Riverside* the plaintiff Lewis sought to refinance the loan on his automobile through Riverside Bank. Riverside advised Lewis that the loan had been approved, but subsequently refused to lend the money. After his car was repossessed

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and sold, Lewis sued Riverside Bank alleging that the [**19] Bank's conduct violated the DTPA. We held that Lewis was not a consumer and therefore had no claim under the DTPA. We said that a person who seeks only to borrow money is not a consumer because the lending of money involves neither a good nor a service.

Since the holding in *Riverside*, we have twice limited the case to its facts, emphasizing that Lewis sought only the extension of credit from Riverside, and nothing more. In *Knight v. International Harvester Credit Corp., 627 S. W.2d 382, 389 (Tex. 1982)*, we held a lender subject to a DTPA claim because the lender and seller "were so inextricably intertwined in the transaction as to be equally responsible for the conduct of the sale." In determining that the borrower was a consumer, we considered the borrower's purpose for the loan. We distinguished *Riverside* because the borrower there sought only the extension of credit, whereas "Knight's objective in the transaction was the purchase of a dump truck." *627 S. W.2d at 389*. In *Flenniken v. Longview Bank & Trust Co., 661 S. W.2d 705 (Tex. 1983)*, we held the purchaser of a home could sue the bank under the DTPA for an unconscionable course of conduct in foreclosing on [**20] his partially constructed home. The bank had agreed to provide the interim financing to the builder in return for an assignment of the purchaser's note and mechanic's lien contract. Again we viewed the transaction from the purchasers' perspective and concluded "the Flennikens did not seek to borrow money; they sought to acquire a house." *661 S. W.2d at 708*.

The rule of law that *Knight* and *Flenniken* announced is not restricted to cases involving financial institutions. In *Cameron v. Terrell and Garrett Co., 618 S. W.2d 535 (Tex. 1981)* we held that a buyer of a house could bring a DTPA action against a realtor from whom he had purchased nothing. In *Cameron*, the realtor, who was the seller's

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agent, represented to the buyer that the house in question was larger than it actually was. We held that the buyer was a DTPA consumer because of the purchase [*567] of the house; therefore, he could bring a DTPA action against anyone in the transaction who violated the act.

Under *Knight* and *Flenniken*,a lender may be subject to a DTPA claim if the borrower's "objective" is the purchase or lease of a good or service thereby qualifying the borrower as a consumer. [**21] Obviously, we cannot determine La Sara's objective concerning this loan, because La Sara's complaint is that it did not authorize the transaction. There is no evidence, however, that Jones represented to the bank that the loan was to purchase or lease goods or services, that the bank thought the loan was for that purpose, or that the loan was one of a series with which La Sara obtained goods or services. In fact, there is no evidence that La Sara ever borrowed money from the bank for goods or services. Because the loan involves only the extension of credit, La Sara has not shown itself to be a consumer and therefore has no DTPA claim.

III. Interest/Attorney's Fees

At trial, La Sara also obtained a judgment for interest and attorney's fees. In the court of appeals, the bank had points of error complaining of both. The court of appeals did not reach those points in light of its holding that La Sara could not recover any damages. Insofar as those points raised questions within our jurisdiction, we now address them to determine what judgment the court of appeals should have rendered. K*nutson v. Morton Foods, Inc., 603 S. W.2d 805 (Tex. 1980)*.

The bank asserted that [**22] La Sara's claim was not one arising from a "written contract ascertaining the sum payable," within the meaning of the prejudgment interest statute, Tex. Rev. Civ. Stat. Ann. art. 5069-1.03 (Vernon

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Supp. 1984). Therefore, according to the bank, La Sara is not entitled to prejudgment interest. *578 S. W.2d 109, 116-117 (Tex. 1979)*. The requirement that the contract set out a sum payable has always been liberally construed by this court. As was said in *Federal Life Insurance Co. v. Kriton, 112 Tex. 532, 249 S. W. 193 (1923)*, it is sufficient if the contract provides the conditions upon which liability depends and fixes a measure by which the sum payable can be ascertained with reasonable certainty, in the light of the attending circumstances." *Id. at 195*. In this case, the depository contract provides the conditions upon which liability depends -- payment of the depositor's funds except according to his instructions, and fixes a measure by which the sum payable can be ascertained -- the amount paid. Hence, this case falls within the prejudgment interest statute.

Article 5069-1.03 was amended in 1979, after La Sara's cause of action arose but before La Sara filed suit. [**23] The change was to provide that interest would begin running thirty days after the sum became due. In this case, however, the trial court awarded interest on each check from the date that it was cashed. It has long been the rule in Texas thatwhen the legislature repeals a statute creating a remedy, that repeal is effective immediately. K*night v. International Harvester Credit Corp., 627 S. W.2d at 384*. It follows that if the legislature amends a remedy such as this one, the change will be effective retroactively. Hence, the trial court erred in calculating interest from the date that each check was cashed or loan made, rather than thirty days thereafter. Therefore, we remand the cause to the trial court to recalculate interest accordingly.

The bank also argued to the court of appeals that La Sara was not entitled to attorney's fees. The basis of the bank's complaint was evidentiary. At trial, La Sara had a local attorney testify to what would be a reasonable fee for

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handling the case. We hold that this testimony was some evidence supporting the trial court's award of attorney's fees. The bank also argued to the court of appeals that there was factually insufficient evidence [**24] to support the trial court's award. That point of error is not within our jurisdiction. Therefore, we must remand the cause to [*568] the court of appeals to consider it. B*iggs v. United States Fire Insurance Co., 611 S. W.2d 624 (Tex. 1981)*.

We affirm the court of appeals in reversing the award of additional damages under the DTPA. We reverse the judgment of the court of appeals and affirm the trial court's judgment for actual damages. We remand the cause to the court of appeals to consider the factual sufficiency of La Sara's evidence on attorney's fees. The court of appeals, after considering that point, is to remand the cause to the trial court to recalculate prejudgment interest in accordance with art. 5069-1.03 as amended.[6]

6 According to the judgment of the trial court, Fidelity is entitled to 20% of La Sara's judgment against the bank.

¿ El banco acá actuó con una actitud de rigor y honestidad en todos los actos y los hechos?

I. ARTÍCULO 2 SOBRE LA COMPRAVENTA

A. SU APLICACIÓN EN NEGOCIOS JURÍDICOS MIXTOS

EL ELEMENTO PREDOMINANTE DEL NEGOCIO

BAUM TEXTILE MILL CO., INC., et al., Appellants, v. MILAU ASSOCIATES, INCORPORATED, et al., Respondents. COURT OF APPEALS OF NEW YORK 42 N. Y.2d 482; 368 N. E.2d 1247 September 8, 1977, ArguedOctober 11, 1977, Decided

OPINION BY: WACHTLER [*484] [**1248] A massive burst in an underground section of pipe,

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connecting a sprinkler system to the city water line, caused substantial water damage to bolts of textiles stored in a warehouse. The plaintiffs who were commercial tenants of the building sought recovery against both Milau Associates, the general contractor which built the warehouse, and Higgins Fire Protection, Inc., the subcontractor which designed and installed the sprinkler system. The suit was brought on the alternative theories of negligence and breach of implied warranty of fitness for a particular purpose.

Evidence adduced at the trial indicated that the break followed the occurrence of a phenomenon known as a "water hammer" -- a sudden and unpredictable interruption in the flow from the city water main, followed by a back-surge and build-up of extreme internal pressure when the flow was again released. According to the plaintiffs' experts, this "hoop tension" caused a crack to develop at the root of a V-shaped notch discovered toward the end of the conduit; the fracture traveled along the length of the vulnerable section of pipe with a tearing action and the torrential result.

The "stress-raising" notch was alleged to have been produced by a dull tooth on the hydraulic squeeze cutter used by Higgins to cut sections of the commercially marketed pipe furnished by the subcontractor as specified in the work contract with Milau. Although the 400-foot-long connection had been carefully tested and had functioned properly in conjunction with the remainder of the system inside the building, only a few months in operation had caused enough rusting at the base of the notch, plaintiffs contended, to affect the integrity of the [**1249] entire system. The defendants produced offsetting expert opinion that the pipe itself was neither defective as manufactured nor improperly installed.

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[*485] The Trial Judge, having denied plaintiffs' request to charge that the contractors had impliedly warranted the fractured pipe to be fit for its intended purpose, submitted the case to the jury on the sole question of negligent installation. The jury returned a verdict in favor of the defendants, finding neither want of due care by Higgins nor negligent supervision by Milau.

The textile companies contest the trial court's restrictive rulings on the law ofwarranty. They assert that the V-shaped notch found in the ruptured section of pipe is adequate proof that this crucial component of the sprinkler system supplied by Higgins was defective. It is their contention that the jury would have been justified in finding a defect in the "goods" furnished under the hybrid sales-services contract without necessarily finding negligence on the part of either defendant. The plaintiffs argue that this defect made the pipe unfit for its intended purpose and that they were entitled to have the jury decide whether there was a breach of an implied warranty under *section 2-315 of the Uniform Commercial Code* or by application of common-law warranty principles.

The majority at the Appellate Division found the record to be "devoid of any evidence that the pipe installed by Higgins was unfit for its intended purpose" (*56 AD2d 587, 588)*, and concluded that neither the code nor the case law could be invoked to grant the extension of warranty protection sought by the plaintiffs. While we agree with this result, we have some difficulty with that court's caveat that, "in a proper case, the implied warranty provisions of the Uniform Commercial Code might apply to the sale of goods' aspect of a hybrid sales-services contract (see *Schenectady Steel Co. v Trimpoli Gen. Constr. Co., 43 AD2d 234* [concurring opn by Greenblott, J.], affd *34 NY2d 939*)." (56 AD2d 587-588.)

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The sales-services dichotomy has been recognized and developed from the days of the law merchant. * In a more contemporary formulation, this court in *Perlmutter v Beth David* [*486] *Hosp. (308 NY 100, 104)* held that, " when service predominates, and transfer of personal property is but an incidental feature of the transaction", the exacting warranty standards for imposing liability without proof of fault will not be imported from the law of sales to cast purveyors of medical services in damages. In that case we held that this prohibition could not be circumvented by conceptually severing the sale of goods aspects of the transaction from the overriding service component so that a hospital's act of supplying and even separately charging for impure blood plasma could not in logic or common sense be separated from a physician's contribution in administering the plasma during the course of treatment. Viewed in its entirety, we held in *Perlmutter* that the transaction could not be characterized in part or in its underlying nature as one for the sale of goods, for Mrs. Perlmutter had checked into the hospital to restore her health, not to purchase blood.

* From its inception, the "English rule" served as a basis for applying the commercial law of sales whenever a transaction resulted in a transfer of chattels. Applying this formulation in *Lee v Griffin* (1 B & S 272; 121 Eng Rep 716 [KB, 1861]), Justice Blackburn held that a contract to manufacture and fit a set of false teeth was subject to sales remedies. Courts in this country, however, generally followed the "labor rule", under which the law of sales would not be applied if the contract required a workman "to put materials together and construct an article for the employer" *(Mixer v Howarth, 38 Mass [21 Pick] 205, 207 [1838]).*

The fact that in *Perlmutter* our "service predominates" analysis led to a conclusion of law which was also

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supported by policy considerations peculiar to the impure blood cases does not strip its analytic approach of vitality. The court made no attempt to mask the fact that reallocating the risk of loss by imposing warranty liability on no greater proof than the adverse result itself would place untoward economic and health-care [**1250] burdens on hospitals and patients alike. However, the court's sensitivity to these policy considerations, rather than restrict the scope of its holding, should suggest the need to assess all hybrid transactions along the sales-services continuum both legally and pragmatically.

As suggested in *Perlmutter,* those who hire experts for the predominant purpose of rendering services, relying on their special skills, cannot expect infallibility. Reasonable expectations, not perfect results in the face of any and all contingencies, will be ensured under a traditional negligence standard of conduct. In other words, unless the parties have contractually bound themselves to a higher standard of performance, reasonable care and competence owed generally by practitioners in the particular trade or profession defines the limits of an injured party's justifiable demands (e. G., *Aegis Prods. v Arriflex Corp. of Amer., 25 AD2d 639* [recognizing that in cases where "the service is performed negligently, the cause of action accruing is for that negligence", and "if it constitutes a breach of contract, the action is for that breach"]).

[*487] The parties to the contract underlying this action were perfectly free at the outset, although not after the fact, to adopt a higher standard of care to govern the contractors' performance. Indeed, under a subcontract in which Higgins undertook to design and put together a sprinkler system tailored to the needs of the commercial tenants, the subcontractor was obligated to "Furnish and install [a] wet pipe sprinkler system all in accordance with the requirements of the New York Fire Insurance Rating

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Organization, including * * * One (1) 8" City water connection from pit at property line to inside of factory building". Additionally, by affixing its corporate signature to the standard form construction subcontract, the fire protection specialist "expressly warranted" that "all * * * materials and equipment [which it] furnished and incorporated [would] be new" and that "all *Work* under this Subcontract shall be of good quality, free from faults and defects and in conformance with the Contract Documents. All *Work* not conforming to these standards may be considered defective" (emphasis added).

Section 2-313 of the Uniform Commercial Code requires that a "seller's" affirmation of fact to a "buyer" be made as part of the basis of the bargain, that is, the contract for the sale of goods. The express warranty section would therefore be no more applicable to a service contract than the code's implied warranty provisions. Of course, where the party rendering services can be shown to have expressly bound itself to the accomplishment of a particular result, the courts will enforce that promise (e. G., *Robins v Finestone, 308 NY 543*; *Frankel v Wolper, 181 App Div 485*, affd *228 NY 582*).

Here the textile company plaintiffs had the opportunity to plead and test the construction of the written warranty provided in the work subcontract at the trial level. They opted instead to prove fault, and if that failed, to seek enforcement of a warranty imposed by law for the sale of goods unfit for their intended purpose. They were unable to convince a jury that Higgins had performed negligently. And they failed as well to demonstrate that the work subcontract was anything other than precisely what the parties had understood it to be: an agreement outlining the materials to be employed and the performance obligations to be assumed by a construction specialist hired to install a sprinkler system. Both the subcontract and the agreement

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between Milau and the owner were on their face and at heart no more than a series of performance [*488] undertakings, plans, schedules and specifications for the incorporation of the specialized system during the erection of a building -- a predominantly labor-intensive endeavor. In the final analysis, the parties contemplated the workmanlike performance of a construction service. The fact that something went wrong less than six months after that service was performed does not change the underlying nature [**1251] of the agreement governing its performance.

Given the predominantly service-oriented character of the transaction, neither the code nor the common law of this Statecan be read to imply an undertaking to guard against economic loss stemming from the nonnegligent performance by a construction firm which has not contractually bound itself to provide perfect results (see *Schenectady Steel Co. v Trimpoli Gen. Constr. Co., 43 AD2d 234, 238-239*; *id., pp 239-240* [Cooke, J., concurring in part] ; *Ben Constr. Corp. v Ventre, 23 AD2d 44*; see, also, *North Amer. Leisure Corp. v A & B Duplicators, Ltd., 468 F2d 695*; 1 Anderson, Uniform Commercial Code [2d ed], §§ 2-102:5, 2-105:10; 1955 Report of NY Law Rev Comm, p 361). In fact,where courts in other jurisdictions have purported to apply an implied warranty of fitness to transactions which in essence contemplated the rendition of services, what was actually imposed was no more than a "warranty" that the performer would not act negligently (e. G., *Bloomsburg Mills v Sordoni Constr. Co.,* 401 Pa 358), or a warranty of workmanlike performance imposing only the degree of care and skill that a reasonably prudent, skilled and qualified person would have exercised under the circumstances (e. G., *Union Mar. & Gen. Ins. Co. v American Export Lines, 274 F Supp 123*; *Pepsi Cola Bottling Co. v Superior Burner Serv. Co., 427 P2d 833*

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[Alaska]), or an implied warranty of competence and ability ordinarily possessed by those in the profession *(Wolfe v Virusky, 306 F Supp 519*). (See, generally, Greenfield, Consumer Protection in Service Transactions -- Implied Warranties and Strict Liability in Tort, 1974 Utah L Rev 661, 668-673.) The performance of Higgins and Milau was tested under precisely this standard and found free from any actionable departure.

To be sure, particularly in cases involving personal injury, the absence of an enforceable contractual relationship for the technical sale of goods will not necessarily result in the foreclosure of all remedies, at least where the policies favoring the imposition of strict tort liability for the marketing of [*489] defective products are present (see, e. G., *Victorson v Boch Laundry Mach. Co., 37 NY2d 395*; *Velez v Craine & Clark Lbr. Corp., 33 NY2d 117*) or where manufacturing misjudgments create an unreasonably dangerous condition (see *Micallef v Miehle, Co., 39 NY2d 376*). However, in the products liability cases, " [rather] than arising out of the will or intention of the parties', the liability imposed on the manufacturer * * * is predicated largely on considerations of sound social policy" *(Victorson v Boch Laundry Mach. Co., supra, p 401*, quoting *Codling v Paglia, 32 NY2d 330, 340-341)*, including consumer reliance, marketing responsibility and the reasonableness of imposing loss redistribution. Yet the language and policies of the tort-based cases "should not be understood as in any way referring to the liability of a manufacturer [or tradesman] under familiar but different doctrines of the law of contracts for injuries sustained by a customer or other person with whom or for whose benefit the manufacturer previously has made a warranty or other agreement, express or implied" *(Victorson v Boch Laundry Mach. Co., supra, p 400*).

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The appellants here, however, had at no time in the course of litigation sought to invoke these doctrines to redress their no less real but somehow less impelling economic loss. Additionally, to a much greater extent than professionals and tradesmen in the services arena where standards are usually set contractually, sellers of goods typically encourage mass public reliance on their products' fitness and safety through advertising, packaging and other promotional [**1252] devices. This phenomenon is reflected in the fact that the code's warranties attaching to sales of goods are underpinned by an assumption of some form of reasonable reliance by the unleveraged buyer.

No such situation presents itself here and we can find no reasonable basis in policy or in law for reading what would amount to a warranty of perfect results into the contractual relationships defined by the parties to this action.

Accordingly, the order of the Appellate Division should be affirmed.

¿ El negocio jurídico en este caso consistió preponderantemente en la provisión de servicios, materia jurídica reglamentada por la lex generalis del common law, o en la venta de mercadería, materia a la que se debe aplicar la lex specialis del Artículo 2 sobre la compraventa de bienes?

CHRISTOPHER ROTTNER, individually and on behalf of others similarly situated v. AVG TECHNOLOGIES USA, INC.; AVG TECHNOLOGIES CZ, S. R. O.; and AUSLOGICS SOFTWARE PTY LTD. UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MASSACHUSETTS 943 F. Supp. 2d 222; 80 U. C. C. Rep. Serv. 2d 730 May 3, 2013, Decided May 3, 2013, Filed

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OPINION BY: STEARNS, D. J. In this proposed class action, plaintiff Christopher Rottner, individually and on behalf of others alleged to be similarly situated, seeks to sue the makers and distributors of AVG PC TuneUp software. Rottner claims that defendants AVG Technologies USA Inc. (AVG US), AVG Technologies CZ, S. R. O. (AVG CZ), [**2] and Auslogics Software Pty Ltd., falsely touted the features of PC TuneUp, thereby inducing computer users to purchase software that did not perform as advertised. AVG US and AVG CZ [1] move to dismiss Rottner's Second Amended Complaint (SAC) [2] pursuant to *Fed. R. Civ. P. 12(b)(6)* for failure to state claims for which relief may be granted.

1 Auslogics has not yet appeared in this action.

2 Rottner was substituted for Dale Theis as the lead plaintiff in the SAC.

BACKGROUND

PC TuneUp is software advertised to optimize a computer's performance by scanning the operating system and removing and fixing harmful errors. Auslogics, an Australian company that designs, creates, sells, and licenses computer software, is responsible for the design and development of the architecture underlying PC TuneUp. The AVG family of companies sells computer security and related software. AVG CZ, located in the Czech Republic, licensed the PC TuneUp technology from Auslogics. AVG CZ markets and sells PC TuneUp within the United States and elsewhere through a website, www. Avg. Com. AVG US, a sister company incorporated in Delaware with its headquarters in the Commonwealth of Massachusetts, is responsible for retail [**3] store and reseller channel sales of PC TuneUp in the United States. AVG US also assists in the maintenance of the www. Avg. Com website and reviews marketing statements posted on the site.

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Rottner is a resident of California. In February of 2012, Rottner's computer began malfunctioning -- its speed and performance decreased, and the system sometimes hanged when opening programs. The internet speed also appeared sluggish. Rotter searched for software that would [*225] repair the internal problems and boost the computer's overall performance. His search turned up an advertisement for a free trial of PC TuneUp, which, in turn, led to the www. Avg. Com website. The website claimed that PC TuneUp would boost internet speed, eliminate freezing and crashing, optimize disk space and speeds, extend battery life, protect privacy, monitor hard drive health, and restore the PC to its peak performance.

Rottner downloaded, installed, and ran the trial version of PC TuneUp. The diagnostic scan reported critical errors on Rottner's computer. PC TuneUp then reported that it had repaired these errors, and advised Rottner to perform weekly scans of his computer to maintain and increase its performance. Rottner, relying [**4] on the representations made by PC TuneUp, purchased and installed the full version of the software. [3] However, the weekly scans did not resolve Rottner's computer problems -- his PC continued to suffer from reduced speed and sluggish performance, freezing, and tortoise-like internet access. Rottner also observed that the installation of the full version of PC TuneUp led to no significant improvement in his PC's performance.

3 During the purchase and installation process, Rottner accepted the mandatory End User License Agreement (EULA). Dkt # 50 at 2.

In November of 2012, Rottner contacted AVG and complained about his problems with PC TuneUp. AVG told Rottner to download a recent update of the PC TuneUp software. [4] After downloading, installing, and running the

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update, Rottner's computer completely froze. When Rottner attempted to reboot the computer, a Windows message told him that a problem had been detected and that Windows would automatically shut down to prevent further damage to his computer. To restore his PC to working condition, Rottner had to fully reformat his hard drive -- losing various personal files in the process -- and reinstall the Windows operating system.

4 The SAC does [**5] not specify whether Rottner contacted AVG CZ or AVG US. At the hearing, however, counsel stated that Rottner made his initial complaint to AVG US.

Rottner alleges that defendants falsely inflated PC TuneUp's capabilities to induce consumers to purchase the software. Rottner's counsel retained a computer forensics expert who concluded that the trial version of PC TuneUp consistently reported that a tested PC suffered from multiple problems regardless of its actual health, exaggerated the number of errors found on the computer, characterized all listed problems as severe, and always proposed weekly scans with the full to-be-purchased version of PC TuneUp as the only viable cure. Rottner alleges six causes of action against the AVG defendants: breach of express warranty pursuant to *Mass. Gen. Laws ch. 106, § 2-313* (Count I); breach of the implied warranty of merchantability pursuant to *Mass. Gen. Laws ch. 106, § 2-314* (Count II); fraudulent inducement (Count III); breach of contract (Count IV); breach of the implied covenant of good faith and fair dealing (Count V); and unjust enrichment (Count VI). [5] The AVG defendants move to dismiss all counts in which they appear for failure to state [**6] a claim pursuant to *Fed. R. Civ. P. 12(b)(6)*. The court heard oral argument on April 30, 2013.

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5 Rottner also alleges a separate count of unjust enrichment against Auslogics.

DISCUSSION

To survive a *Rule 12(b)(6)* motion to dismiss, the factual allegations of the complaint [*226] must "possess enough heft" to set forth "a plausible entitlement to relief." *Bell Atl. Corp. v. Twombly, 550 U. S. 544, 557, 559, 127 S. Ct. 1955, 167 L. Ed. 2d 929 (2007)*; *Thomas v. Rhode Island, 542 F.3d 944, 948 (1st Cir. 2008)*. As the Supreme Court has emphasized, this standard "demands more than an unadorned, the-defendant-unlawfully-harmed-me accusation. A pleading that offers labels and conclusions or a formulaic recitation of the elements of a cause of action will not do. Nor does a complaint suffice if it tenders naked assertion [s] devoid of further factual enhancement." *Ashcroft v. Iqbal, 556 U. S. 662, 678, 129 S. Ct. 1937, 173 L. Ed. 2d 868 (2009)* (internal citations and quotation marks omitted).

Applicable Law

The threshold dispute is over the substantive law to be applied. Defendants contend that Delaware state law is controlling because the EULA to which Rottner agreed at the time of the purchase of PC TuneUp specifies that " [t] his Agreement will be governed by the laws of the [**7] State of Delaware." EULA § 10f. [6] Rottner does not dispute that he accepted the EULA, *see* Dkt # 52 at 2, but argues that the EULA's choice of law (Delaware) provision is contrary to Massachusetts public policy.

6 The EULA also specifies that " [t] he exclusive jurisdiction for any dispute will be state or federal courts sitting in the State of Delaware." *Id.* However, by agreement the parties have waived this provision of the EULA while reserving the right to dispute the applicability of the remaining provisions. *See* Dkt # 52 at 2-4.

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In a diversity action, as is the case here, a federal court applies the choice-of-law rules of the forum state -- in this case, Massachusetts. *Klaxon v. Stentor Electric Mfg. Co., 313 U. S. 487, 496, 61 S. Ct. 1020, 85 L. Ed. 1477 (1941)*. "Massachusetts law has recognized, within reason, the right of the parties to a transaction to select the law governing their relationship." *Morris v. Watsco, Inc., 385 Mass 672, 674, 433 N. E.2d 886 (1982)*. However, Massachusetts courts will not honor a choice-of-law provision when its application "would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which would [**8] be the state of the applicable law in the absence of an effective choice of law by the parties." *Shipley Co., Inc. v. Clark, 728 F. Supp. 818, 825 (D. Mass. 1990)*, quoting *Restatement (Second) of Conflict of Laws § 187(2)(b)* (1971).

Rottner asserts that Massachusetts law should apply because the EULA, which disclaims all implied warranties, *see* EULA § 5c, is contrary to the Massachusetts public policy of offering the fullest possible legal protections to consumers, including a prohibition against the disclaiming by sellers of the implied warranty of merchantability in consumer contracts. *See Mass. Gen. Laws ch. 106, § 2-316A* ("Any language, oral or written, used by a seller or manufacturer of consumer goods and services, which attempts to exclude or modify any implied warranties of merchantability and fitness for a particular purpose or to exclude or modify the consumer's remedies for breach of those warranties, shall be unenforceable with respect to injury to the person."). In contrast, as defendants note in their briefs, Delaware law does permit the disclaimer of implied warranties. *See Del. Code tit. 6, § 2-316* (" [T] o exclude or modify the implied warranty of merchantability or any [**9] part of it the language must mention

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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 [*227] 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.'"). Thus, according to Rottner, applying Delaware law in this case would be "contrary to a fundamental policy of" Massachusetts, and moreover, that Massachusetts has a "materially greater interest" in the outcome of the case than does Delaware because AVG US is headquartered in Massachusetts.

While the argument is superficially appealing, it is based on a fundamentally mistaken premise. As defendants correctly point out, the public policy exception compares the law of the contractually chosen state, not with the law of the forum state, but with the "state of the applicable law in the absence of an effective choice of law by the parties," *Shipley, 728 F. Supp. at 825* (which state defendants contend is California). In determining the state whose law is to be applied absent a controlling contractual choice, [**10] Massachusetts has adopted the "functional" choice-of-law analysis taught by the Restatement (Second) of Conflict of Laws. *Bushkin Assocs., Inc. v. Raytheon Co., 393 Mass. 622, 631, 473 N. E.2d 662 (1985).*

[I] n the absence of a choice of law by the parties, their rights "are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties under the principles stated in *§ 6*." *[Restatement (Second) of Conflict Laws] at § 188(1)*. " [T] he contacts to be taken into account in applying the principles of *§ 6* to determine the law applicable to an issue include: (a) the place of contracting, (b) the place of negotiation of the contract, (c) the place of performance, (d) the location of the subject

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matter of the contract, and (e) the domicil, residence, nationality, place of incorporation and place of business of the parties." *Id.* at *§ 188(2)*. Factors under *§ 6* that are said to be relevant to the choice of the applicable rule of law include: "(a) the needs of the interstate and international systems, (b) the relevant policies of the forum, (c) the relevant policies of other interested states and the relative interests of those states [**11] in the determination of the particular issue, (d) the protection of justified expectations, (e) the basic policies underlying the particular field of law, (f) certainty, predictability and uniformity of result, and (g) ease in the determination and application of the law to be applied.

Id. at 632.

This analysis leads inescapably to the conclusion that Massachusetts would apply California law, and not Massachusetts law, in deciding the enforceability of the disclaimer provisions of the EULA. Rottner is a resident of California who purchased a license from AVG to install PC TuneUp in his computer, all of which occurred in California. The EULA states that the contract is between the purchaser and AVG CZ and not AVG US. AVG CZ is a company formed under the laws of the Czech Republic. EULA § 1d. Thus, for choice of law purposes, the contract was formed, negotiated, and performed in California. Although Rottner has named AVG US, which is based in Massachusetts, as a defendant, Rottner has not made any specific allegations linking any action or omission on the part of AVG US to his decision to purchase and install PC TuneUP. Rottner's expectation that he was visiting a web site based in the [**12] United States (based on the website's IP address) does not alter the analysis, as the EULA specifically identifies AVG CZ as Rottner's contractual partner. [7]

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7 Rottner also argues that his choice of Massachusetts as a forum for the litigation vitiates California's interest in his claims. However, a litigant's choice of forum is not an appropriate factor in the choice-of-law analysis. Indeed, allowing a litigant's choice of forum to determine the law to be applied would simply encourage impermissible forum shopping.

[*228] Although California may have a greater interest than Delaware in Rottner's personal claims involving his purchase and use of PC TuneUp, there is no conflict between California and Delaware law on the validity of a disclaimer by a seller of implied warranties. California law permits the disclaimer of implied warranties under the same terms and conditions as Delaware law. *See Cal. Com. Code § 2316* (" [T] o 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 [**13] 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.'"). Thus, under Massachusetts choice-of-law principles, the contractually chosen law -- that of the state of Delaware -- applies in this case because it "would [not] be contrary to a fundamental policy of a state which would be the state of the applicable law in the absence of an effective choice of law by the parties." *Shipley, 728 F. Supp. at 825*.

Claims against AVG US

AVG US moves to dismiss all claims against it because it did not sell PC TuneUp to Rottner and was not a party to the EULA between Rottner and AVG CZ. For ths reason, it argues that Rottner's contract-based claims (express

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warranty, implied warranty, breach of contract, and breach of the implied covenant of good faith and fair dealing) against AVG US necessarily fail. Further, because AVG CZ's relationship with Rottner is fully defined and regulated by the terms of the EULA, the claim for unjust enrichment also fails. *See BAE Sys. Info. & Elec. Sys. Integration, Inc. v. Lockheed Martin Corp., 2009 Del. Ch. LEXIS 17, 2009 WL 264088, at *7 (Del. Ch. Feb. 3, 2009)* [**14] ("If a contract comprehensively governs the parties' relationship, then it alone must provide the measure of the plaintiff's rights and any claim of unjust enrichment will be denied.").[8] Finally, the claim for fraudulent inducement (like the express warranty claim) also collapses because it was AVG CZ, and not AVG US, that made the allegedly fraudulent statements on which Rottner relied.

8 Rottner also has not identified any benefit AVG US allegedly received from his purchase of PC TuneUp, a critical element of any claim of unjust enrichment.

For his part, Rottner alleges that AVG US reviewed the marketing materials placed on the www. Avg. Com website (including the allegedly fraudulent statements), was a party to the "Privacy Policy" published on the website,[9] and also reviewed the licensing agreements for the AVG brand, such as the one with Auslogics. Additionally, Rottner contends that AVG US and AVG CZ are mere alter egos and should be treated as such for purposes of liability. He notes that AVG CZ and AVG US are owned by the same corporate parent, are "pervasively controlled" by the same corporate officers and employees, and have significantly commingled their efforts to promote [**15] the sale of PC TuneUp in the United States.

9 What this "Privacy Policy" was or why it is relevant to Rottner's claims is not made clear in the SAC.

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[*229] Neither of these arguments has persuasive force. While AVG CZ sells PC TuneUp through a website, the content of which AVG US is alleged in some minimal respects to review, Rottner has made no plausible connection between AVG US's review of the material (it is not clear whether any such review is alleged to take place before or after the material is posted) and his decision either to purchase PC TuneUp, or in the process, to agree to the terms of the EULA. The alter ego theory fares no better. "For the alter ego theory, Delaware courts have looked to the law of the entity in determining whether the entity's separate existence is to be disregarded." *EBG Holdings LLC v. Vredezicht's Gravenhage 109 B. V., 2008 Del. Ch. LEXIS 127, 2008 WL 4057745, at *11 (Del. Ch. Sept. 2, 2008)* (citation omitted). Because AVG US is incorporated in Delaware, the court looks to Delaware law in this regard. Under Delaware law (as under Massachusetts law), " [i] t is only the exceptional case where a court will disregard the corporate form." *Sears, Roebuck & Co. v. Sears plc, 744 F. Supp. 1297, 1305 (D. Del. 1990)*.

Some [**16] specific facts a court may consider when being asked to disregard the corporate form include: (1) whether the company was adequately capitalized for the undertaking; (2) whether the company was solvent; (3) whether corporate formalities were observed; (4) whether the dominant shareholder siphoned company funds; and (5) whether, in general, the company simply functioned as a facade for the dominant shareholder.

*EBG Holdings, 2008 Del. Ch. LEXIS 127, 2008 WL 4057745, at *12*. Rottner has not alleged any facts to support the naked allegation that AVG US was operated as a "facade" for AVG CZ or that it did not adhere to basic corporate formalities in its day-to-day operations. Perhaps of greater significance, Rottner has failed to show "fraud,

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injustice, or inequity in the use of the corporate form." *Sears, 744 F. Supp. at 1304*.

[T] he alleged fraud or inequity must be distinct from the tort alleged in the complaint. Any breach of contract and any tort - such as patent infringement - is, in some sense, an injustice. The underlying cause of action does not supply the necessary fraud or injustice. To hold otherwise would render the fraud or injustice element meaningless, and would sanction bootstrapping.

Id. at 1305. [**17] The only inequity Rottner suggests is that if deprived of the domestic defendant (AVG US), he would then have to litigate against two foreign corporations against whom a judgment might prove difficult to collect should he prevail. However, to the extent the argument has any bearing, it simply casts doubt on the wisdom of the underlying transaction, which is not a valid consideration in any piercing of the corporate veil analysis. In sum, because Rottner has not alleged claims against AVG US for which relief may be granted, these claims will be dismissed.

Claims against AVG CZ[10]

10 Having determined that Delaware law applies, the claims made under Massachusetts law will be recast as equivalent claims under Delaware law.

Defendants contend that the claims for breach of express and implied warranties are inapplicable in this case because those claims are pled under Article 2 of the Uniform Commercial Code (UCC), which covers sales of goods, *see Del. Code tit. 6, § 2-102*, whereas software -- the subject of this dispute -- is not, according to AVG CZ, a "good" under Delaware law. AVG relies on two cases -- *Neilson Bus. Equip. Ctr., Inc. v. Italo V. Monteleone., M. D., P. A., 524 A.2d 1172 (Del. 1987)*, [**18] and *Wharton Mgmt. Grp. v. Sigma Consultants, Inc., 1990 Del. Super. LEXIS 54, 1990 WL 18360 (Del. Super. Ct. Jan. 29,* [*230]

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1990), aff'd *582 A.2d 936 (Del. 1990)* -- for this proposition.

In *Neilson*, the court held that a lease for computer hardware, software, and support services was predominantly a contract for goods, and thus came under the rubric of Article 2 of the UCC. *Neilson, 524 A.2d at 1174-1175*. However, the court left open the question of whether the sale of software alone would be considered a sale of a good under Article 2. In *Wharton*, the court distinguished *Neilson* and found that the sale of customized software was a contract for services, and not goods, under the UCC. *Wharton, 1990 Del. Super. LEXIS 54, 1990 WL 18360, at *2-3*.

Rottner distinguishes the sale of a software package, as in this case, with cases involving the design of software or the transfer of intellectual property. Although the Delaware courts have not directly addressed this distinction, courts nationally have consistently classified the sale of a software package as the sale of a good for UCC purposes. *See, e. G., ePresence, Inc. v. Evolve Software, Inc., 190 F. Supp. 2d 159, 163 (D. Mass. 2002)* (applying California law); *Micro Data Base Sys. Inc. v. Dharma Sys., Inc., 148 F.3d 649, 654 (7th Cir. 1998)* [**19] (applying New Hampshire law); *Advent Sys. Ltd. v. Unisys Corp., 925 F.2d 670, 675-676 (3d Cir. 1991)* (applying Pennsylvania law, and noting that the majority of academic commentary supports the view that software fits with the definition of a good under the UCC); *Newcourt Fin. USA, Inc. v. FT Mortg. Cos., 161 F. Supp. 2d 894, 897-898 (N. D. Ill. 2001)* (applying Illinois law); *Architectronics, Inc. v. Control Sys., Inc., 935 F. Supp. 425, 432 (S. D. N. Y. 1996)* (applying New York Law); *Olcott Int'l & Co. Inc. v. Micro Data Base Sys., Inc., 793 N. E.2d 1063, 1071 (Ind. App. 2003)*.

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Rottner's is the more persuasive view of this dispute. Software is not clearly a good or a service in the abstract, and may qualify as either depending on the particular circumstances of the case. *See RRX Indus., Inc. v. Lab-Con, Inc., 772 F.2d 543, 546 (9th Cir. 1985)* ("Because software packages vary depending on the needs of the individual consumer, we apply a case-by-case analysis."). Delaware, like other jurisdictions that have adopted the UCC, applies a "predominance" test to determine whether a contract is for goods or services. *See Neilson, 524 A.2d at 1174*.

The holding of *Neilson* turned on the fact that the [**20] contract involved the sale of tangible hardware along with software and services, and thus is readily distinguishable from this case. However, PC TuneUp also bears no resemblance to the custom designed software in *Wharton*. In *Wharton*, the programmer had to "prepar [e] a study of [the customer] 's existing operations, to design, develop, and install computer software which would meet [his] specific needs and objectives." *Wharton, 1990 Del. Super. LEXIS 54, 1990 WL 18360, at * 2*. In essence, "it was [the programmer's] knowledge, skill and ability for which Wharton bargained [and] purchased in the main The means of transmission is not the object of the agreement." *1990 Del. Super. LEXIS 54, [WL] at *3*. In contrast, PC TuneUp is a "generally available standardized software." *Olcott, 793 N. E.2d at 1071* (distinguishing "the development of a software program to meet a customer's specific needs" as a contract for services). Thus, the sale of PC TuneUp is more like the sale of a tangible good -- it is "movable at the time of identification to the contract for sale." *Del. Code. tit. 6, § 2-105*. Indeed, Rottner was able to download and install the full version of PC TuneUp after a one-stop payment over the internet. Because the sale of [**21] PC TuneUp is predominantly like the sale of a good

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rather than the provision of services, the UCC warranty [*231] provisions apply. [11]

11 AVG CZ also cites to *Attachmate Corp. v. Health Net, Inc., 2010 U. S. Dist. LEXIS 114445, 2010 WL 4365833, at *2 (W. D. Wash Oct. 26, 2010)*, for the proposition that " [t] he weight of the authority favors application of common law and not the UCC with regard to software licenses."). However, that case involved a claim of copyright infringement, a dispute over intellectual property which is definitively not a "good" under the UCC. *See Lamle v. Mattel, Inc., 394 F.3d 1355, 1359 n.2 (Fed. Cir. 2005)*. There is no suggestion that the purchase of PC TuneUp in this case involved any transfer of intellectual property.

Defendants argue that even if the UCC is applicable, Rottner has failed to make out a claim for breach of express warranties. Section 5a of the EULA warranties for a period of 30-days after purchase (i) that "the medium (if any) on which the [s] oftware is delivered will be free of material defects" and (ii) that "the software will perform substantially in accordance with the applicable specification." [12] Defendants point out that Rottner does not allege a material defect in the delivery [**22] medium, and does not identify any applicable specifications to which PC TuneUp allegedly fails to conform. Moreover, even assuming that Rottner has made out a claim, he failed to provide adequate pre-suit notice of the defects as required by *Del. Code tit. 6, § 2-607(3)(a)* (" [T] he 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.").

12 Section 5c of the EULA disclaims all other warranties not expressly provided, and section 10c of the

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EULA, an integration clause, disavows any previous representations.

Rottner agrees that he is not claiming a material defect in the software delivery medium, as the software was successfully downloaded from the internet. However, Rottner contends that because the "applicable specification" language of the EULA is vague and undefined, the only rational recourse for the consumer is to turn to the advertising claims and the claims broadcast by PC TuneUp itself as the "applicable specifications." This argument has force in view of Delaware's endorsement of the UCC's liberal approach to express warranty provisions. *See Bell Sports, Inc. v. Yarusso, 759 A.2d 582, 592 (Del. 2000)*. [**23] In particular, "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 ." *Id.*, quoting *UCC § 2-313 cmt. 4*.

Moreover, I am confident that the Delaware courts would consider PC TuneUp's claimed functionality as an express warranty separate and apart from the EULA's content-less warranty provisions. In *Bell Sports*, the Court found that a bicycle helmet manual's attempt to disclaim express warranties was invalid where elsewhere in its pages the manual proclaimed the functionality of the helmet. *Bell Sports, 759 A.2d at 591-593*. Here, although the EULA disavowed previous representations, PC TuneUp software trumpets announcements about its functionality (which track the internet advertising claims) each and every time it is run. These claims, therefore, also form an express warranty on which Rottner may properly allege to have relied. [13]

13 Because the express warranties form a basis of the parties' bargain, Rottner has also fairly alleged claims for

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breach of contract and the implied covenant of good faith and fair dealing. [**24] In light of the viable contract claims at law, it is unnecessary for the court to consider his alternative equitable claim for unjust enrichment.

With respect to the reasonableness of his notice to AVG as to the alleged [*232] defects in PC TuneUp, Rottner is correct that this is a question of fact that cannot be resolved on a motion to dismiss. *See Speakman Co. v. Harper Buffing Mach. Co., Inc., 583 F. Supp. 273, 278 (D. Del. 1984)* ("The question of timeliness and adequacy of notice is a factual question which can be decided as a matter of law only if the undisputed facts and the inferences that can be drawn therefrom permit only one interpretation."). Here, Rottner contacted AVG in November of 2012 to complain about PC TuneUp's nonfunctionality, that is, nine months after the purchase. Whether this notice was a timely warning to AVG CZ that "it might be answerable to [Rottner] for breach of contract and of warranty" is a question of fact for later adjudication. [14] *Id. at 277*.

14 Rottner also argues that AVG CZ must have had constructive notice of the defects in PC TuneUp because it is a sophisticated business and has sold this software to consumers over a long period of time.

Defendants are [**25] correct, however, that the EULA more successfully disclaimed any implied warranty. As discussed earlier, Delaware law permits the disclaimer of the implied warranty of merchantability if the disclaimer is conspicuous (and mentions merchantability). *Del. Code tit. 6, § 2-316*. Delaware law also permits the disclaimer of the implied warranty of fitness if the disclaimer is in writing and conspicuously displayed. *Id.* Here, the EULA presents the disclaimer in capital letters in section 5c, and specifically identifies both the implied warranties of

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merchantability and fitness. Consequently, Rottner's claim for any breach of implied warranty will be dismissed.

Finally, defendants contend that Rottner's claim for fraudulent inducement fails because it is not pled with the requisite particularity required by *Rule 9(b)*'s heightened pleading standard. *See Fed. R. Civ. P. 9(b)* ("In alleging fraud a party must state with particularity the circumstances constituting fraud ."). Specifically, defendants argue that Rottner did not identify with particularity the misrepresentations on which he purportedly relied, did not adequately plead that the statements were false, and did not adequately [**26] plead that the false statements were made with the intent to deceive. On review of the SAC, the court disagrees. Rottner pleads that he relied on the statements from the www. Avg. Com website that PC TuneUp would "boost Internet speeds," "eliminate freezing and crashing," and "optimize disk speeds," in choosing to download the free trial, SAC ¶¶ 45-46, and that he further relied on the software's representation that it would continuously repair his computer's errors if he performed the recommended weekly scans. *Id.* ¶¶ 46-47. Rottner adequately alleges that these statements are false based on the report of his forensics expert that the PC TuneUp software consistently reports numerous and severe errors regardless of the health of the computer, and never recommends anything other than the weekly scans. [15] *Id.* ¶¶ 37-40. Finally, Rottner adequately alleges that AVG CZ knew that its marketing materials regarding PC TuneUp were false and that it set out to induce consumers to purchase the software despite this knowledge. [16] *Id.* ¶ 88. Because [*233] the fraud claim is pled with sufficient particularity, it survives the motion to dismiss.

15 Rottner also alleges that some of these claims are scientifically [**27] impossible. *See id.* ¶ 26.

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16 AVG CZ argues that the bulk of Rottner's allegations of fraudulent intent go to the design of the software, which he alleges is attributable to Auslogics, and that the claim therefore does not involve AVG CZ. However, during oral argument AVG CZ agreed that an intermediary seller would also have a duty to consumers to avoid making misrepresentations about its products that it knew or should have known were false.

ORDER

For the foregoing reasons, AVG US's motion to dismiss will be ALLOWED. AVG CZ's motion to dismiss will be ALLOWED as to Count II (breach of implied warranties), and DENIED as to the remaining counts.

¿Los programas de ordenador constituyen una mercadería, y qué de los servicios brindados en apoyo del uso de éstos?

B. EL PERFECCIONAMIENTO DE LOS CONTRATOS

C. LA DOCTRINA DE LA CAUSA EN LOS CONTRATOS TÍPICOS NOMINADOS

LOS REQUISITOS ESTRICTOS DEL *CONSIDERATION* SE AFLOJAN

WISCONSIN KNIFE WORKS, Plaintiff-Appellant, v. NATIONAL METAL CRAFTERS, Defendant-Appellee UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT 781 F.2d 1280; 42 U. C. C. Rep. Serv. 830 December 10, 1985, Argued January 22, 1986, Decided

OPINION BY: POSNER [*1282] This is a diversity breach of contract case; and before getting to the merits we must decide, though neither party contests the point, whether the parties are indeed citizens of different states. The complaint alleges (and the answer admits) that the

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plaintiff, Wisconsin Knife Works, is a division of Black & Decker (U. S.), Inc., a corporation incorporated in Maryland and having its "principal offices other than in the State of Wisconsin," and that the defendant, National Metal Crafters, is a division of Keystone Consolidated Industries, Inc., which is incorporated in Delaware and has its principal place of business in Illinois. Although [**2] a division may, if state law permits, sue and be sued in its own name, see *Fed. R. Civ. P. 17(b)*, the state of which it is a citizen for purposes of determining diversity is the state of which the corporation that owns the division is a citizen. The diversity statute deems a corporation a citizen of any state in which it is incorporated and also of the state in which it has its principal place of business. *28 U. S. C. § 1332(c)*. Hence the complaint adequately alleges that the defendant is a citizen of Delaware and Illinois. An allegation of citizenship proper in form and not contested establishes a party's citizenship for purposes of diversity jurisdiction, *Casio, Inc. v. S. M. & R. Co., 755 F.2d 528, 530 (7th Cir. 1985)*, and the jurisdictional allegations were not contested here. So far so good. Regarding the plaintiff, however, also a division rather than a corporation, the complaint alleges that the corporation that owns it is a citizen of Maryland but fails to allege in what state it has its principal place of business. Assuming for the moment that "principal offices" is an inartful attempt to allege principal place of business, still all [**3] the complaint tells us is that Black & Decker is not a citizen of Wisconsin. That leaves open the possibility that it is a citizen of Illinois or Delaware, in which event the parties are not diverse and the suit must be dismissed.

The first thing a federal judge should do when a complaint is filed is check to see that federal jurisdiction is properly alleged. Because federal judges are not subject to direct check by any other branch of government -- because

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the only restraint on our exercise of power is self-restraint -- we must make every reasonable effort to confine ourselves to the exercise of those powers that the Constitution and Congress have given us. In this case, however, we are satisfied, despite the deficiency in the pleadings, that there is diversity of citizenship. The record shows and counsel confirmed at argument that Black & Decker's headquarters is in Maryland; and although the state in which a corporation has its headquarters is not always the state of the corporation's principal place of business (hence the complaint should not have used the term "principal offices"), usually it is. [**4] The test in this circuit for principal place of business is "nerve center," *In re Air Crash Disaster Near Chicago, 644 F.2d 594, 620 (7th Cir. 1981)*; *Celanese Corp. of America v. Vandalia Warehouse Corp., 424 F.2d 1176, 1178 (7th Cir. 1970)*; and, to continue the neurological metaphor, we look for the corporation's brain, and ordinarily find it where the corporation has its headquarters. In the absence of any reason to think that Black & Decker's principal place of business might be in Illinois or Delaware, the two states of which the defendant is a citizen, the fact that its headquarters is in Maryland warrants an inference that the parties are of diverse citizenship. Compare *Casio, Inc. v. S. M. & R. Co., supra, at 529-30*.

Some courts use a vaguer standard. They look not just to where the corporation has its headquarters but also to the distribution of the corporation's assets and employees. See 13B Wright, Miller & Cooper, Federal Practice and Procedure § 3625 (2d ed. 1984). We prefer the simpler test. Jurisdiction ought to be readily determinable. There are cases where a corporation's headquarters may be divided between states [**5] and cases where the nominal headquarters isn't really the directing intelligence of the corporation, and those cases could give trouble even under

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a simple [*1283] "nerve center" test, but we are satisfied that this is not such a case.

We come, then, to the merits of the appeal. Wisconsin Knife Works, having some unused manufacturing capacity, decided to try to manufacture spade bits for sale to its parent, Black & Decker, a large producer of tools, including drills. A spade bit is made out of a chunk of metal called a spade bit blank; and Wisconsin Knife Works had to find a source of supply for these blanks. National Metal Crafters was eager to be that source. After some negotiating, Wisconsin Knife Works sent National Metal Crafters a series of purchase orders on the back of each of which was printed, "Acceptance of this Order, either by acknowledgement or performance, constitutes an unqualified agreement to the following." A list of "Conditions of Purchase" follows, of which the first is, "No modification of this contract, shall be binding upon Buyer [Wisconsin Knife Works] unless made in writing and signed by Buyer's authorized representative. Buyer shall have the right [**6] to make changes in the Order by a notice, in writing, to Seller." There were six purchase orders in all, each with the identical conditions. National Metal Crafters acknowledged the first two orders (which had been placed on August 21, 1981) by letters that said, "Please accept this as our acknowledgment covering the above subject order," followed by a list of delivery dates. The purchase orders had left those dates blank. Wisconsin Knife Works filled them in, after receiving the acknowledgments, with the dates that National Metal Crafters had supplied in the acknowledgments. There were no written acknowledgments of the last four orders (placed several weeks later, on September 10, 1981). Wisconsin Knife Works wrote in the delivery dates that National Metal Crafters orally supplied after receiving purchase

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orders in which the space for the date of delivery had again been left blank.

Delivery was due in October and November 1981. National Metal Crafters missed the deadlines. But Wisconsin Knife Works did not immediately declare a breach, cancel the contract, or seek damages for late delivery. Indeed, on July 1, 1982, it issued a new batch of purchase orders (later rescinded). By December [**7] 1982 National Metal Crafters was producing spade bit blanks for Wisconsin Knife Works under the original set of purchase orders in adequate quantities, though this was more than a year after the delivery dates in the orders. But, in January 13, 1983, Wisconsin Knife Works notified National Metal Crafters that the contract was terminated. By that date only 144,000 of the more than 281,000 spade bit blanks that Wisconsin Knife Works had ordered in the six purchase orders had been delivered.

Wisconsin Knife Works brought this breach of contract suit, charging that National Metal Crafters had violated the terms of delivery in the contract that was formed by the acceptance of the six purchase orders. National Metal Crafters replied that the delivery dates had not been intended as firm dates. It also counterclaimed for damages for (among other things) the breach of an alleged oral agreement by Wisconsin Knife Works to pay the expenses of maintaining machinery used by National Metal Crafters to fulfill the contract. The parties later stipulated that the amount of these damages was $30,000.

The judge ruled that there had been a contract but left to the jury to decide whether the contract [**8] had been modified and, if so, whether the modified contract had been broken. The jury found that the contract had been modified and not broken. Judgment was entered dismissing Wisconsin Knife Works' suit and awarding National Metal

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Crafters $30,000 on its counterclaim. Wisconsin Knife Works has appealed from the dismissal of its suit. The appeal papers do not discuss the counterclaim, and the effect on it of our remanding the case for further proceedings on Wisconsin Knife Works' claim will have to be resolved on remand.

The principal issue is the effect of the provision in the purchase orders that forbids the contract to be modified other than by a writing signed by an authorized representative [*1284] of the buyer. The theory on which the judge sent the issue of modification to the jury was that the contract could be modified orally or by conduct as well as by a signed writing. National Metal Crafters had presented evidence that Wisconsin Knife Works had accepted late delivery of the spade bit blanks and had cancelled the contract not because of the delays in delivery but because it could not produce spade bits at a price acceptable to Black & Decker.

Section 2-209(2) of [**9] *the Uniform Commercial Code* provides that "asigned 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." (As several other subsections of *section 2-209* are relevant to the appeal, we have printed the entire section as an Appendix to this opinion.) The meaning of this provision and its proviso is not crystalline and there is little pertinent case law. One might think that an agreement to exclude modification except by a signed writing must be signed in any event by the party against whom the requirement is sought to be enforced, that is, by National Metal Crafters, rather than by the party imposing the requirement. But if so the force of the proviso ("but except as between merchants..") becomes unclear, for it

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contemplates that between merchants no separate signature by the party sought to be bound by the requirement is necessary. A possible reconciliation, though not one we need embrace in order [**10] to decide this case, is to read the statute to require a separate signing or initialling of the clause forbidding oral modifications, as well as of the contract in which the clause appears. There was no such signature here; but it doesn't matter; this was a contract "between merchants."Although in ordinary language a manufacturer is not a merchant, "between merchants" is a term of art in the Uniform Commercial Code. It means between commercially sophisticated parties (see *UCC § 2-104(1)*; White & Summers, Handbook of the Law Under the Uniform Commercial Code 345 (2d ed. 1980)), which these were.

Of course there must still be a "signed agreement" containing the clause forbidding modification other than by a signed writing, but there was that (see definition of "agreement" and of "signed" in *UCC §§ 1-201(3)*, (39)). National Metal Crafters' signed acknowledgments of the first two purchase orders signified its assent to the printed conditions and naturally and reasonably led Wisconsin Knife Works to believe that National Metal Crafters meant also to assent to the same conditions should they [**11] appear in any subsequent purchase orders that it accepted. Those subsequent orders were accepted, forming new contracts on the same conditions as the old, by performance -- that is, by National Metal Crafters' beginning the manufacture of the spade bit blanks called for by the orders. See *UCC § 2-207(3)*. So there was an agreement, signed by National Metal Crafters, covering all the purchase orders. The fact that the delivery dates were not on the purchase orders when received by National Metal Crafters is nothing of which it may complain; it was given *carte blanche* to set those dates.

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When National Metal Crafters had difficulty complying with the original specifications for the spade bit blanks, Wisconsin Knife Works modified them; and National Metal Crafters argues that the engineering drawings containing those modifications are the written modification that *section 2-209(2)*, if applicable, calls for. In fact these particular modifications seem to fall within the clause of the contract that allows the buyer (Wisconsin Knife Works) to modify the specifications by notice. The context of this clause makes clear that such notice is not the written modification to which the previous [**12] sentence refers. But in any event there was no modification of the delivery dates. The "pert charts" which National Metal Crafters supplied Wisconsin Knife Works, and which showed new target dates for delivery, do not purport [*1285] to modify the contract and were not signed by Wisconsin Knife Works.

We conclude that the clause forbidding modifications other than in writing was valid and applicable and that the jury should not have been allowed to consider whether the contract had been modified in some other way. This may, however, have been a harmless error. S*ection 2-209(4) of the Uniform Commercial Code* provides that an "attempt at modification" which does not satisfy a contractual requirement that modifications be in writing nevertheless "can operate as a waiver." Although in instructing the jury on modification the judge did not use the word "waiver," maybe he gave the substance of a waiver instruction and maybe therefore the jury found waiver but called it modification. Here is the relevant instruction:

Did the parties modify the contract? The defendant bears the burden [**13] of proof on this one. You shall answer this question yes only if you are convinced to a reasonable certainty that the parties modified the contract.

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If you determine that the defendant had performed in a manner different from the strict obligations imposed on it by the contract, and the plaintiff by conduct or other means of expression induced a reasonable belief by the defendant that strict enforcement was not insisted upon, but that the modified performance was satisfactory and acceptable as equivalent, then you may conclude that the parties have assented to a modification of the original terms of the contract and that the parties have agreed that the different mode of performance will satisfy the obligations imposed on the parties by the contract.

To determine whether this was in substance an instruction on waiver we shall have to consider the background of *section 2-209*, the Code provision on modification and waiver.

Because the performance of the parties to a contract is typically not simultaneous, one party may find himself at the mercy of the other unless the law of contracts protects him. Indeed, the most important thing which that law does is to facilitate exchanges [**14] that are not simultaneous by preventing either party from taking advantage of the vulnerabilities to which sequential performance may give rise. If A contracts to build a highly idiosyncratic gazebo for B, payment due on completion, and when A completes the gazebo B refuses to pay, A may be in a bind -- since the resale value of the gazebo may be much less than A's cost -- except for his right to sue B for the price. Even then, a right to sue for breach of contract, being costly to enforce, is not a completely adequate remedy. B might therefore go to A and say, "If you don't reduce your price I'll refuse to pay and put you to the expense of suit"; and A might knuckle under. If such modifications are allowed, people in B's position will find it harder to make such contracts in the future, and everyone will be worse off.

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The common law dealt with this problem by refusing to enforce modifications unsupported by fresh consideration. See, e. G., *Alaska Packers' Ass'n v. Domenico, 117 F. 99 (9th Cir. 1902)*, discussed in *Selmer Co. v. Blakeslee-Midwest Co., 704 F.2d 924, 927 (7th Cir. 1983)*. Thus in the hypothetical case just put B could not have enforced [**15] A's promise to accept a lower price. But this solution is at once overinclusive and underinclusive -- the former because most modifications are not coercive and should be enforceable whether or not there is fresh consideration, the latter because, since common law courts inquire only into the existence and not the adequacy of consideration, a requirement of fresh consideration has little bite. B might give A a peppercorn, a kitten, or a robe in exchange for A's agreeing to reduce the contract price, and then the modification would be enforceable and A could no longer sue for the original price. See White & Summers, *supra*, at 47; Farnsworth, Contracts 271-78 (1982).

The draftsmen of the Uniform Commercial Code took a fresh approach, by making modifications enforceable even if not supported by consideration (see *section 2-209(1)*) [*1286] and looking to the doctrines of duress and bad faith for the main protection against exploitive or opportunistic attempts at modification, as in our hypothetical case. See *UCC § 2-209*, official comment 2. But they did another thing as well. In *section 2-209(2)* they allowed the parties to exclude oral modifications. National Metal Crafters [**16] argues that two subsections later they took back this grant of power by allowing an unwritten modification to operate as a waiver.

The common law did not enforce agreements such as *section 2-209(2)* authorizes. The "reasoning" was that the parties were always free to agree orally to cancel their contract and the clause forbidding modifications not in

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writing would disappear with the rest of the contract when it was cancelled. "The most ironclad written contract can always be cut into by the acetylene torch of parol modification supported by adequate proof." *Wagner v. GrazianoConstruction Co., 390 Pa. 445, 448, 136 A.2d 82, 83-84 (1957)*. This is not reasoning; it is a conclusion disguised as a metaphor. It may have reflected a fear that such clauses, buried in the fine print of form contracts, were traps for the unwary; a sense that they were unnecessary because only modifications supported by consideration were enforceable; and a disinclination to allow parties in effect to extend the reach of the Statute of Frauds, which requires only some types of contract to be in writing. But the framers of the Uniform Commercial Code, as part and parcel of rejecting the [**17] requirement of consideration for modifications, must have rejected the traditional view; must have believed that the protection which the doctrines of duress and bad faith give against extortionate modifications might need reinforcement -- if not from a requirement of consideration, which had proved ineffective, then from a grant of power to include a clause requiring modifications to be in writing and signed. An equally important point is that with consideration no longer required for modification, it was natural to give the parties some means of providing a substitute for the cautionary and evidentiary function that the requirement of consideration provides; and the means chosen was to allow them to exclude oral modifications.

If *section 2-209(4)*, which as we said provides that an attempted modification which does not comply with subsection (2) can nevertheless operate as a "waiver," is interpreted so broadly that *any* oral modification is effective as a waiver notwithstanding *section 2-209(2)*, both provisions become superfluous and we are back in the common law -- only with not even a requirement of

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consideration to reduce the likelihood of fabricated or unintended oral modifications. [**18] A conceivable but unsatisfactory way around this result is to distinguish between a modification that substitutes a new term for an old, and a waiver, which merely removes an old term. On this interpretation National Metal Crafters could not enforce an oral term of the allegedly modified contract but could be excused from one of the written terms. This would take care of a case such as *Alaska Packers*, where seamen attempted to enforce a contract modification that raised their wages, but would not take care of the functionally identical case where seamen sought to collect the agreed-on wages without doing the agreed-on work. Whether the party claiming modification is seeking to impose an onerous new term on the other party or to wiggle out of an onerous term that the original contract imposed on it is a distinction without a difference. We can see that in this case. National Metal Crafters, while claiming that Wisconsin Knife Works broke their contract as orally modified to extend the delivery date, is not seeking damages for that breach. But this is small comfort to Wisconsin Knife Works, which thought it had a binding contract with fixed delivery dates. Whether called modification [**19] or waiver, what National Metal Crafters is seeking to do is to nullify a key term other than by a signed writing. If it can get away with this merely by testimony about an oral modification, *section 2-209 (2)* becomes very nearly a dead letter.

The path of reconciliation with subsection (4) is found by attending to its [*1287] precise wording. It does not say that an attempted modification "is" a waiver; it says that "it can operate as a waiver." It does not say in what circumstances it can operate as a waiver; but ifan attempted modification is effective as a waiver only if there is reliance, then both *sections 2-209(2)* and *2-209(4)* can be

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given effect. Reliance, if reasonably induced and reasonable in extent, is a common substitute for consideration in making a promise legally enforceable, in part because it adds something in the way of credibility to the mere say-so of one party. The main purpose of forbidding oral modifications is to prevent the promisor from fabricating a modification that will let him escape his obligations under the contract; and the danger of successful fabrication [**20] is less if the promisor has actually incurred a cost, has relied. There is of course a danger of bootstrapping -- of incurring a cost in order to make the case for a modification. But it is a risky course and is therefore less likely to be attempted than merely testifying to a conversation; it makes one put one's money where one's mouth is.

We find support for our proposed reconciliation of subsections (2) and (4) in the secondary literature. See Eisler, *Oral Modification of Sales Contracts Under the Uniform Commercial Code: The Statute of Frauds Problem*, 58 Wash. U. L. Q. 277, 298-302 (1980); Farnsworth, *supra*, at 476-77; 6 Corbin on Contracts 211 (1962). It is true that 2 Anderson on the *Uniform Commercial Code § 2-209*:42 (3d ed. 1982), opines that reliance is not necessary for an attempted modification to operate as a waiver, but he does not explain his conclusion or provide any reason or authority to support it. This provision was quoted along with other material from Anderson in *Double-E Sportswear Corp. v. Girard Trust Bank, 488 F.2d 292, 295 (3d Cir. 1973)*, but there was no issue of reliance in that case. 2 Hawkland, Uniform Commercial [**21] Code Series § 2-209:05, at p. 138 (1985), remarks, "if clear factual evidence other than mere parol points to that conclusion [that an oral agreement was made altering a term of the contract], a waiver may be found. In the normal case, however, courts should be

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careful not to allow the protective features of *sections 2-209(2)* and *(3)* to be nullified by contested parol evidence." (Footnote omitted.) The instruction given by the judge in this case did not comply with the test, but in any event we think a requirement of reliance is clearer than a requirement of "clear factual evidence other than mere parol."

Our approach is not inconsistent with *section 2-209(5)*, which allows a waiver to be withdrawn while the contract is executory, provided there is no "material change of position in reliance on the waiver." Granted, in (5) there can be no tincture of reliance; the whole point of the section is that a waiver may be withdrawn unless there is reliance. But the section has a different domain from *section 2-209(4)*. It is not limited to attempted modifications invalid under subsections (2) or (3); it applies, for example, to an express written and signed waiver, provided only that the [**22] contract is still executory. Suppose that while the contract is still executory the buyer writes the seller a signed letter waiving some term in the contract and then, the next day, before the seller has relied, retracts it in writing; we have no reason to think that such a retraction would not satisfy *section 2-209(5)*, though this is not an issue we need definitively resolve today. In any event we are not suggesting that "waiver" means different things in (4) and (5); it means the same thing; but the *effect* of an attempted modification as a waiver under (4) depends in part on (2), which (4) (but not (5)) qualifies. Waiver and estoppel (which requires reliance to be effective) are frequently bracketed. See, e. G., *Chemetron Corp. v. McLouth Steel Corp., 522 F.2d 469, 472-73 (7th Cir. 1975)*; *Hirsch Rolling Mill Co. v. Milwaukee & Fox River Valley Ry., 165 Wis. 220, 161 N. W. 741 (1917)*.

The statute could be clearer; but the draftsmen were making a big break with the common law in subsections (1)

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and (2), and naturally failed to foresee all the ramifications of the break. The innovations [*1288] made in Article 9 of the UCC were so novel [**23] that the article had to be comprehensively revised only ten years after its promulgation. See Appendix II to the 1978 Official Text of the Uniform Commercial Code. Article 2 was less innovative, but of course its draftsmanship was not flawless -- what human product is? Just a few months ago we wrestled with the mysterious and apparently inadvertent omission of key words in the middle subsection of another section of Article 2. See *Jason's Foods, Inc. v. Peter Eckrich & Sons, Inc., 774 F.2d 214 (7th Cir. 1985)* (section 2-509(2)). Another case of gap-filling in Article 2 is discussed in White & Summers, supra, at 450 (section 2-316(3)(a)). But as a matter of fact we need go no further than *section 2-209(5)* to illustrate the need for filling gaps in Article 2. In holding that that section allows the retraction of a waiver of the Statute of Frauds, the Third Circuit said in *Double-E Sportswear Corp. V. Girard Trust Bank, supra, 488 F.2d at 297 n.7*, "We have found it necessary to fill the interstices of the code," because of "a drafting oversight."

We know that the draftsmen of *section 2-209* wanted to make it possible for parties to exclude oral modifications. [**24] They did not just want to give "modification" another name -- "waiver." Our interpretation gives effect to this purpose. It is also consistent with though not compelled by the case law. There are no Wisconsin cases on point. Cases from other jurisdictions are diverse in outlook. Some take a very hard line against allowing an oral waiver to undo a clause forbidding oral modification. See, e. G., *South Hampton Co. v. Stinnes Corp., 733 F.2d 1108, 1117-18 (5th Cir. 1984)* (Texas law); *U. S. Fibres, Inc. v. Proctor & Schwartz, Inc., 358 F. Supp. 449, 460 (E. D. Mich. 1972)*, aff'd, *509 F.2d 1043 (6th Cir. 1975)* (Pennsylvania

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law). Others allow oral waivers to override such clauses, but in most of these cases it is clear that the party claiming waiver had relied to his detriment. See, e. G., *Gold Kist, Inc. v. Pillow, 582 S. W.2d 77, 79-80 (Tenn. App. 1979)* (where this feature of the case is emphasized); *Linear Corp. v. Standard Hardware Co., 423 So. 2d 966 (Fla. App. 1982)*; cf. R*ose v. Spa Realty Associates, 42 N. Y.2d 338, 343-44, 366 N. E.2d 1279, 1282-83, 397 N. Y. S.2d 922 (1977)*. In cases [**25] not governed by the Uniform Commercial Code, Wisconsin follows the common law rule that allows a contract to be waived orally (unless within the Statute of Frauds) even though the contract provides that it can be modified only in writing. See, e. G., *S & M Rotogravure Service, Inc. v. Baer, 77 Wis. 2d 454, 468-69, 252 N. W.2d 913, 920 (1977)*. But of course the Code, which is in force in Wisconsin as in every other state (with the partial exception of Louisiana), was intended to change this rule for contracts subject to it.

Missing from the jury instruction on "modification" in this case is any reference to reliance, that is, to the incurring of costs by National Metal Crafters in reasonable reliance on assurances by Wisconsin Knife Works that late delivery would be acceptable. And although there is evidence of such reliance, it naturally was not a focus of the case, since the issue was cast as one of completed (not attempted) modification, which does not require reliance to be enforceable. National Metal Crafters must have incurred expenses in producing spade bit blanks after the original delivery dates, but whether these were *reliance* expenses is a separate question. [**26] Maybe National Metal Crafters would have continued to manufacture spade bit blanks anyway, in the hope of selling them to someone else. It may be significant that the stipulated counterclaim damages seem limited to the damages from the breach of a separate oral agreement regarding the maintenance of equipment

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used by National Metal Crafters in fulfilling the contract. The question of reliance cannot be considered so open and shut as to justify our concluding that the judge would have had to direct a verdict for National Metal Crafters, the party with the burden of proof on the issue. Nor, indeed, does National Metal Crafters argue that reliance was shown as a matter of law.

[*1289] There is no need to discuss most of the other alleged errors in the conduct of the trial; they are unlikely to recur in a new trial. We do however point out that Wisconsin Knife Works' objections to the introduction of parol evidence has no merit once the issue is recast as one of waiver. The purpose of the parol evidence rule is to defeat efforts to vary by oral evidence the terms of a written instrument that the parties intended to be the fully integrated expression of their contract; it has no [**27] application when the issue is whether one of the parties later waived strict compliance with those terms.

The only other issue that merits discussion is Wisconsin Knife Works' contention that the judge should not have let in evidence about its high costs of manufacturing spade bits, which it says is irrelevant to whether National Metal Crafters broke the contract. But it is relevant, though to a different issue. National Metal Crafters argues that it did Wisconsin Knife Works a favor by its slow delivery of the spade bit blanks because Wisconsin Knife Works was unable to manufacture spade bits at anywhere near the cost at which Black & Decker could buy them from its existing supplier. If the argument is correct, it shows either that Wisconsin Knife Works sustained no damage from the alleged breach of contract, or, what amounts to the same thing, that the alleged breach was not causally related to that damage. As in tort law, so in contract law, causation is an essential element of liability. See, e. G.,*Lincoln Nat'l Life Ins. Co. v. NCR Corp., 772 F.2d 315, 320 (7th Cir.*

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1985); [**28] *S. J. Groves & Sons Co. v. Warner Co., 576 F.2d 524, 527 (3d Cir. 1978)*. If the damage of which the promisee complains would not have been avoided by the promisor's not breaking his promise, the breach cannot give rise to damages. If Wisconsin Knife Works couldn't have made any money from manufacturing spade bits no matter how promptly National Metal Crafters delivered the blanks for them, the failure to make prompt delivery caused no legal injury and cannot provide the foundation for a successful damage suit even if the late delivery was a breach of the contract.

When a jury instruction is erroneous there must be a new trial unless the error is harmless. On the basis of the record before us we cannot say that the error in allowing the jury to find that the contract had been modified was harmless; but we do not want to exclude the possibility that it might be found to be so, on motion for summary judgment or or otherwise, without the need for a new trial. Obviously National Metal Crafters has a strong case both that it relied on the waiver of the delivery deadlines and that [**29] there was no causal relationship between its late deliveries and the cancellation of the contract. We just are not prepared to say on the record before us that it is such a strong case as not to require submission to a jury.

Circuit Rule 18 shall not apply on remand.

REVERSED and REMANDED.

¿ Por qué los juristas estadounidenses son incapaces de rescatar la doctrina de que un contrato típico nominado de su propia causa?

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D. EL REQUISITO FORMAL DE UNA ESCRITURA EN EL NEGOCIO COMERCIAL

EL *STATUTE OF FRAUDS* EN EL DERECHO COMERCIAL

ST. ANSGAR MILLS, INC., Appellant, vs. DUANE J. STREIT, Appellee. SUPREME COURT OF IOWA 613 N. W.2d 289; 42 U. C. C. Rep. Serv. 2d 58 July 6, 2000, Filed

OPINION BY: CADY [*290] Considered en banc. A grain dealer appeals from an order by the district court granting summary judgment in an action to enforce an oral contract for the sale of corn based on a written confirmation. The district court held the oral contract was unenforceable because the written confirmation was not [*291] delivered within a reasonable time after the oral contract as a matter of law. We reverse the decision of the district court and remand for further proceedings.

I. Background Facts and Proceedings.

St. Ansgar Mills, Inc. is a family-owned agricultural business located in Mitchell County. As a part of its business, St. Ansgar Mills [**2] buys corn from local grain farmers and sells corn to livestock farmers for feed. The price of the corn sold to farmers is established by trades made on the Chicago Board of Trade for delivery with reference to five contract months. The sale of corn for future delivery is hedged by St. Ansgar Mills through an offsetting futures position on the Chicago Board of Trade.

A sale is typically made when a farmer calls St. Ansgar Mills and requests a quote for a cash price of grain for future delivery based on the Chicago Board of Trade price for the delivery. [1] The farmer then accepts or rejects the price. If the price is accepted, St. Ansgar Mills protects the price through a licensed brokerage house by acquiring a hedge position on the Chicago Board of Trade. This hedge

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position, however, obligates St. Ansgar Mills to purchase the corn at the stated price at the time of delivery. Thus, St. Ansgar Mills relies on the farmer who purchased the grain to accept delivery at the agreed price.

1 This is not the exclusive method of sale. Another type of sale is based on an order contingent upon the cash price of the corn reaching a specific level. This type of sale, however, was not involved in this case.

[**3] Duane Streit formerly resided in Mitchell County and currently practices veterinarian medicine in Carroll County. He also raises hogs. He owns a large hog farrowing operation in Carroll County and a hog finishing operation in Mitchell County near Osage. Streit purchased the Osage farm from his father in 1993. Duane's father, John Streit, resides in Mitchell County and helps Duane operate the Osage finishing facility.

Duane and his father have been long-time customers of St. Ansgar Mills. Since 1989, Duane entered into numerous contracts with St. Ansgar Mills for the purchase of large quantities of corn and other grain products. Duane would generally initiate the purchase agreement by calling St. Ansgar Mills on the telephone to obtain a price quote. If an oral contract was made, an employee of St. Ansgar Mills would prepare a written confirmation of the sale and either mail it to Duane to sign and return, or wait for Duane or John to sign the confirmation when they would stop into the business.

John would regularly stop by St. Ansgar Mills sometime during the first ten days of each month and pay the amount of the open account Duane maintained at St. Ansgar Mills for [**4] the purchase of supplies and other materials. On those occasions when St. Ansgar Mills sent the written confirmation to Duane, it was not unusual for Duane to fail to sign the confirmation for a long period of

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time. He also failed to return contracts sent to him. Nevertheless, Duane had never refused delivery of grain he purchased by telephone prior to the incident which gave rise to this case.

On July 1, 1996, John telephoned St. Ansgar Mills to place two orders for the purchase of 60,000 bushels of corn for delivery in December 1996 and May 1997. This order followed an earlier conversation between Duane and St. Ansgar Mills. After the order was placed, St. Ansgar Mills completed the written confirmation but set it aside for John to sign when he was expected to stop by the business to pay the open account. The agreed price of the December corn was $3.53 per bushel. The [*292] price of the May corn was $3.73 per bushel.

John failed to follow his monthly routine of stopping by the business during the month of July. St. Ansgar Mills then asked a local banker who was expected to see John to have John stop into the business.

John did not stop by St. Ansgar Mills until August 10, 1996. On [**5] that date, St. Ansgar Mills delivered the written confirmation to him.

Duane later refused delivery of the corn orally purchased on July 1, 1996. The price of corn had started to decline shortly after July 1, and eventually plummeted well below the quoted price on July 1. After Duane refused delivery of the corn, he purchased corn for his hog operations on the open market at prices well below the contract prices of July 1. St. Ansgar Mills later told Duane it should have followed up earlier with the written confirmation and had no excuse for not doing so.

St. Ansgar Mills then brought this action for breach of contract. It sought damages of $152,100, which was the difference between the contract price of the corn and the market price at the time Duane refused delivery.

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Duane filed a motion for summary judgment. He claimed the oral contract alleged by St. Ansgar Mills was governed by the provisions of the Uniform Commercial Code, and was unenforceable as a matter of law under the statute of frauds. He claimed the written confirmation delivered to John on August 10, 1996 did not satisfy the statute of frauds for two reasons. First, he was not a merchant. Second, the confirmation [**6] was not received within a reasonable time after the alleged oral agreement.

The district court determined a jury question was presented on whether Duane was a merchant under the Uniform Commercial Code. However, the district court found the written confirmation did not satisfy the writing requirements of the statute of frauds because the delivery of the confirmation to John, as Duane's agent, did not occur within a reasonable time after the oral contract as a matter of law. The district court found the size of the order, the volatility of the grain market, and the lack of an explanation by St. Ansgar Mills for failing to send the confirmation to Duane after John failed to stop by the business as expected made the delay between July 1 and August 10 unreasonable as a matter of law.

St. Ansgar Mills appeals. It claims a jury question was presented on the issue of whether a written confirmation was received within a reasonable time. [2]

2Duane did not cross-appeal from the determination by the district court that his status as a merchant was a question for the fact finder. Therefore, the issue is not before us. We limit our review to the issue whether a forty-day delay between the claimed oral contract and receipt of a written confirmation was unreasonable as a matter of law.

[**7]

II. Scope of Review.

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We review a ruling for summary judgment for errors at law. Iowa R. App. P. 4; *Iowa Comprehensive Petroleum Underground Storage Tank Fund Bd. v. Mobil Oil Corp.*, 606 N. W.2d 359, 362 (Iowa 2000). Summary judgment is appropriate where the record indicates no genuine issue of material fact exists, therefore the moving party is entitled to judgment as a matter of law. Iowa R. Civ. P. 237(c). When the facts are not in dispute, we decide whether the district court correctly applied the law to the facts. K*ennedy v. Zimmermann*, 601 N. W.2d 61, 64 (Iowa 1999). In doing so, we view the facts in the light most favorable to the party opposing the motion. *See Mobil*, 606 N. W.2d at 362.

III. Statute of Frauds.

The statute of frauds is one of the most well-known and venerable rules applicable to contract law. Generally, it establishes an exception to the proposition that oral contracts are enforceable in a lawsuit if [*293] sufficiently proven by requiring certain types of contracts to be in writing and signed by the party against whom enforcement is sought. *See* Iowa Code § 554.2201(1).

The statute [**8] of frauds originated in 17th century England to combat the use of fraud and perjury by litigants in court proceedings to establish oral contracts. *See* 2 E. Allan Farnsworth, *Contracts* § 6.1, at 82-83 (2d ed. 1990). At the time, court rules prohibited parties to a lawsuit from testifying as witnesses in their case, and, consequently, an oral contract could only be established with testimony of third parties. *See Azevedo v. Minister,* 86 Nev. 576, 471 P.2d 661, 663 (Nev. 1970). This prohibition allowed witnesses to be persuaded to give false testimony on behalf of a party in an effort to establish an oral contract, leaving the other party at a distinct disadvantage. *See* James J. O'Connell, Jr., *Boats Against a Current: The Courts and*

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the Statute of Frauds, 47 Emory L. J. 253, 257 (1998) [hereinafter O'Connell] [3]

3 Other factors also helped place defendants at a distinct disadvantage. Rules of evidence were undeveloped at the time and courts had little authority to overturn jury verdicts not supported by the evidence. *See* O'Connell, 47 Emory L. J. at 257.

[**9] In 1677, in response to this unsavory practice of using perjury to establish oral contracts, Parliament enacted the statute of frauds to require certain contracts to be supported by written evidence to be enforceable. [4] 29 Car. 2, ch. 3 (1677) (Eng.); *see* Hugh E. Willis, *Statute of Frauds--A Legal Anachronism,* 3 Ind. L. J. 427, 427 (1928). The statute included contracts which were not only particularly susceptible to fraud, but those which posed serious consequences of fraud, including contracts for the sale of goods or property. *See* O'Connell, 47 Emory L. J. at 258.

4 There is some debate as to the date of passage with royal assent for the new bill. Some records indicate the date of passage as April 16, 1676, whereas the actual date was in 1677. *Compare* Marc P. Bouret, *Oral Will Contracts and the Statute of Frauds in California*, *1896-1980: A Summary and Evaluation*, 8 Pepp. L. Rev. 41, 43 (1980) (arguing the statute of frauds was originally enacted in 1676), *with* George P. Costigan, Jr., *The Date and Authorship of the Statute of Frauds*, 26 Harv. L. Rev. 329, 331 (1913) [hereinafter Costigan] (arguing the statute was enacted in 1677). The confusion stems from Pope Gregory XIII's abolition of the "old" calendar in 1582, which was adopted in England in 1751. Costigan, 26 Harv. L. Rev. at 331. The "old" calendar was eleven days ahead of the "new" due to the vernal equinox in March, resulting in confusion in the months of January, February and March. *Id.*

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[**10] Despite a difference in the court rules which gave rise to this statute of frauds, our American legal culture quickly adopted the principle. James J. White & Robert S. Summers, *Uniform Commercial Code*§ 2--1, at 50 (2d ed. 1980) [hereinafter White & Summers] Iowa adopted the statute of frauds in 1851. *See* Iowa Code §§ 2409-10 (1851). The statute of frauds also became a part of the Uniform Sales Act in 1906, which Iowa subsequently adopted in 1924. *See* 1919 Iowa Acts ch. 396 (initially codified at Iowa Code §§ 9930-10007 (1924)). This statute required all contracts for the sale of goods to be in writing. Over time, the Uniform Sales Act was replaced by the Uniform Commercial Code. [5] The Uniform Commercial Code continued to adhere to the statute [*294] of frauds, but was limited in its provisions to the sale of goods in excess of $500. Iowa enacted its version of the Uniform Commercial Code in 1966 including the statute of frauds. *See* 1965 Iowa Acts ch. 413. Iowa's statute of frauds for the sale of goods now provides:

Except as otherwise provided in this section, a contract for the sale of goods for the price of $500 or more is not enforced by way of action [**11] 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 that party's authorized agent or broker.

Iowa Code § 554.2201(1) (1995).

5 After six years of deliberating, the National Conference of Commissioners on Uniform State Laws produced the 1952 Official Text of the Uniform Commercial Code. *See* William A. Schnader, *A Short History of the Preparation and Enactment of the Uniform Commercial Code,* 22 U. Miami L. Rev. 1, 1-2 (1967). In 1954, Pennsylvania was the first state to formally adopt the

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text. *See* 13 Pa. Const. Stat. §§ 1101 to 9507 (1953). By 1968, the Uniform Commercial Code was effective in forty-nine states, the District of Columbia, and the Virgin Islands. *See* Uniform Commercial Code Table, 1 U. L. A. 1-2 (Master ed. 1989). There have been three official revisions, the 1972, the 1978, and the 1987 Official Texts, offered by the Permanent Editorial Board, a board established in 1961 to keep the Code up to date. *See* William A. Schnader, *The Permanent Editorial Board for the Uniform Commercial Code: Can it Accomplish its Object?,*3 Am. Bus. L. J. 137, 138 (1965).

[**12] Although the statute of frauds has been deeply engrained into our law, many of the forces which originally gave rise to the rule are no longer prevalent. White & Summers § 2--1, at 51. This, in turn, has caused some of the rigid requirements of the rule to be modified.

One statutory exception or modification to the statute of frauds which has surfaced applies to merchants. [6] *Id.* § 554.2201(2). Under section 554.2201(2), the writing requirements of section 554.2201(1) are considered to be satisfied if, within a reasonable time, a writing in confirmation of the contract which is sufficient against the sender is received and the merchant receiving it has reason to know of its contents, unless written notice of objection of its contents is given within ten days after receipt. *Id.* Thus, a writing is still required, but it does not need to be signed by the party against whom the contract is sought to be enforced. The purpose of this exception was to put professional buyers and sellers on equal footing by changing the former law under which a party who received a written confirmation of an oral agreement of sale, but who had not signed anything, could hold the other party [**13] to a contract without being bound. *See* White & Summers § 2--3, at 55; *Kimball County Grain Coop. v. Yung,* 200 Neb. 233, 263 N. W.2d 818, 820 (Neb. 1978). It

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also encourages the common, prudent business practice of sending memoranda to confirm oral agreements. White & Summers § 2--3, at 55.

6 The Uniform Commercial Code establishes three general exceptions to the writing requirement: (1) goods made specially for the buyer and not suitable for resale to others towards which the seller has made a substantial beginning of their manufacture or commitments for their procurement; (2) where the party against whom enforcement is sought admits the existence of the contract in pleadings, testimony, or before the court; and (3) goods for which payment has been received and goods accepted. *See* Iowa Code § 554.2201(3)(a)-(c). Additionally, a contract "may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of the contract." *Id.* § 554.2204(1). The agreement which creates the contract qualifies even though the exact moment of its making is undetermined or terms are left open, so long as the parties intended to make a contract. *Id.* § 554.2204(2), (3).

[**14] While the written confirmation exception imposes a specific ten-day requirement for a merchant to object to a written confirmation, it employs a flexible standard of reasonableness to establish the time in which the confirmation must be received. Iowa Code § 554.2201(2). The Uniform Commercial Code specifically defines a reasonable time for taking action in relationship to "the nature, purpose and circumstances" of the action. *Id.* § 554.1204(2). Additionally, the declared purpose of the Uniform Commercial Code is to permit the expansion of commercial practices through the custom and practice of the parties. *See*Iowa Code Ann. § 554.1102 cmt. 2 (course of dealings, usage of trade or course of performance are material in determining a reasonable time). Furthermore, the Uniform Commercial Code relies upon course of

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dealings between the parties to help interpret their conduct. Iowa Code § 554.1205(1). Thus, all relevant circumstances, including custom and practice of the parties, must be considered in determining [*295] what constitutes a reasonable time under section 554.2201(2).

Generally, the determination of the reasonableness of particular conduct is a jury question. *See Pirelli-Armstrong Tire Co. v. Reynolds,* 562 N. W.2d 433, 436 (Iowa 1997); [**15] *see also Harvey v. Great Atl. & Pac. Tea Co.,* 388 F.2d 123, 125 (5th Cir. 1968) (passing judgment on the reasonableness of conduct of the parties must be accomplished in light of all the circumstances of the case and should rarely be disposed of by summary judgment). Thus, the reasonableness of time between an oral contract and a subsequent written confirmation is ordinarily a question of fact for the jury. M*ortgageAmerica Corp. v. American Nat'l Bank,* 651 S. W.2d 851, 856 (Tex. Ct. App. 1983); *Schiavi Mobile Homes, Inc. v. Gagne,* 510 A.2d 236, 238 (Me. 1996) (reasonableness of parties' time for action is a question of fact). It is only in rare cases that a determination of the reasonableness of conduct should be decided by summary adjudication. *Harvey,* 388 F.2d at 125. Summary judgment is appropriate only when the evidence is so one-sided that a party must prevail at trial as a matter of law. *Ridgeway v. Union County Comm'rs,* 775 F. Supp. 1105, 1109 (S. D. Ohio 1991).

There are a host of cases from other jurisdictions which have considered the question of what constitutes a reasonable time under [**16] the written confirmation exception of the Uniform Commercial Code. *See Gestetner Corp. v. Case Equip. Co.*, 815 F.2d 806, 810 (1st Cir. 1987) (roughly five month delay reasonable in light of merchants' relationship and parties' immediate action under contract following oral agreement); *Serna, Inc. v. Harman*, 742 F.2d 186, 189 (5th Cir. 1984) (three and one-half month delay

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reasonable in light of the parties' interaction in the interim, and non-fluctuating prices, thus no prejudice); *Cargill*, *Inc. v. Stafford,* 553 F.2d 1222, 1224 (10th Cir. 1977) (less than one month delay unreasonable despite misdirection of confirmation due to mistaken addressing); *Starry Constr. Co. v. Murphy Oil USA, Inc.*, 785 F. Supp. 1356, 1362-63 (D. Minn. 1992) (six month delay for confirmation of modification order for additional oil unreasonable as a matter of law in light of Persian Gulf War, thus increased prices and demand); *Rockland Indus., Inc. v. Frank Kasmir Assoc.*, 470 F. Supp. 1176, 1179 (N. D. Tex. 1979) (letter sent eight months after alleged oral agreement for two-year continuity agreement unreasonable in light [**17] of lack of evidence supporting reasonableness of delay); *Yung*, 263 N. W.2d at 820 (six month delay in confirming oral agreement delivered one day prior to last possible day of delivery unreasonable); *Azevedo*, 471 P.2d at 666 (ten week delay reasonable in light of immediate performance by both parties following oral agreement)*; Lish v. Compton*, 547 P.2d 223, 226-27 (Utah 1976) (twelve day delay "outside the ambit which fair-minded persons could conclude to be reasonable" in light of volatile price market and lack of excuse for delay other than casual delay). Most of these cases, however, were decided after a trial on the merits and cannot be used to establish a standard or time period as a matter of law. Only a few courts have decided the question as a matter of law under the facts of the case. *Compare Starry,* 785 F. Supp. at 1362-63 (granting summary judgment), and *Lish,* 547 P.2d at 226-27 (removing claim from jury's consideration), *with Barron v. Edwards,* 45 Mich. App. 210, 206 N. W.2d 508, 511 (Mich. Ct. App. 1973) (remanding for further development of facts, summary judgment improper). [**18] However, these cases do not establish a strict principle to apply in this case. The resolution of each case depends upon the particular facts and circumstances.

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In this case, the district court relied upon the large amount of the sale, volatile market conditions, and lack of an explanation by St. Ansgar Mills for failing to send the written confirmation to Duane in determining St. Ansgar Mills acted unreasonably as a matter of law in delaying delivery of the written confirmation until [*296] August 10, 1996. Volatile market conditions, combined with a large sale price, would normally narrow the window of reasonable time under section 554.2201(2). However, they are not the only factors to consider. Other relevant factors which must also be considered in this case reveal the parties had developed a custom or practice to delay delivery of the confirmation. The parties also maintained a long-time amicable business relationship and had engaged in many other similar business transactions without incident. There is also evidence to infer St. Ansgar Mills did not suspect John's failure to follow his customary practice in July of stopping by the business was a concern at the time. These factors [**19] reveal a genuine dispute over the reasonableness of the delay in delivering the written confirmation, and make the resolution of the issue appropriate for the jury. Moreover, conduct is not rendered unreasonable solely because the acting party had no particular explanation for not pursuing different conduct, or regretted not pursuing different conduct in retrospect. The reasonableness of conduct is determined by the facts and circumstances existing at the time.

Considering our principles governing summary adjudication and the need to resolve the legal issue by considering the particular facts and circumstances of each case, we conclude the trial court erred by granting summary judgment. We reverse and remand the case for further proceedings.

REVERSED AND REMANDED.

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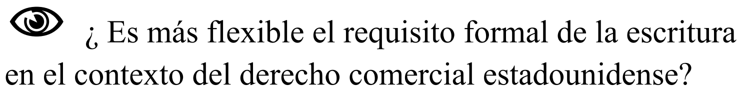

¿ Es más flexible el requisito formal de la escritura en el contexto del derecho comercial estadounidense?

BVS, Inc., Plaintiff - Appellant v. CDW DIRECT, LLC, Defendant - Appellee UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT 759 F.3d 869 December 17, 2013, Submitted July 17, 2014, Filed

OPINION BY: BYE [*870] BVS, Inc. (BVS) sued CDW Direct, LLC (CDW) alleging breach of contract, unjust enrichment, and fraud. The dispute arose from BVS's contract with CDW for a computer storage area network (SAN). The district court granted summary judgment in favor of CDW, finding no genuine dispute of material fact regarding the contract's integration, performance, or how course of dealing affected the contract. BVS appeals arguing the district court erred in granting summary judgment. We reverse and remand.

I

BVS provides online training to banks and credit unions. To do so, it uses a main computer system located in Cedar Rapids, Iowa, and keeps a disaster recovery system at a separate location. As a BVS representative testified, if the system "goes down or is unavailable, we're out of business." In late [**2] 2010, BVS sought to update several components of its system, including its SAN. Updating the SAN would involve an entire solution: hardware, software, implementation, testing and support.

Prior to this, BVS had an ongoing business relationship with CDW. CDW resells technology products and services through its internet-based retail business. BVS purchased products and services from CDW on numerous occasions. BVS would either place an order online, or request a quote from Amer Harb, the CDW account manager assigned to BVS. After Harb provided a quote, BVS would either

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purchase that item online, or a CDW employee would access the BVS account and place the order.

These transactions numbered in the hundreds. Through them, Harb developed a relationship with BVS. When he learned that BVS was looking for a new SAN solution, he saw an opportunity to further that relationship. However, Roy Karon, BVS's owner, expressed doubt that CDW could deliver on such a complicated project.

It soon became clear just how complicated the project would be. Harb brought in a third party, Net App, Inc. (Net App), for assistance in developing the SAN solution. Net App then arranged for another third party, Arrow [**3] Electronics, Inc. (Arrow), to [*871] install and implement the SAN solution. During frequent and extensive discussions, BVS told Harb of their need for a total SAN solution and that BVS was not looking to simply purchase software and hardware. Rather, BVS told Harb it required a complete solution, fully installed and tested to ensure it met BVS's needs. However, Harb's expertise was other than technical. For example, he had another CDW employee ghost-write an email of technical questions. BVS did not know the email was ghost-written at the time, and Karon testified that, had he known Harb had sent a ghost-written email, he would have insisted on dealing with someone from CDW with more technical competence.

On December 3, 2010, CDW sent BVS a quote for hardware, software, and services for the SAN solution. After receiving this quote and still doubtful CDW could deliver, Karon called Harb directly to express his concerns. Harb explained CDW had data center expertise; Karon took this to mean that CDW had the expertise to deliver a SAN solution.

BVS sent CDW a purchase order, which incorporated the quote, and listed hardware, software, training, support

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services, and six "Arrow Provisioned Services." [**4] The next day, CDW sent a purchase order to Arrow to fulfill BVS's purchase order. Harb testified that, at this point, CDW had reached an agreement with BVS; indeed, he testified CDW would not have sent a purchase order to Arrow without such an agreement. One month after BVS sent its purchase order, and after the agreement was made that Harb testified to, CDW sent BVS an invoice (Invoice).

In addition to the items detailed in BVS's purchase order, on its back the Invoice listed Terms and Conditions, including warranty disclaimers, statements that the customer's "sole and exclusive remedy [is] at the sole option of the Seller" to either have CDW reperform or to seek a refund, and further statements limiting CDW's liability. These terms were included on documents generated by BVS's previous, unrelated transactions with CDW. Further, the CDW web site contained disclaimers and liability limitations and were accessible when BVS purchased through CDW's web site. The instant agreement, however, was not reached in the same manner as the previous transactions.

In early February 2011, the parties held a kickoff phone call to discuss and schedule the project. Hardware and software were delivered. [**5] Installation was ultimately scheduled to be complete by March 3, 2011. The project, however, failed. BVS was unable to use its new SAN system. Attempts to fix problems plaguing the system either failed or were refused, until finally, on May 19, 2011 -- more than two months after the expected completion of the project -- BVS decided the system would not be able to function properly. BVS attempted to send the hardware and software back to CDW. CDW refused to take back the system.

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BVS brought suit against CDW, alleging breach of contract, unjust enrichment, and fraud. In granting CDW's motion for summary judgment on these claims, the district court found BVS's purchase order in early December constituted an offer, and CDW accepted that offer when it sent a purchase order to Arrow. By this offer and acceptance, the district court found a contract existed before CDW's Invoice. The district court, however, found the parties' course of dealing supplemented the terms of the agreement and the Invoice integrated the agreement. This finding incorporated the Invoice's warranty disclaimers and meant CDW performed its obligations to deliver hardware and software. BVS appealed.

[*872] II

We review a district [**6] court's interpretation of Iowa law and its decision on summary judgment *de novo*, viewing the evidence in the light most favorable to BVS, the non-moving party. *Cagin v. McFarland Clinic, P. C., 456 F.3d 903, 906 (8th Cir. 2006)*. Summary judgment is appropriate "if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to relief as a matter of law." *Fed. R. Civ. P. 56(a)*. "A dispute is genuine if the evidence is such that it could cause a reasonable jury to return a verdict for either party; a fact is material if its resolution affects the outcome of the case." *Amini v. City of Minneapolis, 643 F.3d 1068, 1074 (8th Cir. 2011)* (citing *Anderson v. Liberty Lobby, Inc., 477 U. S. 242, 248, 252, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986))*.

We agree with the district court's finding that BVS's original purchase order constituted an offer and that CDW accepted that offer when it sent a purchase order to Arrow. We must then determine whether, under Iowa law, the agreement between CDW and BVS was integrated by CDW's Invoice. We conclude the district court erred when

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it ruled, as a matter of law, that the Invoice -- sent after offer and acceptance had already created a contract -- integrated [**7] the contract with respect to terms not included in either BVS's offer or CDW's acceptance.

Under Iowa law, " [a] n agreement is fully integrated when the parties involved adopt a writing or writings as the final and complete expression of the agreement." *Cagin, 456 F.3d at 907* (quoting *Whalen v. Connelly, 545 N. W.2d 284, 290 (Iowa 1996))*. If a contract is fully integrated, "extrinsic evidence [may not] contradict (or even supplement) the terms of the written agreement." *Id. at 907-08* (quoting *Whalen, 545 N. W.2d at 290*). The determination of " [w] hether or not a written agreement is integrated is a question of fact to be determined by the totality of the evidence." *Id. at 908* (quoting *Whalen, 545 N. W.2d at 290*).

In Cagin, because the plaintiff could not produce evidence "to suggest the [contract] did not constitute the final expression of the parties' agreement [,] " the court found "no facts in dispute which could lead a reasonable person to find the [contract] was not fully integrated." *456 F.3d at 908*. Here, however, the parties dispute the particular facts of the oral agreement stemming from Harb and Koran's conversation. Karon allegedly asked for reassurances CDW was capable of the project; [**8] Harb allegedly assured him CDW was. Those alleged promises -- part of the "totality of the evidence" -- suggest the Invoice was not the "final and complete expression of the agreement." A reasonable jury, weighing this evidence, could return a verdict for either party.

The district court -- considering the parties' prior course of dealing as part of the "totality of evidence" - held the parties' course of dealing supplemented the terms of the contract. Because the Invoice came after the agreement, its

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terms are "proposals for addition to the contract." *Iowa Code § 554.2207*. As to merchants, such additional terms become part of the contract unless they materially alter it, i. E., come as a surprise to the party opposing enforcement. Id.; see also *All-Iowa Contracting Co. v. Linear Dynamics, Inc., 296 F. Supp. 2d 969, 979 (N. D. Iowa 2003)* (concluding terms negating standard warranties are normally considered material alterations unless there is no surprise to the party opposing enforcement of the terms negating the warranties). If the course of dealing supplemented the contract, then, BVS would not be surprised by the late inclusion of the warranty disclaimers.

BVS argues the course of dealing [**9] between the parties was inapplicable to the [*873] instant contract. Such consideration is properly a question of fact. See *Grace Label, Inc. v. Kliff, Inc., 355 F. Supp. 2d 965, 972 (S. D. Iowa 2005)* (concluding summary judgment was inappropriate on an issue which involved the parties' course of dealing); see also *St. Ansgar Mills, Inc. v. Streit, 613 N. W.2d 289, 295-96 (Iowa 2000)* (reversing a grant of summary judgment in case involving question whether a delay in sending written confirmation of an oral contract was reasonable under the parties' course of dealing).

BVS and CDW did have extensive dealings with one another. The three ways BVS normally purchased from CDW were to either (1) place an order online, (2) request a quote from Harb for a discounted price and then purchase the item online, or (3) request a quote from Harb and notify Harb via telephone or email of an intention to purchase the item at that discounted price, at which point a CDW employee would access BVS's account and place the order.[1] The transaction at issue here, however, did not have any of the earmarks associated with the parties' prior course of dealing. Their absence is strong evidence this particular transaction [**10] was unique, and there was no intention

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to incorporate the warranty disclaimers included with the Invoice. Without the course of dealing, BVS would be surprised to find warranty disclaimers added after the agreement was reached. A finder of fact, then, should determine whether the parties' course of dealing supplemented the instant agreement.

1 BVS moved to exclude Harb's affidavit, which detailed these previous dealings, from the record for summary judgment, on the grounds that it was in violation of *Federal Rule of Civil Procedure 26*. The district court denied that motion, and BVS appeals that denial. Because we are ruling in BVS's favor in reversing the grant of summary judgment, its motion to exclude the affidavit is moot.

For these reasons, we find genuine issues of material fact remain as to whether the qualitatively different nature of this particular transaction overrides any previous course of dealing, whether the Invoice integrated the agreement, and whether Harb's alleged assurances to Koran provided warranties to the contract. Such questions should be addressed to the finder of fact.[2]

2 Having decided a finder of fact should determine whether the parties' agreement was incorporated [**11] by the Invoice, we recognize the finder of fact should be asked to determine which terms were incorporated into the agreement. This fact-finding will determine dispositive elements regarding BVS's breach of contract claim."Under Iowa law, ' [i] n a breach-of-contract claim, the complaining party must prove: (1) the existence of a contract; *(2) the terms and conditions of the contract*; (3) that it has performed all the terms and conditions required under the contract; (4) the defendant's breach of the contract in some particular way; and (5) that plaintiff has suffered damages as a result of the breach.'" *Cagin, 456*

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F.3d 903 at 906 (quoting *Molo Oil Co. v. River City Ford Truck Sales, Inc., 578 N. W.2d 222, 224 (Iowa 1998))* (emphasis added). Since, under Iowa law, " [g] enerally, questions of performance or breach are for the jury [,] " *Iowa-Ill. Gas & Elec. Co. v. Black Veatch, 497 N. W.2d 821, 825 (Iowa 1993)*, the jury needs to decide the ultimate issue of breach or performance.

III

The district court improperly decided questions of fact which should be left to a jury. We reverse the district court's grant of summary judgment[3] and remand the case for further proceedings consistent with this [**12] opinion.

3 In granting CDW's motion for summary judgment, the district court dismissed BVS's fraud claim. In reversing the summary judgment, we reinstate the fraud claim.

¿ Puede una comunicación escrita posterior acaso integrar un contrato ya perfeccionado?

E. LA OFERTA Y LA ACCEPTACIÓN

LA DENOMINADA 'BATALLA DE LOS FORMULARIOS' ENTRE COMERCIANTES

DIAMOND FRUIT GROWERS, INC., an Oregon corporation, Plaintiff, v. KRACK CORPORATION, an Illinois corporation, Defendant/Third-Party Plaintiff-Appellee, v. METAL-MATIC, INC., a Minnesota corporation, Third-Party Defendant-Appellant UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT 794 F.2d 1440; 1 U. C. C. Rep. Serv. 2d 1073 March 5, 1986, Argued and Submitted July 22, 1986, Filed

OPINION BY: WIGGINS [*1441] Metal-Matic, Inc. (Metal-Matic) appeals from judgment entered after a jury verdict in favor of Krack Corporation (Krack) on Krack's third-party complaint against Metal-Matic. Metal-Matic

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also appeals from the district court's denial of its motion for judgment n. O. V. We have jurisdiction under *28 U. S. C. § 1291 (1982)* and affirm.

FACTS AND PROCEEDINGS BELOW

Krack is a manufacturer of cooling units that contain steel tubing it purchases from outside suppliers. Metal-Matic is one of Krack's tubing suppliers. At the time this dispute arose, Metal-Matic had been supplying tubing to Krack for about ten years. The parties followed the same course of dealing during the entire ten years. At the beginning [**2] of each year, Krack sent a blanket purchase order to Metal-Matic stating how much tubing Krack would need for the year. Then, throughout the year as Krack needed tubing, it sent release purchase orders to Metal-Matic requesting that tubing be shipped. Metal-Matic responded to Krack's release purchase orders by sending Krack an acknowledgment form and then shipping the tubing. [1]

1 The blanket purchase order apparently did no more than establish Krack's willingness to purchase an amount of tubing during the year. The parties' conduct indicates that they intended to establish their contract based on Krack's release purchase orders and Metal-Matic's acknowledgments sent in response to those purchase orders.

Metal-Matic's acknowledgment form disclaimed all liability for consequential damages and limited Metal-Matic's liability for defects in the tubing to refund of the purchase price or replacement or repair of the tubing. As one would expect, these terms were not contained in Krack's purchase order. The following [**3] statement was printed on Metal-Matic's form: "Metal-Matic, Inc.'s acceptance of purchaser's offer or its offer to purchaser is hereby expressly made conditional to purchaser's

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acceptance of the terms and provisions of the acknowledgment form." This statement and the disclaimer of liability were on the back of the acknowledgment form. However, printed at the bottom of the front of the form in bold-face capitals was the following statement: "SEE REVERSE SIDE FOR TERMS AND CONDITIONS OF SALE."

On at least one occasion during the ten-year relationship between Metal-Matic and Krack, Allen Zver, Krack's purchasing manager, discussed the limitation of warranty and disclaimer of liability terms contained in Metal-Matic's acknowledgment form with Robert Van Krevelen, Executive Vice President of Metal-Matic. Zver told Van Krevelen that Krack objected to the terms and tried to convince him to change them, but Van Krevelen refused to do so. After the discussions, Krack continued to accept and pay for tubing from Metal-Matic. [2]

2 Krack contends that there is no evidence of when these discussions took place. That is not the case. Van Krevelen testified that at least some discussions were held before this incident arose. That testimony is not contradicted.

[**4] In February 1981, Krack sold one of its cooling units to Diamond Fruit Growers, Inc. (Diamond) in Oregon, and in September 1981, Diamond installed the unit in a controlled-atmosphere warehouse. In January 1982, the unit began leaking ammonia from a cooling coil made of steel tubing.

After Diamond discovered that ammonia was leaking into the warehouse, Joseph Smith, the engineer who had been responsible for building Diamond's controlled-atmosphere warehouses, was called in to find the source of the leak. Smith testified that he found a pinhole leak in the cooling coil of the Krack cooling unit. Smith inspected the

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coil while it was still inside the unit. He last inspected the coil on April 23, 1982. The coil then sat in a hall at Diamond's warehouse until May, 1984, when John Myers inspected the coil for Metal-Matic.

Myers cut the defective tubing out of the unit and took it to his office. At his office, [*1442] he did more cutting on the tubing. After Myers inspected the tubing, it was also inspected by Bruce Wong for Diamond and Paul Irish for Krack.

Diamond sued Krack to recover the loss in value of fruit that it was forced to remove from the storage room as a result [**5] of the leak. Krack in turn brought a third-party complaint against Metal-Matic and Van Huffel Tube Corporation (Van Huffel), another of its tubing suppliers, seeking contribution or indemnity in the event it was held liable to Diamond. At the close of the evidence, both Metal-Matic and Van Huffel moved for a directed verdict on the third party complaint. The court granted Van Huffel's motion based on evidence that the failed tubing was not manufactured by Van Huffel. The court denied Metal-Matic's motion.

The jury returned a verdict in favor of Diamond against Krack. It then found that Krack was entitled to contribution from Metal-Matic for thirty percent of Diamond's damages. Metal-Matic moved for judgment n. O. V. The court denied that motion and entered judgment on the jury verdict.

Metal-Matic raises two grounds for reversal. First, Metal-Matic contends that as part of its contract with Krack, it disclaimed all liability for consequential damages and specifically limited its liability for defects in the tubing to refund of the purchase price or replacement or repair of the tubing. Second, Metal-Matic asserts that the evidence does not support a finding that it manufactured the [**6]

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tubing in which the leak developed or that it caused the leak. We address each of these contentions in turn.

STANDARD OF REVIEW

Metal-Matic's contention that its disclaimers are part of its contract with Krack presents questions of statutory and contract interpretation, which are questions of law reviewed *de novo. United States v. Binder, 769 F.2d 595, 600 (9th Cir. 1985)*; *Marchese v. Shearson Hayden Stone, Inc., 734 F.2d 414, 417 (9th Cir. 1984)*; *see United States v. McConney, 728 F.2d 1195, 1202* (9th Cir.) (en banc), *cert. denied*, *469 U. S. 824, 105 S. Ct. 101, 83 L. Ed. 2d 46 (1984)*. The jury verdict and the district court's denial of Metal-Matic's motion for judgment n. O. V. will not be reversed by this court if there is substantial evidence to support a finding for Krack. *See Mosesian v. Peat, Marwick, Mitchell & Co., 727 F.2d 873, 877* (9th Cir.), *cert. denied*, *469 U. S. 932, 105 S. Ct. 329, 83 L. Ed. 2d 265 (1984)*.

DISCUSSION

A. M*etal-Matic's Disclaimer of Liability for Consequential Damages*

If the contract between Metal-Matic and Krack contains Metal-Matic's [**7] disclaimer of liability, Metal-Matic is not liable to indemnify Krack for part of Diamond's damages. Therefore, the principal issue before us on this appeal is whether Metal-Matic's disclaimer of liability became part of the contract between these parties.

Relying on *Uniform Commercial Code (U. C. C.) § 2-207*, *Or. Rev. Stat. § 72.2070* (1985), [3] Krack argues that Metal-Matic's disclaimer did not become part of the contract. Metal-Matic, on the other hand, argues that *section 2-207* is inapplicable to this case because the parties discussed the disclaimer, and Krack assented to it.

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3 Metal-Matic's acknowledgment form specified that Minnesota law would apply to the contract, but the parties tried this case based on Oregon law and have relied on Oregon law in this court. We will therefore apply Oregon law to this appeal.

Krack is correct in its assertion that *section 2-207* applies to this case. One intended application of *section 2-207* is to commercial transactions in which the parties exchange printed purchase [**8] order and acknowledgment forms. *See U. C. C. § 2-207* comment 1. [4] The drafters of the [*1443] U. C. C. recognized that "because the [purchase order and acknowledgment] forms are oriented to the thinking of the respective drafting parties, the terms contained in them often do not correspond." *Id. Section 2-207* is an attempt to provide rules of contract formation in such cases. In this case, Krack and Metal-Matic exchanged purchase order and acknowledgment forms that contained different or additional terms. This, then, is a typical *section 2-207* situation. The fact that the parties discussed the terms of their contract after they exchanged their forms does not put this case outside *section 2-207*. *See* 3 R. Duesenburg & L. King, *Sales and Bulk Transfers under the Uniform Commercial Code* (Bender's U. C. C. Service) § 3.05 [2] (1986). *Section 2-207* provides rules of contract formation in cases such as this one in which the parties exchange forms but do not agree on all the terms of their contract.

4 Although the official comments to the U. C. C. are not included in Oregon Revised Statutes, the Oregon courts rely on them. *See, e. G., Willamette-Western Corp. v. Lowry, 279 Ore. 525, 532, 568 P.2d 1339, 1342 (1977)*.

[**9] A brief summary of *section 2-207* is necessary to an understanding of its application to this case. [5] *Section 2-207* changes the common law's mirror-image rule for

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transactions that fall within article 2 of the U. C. C. At common law, an acceptance that varies the terms of the offer is a counteroffer and operates as a rejection of the original offer. *See Idaho Power Co. v. Westinghouse Electric Corp., 596 F.2d 924, 926 (9th Cir. 1979)*. If the offeror goes ahead with the contract after receiving the counteroffer, his performance is an acceptance of the terms of the counteroffer. *See C. Itoh & Co. v. Jordan International Co., 552 F.2d 1228, 1236 (7th Cir. 1977)*; J. White & R. Summers, *Handbook of the Law Under the Uniform Commercial Code*, § 1-2 at 34 (2d ed. 1980).

5 *U. C. C. § 2-207*, *Or. Rev. Stat. § 72.2070*, provides:

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 be 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 contract is sufficient to establish a contract for sale although the writings of the parties do not

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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 the Uniform Commercial Code.

[**10] Generally, *section 2-207(1)* "converts a common law counteroffer into an acceptance even though it states additional or different terms." *Idaho Power, 596 F.2d at 926*; *see U. C. C. § 2-207(1)*. The only requirement under *section 2-207(1)* is that the responding form contain a definite and seasonable expression of acceptance. The terms of the responding form that correspond to the offer constitute the contract. Under *section 2-207(2)*, the additional terms of the responding form become proposals for additions to the contract. Between merchants the additional terms become part of the contract unless the offer is specifically limited to its terms, the offeror objects to the additional terms, or the additional terms materially alter the terms of the offer. *U. C. C. § 2-207(2)*; *see* J. White & R. Summers, § 1-2 at 32.

However, *section 2-207(1)* is subject to a proviso. If a definite and seasonable expression of acceptance expressly conditions acceptance on the offeror's assent to additional or different terms contained therein, the parties' differing forms do not result in a contract unless the offeror assents to the additional terms. *See* J. White & R. Summers, [**11] § 1-2 at 32-33. If the offeror assents, the parties have a contract and the additional terms are a part of that contract. [*1444] If, however, the offeror does not assent, but the parties proceed with the transaction as if they have a contract, their performance results in formation of a contract. *U. C. C. § 2-207(3)*. In that case, the terms of the contract are those on which the parties' forms agree plus any terms supplied by the U. C. C. *Id.; see Boise Cascade Corp. v. Etsco, Ltd., 39 U. C. C. Rep. Serv. (Callaghan)*

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410, 414 (D. Or. 1984); J. White & R. Summers, § 1-2 at 34.

In this case, Metal-Matic expressly conditioned its acceptance on Krack's assent to the additional terms contained in Metal-Matic's acknowledgment form. That form tracks the language of the *section 2-207(1)* proviso, stating that "Metal-Matic, Inc.'s acceptance is hereby *expressly made conditional* to purchaser's acceptance of the terms and provisions of the acknowledgment form." (emphasis added). *See* C. I*toh & Co., 552 F.2d at 1235*. Therefore, we must determine whether Krack assented to Metal-Matic's limitation of liability term.

Metal-Matic argues that [**12] Krack did assent to the limitation of liability term. This argument is based on the discussions between Zver for Krack and Van Krevelen for Metal-Matic. Some time during the ten-year relationship between the companies, these two men discussed Krack's objections to the warranty and liability limitation terms in Metal-Matic's acknowledgment form. Krack attempted to persuade Metal-Matic to change its form, but Metal-Matic refused to do so. After the discussions, the companies continued to do business as in the past. Metal-Matic contends that Krack assented to the limitation of liability term when it continued to accept and pay for tubing after Metal-Matic insisted that the contract contain its terms.

To address Metal-Matic's argument, we must determine what constitutes assent to additional or different terms for purposes of *section 2-207(1)*. The parties have not directed us to any cases that analyze this question and our research has revealed none. [6] We therefore look to the language and structure of *section 2-207* and to the purposes behind that section to determine the correct standard.

6 The United States District Court for the District of Columbia has decided a case on this issue. However, the

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case is of little precedential value because the court provided no analysis to support its decision. In *McKenzie v. Alla-Ohio Coals, Inc., 29 U. C. C. Rep. Serv. (Callaghan) 852, 855 (D. D. C. 1979)*, the offeror objected to a term in the offeree's form. The offeree reaffirmed that term, and the offeror made no further objection. The court held that the term was part of the contract because the parties continued to behave as if they had a contract after the offeree reaffirmed the term.

[**13] One of the principles underlying *section 2-207* is neutrality. If possible, the section should be interpreted so as to give neither party to a contract an advantage simply because it happened to send the first or in some cases the last form. *See* J. White & R. Summers, § 1-2 at 26-27. *Section 2-207* accomplishes this result in part by doing away with the common law's "last shot" rule. *See* 3 R. Duesenberg & L. King, § 3.05 [1] [a] [iii] at 3-73. At common law, the offeree/counter-offeror gets all of its terms simply because it fired the last shot in the exchange of forms. *Section 2-207(3)* does away with this result by giving neither party the terms it attempted to impose unilaterally on the other. *See id.* at 3-71. Instead, all of the terms on which the parties' forms do not agree drop out, and the U. C. C. supplies the missing terms.

Generally, this result is fair because both parties are responsible for the ambiguity in their contract. The parties could have negotiated a contract and agreed on its terms, but for whatever reason, they failed to do so. Therefore, neither party should get its terms. *See* 3 R. Duesenberg & L. King, § 3.05 [2] at 3-88. However, as [**14] White and Summers point out, resort to *section 2-207(3)* will often work to the disadvantage of the seller because he will "wish to undertake less responsibility for the quality of his goods than the Code imposes or else wish to limit his damages liability more narrowly than would the Code." J. White &

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R. Summers, § 1-2 at 34. Nevertheless, White and Summers recommend [*1445] that *section 2-207(3)* be applied in such cases. *Id.* We agree. Application of *section 2-207(3)* is more equitable than giving one party its terms simply because it sent the last form. Further, the terms imposed by the code are presumably equitable and consistent with public policy because they are statutorily imposed. *See* 3 R. Duesenberg & L. King, § 3.05 [2] at 3-88.

With these general principles in mind, we turn now to Metal-Matic's argument that Krack assented to the disclaimer when it continued to accept and pay for tubing once Metal-Matic indicated that it was willing to sell tubing only if its warranty and liability terms were part of the contract. Metal-Matic's argument is appealing. Sound policy supports permitting a seller to control the terms on which it will sell its products, especially [**15] in a case in which the seller has indicated both in writing and orally that those are the only terms on which it is willing to sell the product. Nevertheless, we reject Metal-Matic's argument because we find that these considerations are outweighed by the public policy reflected by Oregon's enactment of the U. C. C.

If we were to accept Metal-Matic's argument, we would reinstate to some extent the common law's last shot rule. To illustrate, assume that the parties in this case had sent the same forms but in the reverse order and that Krack's form contained terms stating that Metal-Matic is liable for all consequential damages and conditioning acceptance on Metal-Matic's assent to Krack's terms. Assume also that Metal-Matic objected to Krack's terms but Krack refused to change them and that the parties continued with their transaction anyway. If we applied Metal-Matic's argument in that case, we would find that Krack's term was part of the contract because Metal-Matic continued to ship tubing

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to Krack after Krack reaffirmed that it would purchase tubing only if Metal-Matic were fully liable for consequential damages. Thus, the result would turn on which party sent the last form, and [**16] would therefore be inconsistent with *section 2-207*'s purpose of doing away with the last shot rule.

That result is avoided by requiring a specific and unequivocal expression of assent on the part of the offeror when the offeree conditions its acceptance on assent to additional or different terms. If the offeror does not give specific and unequivocal assent but the parties act as if they have a contract, the provisions of *section 2-207(3)* apply to fill in the terms of the contract. Application of *section 2-207(3)* is appropriate in that situation because by going ahead with the transaction without resolving their dispute, both parties are responsible for introducing ambiguity into the contract. Further, in a case such as this one, requiring the seller to assume more liability than it intends is not altogether inappropriate. The seller is most responsible for the ambiguity because it inserts a term in its form that requires assent to additional terms and then does not enforce that requirement. If the seller truly does not want to be bound unless the buyer assents to its terms, it can protect itself by not shipping until it obtains that assent. *See C. Itoh & Co., 552 F.2d at 1238*. [**17]

We hold that because Krack's conduct did not indicate unequivocally that Krack intended to assent to Metal-Matic's terms, that conduct did not amount to the assent contemplated by *section 2-207(1)*. *See* 3 R. Duesenberg & L. King, § 3.05 [1] [a] [iii] at 3-74. [7]

7 Metal-Matic also argues that testimony of Krack's own employee shows that both parties understood that Metal-Matic's disclaimers were part of the contract. However, the testimony upon which Metal-Matic bases this

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argument shows only that Krack was aware of Metal-Matic's position, not that Metal-Matic had adopted or agreed to it.

B. S*ufficiency of the Evidence*

Metal-Matic next argues that there is insufficient evidence to support the jury verdict against it. First, Metal-Matic argues that the evidence does not support a [*1446] finding that it manufactured the tubing in which the leak developed. Second, Metal-Matic argues that even if it manufactured the failed tubing, the evidence establishes that it could not have caused [**18] the defect in the tubing. Although the evidence is contradictory on these issues, there is substantial evidence to support a jury verdict in favor of Krack.

1. D*id Metal-Matic Manufacture the Tubing that Failed*?

From 1978 through 1981, when the unit involved in this case was manufactured, Krack purchased tubing only from Metal-Matic and Van Huffel. Metal-Matic leaves the bead on welds in the tubing it manufactures, and Van Huffel removes the bead from welds in its tubing. The bead was left on the welds in the tubing that developed the leak. Nevertheless, Metal-Matic argues that there is no proof that it manufactured this tubing. Metal-Matic's argument is based on testimony that before 1978, Krack also purchased tubing from several smaller suppliers, some of which left the bead on their welds and that Krack puts all of its tubing in common bins.

The evidence on this issue is contradictory. That being the case, it was the jury's responsibility to weigh the evidence and reach a decision. The jury reached a result that is supported by substantial evidence, and we will not disturb it. *See Mosesian, 727 F.2d at 877*.

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2. D*id Metal-Matic Cause the Defect* [**19] ?

Three experts, Wong for Diamond, Myers for Metal-Matic, and Irish for Krack, testified that the hole they observed in the tubing was caused by a hacksaw. One expert, Smith for Diamond, testified that the hole he saw was a pinhole and that there were no saw grooves on the tubing when he inspected it. Smith was the first expert to inspect the cooling unit after the leak was discovered. The next expert to inspect the unit, Myers, did not do so until almost two years after Smith's last inspection. During that time the unit was left in a hall at Diamond's warehouse. When Myers did inspect the unit, he cut the leaky section of tubing out of the unit. He then did more cutting on that section of tubing at his office. The other two experts, Wong and Irish, saw the tubing after Myers inspected it.

Relying on the testimony that the hole in the tubing was caused by a hacksaw, Metal-Matic attempts to show that such a hole could only have been made by Krack. The testimony at trial established that both Krack and Metal-Matic have hacksaws on their premises, but Krack is more likely to use a hacksaw around the tubing than is Metal-Matic.

Again there is evidence that would support a finding [**20] on either side of this issue. The jury weighed the evidence and reached a verdict supported by substantial evidence. That verdict will not be disturbed on appeal. *See Mosesian, 727 F.2d at 877*.

The jury verdict is supported by the evidence and consistent with the U. C. C. Therefore, the district court did not err in denying Metal-Matic's motion for a directed verdict. AFFIRMED.

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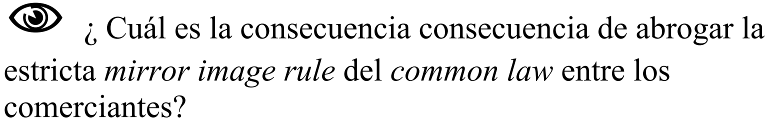

¿ Cuál es la consecuencia consecuencia de abrogar la estricta *mirror image rule* del *common law* entre los comerciantes?

BAYWAY REFINING COMPANY, Plaintiff-Appellee, TOSCO CORPORATION, Plaintiff-Counter-Defendant-Appellee, -v.- OXYGENATED MARKETING AND TRADING A. G., Defendant-Counter-Claimant-Appellant. UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT 215 F.3d 219; 41 U. C. C. Rep. Serv. 2d 713 January 11, 2000, Argued June 8, 2000, Decided

OPINION BY: JACOBS [*220] Plaintiff-appellee Bayway Refining Company ("Bayway") paid federal excise tax on a petroleum transaction, as the Internal Revenue Code requires a petroleum dealer to do in a sale to a buyer who has not procured an exemption under the applicable tax provision. In this diversity suit against the buyer, Oxygenated Marketing and Trading A. G. ("OMT"), Bayway seeks to recover the amount of the tax it paid. One question in this "battle of the forms" contract case is whether, under N. Y. *U. C. C. § 2-207(2)(b)* (McKinney 1993), a contract term allocating liability to [**2] the [*221] buyer for an excise tax is an additional term presumed to have been accepted (as the seller contends) or (as the buyer contends) a material alteration presumed to have been rejected. The United States District Court for the Southern District of New York (McKenna, *J.*) granted summary judgment in favor of the seller, Bayway.

We conclude that, in the circumstances presented: (i) the party opposing the inclusion of an additional term under *§ 2-207(2)(b)* bears the burden of proving that the term amounts to a material alteration; (ii) the district court properly granted summary judgment in favor of the seller,

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because the additional term here did not materially alter the contract; and (iii) the district court properly admitted evidence of custom and practice in the industry despite the fact that it was first proffered in the moving party's reply papers. Accordingly, we affirm.

Background

Bayway and OMT are in the business of buying and selling petroleum products. Bayway contracted to sell to OMT 60,000 barrels of a gasoline blendstock called Methyl Tertiary Butyl Ether ("MTBE"). On February 12, 1998, OMT faxed Bayway a confirmation letter, which operated as the offer, and [**3] which stated in pertinent part:

We are pleased to confirm the details of our purchase from you of MTBE as agreed between Mr. Ben Basil and Roger Ertle on [February 12, 1998.]

This confirmation constitutes the entire contract and represents our understanding of the terms and conditions of our agreement. Any apparent discrepancies or omissions should be brought to our notice within the next two working days.

Bayway faxed its confirmation to OMT the next day. That document, which operated as the acceptance, stated in pertinent part: "We are pleased to confirm the following verbal agreement concluded on February 12, 1998 with your company. This document cancels and supersedes any correspondence in relation to this transaction." Bayway's acceptance then set forth the parties, price, amount and delivery terms, and undertook to incorporate the company's standard terms:

Notwithstanding any other provision of this agreement, where not in conflict with the foregoing, the terms and conditions as set forth in Bayway Refining Company's General Terms and Conditions dated March 01, 1994 along

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with Bayway's Marine Provisions are hereby incorporated in full by [**4] reference in this contract.

The Bayway General Terms and Conditions were not transmitted with Bayway's fax, but Paragraph 10 of its General Terms and Conditions states:

Buyer shall pay seller the amount of any federal, state and local excise, gross receipts, import, motor fuel, superfund and spill taxes and all other federal, state and local taxes however designated, other than taxes on income, paid or incurred by seller directly or indirectly with respect to the oil or product sold hereunder and/or on the value thereof.

This term is referenced as the "Tax Clause."

OMT did not object to Bayway's acceptance or to the incorporation of its General Terms and Conditions (which included the Tax Clause). OMT accepted delivery of the MTBE barrels on March 22, 1998.

The Internal Revenue Code imposes an excise tax, payable by the seller, on the sale of gasoline blendstocks such as MTBE "to any person who is not registered under [*26 U. S. C. § 4101*] " for a tax exemption.*26 U. S. C. A. § 4081(a)(1)(A)(iv) (West Supp. 1999)*. After delivery, Bayway learned that OMT was not registered with the Internal Revenue Service for the tax [**5] exemption. The transaction therefore created a tax liability of $464,035.12, which Bayway paid.

[*222] Invoking the Tax Clause, Bayway demanded payment of the $464,035.12 in taxes in addition to the purchase price of the MTBE. OMT denied that it had agreed to assume the tax liability and refused to pay that invoice item. In response, Bayway filed this diversity suit alleging breach of contract by OMT.

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Upon Bayway's motion for summary judgment, the district court held that the Tax Clause was properly incorporated into the contract. *See Tosco Corp. v. Oxygenated Mktg. & Trading A. G., 1999 U. S. Dist. LEXIS 7903*, No. 98 Civ. 4695, 1999 WL 328342, at *3-*6 (S. D. N. Y. May 24, 1999). The fact that Bayway had failed to attach a copy of the General Terms and Conditions was irrelevant because OMT could have obtained a copy if it had asked for one. *See id.* at *3. The court then analyzed the contract-forming documents, applied the "battle of the forms" framework set forth in N. Y. *U. C. C. § 2-207(2)*, and concluded that OMT failed to carry its burden of proving that the Tax Clause materially altered the contract. *See id.* at *3-*6. The court therefore granted summary judgment in favor of Bayway. [1]

1 The underlying litigation also involved a second MTBE transaction. In June 1998, OMT contracted to sell 35,000 barrels of MTBE to Tosco Refining Company ("Tosco"), Bayway's parent company. Tosco offset the money claimed by Bayway under the Bayway/OMT contract at issue in this appeal. Tosco joined Bayway in its suit against OMT, seeking as alternative relief a declaration that Tosco was entitled to the offset; and OMT counterclaimed. The district court granted summary judgment in favor of OMT, concluding that Tosco had no right of offset under the June 1998 contract. *See Tosco Corp.*, 1999 WL 328342, at *7. Tosco did not appeal that decision, and it is therefore not before this Court.

[**6] Discussion

On appeal, OMT argues (i) that it succeeded in raising genuine issues of fact as to whether the Tax Clause materially altered the Bayway/OMT contract and (ii) that the evidence of custom and practice in the industry, upon

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which the grant of summary judgment turns, was improperly admitted.

We review the district court's grant of summary judgment *de novo*. *See Young v. County of Fulton, 160 F.3d 899, 902 (2d Cir. 1998)*. In so doing, this Court construes the evidence in the light most favorable to the non-moving party and draws all reasonable inferences in its favor. *See Anderson v. Liberty Lobby, Inc., 477 U. S. 242, 255, 91 L. Ed. 2d 202, 106 S. Ct. 2505 (1986)*; *Maguire v. Citicorp Retail Servs., Inc., 147 F.3d 232, 235 (2d Cir. 1998)*. Summary judgment is appropriate only where "there is no genuine issue as to any material fact and the moving party is entitled to a judgment as a matter of law." *Fed. R. Civ. P. 56(c)*.

We affirm for substantially the reasons stated by the district court. We hold--on an issue of first impression in this Court--that in a "battle of the forms" case governed by N. Y. *U. C. C. §* [**7] *2-207(2)(b)*, the party opposing the inclusion of an additional term bears the burden of proving that the term works a material alteration. Viewing the evidence in the light most favorable to OMT, we conclude that OMT failed to shoulder that burden. Finally, we hold that the district court properly admitted the evidence concerning industry custom and practice. [2]

2 OMT raises two arguments for the first time on appeal. First, OMT argues that Bayway's acceptance was effected by a different confirmation fax, sent by a broker, which did not list or reference additional terms, and that the Tax Clause therefore never became a part of the contract. Second, OMT contends that the third "battle of the forms" exception also applies, because a supposed integration clause contained in OMT's offer constitutes a "notification of objection" to any additional terms contained in the Acceptance. N. Y. *U. C. C. § 2-207(2)(c)*. "It is a well-

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established general rule that an appellate court will not consider an issue raised for the first time on appeal." *Greene v. United States, 13 F.3d 577, 586 (2d Cir. 1994)*. We decline to reach these untimely arguments. [**8]

[*223] **A. Battle of the Forms.**

Bayway argued its motion for summary judgment on the basis of New York law, presumably because one of the additional terms incorporated by its acceptance is a New York choice-of-law provision. OMT has accepted New York law as controlling for purposes of Bayway's summary judgment motion.

Under New York law, the rules of engagement for the "battle of the forms" are set out in the Uniform Commercial Code ("U. C. C."), *§ 2-207*:

(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 be 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 [**9] is received. N. Y. *U. C. C. § 2-207*.

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It was undisputed in the district court that Bayway's confirmation fax is effective to form a contract as an acceptance--even though it stated or referenced additional terms (including the Tax Clause)--because it was not made expressly conditional on OMT's assent to the additional terms. *See id. § 2-207(1)*. Therefore, under *§ 2-207(2)*, the Tax Clause is a proposal for an addition to the contract. *See id. § 2-207(2)*. The parties are both merchants within the meaning of the U. C. C. *See id.* § 2-104(1), (3). The Tax Clause therefore is presumed to become part of the contract unless one of the three enumerated exceptions applies. *See id. § 2-207(2)*. In its defense, OMT invokes the "material alteration" exception of *§ 2-207(2)(b)*.

1. *Burden of Proof.*

The allocation of the burden of proof under this exception to *§ 2-207(2)* is a question of New York law, *see United States v. McCombs, 30 F.3d 310, 323-24 (2d Cir. 1994)* (holding that, under the *Erie* doctrine, federal courts sitting in diversity apply the forum state's law concerning burdens of proof), and is answered in the text of New York's U. C. [**10] C. *§ 2-207(2)*. *Section 2-207(2)(b)* is an exception to the general rule of *§ 2-207(2)* that additional terms become part of a contract between merchants. That general rule is in the nature of a presumption concerning the intent of the contracting parties. Thus if neither party introduced any evidence, the Tax Clause would, by the plain language of *§ 2-207(2)*, become part of the contract. To implement that presumption, the burden of proving the materiality of the alteration must fall on the party that opposes inclusion. Accordingly, we hold that under *§ 2-207(2)(b)* the party opposing the inclusion of additional terms shoulders the burden of proof. In so doing, we join almost every court to have considered this issue. *See Avedon Eng'g, Inc. v. Seatex, 126 F.3d 1279, 1284 (10th Cir. 1997)* (describing a

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"conventional UCC analysis" as placing "the burden of showing that [an additional term] is a material alteration on the party opposing its inclusion because *section 2-207* presumes inclusion of additional terms between merchants"); *see also, e. G.*, *Jom, Inc. v. Adell Plastics, Inc., 193 F.3d 47, 59 (1st Cir. 1999)*; *Comark Merchandising, Inc. v. Highland Group, Inc., 932 F.2d 1196, 1201 (7th Cir. 1991)*; [**11] *K I C Chems., Inc. v. ADCO Chem. Co., 1996 U. S. Dist. LEXIS 3244*, No. 95 CIV. 6321, 1996 WL 122420, at *4 (S. D. N. Y. Mar. 20, 1996); *Bergquist Co. v. Sunroc Corp., 777 F. Supp. 1236, 1245 n.11 (E. D. Pa. 1991)*; *LTV Energy Prods. Co. v. Northern States Contracting Co. (In re* [*224] *Chateaugay Corp.), 162 B. R. 949, 956 (Bankr. S. D. N. Y. 1994)*; *Palmer G. Lewis Co. v. ARCO Chem. Co., 904 P.2d 1221, 1229 (Alaska 1995)*; *Wilson Fertilizer & Grain, Inc. v. ADM Milling Co., 654 N. E.2d 848, 850 (Ind. Ct. App. 1995)*; *Eskay Plastics, Ltd. v. Chappell, 34 Wn. App. 210, 660 P.2d 764, 767 (Wash. Ct. App. 1983). But see Westech Eng'g, Inc. v. Clearwater Constructors, Inc., 835 S. W.2d 190, 199 n.3 (Tex. App. 1992).*

2. *Materiality and Per Se Materiality.*

A material alteration is one that would "result in *surprise* or *hardship* if incorporated without express awareness by the other party." N. Y. *U. C. C. § 2-207* cmt. 4 (emphasis added).

Certain additional terms are deemed material as a matter of law. For example, an arbitration clause is *per se* a material alteration in New York because New York law [**12] requires an express agreement to commit disputes to arbitration. *See Marlene Indus. v. Carnac Textiles, Inc., 45 N. Y.2d 327, 408 N. Y. S.2d 410, 413, 380 N. E.2d 239 (1978)*; *see also* N. Y. *U. C. C. § 2-207* cmt. 4 (listing as examples of *per se* material alterations, *inter alia*, waivers

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of warranties of merchantability or fitness for a particular purpose and clauses granting the seller the power to cancel upon the buyer's failure to meet any invoice). OMT characterizes the Tax Clause as a broad-ranging indemnity clause, and analogizes it to these *per se* material alterations. We reject the analogy. The Tax Clause allocates responsibility for the tax payable on a specific sale of goods. *See Union Carbide Corp. v. Oscar Mayer Foods Corp., 947 F.2d 1333, 1335, 1337 (7th Cir. 1991)* (distinguishing between "open-ended" tax liability, which is a material alteration, from "responsibility for taxes shown on an individual invoice," which is not). And unlike an arbitration clause, which waives a range of rights that are solicitously protected, the Tax Clause is limited, discrete and the subject of no special protection. Unable to show that the Tax Clause [**13] is a material alteration *per se*, OMT must prove that in this case the Tax Clause resulted in surprise or hardship. [3]

3 Even if an additional term that places the tax liability on the opposing party was a material alteration *per se*, New York law allows a party to rebut this conclusion in some limited circumstances with a sufficient showing that the additional term reflects the custom and practice in the particular industry. *See Avedon Eng'g, 126 F.3d at 1285 &* n.15 (discussing New York law); *Schubtex, Inc. v. Allen Snyder, Inc., 49 N. Y.2d 1, 424 N. Y. S.2d 133, 135, 399 N. E.2d 1154 (1979)*. As discussed below, Bayway's evidence that the Tax Clause reflects the custom and practice in the petroleum industry is compelling and unrebutted.

3. *Surprise.*

Surprise, within the meaning of the material alteration exception of *§ 2-207(2)(b)*, has both the subjective element of what a party actually knew and the objective element of what a party should have known. *See American Ins. Co. v.*

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El Paso Pipe & Supply Co., 978 F.2d 1185, 1191 (10th Cir. 1992); [**14] *In re Chateaugay, 162 B. R. at 956-57*. A profession of surprise and raised eyebrows are not enough: "Conclusory statements, conjecture, or speculation by the party resisting the motion will not defeat summary judgment." *Kulak v. City of New York, 88 F.3d 63, 71 (2d Cir. 1996)*. To carry the burden of showing surprise, a party must establish that, under the circumstances, it cannot be presumed that a reasonable merchant would have consented to the additional term. *See Union Carbide, 947 F.2d at 1336*.

OMT has adduced evidence that the Tax Clause came as an amazement to OMT's executives, who described the term's incorporation as "contract by ambush" and a "sleight-of-hand proposal." Thus OMT has sufficiently exhibited its subjective surprise. As to objective surprise, however, OMT has alleged no facts and introduced no evidence to show that a reasonable petroleum merchant would be surprised by the Tax Clause. *See In re* [*225] *Chateaugay, 162 B. R. at 957* (including as types of evidence proving objective surprise "the parties' prior course of dealing and the number of written confirmations that they exchanged, industry custom [**15] and the conspicuousness of the term"). OMT had no prior contrary course of dealing with Bayway, and offered nothing concerning trade custom or practice.

Ordinarily, our inquiry into surprise would end here. However, in response to OMT's claim of surprise, Bayway introduced evidence that the Tax Clause reflects custom and practice in the petroleum industry, and on appeal OMT argues that Bayway's own evidence raises a genuine issue of material fact as to whether such a trade practice exists. Although the evidence was introduced by Bayway, [4] we are "obligated to search the record and independently determine whether or not a genuine issue of fact exists."

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Jiminez v. Dreis & Krump Mfg. Co., 736 F.2d 51, 53 (2d Cir. 1984) (quoting *Higgins v. Baker, 309 F. Supp. 635, 639 (S. D. N. Y. 1970))* (internal quotation marks omitted).

4 Bayway introduced the trade practice evidence to rebut OMT's claim of surprise. Typically, Bayway would bear the burden of establishing the custom and practice in the industry. *See Putnam Rolling Ladder Co. v. Manufacturers Hanover Trust Co., 74 N. Y.2d 340, 547 N. Y. S.2d 611, 615, 546 N. E.2d 904 (1989)* ("The burden of proving a trade usage has generally been placed on the party benefiting from its existence."). *See generally* 1 James J. White & Robert S. Summers, *Uniform Commercial Code* § 3-3, at 124 n.52 (4th ed. 1995) (collecting cases). This allocation of burden avoids forcing the party claiming objective surprise to prove a negative.

[**16] Upon our review of the evidence, we conclude that Bayway has adduced compelling proof that shifting tax liability to a buyer is the custom and practice in the petroleum industry. Two industry experts offered unchallenged testimony that it is customary for the buyer to pay all the taxes resulting from a petroleum transaction. One expert stated that "this practice is so universally understood among traders in the industry, that I cannot recall an instance, in all my years of trading and overseeing trades, when the buyer refused to pay the seller for excise or sales taxes."

OMT cites the standard contracts of five major petroleum companies that Bayway introduced to illustrate contract terms similar to the Tax Clause. OMT argues that only three of the five place the tax liability on the buyer, and that there is therefore an issue of fact as to whether the Tax Clause would objectively surprise a merchant in this industry.

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OMT misconstrues the evidence. Three of the contracts--those of CITGO Petroleum, Conoco, and Enron--mirror the Tax Clause. A fourth, Chevron's, differs from the others only in that the cost of the taxes is added into the contract price rather than separately itemized. [**17] Thus Chevron's standard contract affords OMT no support.

The fifth example, the Texaco contract, is silent as to the tax allocation issue in this case. But on this unrebutted record of universal trade custom and practice, silence supports no contrary inference.

Moreover, common sense supports Bayway's evidence of custom and practice. The federal excise tax is imposed when taxable fuels are sold "to any person who is not registered under [*26 U. S. C. § 4101*] ." *26 U. S. C. § 4081(a)(1)(A)(iv)*. The buyer thereby controls whether any tax liability is incurred in a transaction. A trade practice that reflects a rational allocation of incentives (as trade practices usually do) would place the burden of the tax on the party that is in the position to obviate it--here, on OMT as the buyer.

Viewing Bayway's evidence in the light most favorable to OMT, we conclude that allocating the tax liability to the buyer is the custom and practice in the petroleum industry. OMT could not be objectively surprised by the incorporation of an additional term in the contract that reflects such a practice.

[*226] 4. *Hardship.*

To recapitulate: A material alteration [**18] is one that would "result in surprise *or* hardship if incorporated without express awareness by the other party." N. Y. *U. C. C. § 2-207* cmt. 4 (emphasis added). Although this Official Comment to the U. C. C. seemingly treats hardship as an independent ground for finding that an alteration is material, courts have expressed doubt: "You cannot walk

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away from a contract that you can fairly be deemed to have agreed to, merely because performance turns out to be a hardship for you, unless you can squeeze yourself into the impossibility defense or some related doctrine of excuse." *Union Carbide, 947 F.2d at 1336* ("Hardship is a consequence [of material alteration], not a criterion. (Surprise can be either.)"); *see also, e. G.*, *Suzy Phillips Originals, Inc. v. Coville, Inc., 939 F. Supp. 1012, 1017-18 (E. D. N. Y. 1996)* (citing *Union Carbide* with approval and limiting the test for material alteration to surprise); *In re Chateaugay, 162 B. R. at 957* (same).

We need not decide whether hardship is an independent ground of material alteration, because even if it were, OMT failed to raise a genuine issue of material fact as to hardship. [**19] OMT's only evidence of hardship is (generally) that it is a small business dependent on precarious profit margins, and it would suffer a loss it cannot afford. That does not amount to hardship in the present circumstances.

Typically, courts that have relied on hardship to find that an additional term materially alters a contract have done so when the term is one that creates or allocates an open-ended and prolonged liability. *See, e. G.*, *St. Charles Cable TV, Inc. v. Eagle Comtronics, Inc., 687 F. Supp. 820, 827 (S. D. N. Y. 1988)* (finding a hardship in "shifting all risks for any dispute to the buyers"), *aff'd*, *895 F.2d 1410 (2d Cir. 1989)* (unpublished table disposition); *Charles J. King, Inc. v. Barge "LM-10", 518 F. Supp. 1117, 1120 (S. D. N. Y. 1981)*.

The Tax Clause places on a buyer a contractual responsibility that bears on a specific sale of goods, that is (at least) not uncommon in the industry, and that the buyer could avoid by registration. The cry of hardship rings

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hollow, because any loss that the Tax Clause imposed on OMT is limited, routine and self-inflicted.

OMT failed to raise a factual issue as to hardship or surprise. [**20] Summary judgment was therefore appropriately granted in favor of Bayway.

B. Admissibility of the Common Trade Practice Evidence.

OMT argues that the district court erred in considering Bayway's evidence of industry custom and practice because it was submitted with Bayway's reply submission rather than with its moving papers. We review for abuse of discretion the district court's decision to rely upon this evidence. *Cf. Cifarelli v. Village of Babylon, 93 F.3d 47, 53 (2d Cir. 1996)* (reviewing for abuse of discretion the denial of a motion to amend the judgment, in which the non-moving party objected to the court's reliance on an affidavit submitted with the moving party's reply papers).

Bayway brought this suit alleging that the Tax Clause had been validly incorporated and that OMT had breached the contract by refusing to pay the tax. OMT's answer denied generally that the Tax Clause was ever incorporated, without alleging specifically that it was a material alteration under *§ 2-207(2)(b)*. When Bayway moved for summary judgment, its papers tracked the allegations of its complaint. The material alteration argument was raised for the first time in OMT's [**21] opposing papers. Bayway's reply submission was thus its first opportunity to rebut OMT's argument with custom and practice evidence.

We affirm the district court's decision because "reply papers may properly address new material issues raised in the opposition papers so as to avoid giving [*227] unfair advantage to the answering party." *Litton Indus. v. Lehman Bros. Kuhn Loeb Inc., 767 F. Supp. 1220, 1235 (S. D. N. Y. 1991)*, *rev'd on other grounds*, *967 F.2d 742 (2d Cir.*

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1992); *see Bonnie & Co. Fashions, Inc. v. Bankers Trust Co., 945 F. Supp. 693, 708 (S. D. N. Y. 1996)*; *Travelers Ins. Co. v. Buffalo Reinsurance Co., 735 F. Supp. 492, 495* (S. D. N. Y.), *vacated in part on other grounds, 739 F. Supp. 209 (S. D. N. Y. 1990)*; *United States v. International Bus. Machs. Corp., 66 F. R. D. 383, 384 (S. D. N. Y. 1975)*.

In addition to the timing of OMT's material alteration argument, three other reasons support the district court's acceptance of Bayway's evidence:

(i) OMT was not surprised by the affidavits in question. OMT knew that evidence of custom and practice in the industry could refute its material [**22] alteration argument, but chose not to introduce any evidence demonstrating that the Tax Clause was objectively surprising. Instead, OMT simply noted in its opposition papers that "Bayway has presented no evidence whatsoever of any custom in the industry to have such a tax indemnity term in such a contract." This statement undermines OMT's claim that it was treated unfairly by the court's acceptance of Bayway's evidence. *See Cifarelli, 93 F.3d at 53*.

(ii) OMT did not move the district court for leave to file a sur-reply to respond to Bayway's evidence. OMT thus failed to seek a timely remedy for any injustice. *See, e. G., Litton Indus., 767 F. Supp. at 1235* ("Where new evidence is presented in a party's reply brief or affidavit in further support of its summary judgment motion, the district court should permit the nonmoving party to respond to the new matters prior to disposition of the motion.").

(iii) OMT makes no claim that it has any contrary evidence to introduce even if it were given an opportunity to proffer it. OMT's real complaint seems to be that its attempt to surprise Bayway with its material alteration argument was thwarted [**23] by the district court's

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exercise of its discretion to receive evidence on the other side.

Under these circumstances, we conclude that the district court acted within its discretion in accepting and relying upon the affidavits submitted with Bayway's reply papers.

Conclusion

For the foregoing reasons, we affirm the judgment of the district court.

¿ Dónde los términos de la oferta integran el contrato celebrado entre los comerciantes?

RICH HILL and ENZA HILL, on behalf of a class of persons similarly situated, Plaintiffs-Appellees, v. GATEWAY 2000, INC., and DAVID PRAIS, Defendants-Appellants. UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT 105 F.3d 1147; 31 U. C. C. Rep. Serv. 2d 303 December 10, 1996, argued January 6, 1997, decided

OPINION BY: EASTERBROOK [*1148] A customer picks up the phone, orders a computer, and gives a credit card number. Presently a box arrives, containing the computer and a list of terms, said to govern unless the customer returns the computer within 30 days. Are these terms effective as the parties' contract, or is the contract term-free because the order-taker did not read any terms over the phone and elicit the customer's assent?

One of the terms in the box containing a Gateway 2000 system was an arbitration clause. Rich and Enza Hill, the customers, kept the computer [**2] more than 30 days before complaining about its components and performance. They filed suit in federal court arguing, among other things, that the product's shortcomings make Gateway a racketeer (mail and wire fraud are said to be the predicate offenses),

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leading to treble damages under RICO for the Hills and a class of all other purchasers. Gateway asked the district court to enforce the arbitration clause; the judge refused, writing that "the present record is insufficient to support a finding of a valid arbitration agreement between the parties or that the plaintiffs were given adequate notice of the arbitration clause." Gateway took an immediate appeal, as is its right.*9 U. S. C. § 16(a)(1)(A)*.

The Hills say that the arbitration clause did not stand out: they concede noticing the statement of terms but deny reading it closely enough to discover the agreement to arbitrate, and they ask us to conclude that they therefore may go to court. Yet an agreement to arbitrate must be enforced "save upon such grounds as exist at law or in equity for the revocation of any contract." *9 U. S. C. § 2. Doctor's Associates, Inc. v. Casarotto, 134 L. Ed. 2d 902, 116 S. Ct. 1652 (1996)*, holds that this provision [**3] of the Federal Arbitration Act is inconsistent with any requirement that an arbitration clause be prominent. A contract need not be read to be effective; people who accept take the risk that the unread terms may in retrospect prove unwelcome. C*arr v. CIGNA Securities, Inc., 95 F.3d 544, 547 (7th Cir. 1996)*; *Chicago Pacific Corp. v. Canada Life Assurance Co., 850 F.2d 334 (7th Cir. 1988)*. Terms inside Gateway's box stand or fall together. If they constitute the parties' contract because the Hills had an opportunity to return the computer after reading them, then all must be enforced.

ProCD, Inc. v. Zeidenberg, 86 F.3d 1447 (7th Cir. 1996), holds that terms inside a box of software bind consumers who use the software after an opportunity to read the terms and to reject them by returning the product. Likewise, *Carnival Cruise Lines, Inc. v. Shute, 499 U. S. 585, 113 L. Ed. 2d 622, 111 S. Ct. 1522 (1991)*, enforces a forum-selection clause that was included among three

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pages of terms attached to a cruise ship ticket. *ProCD* and *Carnival Cruise Lines* exemplify the many commercial transactions in which people pay for products with terms to follow; *ProCD* discusses others.*86 F.3d at 1451-52*. The district [**4] court concluded in *ProCD* that the contract is formed when the consumer pays for the software; as a result, the court held, only terms known to the consumer at that moment are part of the contract, and provisos inside the box do not count. Although this is one way a contract [*1149] could be formed, it is not the only way: "A vendor, as master of the offer, may invite acceptance by conduct, and may propose limitations on the kind of conduct that constitutes acceptance. A buyer may accept by performing the acts the vendor proposes to treat as acceptance." *Id. at 1452*. Gateway shipped computers with the same sort of accept-or-return offer ProCD made to users of its software. *ProCD* relied on the Uniform Commercial Code rather than any peculiarities of Wisconsin law; both Illinois and South Dakota, the two states whose law might govern relations between Gateway and the Hills, have adopted the UCC; neither side has pointed us to any atypical doctrines in those states that might be pertinent; *ProCD* therefore applies to this dispute.

Plaintiffs ask us to limit *ProCD* to software, but where's the sense in that? *ProCD* is about the law of contract, not the law of software. Payment [**5] preceding the revelation of full terms is common for air transportation, insurance, and many other endeavors. Practical considerations support allowing vendors to enclose the full legal terms with their products. Cashiers cannot be expected to read legal documents to customers before ringing up sales. If the staff at the other end of the phone for direct-sales operations such as Gateway's had to read the four-page statement of terms before taking the buyer's credit card number, the droning voice would anesthetize

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rather than enlighten many potential buyers. Others would hang up in a rage over the waste of their time. And oral recitation would not avoid customers' assertions (whether true or feigned) that the clerk did not read term X to them, or that they did not remember or understand it. Writing provides benefits for both sides of commercial transactions. Customers as a group are better off when vendors skip costly and ineffectual steps such as telephonic recitation, and use instead a simple approve-or-return device. Competent adults are bound by such documents, read or unread. For what little it is worth, we add that the box from Gateway was crammed with software. The computer came [**6] with an operating system, without which it was useful only as a boat anchor. See *Digital Equipment Corp. v. Uniq Digital Technologies, Inc., 73 F.3d 756, 761 (7th Cir. 1996)*. Gateway also included many application programs. So the Hills' effort to limit *ProCD* to software would not avail them factually, even if it were sound legally--which it is not.

For their second sally, the Hills contend that *ProCD* should be limited to executory contracts (to licenses in particular), and therefore does not apply because both parties' performance of this contract was complete when the box arrived at their home. This is legally and factually wrong: legally because the question at hand concerns the *formation* of the contract rather than its *performance*, and factually because both contracts were incompletely performed. *ProCD* did not depend on the fact that the seller characterized the transaction as a license rather than as a contract; we treated it as a contract for the sale of goods and reserved the question whether for other purposes a "license" characterization might be preferable.*86 F.3d at 1450*. All debates about characterization to one side, the transaction in *ProCD* [**7] was no more executory than the one here: Zeidenberg paid for the software and walked out

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of the store with a box under his arm, so if arrival of the box with the product ends the time for revelation of contractual terms, then the time ended in *ProCD* before Zeidenberg opened the box. But of course ProCD had not completed performance with delivery of the box, and neither had Gateway. One element of the transaction was the warranty, which obliges sellers to fix defects in their products. The Hills have invoked Gateway's warranty and are not satisfied with its response, so they are not well positioned to say that Gateway's obligations were fulfilled when the motor carrier unloaded the box. What is more, both ProCD and Gateway promised to help customers to use their products. Long-term service and information obligations are common in the computer business, on both hardware and software sides. Gateway offers "lifetime service" and has a round-the-clock telephone hotline to fulfil this promise. Some vendors spend more money helping customers use their products than on developing and manufacturing them. The document in Gateway's box includes promises of [*1150] future performance that some consumers [**8] value highly; these promises bind Gateway just as the arbitration clause binds the Hills.

Next the Hills insist that *ProCD* is irrelevant because Zeidenberg was a "merchant" and they are not. *Section 2-207(2) of the UCC*, the infamous battle-of-the-forms section, states that "additional terms [following acceptance of an offer] are to be construed as proposals for addition to a contract. Between merchants such terms become part of the contract unless. .". Plaintiffs tell us that *ProCD* came out as it did only because Zeidenberg was a "merchant" and the terms inside ProCD's box were not excluded by the "unless" clause. This argument pays scant attention to the opinion in *ProCD*, which concluded that, when there is only one form, " *§ 2-207* is irrelevant." *86 F.3d at 1452*. The question in *ProCD* was not whether terms were added

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to a contract after its formation, but how and when the contract was formed--in particular, whether a vendor may propose that a contract of sale be formed, not in the store (or over the phone) with the payment of money or a general "send me the product," but after the customer has had a chance to inspect both the item and the terms. *ProCD* answers [**9] "yes," for merchants and consumers alike. Yet again, for what little it is worth we observe that the Hills misunderstand the setting of *ProCD*. A "merchant" under the UCC "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", *§ 2-104(1)*. Zeidenberg bought the product at a retail store, an uncommon place for merchants to acquire inventory. His corporation put ProCD's database on the Internet for anyone to browse, which led to the litigation but did not make Zeidenberg a software merchant.

At oral argument the Hills propounded still another distinction: the box containing ProCD's software displayed a notice that additional terms were within, while the box containing Gateway's computer did not. The difference is functional, not legal. Consumers browsing the aisles of a store can look at the box, and if they are unwilling to deal with the prospect of additional terms can leave the box alone, avoiding the transactions costs of returning the package after reviewing its contents. Gateway's box, by contrast, is just a shipping carton; it is not on display [**10] anywhere. Its function is to protect the product during transit, and the information on its sides is for the use of handlers ("Fragile!" "This Side Up!") rather than would-be purchasers.

Perhaps the Hills would have had a better argument if they were first alerted to the bundling of hardware and legal-ware after opening the box and wanted to return the

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computer in order to avoid disagreeable terms, but were dissuaded by the expense of shipping. What the remedy would be in such a case--could it exceed the shipping charges?--is an interesting question, but one that need not detain us because the Hills knew before they ordered the computer that the carton would include *some* important terms, and they did not seek to discover these in advance. Gateway's ads state that their products come with limited warranties and lifetime support. How limited was the warranty--30 days, with service contingent on shipping the computer back, or five years, with free onsite service? What sort of support was offered? Shoppers have three principal ways to discover these things. First, they can ask the vendor to send a copy before deciding whether to buy. The Magnuson-Moss Warranty Act requires firms [**11] to distribute their warranty terms on request, *15 U. S. C. § 2302(b)(1)(A)*; the Hills do not contend that Gateway would have refused to enclose the remaining terms too. Concealment would be bad for business, scaring some customers away and leading to excess returns from others. Second, shoppers can consult public sources (computer magazines, the Web sites of vendors) that may contain this information. Third, they may inspect the documents after the product's delivery. Like Zeidenberg, the Hills took the third option. By keeping the computer beyond 30 days, the Hills accepted Gateway's offer, including the arbitration clause.

The Hills' remaining arguments, including a contention that the arbitration [*1151] clause is unenforceable as part of a scheme to defraud, do not require more than a citation to *Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U. S. 395, 18 L. Ed. 2d 1270, 87 S. Ct. 1801 (1967)*. Whatever may be said pro and con about the cost and efficacy of arbitration (which the Hills disparage) is for Congress and the contracting parties to consider. Claims based on RICO

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are no less arbitrable than those founded on the contract or the law of torts. *Shearson/ American Express, Inc. v. McMahon, 482 U. S. 220,* [**12] *238-42, 96 L. Ed. 2d 185, 107 S. Ct. 2332 (1987)*. The decision of the district court is vacated, and this case is remanded with instructions to compel the Hills to submit their dispute to arbitration.

¿ Un formulario escondido dentro del paquete puede integrar el contrato con un consumidor?

F. LA INTERPRETACIÓN CONTRACTUAL

G. LOS USOS COMERCIALES

H. EL *PAROLE EVIDENCE RULE* SE AFLOJA

COLUMBIA NITROGEN CORPORATION, Appellant, v. ROYSTER COMPANY, Appellee UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT 451 F.2d 3; 9 U. C. C. Rep. Serv. 977 April 6, 1971, Argued October 26, 1971, Decided

OPINION BY: BUTZNER [*6] Columbia Nitrogen Corp. appeals a judgment in the amount of $750,000 in favor of F. S. Royster Guano Co. for breach of a contract for the sale of phosphate to Columbia by Royster. Columbia defended on the grounds that the contract, construed in light of the usage of the trade and course of dealing, imposed no duty to accept at the quoted prices the minimum quantities stated in the contract. It also asserted an antitrust defense and counterclaim based on Royster's alleged reciprocal trade practices. [1] The district court excluded the evidence about course of dealing and usage of the trade. It submitted the antitrust issues based on coercive reciprocity to the jury, but refused to submit the alternative theory of non-coercive reciprocity. The jury found for Royster on both the contract claim and the antitrust counterclaim. We hold that Columbia's proffered evidence was improperly excluded and Columbia is entitled to a new

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trial on the contractual issues. With respect to the antitrust issues, we affirm.

1 Royster alleged diversity jurisdiction.*28 U. S. C. § 1332 (1964)*. Columbia's defense and counterclaim were based on *15 U. S. C. §§ 1* and *15 (1964)*.

[**2] I.

Royster manufactures and markets mixed fertilizers, the principal components of which are nitrogen, phosphate and potash. Columbia is primarily a producer of nitrogen, although it manufactures some mixed fertilizer. For several years Royster had been a major purchaser of Columbia's products, but Columbia had never been a significant customer of Royster. In the fall of 1966, Royster constructed a facility which enabled it to produce more phosphate than it needed in its own operations. After extensive negotiations, the companies executed a contract for Royster's sale of a minimum of 31,000 tons of phosphate each year for three years to Columbia, with an option to extend the term. The contract stated the price per ton, subject to an escalation clause dependent on production costs. [2]

2 In pertinent part, the contract provides:

"Contract made as of this 8th day of May between COLUMBIA NITROGEN CORPORATION, a Delaware corporation, (hereinafter called the Buyer) hereby agrees to purchase and accept from F. S. ROYSTER GUANO COMPANY, a Virginia corporation, (hereinafter called the Seller) agrees to furnish quantities of Diammonium Phosphate 18-46-0, Granular Triple Superphosphate 0-46-0, and Run-of-Pile Triple Superphosphate 0-46-0 on the following terms and conditions.

"*Period Covered by Contract* -- This contract to begin July 1, 1967, and continue through June 30, 1970, with

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renewal privileges for an additional three year period based upon notification by Buyer and acceptance by Seller on or before June 30, 1969. Failure of notification by either party on or before June 30, 1969, constitutes an automatic renewal for an additional one-year period beyond June 30, 1970, and on a year-to-year basis thereafter unless notification of cancellation is given by either party 90 days prior to June 30 of each year.

"Products Supplied Under Contract

"Seller agrees to provide additional quantities beyond the minimum specified tonnage for products listed above provided Seller has the capacity and ability to provide such additional quantities. * * *

"*Price* -- In Bulk F. O. B. Cars, Royster, Florida. * * *

"*Default* -- If Buyer fails to pay for any delivery under this contract within 30 days after Seller's invoice to Buyer and then if such invoice is not paid within an additional 30 days after the Seller notifies the Buyer of such default, then after that time the Seller may at his option defer further deliveries hereunder or take such action as in their judgment they may decide including cancellation of this contract. Any balances carried beyond 30 days will carry a service fee of 3/4 of 1% per month. * * *

"*Escalation* -- The escalation factor up or down shall be based upon the effects of changing raw material cost of sulphur, rock phosphate, and labor as follows. These escalations up or down to become effective against shipments of products covered by this contract 30 days after notification by Seller to Buyer. * * *

"No verbal understanding will be recognized by either party hereto; this contract expresses all the terms and conditions of the agreement, shall be signed in duplicate

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and shall not become operative until approved in writing by the Seller."

[**3] [*7] Phosphate prices soon plunged precipitously. Unable to resell the phosphate at a competitive price, Columbia ordered only part of the scheduled tonnage. At Columbia's request, Royster lowered its price for diammonium phosphate on shipments for three months in 1967, but specified that subsequent shipments would be at the original contract price. Even with this concession, Royster's price was still substantially above the market. As a result, Columbia ordered less than a tenth of the phosphate Royster was to ship in the first contract year. When pressed by Royster, Columbia offered to take the phosphate at the current market price and resell it without brokerage fee. Royster, however, insisted on the contract price. When Columbia refused delivery, Royster sold the unaccepted phosphate for Columbia's account at a price substantially below the contract price.

II.

Columbia assigns error to the pretrial ruling of the district court excluding all evidence on usage of the trade and course of dealing between the parties. It offered the testimony of witnesses with long experience in the trade that because of uncertain crop and weather conditions, farming practices, and [**4] government agricultural programs, express price and quantity terms in contracts for materials in the mixed fertilizer industry are mere projections to be adjusted according to market forces. [3]

3 Typical of the proffered testimony are the following excerpts:

para. "The contracts generally entered into between buyer and seller of materials has always been, in my opinion, construed to be the buyer's best estimate of his anticipated requirements for a given period of time. It is

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well known in our industry that weather conditions, farming practices, government farm control programs, change requirements from time to time. And therefore allowances were always made to meet these circumstances as they arose."

para. "Tonnage requirements fluctuate greatly, and that is one reason that the contracts are not considered as binding as most contracts are, because the buyer normally would buy on historical basis, but his normal average use would be per annum of any given material. Now that can be affected very decidedly by adverse weather conditions such as a drought, or a flood, or maybe governmental programs which we have been faced with for many, many years, seed grain programs. They pay the farmer not to plant. If he doesn't plant, he doesn't use the fertilizer. When the contracts are made, we do not know of all these contingencies and what they are going to be. So the contract is made for what is considered a fair estimate of his requirements. And, the contract is considered binding to the extent, on him morally, that if he uses the tonnage that he will execute the contract in good faith as the buyer. * * *"

para. "I have never heard of a contract of this type being enforced legally. * * Well, it undoubtedly sounds ridiculous to people from other industries, but there is a very definite, several very definite reasons why the fertilizer business is always operated under what we call gentlemen's agreements. * * *"

para. "The custom in the fertilizer industry is that the seller either meets the competitive situation or releases the buyer from it upon proof that he can buy it at that price. * * * They will either have the option of meeting it or releasing him from taking additional tonnage or holding him to that price. * * *"

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para. And this custom exists "regardless of the contractual provisions."

para. "The custom was that [these contracts] were not worth the cost of the paper they were printed on."

[**5] [*8] Columbia also offered proof of its business dealings with Royster over the six-year period preceding the phosphate contract. Since Columbia had not been a significant purchaser of Royster's products, these dealings were almost exclusively nitrogen sales to Royster or exchanges of stock carried in inventory. The pattern which emerges, Columbia claimed, is one of repeated and substantial deviation from the stated amount or price, including four instances where Royster took none of the goods for which it had contracted. Columbia offered proof that the total variance amounted to more than $500,000 in reduced sales. This experience, a Columbia officer offered to testify, formed the basis of an understanding on which he depended in conducting negotiations with Royster.

The district court held that the evidence should be excluded. It ruled that "custom and usage or course of dealing are not admissible to contradict the express, plain, unambiguous language of a valid written contract, which by virtue of its detail negates the proposition that the contract is open to variances in its terms. * * *"

A number of Virginia cases have held that extrinsic evidence may not be received [**6] to explain or supplement a written contract unless the court finds the writing is ambiguous. E. *g.*, *Mathieson Alkali Works v. Virginia Banner Coal Corp., 147 Va. 125, 136 S. E. 673 (1927)*. This rule, however, has been changed bythe Uniform Commercial Code which Virginia has adopted. The Code expressly states that it "shall be liberally construed and applied to promote its underlying purposes and policies," which include "the continued expansion of

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commercial practices through custom, usage and agreement of the parties * * *." *Va. Code Ann. § 8.1-102* (1965). The importance of usage of trade and course of dealing between the parties is shown by *§ 8.2-202*, [4] which [*9] authorizes their use to explain or supplement a contract. The official comment states this section rejects the old rule that evidence of course of dealing or usage of trade can be introduced only when the contract is ambiguous. [5] And the Virginia commentators, noting that "this section reflects a more liberal [**7] approach to the introduction of parol evidence * * * than has been followed in Virginia," express the opinion that *Mathieson, supra*, and similar Virginia cases no longer should be followed. V*a. Code Ann. § 8.2-202*, Va. Comment. S*ee also Portsmouth Gas Co. v. Shebar, 209 Va. 250, 253 n.1, 163 S. E.2d 205, 208 n.1 (1968)* (dictum). We hold, therefore, that a finding of ambiguity is not necessary for the admission of extrinsic evidence about the usage of the trade and the parties' course of dealing.

4 *Va. Code Ann. § 8.2-202* provides:

"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 (*§ 8.1-205*) or by course of performance (§ 8.2-208); and

(b) by evidence of consistent additional terms unless the court find the writing to have been intended also as a complete and exclusive statement of the terms of the agreement." [**8]

5 *Va. Code Ann. § 8.2-202*, Comment 1 states:

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"This section definitely rejects:

* * *

"(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."

We turn next to Royster's claim that Columbia's evidence was properly excluded because it was inconsistent with the express terms of their agreement. There can be no doubt that the Uniform Commercial Code restates the well established rule thatevidence of usage of trade and course of dealing should be excluded whenever it cannot be reasonably construed as consistent with the terms of the contract. D*ivision of Triple T Service, Inc. v. Mobil Oil Corp., 60 Misc. 2d 720, 304 N. Y. S.2d 191, 203 (1969)*, *aff'd mem.*, *34 A. D.2d 618, 311 N. Y. S.2d 961 (1970)*. Royster argues that the evidence [**9] should be excluded as inconsistent because the contract contains detailed provisions regarding the base price, escalation, minimum tonnage, and delivery schedules. The argument is based on the premise that because a contract appears on its face to be complete, evidence of course of dealing and usage of trade should be excluded. We believe, however, that neither the language nor the policy of the Code supports such a broad exclusionary rule. S*ection 8.2-202* expressly allows evidence of course of dealing or usage of trade to explain or supplement terms intended by the parties as a final expression of their agreement. [6] When this section is read in light of *Va. Code Ann. § 8.1-205(4)*, [7] it is clear that the test of admissibility is not whether the contract appears on its face to be complete in every detail, but whether the proffered evidence of course of dealing and trade usage reasonably can be construed as consistent with the express terms of the agreement.

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6 This section is set forth in full at note 4, *supra*.

7 *Va. Code Ann. § 8.1-205(4)* states:

"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."

[**10] The proffered testimony sought to establish that because of changing weather conditions, farming practices, and government agricultural programs, dealers adjusted prices, quantities, and delivery schedules to reflect declining market conditions. For the following reasons it is reasonable to construe this evidence as consistent with the express terms of the contract:

The contract does not expressly state that course of dealing and usage of trade cannot be used to explain or supplement the written contract.

The contract is silent about adjusting prices and quantities to reflect a declining market. It neither permits nor prohibits [*10] adjustment, and this neutrality provides a fitting occasion for recourse to usage of trade and prior dealing to supplement the contract and explain its terms.

Minimum tonnages and additional quantities are expressed in terms of "Products Supplied Under Contract." Significantly, they are not expressed as just "Products" or as "Products Purchased Under Contract." The description used by the parties is consistent with the proffered testimony.

Finally, the default clause of the contract refers only to the failure of the buyer to pay for delivered [**11] phosphate. [8] During the contract negotiations, Columbia rejected a Royster proposal for liquidated damages of $10

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for each ton Columbia declined to accept. On the other hand, Royster rejected a Columbia proposal for a clause that tied the price to the market by obligating Royster to conform its price to offers Columbia received from other phosphate producers. The parties, having rejected both proposals, failed to state any consequences of Columbia's refusal to take delivery -- the kind of default Royster alleges in this case. Royster insists that we span this hiatus by applying the general law of contracts permitting recovery of damages upon the buyer's refusal to take delivery according to the written provisions of the contract. This solution is not what the Uniform Commercial Code prescribes. Before allowing damages, a court must first determine whether the buyer has in fact defaulted. It must do this by supplementing and explaining the agreement with evidence of trade usage and course of dealing that is consistent with the contract's express terms. *Va. Code Ann. §§ 8.1-205(4)*, *8.2-202*. Faithful adherence to this mandate reflects the reality of the marketplace and avoids the [**12] overly legalistic interpretations which the Code seeks to abolish.

8 The default clause is set forth at note 2, *supra*.

Royster also contends that Columbia's proffered testimony was properly rejected because it dealt with mutual willingness of buyer and seller to adjust contract terms to the market. Columbia, Royster protests, seeks unilateral adjustment. This argument misses the point. What Columbia seeks to show is a practice of mutual adjustments so prevalent in the industry and in prior dealings between the parties that it formed a part of the agreement governing this transaction. It is not insisting on a unilateral right to modify the contract.

Nor can we accept Royster's contention that the testimony should be excluded under the contract clause:

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"No verbal understanding will be recognized by either party hereto; this contract expresses all the terms and conditions of the agreement, shall be signed in duplicate, and shall not become operative until approved in writing by the Seller."

[**13] Course of dealing and trade usage are not synonymous with verbal understandings, terms and conditions. S*ection 8.2-202*draws a distinction between supplementing a written contract by consistent additional terms and supplementing it by course of dealing or usage of trade. [9] Evidence of additional terms must be excluded when "the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement." Significantly, no similar limitation is placed on the introduction of evidence of course of dealing or usage of trade. Indeed the official comment notes that course of dealing and usage of trade, unless carefully negated, are admissible to supplement the terms of any writing, and that contracts are to be read on the assumption that these elements were taken for granted when the document was [*11] phrased. [10] Since the Code assigns course of dealing and trade usage unique and important roles, they should not be conclusively rejected by reading them into stereotyped language that makes no specific reference to them. C*f. Provident Tradesmens Bank & Trust Co. v. Pemberton, 196 Pa. Super. 180, 173 A.2d 780 (1961)*. [**14] Indeed, the Code's official commentators urge that overly simplistic and overly legalistic interpretation of a contract should be shunned. [11]

9 This section is set forth in full at note 4, *supra*.

10 *Va. Code Ann. § 8.2-202*, Comment 2 states:

"Paragraph (a) [of § 8.202] makes admissible evidence of course of dealing, usage of trade and course of performance to explain or supplement the terms of any

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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."

See also Levie, Trade Usage and Custom under the Common Law and the Uniform Commercial Code, 40 N. Y. U. L. Rev. 1101, 1111 (1965).

[**15]

11 Referring to the general provisions about course of dealing and trade usage, *Va. Code Ann. § 8.1-205*, Comment 1 states:

"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."

We conclude, therefore, that Columbia's evidence about course of dealing and usage of trade should have been admitted. Its exclusion requires that the judgment against Columbia must be set aside and the case retried.

III.

We find no error in the district court's refusal to enter judgment for Columbia on the basis of a purchase order

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Columbia issued and Royster acknowledged ten days after the contract was signed. On its face, the order included shipping and invoicing instructions, [**16] and the printed statement: "Seller's acknowledgment required, see reverse side for terms and conditions which are a part of this order and have the same force and effect as if set out on its face." On the reverse of the form were the following printed provisions:

"8. Purchaser reserves the right at any time to change this order in any particular with respect to goods not theretofore shipped thereunder. If any such change shall increase Seller's cost of performance, Seller shall immediately notify Purchaser thereof and an equitable adjustment in the price shall be made by written amendment to this order."

* * *

"10. In case of conflict of any of the Purchaser's terms with those of Seller, Purchaser's terms will govern unless specific exception is agreed to in writing by Purchaser."

Royster acknowledged the receipt of the purchase order in writing.

Both parties agree that the contract and the purchase order must be read together. Relying on *Va. Code Ann. § 8.2-207*, Columbia argues that the purchase order amended the contract because Royster's signed acknowledgment was an express agreement to the additional terms printed on the back.

The flaw in Columbia's [**17] argument is that *§ 8.2-207* applies only to the formation of contracts. It states, with certain exceptions not in issue here, that " [a] definite and seasonable expression of acceptance * * * operates as an acceptance even though it states terms additional [*12] to or different from those offered or agreed upon * * *."

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Here the bargain became effective upon the execution of the contract several days before Columbia issued the purchase order. Indeed, the order itself acknowledges the contract for it expressly states that it was issued "to cover concentrated phosphate per contract dated May 8, 1967." [12]

12 On this basis, cases under *§ 2-207 of the Uniform Commercial Code* cited by Columbia are distinguishable; *e. G. Southeastern Enameling Corp. v. General Bronze Corp., 434 F.2d 330 (5th Cir. 1970)*, where the additional terms were included in a written confirmation, and *Roto-Lith, Ltd. v. F. P. Bartlett & Co., Inc., 297 F.2d 497 (1st Cir. 1962)*, where the additional terms were printed on the acknowledgment form denoting acceptance.

[**18] As an alternative theory for summary judgment, Columbia argues that the purchase order was a modification of the contract under § 8.2-209. Noting that under this section "an agreement modifying a contract within this title needs no consideration to be binding," Columbia claimed that Royster's acknowledgment of the purchase order effected a modification reflecting the additional terms printed on the reverse side.

The purchase order, however, does not purport to modify the terms of the contract. Columbia reserved the right to change only the order. The district judge held that this reservation referred to the order's shipping and invoicing instructions and not to the terms and conditions of the contract. The reference to the equitable adjustment in price in the second sentence of the reservation supports his interpretation. His ruling, we believe, is unimpeachable.

For the same reason there was no occasion to admit the purchase order in evidence. There is no dispute about shipping or invoicing, and the order, therefore, was not pertinent to the issues before the jury. Furthermore, it cannot be said that the purchase order corroborates the

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usage of trade or course of dealing [**19] on which Columbia relies. Neither trade usage nor prior dealing sanction unilateral modification of the contract regardless of market conditions. Accompanied by proper instructions describing its role in the transaction, the order could have been admitted into evidence along with the contract. It has, however, no direct bearing on the controversy, and we find no abuse of discretion in its exclusion.

IV.

Contrary to Columbia's contention, we find no reversible error in the district judge's charge to the jury on damages. However, the charge should be amplified on retrial.

Royster sold all the phosphate Columbia had rejected to the Mobil Oil Company for a sum considerably below the contract price. To recover the difference between the contract price and the resale price, Royster's sale to Mobil must have been "made in good faith and in a commercially reasonable manner." *Va. Code Ann. § 8.2-706(1)*. Borrowing from the official comment, the court instructed the jury that "what is a commercially reasonable manner depends on the nature of the goods, the condition of the market and other [**20] circumstances in the case, and cannot be measured by any legal yardstick or divided into degrees. In determining whether the sale of the goods was done * * * in a commercially reasonable manner, you must inquire into all aspects of the sale and not just its manner." This is an accurate statement as far as it goes, but the comment further states that the statute is drawn to enable the seller "to resell in accordance with reasonable commercial practices so as to realize as high a price as possible in the circumstances," and "to dispose of the goods to the best advantage." *Va. Code Ann. § 8.2-706*, Comments 4 and 6.

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The record discloses conflicting testimony about the market price, problems [*13] of storage, and difficulties in making a sale of a large quantity of phosphate. In view of this evidence, it is important for the jury to be fully informed about a seller's obligation to dispose of the goods in a commercially reasonable manner. On retrial, therefore, the instruction explaining this section of the code should mention Royster's duty to realize as high a price as possible under all the circumstances. We find no merit in the other assignments of error to the court's charge [**21] on damages.

V.

As an affirmative defense to Royster's action on the contract and as the basis for a counterclaim, Columbia pleaded that Royster had violated *§ 1* of the Sherman Antitrust Act, *15 U. S. C. § 1 (1964)*, [13] by engaging in reciprocal dealing. [14] Columbia introduced proof, denied by Royster, that Royster had exerted economic leverage through its purchases of nitrogen from Columbia to coerce Columbia to sign the phosphate contract. The court submitted the issue of coercive reciprocity to the jury, which found against Columbia on both its defense and counterclaim. [15]

13 *15 U. S. C. § 1* provides in part:

"Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal * *."

14 "The phrase 'reciprocal dealing' refers to the use of buying power to secure an advantage in the sale of one's products. While reciprocal dealing arrangements may take varied forms, the central core is the use of purchasing power to promote sales." ABA Antitrust Developments 1955-1968 at 11 (1968).

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[**22]

15 Since Royster prevailed, the propriety of the submission of the claim of coercive reciprocity to the jury is not directly in issue on appeal.

Relying on the oft noted analogy to tying arrangements, [16] the district court instructed the jury to the effect that Columbia had to prove, among other facts, that a "not insubstantial" amount of interstate commerce was affected. See *Northern Pacific Ry. v. United States, 356 U. S. 1, 6, 78 S. Ct. 514, 2 L. Ed. 2d 545 (1958)*. Columbia, citing *Fortner Enterprises, Inc. v. United States Steel Corp., 394 U. S. 495, 22 L. Ed. 2d 495, 89 S. Ct. 1252 (1969)*, now protests that proof of a "not insubstantial" amount of interstate commerce is an essential element only of a per se violation of the Sherman Act. It complains that this portion of the charge erroneously restricted the antitrust issues to a per se violation and foreclosed the claim sanctioned by *Fortner* "that the general standards of the Sherman Act have been violated." *394 U. S. at 500, 89 S. Ct. at 1257*.

16 *See, e. G.*, *United States v. General Dynamics Corp., 258 F. Supp. 36, 65 (S. D. N. Y.1966)*; Handler, Emerging Antitrust Issues: Reciprocity, Diversity and Joint Ventures, 49 Va. L. Rev. 433, 437 (1963); Hausman, Reciprocal Dealing and the Antitrust Laws, 77 Harv. L. Rev. 873, 883 (1964).

[**23] Columbia, however, did not comply with *Rule 51 of the Federal Rules of Civil Procedure* by stating distinctly that it objected to the "not insubstantial" test. Instead it countered by requesting an instruction that it met the test on the basis of *International Salt Co. v. United States, 332 U. S. 392, 68 S. Ct. 12, 92 L. Ed. 20 (1947)*, if the jury found the amount of affected business exceeded $500,000. The court first refused this request, but later it gave a supplemental charge to this effect. Having willingly

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embraced the advantages of going to the jury on a per se theory, Columbia cannot now shift to a theory based on the general standards of the Sherman Act. Moreover, since the jury's verdict discloses that it recognized that more than $500,000 of trade was affected, Columbia could not have been prejudiced by the charge. We also find no reversible error in the timing of the supplemental charge or in the court's modification of the language of Columbia's request. See *Wiles v. Nationwide* [*14] *Life Insurance Co., 334 F.2d 296, 300 (4th Cir. 1964)*.

VI.

Columbia now emphasizes an alternative antitrust theory. It contends that non-coercive [**24] reciprocity affords both a valid affirmative defense to Royster's action on the phosphate contract and a basis for recovery of treble damages on its counterclaim. The district court declined to submit these issues to the jury.

Coercive reciprocity has long been recognized as an anti-competitive practice that violates the antitrust laws. [17] Recent dictum of the Supreme Court, however, citing a description of the anti-competitive harm flowing from voluntary reciprocal dealing, evenhandedly condemned reciprocal trading that ensued either from coercion or "from more subtle arrangements." *FTC v. Consolidated Foods Corp., 380 U. S. 592, 594* & n. 2, *85 S. Ct. 1220, 14 L. Ed. 2d 95 (1965)*. Influenced in part by this opinion, one court has stated that non-coercive contracts for reciprocal dealing may violate *§ 1* of the Sherman Act. In reaching this conclusion, it reasoned that the antitrust laws are not designed merely to protect the individual merchant from coercion and other predatory practices."The legislation," said the court, "is intended to preserve free competition. Reciprocity, whether mutual or coercive, serves to exclude competitors by the exercise of large scale [**25]

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purchasing power." *United States v. General Dynamics Corp., 258 F. Supp. 36, 66 (S. D. N. Y.1966)*.

17 *FTC v. Consolidated Foods Corp., 380 U. S. 592, 85 S. Ct. 1220, 14 L. Ed. 2d 95 (1965)*; California Packing Corp., 25 F. T. C. 379 (1937); Mechanical Mfg. Co., 16 F. T. C. 67 (1932); Waugh Equip. Co., 15 F. T. C. 232 (1931). Recently, the Government has obtained a series of consent decrees based on *§§ 1* and *2* of the Sherman Act barring reciprocal dealing. E. *g*., United States v. Bethlehem Steel Corp., 1970 Trade Cas. para. 73,376 (E. D. Pa., Dec. 11, 1970); United States v. General Tire & Rubber Co., 1970 Trade Cas. para. 73,303 (N. D. Ohio, Oct. 21, 1970). S*ee also* ABA Antitrust Developments 1955-1968 at 11-14, 87-89 (1968, Supp. 1971).

In view of our disposition of this aspect of the case, we may assume, without deciding, that the reciprocal dealing disclosed by this record violated *§ 1* of the Sherman Act. [18] It [**26] does not follow, however, that Columbia is entitled to assert non-coercive reciprocity as an affirmative defense or as the basis for recovering treble damages on its counterclaim. [19]

18 Viewing, as we must, the evidence on this issue in the light most favorable to Columbia, the record discloses a long term written contract for Columbia's purchase from Royster of approximately $4,750,000 worth of phosphate conditioned on anticipated purchases of approximately $4,000,000 worth of nitrates by Royster from Columbia. This agreement was reached voluntarily by both parties who enjoyed sufficient economic strength to appreciably restrain free competition in the market.

19 We, of course, express no opinion on whether the Government, or a person not a party to the reciprocal dealing, could maintain an action under *§ 1* of the Sherman

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Act based on the agreement between Royster and Columbia.

Even in diversity actions, [**27] the effect of an act made illegal by a federal statute is to be decided by federal, not state, law. S*ola Electric Co. v. Jefferson Electric Co., 317 U. S. 173, 176, 63 S. Ct. 172, 87 L. Ed. 165 (1942)*. Assuming as we have that the reciprocal dealing violated *§ 1* of the *Sherman Act, Kelly v. Kosuga, 358 U. S. 516, 79 S. Ct. 429, 3 L. Ed. 2d 475 (1959)*, precludes one of the participants from interposing the violation as an affirmative defense to an action on the contract. In *Kelly*, the buyer of 50 carloads of onions, withdrew from storage only 13 cars, and the seller was forced to sell the remaining 37 on a declining market for the buyer's account. The seller then brought an action for the unpaid balance of the purchase price of the 13 cars and damages for the 37 cars. The buyer pleaded as an affirmative defense that the sale was part of an indivisible agreement, to which both the buyer and the seller were parties, that violated *§ 1* of the Sherman [*15] Act. The district court struck the defense and entered summary judgment for the unpaid purchase price and storage charges less the amount obtained by the sale of the 37 cars. The Supreme Court [**28] affirmed, restating the settled principle that"the Sherman Act's express remedies could not be added to judicially by including the avoidance of private contracts as a sanction." *358 U. S. at 519, 79 S. Ct. at 431*. The Court further concluded that only where "the judgment of the Court would itself be enforcing the precise conduct made unlawful by the Act" may the defense of illegality be interposed.*358 U. S. at 520, 79 S. Ct. at 432*. With reference to the argument that the sale and the agreement to fix prices were indivisible, it said:

"Where, as here, a lawful sale for a fair consideration constitutes an intelligible economic transaction in itself, we do not think it inappropriate or violative of the intent of the

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parties to give it effect even though it furnished the occasion for a restrictive agreement of the sort here in question." *358 U. S. at 521, 79 S. Ct. at 432*.

Here, as in *Kelly*, the sale was "an intelligible economic transaction in itself," the price was fair, and the terms were voluntarily accepted. By the time [**29] Royster brought this action, the parties had terminated their reciprocal dealing, and the award of damages to Royster can not exclude competitors. We conclude, therefore, that the district court did not err in refusing to charge the jury on Columbia's affirmative defense of non-coercive reciprocity.[20]

20 Because the jury's verdict settled the issue of coercive reciprocity, we find no occasion to express an opinion about the application of Kelly v. Kosuga to the defense of coercive reciprocal dealing. C*f. Associated Press v. Taft-Ingalls Corp., 340 F.2d 753, 768 (6th Cir. 1965)* (tying arrangement).

VII.

Although we have assumed for the purposes of this case that the non-coercive reciprocal agreement disclosed by the record violated *§ 1* of the Sherman Act, Columbia cannot recover on its counterclaim. Voluntary participation in an agreement, uninfluenced by economic domination of one party [**30] over the other, is inherent in the concept of non-coercive reciprocal dealing. Since the jury's verdict disposed of the issue of coercive reciprocity, Columbia is limited in pressing its non-coercive theory of recovery to evidence disclosing the voluntary, joint participation and equal fault of the parties.

The most recent authority touching this aspect of the case is *Perma Life Mufflers, Inc. v. International Parts Corp., 392 U. S. 134, 140, 88 S. Ct. 1981, 1985, 20 L. Ed. 2d 982 (1968)*, where the Court broadly stated "that the

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doctrine of in pari delicto * * * is not to be recognized as a defense to an antitrust action." That case, however, involved opponents of decidedly unequal strength enmeshed in an illegal scheme. The plaintiffs, the Court noted, "participated to the extent of utilizing illegal arrangements formulated and carried out by others * * * [but] their participation was not voluntary in any meaningful sense." *392 U. S. at 139, 88 S. Ct. at 1985*. Recognizing that the scheme had been thrust upon the plaintiffs, offering them no choice but to cooperate, Mr. Justice Black speaking for the Court said:

"We need not decide * * * whether [**31] * * * truly complete involvement and participation in a monopolistic scheme could ever be a basis, wholly apart from the idea of pari delicto, for barring a plaintiff's cause of action * * *." *392 U. S. at 140, 88 S. Ct. at 1985*.

Columbia's counterclaim is the type of case the Court expressly excluded from the scope of its opinion. Separate opinions in *Perma Life* representing the views of five of the members of the Court, however, provide guidance for the resolution of this issue. These opinions teach thatwhen parties of substantially equal economic strength mutually participate in the formulation and execution of the scheme and bear equal responsibility [*16] for the consequent restraint of trade, each is barred from seeking treble damages from the other. [21]

21 *See 392 U. S. at 146, 147, 149*, and *156, 88 S. Ct. 1981*.

We think it plain, therefore, thata party, [**32] who voluntarily formulates and equally participates in a non-coercive agreement for reciprocal dealing until a declining market makes its purchases unprofitable, cannot maintain an action under *§ 1* of the Sherman Act against its trading partner. S*ee Premier Electrical Construction Co. v. Miller-*

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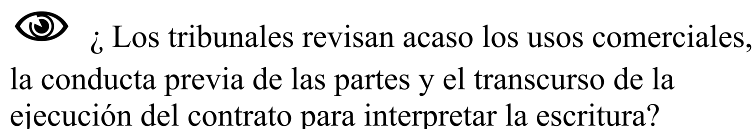
Davis Co., 422 F.2d 1132, 1138 (7th Cir. 1970) (dictum). Accordingly, we conclude the district court committed no error by declining to instruct the jury that Columbia could recover on its counterclaim if it proved a non-coercive agreement for reciprocal dealing.

With respect to all the antitrust issues, the judgment of the district court is affirmed. The judgment for Royster on the contract is vacated, and the case is remanded for further proceedings consistent with this opinion. Each party shall bear its own costs.



¿ Los tribunales revisan acaso los usos comerciales, la conducta previa de las partes y el transcurso de la ejecución del contrato para interpretar la escritura?

I. LAS ESTIPULACIONES CONTRACTUALES

EL REQUISITO TAXATIVO DE LA ESTIPULACIÓN DE TODOS LOS TÉRMINOS DEL CONTRATO SE AFLOJA

CASSERLIE ET AL., APPELLANTS, v. SHELL OIL COMPANY ET AL., AP-PELLEES. SUPREME COURT OF OHIO 121 Ohio St. 3d 55; 902 N. E.2d 1; 68 U. C. C. Rep. Serv. 2d 310 May 20, 2008, Submitted January 6, 2009, Decided

OPINION BY: MOYER

I

[**P1] Appellants' proposition of law proposes that " [t]he definition of Good Faith under the [Uniform Commercial Code] incorporating an 'honesty in fact' component requires a subjective inquiry." We disagree and affirm the judgment of the court of appeals.

II

[**P2] Appellants, Donald Casserlie and others, are a group of independent Shell lessee-dealers in the greater

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Cleveland area (collectively, "the dealers"). The appellees in this case are Shell Oil Company, its partners, and its successors (collectively, "Shell"), who at various times between 1995 and the time the complaint was filed sold Shell-branded gasoline to the dealers in the greater Cleveland area. The dealers leased gas stations, including equipment and land, from Shell and operated them as franchisees. The parties' contracts obligated the dealers to buy gasoline only from Shell at a wholesale price set by Shell at [*56] the time of delivery. This type of term in a contract is known as an open-price term.

[**P3] The price paid by the dealers is referred to as the dealer-tank-wagon ("DTW") price because it includes the cost of delivery to the stations. Shell charged the dealers a DTW price that was based on market factors including the prices offered by its major competitor, British Petroleum ("BP"), and the street price within areas of Cleveland. In each area of the city, called a price administration district ("PAD"), Shell charged all dealers the same DTW price.

[**P4] In 1998, Shell, Texaco, and Saudi Aramco formed Equilon Enterprises L. L. C.; Shell's agreements with service stations in Cleveland were assigned to Equilon. In November 1999, Equilon and appellee Lyden Company entered into a joint venture called True North Energy, L. L. C. True North became the distributor of Shell-branded gasoline in the Cleveland area, including to the stations operated by the dealers. True North set the DTW price as the wholesale price it had paid Equilon for gasoline plus six or seven cents per gallon.

[**P5] Shell also sold gasoline to "jobbers," which were independent companies operating non-Shell-owned gas stations. Jobbers purchased gasoline directly at the oil company's terminal and paid the "rack" price, which was

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the cost of purchasing gasoline at the oil company's terminal and thus did not include delivery costs.

[**P6] In 1999, the dealers filed suit against Shell, alleging, among other claims, that Shell had engaged in bad faith when it set the DTW price. The dealers alleged that the rack price was often substantially lower than the DTW price. This allowed jobbers, including Lyden Company, to offer wholesale DTW prices that were substantially lower than the DTW price charged to the dealers. The dealers contend that this pricing is unreasonable and is part of a marketing plan proposed by Shell that was designed to drive them out of business. The dealers assert that Shell's goal was to eliminate them so that Shell could take over operation of the gas stations, thus profiting from all of the sales, including nonfuel sales, at the stations, and not just from wholesale gasoline sales to and rental income from the dealers.

[**P7] The parties agreed to bifurcate the proceedings and move forward only on the bad-faith claim. On April 13, 2005, the trial court granted summary judgment for Shell. The court found that Shell did not violate *R. C. 1302.18*, which codifies Uniform Commercial Code ("UCC") *section 2-305* and requires a price to be fixed in good faith, when it set the DTW price and that the dealers had not proven that the price had been set in a commercially unreasonable manner.

[**P8] The dealers appealed, arguing that bad faith may be shown either by evidence of a party's intent, a subjective standard, or by evidence of its commercial [*57] unreasonableness, which is an objective standard. The court of appeals affirmed the trial court's ruling and adopted an objective standard based on *Tom-Lin Ents. v. Sunoco, Inc. (R&M) (C. A.6, 2003), 349 F.3d 277*. The court determined that the dealers failed to show that Shell's prices were not

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commercially reasonable. The cause is before this court upon our acceptance of a discretionary appeal.

III

[**P9] As a preliminary matter, we review de novo the granting of summary judgment. *Comer v. Risko, 106 Ohio St.3d 185, 2005 Ohio 4559, 833 N. E.2d 712, P 8*.

[**P10] The parties agree that Shell has authority pursuant to the dealer agreements to set the price of gasoline at the time of delivery. They agree that the price must be set subject to *R. C. 1302.18*, which requires the price to be "reasonable." *R. C. 1302.18(A)*. Pursuant to *R. C. 1302.18(B)* (*UCC section 2-305*(2)), the price must be set "in good faith." "Good faith" is defined generally as "honesty in fact in the conduct or transaction concerned," *R. C. 1301.01(S)*, but in the case of a merchant, "'good faith' * * * means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." *R. C. 1302.01(A)(2)*. It is undisputed that Shell is a "merchant," as defined in *R. C. 1302.01(A)(5)*.

[**P11] Shell argues that good faith requires an objective inquiry and is demonstrated when a seller's price is within the range of its competitors and the seller has not discriminated between similarly situated buyers. Shell also contends that "an inquiry into the seller's subjective intent is neither permitted nor required." The dealers argue that good faith requires a subjective inquiry and ask, " [H] ow can an open price, specifically calculated to drive a contractual partner out of business, be a 'good faith' price."

[**P12] The trial court and court of appeals agreed with Shell, relying on *Tom-Lin Enters., 349 F.3d 277*. In *Tom-Lin*, the court confronted an agreement nearly identical to the one between the dealers and Shell and concluded, applying Ohio law, that an inquiry into good faith required "an *objective* analysis of the merchant-seller's conduct."

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(Emphasis sic and footnote omitted.) *Id. at 281-282*. Thus, neither the trial court nor the court of appeals considered whether an examination into "good faith" required a subjective inquiry, and neither court engaged in a subjective inquiry.

[**P13] It is not disputed that the latter half of the definition of good faith, "the observance of reasonable commercial standards of fair dealing in the trade," requires only an objective analysis. The issue before us is whether there is room for a subjective inquiry within the honesty-in-fact analysis in these circumstances.

[**P14] [*58] The UCC does not define the term "honesty in fact." It should also be noted that " [c] ourts and commentators have recognized that the meaning of 'good faith' is not uniform throughout the [UCC] ." *Mathis v. Exxon Corp. (C. A.5, 2002), 302 F.3d 448, 456*. See also *Martin Marietta Corp. v. New Jersey Nat'l Bank (C. A.3, 1979), 612 F.2d 745, 751* (noting that good faith is considered subjective in Article 1 but objective in Article 2). Thus, case law defining good faith in other areas of the UCC, such as the Article 1 covenant of good faith and fair dealing, is of somewhat limited value here. Non-UCC cases defining good faith are of even less relevance.

[**P15] Official Comment 3 to *UCC section 2-305* does provide some guidance. That comment provides, in full:

[**P16] " [*UCC section 2-305(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. (*Section 2-103* [*R. C.*

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1302.01]). 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."

[**P17] Comment 3 explains that the purpose of *R. C. 1302.18(B)* is to restrict the price a seller or buyer may set when the contract price has been left open, by requiring the price to be fixed in good faith. The second sentence of the comment does not remove honesty in fact from the definition of good faith in this context, because it uses the nonexclusive term "includes." The last sentence, however, is not limited to part of the good-faith definition but rather provides a safe harbor where a "posted price" satisfies good faith in its entirety.

[**P18] A number of cases from other jurisdictions considering openprice terms have relied on the posted-price comment. [1] This court has noted in the past that "it is desirable to conform our interpretations of the Uniform Commercial Code to those of our sister states." *Edward A. Kemmler Mem. Found. v. 691/733 E. Dublin-Granville Rd. Co. (1992), 62 Ohio St.3d 494, 499, 584 N. E.2d 695*. Relying on the Official Comments to the UCC helps to achieve this uniformity, as does reviewing case law that has previously interpreted particular provisions.

1 See *Havird Oil Co., Inc. v. Marathon Oil Co., Inc. (C. A.4, 1998), 149 F.3d 283, 290-291*; *Richard Short Oil Co., Inc. v. Texaco, Inc. (C. A.8, 1986), 799 F.2d 415, 422*; *United Food Mart, Inc. v. Motiva Ents., L. L. C. (S. D. Fla.2005), 457 F. Supp.2d 1329, 1334-1338*; *Wayman v. Amoco Oil Co. (D. Kan.1996), 923 F. Supp. 1322, 1349*; *Shell Oil Co. v. HRN, Inc. (Tex.2004), 144 S. W.3d 429, 433-438*.

[**P19] The Supreme Court of Texas addressed the very issue before us here in an essentially identical fact

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pattern in *Shell Oil Co. v. HRN, Inc.* [*59] *(Tex.2004), 144 S. W.3d 429*. Independent gasoline dealers brought suit against Shell, alleging that the prices were not set in good faith under *UCC section 2-305(2)* because Shell had set the prices intending to put them out of business. *144 S. W.3d 429, 431-432*. The court held that Shell did not violate its duty of good faith, because the posted price was both commercially reasonable and nondiscriminatory. *Id. at 435-436*. It noted that "' [i] t is abundantly clear * * * that the chief concern of the UCC Drafting Committee in adopting *§ 2-305(2)* was to prevent discriminatory pricing.'" *Id. at 434*, quoting *Wayman, 923 F. Supp. at 1346-1347*. A subjective good-faith inquiry "injects uncertainty into the law of contracts and undermines one of the UCC's primary goals-to 'promot [e] certainty and predictability in commercial transactions.'" *Id. at 435*, quoting *Am. Airlines Emps. Fed. Credit Union v. Martin (Tex. 2000), 29 S. W.3d 86, 92*, quoting *Putnam Rolling Ladder Co., Inc. v. Mfrs. Hanover Trust Co. (1989), 74 N. Y.2d 340, 349, 547 N. Y. S.2d 611, 546 N. E.2d 904*. The drafters of the UCC, therefore, incorporated the posted-price safe harbor to prevent extensive litigation involving any open-price term, "while seeking 'to avoid discriminatory prices.' " Id., quoting Malcolm, The Proposed Commercial Code: A Report on Developments from May 1950 through February 1951 (1951), 6 Bus. Law. 113, 186. The court concluded that subjective intent was not intended to stand alone as a basis for liability: " [A] llegations of dishonesty under this section must also have some basis in objective fact which at a minimum requires some connection to the commercial realities of the case." *Id. at 435-436*.

[**P20] A few cases note the posted-price comment but conclude that it does not provide a safe harbor where there is subjective bad faith. See *Marcoux v. Shell Oil Prods. Co. L. L. C. (C. A.1, 2008), 524 F.3d 33, 50*; *Mathis, 302 F.3d*

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at 455-456; *Bob's Shell, Inc. v. O'Connell Oil Assoc., Inc. (Aug. 31, 2005), D. Mass. No. 03-30169, 2005 U. S. Dist. LEXIS 21318, 2005 WL 2365324*; see also *Allapattah Servs., Inc. v. Exxon Corp. (S. D. Fla.1999), 61 F. Supp.2d 1308, 1322* (finding that when the seller double charged for credit-card processing, the action was not a "normal case," because the dispute was not over the actual price charged but over the manner in which the price was calculated; thus, the safe-harbor provision did not apply). Those cases contend that the comment is limited to the "normal case," which does not include a situation where the seller is purposefully trying to drive the buyer out of business.

[**P21] This interpretation would eviscerate the safe harbor in any action in which the plaintiff alleges circumstantial evidence of an improper motive, leading to drawn-out litigation "even if the prices ultimately charged were undisputedly within the range of those charged throughout the industry." *HRN, 144 S. W.3d at 435*. See Berry, Byers, & Oates, Open Price Agreements: Good Faith Pricing in the Franchise Relationship (2007), *27 Franchise L. J. 45, 49*. If a subjective inquiry could determine bad faith, a seller charging a fair price, even exactly the [*60] same price as another, good-faith seller, could be deemed to be acting in bad faith.

[**P22] There appear to be five other cases, besides *HRN*, that directly address the issue of subjectivity. Two, each holding in favor of a subjective inquiry, were decided under Massachusetts law. See *Marcoux, 524 F.3d 33*; *Bob's Shell, 2005 U. S. Dist. LEXIS 21318, 2005 WL 2365324*. *Mathis, 302 F.3d 448*, the only other case proposing subjectivity, is no longer good law, as it was decided by the Fifth Circuit Court of Appeals under Texas law before the Texas Supreme Court issued its ruling in *HRN*. The final two cases, including one from the Sixth Circuit applying Ohio law, conclude that *UCC section 2-305* requires only

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an objective inquiry. See *Tom-Lin Ents., 349 F.3d 277*; *United Food Mart, Inc. v. Motiva Ents., L. L. C. (S. D. Fla. 2005), 457 F. Supp.2d 1329* There are a number of other cases discussing similar open-price-term contracts under *UCC section 2-305* that conduct only an objective analysis, although those cases do not directly state that a subjective inquiry is inappropriate. See, e. G., *Schwartz v. Sun Co., Inc. (R & M) (C. A.6, 2002), 276 F.3d 900, 905*; *Mikeron, Inc. v. Exxon Co., U. S. A. (D. Md.2003), 264 F. Supp.2d 268, 276*; *T. A. M., Inc. v. Gulf Oil Corp. (E. D. Pa.1982), 553 F. Supp. 499, 509*. In total, prior to this court's opinion today, at least three jurisdictions found that the test could be met only with objective evidence of bad faith, while only one concluded that evidence of intent was sufficient.

[**P23] All of this is not to say that intent is necessarily irrelevant to an analysis of good faith under *UCC section 2-305(2)*, but only that a subjective inquiry is not permitted when the posted-price safe harbor applies. By its language, the safe harbor does not apply when it is not the "normal case" or when the price setter is not imposing a "posted price," "given price," "price in effect," "market price," or the like. As long as a price is commercially reasonable, it qualifies as the "normal case." The touchstone of prices set through open-priceterm contracts under *UCC section 2-305* is reasonableness. A price that is nondiscriminatory among similarly situated buyers correspondingly qualifies as a "posted price" or the like. A discriminatory price could not be considered a "posted" or "market" price, because, in effect, the seller is not being "honest in fact" about the price that it is charging as a posted price, since it is charging a different price to other buyers.

[**P24] Therefore, a price that is both commercially reasonable and nondiscriminatory fits within the limits of the safe harbor and complies with the statute's good-faith requirement. Given our conclusion below that the safe

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harbor applies to the facts of this case, we are not required to precisely define good faith as it is used in *section 2-305(2)*. We offer no opinion, in particular, on the role of subjective intent within the good-faith analysis beyond the safe harbor.

[*61] IV

[**P25] The facts of this case demonstrate that the prices set by Shell were both commercially reasonable and nondiscriminatory. Aside from claiming that Shell's goal in setting prices was to drive the dealers out of business, the only evidence of bad faith was that the prices set were too high for dealers to remain profitable and compete with jobbers in the Cleveland area. However, Shell is not required to sell gasoline at a price that is profitable for buyers. "A good-faith price under *section [2-305]* is not synonymous with a fair market price or the lowest price available." *HRN, 144 S. W.3d at 437*. As noted by the court of appeals: "The trial court * * * found that Shell submitted expert testimony which established that the DTW prices set by the company were within the range set by its competitors." *Casserlie v. Shell Oil Co., 2007 Ohio 2633, at P 31*. The dealers failed to rebut this evidence. Id.

[**P26] The dealers also point out that Shell's prices varied throughout the area because of PAD pricing. But the fact that Shell's DTW prices varied by PADs does not itself demonstrate unreasonable or discriminatory pricing. It is reasonable for Shell to adjust according to competition, and there is no evidence that Shell discriminated among similarly situated buyers, such as dealers within a given PAD or dealers in similar PADs.

[**P27] Finally, the only other argument of discrimination put forth by the dealers is that jobbers were charged significantly less, specifically, the rack price rather than the DTW price. Jobbers and dealers are not, however,

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similarly situated buyers. The price difference is partially explained by the fact that the DTW price includes a delivery charge, while the rack price does not. We further find the Sixth Circuit Court of Appeals analysis comparing jobbers and dealers in *Tom-Lin instructive*, just as the lower courts did. See *Tom-Lin Ents., 349 F.3d at 285-286*. *Tom-Lin* noted that jobbers perform additional functions compared to dealers, such as maintaining the properties they own and bearing the risk of environmental liability. *Id. at 285*. Because jobbers relieve Shell of these obligations, they are charged a lower price. The dealers have not challenged these differences. The disparate pricing between jobbers and dealers is not evidence of discrimination.

V

[**P28] When a price that has been left open in a contract is fixed at a price posted by a seller or buyer, and the posted price is both commercially reasonable and nondiscriminatory, the price setter has acted in good faith as required by *R. C. 1302.18(B)*, and a subjective inquiry into the motives of the price setter is not permitted. In this case, the dealers have not provided any evidence that the prices set by Shell were commercially unreasonable or discriminatory. The [*62] posted-price safe harbor therefore applies, and we affirm the judgment of the court of appeals.

Judgment affirmed.

DISSENT BY: PFEIFER

[**P29] The majority opinion's reliance on the safe-harbor presumption is misplaced, as shown by one simple fact: Official Comment 3 to Uniform Commercial Code ("UCC") *section 2-305*, which introduced the concept of a safe-harbor presumption, has never been adopted by the General Assembly. See Am. S. B. No. 5, 129 Ohio Laws 13, 28. The safe-harbor presumption is not part of the law

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of Ohio, despite the majority opinion's insouciant belief to the contrary.

[**P30] "Good faith" is generally treated as incorporating both subjective and objective standards. Although *R. C. 1302.18* deals exclusively with open-price terms, it does not define "good faith" differently from its customary meaning. Many different jurisdictions in many different contexts, including in the context of an open-price term, define "good faith" as requiring both subjective and objective analysis. I am more persuaded by the bulk of these cases than by the fact that three out of four jurisdictions (one of which, in my view, mistakenly applied Ohio law) have decided that an open-price term is susceptible only of objective analysis. See *Bhatia v. Debek (2008), 287 Conn. 397, 412, 948 A.2d 1009*, quoting *Kendzierski v. Goodson (1990), 21 Conn. App. 424, 429-430, 574 A.2d 249* ("In common usage, the term good faith has a well-defined and generally understood meaning, being ordinarily used to describe that state of mind denoting honesty of purpose, freedom from intention to defraud, and, generally speaking, means being faithful to one's duty or obligation. * * * Whether good faith exists is a question of fact to be determined from all the circumstances"); *Tonka Tours, Inc. v. Chadima (Minn.1985), 372 N. W.2d 723, 728* (determining good faith "necessarily involves factual findings. * * * It is for the trier of fact to evaluate the credibility of a claim of 'honesty in fact' and, in doing so, to take account of the reasonableness or unreasonableness of the claim"); *Smalygo v. Green (Okla.2008), 2008 OK 34, 184 P.3d 554, 559* ("By requiring good faith, the Legislature did not create an ambiguity nor did it render the provision vague. Rather, it employed a well-known legal concept that applies to a variety of situations and transactions. For example, the Uniform Commercial Code defines 'good

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faith' as 'honesty in fact and the observance of reasonable commercial standards of fair [*63] dealing.' * * * Similarly, the concept of subjective honesty combined with objective reasonableness is found in an insurer's 'implied-in-law duty to act in good faith and deal fairly with the insured to ensure that the policy benefits are received.' *Christian v. Am. Home Assurance Co., 1977 OK 141, P 8, 577 P.2d 899, 901*"); *Simmons v. Jenkins (1988), 230 Mont. 429, 435, 750 P.2d 1067* ("the *breach* of a duty of good faith is a question of fact not susceptible to summary judgment" [emphasis sic]); *Miller Brewing Co. v. Ed Roleson, Jr., Inc. (2006), 365 Ark. 38, 45, 223 S. W.3d 806* (in determining whether the Miller Brewing Company violated the Arkansas Franchise Practices Act, *Ark. Code Ann. 4-72-201 et seq.*, the Supreme Court of Arkansas stated that " [w] hether Miller dealt with the franchise in a commercially reasonable manner and in good faith is a fact question for the jury"); *Garrett v. BankWest, Inc. (S. D.1990), 459 N. W.2d 833, 841* ("Good faith is derived from the transaction and conduct of the parties. Its meaning varies with the context and emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party"); and *Brunswick Hills Racquet Club, Inc. v. Route 18 Shopping Ctr. Assocs. (2005), 182 N. J. 210, 224-225, 864 A.2d 387*, quoting 4 Williston on Contracts (3d Ed.1961), Section 610B ("The covenant of good faith and fair dealing calls for parties to a contract to refrain from doing 'anything which will have the effect of destroying or injuring the right of the other party to receive' the benefits of the contract").

[**P31] The majority opinion dismisses these cases as being of "limited value" because they do not specifically address open-price terms. But "good faith" does not have a different meaning in Ohio, which has not adopted the UCC comments, when used with open-price terms than when

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used in any other context. Although the cases mentioned above discussed "good faith" in a variety of contexts, the courts agree that it is not possible to determine whether a party acted in "good faith" without a subjective inquiry. See *Allapattah Servs., Inc. v. Exxon Corp. (S. D. Fla.1999), 61 F. Supp.2d 1308, 1322, fn. 24* (The UCC "imposes a duty on merchants to meet good faith requirements that are measured both subjectively and objectively").

[**P32] We have had little occasion to discuss "good faith" in Ohio other than to parrot the Revised Code. See *Master Chem. Corp. v. Inkrott (1990), 55 Ohio St.3d 23, 28, 563 N. E.2d 26* ("'Good faith' is defined in UCC 1-201(19), *R. C. 1301.01(S)*, as 'honesty in fact in the conduct or transaction concerned'"); *Arcanum Natl. Bank v. Hessler (1982), 69 Ohio St. 2d 549, 554, 23 O. O.3d 468, 433 N. E.2d 204* (same). But we have defined "bad faith" as " 'that which imports a dishonest purpose and implies wrongdoing or some motive of self-interest.' " *Master Chem., 55 Ohio St.3d at 28*, quoting *Smith v. Halverson (S. D.1978), 273 N. W.2d 146, 151* (Wollman, C. J., dissenting). See Black's Law Dictionary (8th Ed.2004) 713 ("good faith" is defined as the "absence of intent to [*64] defraud or to seek unconscionable advantage"). *Tom-Lin Ents., Inc. v. Sunoco, Inc. (R&M) (C. A.6, 2003), 349 F.3d 277*, on which the majority opinion relies, clearly misinterpreted *Master Chem.* in concluding that "good faith" requires only objective inquiry. The definition of "bad faith" in *Master Chem.* is the closest that opinion came to addressing the issue before us, and it does not support the conclusion reached by the court in *Tom-Lin* or the conclusion reached by the majority in this case. *Master Chem., 55 Ohio St.3d at 28*.

[**P33] Although Shell cited several cases from federal courts to support its contention that prices set pursuant to an open-price term are subject to only objective inquiry,

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none of them are persuasive. *Ajir v. Exxon Corp. (May 26, 1999), C. A. 9 Nos. 97-17032 and 97-17134, 1999 U. S. App. LEXIS 11046, 1999 WL 393666*, did not address "good faith" but only whether the price charged was "commercially reasonable." *1999 U. S. App. LEXIS 11046, [WL] at *7*. *Schwartz v. Sun Co., Inc. (C. A.6, 2002), 276 F.3d 900, 905*, does not support Shell's contention, because the court addressed only the "commercially reasonable" aspect of "good faith." *USX Corp. v. Internatl. Minerals & Chems. Corp. (Feb.8, 1989), N. D. Ill. No. 86 C 2254, 1989 U. S. Dist. LEXIS 1277, 1989 WL 10851, *1*, does not support Shell's contention, because the court emphasized only that the obligation to fix a price in good faith does not "impose a requirement for a seller to match the lowest price available," an issue that is not before us. *Adams v. G. J. Creel & Sons, Inc. (1995), 320 S. C. 274, 279, 465 S. E.2d 84*, does not support Shell's contention, because the court stated only that the plaintiff did not produce evidence that the price fixed by the defendant was unreasonable. *Richard Short Oil Co., Inc. v. Texaco, Inc. (C. A.8, 1986), 799 F.2d 415, 422-423*, also does not speak directly to subjective or objective inquiry; the court concluded that Short had not presented sufficient evidence to support a claim that Texaco did not act in good faith when it set a cap on rebates, in part because Short did not show that Texaco was dishonest or had a bad motive to injure Short. *Wayman v. Amoco Oil Co. (D. Kan.1996), 923 F. Supp. 1322, 1349*, does not support Shell's contention. In *Wayman*, the court concluded that the plaintiffs could not establish that Amoco had set its price in bad faith. That court stated, however, that " [i] f there was evidence that Amoco had, for example, engaged in discriminatory pricing or tried to run plaintiffs out of business, then the court's decision might be different." *T. A. M., Inc. v. Gulf Oil Corp. (D. C. Pa.1982), 553 F. Supp. 499, 509*, does not support Shell's contention. The court stated, with respect to "good faith," that " [t] he

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plaintiffs have not alleged that the prices they were asked to pay differed from those demanded of other Gulf dealers." In short, none of these cases provide a reason to conclude that the analysis of whether a defendant acted in good faith in setting a price under an open-price term is amenable only to objective inquiry.

[**P34] [*65] The majority opinion also relies on *Shell Oil Co. v. HRN, Inc. (Tex.2004), 144 S. W.3d 429*, in which the Supreme Court of Texas considered the issue that is before us and concluded that open-price terms are subject only to objective inquiry. Because the court in *HRN* relied on the readily distinguishable federal cases discussed above and on the safe-harbor presumption, which Ohio has not adopted, this court should not rely on *HRN*. See *Bob's Shell, Inc. v. O'Connell Oil Assoc., Inc. (Aug. 31, 2005), D. Mass. No. 03-30169, 2005 U. S. Dist. LEXIS 21318, 2005 WL 2365324* (the court rejected the logic and conclusion of *HRN* and stated that it agreed "with Plaintiffs' assertion that [*UCC] section 2-305*'s purpose of preventing price discrimination should bar a supplier from trying to drive its dealers out of business").

[**P35] "Good faith" in the context of open-price terms should be subject to both objective and subjective inquiry. Even courts and commentators who have written in favor of the safe-harbor presumption have concluded that an intent to drive a contractual partner out of business might overcome the presumption. *Wayman, 923 F. Supp. at 1349*; Berry, Byers, and Oates, Open Price Agreements: Good Faith Pricing in the Franchise Relationship (2007), *27 Franchise L. J. 45, 51*. See *Wilson v. Amerada Hess Corp. (2001), 168 N. J. 236, 247, 773 A.2d 1121* ("various courts have stated that a party must exercise discretion reasonably *and with proper motive* when that party is vested with the exercise of discretion under a contract" [emphasis added]). I can conceive of situations in which nondiscriminatory

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pricing could violate "good faith." For instance, in this case, it is alleged that Shell charged all of its similarly situated franchisees the same price, and it is alleged that that price was set too high for them to profitably operate a gas station. In that situation, even though the pricing was nondiscriminatory, it was designed to drive a contractual partner out of business. So much for the concept of a partnership.

[**P36] I believe that "good faith" as defined in *R. C. 1302.01* requires parties to act both honestly in fact and according to reasonable commercial standards. A court's analysis of a merchant's good faith, then, should be both subjective and objective. Furthermore, the safe-harbor presumption, even though not part of the law of Ohio, only applies in the normal case; at a minimum, the appellants should be allowed to attempt to establish that this is not a normal case. I would reverse the judgment of the court of appeals and remand the cause for further consideration consistent with this opinion. After this opinion becomes public, all franchisees in Ohio should watch their wallets very carefully because their franchisors will no longer be held to subjective good-faith standards. Instead, the law of the ocean applies: the big fish are free to consume smaller fish at will. Apparently, not until the waters are exclusively inhabited by a few great white sharks will the majority decide they need a bigger boat or a more robust interpretation of the UCC.

¿ Son para nosotros un misterio los gap fillers del Código Comercial Uniforme, tratándose de los contratos típicos nominados?

J. EL RIESGO DE PÉRDIDA

COOK SPECIALTY COMPANY v. RANDOLPH SCHRLOCK, a/k/a RANDOLPH SCURLOCK, R. T. L.

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LINES, INC., MACHINERY SYSTEMS INTERNATIONAL, LTD. UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA 772 F. Supp. 1532;16 U. C. C. Rep. Serv. 2d 360 September 25, 1991, Decided September 25, 1991, Filed

OPINION BY: WALDMAN [*1532] Defendant Machinery Systems, Inc. ("MSI") contracted to sell plaintiff a machine known as a Dries & Krump Hydraulic Press Brake. When the machine was lost in transit, plaintiff sued defendants to recover for the loss. Presently before the court is plaintiff's Motion for Summary Judgment and defendant MSI's Cross-Motion for Summary Judgment.

I. LEGAL STANDARD

In considering a motion for summary judgment, the court must consider whether the pleadings, depositions, answers to interrogatories and admissions on file, together [*1533] with the affidavits, show there is no genuine issue as to any material fact, and whether the moving party is entitled to a judgment as a matter of law. *Fed. R. Civ. P. 56(c)*. A*nderson v. Liberty Lobby, Inc., 477 U. S. 242, 247, 91 L. Ed. 2d 202, 106 S. Ct. 2505 (1986)*; *Arnold Pontiac-GMC, Inc. v. General Motors Corporation,* [**2] *786 F.2d 564, 568 (3d Cir. 1986)*; only facts that may affect the outcome of a case under applicable law are "material." *Anderson, supra at 248*. All reasonable inferences from the record must be drawn in favor of the non-movant. *Anderson, supra at 255*. Although the movant has the initial burden of demonstrating an absence of genuine issues of material fact, the non-movant must then establish the existence of each element on which it bears the burden of proof. *J. F. Feeser, Inc. v. Serv-A-Portion, 909 F.2d 1524, 1531 (3d Cir. 1990)*, cert. denied *113 L. Ed. 2d 246, 111 S. Ct. 1313 (1991)*, (citing *Celotex Corp. v. Catrett,*

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477 U. S. 317, 323, 91 L. Ed. 2d 265, 106 S. Ct. 2548 (1986)).

II. FACTS

The pertinent facts are not contested and are as follow.

Plaintiff entered into a sales contract with defendant MSI for the purchase of a Dries & Krump Press Brake in August of 1989 for $28,000. The terms of the contract were F. O. B. MSI's warehouse in Schaumburg, Illinois. Defendant R. T. L., also known as Randy's Truck Lines, ("the carrier") was used to deliver the press brake from the defendant's warehouse to the plaintiff in Pennsylvania. MSI obtained a certificate of insurance from the carrier with a face amount of $100,000 [**3] and showing a $2,500 deductible (See dfdt. ex. D.)

On October 20, 1989, the carrier took possession of the press brake at MSI's warehouse. While still in transit, the press brake fell from the carrier's truck. The carrier was cited by the Illinois State Police for not properly securing the load. Plaintiff has recovered damages of $5,000 from the carrier's insurer, the applicable policy limit for this particular incident. The machine was worth $28,000. [1]

1 Plaintiff, who also sued for certain consequential damages, asserts a claim for a total of $81,000.

III. DISCUSSION

This dispute is governed by the Uniform Commercial Code ("UCC") provisions regarding risk of loss. The parties agree that there is no meaningful distinction between the pertinent law of Pennsylvania and Illinois, both of which have adopted the UCC.

The term "F. O. B., place of shipment," means that "the seller must at that place ship the goods in the manner provided in this Article (section 2-504) and bear the expense and risk of putting them [**4] into the possession

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of the carrier." *13 Pa. C. S. A. § 2319*. Thus, MSI bore the expense and risk of putting the machine into the carrier's possession for delivery. At the time the carrier takes possession, the risk of loss shifts to the buyer. The UCC provides:

> 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 *.13 Pa. C. S. A. § 2509*.

Goods are not "duly delivered" under § 2-509, however, unless a contract is entered which satisfies the provisions of Section 2-504. See *13 Pa. C. S. A. § 2509*, Official Comment 2. Section 2-504, entitled "Shipment by Seller" provides that:

> 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 [*1534] for their transportation as may be reasonable having regard to the nature of the goods and other circumstances of the case. *13 Pa. C. S. A. § 2504* (emphasis [**5] added).

Plaintiff argues that the contract MSI made for the delivery of the press brake was not reasonable because defendant failed to ensure that the carrier had sufficient insurance coverage to compensate plaintiff for a loss in transit. Plaintiff thus argues that the press brake was never duly delivered to a carrier within the meaning of section 2-

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509 and accordingly the risk of loss never passed to plaintiff.

Plaintiff relies on two cases. In the first, *La Casse v. Blaustein, 93 Misc. 2d 572, 403 N. Y. S.2d 440 (Civ. Ct. 1978)*, the defendant seller shipped calculators to the plaintiff buyer, a college student, in two cartons by fourth class mail. The buyer authorized the seller to spend up to $50 for shipping and insurance. The seller spent only $9.98 and insured each carton, valued at $1663, for $200. The seller wrongly addressed one of the cartons, and inscribed a theft-tempting notation on it. The New York County Civil Court held that the defendant had improperly arranged for transportation of the calculators.

La Casse is the only reported case which suggests that a seller's failure to obtain adequate insurance may breach his duty to make a reasonable contract for shipment under § [**6] 2-504. The dearth of support for plaintiff's position is instructive. A leading UCC authority has remarked: "Under this subsection [§ 2-504], what constitutes an 'unreasonable' contract of transportation? Egregious cases do arise." See J. White and R. Summers, Uniform Commercial Code § 5-2 (1988). The only such "egregious case" identified by White and Summers is La Casse, where "the package was underinsured, misaddressed, shipped by fourth class mail, and bore a 'theft-tempting' inscription." White and Summers, supra, at § 5-2.

The actions taken by the defendant in La Casse were utterly reckless. Moreover, unlike the defendant in that case, MSI did not undertake the responsibility to insure the shipment, and did not ship the press brake at a lower cost than the plaintiff expressly authorized it to pay.

Plaintiff also relies on *Miller v. Harvey, 221 N. Y. 57 (1917)*. This pre-Code case is inapplicable. In Miller, by failing to declare the actual value of goods shipped on a

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form provided for that purpose, the seller effectively contracted away the buyer's rights against the carrier. Official Comment 3 to section 2-504 states:

> it is an improper contract [**7] 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.

Thus, a contract is improper if the seller agrees to an inadequate valuation of the shipment and thereby extinguishes the buyer's opportunity to recover from the carrier. That is quite different from a seller's failure to ensure that a carrier has sufficient insurance to cover a particular potential loss, in which case the carrier is still liable to the buyer.

Plaintiff's focus on a single sentence of Official Comment 3 ignores the explicit language of the statute which defines reasonable in the context of "having regard to the nature of the goods," *13 Pa. C. S. A. § 2504*, and the portion of the Comment which states:

> 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 and the like Id., Official Comment 3.

The clear implication is that the reasonableness of a shipper's conduct [**8] under § 2-504 is determined with regard to the mode of transport selected. It would be unreasonable, for example, to send perishables without refrigeration. See *Larsen v. A. C. Carpenter, Inc., 620 F. Supp. 1084, 1119 (E. D. N. Y. 1985)*. No inference fairly

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can be drawn from the section that a seller [*1535] has an obligation to investigate the amount and terms of insurance held by the carrier.

The court finds as a matter of law that MSI's conduct was not unreasonable under section 2-504. MSI obtained from the carrier a certificate of insurance and did nothing to impair plaintiff's right to recover for any loss from the carrier. [2] Accidents occur in transit. For this reason, the UCC has specifically established mercantile symbols which delineate the risk of loss in a transaction so that the appropriate party might obtain insurance on the shipment. The contract in this case was "F. O. B." seller's warehouse. Plaintiff clearly bears the risk of loss in transit.

> 2 Plaintiff's argument that because the carrier used an allegedly unprofessional sounding name, Randy's Truck Line, and inelegant stationary, MSI was on notice that the carrier was unreliable is untenable. The Philadelphia telephone directory alone lists dozens of moving companies bearing the name, often just the first name, of an individual. Moreover, plaintiff has made no showing that the carrier, which is a party defendant, does not in fact have the means to satisfy a judgment in the amount sought.

[**9] There are no material facts in dispute and MSI is entitled to judgment as a matter of law. An appropriate order will be entered.

ORDER

AND NOW, this 25th day of September, 1991, upon consideration of the Cross-Motions for Summary Judgment of plaintiff, Cook Specialty Company, and defendant, Machinery Systems International Ltd., and the respective responses thereto, *IT IS HEREBY ORDERED* that plaintiff's Motion is *DENIED* and defendant's Motion is *GRANTED,* and *JUDGMENT* is entered in the above case

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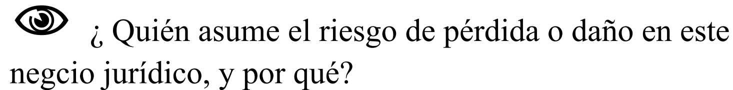
for defendant Machinery Systems International, Ltd. and against plaintiff Cook Specialty Company.



¿ Quién asume el riesgo de pérdida o daño en este negcio jurídico, y por qué?

K. LAS GARANTÍAS EN EL NEGOCIO COMERCIAL

LAS GARANTÍAS EXPLÍCITAS

LA BASE DE LA NEGOCIACIÓN

KEY v. BAGEN et al. Court of Appeals of Georgia 136 Ga. App. 373; 18 U. C. C. Rep. Serv. 882 September 29, 1975, Submitted October 29, 1975, Decided

OPINION BY: EVANS [*373] [**235] This case involves the sale of a horse. The horse, "Lilting Heart," owned by Dr. John Hartley, Jr., was sold through Dr. Hartley's agents, Leonard and Sarah Bagen by their employees, a Mr. Ward and Mrs. Brown. The horse was purchased by Ernest D. Key, Jr., for his daughter, who purchased same in reliance on the representations and selection of Ward and Mrs. Brown, who knew the horse was not suitable for Key's daughter. The horse threw the daughter when she rode it and was unsuitable for her. Upon learning the horse was unsuitable, Key demanded that Dr. Hartley and the Bagens return his money or replace the horse. The demand not being met, Key sued Dr. Hartley, the owner, and Leonard Bagen and Sarah Bagen, his agents, for damages as a consequence of the breach of warranty. Plaintiff contended there had been a breach of warranty and misrepresentation.

As a part of their separate answers, these defendants moved to dismiss the complaint. After a hearing thereon, the motion to dismiss was granted and the complaint was dismissed as to all defendants. Plaintiff appeals. H*eld:*

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1. This transaction for the purchase of a horse, apparently for recreational use, while possibly a casual sale, nevertheless, is provided for in the Uniform Commercial Code which applies to transactions in goods. See Code Ann. §§ 109A-2 -- 102, 109A-2 -- 105.

2. Any affirmation of fact or promise made by the seller to the buyer relating to the goods becomes a part of the basis of the bargain; and "creates an express warranty that the goods shall conform to the affirmation or promise." Code Ann. §§ 109A-2 -- 313, 109A-2 -- 315; *Hill Aircraft &c. Corp. v. Simon, 122 Ga. App. 524, 527 (2) (177 SE2d 803*).

3. Under the Civil Practice Act, § 9 (Code Ann. § 81A-109 (b)), "the circumstance constituting fraud or mistake shall be stated with particularity." Here the allegations of fact that the agent represented the horse to be safe and suitable to learn equitation; that the horse [*374] was well behaved, and even a novice might ride without problem; that defendants knew the horse was being purchased for a young girl to ride and learn equitation; and that the horse was not suitable for the daughter in learning equitation; and that said representations were made within the scope of their authority, are sufficient affirmance of fact stating the circumstances which constituted fraud and misrepresentation in this case. On motion to dismiss, the allegations of [**236] petitioner shall be construed most strongly against the movant and in favor of the pleader. See *Robinson v. A. Const. Co., 130 Ga. App. 56, 59 (202 SE2d 248*); *Hunter v. A-1 Bonding Service, Inc., 118 Ga. App. 498, 499 (164 SE2d 246*). The defendants had sufficient notice to enable them to know they were being charged with fraud and misrepresentation to prepare a proper defense. H*ayes v. Hallmark Apts., 232 Ga. 307, 309 (207 SE2d 197*).

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4. This case differs on its facts from *Goldman v. Hart, 134 Ga. App. 422 (214 SE2d 670*), and in addition, here the essentials of fraud and deceit, where false representations have been made and relied upon, have been met. In the *Goldman* case, *supra, at page 424* in Division 5,the petitioner plead himself out of court by pleading facts showing that there was no fraud practiced by that defendant.

5. Generally, where two parties contract and a suit is filed for the breach thereof, the agent of the contracting party is not liable for his principal's default. See *Hill v. Daniel, 52 Ga. App. 427* (2), 428 (*183 SE 662*). But here it appears that this complaint proceeds under the new Civil Practice Act which allows suits for torts and contract in one and the same action, and that Dr. Hartley is sued for breach of contract, while his agents, Mr. and Mrs. Bagen are being sued for tort. This is allowable under the present law. See *Bacon v. Winter, 118 Ga. App. 358 (3) (163 SE2d 890*); *Cohen v. Garland, 119 Ga. App. 333* (3), 337 (*167 SE2d 599*).

6. The petition should not have been dismissed unless it appeared beyond doubt from the pleadings therein that the plaintiff could not prove any set of facts in support of his claims which would entitle him to relief. See *American Southern Ins. Co. v. Kirkland, 118 Ga. App. 170* [*375] *(162 SE2d 862*). The court erred in dismissing the petition.

JUDGMENT REVERSED.

¿ En Estados Unidos acaso toda representación fáctica sobre la mercadería constituye una garantía expresa?

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LAS GARANTÍAS LEGALES

LA *WARRANTY OF TITLE*

BRYON MOORE, plaintiff-appellant, v. PRO-TEAM CORVETTE SALES, INC., defendant-appellee COURT OF APPEALS OF OHIO, THIRD APPELLATE DISTRICT, HENRY COUNTY 786 N. E.2d 903; 48 U. C. C. Rep. Serv. 2d 528 August 20, 2002, Date of Judgment Entry

OPINION BY: Walters %%03] [*72] [**P1] Plaintiff-Appellant, Bryon Moore, brings this appeal from a Henry County Common Pleas Court decision which dismissed his action against Defendant-Appellee, Pro Team Corvette Sales, Inc., regarding a contract for the sale of a 1974 Chevrolet Corvette, which was subsequently discovered to be stolen. On appeal, Moore argues that terms within the agreement did not effectively disclaim the implied warranty of title under *R. C. 1302.25* (U. C. C. 2-312). Because *R. C. 1302.25* provides for a buyer's basic needs with respect to the type of title he in good faith expects to acquire by his purchase, namely, a good, clean title transferred to him in a rightful manner, we find that the provision lacks sufficient specificity to disclaim the implied warranty of title. Accordingly, we reverse the judgment of the trial court.

[**P2] Facts and procedural history relevant to issues raised on appeal are as follows: In October 1994, Moore drove from his Gross Isle, Michigan residence to Pro Team Corvette Sales, Inc. ("Pro Team"), located in Napoleon, Ohio, in order to purchase a Chevrolet Corvette. On October 17, 1994, he signed as agreement to purchase a 1974 Corvette, as well as a%%04] separate agreement to trade in his 1975 Corvette. When Moore attempted to register the car with the Michigan Bureau of Motor Vehicles, he learned that the car had been reported stolen in Texas, and therefore could not be registered. The Michigan

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State Police subsequently confiscated the car and returned it to Texas.

[**P3] On October 15, 1996, Moore filed suit against Pro Team, arguing that its failure to provide good title to the vehicle was negligent. He also claimed unjust enrichment, breach of statutory warranties, and violations of Ohio's Consumer Sales Practices Act. Pro Team denied all liability, claiming that it had excluded all warranties, including the warranty of title, in the purchase agreement. Pro Team also filed a third-party complaint against the dealership that sold the car to Pro Team, as well as the person who sold the car to that dealer, the Michigan State Police, and the sheriff of San Patricio County, Texas.

[**P4] In defending the suit, Pro Team relied upon language in its contract indicating that the Corvette was being sold "as is" and that the all warranties, including the warranty of title, were excluded from the agreement. Moore sought summary judgment, arguing that the language contained in the agreement was not sufficient to constitute a valid disclaimer of statutorily implied warranties of title. This motion was denied. Moore subsequently dismissed all counts [*73] unrelated to the warranty provisions. In February 2002, the trial court dismissed his remaining claims, concluding that the language contained in the agreement was sufficiently specific to permit exclusion of the warranty of title under *R. C. 1302.25(B)*.

[**P5] Moore appeals the trial court's judgment, presenting the following single assignment of error for our review: "The Trial Court erred when it concluded that the dealer's contract properly excluded the warranty of title."

[**P6] In Ohio, "a seller warrants that he will convey good title free from any security interest or other lien or encumbrance of which the buyer is without knowledge when the contract is made." [1] This implied warranty of title

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is codified in *R. C. 1302.25*, which is identical to and modeled after U. C. C. section 2-312, providing as follows:

1 *Levin v. Nielsen (1973), 37 Ohio App.2d 29, 34, 66 Ohio Op. 2d 52, 306 N. E.2d 173*; *R. C. 1302.25(A)*.

[**P7] "(A) Subject to division (B) of this section there is in a contract for sale a warranty by the seller that:

[**P8] "(1) The title conveyed shall be good, and its transfer rightful; and

[**P9] "(2) 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.

[**P10] "(B) A warranty under division (A) of this section 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.

[**P11] "(C) 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."

[**P12] %%05] Accordingly, "unless excluded or modified, *R. C. 1302.25(A)* adds to a sales contract a warranty by the seller that the title conveyed shall be good and its transfer rightful." [2] As provided by *R. C. 1302.25(B)*, a warranty of title may be excluded or modified by specific language giving the purchaser reasons to know that the vendor is only selling what title he possesses. "This code section provides for a buyer's basic needs in respect to the type of title he in good faith [*74]

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expects to acquire by his purchase, namely, a good, clean title transferred to him in a rightful manner so that he will not be exposed to a lawsuit in order to protect it." [3] "In the usual case,the buyer expects to get a good title, and regards disclaimers as affecting only risks with regard to quality." [4]

2 *Gonder v. Ada Community Improvement Corp*. (March 11, 1996), Hardin App. No. 6-95-18, *1996 Ohio App. LEXIS 1001* .

3 *Gonder*, supra, citing to the Official Code Comment 1 to U. C. C. 2-312 (*R. C. 1302.25(A)*).

4 1 Hawkland UCC Series (2001) § 2-312:5, Disclaimer of Warranty of Title--Contractual Terms .

[**P13] The Michigan Court of Appeals, in *Jones v. Linebaugh*, [5] held that "very precise and unambiguous language must be used to exclude a warranty so basic to the sale of goods as is title." [6] Specific language is necessary to relieve the buyer of the idea that any disclaimer of warranty relates only to quality. [7] In *Sunseri v. RKO-Stanley Warner Theaters, Inc*., [8] the court found language stating that the seller "shall in nowise be * * * liable * * * upon or under guaranties [sic] or warranties * * * including, but not limited to, the implied warranty of title" lacked sufficient specificity to disclaim the warranty of title. The court reasoned that the language used was ineffective because it was "couched in negative terminology, expressing what the seller will not be liable for rather than what the buyer is or is not receiving. The inadequacy of such a caveat is best illustrated by juxtaposing it with title disclaimer provisions suggested by authorities in the subject area. For example, 18 Am. Jur. Legal Forms 2d s 253:825 (1974), provides: 'Seller makes no warranty as to the title to the goods, and buyer assumes all risks of nonownership of the goods by seller.'" [9] "Where the language in a purported disclaimer expresses how the seller's [*75] liability will be limited

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rather than what title (or lack thereof) the seller purports to transfer, the purported disclaimer is ineffective."[10]

5 *Jones v. Linebaugh (1971), 34 Mich. App. 305, 191 N. W.2d 142*.

6 *Id., 191 N. W.2d at 144-145*; cited with approval in 1 White & Summers, Uniform Commercial Code (4th ed.) § 9-13, The Warranties of Title and Against Infringement, Section 2-312-- Disclaimer. See also *Kel-Keef Enterprises, Inc. v. Quality Components Corp. (2000), 316 Ill. App. 3d 998, 1014, 738 N. E.2d 524, 535-536, 250 Ill. Dec. 308*, appeal denied by *193 Ill. 2d 599, 744 N. E.2d 289*; *Lawson v. Turner (Fla. App. 1981), 404 So. 2d 424, 425, 32 U. C. C. Rep. Serv. 744*.

7 1 Hawkland UCC Series (2001) § 2-312:5, Disclaimer of Warranty of Title--Contractual Terms.

8 *Sunseri v. RKO-Stanley Warner Theatres, Inc. (1977), 248 Pa. Super. 111, 374 A.2d 1342, 1344*.

9 *374 A.2d at 1345*; cited with approval in *67 American Jurisprudence 2d Sales § 840*, Exclusions of Warranties of Title and Against Encumbrances and Infringement. See also *Rockdale Cable T. V. Co. v. Spadora (1981), 97 Ill. App. 3d 754, 757, 423 N. E.2d 555, 558, 53 Ill. Dec. 171* (finding language stating that the seller purports to transfer only such "right, title and interest" as he may possess insufficient to disclaim the implied warranty of title).

10 *Kel-Keef, 738 N. E.2d at 536*.

[**P14] %%06] The relevant portion of the sale contract states: "All warranties pursuant to *O. R. C. 1302.25* (U. C. C. 2-312) (warranty of title and against infringement) are hereby excluded from this transaction." In light of the foregoing discussion, we find this language to be akin to that which expresses how the seller's liability will be limited, rather than what title the seller purports to

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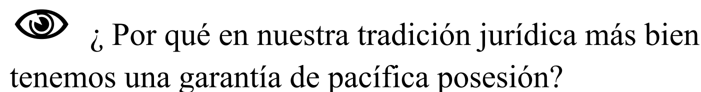
transfer, and conclude that the provision lacks sufficient specificity to disclaim the implied warranty of title. Accordingly, Moore's assignment of error is sustained.

[**P15] Having found error prejudicial to the appellant herein, in the particulars assigned and argued, the judgment of the trial court is hereby reversed and the matter is remanded for further proceedings in accordance with this opinion.

JUDGMENT REVERSED AND CAUSE REMANDED.



¿ Por qué en nuestra tradición jurídica más bien tenemos una garantía de pacífica posesión?

LAS GARANTÍAS IMPLÍCITAS

COMERCIALIZACIÓN E IDONEIDAD PARA FINES ORDINARIOS

DANIEL R. SHAFFER, Petitioner, v. VICTORIA STATION, INC., et al, Respondents SUPREME COURT OF WASHINGTON 588 P.2d 233; 25 U. C. C. Rep. Serv. 427 December 28, 1978

OPINION BY: DOLLIVER [*296] [**234] On March 26, 1974, plaintiff Shaffer ordered a glass of wine at the Victoria Station, a restaurant operated by defendant. In the course of taking his first or second sip, the wine glass broke in Mr. Shaffer's hand, resulting in alleged permanent injury.

Plaintiff brought this action based upon three theories: negligence, breach of implied warranty under the Uniform Commercial Code, and strict liability under the theory of *Restatement (Second) of Torts § 402A* (1965). The manufacturer of the glass was named as a defendant, but was never served. Prior to trial, as counsel and the trial judge were discussing proposed instructions, plaintiff's attorney indicated that he could not prove negligence, and wished to submit the case to the jury on the grounds of

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breach of warranty and strict liability. Plaintiff then took a voluntary nonsuit on the negligence issue. At the same time, the court ruled the case sounded in negligence alone, and granted the defendant's motion for dismissal. The Court of Appeals affirmed. S*haffer v. Victoria Station, Inc., 18 Wn. App. 816, 572 P.2d 737 (1977)*. We reverse the Court of Appeals.

I

Defendant argues the Uniform Commercial Code (RCW 62A) does not apply since the restaurant was not a merchant with respect to wine glasses as defined in *RCW 62A.2-104* and, since the glass itself was not sold, there was no passing of title as required under *RCW 62A.2-106*. Plaintiff, however, points to *RCW 62A.2-314* as being decisive. We agree. R*CW 62A.2-314* reads, *inter alia*:

[*297] (1)Unless excluded or modified (RCW 62A.2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant 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. .

(c) are fit for the ordinary purposes for which such goods are used; and

. .

(e) are adequately contained, packaged, and labeled as the agreement may require;

[1] It is our opinion that, when the Uniform Commercial Code states "the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale" and that such food and drink must be "adequately contained, packaged, and labeled as the agreement may

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require", it covers entirely the situation before us. Plaintiff ordered a drink (a glass of wine) from defendant. Defendant sold and served the glass of wine to plaintiff to be consumed by plaintiff on the premises. The wine could not be served as a drink nor could it be [**235] consumed without an adequate container. The drink sold includes the wine and the container both of which must be fit for the ordinary purpose for which used. Plaintiff alleges the drink sold -- wine in a glass -- was unfit and has, therefore, stated a cause of action.

In addition to the language of *RCW 62A.2-314*, we believe the language of *RCW 62A.1-103* is applicable. It states:

Unless displaced by the particular provisions of this Title, 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.

Plaintiff urges that cases which apply the Uniform Commercial Code where the goods are leased rather than sold (*see, e. G., Baker v. Seattle*, 79 Wn.2d 198, 484 P.2d 405 (1971)), or are under a bailment for mutual benefit (*see,* [*298] *e. G., Fulbright v. Klamath Gas Co.*, 271 Ore. 449, 533 P.2d 316 (1975)), be extended to the facts before us. We believe this is unnecessary. A more straightforward and less tortuous approach is that adopted in *Hadley v. Hillcrest Dairy, Inc.*, 341 Mass. 624, 171 N. E.2d 293 (1961). In that case, a bottle of milk delivered to the plaintiff's home shattered and cut the plaintiff's hand. The Massachusetts Supreme Judicial Court, relying on the Massachusetts sales act (which was not, as argued by defendant, significantly different in its applicable part from the Uniform Commercial Code), held at page 627, "In our

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view it is immaterial whether or not the property in the jug passed to the plaintiff." The court goes on to cite *Geddling v. Marsh*, (1920) 1 K. B. 668. In that case, a retailer received bottled mineral water from the manufacturer and was injured by an exploding bottle. The court found the bottles were not sold to the retailer but held the retailer could recover under a breach of an implied warranty of fitness. The court said at pages 671-72:

In this case there was only one contract -- namely, a contract between the plaintiff and the defendant that the plaintiff should be supplied with mineral waters. Mineral waters could not be supplied except in bottles, and therefore the plaintiff was asking to be supplied with mineral waters in bottles. That undoubtedly is a contract of sale, and I will assume that in that contract there might be a condition that the bottles should not be bought by the plaintiff but should be hired; but the question the county court judge had to consider was whether the bottles were not "supplied under a contract of sale." This was a contract of sale none the less because there was a special provision with regard to the bottles. The section, in my opinion, extends not only to the goods actually bought under the contract but to goods "supplied under the contract of sale." This particular bottle was thus "supplied under a contract of sale," and it follows that it should be reasonably fit for the purpose for which it was supplied. In fact it was not reasonably fit and in consequence of that unfitness the plaintiff was injured.

[*299] *See also Sartin v. Blackwell*, 200 Miss. 579, 28 So. 2d 222 (1946). Plaintiff has a cause of action both on the face of the statute and under the principles of case law elucidated above.

II

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We also hold an action lies under the strict liability theory of Restatement (Second) of Torts § 402A (1965). The policy questions of strict liability and their application to retailers have been previously determined. S*ee Seattle-First Nat'l Bank v. Tabert Volkswagen of America, Inc.*, 86 Wn.2d 145, 542 P.2d 774 (1975); *Ulmer v. Ford Motor Co.*, 75 Wn.2d 522, 452 P.2d 729 (1969). The only question remaining is whether section 402A applies to the transaction here. In addressing this issue, the Court of Appeals expressed concern over an uncontrollable broadening of the doctrine of strict liability:

Were the wine glass in question held to be a mere facet of the sale of the "glass of wine" and thus a "product" for the [**236] purposes of section 402A, the theory of strict liability would be greatly and unnecessarily expanded. The reasonably clear standard of engagement "in the business of selling a product" would be abandoned in deference to a less predictable question -- whether the injury-producing aspect of the sale was necessary to the sale. If a wine glass renders a restaurateur strictly liable because he could not sell wine without it, what of other tablewear, the waiters and the bus boys, the furnishings to effect an attractive atmosphere, or the building housing the establishment? The argument could be made that numerous aspects of a restaurant's operation, or that of any other retailer, are integral to each sale. To ignore the fact that this allegedly defective glass was never sold would create great uncertainty as to the limits of strict liability. *Shaffer*, at 820-21.

[2] We do not agree with the gloomy view of the Court of Appeals of the consequences of allowing the plaintiff to proceed with this action. We hold the sale of a glass of wine is subject to the strict liability provisions of *section 402A*. If their predictions as to future lawsuits come to pass, we will [*300] deal with the litigation at that time.

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Confirmation of the applicability of *section 402A* to this case is given in comment *h*, which says:

> The defective condition may arise not only from harmful ingredients, not characteristic of the product itself either as to presence or quantity, but also from foreign objects contained in the product, from decay or deterioration before sale, or from the way in which the product is prepared or packed. No reason is apparent for distinguishing between the product itself and the container in which it is supplied; and the two are purchased by the user or consumer as an integrated whole. Where the container is itself dangerous, the product is sold in a defective condition. Thus a carbonated beverage in a bottle which is so weak, or cracked, or jagged at the edges, or bottled under such excessive pressure that it may explode or otherwise cause harm to the person who handles it, is in a defective and dangerous condition. The container cannot logically be separated from the contents when the two are sold as a unit, and the liability stated in this Section arises not only when the consumer drinks the beverage and is poisoned by it, but also when he is injured by the bottle while he is handling it preparatory to consumption.

Restatement (Second) of Torts § 402A, comment h at 352 (1965).

Plaintiff has stated a cause of action under theories of implied warranty of fitness and strict liability. The Court of Appeals is reversed.

¿ Si el Código de Comercio Uniforme considera la comida y la bebida que sirven los restaurantes como una mercadería, que queda del *common law*?

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ADECUACIÓN PARA UN FIN PARTICULAR

FERDINAND LEAL, ET AL., Plaintiffs-Appellees v. JOSEPH D. HOLTVOGT, ET AL., Defendants-Appellants COURT OF APPEALS OF OHIO, SECOND APPELLATE DISTRICT, MIAMI COUNTY 702 N. E.2d 1246; 37 U. C. C. Rep. Serv. 2d 953 August 7, 1998, Rendered

OPINION BY: FAIN [*59] [**1251] Defendants-appellants and cross-appellees Joseph and Claudia Holtvogt appeal from a judgment awarding compensatory damages to plaintiffs-appellees and cross-appellants Mary and Ferdinand Leal. The Leals cross-appeal from that part of the judgment awarding compensatory damages, punitive damages, and attorney fees to the Holtvogts.

This appeal involves a sale by the Holtvogts to the Leals of a one-half interest in an Arabian stallion named Mc Que Jabask. The Holtvogts contend that they neither negligently misrepresented the condition of the stallion nor gave the Leals an express warranty regarding the stallion. Further, they argue that the damage award against them is against the manifest weight of the evidence. The Holtvogts also argue that under the agreement the Leals should be required to pay for half of all the costs expended for Mc Que Jabask before his death. Finally, they argue that the trial court did not award them adequate attorney fees.

The Leals contend that the Holtvogts fraudulently misrepresented the condition of the stallion and that, because of this fraud, they should receive punitive damages and attorney fees. They also argue that Mrs. Leal did not defame Mr. Holtvogt.

We conclude that the record supports the trial court's award of compensatory damages to the Leals. Further, we conclude that there is evidence in the record to support the

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trial court's award of punitive damages and attorney fees to the Holtvogts. We also conclude that the amount of compensatory damages awarded to the Holtvogts by the trial court was supported by the record. Finally, we conclude that both the Holtvogts and the Leals may be entitled to further compensatory damages.

Accordingly, the judgment of the trial court is *Affirmed in part* and *Reversed in part*, and this cause is *Remanded* for further proceedings.

I

Joseph and Claudia Holtvogt owned and operated Shady Glen Arabians, a horse barn in Miami County, Ohio. They were experienced in Arabian horse training, breeding, boarding, selling, and showing. In 1992, the Leals, novices in the equine industry, decided to begin raising horses. In April, 1993, Ferdinand [*60] Leal began visiting Shady Glen Arabians regularly to learn how to ride and handle horses. Before long, a friendship developed between the Holtvogts and Leals, and Ferdinand Leal began spending three to four days each week at the Holtvogts' barn helping Joseph Holtvogt with the horses.

In late 1993, the Leals decided they wanted to start a breeding program by purchasing a stallion to breed with a mare they owned. At first, they were interested in purchasing Procale, a stallion owned by John Bowman. After talking to Mr. Holtvogt about Procale, the Leals decided not to buy [**1252] him. The Holtvogts then offered the Leals a one-half interest in Mc Que Jabask, an Arabian stallion that the Holtvogts owned. At trial, the Leals testified that before they agreed to invest in Mc Que Jabask, Mr. Holtvogt made a number of statements regarding the stallion, such as: Mc Que Jabask was a national top ten champion in three categories; he was an all-around winning stallion; he earns $20,000.00 per year in

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stud fees; he is capable of attaining national show titles again; and his foals were selling for $6,000 to $10,000 each [these statements will be referred to hereinafter as "the five contested statements"]

In January, 1994, the Leals and Holtvogts entered into a contract of sale for a one-half interest in Mc Que Jabask for $16,000. The contract also established a partnership agreement, which called for the parties to share equally in the expenses and profits arising from their joint ownership of Mc Que Jabask.

There was expert testimony that prior to January, 1994, Mc Que Jabask had been treated for lameness and was suffering a chronic lameness condition in his right rear and fore fetlocks. Mr. Holtvogt testified that he had taken the stallion for lameness treatments numerous times. He also stated that he did not disclose this information to the Leals.

By July, 1994, the Leals were dissatisfied with the partnership and indicated to the Holtvogts that they wanted either a refund of their money or a remedy for their concerns. In March, 1995, the mortality insurance on Mc Que Jabask lapsed when neither the Leals nor the Holtvogts paid the insurance premium.

Mary Leal, a former Dayton police officer, was unhappy with the partnership. She began making disparaging remarks about Joseph Holtvogt's honesty and integrity to the past and present customers of Shady Glen Arabians. As a result of these remarks, Joseph Holtvogt testified that he suffered from depression, had visited some medical doctors, and was on medication. The Holtvogts did stipulate, however, that they could not prove any business or economic damages due to Mary Leal's remarks.

On January 17, 1996, Mc Que Jabask died from stomach ulcer complications. Since neither party had

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renewed the stallion's mortality insurance, Mc Que Jabask was uninsured.

[*61] In February, 1995, the Leals filed suit against the Holtvogts, who then brought counterclaims against the Leals. The Miami Country Common Pleas Court found that the Holtvogts had negligently misrepresented the stallion's condition and that they had breached an "express warranty on the condition of the horse for the purposes intended" and awarded the Leals $16,000 in compensatory damages. The court further found that the Leals had four of their own horses boarded at the Holtvogts' barn and that the Leals had failed to pay for their care and upkeep. Thus, the trial court awarded the Holtvogts $800.23 in compensatory damages for the services they had provided for these four horses. The court also found that Mary Leal slandered Joseph Holtvogt and, after concluding that Mr. Holtvogt's damages were minimal to nominal, awarded him $1,000 in compensatory damages. Finding Mary Leal's statements to have been made with malice, the court also awarded the Holtvogts punitive damages and attorney fees of $1,000. The $1,000 award for punitive damages and attorney fees was vacated by the trial court after the parties reminded the court that it had been stipulated that there would be an additional hearing to present evidence for attorney fees if the court found punitive damages were appropriate. After this additional hearing, the trial court awarded the Holtvogts $3,000 for punitive damages and attorney fees. Both the Holtvogts and the Leals appeal from the judgment of the trial court.

II

The Holtvogts' Second Assignment of Error is as follows:

The trial court committed reversible error when it held that defendants' actions constituted negligent

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misrepresentation because plaintiffs failed to present any factual evidence whatsoever which would lead a reasonable person to believe that Mc Que Jabask was lame at the time the parties entered into [**1253] the partnership agreement or that Mc Que Jabask was not fit to be shown.

The Holtvogts contend that the Leals failed to establish the requisite elements for a claim of negligent misrepresentation and that the trial court's conclusion is against the manifest weight of the evidence and contrary to law for two reasons. First, they argue that the expert testimony in the record does not establish that Mc Que Jabask was lame at the time the parties entered into the agreement. Second, they argue that the trial court's conclusion that the stallion was not fit to be shown is against the manifest weight of the evidence because there is no proof that the stallion could not be shown and that, even if he was not able to be shown, this inability would not have affected his ability to earn stud fees.

We begin by addressing the issue of whether the Holtvogts negligently misrepresented the condition of Mc Que Jabask when they failed to disclose his lameness. Whether Mc Que Jabask was lame at the time of the agreement was [*62] hotly contested at trial,with both sides presenting expert testimony from veterinarians and introducing numerous exhibits ranging from x-rays to a video tape. The trial court concluded that the Holtvogts had negligently misrepresented the stallion's condition by failing to inform the Leals that he suffered from chronic lameness. We conclude that, regardless of the evidence presented, the Holtvogts could not have made a negligent misrepresentation by failing to disclose to the Leals that Mc Que Jabask suffered from lameness.

Negligent misrepresentation is defined as follows:

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one who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, *supplies false information* for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in communicating the information.

Textron Financial Corp. v. Nationwide Mut. Ins. Co. (1996), 115 Ohio App. 3d 137, 149, 684 N. E.2d 1261, *cert. denied*, *78 Ohio St. 3d 1425, 1425, 676 N. E.2d 531*. (Emphasis in original.)

A negligent misrepresentation occurs when one "*supplies false information* for the guidance of others." *115 Ohio App. 3d at 149*. In other words, a "negligent misrepresentation does not lie for omissions; there must be some affirmative false statement." ***Id***. (citation omitted); *see Zuber v. Ohio Dept. of Insurance (1986), 34 Ohio App. 3d 42, 45-46, 516 N. E.2d 244*. The Holtvogts' concealment of Mc Que Jabask's lameness cannot support a claim of negligent misrepresentation, since it was not an affirmative false statement. Thus, the trial court erred when it found that the Holtvogts negligently misrepresented the condition of the stallion to the Leals when they failed to disclose his lameness.

We next address the trial court's finding that the Holtvogts negligently misrepresented Mc Que Jabask by holding the stallion out as being fit to be shown. A judgment that is "supported by some competent, credible evidence going to all the essential elements of the case will not be reversed by a reviewing court as being against the manifest weight of the evidence." *Seasons Coal Co. v.*

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Cleveland (1984), 10 Ohio St. 3d 77, 80, 461 N. E.2d 1273 (citation omitted).

The trial court, in its findings of fact,concluded that the Holtvogts were experienced equine breeders and trainers and that the Leals were novices in the equine industry. Further, the court found that the Holtvogts falsely represented to the Leals that the stallion was fit to be shown and that the Holtvogts failed to exercise reasonable care in communicating this information. Finally, the trial [*63] court concluded that the Leals justifiably relied on the Holtvogts' representations and consequently suffered a $16,000 loss.

These findings of fact and conclusions of law are not against the manifest weight of the evidence. The record reflects that the Holtvogts were quite experienced with training, breeding, showing, and boarding Arabian [**1254] horses. There is evidence that the Leals were novices in the horse industry. Further, the record shows that in late 1993, the Leals decided to buy an investment stallion to start a breeding program and that they were particularly interested in Procale, a stallion owned by John Bowman. The record demonstrates that Mr. Holtvogt, after persuading the Leals that Procale was not a suitable horse for their purposes, offered them one-half interest in Mc Que Jabask. Further, there is evidence that Mr. Holtvogt represented to the Leals that with the help of the Leals' money, Mc Que Jabask could be promoted, advertised, and shown to increase his national recognition, thus enabling him to bring in higher stud fees.

The record further supports a finding that the stallion was not fit to be shown. Dr. Patterson, a veterinarian who performed an independent examination as directed by the trial court, testified at trial and concluded to a reasonable veterinary certainty that Mc Que Jabask was suffering from

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chronic lameness in his right fore fetlock and right rear fetlock. He stated that while walking, the stallion tended to fall over his right rear limb fairly consistently and that this lameness was also visible while the stallion was running, as there was definite short striding on the stallion's right rear fetlock and a lack of good suspension on the right fore fetlock. Dr. Patterson testified that the stallion "comes off lame." Further, Dr. Patterson testified that Mc Que Jabask's general muscle tone was consistent with that of a horse not in active athletic training. Thus, the record supports the trial court's finding that Mc Que Jabask was not fit to be shown due to his lameness.

While testifying, Dr. Patterson also stated that the conditions that he saw in the stallion's fetlocks take years to develop and thus concluded that the chronic lameness did exist in January, 1994, when the agreement between the parties was entered into. Thus, competent and credible evidence was presented at trial to demonstrate that the Holtvogts supplied false information to lead the Leals to invest in Mc Que Jabask.

The record also indicates that the Holtvogts knew that Mc Que Jabask had been treated for lameness prior to January, 1994. Mr. Holtvogt testified that they had taken him for lameness treatments at least half a dozen times. Thus, competent and credible evidence was presented at trial to show that the Holtvogts failed to exercise reasonable care in communicating Mc Que Jabask's lameness to the Leals.

[*64] As for the Leals' reliance on the Holtvogts' representations, the record shows that the parties had become social friends over time and both of the Leals testified that they relied on Mr. Holtvogt's representations. In fact, Mr. Leal, who spent several days a week at the Holtvogts' barn, testified, " * * * Joe and I have a really,

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really good relationship, um, I trust him a lot, he, he won my trust. He is my teacher. At that time [before the problems over Mc Que Jabask arose] he, everything he told me that good or it is not good I believed him." Thus, from our review of the record we find competent and credible evidence supports the trial court's finding that the Leals justifiably relied upon the Holtvogts' representations that the horse was fit to be shown.

It is also clear from the record that due to their reliance on the Holtvogts' representations, the Leals had a pecuniary loss that they otherwise would not have suffered. The Leals both testified that if they had known Mc Que Jabask had been treated for lameness prior to the agreement, they would not have invested in him. Thus, our review of the record supports the trial court's finding that the Holtvogts negligently misrepresented to the Leals that Mc Que Jabask was fit to be shown.

The Holtvogts finally contend that even if Mc Que Jabask was not able to be shown, this inability would not have affected his ability to earn stud fees. They argue that there was no need to show Mc Que Jabask because he had already established a show record that would attract breeders. We cannot find support in the record for the Holtvogts' argument. At trial, Dixie Gansmiller, an experienced horse breeder, testified that a person could not successfully advertise a stallion for stud unless it was actively being shown simultaneously.

Thus, the Holtvogts' argument that their failure to disclose Mc Que Jabask's lameness did not make a claim for negligent misrepresentation [**1255] is well-taken. Competent and credible evidence in the record does, however, support the trial court's finding that the Holtvogts did negligently misrepresent to the Leals that Mc Que Jabask was fit to be shown. Therefore, the trial court's

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findings of fact and conclusions of law regarding the Holtvogts' negligent misrepresentation that the stallion was fit to be shown are not against the manifest weight of the evidence.

The Holtvogts' Second Assignment of Error is overruled.

III

The Holtvogts' First Assignment of Error is as follows:

The trial court committed reversible error when it found that defendants' actions constituted a breach of an expressed warranty because the transaction between the parties does not meet the definitional requirements under ohio [*65] expressed warranty law; defendants' conduct does not rise to the level of an expressed warranty; and the integration clause in the partnership agreement precludes the court's consideration of any and all prior oral representations.

The Holtvogts' argument that there was no breach of an express warranty is three-fold. First, they argue that Ohio's express warranty law is not applicable to their transaction. Second, they argue that their conduct was not sufficient to constitute an express warranty. Third, they argue that there was a clause in the parties' agreement precluding consideration of any oral representations.

We begin with the Holtvogts' argument that Ohio's express warranty law does not apply to the transaction that occurred between the parties. The Holtvogts contend that an express warranty can arise only if there has been a "sale" between the parties and that their transaction with the Leals created a "partnership agreement," not a "sale."

We first address this argument by noting that Ohio warranty law is governed by the Uniform Commercial Code, Sales, *R. C. Chapter 1302.* The scope of Chapter

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1302 is set forth in 1302.02, which provides in part that "*sections 1302.01 to 1302.98*, inclusive, of the Revised Code, apply to transactions in goods." *R. C. 1302.02*. Goods are defined as "all things * * * which are moveable at the time of identification to the contract for sale * * * [and] must be both existing and identified before any interest in them can pass." *R. C. 1302.01(A)(8)*. The Arabian stallion, Mc Que Jabask, was moveable, existing, and could be identified at the time of the contract. Thus, he would qualify as a "good" under *R. C. 1302.02*.

As for the Holtvogts' contention that the transaction was not a "sale," they correctly argue that a "sale" is defined as "the passing of title from the seller to the buyer for a price." *R. C. 1302.01(A)(11)*. There is no statutory requirement, however, that full title to the good must pass from the buyer to the seller. In fact, Chapter 1302.01 explicitly states, in its definition of "goods," "there may be a sale of a part interest in existing identified goods." *R. C. 1302.01(A)(8)*. Thus, although the transaction involved the sale of only a half-interest in Mc Que Jabask, the transaction was within the definitional requirements of R. C. 1302 and thus is governed by Ohio warranty law. Therefore, the first part of the Holtvogts' argument is not well-taken.

We next address the Holtvogts'argument that their conduct did not amount to an express warranty. The trial court found that " * * * the [Holtvogts] engaged in 'puffing' at the time of the sale of the one-half interest in the horse but did not fraudulently misrepresent a material fact." Although the trial court did not enlighten us as to what part of the Holtvogts' conduct it believed to be "puffing," our review of the record leads us to believe that the trial court was talking about [*66] the five contested statements that the Leals claim the Holtvogts made. The Holtvogts contend that the trial court's finding that they engaged in "puffing"

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is inconsistent with the trial court's conclusion that they gave the Leals an express warranty.

R. C. Chapter 1302.26 states the following:

(A) Express warranties by the seller are created as follows:

(1) 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 [**1256] the goods shall conform to the affirmation or promise.

(2) 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.

(3) * * *

(B) * * * 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. *R. C. 1302.26*.

"Puffing," or merely stating the seller's opinion, cannot amount to an express warranty. *See Slyman v. Pickwick Farms (1984), 15 Ohio App. 3d 25, 28, 472 N. E.2d 380*; *R. C. 1302.26(B)*. The five contested statements were the subject of extensive testimony during the trial. Mr. Holtvogt denied making any of these statements and the Leals repeatedly testified that Mr. Holtvogt did make these statements. The trial court seems to have found the five contested statements to be "puffing." Our review of the record shows that there is credible and competent evidence that these five contested statements were no more than "puffing." The Holtvogts correctly argue that when

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statements are mere "puffing," they cannot constitute an express warranty.

We cannot sustain this Assignment of Error, however, because we find that the Holtvogts breached an implied warranty of fitness for a particular purpose.

In its entry, the trial court found the following:

" * * * the information the [Holtvogts] failed to apprise the [Leals] was the lameness of the horse at the time the contract was executed in January 1994.

The [Leals] suffered damages in the amount of $16,000.00 as a result of this negligent misrepresentation.

The ***same set of facts*** establish a cause of action for breach of express warranty ***on the condition of the horse for the purposes intended*** * * * ." (emphasis added).

[*67] In its entry, the trial court did not just say an express warranty was breached, but rather said that an "express warranty ***on the condition of the horse for the purposes intended***" was breached. We conclude that the trial court intended to say that an implied warranty of fitness for a particular purpose was breached. Our conclusion is supported by the trial court's statement that the same set of facts establishes claims for both a breach of express warranty on the condition of the horse for the purposes intended and negligent misrepresentation. We note that the elements of a claim for negligent misrepresentation and breach of an implied warranty of fitness for a particular purpose are quite similar, while the elements of negligent misrepresentation and breach of an express warranty are not similar. Thus, we conclude that the trial court, in its conclusions of law, intended to say that an implied warranty of fitness for a particular purpose was given and breached by the Holtvogts when they failed to disclose Mc Que Jabask's lameness to the Leals.

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An implied warranty of fitness for a particular purpose is covered by the Uniform Commercial Code, Sales, *R. C. Chapter 1302.28*, which provides:

"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 *section 1302.29 of the Revised Code* an implied warranty that the goods shall be fit for such purpose." *R. C. 1302.28*.

Ohio courts have set forth the following test to determine whether an implied warranty of fitness for a particular purpose has been created: (1) the seller must have reason to know of the buyer's particular purpose; (2) the seller must have reason to know that the buyer is relying on the seller's skill or judgment to furnish or select appropriate goods; and (3) the buyer must, in fact, rely upon the seller's skill or judgment. H*ollingsworth v. The Software House, Inc. (1986), 32 Ohio App. 3d 61, 65, 513 N. E.2d 1372*; *Delorise Brown, M. D., Inc. v. Allio (1993), 86 Ohio App. 3d 359, 362, 620 N. E.2d 1020*.

The first element requires that Mr. Holtvogt knew why the Leals decided to buy [**1257] an interest in Mc Que Jabask. From our review of the record, we see that Mr. Holtvogt clearly knew that the Leals wanted to buy an interest in the stallion to start a breeding program. Mr. Holtvogt testified:

" * * * [The Leals] had explained what type of horse they were looking for [and] it seemed to me that [Mc Que] Jabask fit the bill [of] what they were looking for and that's why I mentioned to them, uh, to Ferdinand that there might be a possibility that we would be interested in selling part interest in him.

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* * * The things that they were saying, * * * those things were, were present in, in [Mc Que] Jabask * * * .

[*68] * * * It just, it made sense that, you know, in the fact that the Leals could breed to [Mc Que] Jabask * * * * * * Um, we could, uh, with the experience and the reputation that we had we could help market their foals, um, it was, I really felt that it was something that could work."

Thus, evidence of the first element of an implied warranty of fitness for a particular purpose was presented at trial.

The second element requires that Mr. Holtvogt had reason to know that the Leals were relying on his skill and judgment to select or furnish the appropriate goods. Evidence presented at trial shows that Mr. Holtvogt knew, or at least should have known, that the Leals were relying on his judgment when they purchased an interest in the stallion. The relationship between Mr. Holtvogt and Mr. Leal was like that of a teacher and student. Mr. Leal spent a great deal of time at the Holtvogts' barn, helping Mr. Holtvogt with the horses and learning from Mr. Holtvogt. Mr. Holtvogt testified that he was an expert trainer and breeder with Arabian horses, and the evidence shows that he knew Mr. Leal knew very little about horses. Furthermore, the Leals testified that they were interested in purchasing another horse, Procale, but that Mr. Holtvogt steered them away from that horse, saying that horse was not the type of horse that the Leals wanted to buy. Mr. Holtvogt even testified that he mentioned Mc Que Jabask to the Leals because the stallion was the type of horse that they were looking for. Thus, evidence of the second element of an implied warranty of fitness for a particular purpose was presented at trial.

The third element requires that the Leals actually did rely upon Mr. Holtvogt's skill and judgment when they

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purchased an interest in the stallion. The trial court found that the Leals justifiably relied upon the Holtvogts' representations regarding the stallion. This finding is not against the manifest weight of the evidence. As stated earlier, there was competent and credible evidence presented at trial to support this finding as both Leals were novices in the horse industry and they testified that they trusted Mr. Holtvogt and considered him to be the expert. Thus, evidence of the third element was presented at trial.

Because all three elements were proven at trial, we conclude that an implied warranty of fitness for a particular purpose was given by the Holtvogts to the Leals at the time of the sale. There must be evidence that the warranty was breached if the Leals are to recover. D***elorise Brown, M. D., Inc***., *86 Ohio App. 3d at 363*. "Whether a warranty has failed to fulfill its essential purpose is ordinarily a determination for the factfinder." *Id.*

The trial court found that a warranty was breached by the Holtvogts because the horse was lame. As stated above, competent and credible evidence was presented to support the trial court's finding that Mc Que Jabask suffered [*69] from chronic lameness at the time of the sale. At trial, Dixie Gansmiller testified that even though a lame stallion could stand for stud, its lameness would affect her decision whether to breed her mares with it. Thus, we conclude that competent and credible evidence in the record does demonstrate that Mc Que Jabask was not fit for the particular purpose intended by the Leals when they invested in him.

Finally, we address the Holtvogts' argument that there was no express warranty because the partnership agreement had an integration clause that nullified any and all prior oral representations that were not specifically mentioned within the document. As we stated above, there was not an express

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warranty in this case, so we will consider this [**1258] argument by applying it to the Holtvogt's breach of an implied warranty of fitness for a particular purpose.

The partnership agreement that the parties entered into had the following clause: "This contract contains the entire agreements between the parties and no oral agreements shall be binding nor shall any modification of this agreement be binding unless in writing." As we have already stated, the transaction between the Leals and the Holtvogts is governed by the Uniform Commercial Code, Sales, *R. C. Chapter 1302. R. C. 1302.05*, which discusses final written expressions and the admissibility of parol or extrinsic evidence, states:

"Terms * * * which are * * * set forth in a writing intended by the parties as a final expression of their agreement * * * may not be contradicted by evidence of any *prior agreement* or of a *contemporaneous oral agreement* but may be explained or supplemented * * * ." *R. C. 1302.05* (emphasis added).

We first note that the integration clause in the agreement could preclude consideration of an express warranty, if an express warranty had been given by the Holtvogts. We have already stated, however, that no express warranty was given but rather the Holtvogts breached an implied warranty of fitness for a particular purpose when they failed to disclose Mc Que Jabask's lameness to the Leals. The Holtvogts' failure to disclose this information does not amount to a "prior agreement" or "contemporaneous oral agreement" that the Leals are trying to introduce to change the terms of the agreement. An integration clause does not affect an implied warranty of fitness for a particular purpose because an integration clause essentially says that everything the parties agreed to is within the four corners of the document. An implied

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warranty of fitness for a particular purpose is not something that is explicitly agreed to or discussed by the parties. In fact, an implied warranty of fitness for a particular purpose can be given without the parties' knowledge.

We do note that another Ohio appellate court has stated, "it has been held that an integration clause * * * which provides that the entire agreement between the [*70] parties is contained within the four corners of the contract is effective to waive any implied warranty. N***ick Mikalacki Constr. Co. v. M. J. L. Truck Sales, Inc.*** *(1986), 33 Ohio App. 3d 228, 515 N. E.2d 24 * * * ."* ***Schneider v. Miller*** *(1991), 73 Ohio App. 3d 335, 339, 597 N. E.2d 175*. However, we do not believe that this statement accurately summarizes the holding in the Nick Mikalacki Constr. Co**.** case. In both the ***Schneider*** and ***Nick Mikalacki Constr. Co.*** cases, the contracts in question involved integration clauses ***and*** "as is" clauses. In ***Nick Mikalacki Constr. Co.***, the court held that when there is an integration clause in a contract that has an "as is" clause, the "as is" clause will prevent any implied warranties from arising. N***ick Mikalacki Constr. Co. v. M. J. L. Truck Sales, Inc***. *(1986), 33 Ohio App. 3d 228, 229-30, 515 N. E.2d 24*. Thus, it was the "as is" clause that prevented any implied warranty, not the integration clause, as stated in ***Schneider***. There was no "as is" clause in the agreement between the Holtvogts and the Leals. Thus, reliance on ***Schneider*** or ***Nick Mikalacki Constr. Co.*** would be misplaced.

The argument that the integration clause prevented an implied warranty of fitness for a particular purpose from arising is not well-taken.

The Holtvogts' First Assignment of Error is overruled.

IV

The Holtvogts' Third Assignment of Error is as follows:

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The trial court committed reversible error when it only awarded defendants $800.23 out of the $4,167.98 owed to defendants by plaintiffs.

The Holtvogts make two alternative arguments under this Assignment of Error. First, they claim that the trial court erred when it essentially rescinded their agreement with the Leals by awarding the Leals the $16,000 they invested in the stallion. Second, and in the alternative, they contend that the agreement was not rescinded but that the Leals were merely awarded $16,000 in damages. They argue that regardless of which argument is followed, the agreement is still enforceable [**1259] and the Leals should have to pay $3,367.75 for half of the expenses incurred for Mc Que Jabask.

The trial court, in its findings of fact, determined the following:

"As a result of [the] negligent misrepresentation, the [Leals] invested $16,000.00 they would have otherwise not invested and were damaged in this amount.

* * *

The [Holtvogts] also presented evidence the [Leals] owed the [Holtvogts] stable fees for the horses Kalua, Tsequel, Allee and CS Coquette in the amount of [*71] $800.23 * * * *The Court rejects the claim that any such fees are owed by [Leals] for McQue* [sic] *Jabask.*" (emphasis added).

In its conclusions of law, the trial court held:

The [Leals] suffered damages in the amount of $16,000.00 as a result of [the] negligent misrepresentation. * * *

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The [Holtvogts] have established they provided services for four of the [Leals'] other horses for which they have not been paid and for which the total amount is $800.93 [sic] ."

In its final judgment entry, the court characterized the $800.23 as "compensatory damages."

Our review of the record shows that the trial court concluded that if the Holtvogts had disclosed the stallion's lameness to the Leals, the Leals would have never entered into the agreement. Thus, we find no error in the trial court's decision to hold the Leals harmless for any expenses incurred under the partnership. The Holtvogts should not be able to collect half of the costs incurred under a partnership which they misled the Leals into entering.

The Holtvogts' Third Assignment of Error is overruled.

V

The Holtvogts' Fourth Assignment of Error is as follows:

EVEN IF THIS COURT FINDS THAT PLAINTIFF'S PRESENTED SUFFICIENT EVIDENCE TO SUPPORT THEIR NEGLIGENT MISREPRESENTATION AND EXPRESSED WARRANTY CLAIMS, THE TRIAL COURT'S AWARD OF $16,000.00 %%0] TO PLAINTIFFS WAS AGAINST THE MANIFEST WEIGHT OF THE EVIDENCE AND CONTRARY TO LAW.

Although this Assignment of Error raises a manifest weight issue, the Holtvogts do not make an argument regarding the evidence. Instead, they argue that the trial court essentially rescinded the parties' agreement without returning the parties to the positions they occupied before the agreement was signed. In support, they argue that the Leals attempted to breed two of their mares to Mc Que Jabask for free under the agreement, and that as a result,

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one of the mares produced a foal. They claim that the normal stud fee is $1,000 per horse and that because the agreement was rescinded, the Leals should have to pay $2,000 for their breedings. We find this argument to be well-taken. Our review of the record indicates, however, that returning the parties to the positions they occupied before the agreement will not be an easy task.

[*72] We begin by noting that the record indicates that the Holtvogts charged varying stud fees for Mc Que Jabask. The record reveals stud fees normally ranging between $900 and $1,000, with one person winning a free breeding with the stallion. The record also indicates that the Holtvogts would deduct stud fee credits from the Leals' bill when the mares being bred with Mc Que Jabask did not "catch," *i. E.*, conceive. We believe this indicates that in at least some instances, the Holtvogts would refund the stud fees to customers whose mares were not in foal as a result of the breeding. If this is true, the Leals would only owe the Holtvogts $1,000, because only one of their mares produced a foal from the breedings.

We also note that the Holtvogts present only half the story when they argue that they were not returned to their original position. The record reveals that in paying for their half of Mc Que Jabask's expenses under the agreement, the Leals made at least three payments totaling $908. Thus, if the parties are to be returned to their original positions, the Holtvogts should return all the money the Leals paid for Mc Que Jabask.

[**1260] The Holtvogts' Fourth Assignment of Error is sustained. The case will be remanded to the trial court for a determination of the amounts owed to each party to return the parties to their original positions before the agreement was entered into.

VI

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The Holtvogts' Fifth Assignment of Error is as follows:

THE TRIAL COURT COMMITTED REVERSIBLE ERROR WHEN IT ARBITRARILY AND CAPRICIOUSLY AWARDED DEFENDANTS A MEAGER TWO THOUSAND DOLLARS AND NO/CENTS ($2,000.00) IN ATTORNEY FEES SINCE THE PARTIES STIPULATED THAT THE PROFESSIONAL SERVICES OF DEFENDANTS' COUNSEL, WHICH TOTALED TWENTY-THREE THOUSAND SEVEN HUNDRED FORTY-FIVE DOLLARS AND NO/CENTS ($23,745.00), WAS FAIR AND REASONABLE AND SINCE OVER 20% OF DEFENDANTS' ATTORNEY FEES WERE ATTRIBUTABLE TO DEFENDANTS' DEFAMATION CLAIMS.

The Holtvogts argue that the trial court's award of attorney fees was inadequate and contrary to law. In its first entry, the trial court awarded the Holtvogts punitive damages in the amount of $1,000. That amount was later vacated by the trial court when it realized that the parties had stipulated earlier in the case that there would be an additional hearing to present evidence on attorney fees if the court found that punitive damages were appropriate. Following this hearing, the trial court awarded the Holtvogts $3,000 for punitive damages and attorney fees. The Holtvogts argue that because the parties stipulated that the professional services performed by the Holtvogts' counsel were necessary and reasonable, the only issue that the court had to determine [*73] was the total percentage of attorney fees attributable to the Holtvogts' defamation claim. Further, they argue that the award is unreasonably small in light of Mrs. Leal's malicious conduct.

When punitive damages are awarded, a trial court has discretion to award attorney fees. *See Columbus Finance,*

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Inc. v. Howard (1975), 42 Ohio St. 2d 178, 183, 327 N. E.2d 654 (stating that "if punitive damages are proper, the aggrieved party ***may*** also recover reasonable attorney fees") (emphasis added). As we note below, in our discussion of the Leals' Third Cross-Assignment of Error, the trial court's award of punitive damages is supported by the record. Thus, an award of attorney fees was permitted in this case.

We begin by addressing the Holtvogts' argument that because the parties stipulated that the professional services performed by the Holtvogts' counsel were necessary and reasonable, the only issue that the court had to determine was the total percentage of attorney fees attributable to the Holtvogts' defamation claim. A trial court must consider the following factors when awarding attorney fees: "(1) the time and labor involved in maintaining the litigation,(2) the novelty, complexity, and difficulty of the questions involved, (3) the professional skill required to perform the necessary services, (4) the experience, reputation, and ability of the attorneys, and (5) the miscellaneous expenses of the litigation." ***Uebelacker v. Cincom Systems, Inc.*** *(1992), 80 Ohio App. 3d 97, 105, 608 N. E.2d 858*. Further, there must be evidence presented regarding the reasonableness of attorney fees before the trial court can make such an award. ***Id.*** In consideration of all of these factors, we cannot agree with the Holtvogts that because the necessity and reasonableness of the attorney fees was stipulated, all the trial court needed to do was pick a percentage of the fees to award. The trial court needed to consider all of the above factors. Thus, this part of the Holtvogts' argument is not well-taken.

We next address the Holtvogts' argument that such a minimal award in the light of Mrs. Leal's malicious conduct is unreasonable. The Holtvogts argue that the $3,000 award for punitive damages and attorney fees breaks down into $1,000 for punitive damages and $2,000 for attorney fees.

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Assuming this to be the case, we cannot find error in the trial court's award.

As we just noted, there are numerous factors that a trial court must consider before making an award of attorney fees. From our review of the record, we conclude that there was sufficient evidence presented to the trial court for it to consider each of the above factors before making its determination. In [**1261] fact, we note that on March 10, 1997, a hearing was held solely for the attorneys to present evidence to the trial court regarding punitive damages and attorney fees. [*74] At this hearing, one of the witnesses was the Holtvogts' counsel, who testified regarding the bills for his legal services and the breakdown of his fees. Although the trial court did not state its reasons for awarding attorney fees, there is no evidence in the record to lead us conclude that the trial court did not consider these factors when making its determination. In the absence of evidence to the contrary, we must presume that the trial court did consider these factors when making its award. *See Dayton Women's Health Ctr., Inc. v. Enix (1993), 86 Ohio App. 3d 777, 780, 621 N. E.2d 1262*. As we stated above, an award of attorney fees is discretionary with the trial court. *See**Columbus Finance**, 42 Ohio St. 2d at 183*. From our review of the record, we cannot say that the trial court abused its discretion.

The Holtvogts' Fifth Assignment of Error is overruled.

We now address the Leals' Cross-Assignments of Error.

VI

The Leals' First Cross-Assignment of Error is as follows:

The trial court erred in determining the appellants had engaged in only negligent misrepresentation when

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appellees produced evidence sustaining their burden of proof on the claim of fraud.

The Leals contend that at trial they presented evidence of two instances of fraud by the Holtvogts: first, they argue that there was evidence to show that the Holtvogts' statements prior to the sale of the stallion were fraud and not mere "puffing;" second, they argue that the Holtvogts' failure to disclose Mc Que Jabask's lameness constitutes fraud. The Leals also claim that the trial court erred when it found that malice was a necessary element of fraud.

The trial court found the following on the issue of fraud:

"Factually, the Court determines the Defendants engaged in 'puffing' at the time of the sale of the one-half interest in the horse but did not fraudulently misrepresent a material fact."

This sentence is the only reference in the trial court's entry that accounts for the Leals' claim that the Holtvogts' statements prior to the sale of the stallion constituted fraud. The trial court did not specifically address whether the Holtvogts' failure to disclose the stallion's lameness constituted fraud, but rather characterized it as negligent misrepresentation. As discussed above, the Holtvogts' failure to disclose the stallion's lameness cannot establish a claim of negligent misrepresentation.

We begin by addressing the Leals' argument that the Holtvogts committed fraud with the statements that they made prior to the sale of the one-half interest [*75] in Mc Que Jabask. The Leals contend that Mr. Holtvogt committed fraud when he made the five contested statements to induce them to invest in the stallion. At trial, the Holtvogts claimed that they did not make the five contested statements.

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In its entries, the trial court did not explain whether it found all of the five contested statements to be "puffing," or only some of the five contested statements to be "puffing," with the rest contributing to the trial court's finding of negligent misrepresentation. The trial court also failed to state which, if any, of the five contested statements it believed were actually made by Mr. Holtvogt. Rather, it simply found that "the Defendants engaged in 'puffing' at the time of the sale."

Because it is not clear to us whether the trial court found that any of the five contested statements were actually made, we will not address this part of the Leals' argument. Furthermore, there is really no need for us to address this argument because we find that the Holtvogts' failure to disclose Mc Que Jabask's lameness does constitute fraud.

The Leal's contend that the second instance of fraud committed by the Holtvogts was their failure to disclose the stallion's lameness. As we found earlier, an action for negligent misrepresentation is only actionable when an affirmative false statement has been made; it is not actionable for omissions. [**1262] A claim of fraud, however, "is maintainable not only as a result of affirmative misrepresentations, but ***also for negative ones, such as the failure of a party * * * to fully disclose facts*** of a material nature where there exists a duty to speak." ***Textron Financial Corp***., *115 Ohio App. 3d at 153* (citation omitted) (emphasis added). Thus, although the Holtvogts' failure to disclose the stallion's lameness could not be negligent misrepresentation, it could constitute fraud.

The elements of fraud are as follows:

"(a) a representation or, where there is a duty to disclose, concealment of a fact, (b) which is material to the

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transaction at hand, (c) made falsely, with knowledge of its falsity, or with such utter disregard and recklessness as to whether it is true or false that knowledge may be inferred, (d) with the intent of misleading another into relying upon it, (e) justifiable reliance upon the representation or concealment, and (f) a resulting injury proximately caused by the reliance."

Mussivand v. David (1989), 45 Ohio St. 3d 314, 322, 544 N. E.2d 265; *Cohen v. Lamko, Inc. (1984), 10 Ohio St. 3d 167, 169, 462 N. E.2d 407*.

The first element of fraud requires that the Holtvogts concealed a fact that they had a duty to disclose. "It has generally been held that nondisclosure [*76] of a fact will become the equivalent of fraudulent concealment when it is the duty of the person to speak in order to place the other party on equal footing with him." ***Davis v.*** *Sun Refining*%%0] *& Marketing Co. (1996), 109 Ohio App. 3d 42, 55, 671 N. E.2d 1049*. A person's duty to speak does not necessarily depend on the existence of a fiduciary relationship; "it may arise in any situation where one party imposes confidence in the other because of that person's position, and the other party knows of this confidence." *Mancini v. Gorick (1987), 41 Ohio App. 3d 373, 374-75, 536 N. E.2d 8* (citation omitted). A review of the record shows that the Holtvogts failed to disclose Mc Que Jabask's lameness to the Leals. The record also reveals that both of the Leals testified that they considered Mr. Holtvogt to be a professional trainer and that they trusted his expertise. There is evidence in the record that Mr. Holtvogt had knowledge of this confidence, since he knew the Leals were not experienced in the equine industry. The evidence also shows that Mr. Holtvogt informed the Leals of his expertise. Mr. Leal testified:

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" * * * [Mr. Holtvogt] told me about his reputation that he's been doing this since he was a kid, he's been around horses when he was a kid and he told me that he's been to a lot of shows, Arabian shows and people know him, his reputation * * * ."

The second element of fraud would be met if the concealed lameness of Mc Que Jabask was material to the transaction. A fact is material if it is likely, "under the circumstances, to affect the conduct of a reasonable person with reference to the transaction." ***Van Camp v. Bradford*** *(1993), 63 Ohio Misc. 2d 245, 255, 623 N. E.2d 731*. Both the Leals testified that if they had known of the stallion's lameness, they would not have bought a one-half interest in him.

The third element of fraud requires that the Holtvogts knew that Mc Que Jabask was chronically lame at the time of the sale. As stated earlier, our review of the record demonstrates that evidence was presented to show that the Holtvogts knew that Mc Que Jabask had been treated for lameness numerous times prior to the sale.

The fourth element of fraud requires that the Holtvogts, in their failure to disclose Mc Que Jabask's lameness, intended to induce the Leals to buy an interest in the stallion. Intent must be inferred from the totality of the circumstances, because it is rarely provable by direct evidence. D*avis, 109 Ohio App. 3d at 56*. At trial, Mr. Holtvogt testified that before the contract, the couples discussed Mc Que Jabask's show records, breedings, and offspring; everything about the stallion except his lameness. [*77] Considering all of the circumstances surrounding the sale, the record supports an inference that the Holtvogts [**1263] avoided telling the Leals of the stallion's lameness in order to induce them to buy.

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The fifth element of fraud requires that the Leals justifiably relied on the Holtvogts' description of the stallion and their failure to inform the Leals of its lameness. "The question of justifiable reliance is one of fact and requires an inquiry into the relationship between the parties." *Crown Property Dev., Inc. v. Omega Oil Co. (1996), 113 Ohio App. 3d 647, 657, 681 N. E.2d 1343*. The trial court, in its findings of fact, concluded that the Leals justifiably relied on the Holtvogts' representations of the stallion. From our review of the record, we find that there is competent and credible evidence to support this finding.

The final element of fraud requires that the Leals suffered an injury due to their reliance. The trial court found that the Leals were injured when they invested $16,000 in the stallion due to their belief that he was healthy. From our review of the record, we find competent and credible evidence to support this finding.

Because all six elements of fraud were proven, we agree with the Leals that the Holtvogts committed fraud when they failed to disclose Mc Que Jabask's chronic lameness.

Finally, we address the Leals' argument that the trial court erred when it found that malice is a necessary element of fraud. We find no basis for this argument, since a review of the trial court entry fails to demonstrate to us that the trial court made such a finding. The trial court entry states as follows:

"Factually, the Court determines the Defendants engaged in 'puffing' at the time of the sale of the one-half interest in the horse but did not fraudulently misrepresent a material fact."

* * *

* * *

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"Factually, the Court finds no malice on the part of the Defendants in this regard."

From the trial court's entry, it does not seem to us that the trial court required malice as an element of a claim of fraud. The sentence regarding malice merely states one of the trial court's many findings of fact. Thus, this argument is not well-taken.

Although we conclude that the trial court erred when it found against the Leals on their claim of fraud, we further conclude that this error was harmless. For the reasons set forth in Part VIII, below, we conclude that the trial court did not err in failing to award attorney fees or punitive damages against the Holtvogts. The trial court did find, erroneously in our opinion, that the Holtvogts [*78] had negligently misrepresented the condition of Mc Que Jabask by failing to inform the Leals of his chronic lameness. Presumably, the trial court took this into consideration when it fashioned the remedy of rescission, placing the Leals in the condition they were in before the transaction. The trial court's mischaracterization of the Holtvogts' conduct as negligent misrepresentation, rather than fraud, had no adverse consequences to the Leals, since we conclude that they were not entitled to punitive damages or attorney fees, and the remedy of rescission gave them everything to which they would be entitled as a result of the fraud.

The Leals' First Cross-Assignment of Error is overruled.

VIII

The Leals' Second Cross-Assignment of Error is as follows:

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The trial court erred in failing to award appellees punitive damages and attorney fees once they had proven each and every element of fraud.

The Leals claim that they should be awarded punitive damages and attorney fees based on the fact that the Holtvogts committed fraud. In particular, they argue that these damages are warranted because Mr. Holtvogt took advantage of the relationship of trust he developed with Mr. Leal. As we concluded above, the Leals did prove that the Holtvogts committed fraud when they failed to disclose Mc Que Jabask's lameness. The trial court did not specifically address punitive damages or attorney fees for the Leals but did find no malice on the part of the Holtvogts.

This court has previously held that punitive damages may be proper in cases involving [**1264] fraud. D*avis, 109 Ohio App. 3d at 58* (citing *Byrley v. Nationwide Life Ins. Co. (1994), 94 Ohio App. 3d 1, 20, 640 N. E.2d 187*). We have also held that where punitive damages are warranted in a case involving fraud, attorney fees may also be awarded. F*armers State Bank & Trust Co. v. Mikesell (1988), 51 Ohio App. 3d 69, 86, 554 N. E.2d 900*; *Roberts v. Mason (1859), 10 Ohio St. 277, 281*.

"To establish a claim for punitive damages in an action for fraud, [a party] must demonstrate, in addition to proving the elements of the tort itself, 'that the fraud is aggravated by the existence of malice or ill will, or must demonstrate that the wrongdoing is particularly gross or egregious.'" ***Davis****, 109 Ohio App. 3d at 58* (quoting *Charles R. Combs Trucking, Inc. v. Internatl. Harvester Co. (1984), 12 Ohio St. 3d 241, 466 N. E.2d 883*, paragraph three of the syllabus). From our review of the record, we cannot agree that the Holtvogts acted with malice toward the Leals. We do not believe that the Holtvogts' conduct had the requisite ill will or such a conscious [*79] disregard for the rights

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and safety of others to constitute malice as a matter of law. Thus, the trial court could find, as it did, that there was no malice, and an award of punitive damages and attorney fees for the Leals would be improper in this case.

The Leals' Second Cross-Assignment of Error is overruled.

IX

The Leals' Third Cross-Assignment of Error is as follows:

The trial court erred in determining that appellee defamed the appellant, joe holtvogt, and that he was entitled to damages.

The Leals' arguments in this Cross-Assignment of Error are four-fold. First, the Leals argue that Mrs. Leal's statements regarding Mr. Holtvogt were mere opinion. Second, they argue that Mrs. Leals' statements could have been interpreted as innocent or defamatory and that under Ohio's "innocent construction rule," the innocent interpretation should be taken. Third, the Leals contend that the trial court erred in finding Mrs. Leal's statements to be slander *per se* because they were slander *per quod*. The Leals point out that this distinction is important because slander *per quod* requires the offended party to prove special damages resulting from the statements. Fourth, the Leals argue that the trial court erred when it found that Mrs. Leal's statements were made with malice. As part of this argument, the Leals also contend that the trial court erred when it awarded the Holtvogts' punitive damages.

We begin by addressing the Leals' argument that Mrs. Leal's statements regarding Mr. Holtvogt were mere opinion. The trial court found that Mrs. Leal "made disparaging remarks about the integrity and honesty of [Mr. Holtvogt] * * * which constituted slander." Thus, the trial

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court concluded that Mrs. Leal's statements were more than mere opinion.

The Ohio Constitution provides "Every citizen may freely speak, * * *his sentiments on all subjects, being responsible for the abuse of the right; and no law shall be passed to restrain or abridge the liberty of speech * * * ." Because the Ohio Constitution provides this guarantee for the protection of opinion, we must examine whether Mrs. Leal's statements were opinion or fact. *See Condit v. Clermont Cty. Review (1996), 110 Ohio App. 3d 755, 759, 675 N. E.2d 475*.

Ohio courts use a "totality of the circumstances" test to determine whether a statement is fact or opinion. *Vail v. The Plain Dealer Publishing Co. (1995), 72 Ohio St. 3d 279, 282, 649 N. E.2d 182*, *cert. denied*, *516 U. S. 1043, 116 S. Ct. 700, 700, 133 L. Ed. 2d 657*. Under this test, a court must consider the following four factors: (1) the specific language used, (2) whether the statement is [*80] verifiable, (3) the general context of the statement, and (4) the broader context of the statement. ***Id***. This is not a bright-line test, but is a fluid standard, with the weight given to each of the factors varying depending on the circumstances of the case. ***Id***.

First, we must examine the specific language used. This factor calls for us to determine whether an ordinary person would view Mrs. Leal's words to be of a factual nature, where their meaning is readily ascertainable, or opinion, where their meaning is [**1265] ambiguous. C***ondit****, 110 Ohio App. 3d at 759*; ***Vail****, 72 Ohio St. 3d at 282*. Our review of the record indicates that Mrs. Leal contacted customers of the Holtvogts' barn and told them that Mr. Holtvogt had lied to the Leals about Mc Que Jabask's value, show records, and stud fees, and that Mr. Holtvogts "was cheating her out of breeding fees for their

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partnership." We believe that an ordinary person would view these statements as fact, not mere opinion, because their meaning is clearly ascertainable, not ambiguous.

Second, we consider whether Mrs. Leal's statements were verifiable. "When the statement lacks a plausible method of verification, a reasonable [person] will not believe that the statement has specific factual content." ***Condit**, 110 Ohio App. 3d at 760* (citation omitted). The Ohio Supreme Court has stated that statements regarding a person's honesty are possibly verifiable. V***ail,** 72 Ohio St. 3d at 283*. The record reveals that Mrs. Leal did say Mr. Holtvogt had lied to her, cheated her out of money, and that she also %%0] called him untrustworthy. Thus, we believe that Mrs. Leal's statements should be viewed as verifiable.

Finally, we consider both the specific and broader contexts of Mrs. Leal's statements. The record shows that three people testified that Mrs. Leal telephoned them asking about their interactions with Mr. Holtvogt. They testified that she asked them whether Mr. Holtvogt had revealed to them that the Leals were part owners in Mc Que Jabask, whether they had bred mares with Mc Que Jabask, and if so, what amount of stud fees they paid. As discussed above, they testified that Mrs. Leal told them that Mr. Holtvogt made various misrepresentations to her and that he was untrustworthy. In fact, one of the witnesses testified that Mrs. Leal told her "that [she] should keep a good eye on [her] mare and should consider the possibility of moving that mare away from [Mr.] Holtvogt's barn because she [(Mrs. Leal)] did not feel that they gave proper care and that [her] mare might be in possible danger being there because she [(Mrs. Leal)] would not put it past Joe Holtvogt to burn down his barn, horses and all, to collect the insurance money."

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The witnesses also testified that Mrs. Leal sounded upset, irrational, and hostile on the phone. All three testified that Mrs. Leal made statements about [*81] her intentions of doing everything she could to put Mr. Holtvogt out of business. Two of the witnesses also testified that she informed them that she was a former Dayton police officer. We believe that a reasonable person who heard these statements from a woman on the phone would at least be concerned about doing business with Mr. Holtvogt and suspicious of his integrity. While Mrs. Leal's anger and hostility might lead a reasonable person to discount some of her accusations, it is also conceivable that a reasonable person would just assume that he or she would be angry, too, if he or she had been tricked in these ways. Our conclusion is supported by the testimony of one of the witnesses, who stated that after discussing Mrs. Leal's call, he and his wife agreed that maybe it was good that the mare they bred with Mc Que Jabask did not "catch."

We find that the trial court's conclusion that Mrs. Leal's statements regarding Mr. Holtvogt were more than mere opinion is supported by credible and competent evidence in the record. This part of the Leals' argument is not well-taken.

We next address the Leals' argument that Mrs. Leals' statements could have been interpreted as innocent or defamatory, and that under Ohio's "innocent construction rule," the innocent interpretation should be taken. The "innocent construction" rule states that if a statement is "susceptible to two meanings, one defamatory and one innocent, the defamatory meaning should be rejected, and the innocent meaning adopted." *Yeager v. Local Union 20 (1983), 6 Ohio St. 3d 369, 372, 453 N. E.2d 666*; *see, also, Van Deusen v. Baldwin* (1994), 99 Ohio App. 3d 416, 419, *650 N. E.2d 963*. Unfortunately, the Leals' briefs do not explain how Mrs. Leal's statements could be interpreted

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innocently. From our review of the record, we cannot see how Mrs. Leal's statements could have any meaning other than that Mr. Holtvogt is untrustworthy. Thus, we conclude that this part of the Holtvogts' argument is not well-taken.

We next address the Leals' argument that the trial court erred in finding Mrs. Leal's [**1266] statements to be slander *per se* because they were slander *per quod*. The Leals argue that slander *per quod* requires a showing of actual damages and that because the Holtvogts failed to prove that they established any damages, they should not have received a damage award on this claim. The trial court did not mention slander *per se* or slander *per quod*, but generally found Mrs. Leal's statements to be defamatory.

This court has previously held that slander *per se* "means that the slander is accomplished by the very words spoken." *King v. Bogner (1993), 88 Ohio App. 3d 564, 567, 624 N. E.2d 364*; *Rainey v. Shaffer (1983), 8 Ohio App. 3d 262, 264, 456 N. E.2d 1328*. When a claim [*82] of slander *per se* is established, damages will be presumed. K***ing**, 88 Ohio App. 3d at 567*. A statement that "tends to injure one in one's trade or occupation" will be considered slander *per se*. ***Id.** at 568*; *McCartney v. Oblates of St. Francis deSales (1992), 80 Ohio App. 3d 345, 353, 609 N. E.2d 216*. From our review of the record, we find there is competent and credible evidence that Mrs. Leal's statements would tend to harm Mr. Holtvogt's business. The witnesses testified that Mrs. Leal expressed to them her intention of putting Mr. Holtvogt out of business. Further, at least one witness stated that Mrs. Leal encouraged her to remove her mares from the Holtvogt's barn. Thus, we find no error in the trial court's award of damages for this defamation because we believe Mrs. Leal's statements constitute slander *per se*. This part of the Leals' argument is not well-taken.

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Finally, we address the Leals argument that the trial court erred when it found that Mrs. Leal's statements were made with malice. The trial court found that "by clear and convincing evidence [Mrs. Leal's] statements were made with malice."

To receive punitive damages on a claim for defamation *per se*, one must separately prove either actual damages or show that the other party acted with actual malice. *Bryans v. English Nanny & Governess School, Inc. (1996), 117 Ohio App. 3d 303, 317, 690 N. E.2d 582*. Actual malice has been defined as "anger, hatred, ill will, a spirit of revenge, or a reckless disregard of the consequences or the legal rights of others." *Id.*; *Worrell v. Multipress, Inc. (1989), 45 Ohio St. 3d 241, 248, 543 N. E.2d 1277*.

Our review of the record supports the trial court's finding that Mrs. Leal's statements constituted malice. One of the witnesses testified that during their phone conversation, Mrs. Leal said that she "wanted her money back and that she would do anything in her power to get that money back and that she was going to do everything that she could to see that [Mr. Holtvogt] either went out of business or [gave] her money back." One witness testified that Mrs. Leal told her to consider moving her mare from Mr. Holtvogt's barn. From this testimony, we conclude that there is competent and credible evidence in the record to support the trial court's finding of actual malice in Mrs. Leal's statements. As actual malice was demonstrated, we cannot find error in the trial court's award of punitive damages. This part of the Leals' argument is not well-taken.

The Leals' Third Cross-Assignment of Error is overruled.

X

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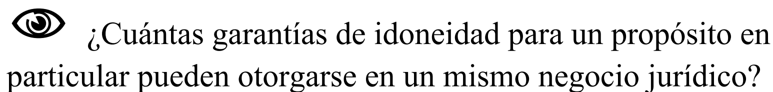
The Holtvogts' First, Second, Third, and Fifth Assignments of Error having been overruled; all of the Leals' cross-assignments of error having been overruled; and [*83] the Holtvogts' Fourth Assignment of Error having being sustained, the judgment of the trial court is *Affirmed***,** in part**,** and *Reversed***,** in part, and this cause is *Remanded* for further proceedings consistent with this opinion, which would include a recomputation of damages to reflect the Leals' obligations to the Holtvogts for stud fees for the mares they bred with Mc Que Jabask, and the Holtvogts' obligation to refund the moneys paid to them by the Leals as and for their share of Mc Que Jabask's expenses.


¿Cuántas garantías de idoneidad para un propósito en particular pueden otorgarse en un mismo negocio jurídico?

LA EXCLUSIÓN DE LAS GARANTÍAS EN EL NEGOCIO COMERCIAL

EL *DISCLAIMER* DE LA GARANTÍA EXPLÍCITA

BELL SPORTS, INC., a foreign corporation, Defendant, Appellant, v. BRIAN J. YARUSSO, Plaintiff, Appellee. SUPREME COURT OF DELAWARE 759 A.2d 582; 42 U. C. C. Rep. Serv. 2d 714 June 6, 2000, Submitted September 7, 2000, Decided

OPINION BY: WALSH [*584] This is an appeal from a Superior Court denial of judgment as a matter of law, or alternatively, for a new trial following an award of damages in a product liability action. The defendant-appellant claims error on the part of the trial judge in ruling on the qualifications of plaintiff's expert witnesses and in permitting the substance of that testimony to establish a jury question on claims for breach of warranty. [**2] The appellant further asserts that the jury verdict was internally inconsistent and that the Superior Court should have

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declared a mistrial after discharging a juror for cause during trial. Upon careful review of the record, we conclude that the Superior Court did not abuse its discretion in permitting the testimony of plaintiff's experts nor in submitting the issues of breach of warranty to the jury. We further conclude that the jury's verdict did not lack consistency and that the refusal to grant a mistrial was not error.

I

On October 20, 1991, Brian J. Yarusso ("Yarusso"), then 22 years of age, was riding his off-road motorcycle [1] at a dirt motocross track located off Church Road in Newark, Delaware. Yarusso was wearing a full complement of safety equipment in addition to the helmet that is the subject of this dispute. While traveling over a series of dirt moguls, or bumps, Yarusso hit one of the moguls in such a way that he was catapulted over the handlebars of the motorcycle. He landed on his head, flipped over and came to rest face down in the dirt. As a result of his fall, Yarusso sustained a burst fracture of the C5 vertebral body and was rendered a quadriplegic. [2]

1 "Off-road" motorcycles are equipped with motors, tires, seats and suspension components specifically designed to function effectively under adverse riding conditions typical of motocross tracks, woods and fields. They are generally much lighter in weight than motorcycles designed for street use, have a higher degree of suspension clearance/compliance and are usually not equipped with horns, lights and other features required for legal street operation. [**3]

2 Dr. Joseph Cusick, a neurosurgeon, described Yarusso's specific injuries. He testified that Yarusso's C5 vertebral body sustained major damage due to a "severe axiocompression load, usually .. without much extension or

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flexion." The magnitude of the load was sufficient to crack the bone, push the spinal disk into the soft bone, and "explode" the disc into the spinal cord and some of the other disks.

Yarusso filed suit in the Superior Court against Bell Sports, Inc. ("Bell"), the manufacturer of the Bell Moto 5 helmet he was wearing at the time of the accident. Yarusso's suit against Bell was predicated on a claim that the enhanced injuries he suffered were the proximate result of a defect in the helmet's design. The Bell Moto-5 is a full-face motocross helmet that was designed for off-road use. It complies with federal Department of Transportation ("DOT") standards and is also certified by the Snell Foundation, a leading worldwide helmet research and testing laboratory. [3] The helmet is constructed of a fiberglass outer shell, an inner crushable liner, and a retention system consisting [**4] of a chinstrap and D-ring pull-tab. While all three of these components are designed to interact, [*585] the inner liner is considered the most important safety feature of the helmet. The expanded polystyrene material of which this liner is primarily constructed is designed to compress upon contact with a solid object.

3 A motorcycle rider's helmet must have DOT certification in order to participate in any races sanctioned by the American Motorcycle Association ("AMA"). The AMA also recommends the use of a Snell-certified helmet.

Yarusso's complaint contained alternative grounds for recovery. He alleged negligence in the design and construction of the helmet, breach of express warranties and breach of an implied warranty of merchantability. Yarusso's express warranty claim arose from specific textual representations in the helmet's accompanying owner's manual (the "manual"), the relevant portions of

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which are as follows (emphasis printed in manual also reproduced below):

Five Year Limited Warranty: Any [**5] Bell helmet found by the factory to be defective in materials or workmanship within five years from the date of purchase will be repaired or replaced at the option of the manufacturer, free of charge, when received at the factory, freight pre-paid.. This warranty is expressly in lieu of all other warranties, and any implied warranties of merchantability or fitness for a particular purpose created hereby, are limited in duration to the same duration as the express warranty herein. Bell shall not be liable for any incidental or consequential damages..

Introduction: Your new Moto-5 helmet is another in the long line of innovative off-road helmets from Bell.. The primary function of a helmet is to reduce the harmful effects of a blow to the head. However, it is important to recognize that the wearing of a helmet is not an assurance of absolute protection. NO HELMET CAN PROTECT THE WEARER AGAINST ALL FORESEEABLE IMPACTS.

Helmet Performance: The Moto-5 is designed to absorb the force of a blow first by spreading it over as wide an area of the outer shell as possible, and second by the crushing of the non-resilient inner liner. Damage to the helmet after an impact [**6] is not a sign of any defect in the helmet design or construction. It is exactly what the helmet is designed to do.

NOTICE: No helmet can protect the user from all foreseeable impacts. To obtain the maximum protection offered by any helmet, it must fit firmly on the head and the chinstrap must be securely fastened.

Yarusso testified at trial that he purchased this particular helmet based on the specific assertions, quoted

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above, that "the primary function of a helmet is to reduce the harmful effects of a blow to the head."

Yarusso's implied warranty of merchantability claim arose out of his contention that the helmet was not merchantable because it was sold as an off-road helmet but was designed to function for "on-road" use. Because the helmet met DOT street helmet standards, Yarusso claimed that it was actually designed with a very stiff liner that would effectively function for on-road use but would not protect a rider against foreseeable off-road falls, where the impact surface could conceivably be softer.

A pivotal factual issue at trial was whether the helmet liner properly crushed, as designed, at the time Yarusso's head impacted the ground after his fall. [**7] Yarusso claimed that the injuries to his neck were caused by the stiffness or density of the liner material at the helmet crown. At trial, he offered expert testimony by Maurice Fox ("Fox"), a safety consultant who had been employed by a helmet manufacturer during the 1970's. Fox opined that Yarusso's helmet sustained the majority of the fall's impact at its crown where the liner was too dense to crush sufficiently, thereby transmitting excessive force to Yarusso's neck, resulting in his paralysis. Fox's testimony however, was directed primarily at Yarusso's negligence claim against Bell, which the jury subsequently rejected.

Joseph Cusick, M. D. ("Cusick"), a neurological expert, similarly testified that the [*586] neck injuries sustained by Yarusso were consistent with impact at the top, or crown, of the helmet. Cusick further testified that a 20-30% reduction of force to Yarusso's body would have been sufficient to avoid injury because his body would have been able to withstand this lower level of force.

Richard Stalnaker, Ph. D. ("Stalnaker"), a biomechanical engineer, also testified on behalf of Yarusso

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and largely affirmed Fox's opinion. His testimony was crucial in the jury's determination [**8] that Bell had breached express and implied warranties. Stalnaker determined that the force of Yarusso's impact with the ground was equivalent to 60 foot pounds, and that adequate crush of the helmet liner would have reduced it significantly to avert injury. Although Stalnaker modified the analytical process used to reconstruct the accident to coincide with that presented by Bell's expert reconstruction witness at trial, Bell's counsel rejected an opportunity to delay the trial and requested only a mistrial. Because the trial judge determined that the factual foundation for Stalnaker's testimony was unchanged despite his use of an alternative analytical, she denied the motion for mistrial leaving the matter for attack through cross-examination.

Bell offered its own expert testimony at trial disputing the helmet's point of impact from the accident and asserting the inability of any helmet to protect its user from severe neck injuries. The principal designer of the helmet, James Sundahl ("Sundahl"), testified that any helmet must be designed to protect its user from a multitude of accident types. He further opined that in circumstances involving a helmet's impact with a soft surfaces [**9] the surface itself, rather than the helmet, absorbs a greater portion of the energy. When questioned about the representation in the helmet's manual, Sundahl testified that it was "wrong."

James McElhaney, Ph. D. ("McElhaney"), a professor of biomechanics at Duke University, testified for Bell and disputed Yarusso's contention that the helmet was impacted at its crown. McElhaney testified that the front of Yarusso's helmet liner was crushed in a fashion indicating a substantial blow to that area. Both Sundahl and McElhaney presented evidence of industry-wide research to the effect that no helmet can offer "any significant protection of the neck because the mass of the torso is so much more than

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the energy levels that a helmet can manage." Bell's experts claimed that this helmet and helmets in general are designed to protect users from head and brain injuries and the helmet in this case did precisely that.

Upon the conclusion of Yarusso's case, he abandoned his failure to warn claim. At the close of all the evidence, Bell moved for judgment as a matter of law as to liability. The trial court granted judgment as a matter of law on Yarusso's breach of implied warranty for a particular [**10] purpose claim, but denied Bell's motion on the remaining counts. The jury was then charged on the remaining claims of negligence, breach of implied warranty of merchantability and breach of express warranty.

On the second day of jury deliberations, one juror notified the trial court that he had reviewed outside information regarding motorcycle helmets in connection with securing a motorcycle licensing examiner's certificate. The jury also notified the court that they were deadlocked. The trial judge subsequently interrogated the juror who had disclosed his outside knowledge out of the presence of the remaining jurors. The trial judge determined that while the juror had not yet shared this extraneous information with other jurors, he had violated the direct instruction to decide the case solely from the evidence presented. The trial judge dismissed the juror prompting a motion from Bell for a mistrial, which was denied. Because both parties had agreed at the outset of the trial to accept a jury of eleven members, the remaining jurors were permitted to deliberate.

[*587] Through specific answers to interrogatories, the jury ultimately found that Bell was not negligent, but had breached an [**11] express or implied warranty, which proximately caused Yarusso's enhanced injury. Yarusso was awarded $1,812,000 in damages. Bell objected that the

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verdict was inconsistent and renewed its motions for judgment as a matter of law or alternatively for a new trial on liability only, all of which were denied by the Superior Court. This appeal followed.

II

This Court's standard of review from a ruling on a motion for judgment as a matter of law is whether under any reasonable view of the evidence, the jury could have justifiably found for the non-moving party. *See Mazda Motor Corp. v. Lindahl, Del. Supr., 706 A.2d 526, 530 (1998)*. The Court reviews a trial court's decisions to admit evidence and/or deny a motion for a new trial under an abuse of discretion standard. *See Young v. Frase, Del. Supr., 702 A.2d 1234, 1236 (1997)*.

Bell contends that the critical element in this case, whether the helmet was defective, was based on Yarusso's claim that it failed to protect his neck when thrown from the motorcycle even though he received no head injuries. Bell asserts that Yarusso's ability to prove this claim rested entirely on the expert testimony of Fox and [**12] Stalnaker, and that the trial court abused its discretion in finding Fox and Stalnaker qualified and in further determining that their testimony was not "new science", thereby precluding an analysis under *Daubert v. Merrell Dow Pharmaceuticals, Inc., 509 U. S. 579, 125 L. Ed. 2d 469, 113 S. Ct. 2786 (1993)*. Bell claims that an independent *Daubert* analysis is required, as a matter of law, prior to the admission of any expert testimony. Because Yarusso presented no other testimony that a helmet could protect a neck from injury, the argument goes, the trial court's error cannot be considered harmless and the verdict was improper as a matter of law.

Bell further contends that had the trial court conducted a *Daubert* analysis, allowing the introduction of Fox and

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Stalnaker's testimony would have constituted a "gross" abuse of discretion. First, Bell submits that the testimony was not properly based on accepted scientific protocol. Fox's testimony, it claims, did not reflect scientific knowledge because his assertions were made following the use of tests suggested to him by Yarusso's counsel, neither of which was derived by scientific methodology. [4] Stalnaker's use [**13] of football helmet protocol to demonstrate how a helmet could protect its wearer's neck, Bell claims, was methodologically flawed and yielded an opinion not based on facts reasonably relied on by experts in the field.

4 Bell points to two tests performed by Fox. One test confirmed that the denser the helmet's liner, the greater the force necessary to crush it. The other found that the ground absorbs the energy on impact into soft earth regardless of the density of the liner.

Bell argues that Yarusso's expert testimony is also barred based on its alleged origin in theory that has not been generally accepted by the scientific community. Bell contends that neither Fox, who worked in the helmet industry in the 1970's and early 1980's, nor Stalnaker, who has never worked for a helmet company, is aware of current scientific opinion that a helmet cannot offer significant neck protection. Bell further notes that neither expert offered independent proof from the scientific community, in the form of peer review, of [**14] their unpublished theory's acceptance and viability.

Yarusso counters that Fox and Stalnaker were both properly qualified and their testimony was competent and, therefore, admissible. With over 21 years of experience in the helmet industry, much of which involved testing and studying the safety performance of helmets, Yarusso argues that Fox is eminently qualified to offer expert testimony.

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He notes that Fox continues [*588] to work with the helmet industry and serves as an expert consultant to several helmet companies. Yarusso claims that Bell's contention that Fox's experience is outdated is unfounded since the principles of physics upon which the helmet's shell and liner were studied have not changed.

Yarusso argues that Stalnaker's general credentials too are impeccable, sufficiently so that Bell chose not to challenge them. Stalnaker's decision to use a football helmet protocol in his testing was mandated, Yarusso contends, by the absence of a testing standard applicable to off-road helmets. Moreover, because his research determined that the helmet's liner was too stiff to properly deform within the protocol standards from this accident, testing under more severe DOT or Snell standards [**15] was rendered unnecessary. Similarly, because the helmet's damage in this case was centralized at its crown and was sustained following impact with a soft surface (dirt), Stalnaker was forced to use alternative testing methods to yield accurate results. Yarusso argues that reliable techniques or methodology that aid the decision making process are admissible, even if they have "certain flaws."

Yarusso also takes issue with Bell's conclusion that the scientific community has rejected the notion that a helmet can provide protection for the neck. Given the specific circumstances from his accident, whereby the weight of his torso did not fully "load" the neck, Yarusso postulates that the scientific community would generally agree that a properly designed helmet could provide an adequate measure of safety. Stalnaker offered testimony that testing and research has been conducted by other scientists in the industry in support of a theory that helmets can, in specific instances, protect users from neck injuries. Thus, Yarusso contends that the specific facts of this case required its experts to use alternative testing methods and make

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references to other helmet designs, both of which were [**16] based on accepted scientific principles permitting further consideration by a fact finder at trial.

Delaware Rule of Evidence 702 governs the admission of expert witness testimony. It provides, "If scientific, technical or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training or education may testify thereto in the form of an opinion or otherwise."D. R. E. 702 is identical to *Federal Rule of Evidence 702* ("*F. R. E. 702*") and has been interpreted by the United States Supreme Court, in *Daubert, 509 U. S. at 589*, to obligate a trial judge to "ensure that any and all scientific testimony is not only relevant, but reliable." *Daubert* further identifies certain factors for the trial judge to consider in performing a "gatekeeper" function, including testing, peer review, error rates and acceptability in the relevant scientific community, some or all of which might prove helpful in determining the reliability of a particular scientific theory or technique.*509 U. S. at 597*.

In *Kumho Tire Co., Ltd. v. Carmichael, 526 U. S. 137, 149, 143 L. Ed. 2d 238, 119 S. Ct. 1167 (1999)*, [**17] the Court extended the gatekeeping obligation of the trial judge to apply to all expert testimony on "scientific, technical or other specialized" matters. The Supreme Court's holding in *Kumho Tire* also reaffirmed *Daubert's* description of the trial judge's *F. R. E. 702* inquiry as "flexible" and not requiring "a definitive checklist or test," but clarifying that it must be "tied to the facts" of a particular case. I*d. at 150*. The Court further concluded that"the trial judge must have considerable leeway in deciding in a particular case how to go about determining whether particular expert testimony is reliable." *526 U. S. at 152*.

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Daubert and *Kumho Tire* were decided by the U. S. Supreme Court in its federal supervisory role, and its interpretation of [*589] *F. R. E. 702* is binding only on lower federal courts. In *M. G. Bancorporation, Inc. v. LeBeau, Del. Supr., 737 A.2d 513 (1999)*, this Court expressly adopted the holdings of *Daubert* and *Kumho Tire* as correct interpretations of D. R. E. 702. *LeBeau,* however, was not decided until approximately one year after the ruling presently under consideration. Indeed, the U. S. Supreme [**18] Court had not yet decided *Kumho Tire* at the time the Superior Court passed upon the qualification of Fox and Stalnaker.

The issue of Fox and Stalnaker's qualification as experts was the subject of *in limine* hearings and a substantial pretrial record generated by the parties on Bell's claim that they lacked the necessary expertise to give opinions on the relationship between helmet design and injury causation. Before Fox was called to testify at trial, counsel for Bell prefaced his objection to Fox's testimony by noting that counsel's position had already been presented in "our memo that the Court has had." The essential objection to Fox was that while he had experience in helmet testimony his experience with the particular helmet in question was limited and in any event Fox had not offered "any alternative design." Fox's expertise was defended by Yarusso's counsel who noted that Fox had been "associated with a variety of helmet testing laboratories over the years" and is intimately familiar with how helmets are designed for usage on road and off road. The Superior Court questioned Yarusso's counsel about whether the opinion of alternative design was intended to show that there [**19] should have been a "more resilient, more readily compressible material." After this colloquy, the trial judge overruled the objection noting that *Daubert* dealt with new science and, in any event, alleged limits in

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Fox's helmet testing could be explored in cross-examination.

With respect to Stalnaker, again there had been an *in limine* effort to exclude his testimony and later at trial an objection was made that Stalnaker had changed the foundation for his testimony. The court specifically rejected that claim. [5]

5 The court stated: "I don't buy because he has demonstrated - now, whether you agree with him or not, he's got sufficient experience and education to understand the physiology of injury, and I'm content that's - that he's met the criteria."

The Superior Court amplified upon Bell's objection to the testimony of Fox and Stalnaker in its post-trial rejection of Bell's motion for a new trial.

Fox's testimony .. was directed primarily at the plaintiff's negligence case. I was satisfied that [**20] his qualifications were sufficient on the basis of his education and experience to permit him to testify. The weight to be given to his testimony was left to the jury. Since the jury did not find in the plaintiff's favor on the negligence charge, Fox's testimony is of little consequence.

Stalnaker's testimony was pivotal. It was he who testified that the force of the accident was 60 foot pounds, and that the crush of the liner would have reduced it sufficiently to avert injury. The deposition testimony of Stalnaker had been taken prior to trial. He apparently had developed his own accident reconstruction analysis, working backward from his assessment of the kind of force needed to produce the injury. He concluded that the force was 60 foot pounds. At the time of trial, he rejected his own reconstruction and relied upon the reconstruction of plaintiff's reconstruction expert, Newbold, who had reached the same conclusion, though through a different analytical

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process. When the change in the foundation of the Stalnaker testimony came to light, the defendant was offered the opportunity to suggest a remedy, such as a delay in the trial, so he could react to the change. No remedy was requested, [**21] except a mistrial. Since the foundation fact for Stalnaker's testimony was unchanged although the analysis getting to [*590] that fact was different, I concluded in the exercise of my discretion that a mistrial was not appropriate. Furthermore, the defense vigorously cross examined Stalnaker on that change in his testimony in an attempt to challenge his credibility and competence. [6]

6 *Yarusso v. Bell Sports, Inc., Del. Super., 1999 Del. Super. LEXIS 231*, C. A. No. 93C-10-132, slip. op. at 21-22 (April 1, 1999).

Because this Court's approval of the *Daubert/Kumho Tire* approach for deciding disputed issues under D. R. E. 702 had not been promulgated at the time of trial in this case, the Superior Court's ruling on admissibility cannot be tested by the later-enacted standard. [7] The Superior Court ruling was consistent, however, with the Court's decisional standards then in effect. Since the adoption of the Delaware Rules of Evidence in 1980, this Court has recognized thatopinion evidence may be offered if an expert's education, training [**22] or general experience demonstrates sufficient knowledge of general principles, even if the expert does not have particular experiences with the exact issue under examination. *See e. G. Yankanwich v. Wharton, Del. Supr., 460 A.2d 1326, 1329-30 (1983)* (personal observation and experience may provide basis for expert opinion on accident reconstruction by police officers); *DiSabatino Bros. Inc. v. Wortman, Del. Supr., 453 A.2d 102, 106 (1982)* ("An experienced practicing physician is an expert, and it is not required that he be a specialist in the particular malady at issue in order to make

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his testimony as an expert admissible."). If scientific issues are implicated in the expert's conclusion, in-depth experience in the underlying scientific principles is required of the expert. *See State v. Ruthardt, Del. Super., 680 A.2d 349, 361 (1996)* (cited with approval in *Zimmerman v. State, Del. Supr., 693 A.2d 311, 314 (1997))*.

7 Nor can the Superior Court's ruling on admissibility be tested by the stringent standards promulgated by other federal decisions implementing *Daubert* relied upon by Bell. *See e. G. Goebel v. Denver and Rio Grande W. R. R. Co., 10th Cir., 215 F.3d 1083, 1088 (2000)* (holding that *Daubert* findings must be made specific on record).

[**23] Under the standards of admissibility for expert testimony then in effect, we are satisfied that the Superior Court, after full *in limine* hearings, did not abuse its discretion in permitting the expert testimony of both Fox and Stalnaker. Those hearings and the written submission of the parties permitted the trial judge to gauge the competing positions of the parties concerning the expertise of the proposed witnesses, their familiarity with the underlying scientific principles and the relevance of their opinion to the disputed issues.

With extensive experience in the helmet industry, much of which involved testing and studying the safety performance of helmets, Fox is qualified to have offered expert testimony, as the Superior Court determined. At the time of trial, Fox was continuing to serve as an expert consultant to several helmet companies. The underlying principles of physics upon which the helmet's shell and liner were studied in this case have not changed over time. Moreover, as the Superior Court noted in its post-trial ruling, Fox's testimony was directed primarily to the theory of negligent design -- a premise rejected by the jury in fixing liability on the warranty [**24] claims alone.

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At trial, Bell did not directly contest Stalnaker's qualifications as an expert but sought to strike his testimony because he allegedly changed his own accident reconstruction theory in favor of that advanced by another of the plaintiff's experts. The sole remedy sought by Bell at trial in this regard was the grant of a mistrial. The Superior Court had discretionary authority to grant Bell a range of remedies from a delay in the trial to a mistrial. Under the circumstances, since Stalnaker's basic scientific analysis did not change and his qualifications were not directly [*591] at issue, the Superior Court did not abuse its discretion in denying Bell's motion for mistrial.

Finally, we conclude that the Superior Court was correct in noting that the underlying scientific dispute over the helmet's ability to withstand impact was not "new science" in the sense that the expert evidence on either side offered scientific theory in a previously unexplored area. As the record indicates, the helmet industry has for years conducted continuous testing of helmets of all types, including off-road helmets. While *Kumho Tire's* teaching, as adopted by this Court in *LeBeau,* obviously [**25] extends *Daubert's* analysis for admissibility to all scientific evidence, the Superior Court's ruling did not depend for its validity on whether it was required to follow a "new scientific" analysis or not. In the final analysis, the correctness of the Superior Court's ruling must be viewed from the appellate standard of whether the trial court abused its discretion. [8]

8 While this Court's adoption of the *Daubert/Kumho Tire* analysis also incorporated an abuse of discretion test for appellate review of a trial court's ruling and D. R. E. 702, prior Delaware decisional law was equally deferential. *See Robelen Piano Co. v. DiFonzo, Del. Supr., 53 Del. 346, 169 A.2d 240, 246 (1961).*

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We find no abuse of discretion on the part of the lower court in this case. A substantial pretrial record was generated, most of which contained expert testimony and opinion evidence presented by both parties. A review of those records afforded the trial judge the opportunity to determine the experts' qualifications [**26] and the reliability and relevance of their testimony. The trial judge found both Fox and Stalnaker to be properly qualified to offer expert testimony by their knowledge, skill, experience, training and/or education.

Fox's testimony was allowed based on his years of experience in the helmet industry and knowledge of its products. Stalnaker, a respected physicist, offered opinions predicated on his performance of a variety of tests that appear both sufficiently based on scientific methodology and specifically related to the circumstances of Yarusso's accident. As permitted by D. R. E. 702, their testimony served to assist the jury to understand the evidence and determine facts. Yarusso's experts were subjected to rigorous cross-examination, a safeguard recognized in *Daubert.* [9] The trial judge also permitted Bell's experts to present competent evidence to counter Yarusso's claims. The jury apparently found Yarusso's expert and opinion testimony more convincing, but that result does not require a heightened standard of review by this Court of the criteria governing the admissibility of the expert testimony it favored.

9 As the Supreme Court noted in *Daubert* (addressing concerns that abandonment of *Frye's* general acceptance standard will result in admissibility of "pseudoscientific assertions"), "Vigorous cross-examination, presentation of contrary evidence, and careful instruction on the burden of proof are the traditional and appropriate means of attacking shaky but admissible evidence." *509 U. S. at 596*. See also, to the same effect, *Barriocanal v. Gibbs, Del. Supr., 697*

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A.2d 1169, 1173 (1997) (citing *Daubert* and *State v. Cephas, Del. Supr., 637 A.2d 20, 28 (1993))*.

[**27] For these reasons, we conclude that the Superior Court did not abuse its discretion in permitting the expert testimony tendered on behalf of Yarusso after having determined the witnesses to be qualified by education, experience, and their opinions relevant to the issues in dispute.

III

By its verdict, the jury specifically determined that Bell had not negligently designed the Moto-5 helmet but that Bell had breached "an express or implied warranty" when it sold the helmet and that "conduct proximately caused Brian Yarusso to suffer enhanced injuries." Bell argues on appeal that Yarusso failed, as a matter of law, to establish an evidentiary basis for recovery under either express or implied warranty and the trial court should [*592] have granted judgment in its favor as to those claims.

Preliminarily, we note that the jury was permitted to find liability under alternative forms of breach of warranty, express or implied, without differentiating between the two. [10] Bell did not object to the warranty claims being submitted in that format and, thus, the verdict may be sustained if there is record and legal support for recovery under either theory.

10 The Superior Court granted Bell judgment as a matter of law as to Yarusso's claim of breach of implied warranty for a particular purpose but permitted the jury to consider the implied warranty claim based on merchantability.

[**28] A.

The statutory basis for a claim for damages based on breach of an express warranty arising out of a sale of goods

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under Delaware law is found in this State's counterpart of the Uniform Commercial Code. Title 6, *section 2-313(1)* provides that express warranties of a seller of goods 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.

Additionally,6 *Del. C.* § 2-313(2) states that:

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 [**29] purporting to be merely the seller's opinion or commendation of the goods does not create a warranty.

Title 6, *section 2-313(1)* and *(2)* are identical to *§ 2-313(1)* and *(2)* of the Uniform Commercial Code. The official commentary to that section under the U. C. C. indicates that the drafters intended its warranty provisions to be construed and applied liberally in favor of a buyer of goods. *See* U. C. C. *§ 2-313* cmt. 1 (1977) ("Express warranties rest on 'dickered' aspects of the individual bargain, and go so clearly to the essence of that bargain that words of a disclaimer in a form are repugnant to the basic dickered terms."); U. C. C. *§ 2-313* cmt. 3 ("In actual

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practice affirmations of fact made by a 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."); U. C. C. *§ 2-313* cmt. 4 ("[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.."). The [**30] language of the U. C. C.'s official commentary may be applied by analogy to the sale of goods governed by 6 *Del. C.* § 2-313 in the reconciliation of any ensuing express warranty disputes. Thus, Bell's argument in this case that the express warranty terms in the manual are strictly limited to the "Five Year Limited Warranty" section, which also contained a purportedly effective disclaimer of those terms, is unfounded.

Formal wording is not necessary to create a warranty and a seller does not have to express any specific intention to create one. *See Pack & Process, Inc. v. Celotex Corp., Del. Super., 503 A.2d 646, 658-69 (1985)*. Here the additional terms [*593] found in the manual's "Introduction" and "Helmet Performance" sections (stating that "the primary function of a helmet is to reduce the harmful effects of a blow to the head.." and ".. The [helmet] is designed to absorb the force of a blow by spreading it over as wide an area of the outer shell as possible..") are textual representations constituting affirmations of fact upon which a buyer is entitled to rely. While this Court does not appear to have specifically addressed the issue, other courts have held that [**31] express warranties can arise from similar textual representations found in owners' manuals even where not specifically labeled as such. *See e. G., Kinlaw v. Long Mfg. N. C., Inc., N. C. Supr., 298 N. C. 494, 259 S. E.2d 552, 557 (1979)*; *Hawkins Constr. Co. v.*

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Matthews Co., Neb. Supr., 190 Neb. 546, 209 N. W.2d 643, 654-55 (1973).

The restrictive provision of 6 *Del. C.* § 2-316(1), renders Bell's effort to disclaim any express warranties in the manual's "Five Year Limited Warranty" ineffective as a matter of law. *See* U. C. C. § 2-316(1) cmt. 1 (stating that "this section.. 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.."). While the manual contains disclaimers warning potential users that the helmet cannot prevent all injuries, other representations were made to assure a potential buyer that the helmet's liner was designed to reduce the harmful effects of a blow to the head. Those representations constituted essential elements of a valid express warranty that may not be effectively disclaimed as a matter of law. *See Jensen v. Seigel Mobile Homes Group, Idaho Supr., 105 Idaho 189, 668 P.2d 65 at 71-72 (1983)* [**32] (holding that one principle of the law of warranty is to hold a seller responsible for its representations and assuring that a buyer receives that which he bargained for).

Bell argues that even if an express warranty was created and not effectively disclaimed here, the manual's textual representations promise only to prevent injuries to the head, not to a user's neck. Furthermore, Bell argues, the helmet's liner did crush as designed, thereby precluding a finding that the warranty was breached. Yarusso counters this argument by pointing out that injuries to the neck may logically follow a blow to the head, the helmet's liner did not sufficiently crush to prevent his injury and, as a result, he did not get what he bargained for. Upon review of the evidence, much of which was admittedly supplied by testimony of Yarusso's experts, the jury came to a logical conclusion that an express warranty was made in the helmet's manual. Upon consideration of this representation

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in relation to the specific facts of this case, they also concluded that the warranty was breached. In view of the evidence presented by the experts for both parties on the relationship between the helmet's design and the [**33] risk of neck injury, a factual predicate existed for the jury to determine whether there was a basis for recovery under the express warranty claim. The Superior Court did not err in submitting that issue to the jury.

B.

Our holding sustaining the jury's verdict on the claim of breach of express warranty renders an in-depth consideration of Bell's implied warranty arguments unnecessary, since the jury was permitted to find a breach of warranty on alternative grounds. The Superior Court in rejecting Bell's post-trial motions also declined to rule on the merits of Bell's attack on the implied warranty finding in view of the jury's finding of liability on the express warranty claim. We also are not required to address Bell's contention that Yarusso was obligated, as a matter of law, to present evidence of a safer alternative design. *See Mazda Motor Corp. v. Lindahl, Del. Supr., 706 A.2d 526, 530 (1996)*. We note, however, that Yarusso's experts never claimed that a helmet can reduce the probability of a user's neck injury in all circumstances, and they were not required to [*594] present evidence that a helmet could be designed to achieve this. Expert evidence was presented, [**34] however, that a helmet could be designed with a softer liner that would, in theory, limit the amount of force placed on the user's neck, thereby reducing the probability of partial-load direct downward neck injuries, particularly upon impact with harder surfaces. There was, thus, a sufficient factual predicate for submission of the implied warranty claim to the jury.

IV

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In a related vein, Bell next argues that the jury's finding for Yarusso on breach of express and implied warranties is inconsistent with its finding that Bell was not negligent. Because the jury found no product defect leading to negligent conduct on Bell's part, it could not have properly found, the argument runs, that a defect existed in the helmet upon which any warranty claims relied. *See Ruffin v. Shaw Indus., Inc., 4th Cir., 149 F.3d 294, 301 (1998)* (holding that the requirements of both actions are nearly alike and that a finding on one claim often "applies equally" to the other); *Prentis v. Yale Mfg. Co., Mich. Supr., 421 Mich. 670, 365 N. W.2d 176, 186 (1984)* (both actions "involve identical evidence and require proof of exactly the same elements"). In essence, Bell contends [**35] that because its product was not defective, a verdict in favor of Yarusso on warranty and negligence claims was precluded. [11]

11 The jury was requested to determine the basis for Bell's liability in the following two-part inquiry.

(1)(a) Do you find by a preponderance of the evidence that Bell Sports negligently designed the Bell Moto-5 Helmet?

__YES X NO

(b) Do you find that Bell Sports breached an express or implied warranty when it sold Mr. Yarusso a Bell Moto-5 Helmet?

X YES __NO

If your answer to parts a or b of Question 1 is "Yes," go on to Question 2.

If, as Bell now asserts, a finding of no negligence in Answer (1)(a) precludes a finding as to breach of warranty, express or implied, it should have objected to the verdict form or requested a modification consistent with its present position, *i. E.,* that answer of "No" as to (1)(a) ends the

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liability inquiry. As we read the record, it tendered no objection to the verdict format.

A claim for breach of [**36] warranty, express or implied, is conceptually distinct from a negligence claim because the latter focuses on the manufacturer's conduct, whereas a breach of warranty claim evaluates the product itself. *See Cline v. Prowler Indus. of Md., Inc., Del. Supr., 418 A.2d 968, 978, n.19 (1980)* (the focus of a negligence claim is the manufacturer's conduct and the breach of an accepted standard of conduct); *Borel v. Fibreboard Paper Prod. Corp., 5th Cir., 493 F.2d 1076, 1094 (1973)* (in a products liability case with inconsistent verdicts, it is within the jury's prerogative so long as evidence supports the finding); *Community Television Serv. v. Dresser Indus., Inc., D. S. D., 435 F. Supp. 214, 216 (1977)* (jury could find defendant neither negligent nor strictly liable while finding as a matter of law that representations in a brochure created an express warranty that defendant breached). Based on the foregoing authorities, we find no fatal inconsistency between the jury's verdict negating negligence but finding breach of warranty.

V

Finally, we consider Bell's contention that it was entitled to a mistrial after the discharge of one juror [**37] from the panel during deliberations. This claim is predicated on the fact that prior to the juror's dismissal, the panel indicated it was deadlocked. Because the juror was dismissed without an explanation, Bell claims that the remaining jurors were left with an impression that the juror had done something wrong and whichever side that juror was supporting would have "lost credibility." The jury's verdict was, therefore, conceivably swayed against Bell as a result of that juror's dismissal.

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[*595] The granting of a mistrial for juror misconduct is part of the trial judge's case management function and is reviewed under an abuse of discretion standard. *See Temple v. Raymark Indus., Del. Supr., 716 A.2d 975, 1998 WL 138929*, at *2 (1998) (ORDER). We find no merit to this argument. It is undisputed that the trial judge determined that the dismissed juror shared no extraneous information with any other members on the panel prior to his dismissal. *Compare Diaz v. State, Del. Supr, 743 A.2d 1166 (1999)* (ruling juror's comments in open court regarding the interpretation of live testimony prejudicial). The trial judge dealt with the situation upon learning of the juror's misdeed [**38] by swiftly discharging him and subsequently allowed the jury to continue its deliberations. *Id.* Moreover, prior to trial, both parties had agreed that should circumstances warrant it, an eleven-member panel was acceptable. *See* Super Ct. Civ. R. 48. The trial court did not abuse its discretion in dismissing this juror and there was no basis to order a mistrial.

The judgment of the Superior Court is AFFIRMED.

¿ Luego de explícitamente se otorgue una garantía, no es contradictorio descargarse de responsabilidad?

EL *DISCLAIMER* DE LA GARANTÍA ÍMPLICITA

EDWARD CATE, JR., d/b/a CATE'S TRANSMISSION SERVICE, Petitioner, v. DOVER CORPORATION, Respondent SUPREME COURT OF TEXAS 790 S. W.2d 559; 12 U. C. C. Rep. Serv. 2d 47 June 6, 1990, Delivered

OPINION BY: DOGGETT [*560] We consider the enforceability of a disclaimer of implied warranties. The trial court upheld the disclaimer and granted summary judgment in favor of Dover Corporation. The court of appeals affirmed.*776 S. W.2d 680*. We reverse the

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judgment of the court of appeals and remand this cause to the trial court for further proceedings consistent with this opinion.

In September 1984, Edward Cate, doing business as Cate's Transmission Service, purchased from Beech Tire Mart three lifts manufactured and designed by Dover Corporation to elevate vehicles for maintenance. Despite repairs made by Beech and Dover, the lifts never functioned properly. Dover contends that Cate's subsequent claim against it for breach of the implied warranty of merchantability is barred by a disclaimer contained within a written, express warranty.

[**2] This warranty is set forth on a separate page headed in blue half inch block print, with the heading: "YOU CAN TAKE ROTARY'S NEW 5-YEAR WARRANTY AND TEAR IT APART." The statement is followed by bold black type stating, "And, when you are through, it'll be just as solid as the No. 1 lift company in America. Rotary." The text of the warranty itself is in black type, contained within double blue lines, and appears under the blue three-eighths inch block print heading "WARRANTY." The disclaimer of implied warranties, although contained in a separate paragraph within the warranty text, is in the same typeface, size, and color as the remainder of the text.

EXHIBIT A

YOU CAN TAKE ROTARY'S NEW 5-YEAR WARRANTY AND TEAR IT APART.

And, when you're through, it'll be just as solid as the No. 1 lift company in America. Rotary.

Not so with some of the other companies. They may offer you a multi-year warranty, too. But you're likely to discover it's limited to parts only.

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And, hidden in all the mumbo-jumbo, you may find out -- too late -- that their beautifully worded "warranty" doesn't even cover major components. Like power units. So what you really have is a great warranty that covers [**3] almost nothing.

We at Rotary are proud of the surface lift products we manufacture. And we don't have to "play it safe" when it comes to guaranteeing them. Here's what our new 5-year warranty says:

WARRANTY

All Rotary Surface Mounted Lifts are guaranteed to the original owner for five years from invoice date. Rotary Lift Division here after is known as "The Company". The Company shall replace for the full five years those parts returned to the factory which prove upon inspection by the Company to be defective. The Company shall pay for reasonable costs of transportation and labor for replacement of said parts for the first 12 months only. Purchaser will bear costs of transportation and labor for parts returned after the first year and the remainder of this warranty. This warranty shall not apply unless the product is installed, used and maintained in accordance with the Company's specifications as set forth in the Company's installation, operation and maintenance instructions.

This warranty does not cover normal maintenance or adjustments, damage or malfunction caused by improper handling, installation, abuse, misuse, negligence or carelessness of operation.

This warranty [**4] is exclusive and is in lieu of all other warranties expressed or implied including any implied warranty of merchantability or any implied warranty of fitness for a particular purpose, which implied warranties are hereby expressly excluded.

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The remedies described are exclusive and in no event shall the Company be liable for special, consequential or incidental damages for the breach of or delay in performance of the warranty.

This warranty shall be governed by the State of Indiana, and shall be subject to the exclusive jurisdiction of the Court of the State of Indiana in the County of Jefferson.

AMERICAN MADE

An implied warranty of merchantability arises in a contract for the sale of goods unless expressly excluded or modified by conspicuous language. *Tex. Bus. & Com. Code Ann. §§ 2.314(a), 2.316(b)* (Vernon 1968). Whether a particular disclaimer is conspicuous is a question of law to be determined by the following definition:

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 a body of a form is conspicuous [**5] if it is larger or of other contrasting type or color. But in a telegram, any stated term is conspicuous.

Id. § 1.201(10). Further explanation is provided by comment 10 thereto:

This [section] 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.

In interpreting this language, Dover argues that a lesser standard of conspicuousness should apply to a disclaimer made to a merchant, such as Cate. Admittedly, an ambiguity is created by the requirement that disclaimer language be conspicuous to "a reasonable person *against whom it is to operate."* Comment 10, however, clearly

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contemplated an objective standard, stating the test as "whether attention can reasonably be expected to be called to it."

We then turn to an application of an objective standard of conspicuousness to Dover's warranty. The top forty percent of the written warranty is devoted to extolling its virtues. The warranty itself, contained within double blue lines, is then set out in five paragraphs in normal black type under the heading "WARRANTY." Nothing distinguishes the third paragraph, which [**6] contains the exclusionary language. It is printed in the same typeface, size and color as the rest of the warranty text. Although the warranty in its entirety may be considered conspicuous, the disclaimer is hidden among attention-getting language purporting to grant the best warranty available. [1]

1 Justice Grant's dissent in the court of appeals correctly characterizes the warranty as follows:

Dover has cleverly buried the disclaimer provision within language that strongly suggests a warranty that greatly benefits the consumer. The bold print language suggests that warranties were included rather than excluded. *See Mallory v. Conida Warehouses, Inc., 134 Mich. App. 28, 350 N. W.2d 825 (1984)*.

776 S. W.2d at 685.

[*561] Dover cites *Ellmer v. Delaware Mini-Computer Systems, Inc., 665 S. W.2d 158* (Tex. App. -- Dallas 1983, no writ), as authority for imposing a subjective standard of conspicuousness. In finding a disclaimer conspicuous, that court did look to the circumstances surrounding [**7] the transaction. That particular language, however, was in bold print, unlike the language under review here. Nor did that court give consideration to the effect of comment 10. Nevertheless, to the extent that *Ellmer* may be read as imposing a subjective standard, we disapprove it. [2]

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2 The other case relied upon by Dover, *W. R. Weaver Co. v. Burroughs Corp., 580 S. W.2d 76, 81* (Tex. Civ. App. -- El Paso 1979, writ ref'd n. R. E.), is distinguishable because it concerned a lease agreement, to which the UCC does not apply.

Although this is a case of first impression in Texas, the facts here parallel those reviewed in other states. In *Massey-Ferguson, Inc. v. Utley, 439 S. W.2d 57, 59 (Ky. Ct. App. 1969)*, a disclaimer hidden under the heading "WARRANTY and AGREEMENT" was found not to be conspicuous:

It is true that the *heading* was in large, bold-face type, but there was nothing to suggest that an exclusion was being made; on the contrary, the words of the headings indicated a *making* of warranties [**8] rather than a *disclaimer.*

(Emphasis in original.) Similarly, in *Hartman v. Jensen's, Inc., 277 S. C. 501, 289 S. E.2d 648 (S. C. 1982)*, the court found that placing a disclaimer under the bold heading "Terms of Warranty" failed to alert the consumer to the fact that an exclusion was intended. [3] Dover's disclaimer similarly fails to attract the attention of a reasonable person and is not conspicuous.

3 *See also Mack Trucks of Arkansas, Inc. v. Jet Asphalt & Rock Co., 246 Ark. 101, 437 S. W.2d 459 (1969)* (disclaimer contained within warranty text under headings "Vehicle Warranty" and "Supplement to Mack Standard Warranty applicable to Mack Diesel Engines" held not conspicuous in part because neither title suggests the exclusion or modification of an implied warranty); *Blankenship v. Northtown Ford, Inc., 95 Ill. App. 3d 303, 50 Ill. Dec. 850, 420 N. E.2d 167 (1981)* (the heading "Factory Warranty" is misleading, and a disclaimer which follows a misleading heading cannot be deemed to comply

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with the UCC); *Seibel v. Layne & Bowler, Inc., 56 Or. App. 387, 641 P.2d 668*, *rev. denied, 293 Or. 190, 648 P.2d 852 (1982)* (disclaimer held not conspicuous when only the paragraph heading "Warranty" stood out and suggested the making of the warranties, not their exclusion); *Dorman v. International Harvester, Co., 46 Cal. App. 3d 11, 120 Cal. Rptr. 516 (2d Dist. 1975)* (inconspicuous disclaimer provision lacked a heading such as "DISCLAIMER OF WARRANTIES" which would adequately call the exclusionary language to the attention of the buyer); *Richards v. Goerg Boat & Motors, Inc., 179 Ind. App. 102, 384 N. E.2d 1084 (3d Dist. 1979)* (disclaimer language contained within warranty text held ineffective); B. Clark & C. Smith, The Law of Product Warranties para. 8.03 [2] (1984) ("disclaimer paragraph should be conspicuously captioned as a "DISCLAIMER OF WARRANTIES," or the paragraph should at least capitalize all words relating to the disclaimer").

[**9] Dover argues that *Singleton v. LaCoure, 712 S. W.2d 757* (Tex. App. -- Houston [14th Dist.] 1986, writ ref'd n. R. E.), held that a disclaimer in the same print as the rest of a form contract was conspicuous. While the disclaimer on the *back* of the form in *Singleton* was undistinguished in typeface, size and color from the remainder of the text, the same provision was repeated in a box as the only preprinted paragraph on the front of the contract.712 S. W.2d 758-59. *Singleton* is thus distinguishable from the case at bar.

Dover argues that even an inconspicuous disclaimer should be given effect because Cate had actual knowledge of it at the time of the purchase. Because the object of the conspicuousness requirement is to protect the buyer from surprise and an unknowing waiver of his or her rights, inconspicuous language is immaterial when the buyer has actual knowledge of the disclaimer. This knowledge can

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result from the buyer's prior dealings with the seller, or by the seller specifically bringing the inconspicuous waiver to the buyer's attention. The Code appears to recognize that actual knowledge of the disclaimer overrides the question of conspicuousness. For [**10] [*562] example, Section 2.316(b) does not mandate a written disclaimer of the implied warranty of merchantability but clearly provides that an oral disclaimer may be effective. [4] Similarly, Section 2.316(c) (3) allows an implied warranty to be excluded or modified by methods other than a conspicuous writing: course of dealing, course of performance, or usage of trade. When the buyer is not surprised by the disclaimer, insisting on compliance with the conspicuousness requirement serves no purpose. *See* R. Anderson, *Uniform Commercial Code* § 2.316:49-50 (1983). The extent of a buyer's knowledge of a disclaimer of the implied warranty of merchantability is thus clearly relevant to a determination of its enforceability. *See Sinaleton v. LaCoure, 712 S. W.2d 757, 759* (Tex. App. -- Houston [14th Dist.] 1986, writ ref'd n. R. E.) (relying in part on buyer's acknowledgement to enforce disclaimer). The seller has the burden of proving the buyer's actual knowledge of the disclaimer.

4 *Tex. Bus. & Com. Code § 2.316*, comment 1 (section seeks to protect buyer from unexpected and unbargained language of disclaimer by permitting exclusion of implied warranties only by conspicuous language or other circumstances which protect buyer from surprise); *see also* Weintraub, *Disclaimer of Warranties and Limitation of Damages for Breach of Warranty Under the UCC,* 53 Tex. L. Rev. 60, 66 (1974); J. White & R. Summers, *Uniform Commercial Code* § 12-5, n.76 (2d ed. 1980) (seller may effectively disclaim by orally explaining inconspicuous written disclaimer, provided word "merchantability" used).

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[**11] As this is a summary judgment case, the issue on appeal is whether Dover met its burden by establishing that there exists no genuine issue of material fact thereby entitling it to judgment as a matter of law. C*ity of Houston v. Clear Creek Basin Authority, 589 S. W.2d 671, 678 (Tex. 1979)*. All doubts as to the existence of a genuine issue of material fact are resolved against the movant, and we must view the evidence in the light most favorable to the Petitioner. G*reat American Reserve Ins. Co. v. San Antonio Plumbing Supply Co., 391 S. W.2d 41, 47 (Tex. 1965)*. In support of its claim that Cate had actual knowledge of the disclaimer, Dover relies on Cate's deposition testimony, as follows:

Q: Do you know, or do you remember what kinds of warranties you received when you bought the lifts?

A: I may be wrong, but I think it was a five year warranty.

Q: What was your understanding of that warranty?

A: Any problems would be taken care of within the five year period.

Q: Do you know if that warranty was from Beech Equipment, or from Dover?

A: I believe it was from Dover.

Q: Did you receive any written documentation in regard to that warranty?

A: [**12] Yes, ma'am.

Although it is clear that Cate understood the warranty to extend for only five years, it is not clear that he understood any other limitations or exclusions. Merely providing a buyer a copy of documents containing an inconspicuous disclaimer does not establish actual

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knowledge. Dover has failed to establish that as a matter of law Cate had actual knowledge of the disclaimer.

We hold that,to be enforceable, a written disclaimer of the implied warranty of merchantability made in connection with a sale of goods must be conspicuous to a reasonable person. We further hold that such a disclaimer contained in text undistinguished in typeface, size or color within a form purporting to grant a warranty is not conspicuous, and is unenforceable unless the buyer has actual knowledge of the disclaimer. For the reasons stated herein, we reverse the judgment of the court of appeals and remand to the trial court for further proceedings consistent with this opinion.

CONCURRING OPINION BY: SPEARS; RAY

[*564] Although I concur in the court's opinion, I write separately to declare that the time has come for the [**13] legislature to consider the realities of the marketplace and prohibit all disclaimers of the implied warranties of merchantability and fitness.

These implied warranties, created by common-law courts long before the adoption of the U. C. C., developed to protect purchasers from losses suffered because of "the frustration of their expectations about the worth, efficacy, or desirability" of a product. W. Keeton, *Prosser and Keeton on The Law of Torts* § 95A (5th ed. 1984). Implication of these warranties into every goods contract, without regard to the parties actual assent to their terms, served "to police, to prevent, and to remedy" unfair consumer transactions. Llewellyn, *On warranty of Quality, and Society*, 39 Colum. L. Rev. 699, 699 (1936); *Humber v. Morton, 426 S. W. 2d 554, 557-58 (Tex. 1968)*. These implied warranties also serve other important purposes: they create incentives to produce and market higher quality products; they discourage shoddy workmanship and

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unethical trade practices; and they place responsibility on those who profit from the sale of goods, have the greatest control over the products, and are better able to bear the risk of loss. H*umber, 426* [**14] *S. W.2d at 562*; *Decker & Sons v. Capps, 139 Tex. 609, 610, 164 S. W.2d 828, 829 (1942)*. Section 2.316 of the U. C. C., however, subverts all of these purposes by giving sellers almost unlimited license to disclaim implied warranties.

We live in an age when sellers of goods "saturate the marketplace and all of our senses" with the most extraordinary claims about the worth of their products. Anderson, *The Supreme Court of Texas and the Duty to Read the Contracts you Sign,* 15 Tex. Tech L. Rev. 517, 544 (1984); *Henningsen v. BloomField Motors, Inc., 32 N. J. 358, 161 A.2d 69, 84 (N. J. 1960)*. Yet, the same sellers under the *carte blanche* granted them by section 2.316 of the U. C. C. refuse to guarantee and indeed expressly disclaim that their products are merchantable or even fit for their intended purposes. Under section 2.316, not much is actually required for an effective disclaimer. To disclaim the implied warranty of merchantability the seller need only include the word "merchantability" in a conspicuous fashion. *Tex. Bus. & Com. Code Ann. § 2.316(b)*(Vernon 1968). To disclaim the implied warranty of fitness the seller must use a writing and must make the disclaimer conspicuous. [**15] *Id.* at § 2.316(2). No particular form of words is needed to disclaim an implied warranty of fitness, nor does section 2.316 require the buyer to be actually aware of the disclaimer before it will be enforced. All implied warranties can be disclaimed by the mere inclusion of expressions like "as is" or "with all faults". *Id*. at § 2.316, comment 1. Finally, as today's majority makes clear, section 2.316 does not even require the disclaimer to be conspicuous if the buyer's actual knowledge of the disclaimer can be shown.

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By establishing specific "requirements" for disclaimers, section 2.316 ostensibly "seeks to protect a buyer from unexpected and unbargained language of disclaimer." *Tex. Bus. & Com. Code § 2.316*, comment 1 (Vernon 1968). In reality, however, section 2.316 completely undermines implied warranties. Implicitly, section 2.316 adopts the position that disclaimers should be enforced because society benefits when parties to a contract are allowed to set *all* the terms of their agreement. The problem with this position, and with section 2.316 generally, is twofold: it ignores the fact that governmental implication of protective terms into private contracts is commonplace [**16] (e. G. the *implied* warranties of merchantability and fitness); and, more importantly, it rests on the faulty premise that contractual disclaimers are generally freely bargained for elements of a contract.

Freedom of contract arguments generally, and section 2.316 specifically, presuppose and are based on "the image of individuals meeting in the marketplace" on equal ground to negotiate the terms of a contract. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction, 96 Harv. L. Rev. 1174, 1216 (1983)*. At one time, this image may have accurately reflected marketplace realities. However, the last half [*565] of the twentieth century has witnessed "the rise of the corporation" and, increasingly, the displacement of physical persons as sellers in consumer and commercial contracts. Phillips, *Unconscionability and Article 2 Implied Warranty Disclaimers, 62 Chi.-Kent L. Rev. 199, 239 (1985)*. This development has led to innumerable situations in which consumers deal from an unequal bargaining position, the most prominent example being the ubiquitous standard form contract which is now used by most sellers of goods and which invariably contains an implied warranty disclaimer. [**17] *See Melody Home Mfg. Co. v. Barnes, 741 S. W.2d 349, 355 (Tex. 1987)*; *Henningsen,*

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161 A.2d at 86-89; Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power,* 84 Harv. L. Rev. 529, 529 (1971)("standard form contracts probably account for more than ninety-nine percent of all the contracts now made"); IL. Vold, *Handbook of the Law of Sales* 447 (2d ed. 1959)(dramatic rise in corporate power has yielded the standard form contract whose terms are drafted by the seller and usually contain implied warranty disclaimers).

The great majority of buyers never read an implied warranty disclaimer found in a standard form contract. [1] Even when implied warranty disclaimers are read, their legal significance is not generally understood. Such disclaimers include unfamiliar terminology (e. G. "implied warranty of merchantability"), and comprehending their legal effect requires one not only to understand what substantive rights are involved, but also to grasp that these rights have been lost via the disclaimer. Phillips, *Unconscionability and Article 2 Implied Warranty Disclaimers, 62 Chi.-Kent L. Rev. 199, 243 (1985)*; *see also* Federal Trade Commission, [**18] *Facts for Consumers* (Mar. 23, 1979)(more than 35% of those surveyed mistakenly believed that an "as is" disclaimer meant the dealer would have to pay some, if not all, costs if a car broke down within 25 days of a sale). Finally, even if a buyer reads and understands an implied warranty disclaimer, chances are he will be without power to either strike these terms or "shop around" for better ones. If the buyer attempts the former, he will likely run into an employee who is unauthorized to alter the form contract; if he attempts the latter, he will likely confront a competitor who offers substantially the same form terms. H*enningsen, 161 A.2d at 87*. In short, the "marketplace reality" suggests that freedom of contract in the sale of goods is actually

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nonexistent; a buyer today can either take the contract with the disclaimer attached or leave it and go without the good.

1 *See RESTATEMENT (SECOND) OF CONTRACTS § 211, Comment b* (1981):

A party who makes regular use of a standardized form of agreement does not ordinarily expect his customers to understand or even to read the standard terms. One purpose of standardization is to eliminate bargaining over details of individual transactions, and that purpose would not be served if a substantial number of customers retained counsel and reviewed the standard terms. Customers do not in fact ordinarily understand or even read the standard terms.

Id.; *see also* Rakoff, *Contracts of Adhesion: An Essay in Reconstruction, 96 Harv. L. Rev. 1174, 1179 n.21 (1983)*(citing numerous commentators who declare that standard terms not read or understood, and some empirical studies asserting same proposition); Phillips, *Unconscionability and Article 2 Implied Warranty Disclaimers, 62 Chi.-Kent L. Rev. 199, 243 (1985)*(many sales do not involve a written sales contract that is presented before the goods change hands; usually, the disclaimer is inside the package and is not seen until after the sale is completed).

[**19] Increasingly, the courts and legislatures of other states have acted to ameliorate or to avoid entirely the harsh consequences wrought by section 2.316. Several courts have refused to enforce disclaimers, on public policy grounds, unless the disclaimer sets forth the particular qualities and characteristics of fitness being waived, is clearly brought to the buyer's attention and is expressly agreed to by the buyer. *See*, *e. G., Hiigel v. General Motors Corp., 190 Colo. 57, 544 P.2d 983 (Colo. 1975)*; *Jensen v. Siegel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65*

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(Idaho 1983); *Louisiana Nat'l Leasing Corp. v. ADF Serv., Inc., 377 So.2d 92 (La. 1979)*; *Scientific Application, Inc. v. Delkamp, 303 N. W.2d 71 (N. D. 1981)*; *Zabriskie Chevrolet, Inc. v. Smith,* [*566] *99 N. J. Super. 441, 240 A.2d 195 (N. J. 1968)*; *Woods v. Secord, 122 N. H. 323, 444 A.2d 539 (N. H. 1982)*; *Seibel v. Layne & Bowler, Inc., 56 Ore. App. 387, 641 P.2d 668 (Or. 1982)*; *Berg v. Stromme, 79 Wash. 2d 184, 484 P.2d 380 (Wash. 1971)*.

A number of other courts have found even conspicuous disclaimers to be unconscionable under section 2-302 of the U. C. C., despite the disclaimer's [**20] compliance with § 2.316. *See, e. G., FMC Fin. Corp. v. Murphree, 632 F.2d 413 (5th Cir. 1980)*; *A & M Produce Co. V. FMC Corp., 135 Cal. App. 3d 473, 186 Cal. Rptr. 114 (1982)*; *Chrysler Corp. v. Wilson Plumbing Co., 132 Ga. App. 435, 208 S. E.2d 321 (1974)*; *Hahn v. Ford Motor Co., 434 N. E.2d 943 (Ind. App. 1982)*; *Sarfati v. M. A. Hittner & Sons, 35 A. D.2d 1004, 318 N. Y. S.2d 352 (1971)*, *aff'd 30 N. Y.2d 613, 331 N. Y. S.2d 40, 282 N. E.2d 126 (1972)*; *Evans v. Graham Ford, Inc., 2 Ohio App. 3d 435, 442 N. E.2d 777, 24 Ohio Op. 3d 140 (1981)*; *Eckstein v. Cummins, 41 Ohio App. 2d 1, 321 N. E.2d 897, 70 Ohio Op. 2d 10 (1974)*; *Durham v. Ciba-Geigy Corp., 315 N. W.2d 696 (S. D. 1982)*; *Rottinghaus v. Howell, 35 Wash. App. 99, 666 P.2d 899 (1983)*; *See generally* Phillips, *Unconscionability and Article 2 Implied Warranty Disclaimers, 62 Chi.-Kent L. Rev. 199, 262-63 (1985)*(arguing that § 2-302 should be aggressively applied to invalidate disclaimers of implied warranties, and concluding that such disclaimers should be "per se unconscionable" in consumer cases).

Several states have gone even further by enacting protective legislation which [**21] forbids implied warranty disclaimers or by repealing section 2.316 of the Code. *See. e. G., ALA. CODE §§ 2.316(5)*,2-719(4) (1975); *CONN. GEN. STAT. § 42-179* (1984); D. C. CODE ANN.

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§ 28:2.316.1(1984); *KAN. STAT. ANN.§ 50-636(a)*(1983); ME. REV. STAT. ANN. tit. 11, § 2.31 (1973); MD. COM. LAW ANN. § 2.316 (1982); *MASS. ANN. LAWS ch. 106, § 2.316A* (1984); *MINN. STAT. ANN. § 325.19* (1982); 1976 Miss. Laws, Ch.385, Preamble; *MISS. CODE ANN. § 11-7-18*; *VT. STAT. ANN. tit. 9A, § 2.316(5)*(1981); WASH. REV. CODE § 62A-2.316(4) (1966); *W. VA. CODE § 46A-6-107* (1980); *see also* Uniform Consumer Credit Code § 2.308 (1974); Model Consumer Credit Act §§ 2.503,8.108 (1973).

Finally, the federal Magnuson-Moss Warranty Act places severe limits on the seller's ability to disclaim implied warranties in the sale of consumer goods.*15 U. S. C. §§ 2301-12 (1982)*. The Act's most important clause essentially provides that *if* a seller gives a written express warranty, he cannot disclaim the implied warranties. *Id*. § 2308(a). The Act effectively prohibits the common practice of a seller boldly announcing an express warranty of limited value and then disclaiming the more valuable [**22] implied warranties, leaving the consumer with a delusive remedy at best.

Our own prior decisions reflect a growing hostility toward attempted disclaimers of important rights. For example, in *Cromwell v. Housing Authority of City ofDallas,* we held that an exculpatory provision exempting a landlord from liability for negligence was void as against public policy because of the disparate bargaining positions of the parties and the "take it or leave it" nature of the contract.*494 S. W.2d 887, 889 (Tex. 1973)*. More recently, in *Melody Home Mfg. Co. v. Barnes,* we created a new common-law implied warranty of good and workmanlike repair and further held that the new warranty could not be waived or disclaimed. *741 S. W.2d 349, 354-55 (Tex. 1987)*. In so holding, we recognized that "(i] t would be incongruous if public policy required the creation of an

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implied warranty, yet allowed the warranty to be disclaimed and its protection eliminated merely by a pre-printed standard form disclaimer or an unintelligible merger clause" *Id. at 355*; *see also Crowder v. Vandendeale, 564 S. W.2d 879, 881 (Mo. 1978)*(boilerplate waiver provisions, even if conspicuous, would not be allowed [**23] to extinguish so important a creature of public policy as the implied warranty of habitability and workmanship).

In other contexts, the Texas legislature has refused to allow the rights and remedies it creates to fall victim to skillfully drafted waiver provisions or disclaimers. *See. e. G., Tex. Bus. & Com. Code Ann. § 17.42(a)* (Vernon Supp. 1990)(DTPA waiver [*567] unenforceable and void as against public policy unless defendant proves consumer is not in a significantly disparate bargaining position, the consumer is represented by legal counsel, and the waiver is by express provision in a written contract signed by both consumer and his counsel); Tex. Rev. Civ. Stat. Ann. art. 5221f, § 18 (Vernon Supp. 1987)(waiver of the provisions of the Manufactured Housing Standards Act unenforceable and void); *Tex. Bus. Com. Code Ann. §§ 9.504, 9.506* (Vernon Supp. 1985)(debtor may not waive, until after default, rights to notice of sale and to redemption of collateral); Tex. Bus. Comm. Code Ann. § 2-719(3)(presumptively invalidating disclaimers of liability for personal injuries in contracts for the sale of consumer goods).

The realities of the modern marketplace demand that the [**24] legislature prohibit implied warranty disclaimers by repealing *section 2.316* of the U. C. C. Without such action, Texas courts will be forced to rely on "covert tools", such as the unconscionability provision in section 2-302 or the "conspicuous" requirement in *section 2.316*, to reach a just and fair result in disclaimer suits. When these tools are

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used, guidance, predictability and consistency in the law is sacrificed, while limited judicial resources are spent policing unjust bargains that could have been avoided. Were it up to the judicial branch, the courts could declare such disclaimers void as against public policy. If the legislature has the interests of Texas citizens at heart, it will repeal *section 2.316* because, no matter how conspicuous, such disclaimers are abusive of consumers.

CONCURRING AND DISSENTING OPINION BY: RAY I concur in that portion of the court's opinion requiring that a written disclaimer of the implied warranty of merchantability must be conspicuous to a reasonable person. I write separately, however, to take issue with the court's immediate erosion of that standard by permitting a showing of actual knowledge of the disclaimer to override [**25] a lack of conspicuousness.

The statute, on its face, provides for no actual knowledge exception. There is no room for judicial crafting of those omitted by the legislature. I would hold that the extent of a buyer's knowledge of a disclaimer is irrelevant to a determination of its enforceability under Section 2.316(b) of the UCC. [1]

1 This approach is taken in *Rehurek v. Chrysler Credit Corp., 262 So. 2d 452* (Fla. Dist. Ct. App.), *cert. denied, 267 So. 2d 833 (Fla. 1972)* (inconspicuous disclaimer ineffective even though the buyer admitted having read it before the purchase).

The effect of actual knowledge is subject to debate among leading commentators on commercial law. The purpose of the objective standard of conspicuousness adopted by the court today reflects the view that "the drafters intended a rigid adherence to the conspicuousness requirement in order to avoid arguments concerning what the parties said about the warranties at the time of the sale."

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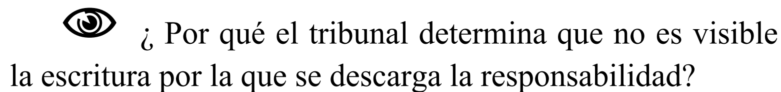
J. White and R. Summers, *Uniform Commercial* [**26] *Code* § 12-5 (2d ed. 1980). An absolute rule that an inconspicuous disclaimer is invalid, despite the buyer's actual knowledge, encourages sellers to make their disclaimers conspicuous, thereby reducing the need for courts to evaluate swearing matches as to actual awareness in particular cases. *See* W. Powers, *Texas Products Liability Law* § 2.0723 (1989). Today's decision condemns our courts to a parade of suchcases.



¿ Por qué el tribunal determina que no es visible la escritura por la que se descarga la responsabilidad?

LA LIMITACIÓN DE LAS GARANTÍAS

WILSON TRADING CORPORATION, Respondent, v. DAVID FERGUSON, LTD., Appellant Court of Appeals of New York 23 N. Y.2d 398; 244 N. E.2d 685 October 17, 1968, Submitted December 12, 1968, Decided

OPINION BY: JASEN [*400] [**686] %%0] The plaintiff, Wilson Trading Corporation, entered into a contract with the defendant, David Ferguson, Ltd., for the sale of a specified quantity of yarn. After the yarn was delivered, cut and knitted into sweaters, the finished [*401] product was washed. It was during this washing that it was discovered that the color of the yarn had "shaded" -- that is, "there was a variation in color from piece to piece and within the pieces." This defect, the defendant claims, rendered the sweaters "unmarketable".

This action for the contract price of the yarn was commenced after the defendant refused payment. As a defense to the action and as a counterclaim for damages, the defendant alleges that " [plaintiff] has failed to perform all of the conditions of the contract on its part required to be performed, and has delivered * * * defective and unworkmanlike goods".

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The sales contract provides in pertinent part:

"2. No claims relating to excessive moisture content, short weight, count variations, twist, quality or shade shall be allowed *if made after weaving, knitting, or processing*, or more than 10 days after receipt of shipment.* * * The buyer shall within 10 days of the receipt of the merchandise by himself or agent examine the merchandise for any and all defects." (Emphasis supplied.)

"4. This instrument constitutes the entire agreement between the parties, superseding all previous communications, oral or written, and no changes, amendments or additions hereto will be recognized unless in writing signed by both seller and buyer or buyer's agent. It is expressly agreed that no representations or warranties, express or implied, have been or are made by the seller except as stated herein, and the seller makes no warranty, express or implied, as to the fitness for buyer's purposes of yarn purchased hereunder, seller's obligations, except as expressly stated herein, being limited to the *delivery of good merchantable yarn of the description stated herein*".(Emphasis supplied.)

Special Term granted plaintiff summary judgment for the contract price of the yarn sold on the ground that "notice of the alleged breach of warranty for defect in shading was not given within the time expressly limited and is not now available by way of defense or counterclaim." The Appellate Division affirmed, without opinion.

The defendant on this appeal urges that the time limitation provision on claims in the contract was unreasonable since the defect in the color of the yarn was latent and could not be discovered [*402] until after the yarn was processed and the finished product washed.

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Defendant's affidavits allege thatits sweaters were rendered unsaleable because [**687] of latent defects in the yarn which caused "variation in color from piece to piece and within the pieces." This allegation is sufficient to create a question of fact concerning the merchantability of the yarn (*Uniform Commercial Code, § 2-314, subd. [2]*). Indeed, the plaintiff does not seriously dispute the fact that its yarn was unmerchantable, but instead, like Special Term, relies upon the failure of defendant to give notice of the breach of warranty within the time limits prescribed by paragraph 2 of the contract.

Subdivision (3) (par. [a]) of *section 2-607 of the Uniform Commercial Code* expressly provides that a buyer who accepts goods has a reasonable time after he discovers or should have discovered a breach to notify the seller of such breach.(Cf. 5 Williston, Contracts [3d ed.], § 713.) Defendant's affidavits allege that a claim was made immediately upon discovery of the breach of warranty after the yarn was knitted and washed, and that this was the earliest possible moment at which the defects could reasonably be discovered in the normal manufacturing process. Defendant's affidavits are, therefore, sufficient to create a question of fact concerning whether notice of the latent defects alleged was given within a reasonable time. (Cf. Ann., *17 ALR 3d 1010, 1112-1115* [1968] .)

However,the Uniform Commercial Code allows the parties, within limits established by the code, to modify or exclude warranties and to limit remedies for breach of warranty. The courts below have found that the sales contract bars all claims not made before knitting and processing. Concededly, defendant discovered and gave notice of the alleged breach of warranty after knitting and washing.

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We are, therefore, confronted with the effect to be given the time limitation provision in paragraph 2 of the contract. Analytically, paragraph 2 presents separate and distinct issues concerning its effect as a valid limitation on remedies for breach of warranty (*Uniform Commercial Code, § 2-316*, *subd. [4]* ; *§ 2-719*) and its effect as a modification of the express warranty of merchantability (*Uniform Commercial Code, § 2-316*, *subd. [1]*) established by paragraph 4 of the contract.

[*403] Parties to a contract are given broad latitude within which to fashion their own remedies for breach of contract (*Uniform Commercial Code, § 2-316*, *subd. [4]* ; *§§ 2-718*, *2-719*). Nevertheless, it is clear from the official comments to *section 2-719 of the Uniform CommercialCode* that it is the very essence of a sales contract that at least minimum adequate remedies be available for its breach."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." (*Uniform Commercial Code, § 2-719*, official comment 1; emphasis supplied.)

It follows thatcontractual limitations upon remedies are generally to be enforced unless unconscionable. This analysis is buttressed by the fact that the official comments to *section 2-302 of the Uniform Commercial Code*, the code provision pertaining to unconscionable contracts or clauses, cites *Kansas City Wholesale Grocery Co. v. Weber Packing Corp. (93 Utah 414* [1937]), a case invalidating a time limitation provision as applied to latent defects, as illustrating the underlying basis for *section 2-302*.[1]

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1 We recognize that the Superior Court of Pennsylvania in *Vandenberg & Sons, N. V.* v. *Siter* (204 Pa. Super. Ct. 392 [1964]) held that the manifest unreasonableness of a time limitation clause presented a question of fact for trial (citing *Uniform Commercial Code, § 1-204* and two pre-Uniform Commercial Code cases). However, the Pennsylvania Superior Court did not consider the sections of the code pertaining to limitation of remedies for breach of warranty. (*Uniform Commercial Code, § 2-316*, subd. [4*] ; §§ 2-718*, *2-719*.) When these interrelated sections are considered in light of the official comments to *section 2-719 of the Uniform Commercial Code*, it is clear that the issue of the reasonability of limitations upon contractual remedies presents a question of unconscionability for the court. For this reason we decline to follow *Vandenberg & Sons, N. V. V. Siter* (*supra*).

-

[**688] Whether a contract or any clause of the contract is unconscionable is a matter for the court to decide against the background of the contract's commercial setting, purpose, and effect, [*404] and the existence of this issue would not therefore bar summary judgment. [2]

2 In construing *section 2-302* (subd. [2]) as a matter of first impression, *Sinkoff Beverage Co. v. Schlitz Brewing Co. (51 Misc 2d 446*) acknowledges that the issue of unconscionability is a matter of law for the court, but holds that a hearing to determine the commercial setting, purpose, and effect of a contract is mandatory rather than discretionary when the court accepts the possibility of unconscionability. Neither party argues that Special Term should have held an evidentiary hearing on the issue of unconscionability, and accordingly we express no opinion on this issue.(Cf. Cohen and Karger, Powers of the New York Court of Appeals [Rev. ed., 1952], §§ 161, 162.)

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However, it is unnecessary to decide the issue of whether the time limitation is unconscionable on this appeal for*section 2-719* (subd. [2]) of the Uniform Commercial Code provides that the general remedy provisions of the code apply when "circumstances cause an exclusive or limited remedy to fail of its essential purpose". As explained by the officialcomments to this section: "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." (*Uniform Commercial Code, § 2-719*, official comment 1.) Here, paragraph 2 of the contract bars all claims for shade and other specified defects made after knitting and processing. Its effect is to eliminate any remedy for shade defects not reasonably discoverable within the time limitation period. It is true thatparties may set by agreement any time not manifestly unreasonable whenever the code "requires any action to be taken within a reasonable time" (*Uniform Commercial Code, § 1-204*, *subd. [1]*), but here the time provision eliminates all remedy for defects not discoverable before knitting and processing and *section 2-719* (subd. [2]) of the Uniform Commercial Code therefore applies.

Defendant's affidavits allege that sweaters manufactured from the yarn were rendered unmarketable because of latent shading defects not reasonably discoverable before knitting and processing of the yarn into sweaters. If these factual allegations are established at trial, the limited remedy established by paragraph 2 has failed its "essential purpose" and the buyer is, in effect, without remedy. The time limitation clause of the contract, therefore, insofar as it applies to defects not [*405] reasonably discoverable within the time limits established by the contract, must give way tothe general code rule that

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a buyer has a reasonable time to notify the seller of breach of contract after he discovers or should have discovered the defect.(*Uniform Commercial Code, § 2-607*, *subd. [3],* par. [a] .) As indicated above, defendant's affidavits are sufficient to create a question of fact concerning whether notice was given within a reasonable time after the shading defect should have been discovered.

It can be argued that paragraph 2 of the contract, insofar as it bars all claims for enumerated defects not reasonably discoverable within the time period established, purports to exclude these defects from the coverage of the express warranty of [**689] merchantability. By this analysis, the contract not only limits remedies for its breach, but also purports to modify the warranty of merchantability. An attempt to both warrant and refuse to warrant goods creates an ambiguity which can only be resolved by making one term yield to the other (cf. Hawkland, Limitation of Warranty under the Uniform Commercial Code, 11 How. L. J. 28 [1965]). S*ection 2-316* (subd. [1]) of the Uniform Commercial Code provides that warranty language prevails over the disclaimer if the two cannot be reasonably reconciled.

Here,the contract expressly creates an unlimited express warranty of merchantability while in a separate clause purports to indirectlymodify the warranty without expressly mentioning the word merchantability. Under these circumstances, the language creating the unlimited express warranty must prevail over the time limitation insofar as the latter modifies the warranty. It follows that the express warranty of merchantability includes latent shading defects and defendant may claim for such defects not reasonably discoverable within the time limits established by the contract if plaintiff was notified of these defects within a reasonable time after they were or should have been discovered.

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The result reached under the Uniform Commercial Code is, therefore, similar to the pre-code case law holding unreasonable contractual provisions expressly limiting the time for inspection, trial or testing of goods inapplicable or invalid with respect to latent defects. (*Randy Knitwear v. American Cyanamid Co.,* [*406] *7 N Y 2d 791*; *Jessel v. Lockwood Textile Corp., 276 App. Div. 378*; *Torrance v. Durisol, Inc., 20 Conn. Supp. 62*; *Kansas City Wholesale Grocery Co. V. Weber Packing Corp., supra*; *National Grocery Co. v. Pratt-Low Preserving Co., 170 Wash. 575*; cf. Ann., *52 ALR 2d 953-957* [1957] .) In fact, in *Randy Knitwear (supra)* this court held a contractual provision remarkably similar to the time limitation clause in the instant case to present a factual question for trial concerning the reasonableness of the time limitation.

In sum, there are factual issues for trial concerning whether the shading defects alleged were discoverable before knitting and processing, and, if not, whether notice of the defects was given within a reasonable time after the defects were or should have been discovered. If the shading defects were not reasonably discoverable before knitting and processing and notice was given within a reasonable time after the defects were or should have been discovered, a further factual issue of whether the sweaters were rendered unsaleable because of the defect is presented for trial.

The order of the Appellate Division should be reversed, with costs, and plaintiff's motion for summary judgment should be denied.

CONCUR BY: FULD I agree that there should be a reversal -- but on the sole ground that a substantial question of fact has been raised as to whether the clause limiting the time in which to make a claim is "manifestly unreasonable" (*Uniform Commercial Code, § 1-204*) as applied to the type

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of defect here complained of. In this view, it is not necessary to consider the relevancy, if any, of other provisions of the Uniform Commercial Code (e. G., *§§ 2-302*, *2-316*, *2-719*), dealing with "unconscionable" contracts or clauses, exclusion of implied warranties or limitations on damages.

¿Cuál habría sido el resultado si la cláusula contracual que descarga la responsabilidad no hubiese fracasado en su propósito esencial?

ROBERT COOLEY and RITA COOLEY, d/b/a COOLEY DAIRY; DONALD WEED; BEN KONISHI, D. V. M.; PAMELA ANN KONISHI; MARK KONISHI; and JEFFREY KONISHI, Petitioners and Cross-Respondents, v. BIG HORN HARVESTORE SYSTEMS, INC., a Colorado corporation, and A. O. SMITH HARVESTORE PRODUCTS, INC., a Delaware corporation, Respondents and Cross-Petitioners Supreme Court of Colorado 813 P.2d 736; 14 U. C. C. Rep. Serv. 2d 977 June 24, 1991

OPINION BY: KIRSHBAUM [*738] In *Cooley v. Big Horn Harvestore Systems, Inc., 767 P.2d 740 (Colo. App. 1988)*, the Colorado Court of Appeals affirmed in part and reversed in part a judgment entered on a jury verdict in favor of the petitioners and cross-respondents, plaintiffs at trial, and against respondents and cross-petitioners, defendants at trial. Having granted certiorari to consider the propriety of the Court of Appeals decision, [**2] we affirm in part, reverse in part, and remand the case with directions.

I

In July 1980, plaintiffs Robert Cooley and Rita Cooley executed two agreements with defendant Big Horn Harvestore Systems, Inc. (hereinafter Big Horn), in connection with their purchase of a Harvestore automated grain storage and distribution system for use in their dairy

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operation. Big Horn is an independent distributor of Harvestore systems pursuant to agreements with defendant A. O. Smith Harvestore Products, Inc. (hereinafter AOSHPI), the manufacturer of the Harvestore system. [1] The Cooleys purchased the Harvestore [*739] system to improve the efficiency and productivity of their dairy. Plaintiffs Donald Weed; Ben Konishi, D. V. M.; Pamela Konishi; Mark Konishi; and Jeffrey Konishi are owners of cows placed in the Cooleys' dairy herd pursuant to an agreement obligating the Cooleys to care for and feed the cows in return for the right to retain the proceeds of sale of milk produced by those cows.

1 The transaction was structured as a lease-purchase. The Cooleys executed two purchase orders with Big Horn. Big Horn purchased the Harvestore equipment from AOSHPI and then nominally sold it to the financing lessor, Agristor Leasing. The Cooleys and Agristor later executed a lease with purchase option. Agristor, a named party defendant, is not a party to this appeal. Unless otherwise indicated, all references to the term "purchase agreement" in this opinion refer to the documents dated July 28, 1980, executed by Big Horn and by the Cooleys, each of which contains identical language respecting applicable warranties, exclusions, disclaimers and remedies.

[**3] The Harvestore system is designed to enhance the nutritional quality of cattle feed by means of an in-silo fermentation process. An essential feature of the system is its asserted ability to limit oxygen contact with the feed, thus facilitating long-term storage of grain. The Harvestore silo itself is composed of glass-fused-to-steel panels. The silo also features breather bags which expand or contract to equalize the pressure inside and outside the silo no matter how frequently outside temperature patterns might vary. Because the oxygen exchange takes place completely within the breather bags, damaging oxygen contact with the

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feed is limited. During the two years prior to the sale, Big Horn provided the Cooleys with numerous promotional materials prepared by AOSHPI, including films, videotapes, pamphlets, and a book explaining the Harvestore system.

In early 1981, the Cooleys began to feed their herd with grain stored in the Harvestore system. Shortly thereafter, the health of the herd began to deteriorate and milk production substantially declined. The Cooleys informed Big Horn of these developments, and over the succeeding eighteen months Big Horn representatives made repairs to [**4] the structure, gave advice to the Cooleys concerning feed ratios, and assured the Cooleys that the system was functioning properly.

The health of the cows continued to deteriorate. Some died, and the Cooleys ultimately sold the remainder of the herd in 1983. The plaintiffs then filed this action against Big Horn and AOSHPI seeking damages based on claims of breach of implied warranties of merchantability and fitness for a particular purpose, breach of express warranties, breach of contract because of the failure of essential purpose of a limited remedy of suit for breach of warranty to repair or replace any defective part thereof (hereinafter referred to as the "failure of essential purpose" claim), negligence, deceit, and revocation of acceptance. [2]

2 The Konishis and Weed claimed damages against AOSHPI for the death of and injury to their cows pursuant to *section 4-2-318, 2 C. R. S.* (1973), which provides that warranties extend to any person "who may reasonably be expected to use, consume, or be affected by the goods and who is injured by breach of the warranty."

[**5] Prior to the commencement of trial, the trial court entered summary judgment in favor of the defendants and against the plaintiffs on all claims of breach of implied

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warranties and breach of express warranties. The claims alleging revocation of acceptance and deceit were also dismissed by the trial court. The jury was instructed solely on the claim against AOSHPI and Big Horn for failure of essential purpose of the warranty and on a claim against Big Horn for negligence in recommending improper nutritional programs.

The jury returned a verdict in favor of the plaintiffs and against Big Horn on the negligence claim in the total amount of $87,723.77. The jury also returned a verdict in favor of the plaintiffs and against both Big Horn and AOSHPI in the amount of $245,077.26 on the failure of essential purpose claim. In special verdict forms, the jury assigned seventy-five percent liability to Big Horn and twenty-five percent liability to AOSHPI on the failure of essential purpose claim. The jury also found Big Horn ninety percent negligent and the Cooleys ten percent negligent on the negligence claim. The trial court therefore reduced the amount of damages recoverable [*740] on the negligence [**6] claim to the sum of $78,951.40. The trial court also determined that the award of damages returned by the jury on the negligence claim duplicated a portion of the award of damages returned on the failure of essential purpose claim. The trial court ultimately entered judgment for the plaintiffs and against Big Horn and AOSHPI in the amount of $245,077.26.

On appeal, the Court of Appeals affirmed the negligence verdict against Big Horn but reversed the failure of essential purpose verdict against AOSHPI and Big Horn. The court held that the plaintiffs were barred from asserting their failure of essential purpose claim because AOSHPI was entitled to receive timely notice of the claim pursuant to *section 4-2-607(3)(a), 2 C. R. S.* (1973), of the Colorado Commercial Code (hereinafter the Code) and the plaintiffs did not give such notice to AOSHPI. The court reversed the

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failure of essential purpose verdict against Big Horn on the ground that the purchase agreement limited Big Horn's responsibility to proper installation of the Harvestore system and the evidence did not establish any failure of installation. [3] Observing that it could not determine what factors were considered by the jury [**7] in its calculations of damages on the negligence claim, and determining that the plaintiffs were entitled to recover damages for economic loss on their negligence claim, the Court of Appeals remanded the case for a new trial on the issue of the amount of damages attributable to Big Horn's negligence.

3 This issue has not been appealed and thus is not before this court.

We granted the plaintiffs' petition for certiorari and the defendants' cross-petitions for certiorari to consider the following issues: whether *section 4-2-607(3)(a), 2 C. R. S.* (1973), requires notice to a remote manufacturer as a condition precedent to the initiation of a breach of contract claim based on the failure of essential purpose doctrine; whether evidence of specific defects in material or workmanship is essential to a failure of essential purpose claim; whether a contractual disclaimer of consequential damages is rendered invalid by the establishment of a failure of essential purpose claim; whether an exculpatory clause was sufficient to disclaim [**8] negligence in providing nutritional advice; whether the record contains sufficient evidence to establish the plaintiffs' claim of negligent nutritional advice; and whether the case should be remanded for retrial on the issue of damages. [4]

4 Because of the grounds upon which the Court of Appeals resolved the case, it did not consider the effect of the lack of evidence of defects in materials or workmanship or the effect of the consequential damages disclaimer.

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II

The Court of Appeals held that a commercial buyer seeking recovery from a manufacturer for a breach of contract claim resulting in property damage alone must, pursuant to the provisions of *section 4-2-607(3)(a), 2 C. R. S.* (1973), give the manufacturer timely notice of the claimed breach as a condition precedent to any recovery. The plaintiffs contend that they complied with the notice provisions of the statute by giving timely notice of their failure of essential purpose claim to Big Horn. We agree with the plaintiffs' contention.

Section 4-2-607(3)(a), 2 C. R. S. [**9] (1973), provides that "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 ." This provision serves as a condition precedent to a buyer's right to recover for breach of contract under the statute. P*almer v. A. H. Robins Co., 684 P.2d 187, 206 (Colo. 1984)*. The question of what constitutes a reasonable time is dependent on the circumstances of each case. W*hite v. Mississippi Order Buyers, Inc., 648 P.2d 682 (Colo. App. 1982)*. The parties agree that the plaintiffs gave timely notice to Big Horn of their claim but did not directly notify AOSHPI of such claim.

The notice provision of *section 4-2-607(3)(a)* serves three primary purposes. It [*741] provides the seller with an opportunity to correct defects, gives the seller time to undertake negotiations and prepare for litigation, and protects the seller from the difficulties of attempting to defend stale claims. Palmer v. A. H. Robins Co.; *Prutch v. Ford Motor Co., 618 P.2d 657 (Colo. 1980)*. See generally White and Summers, Uniform Commercial [**10] Code § 11-10 at 481 (3d ed. 1980). The Code defines 'seller' as "a

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person who sells or contracts to sell goods." *§ 4-2-103(1)(d), 2 C. R. S.* (1973). The official comment to the Code states in pertinent part that "the rule of requiring notification is designed to defeat commercial bad faith, not to deprive a good faith consumer of his remedy." *§ 4-2-607, 2 C. R. S.* comment 4 (1973).

In *Palmer v. A. H. Robins Co., 684 P.2d 187*, this court construed the statute's notice provision in the context of a product liability action. In Palmer, a consumer injured through use of a defective intrauterine device sought recovery for damages against the manufacturer of the product, A. H. Robins Co. Although the plaintiff, prior to initiating litigation, notified the immediate seller, her doctor, of the fact that she allegedly sustained injuries as a result of defects in the product, she did not so notify Robins. Robins argued that the plaintiff's claims against it should be dismissed for failure to comply with *section 4-2-607(3)(a)*.

We rejected that argument. We construed the term "seller" as used in *section 4-2-607(3)(a)* to "refer only to the immediate seller who tendered the [**11] goods to the buyer." *Palmer at 206*. We explained that "under this construction, as long as the buyer has given notice of the defect to his or her immediate seller, no further notification to those distributors beyond the immediate seller is required." Id. We also observed that a relaxed notification requirement was especially appropriate in Palmer because the plaintiff was a lay consumer who "would not ordinarily know of the notice requirement." *Id. at 207 n.3*.

The Court of Appeals concluded that the plaintiffs here were commercial purchasers who suffered only economic loss, as distinguished from the lay consumer who sought relief in Palmer. Assuming, arguendo, that the plaintiffs here were commercial purchasers, [5] it must be observed

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that our decision in Palmer required construction of a statute adopted by the General Assembly for application in all commercial contexts. The language of *section 4-2-607(3)(a)* is unambiguous: it requires a buyer to give notice of a defective product only to the "seller." See 2 Anderson, Uniform Commercial Code § 2.607:24. The General Assembly has not elected to require advance notice to a manufacturer [**12] of litigation for breach of the manufacturer's warranty of a product, and we find no compelling reason to create such a condition precedent judicially in the context of commercial litigation. The filing of a lawsuit is sufficient notice to encourage settlement of claims, and applicable statutes of limitation protect manufacturers from the difficulties of defending against stale claims. See Palmer; *Owens v. Glendale Optical, 590 F. Supp. 32, 36 (S. D. Ill. 1984)*; *Shooshanian v. Wagner 672 P.2d 455 (Alaska 1983)*; *Mattos, Inc. v. Hash, 279 Md. 371, 368 A.2d 993, 996 (Md. 1977)*.

5 The trial court made no factual determination regarding the status of the plaintiffs. We are not prepared to conclude on the basis of the record that with regard to their purchase of the Harvestore system the Cooleys were sophisticated commercial buyers or that the other plaintiffs were sophisticated commercial users of the system.

Several courts considering whether a purchaser [**13] seeking recovery under a manufacturer's warranty must give notice to the manufacturer as well as to the seller of the product under statutory provisions similar to *section 4-2-607(3)(a)* have reached a similar result. See, e. G., *Firestone Tire and Rubber Co. v. Cannon, 53 Md. App. 106, 452 A.2d 192 (1982)*, aff'd, *295 Md. 528, 456 A.2d 930 (1983)*. Some courts have reached contrary results. See *Morrow v. New Moon Homes, Inc., 548 P.2d 279 (Alaska 1976)*; *Branden v. Gerbie, 62 Ill. App. 3d 138, 379 N. E.2d 7, 19 Ill. Dec. 492 (1978)*; *Western Equip. Co. v. Sheridan*

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Iron Works, Inc., 605 P.2d 806 (Wyo. 1980). Many such courts have recognized that in [*742] most nationwide product distribution systems, the seller/representative dealer may be presumed to actually inform the manufacturer of any major product defects. G*oldstein v. G. D. Searle & Co., 62 Ill. App. 3d 344, 347-48, 378 N. E.2d 1083, 1086-87, 19 Ill. Dec. 208 (1978)*; see also Prince, Overprotecting the Consumer? § 2-607(3)(a). Notice of Breach in Non-Privity Contexts, *66 N. C. L. Rev. 107, 151 (1987)*. [**14] Furthermore, as one commentator has noted, "it is perhaps more reasonable to treat notice to an immediate seller as sufficient against a remote seller than vice versa, in view of the immediacy of relation that exists in the one instance but not in the other." Phillips, Notice of Breach in Sales and Strict Tort Liability Law: Should There be a Difference?, 47 Ind. L. J. 457, 473 (1971); see also *Snell v. G. D. Searle & Co., 595 F. Supp. 654, 656 (N. D. Ala. 1984)* (applying Alabama law); *Firestone Tire and Rubber Co. v. Cannon, 53 Md. App. 106, 452 A.2d 192 (1982)*, aff'd, *295 Md. 528, 456 A.2d 930 (1983)*. This presumption forms the basis of the principle that a remote manufacturer may raise as its own defense the buyer's failure to give timely notice to the immediate seller. See, e. G., *Snell v. G. D. Searle & Co., 595 F. Supp. 654, 656 (N. D. Ala. 1984)* (applying Alabama law); *Owens v. Glendale Optical Co., 590 F. Supp. 32, 36 (S. D. Ill. 1984)* (applying Illinois law); *Goldstein v. G. D. Searle & Co., 62 Ill. App. 3d 344, 347-48, 378 N. E.2d 1083, 1086-87, 19 Ill. Dec. 208 (1978)*. [**15] In view of the unambiguous language of *section 4-2-607(3)(a)*, we conclude that a purchaser injured by a product is not required to give notice of such injury to a remote manufacturer prior to initiating litigation against such manufacturer.

AOSHPI urges us to adopt the rationale expressed in *Carson v. Chevron Chemical Co., 6 Kan. App. 2d 776, 635*

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P.2d 1248 (1981). In that case three farmers brought suit against a herbicide manufacturer and dealer to recover damages for breach of warranties. Observing that in ordinary buyer-seller relationships the Kansas Commercial Code equivalent of *section 4-2-607(3)(a)* requires that notice of an alleged breach need only be given to the buyer's immediate seller, *Carson at 1256*, the Kansas Court of Appeals concluded that the plaintiffs were required to notify the manufacturer under the particular circumstances of that case. The court explained its holding as follows:

In those instances, however, where the buyer and the other parties to the manufacture, distribution and sale of the product are closely related, or where the other parties actively participate in the consummation of the actual sale of the product, [**16] the reasons for the exclusion of such other parties from the *K. S. A. 84-2-607(3)(a)* notice provision cease to exist. Id.

In our view, the rationale of Carson supports the result we reach. The Kansas Court of Appeals emphasized that under the circumstances disclosed by the evidence the defendant was in effect a direct seller to the plaintiffs. Here, AOSHPI, the manufacturer, was isolated and insulated from the plaintiffs. The contract specified that Big Horn was the seller. AOSHPI, if a seller, was a seller to Big Horn, not to the plaintiffs. As far as the plaintiffs were concerned, the only direct relationship established by the contract and by the conduct of the parties was their relationship with Big Horn. Under these circumstances, to require the plaintiffs to give statutory notice to AOSHPI when not specifically required to do so by statute would unreasonably promote commercial bad faith and inequitably deprive good faith consumers of a remedy,

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contrary to the purpose of the statute. We reject such a construction.

III

AOSHPI contends that to recover on their failure of essential purpose claim, the plaintiffs were required to establish the existence of some specific defect [**17] in materials or workmanship, which they failed to do. AOSHPI alternatively asserts that the purchase contract itself prohibits recovery of consequential damages by the plaintiffs. [*743] We disagree with these arguments. [6]

6 As previously indicated, the Court of Appeals did not address these questions. See n.4, infra.

A

Section 4-2-719, 2 C. R. S. (1973), contains the following pertinent provisions respecting the abilities of contracting parties to limit the remedies which are available to a purchaser in the event a seller breaches an agreement:

Contractual modification or limitation of remedy. (1) Subject to the provisions of subsections (2) and (3) of this section and of *section 4-2-718* 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 [**18] and replacement of nonconforming 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.

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(2) Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this title.

§ 4-2-719, 2 C. R. S. (1973). These provisions allow great flexibility in negotiations for the provision of goods. *Section 4-2-719(2)*, however, reflects a legislative determination that in limited circumstances enforcement of an agreement to restrict a buyer's potential remedies would produce unconscionable results. See generally, Eddy, On the Essential Purpose of Limited Remedies: The Metaphysics of UCC Section 2-719(2), 65 Calif. L. Rev. 28 (1977).

The plaintiffs' failure of essential purpose claim is premised on the language of *section 4-2-719(2)*. [7] The plaintiffs acknowledge that the purchase agreement contains an express warranty of repair or replacement and a disclaimer clause limiting their remedy to a suit for breach of that warranty. [8] They argued at trial that because this remedy failed of its essential [*744] purpose, the language [**19] of the agreement purporting to limit their available remedies was not enforceable. The failure of essential purpose claim was tried on this theory, and the jury instructions stated that to return a verdict for the plaintiffs against AOSHPI, the jury must first determine that the plaintiffs had established the necessary factual predicate for application of the failure of essential purpose doctrine. See *Balistreri Greenhouses v. Roper Corp., 767 P.2d 736 (Colo. App. 1988)*; *Leprino v. Intermountain Brick Co., 759 P.2d 835 (Colo. App. 1988)*.

7 To establish their claim of failure of essential purpose of the remedy of suit for breach of a warranty to repair or replace any defective product or parts thereof, the plaintiffs were required to establish that the product was defective in material or workmanship, that the defendants had an

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opportunity to repair or replace the defects, that they were unable to do so, that their inability to effectively repair or replace substantially affected the value of the product and that the impairment of the value damaged the plaintiffs. See C. Smith & B. Clark, The Law of Product Warranties, 8.04 [2] (1984). [**20]

8 The purchase agreement contains the following pertinent provisions:

WARRANTY OF MANUFACTURER AND SELLER

If within the time limits specified below, any product sold under this purchase order, or any part thereof, shall prove to be defective in material or workmanship upon examination by the Manufacturer, the Manufacturer will supply an identical or substantially similar replacement part f. O. B. the Manufacturer's factory, or the Manufacturer, at its option, will repair or allow credit for such part. .

SECOND DISCLAIMER

NO OTHER WARRANTY, EITHER EXPRESS OR IMPLIED AND INCLUDING A WARRANTY OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE HAS BEEN OR WILL BE MADE BY OR IN BEHALF OF THE MANUFACTURER OR THE SELLER OR BY OPERATION OF LAW WITH RESPECT TO THE EQUIPMENT AND ACCESSORIES OR THEIR INSTALLATION, USE, OPERATION, REPLACEMENT OR REPAIR. NEITHER THE MANUFACTURER NOR THE SELLER SHALL BE LIABLE BY VIRTUE OF THIS WARRANTY, OR OTHERWISE, FOR ANY SPECIAL OR CONSEQUENTIAL LOSS OR DAMAGE (INCLUDING BUT NOT LIMITED TO THOSE RESULTING FROM THE CONDITION OR QUALITY OF ANY CROP OR MATERIAL STORED IN THE STRUCTURE) RESULTING FROM THE USE OR LOSS OF THE USE

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OF EQUIPMENT AND ACCESSORIES. THE MANUFACTURER MAKES NO WARRANTY WITH RESPECT TO THE ERECTION OR INSTALLATION OF THE EQUIPMENT, ACCESSORIES, OR RELATED EQUIPMENT BY THE HARVESTORE DEALER, WHO IS AN INDEPENDENT CONTRACTOR, OR ANY OTHER INDEPENDENT CONTRACTOR. IRRESPECTIVE OF ANY STATUTE, THE BUYER RECOGNIZES THAT THE EXPRESS WARRANTY SET FORTH ABOVE, IS THE EXCLUSIVE REMEDY TO WHICH HE IS ENTITLED AND HE WAIVES ALL OTHER REMEDIES, STATUTORY OR OTHERWISE.

[**21] AOSHPI initially asserts that there was insufficient evidence for the jury to find a failure of essential purpose because there was no evidence of any specific defect in material or workmanship [9] and because AOSHPI was not given an opportunity to repair or replace such defect.

9 The record contains evidence of defects in operational components of the Harvestore system, which defects were repaired by Big Horn, as well as evidence of a dent in the system's structure which was not repaired.

The policy behind the statutory provision establishing the failure of essential purpose doctrine is discussed in the official comments to the Code, as follows:

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 [**22] or duties outlined in the contract. Under subsection (2), where an apparently fair and reasonable clause because of circumstances fails in its purpose or operates to deprive

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either party of the substantial value of the bargain, it must give way to the general remedy provisions of this Article.

§ 4-2-719, 2 C. R. S. comment 1 (1973). The comment makes clear that determination of the applicability of the failure of essential purpose doctrine requires a two-tiered evaluation: first, identification of the essential purpose of the limited remedy, and second, whether the remedy in fact failed to accomplish such purpose. M*ilgard Tempering, Inc. v. Selas Corp., 902 F.2d 703 (9th Cir. 1990)*; *Chatlos Systems, Inc. v. National Cash Register Corp., 635 F.2d 1081 (3d Cir. 1980)*. From a buyer's standpoint, a promise to repair or replace defective parts supplies assurance that within a reasonable period of time defective goods will be put into the condition they were warranted to be in at the time they were purchased. [10] Milgard; Chatlos; *Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978)*; *Beal v. General Motors Corp., 354 F. Supp. 423 (D. Del. 1973)*. [**23] See C. Smith & B. Clark, The Law of Product Warranties, 8.04 [2] at 8-52 (1984). The plaintiffs introduced sufficient evidence to establish that the Harvestore system was never functional, thus permitting the jury to conclude that the limited remedy of a suit for breach of the warranty to repair or replace failed of its essential purpose.

10 From the seller's standpoint, the purpose of such warranty is to foreclose efforts by the buyer to return goods or to recover damages as a remedy for defective goods.

AOSHPI suggests that its warranty protecting against a defect in material and workmanship is limited solely to protection against flaws resulting from the manufacturing process and did not encompass general product design defects. From this premise, AOSHPI concludes that lack of evidence of some specific defect in some specific manufactured part is fatal to the failure of essential purpose

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claim. This view of the transaction is not supported by the evidence.

The product advertised, purchased, and warranted [**24] was a functioning system for storage and distribution of grain. The Cooleys purchased this system. They did not purchase a combination of component parts. See *Polycon Industries, Inc. v. Hercules Inc., 471 F. Supp. 1316, 1323 (E. D. Wis. 1979)*. But see *Lombard Corp. v. Quality Aluminum Prods. Co., 261 F.2d 336 (6th Cir. 1958)*; *Bruffey Contracting Co. v. Burroughs Corp., 522 F. Supp. 769 (D. Md. 1981)*, aff'd *681 F.2d 812 (4th Cir. 1982)*. A remedy fails of its essential purpose [*745] if it operates to deprive a party of the substantial value of the contract. *§ 4-2-719(2), 2 C. R. S.* comment 1 (1973). Fair application of warranty principles require a determination of what the seller has agreed to sell and what the buyer has agreed to pay for. See *§ 4-2-313, 2 C. R. S.* comment 4 (1973). See also *Computerized Radiological Services v. Syntex Corp., 595 F. Supp. 1495 (E. D. N. Y. 1984)* aff'd in part, rev'd in part on other grounds, *786 F.2d 72 (2d Cir. 1986)*. The Cooleys' purchase had value only to the extent the Harvestore system functioned, as advertised, as an entire unit to increase [**25] the productivity of their dairy herd. Additionally, AOSHPI's warranty promised repair or replacement of any defective product or part thereof. The evidence established that the product was defective and was not repaired or replaced with a non-defective product. In these circumstances, the Cooleys were entitled to argue to the jury that the limited remedy of repair or replacement failed to guarantee them the value of the system they purchased. A*gristor Credit Corp. v. Schmidlin, 601 F. Supp. 1307 (D. Or. 1985)*. The record clearly supports the jury's conclusion that the system as a whole was defective.

AOSHPI's argument that it was not given an opportunity to repair or replace the Harvestore system is

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not persuasive. The purchase agreement does not specify the means by which the Cooleys were to provide AOSHPI with the opportunity to repair or replace defects. The agreement does provide that "no product or part shall be returned to the Seller without written authorization and shipping instructions first having been obtained from the Seller." This provision in essence directs the Cooleys to address any questions concerning the Harvestore system to Big Horn. The evidence [**26] fully supports the conclusion that, as the Cooleys alleged, the agreement was intended to assure the Cooleys that Big Horn would assume any role assigned by the purchase agreements to AOSHPI to repair defects in the system; to determine what parts, if any, to replace; and to inform the Cooleys how the provisions of the remedy to repair or replace were to be effectuated.

B

AOSHPI also argues that the purchase agreement prohibits the plaintiffs from recovering any consequential damages on their failure of essential purpose claim. We disagree.

The jury returned a verdict in the amount of $245,077.26, against AOSHPI and Big Horn on the plaintiffs' failure of essential purpose claim, which sum included consequential damages for injuries to the plaintiffs' herds and for loss of milk profits. The verdict form did not require the jury to itemize its damage award. However, the evidence with regard to damages was presented in three distinct categories, as follows: the value of the Harvestore system ($88,636.00), damage to the dairy herds ($87,723.77), and loss of milk profits ($68,717.49).

The purchase agreement contains the following pertinent provision:

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NEITHER THE MANUFACTURER NOR [**27] THE SELLER SHALL BE LIABLE BY VIRTUE OF THIS WARRANTY, OR OTHERWISE, FOR ANY SPECIAL OR CONSEQUENTIAL LOSS OR DAMAGE (INCLUDING BUT NOT LIMITED TO THOSE RESULTING FROM THE CONDITION OR QUALITY OF ANY CROP OR MATERIAL STORED IN THE STRUCTURE) RESULTING FROM THE USE OR LOSS OF THE USE OF EQUIPMENT AND ACCESSORIES.

The trial court concluded that this provision did not bar the plaintiff from recovering consequential damages in view of the language of *section 4-2-719(2), 2 C. R. S.* (1973). AOSHPI argues that *section 4-2-719(3), 2 C. R. S.* (1973), which permits buyers to waive their rights to recover consequential damages, controls. We agree with the trial court.

We have determined that the evidence supports the jury's verdict that the limited remedy of replacement or repair of defective parts failed of its essential purpose. *Section 4-2-719(2)* states that when a seller [*746] is found liable to a buyer on the basis of the failure of essential purpose doctrine, "remedy may be had as provided in this title." *Section 4-2-714(3)* of the Code expressly provides that a purchaser may recover consequential damages resulting from a seller's breach of contract. Thus the Code clearly establishes consequential [**28] damages as a remedy available to buyers of goods.

Section 4-2-719(3) of the Code states as follows:

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.

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§ 4-2-719(3), 2 C. R. S. (1973). AOSHPI argues that *section 4-2-719(3)* establishes the right of contracting parties to limit the general availability of consequential damages established by *section 4-2-714* and that the Cooleys did so limit their rights here. [11]

11 *Section 4-2-714(3), 2 C. R. S.* (1973), provides that where there has been a breach in regard to accepted goods "in a proper case, any incidental and consequential damages under *section 4-2-715* may also be recovered."

Courts that have considered the relationship of these two provisions as they appear in other state commercial codes have reached divergent results. Many courts have [**29] concluded that the broad sweep of the literal language of provisions identical to *section 4-2-719(2)* represents a legislative decision to permit a buyer who suffers loss because of the failure of essential purpose of a limited remedy of repair or replacement to recover all damages resulting from such failure. See, e. G., *Milgard, Tempering Inc. v. Selas Corp., 902 F.2d 703 (9th Cir. 1990)* (applying Washington law); *Fiorito Bros. v. Fruehauf Corp., 747 F.2d 1309 (9th Cir. 1984)*; *Soo Line R. R. v. Fruehauf Corp., 547 F.2d 1365 (8th Cir. 1977)*; *Beal v. General Motors Corp., 354 F. Supp. 423 (D. Del. 1973)*; *Jones & McKnight Corp. v. Birdsboro Corp., 320 F. Supp. 39*, (N. D. Ill. 1970); *Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978)*. Indeed, our own Court of Appeals has so construed *section 4-2-719(2)* of the Code. J. *A. Balistreri Greenhouses v. Roper Corp., 767 P.2d 736 (Colo. App. 1988)*; *Leprino v. Intermountain Brick Co., 759 P.2d 835, 837 (Colo. App. 1988)*; cf. W*enner Petroleum Corp. v. Mitsui & Co. (U. S. A.), Inc., 748 P.2d 356 (Colo. App. 1987)*. [**30]

It has been observed that the decision of contracting parties to limit potential remedies to the single remedy to

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repair or replace defective parts is based on a number of assumptions which, if unfounded, fundamentally change the parties' intended allocation of risk. *Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978)*. These include the assumptions that the seller will diligently and in good faith attempt to repair, that the seller will be able to effect repairs within a reasonable time period, and that any consequential loss sustained during the period of repair will be minimal. *Waters v. Massey-Ferguson, Inc., 775 F.2d 587 (4th Cir. 1985)*; *S. M. Wilson & Co. v. Smith International, 587 F.2d 1363 (9th Cir. 1978)*; *AES Technology Sys., Inc. v. Coherent Radiation, 583 F.2d 933 (7th Cir. 1978)*. See generally, Eddy, On the Essential Purpose of Limited Remedies: The Metaphysics of UCC Section 2-719(2), 65 Calif. L. Rev. 28 (1977). Under the rationale of these cases, a loss that is itself caused by the failure of the remedy of suit for breach of a warranty [**31] to repair or replace defective parts could not be within the contemplation of the parties, and therefore should not be prohibited when such bargained-for remedy fails of its essential purpose. A buyer reasonably expecting to avoid significant consequential loss through the effective use of such remedy should not be required to absorb such loss when the remedy fails of its essential purpose. See *Waters v. Massey-Ferguson, Inc., 775 F.2d 587, 591-92 (4th Cir. 1985)*; *Kearney & Trecker v. Master Engraving, 107 N. J. 584, 527 A.2d 429 (1987)*.

A few courts have determined that the adequacy of the buyer's remedy in the absence [*747] of the ability to recover consequential damages should govern the applicability of the two provisions. *Kelynack v. Yamaha Motor Corp., U. S. A., 152 Mich. App. 105, 394 N. W.2d 17 (1986)* (where the bulk of the damages were consequential, remedy without consequential damages was no remedy at all); see also *Earl M. Jorgensen Co. v. Mark Constr. Inc.,*

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56 Haw. 466, 540 P.2d 978 (1975); *Oldham's Farm Sausage Co. v. Salco, Inc., 633 S. W.2d 177 (Mo. App. 1982)*. [**32] These courts give great weight to language in their statutes that mirrors the language of *section 4-2-719* of the Code. This approach requires determination on a case-by-case basis of whether a particular limitation is conscionable under all applicable circumstances.

Finally, some courts, emphasizing language of commercial code provisions adopted in their jurisdictions that parallel the language of *section 4-2-719(3)*, have concluded that the two sections constitute distinct clauses applicable to different circumstances. Under this view, *section 4-2-719(3)* is a particular provision modifying the availability of consequential damages established generally by *section 4-2-714(3)*. See *Kaplan v. RCA Corp., 783 F.2d 463, 467 (4th Cir. 1986)*; *Lewis Refrigeration Co. v. Sawyer Fruit, Vegetable and Cold Storage Co., 709 F.2d 427, 434-35 (6th Cir. 1983)*; *Chatlos Systems, Inc. v. National Cash Register Corp., 635 F.2d 1081, 1086 (3d Cir. 1980)*; *S. M. Wilson & Co. v. Smith Int'l, Inc., 587 F.2d 1363, 1375 (9th Cir. 1978)*; *Johnson v. John Deere Co., 306 N. W.2d 231, 238 (S. D. 1981)*; *Envirotech Corp. v. Halco Eng'r, Inc., 234 Va. 583, 364 S. E.2d 215, 220 (1988)*. [**33] See also J. White & R. Summers, Uniform Commercial Code § 12-10 (3d ed. 1980); B. Clark & C. Smith, The Law of Product Warranties § 8.04 [2] [c] (1984 & 1990 Supp.). This approach suggests that the failure of essential purposes doctrine articulated in *section 4-2-719(2)* requires application of a substantial value of the bargain standard, while the question of the viability of a contractual waiver of the availability of the remedy of consequential damages contained in *section 4-2-719(3)* is measured by a conscionability standard. Thus, a remedy may fail in its essential purpose because it deprives a party of the substantial value of a bargained-for benefit, but a clearly

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expressed exclusion of consequential damages as a remedy available to such party in that circumstance is enforceable if not unconscionable.

In construing statutory provisions, we must give effect to the language and intent of the General Assembly and seek to harmonize apparently contrasting provisions. D*anielson v. Castle Meadows, Inc., 791 P.2d 1106 (Colo. 1990)*; *City of Ouray v. Olin, 761 P.2d 784 (Colo. 1988)*. The Code itself provides some guidance in resolving the [**34] issue here presented. It is designed to enhance freedom of contract and innovation in commercial practices while establishing good faith, diligence and reasonableness as limits upon such freedom of contract. *§ 4-1-102, 2 C. R. S.* (1973). It also provides that the remedies provided thereunder are to be liberally administered to further those ends. *§ 4-1-106, 2 C. R. S.* (1973). In view of these guidelines, we find persuasive those authorities which suggest that the two subsections in question must be construed together to effectuate their purposes.

In adopting *section 4-2-719(2)*, the General Assembly recognized that while contracting parties may generally limit the remedies available in the event of foreseeable and bargained-for contingencies, when a limited remedy fails of its essential purpose any contractual limitation directly related to the assumption that the limited remedy constituted a sufficient remedy must also fail. In effect, this provision protects contracting parties from unforeseen and unbargained-for contingencies. In adopting *section 4-2-719(3)*, the General Assembly recognized that in most situations contracting parties may agree to limit or exclude the availability of [**35] the remedy of consequential damages, subject to a conscionability standard. Neither section grants absolute rights to contracting parties.

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It is neither possible nor desirable to suggest absolute guidelines for the reconciliation [*748] of these two provisions in all cases. In this case, however, the applicability of the statutory scheme is not difficult. The purchase agreement purports to exclude all warranties other than the promise to repair or replace defective parts while simultaneously excluding all remedies for the recovery of economic loss sustained as a breach of that limited warranty. The language excluding consequential damages and the language limiting remedies appears in the same sentence of the purchase agreement. That sentence commences with the following phrase: "Neither the manufacturer nor the seller shall be liable by virtue of this warranty, or otherwise, for any special or consequential loss or damage ."

In construing the terms of a contract, courts must give full effect to the intent of the parties as expressed by the language of the agreement. I*n re May v. United States, 756 P.2d 362 (Colo. 1988)*. The above-quoted sentence of the purchase agreement [**36] refers to the exclusion of the remedy of consequential damages resulting from liability "by virtue of this warranty, or otherwise." The remedy of suit for breach of warranty having failed in its essential purpose, the plaintiffs' remedy of consequential damages here does not arise by virtue of that warranty. The phrase "or otherwise" does not, in our view, evidence an intent to render consequential damages unavailable when the only remedy provided by the purchase agreement fails of its essential purpose and therefore is no remedy at all.

While in other circumstances parties may, pursuant to *section 4-2-719(3)*, by clear and unambiguous language, unequivocally state in a separate provision that the remedy of consequential damages shall not be available in the event the remedy of a suit for breach of a limited warranty to repair or replace fails of its essential purpose, no such

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intent may be gleaned from the language of this purchase agreement. To the extent the parties here agreed to limit the availability of consequential damages as a remedy, they did so on the assumption that the limited warranty to repair or replace would suffice to protect the plaintiffs from substantial consequential [**37] damage losses. The total inadequacy of that warranty was neither foreseen nor bargained for. See *Fidelity and Deposit Co. v. Krebs Engineers, 859 F.2d 501 (7th Cir. 1988)*; *Waters v. Massey-Ferguson, Inc., 775 F.2d 587 (4th Cir. 1985)*.

When a purchase agreement establishing that the only warranty provided is a warranty to repair or replace defective parts contains no separate provision unambiguously recording the intent of parties to prohibit a buyer's recovery of consequential damages even when such sole remedy fails of its essential purpose, the buyer is entitled by virtue of *section 4-2-719(2)* to the statutory remedy of consequential damages notwithstanding a general contractual disclaimer to the contrary. The purchase agreement here contains no such provision; thus the trial court properly concluded that the plaintiffs were not foreclosed from recovering consequential damages.

IV

Big Horn contends that the Court of Appeals erred in affirming the judgment entered against it on the plaintiffs' negligence claim. Big Horn argues that the purchase agreement contains language that bars the filing of any negligence claim and, alternatively, that [**38] the evidence adduced at trial does not support the jury's verdict with respect to that claim. We reject those arguments.

A

The purchase agreement contains the following sentence:

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IRRESPECTIVE OF ANY STATUTE, THE BUYER RECOGNIZES THAT THE EXPRESS WARRANTY SET FORTH ABOVE, IS THE EXCLUSIVE REMEDY TO WHICH HE IS ENTITLED AND HE WAIVES ALL OTHER REMEDIES, STATUTORY OR OTHERWISE.

Insofar as it is applicable to Big Horn, the warranty referred to states as follows: "The Seller warrants only that the foundation will be properly installed and that the [*749] product will be erected in strict conformance with the Manufacturer's specifications." Big Horn argues that this sentence of the purchase agreement bars the plaintiffs from asserting any right to recover damages allegedly resulting from negligent conduct by Big Horn. We do not agree.

The contract provision in question resembles a forfeiture clause. Such clauses are not favored in Colorado. G*rooms v. Rice, 163 Colo. 234, 429 P.2d 298 (1967)*. To be enforceable, contractual provisions seeking to effect a waiver or forfeiture of a party's rights must be couched in clear, unambiguous language. M*ontgomery Ward & Co. v. Reich, 131 Colo. 407, 282 P.2d 1091 (1955)*. [**39]

The sentence in question is at best ambiguous and imprecise. Initially, it must be noted that the statement that the "express warranty" is the buyers' "exclusive remedy" constitutes a non sequitur. While damages for breach of warranty is a remedy, a warranty is a guarantee, not a remedy.

More importantly, as the Court of Appeals observed, the limiting clause, in context, merely constitutes a limitation on the buyers' choice of remedies for the seller's failure to properly assemble the Harvestore system. The sentence does not contain a limitation on the buyers' right to seek remedies for negligent conduct distinct from conduct necessary to install a foundation and erect the superstructure. The plaintiffs' negligence claim against Big

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Horn is based on an alleged breach of a separate duty of care arising from Big Horn's conduct in providing advice and recommendations concerning adoption, modification or rejection of nutritional programs.

Big Horn argues alternatively that its provision of nutritional advice to the plaintiffs was a service contemplated by the purchase agreement and therefore subject to the exclusivity language of the contract. The purchase agreement contradicts such [**40] argument. It provides expressly that the document constitutes "the entire and only agreement between the Seller and Buyer; and no oral statements or agreements not confirmed herein, or by subsequent written agreements, shall be binding on either the Seller or Buyer." Big Horn's responsibilities with regard to the communication of information concerning nutritional programs were not governed by the purchase agreement. We therefore agree with the Court of Appeals that the purchase agreement does not bar the plaintiffs' negligence claim against Big Horn.

B

Big Horn also contends that, contrary to the conclusion of the Court of Appeals, the evidence adduced at trial failed to establish any negligent conduct on its part and failed to establish the applicable standard of care by which to measure its conduct. We again disagree.

Factual findings implicit in a jury verdict will be upheld on appeal if supported by the evidence considered in the light most favorable to the prevailing party. D*enver Dry Goods Co. v. Gettman, 167 Colo. 539, 448 P.2d 954 (1969)*. When viewed in the light most favorable to the plaintiffs, the evidence establishes that Big Horn agents [**41] repeatedly gave the plaintiffs advice concerning appropriate ratios of nutrients and feeds, that Big Horn was not qualified to give such advice, that the advice was

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incorrect, and that the plaintiffs sustained damages as a result of such incorrect advice. Expert witnesses testified on behalf of Big Horn as well as on behalf of the plaintiffs; their testimony, together with the trial court's instructions, was sufficient to inform the jury of the standard of care applicable to persons purporting to be qualified to give advice concerning nutritional feeding programs for dairy herds. See *Melville v. Southward, 791 P.2d 383 (Colo. 1990)*. We find ample evidentiary support in the record for the jury's conclusion that Big Horn acted negligently in breach of a duty of care it owed to the plaintiffs.

V

The plaintiffs contend that the Court of Appeals erred in remanding the case for a new trial on the issue of the amount of [*750] damages attributable to Big Horn's negligence. Big Horn argues that the Court of Appeals erred in failing to order a new trial on the issue of liability for negligence as well as on the issue of damages. We conclude that a new trial is not warranted.

The [**42] Court of Appeals ordered a new trial on the question of the appropriate amount of damages to be assessed against Big Horn in large part because it reversed the judgment entered for the plaintiffs on their failure of essential purpose claim. We have concluded that the judgment entered on the claim against AOSHPI must be reinstated. The trial court expressly concluded that, in view of the evidence, the instructions, and the parties' theories of the case, the special jury verdict establishing the sum of $245,077.26 as the total damages to which the plaintiffs were entitled on their failure of essential purpose claim included all damages separately assessed against Big Horn on the plaintiffs' negligence claim. This ruling is supported by the record. We therefore agree with the plaintiffs'

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argument that no retrial with respect to questions of the jury's award of damages is necessary.

Big Horn asserts that it should have been granted a new trial on the question of its liability for negligence because the jury improperly considered Big Horn's alleged liability on the failure of essential purpose claim. Big Horn contends that in view of the Court of Appeals' conclusion that Big Horn was [**43] not liable to the plaintiffs on the failure of essential purpose claim, the trial court must be deemed to have erred in failing to grant Big Horn's motion for directed verdict on that issue. Accordingly, Big Horn argues, it is entitled to a new trial during which questions of liability based on theories of negligence are not confused with questions of liability based on contract principles.

We do not find this argument persuasive. The jury was properly instructed on the elements of the plaintiffs' separate and distinct claim of negligence by Big Horn, and we have determined that there was sufficient evidence to support the jury's verdict against Big Horn on that claim. Separate special verdict forms permitting the jury to enter a verdict against the plaintiffs on their failure of essential purpose claim against AOSHPI and Big Horn while simultaneously entering a verdict in favor of the plaintiffs on their negligence claim against Big Horn further emphasized the distinct bases of the plaintiffs' two claims for relief. As we view the record, Big Horn has not established that the jury's consideration of the plaintiffs' failure of essential purpose claim against it and AOSHPI created juror [**44] confusion with reference to Big Horn's liability on the negligence claim. See *Moseley v. Lemirato, 149 Colo. 440, 370 P.2d 450 (1962)*.

VI

For the foregoing reasons, we reverse those portions of the judgment of the Court of Appeals vacating the trial

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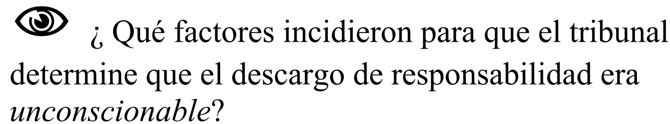
court judgment entered in favor of the plaintiffs on their failure of essential purpose claim against AOSHPI. The judgment of the Court of Appeals is otherwise affirmed, and the case is remanded to that court with directions to reinstate the judgment entered by the trial court in favor of the plaintiffs and against AOSHPI on the failure of essential purpose claim and in favor of the plaintiffs and against Big Horn on the negligence claim.


¿ Qué factores incidieron para que el tribunal determine que el descargo de responsabilidad era *unconscionable*?

L. EL CUMPLIMIENTO DEL CONTRATO COMERCIAL

EL DECLIVE DEL REQUISITO TAXATIVO DE *PERFECT TENDER* EN EL NEGOCIO COMERCIAL

ERNEST RAMIREZ AND ADELE RAMIREZ, plaintiffs-respondents, v. AUTOSPORT, A CORPORATION OF THE STATE OF NEW JERSEY, defendant-appellant SUPREME COURT OF NEW JERSEY 440 A.2d 1345; 33 U. C. C. Rep. Serv. 134 December 14, 1981, Argued February 4, 1982, Decided

OPINION BY: POLLOCK [*281] [**1347] This case raises several issues under the Uniform Commercial Code ("the Code" and "UCC") concerning whether a buyer may reject a tender of goods with minor defects and whether a seller may cure the defects. We consider also the remedies available to the buyer, including cancellation of the contract. The main issue is whether plaintiffs, Mr. and Mrs. Ramirez, could reject the tender by defendant, Autosport, of a camper van with minor defects and cancel the contract for the purchase of the van.

The trial court ruled that Mr. and Mrs. Ramirez rightfully rejected the van and awarded them the fair market value of their trade-in van. The Appellate Division

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affirmed in a brief *per curiam* decision which, like the trial court opinion, was unreported. We affirm the judgment of the Appellate Division.

I

Following a mobile home show at the Meadowlands Sports Complex, Mr. and Mrs. Ramirez visited Autosport's showroom in Somerville. On July 20, 1978 the Ramirezes and Donald Graff, a [*282] salesman for Autosport, agreed on the sale of a new camper and the trade-in of the van owned by Mr. and Mrs. Ramirez. Autosport and the Ramirezes signed a simple contract reflecting a $14,100 purchase price for the new van with a $4,700 trade-in allowance for the Ramirez van, which Mr. and Mrs. Ramirez left with Autosport. After further allowance for taxes, title and documentary fees, the net price was $9,902. Because Autosport needed two weeks to prepare the new van, the contract provided for delivery on or about August 3, 1978.

On that date, Mr. and Mrs. Ramirez returned with their checks to Autosport to pick up the new van. Graff was not there so Mr. White, another salesman, met them. Inspection disclosed several defects in the van. The paint was scratched, both the electric and sewer hookups were missing, and the hubcaps were not installed. White advised the Ramirezes not to accept the camper because it was not ready.

Mr. and Mrs. Ramirez wanted the van for a summer vacation and called Graff several times. Each time Graff told them it was not ready for delivery. Finally, Graff called to notify them that the camper was ready. On August 14 Mr. and Mrs. Ramirez went to Autosport to accept delivery, but [**1348] workers were still touching up the outside paint. Also, the camper windows were open, and the dining area cushions were soaking wet. Mr. and Mrs. Ramirez

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could not use the camper in that condition, but Mr. Leis, Autosport's manager, suggested that they take the van and that Autosport would replace the cushions later. Mrs. Ramirez counteroffered to accept the van if they could withhold $2,000, but Leis agreed to no more than $250, which she refused. Leis then agreed to replace the cushions and to call them when the van was ready.

On August 15, 1978 Autosport transferred title to the van to Mr. and Mrs. Ramirez, a fact unknown to them until the summer of 1979. Between August 15 and September 1, 1978 Mrs. Ramirez called Graff several times urging him to complete the preparation of the van, but Graff constantly advised her [*283] that the van was not ready. He finally informed her that they could pick it up on September 1.

When Mr. and Mrs. Ramirez went to the showroom on September 1, Graff asked them to wait. And wait they did -- for one and a half hours. No one from Autosport came forward to talk with them, and the Ramirezes left in disgust.

On October 5, 1978 Mr. and Mrs. Ramirez went to Autosport with an attorney friend. Although the parties disagreed on what occurred, the general topic was whether they should proceed with the deal or Autosport should return to the Ramirezes their trade-in van. Mrs. Ramirez claimed they rejected the new van and requested the return of their trade-in. Mr. Lustig, the owner of Autosport, thought, however, that the deal could be salvaged if the parties could agree on the dollar amount of a credit for the Ramirezes. Mr. and Mrs. Ramirez never took possession of the new van and repeated their request for the return of their trade-in. Later in October, however, Autosport sold the trade-in to an innocent third party for $4,995. Autosport claimed that the Ramirez' van had a book value of $3,200 and claimed further that it spent $1,159.62 to repair their

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van. By subtracting the total of those two figures, $4,159.62, from the $4,995.00 sale price, Autosport claimed a $600-700 profit on the sale.

On November 20, 1978 the Ramirezes sued Autosport seeking, among other things, rescission of the contract. Autosport counterclaimed for breach of contract.

II

Our initial inquiry is whether a consumer may reject defective goods that do not conform to the contract of sale. The basic issue is whether under the UCC, adopted in New Jersey as *N. J. S. A. 12A:1-101 et seq.*, a seller has the duty to deliver goods that conform precisely to the contract. We conclude that the seller is under such a duty to make a "perfect tender" and that a buyer has the right to reject goods that do not conform to the [*284] contract. That conclusion, however, does not resolve the entire dispute between buyer and seller. A more complete answer requires a brief statement of the history of the mutual obligations of buyers and sellers of commercial goods.

In the nineteenth century, sellers were required to deliver goods that complied exactly with the sales agreement. S*ee Filley v. Pope, 115 U. S. 213, 220, 6 S. Ct. 19, 21, 29 L. Ed. 372,373 (1885)* (buyer not obliged to accept otherwise conforming scrap iron shipped to New Orleans from Leith, rather than Glasgow, Scotland, as required by contract); *Columbian Iron Works & Dry-Dock Co. v. Douglas, 84 Md. 44, 47, 34 A. 1118, 1120-1121 (1896)* (buyer who agreed to purchase steel scrap from United States cruisers not obliged to take any other kind of scrap). That rule, known as the "perfect tender" rule, remained part of the law of sales well into the twentieth century. By the 1920's the doctrine was so entrenched in the law that Judge Learned Hand declared " [t] here is no room in commercial contracts for the doctrine of substantial

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performance." *Mitsubishi Goshi Kaisha v. J. Aron & Co., Inc., 16 F.2d 185, 186* (2 Cir. 1926).

[**1349] The harshness of the rule led courts to seek to ameliorate its effect and to bring the law of sales in closer harmony with the law of contracts, which allows rescission only for material breaches. L*eRoy Dyal Co. v. Allen, 161 F.2d 152, 155* (4 Cir.1947). *See* 5 Corbin, *Contracts* § 1104 at 464 (1951); 12 Williston, *Contracts* § 1455 at 14 (3 ed. 1970). Nevertheless, a variation of the perfect tender rule appeared in the Uniform Sales Act. *N. J. S. A.* 46:30-75 (purchasers permitted to reject goods or rescind contracts for any breach of warranty); *N. J. S. A.* 46:30-18 to -21 (warranties extended to include all the seller's obligations to the goods). S*ee* Honnold, "Buyer's Right of Rejection, A Study in the Impact of Codification Upon a Commercial Problem", 97 *U. Pa. L. Rev.* 457, 460 (1949). The chief objection to the continuation of the perfect tender rule was that buyers in a declining market would reject goods for minor nonconformities and force the loss on surprised sellers. *See* Hawkland, *Sales and Bulk Sales Under the Uniform Commercial* [*285] *Code*, 120-122 (1958), cited in *N. J. S. A. 12A:2-508*, New Jersey Study Comment 3.

To the extent that a buyer can reject goods for any nonconformity, the UCC retains the perfect tender rule. Section 2-106 states that goods conform to a contract "when they are in accordance with the obligations under the contract". N. *J. S. A. 12A:2-106*. Section 2-601 authorizes a buyer to reject goods if they "or the tender of delivery fail in any respect to conform to the contract". N. *J. S. A. 12A:2-601*. The Code,however, mitigates the harshness of the perfect tender rule and balances the interests of buyer and seller. *See Restatement (Second), Contracts, § 241 comment (b)* (1981). The Code achieves that result through its provisions for revocation of acceptance and cure. *N. J. S. A. 12A:2-608*, 2-508.

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Initially, the rights of the parties vary depending on whether the rejection occurs before or after acceptance of the goods. Before acceptance, the buyer may reject goods for any nonconformity. *N. J. S. A. 12A:2-601*. Because of the seller's right to cure, however, the buyer's rejection does not necessarily discharge the contract. N. *J. S. A. 12A:2-508*. Within the time set for performance in the contract, the seller's right to cure is unconditional. I*d*., subsec. (1); *see id.*, Official Comment 1. Some authorities recommend granting a breaching party a right to cure in all contracts, not merely those for the sale of goods. R*estatement (Second), Contracts*, ch. 10, especially §§ 237 and 241. Underlying the right to cure in both kinds of contracts is the recognition that parties should be encouraged to communicate with each other and to resolve their own problems. Id.,Introduction p. 193.

The rights of the parties also vary if rejection occurs after the time set for performance. After expiration of that time, the seller has a further reasonable time to cure if he believed reasonably that the goods would be acceptable with or without a money allowance. *N. J. S. A. 12A:2-508(2)*. The determination of what constitutes a further reasonable time depends on the [*286] surrounding circumstances, which include the change of position by and the amount of inconvenience to the buyer. *N. J. S. A. 12A:2-508*, Official Comment 3. Those circumstances also include the length of time needed by the seller to correct the nonconformity and his ability to salvage the goods by resale to others. S*ee Restatement (Second), Contracts, § 241 comment (d)*. Thus, the Code balances the buyer's right to reject nonconforming goods with a "second chance" for the seller to conform the goods to the contract under certain limited circumstances. N. *J. S. A. 12A:2-508*, New Jersey Study Comment 1.

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After acceptance, the Code strikes a different balance: the buyer may revoke acceptance only if the nonconformity substantially impairs the value of the goods to him. N. *J. S. A. 12A:2-608*. See *Herbstman v. Eastman Kodak Co., 68 N. J. 1, 9 (1975)*. *See generally*, Priest, "Breach [**1350] and Remedy for the Tender of Non-Conforming Goods under the Uniform Commercial Code: An Economic Approach," 91 *Harv. L. Rev.* 960, 971-973 (1978). This provision protects the seller from revocation for trivial defects. H*erbstman, supra, 68 N. J. at 9*. It also prevents the buyer from taking undue advantage of the seller by allowing goods to depreciate and then returning them because of asserted minor defects. S*ee* White & Summers, *Uniform Commercial Code*, § 8-3 at 391 (2 ed. 1980). Because this case involves rejection of goods, we need not decide whether a seller has a right to cure substantial defects that justify revocation of acceptance. S*ee Pavesi v. Ford Motor Co., 155 N. J. Super. 373, 378 (App. Div.1978)* (right to cure after acceptance limited to trivial defects) and White & Summers, *supra*, § 8-4 at 319 n.76 (open question as to the relationship between §§ 2-608 and 2-508).

Other courts agree that the buyer has a right of rejection for any nonconformity, but that the seller has a countervailing right to cure within a reasonable time. *Marine Mart Inc. v. Pearce, 252 Ark. 601, 480 S. W.2d 133, 137 (1972)*. *See Intermeat, Inc. v. American Poultry, Inc., 575 F.2d 1017, 1024* (2 Cir. 1978); *Moulton Cavity & Mold., Inc. v. Lyn-Flex Industries, 396 A.2d 1024, 1027* [*287] *n.6 (Me.1979)*; *Uchitel v. F. R. Tripler & Co., 107 Misc.2d 310, 316, 434 N. Y. S.2d 77, 81 (App. Term 1980)*; *Rutland Music Services, Inc. v. Ford Motor Co., 422 A.2d 248, 249 (Vt.1980)*. *But see McKenzie v. Alla-Ohio Coals, Inc., 29 U. C. C. Rep. 852, 856-857 (D. D. C.1979)*.

One New Jersey case, *Gindy Mfg. Corp. v. Cardinale Trucking Corp.*, suggests that, because some defects can be

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cured, they do not justify rejection.*111 N. J. Super. 383, 387 n.1 (Law Div.1970)*. *Accord, Adams v. Tremontin, 42 N. J. Super. 313, 325 (App. Div.1956)* (Uniform Sales Act). B*ut see Sudol v. Rudy Papa Motors, 175 N. J. Super. 238, 240-241 (D. Ct.1980)* (§ 2-601 contains perfect tender rule). Nonetheless, we conclude that the perfect tender rule is preserved to the extent of permitting a buyer to reject goods for any defects. Because of the seller's right to cure, rejection does not terminate the contract. Accordingly, we disapprove the suggestion in *Gindy* that curable defects do not justify rejection.

A further problem, however, is identifying the remedy available to a buyer who rejects goods with insubstantial defects that the seller fails to cure within a reasonable time. The Code provides expressly that when "the buyer rightfully rejects, then with respect to the goods involved, the buyer may cancel." *N. J. S. A. 12A:2-711*."Cancellation" occurs when either party puts an end to the contract for breach by the other. N. *J. S. A. 12A:2-106(4)*. Nonetheless, some confusion exists whether the equitable remedy of rescission survives under the Code. *Compare Ventura v. Ford Motor Corp., 173 N. J. Super. 501, 503 (Ch. Div.1980)*, *aff'd 180 N. J. Super. 45 (App. Div.1981)* (rescission under UCC) *and Pavesi v. Ford Motor Corp., supra, 155 N. J. Super. at 377* (equitable remedies still available since not specifically superceded, § 1-103) *with Edelstein v. Toyota Motors Dist., 176 N. J. Super. 57, 63-64 (App. Div.1980)* (under UCC rescission is revocation of acceptance) *and Sudol v. Rudy Papa Motors, supra, 175 N. J. Super. at 241-242* (under UCC, rescission no longer exists as such).

[*288] The Code eschews the word "rescission" and substitutes the terms "cancellation", "revocation of acceptance", and "rightful rejection". N. *J. S. A. 12A:2-106(4)*; 2-608; and 2-711 & Official Comment 1. Although

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neither "rejection" nor "revocation of acceptance" is defined in the Code, rejection includes both the buyer's refusal to accept or keep delivered goods and his notification to the seller that he will not keep them. White & Summers, *supra*, § 8-1 at 293. Revocation of acceptance is like rejection, but occurs after the buyer [**1351] has accepted the goods. Nonetheless, revocation of acceptance is intended to provide the same relief as rescission of a contract of sale of goods. N. *J. S. A. 12A:2-608* Official Comment 1; N. J. Study Comment 2. In brief, revocation is tantamount to rescission. *See Herbstman v. Eastman Kodak Co., supra, 68 N. J. at 9*; *accord, Peckham v. Larsen Chevrolet-Buick-Oldsmobile, Inc., 99 Idaho 675, 677, 587 P.2d 816, 818 (1978)* (rescission and revocation of acceptance amount to the same thing). Similarly, subject to the seller's right to cure, a buyer who rightfully rejects goods, like one who revokes his acceptance, may cancel the contract. N. *J. S. A. 12A:2-711* & Official Comment 1. We need not resolve the extent to which rescission for reasons other than rejection or revocation of acceptance, *e. G.* fraud and mistake, survives as a remedy outside the Code. *Compare N. J. S. A. 12A:1-103 and* White & Summers, *supra*, § 8-1, p. 295, *with N. J. S. A. 12A:2-721*. Accordingly, we approve *Edelstein* and *Sudol*, which recognize that explicit Code remedies replace rescission, and disapprove *Ventura* and *Pavesi* to the extent they suggest the UCC expressly recognizes rescission as a remedy.

Although the complaint requested rescission of the contract, plaintiffs actually sought not only the end of their contractual obligations, but also restoration to their pre-contractual position. That request incorporated the equitable doctrine of restitution, the purpose of which is to restore plaintiff to as good a position as he occupied before the contract. Corbin, *supra*, § 1102 at 455. In UCC

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parlance, plaintiffs' request was for the cancellation [*289] of the contract and recovery of the price paid. N. *J. S. A. 12A:2-106(4)*, 2-711.

General contract law permits rescission only for material breaches, and the Code restates "materiality" in terms of "substantial impairment". S*ee Herbstman v. Eastman Kodak Co., supra, 68 N. J. at 9*; *id. at 15* (Conford, J., concurring). The Code permits a buyer who rightfully rejects goods to cancel a contract of sale. N. *J. S. A. 12A:2-711*. Because a buyer may reject goods with insubstantial defects, he also may cancel the contract if those defects remain uncured. Otherwise, a seller's failure to cure minor defects would compel a buyer to accept imperfect goods and collect for any loss caused by the nonconformity. *N. J. S. A. 12A:2-714*.

Although the Code permits cancellation by rejection for minor defects, it permits revocation of acceptance only for substantial impairments. That distinction is consistent with other Code provisions that depend on whether the buyer has accepted the goods. Acceptance creates liability in the buyer for the price, *N. J. S. A. 12A:2-709(1)*, and precludes rejection. N. *J. S. A. 12A:2-607(2)*; *N. J. S. A. 12A:2-606*, New Jersey Study Comment 1. Also, once a buyer accepts goods, he has the burden to prove any defect. N. *J. S. A. 12A:2-607(4)*; White & Summers, *supra*, § 8-2 at 297. By contrast, where goods are rejected for not conforming to the contract, the burden is on the seller to prove that the nonconformity was corrected. *Miron v. Yonkers Raceway, Inc., 400 F.2d 112, 119* (2 Cir. 1968).

Underlying the Code provisions is the recognition of the revolutionary change in business practices in this century. The purchase of goods is no longer a simple transaction in which a buyer purchases individually-made goods from a seller in a face-to-face transaction. Our

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economy depends on a complex system for the manufacture, distribution, and sale of goods, a system in which manufacturers and consumers rarely meet. Faceless manufacturers mass-produce goods for unknown consumers who purchase those goods from merchants exercising [*290] little or no control over the quality of their production. In an age of assembly lines, we are accustomed to cars with scratches, television sets without knobs and other products with all kinds of defects. Buyers no longer expect a "perfect tender". If a merchant sells defective goods, the reasonable expectation of the parties is that the buyer will return those goods and that the seller will repair or replace them.

[**1352] Recognizing this commercial reality, the Code permits a seller to cure imperfect tenders. Should the seller fail to cure the defects, whether substantial or not, the balance shifts again in favor of the buyer, who has the right to cancel or seek damages. N. *J. S. A. 12A:2-711*. In general, economic considerations would induce sellers to cure minor defects. S*ee generally* Priest, *supra*, 91 *Harv. L. Rev.* 973-974. Assuming the seller does not cure, however, the buyer should be permitted to exercise his remedies under *N. J. S. A. 12A:2-711*. The Code remedies for consumers are to be liberally construed, and the buyer should have the option of cancelling if the seller does not provide conforming goods. S*ee N. J. S. A. 12A:1-106*.

To summarize, the UCC preserves the perfect tender rule to the extent of permitting a buyer to reject goods for any nonconformity. Nonetheless, that rejection does not automatically terminate the contract. A seller may still effect a cure and preclude unfair rejection and cancellation by the buyer. *N. J. S. A. 12A:2-508*, Official Comment 2; *N. J. S. A. 12A:2-711*, Official Comment 1.

III

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The trial court found that Mr. and Mrs. Ramirez had rejected the van within a reasonable time under *N. J. S. A. 12A:2-602*. The court found that on August 3, 1978 Autosport's salesman advised the Ramirezes not to accept the van and that on August 14, they rejected delivery and Autosport agreed to replace the cushions. Those findings are supported by substantial credible evidence, and we sustain them. S*ee Rova Farms* [*291] *Resort v. Investors Ins. Co., 65 N. J. 474, 483-484 (1974)*. Although the trial court did not find whether Autosport cured the defects within a reasonable time, we find that Autosport did not effect a cure. Clearly the van was not ready for delivery during August, 1978 when Mr. and Mrs. Ramirez rejected it, and Autosport had the burden of proving that it had corrected the defects. Although the Ramirezes gave Autosport ample time to correct the defects, Autosport did not demonstrate that the van conformed to the contract on September 1. In fact, on that date, when Mr. and Mrs. Ramirez returned at Autosport's invitation, all they received was discourtesy.

On the assumption that substantial impairment is necessary only when a purchaser seeks to revoke acceptance under *N. J. S. A. 12A:2-608*, the trial court correctly refrained from deciding whether the defects substantially impaired the van. The court properly concluded that plaintiffs were entitled to "rescind" -- *i. E.*, to "cancel" -- the contract.

Because Autosport had sold the trade-in to an innocent third party, the trial court determined that the Ramirezes were entitled not to the return of the trade-in, but to its fair market value, which the court set at the contract price of $4,700. A buyer who rightfully rejects goods and cancels the contract may, among other possible remedies, recover so much of the purchase price as has been paid. N. *J. S. A.*

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12A:2-711. The Code, however, does not define "pay" and does not require payment to be made in cash.

A common method of partial payment for vans, cars, boats and other items of personal property is by a "trade-in". When concerned with used vans and the like, the trade-in market is an acceptable, and perhaps the most appropriate, market in which to measure damages. It is the market in which the parties dealt; by their voluntary act they have established the value of the traded-in article. S*ee Frantz Equipment Co. v. Anderson, 37 N. J. 420, 431-432 (1962)* (in computing purchaser's damages for alleged breach of uniform conditional sales law, trade-in value [*292] of tractor was appropriate measure); *accord, California Airmotive Corp. v. Jones, 415 F.2d 554, 556* (6 Cir. 1969). In other circumstances, a measure of damages other than the trade-in value might be appropriate. S*ee Chemical Bank v. Miller Yacht Sales, 173 N. J. Super. 90, 103 (App. Div.1980)* (in determining value of security interest in boat, court rejected both book value and contract trade-in value and adopted resale value as appropriate measure of damages).

[**1353] The ultimate issue is determining the fair market value of the trade-in. This Court has defined fair market value as "the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts." *In re Estate of Romnes, 79 N. J. 139, 144 (1978)*. Although the value of the trade-in van as set forth in the sales contract was not the only possible standard, it is an appropriate measure of fair market value.

For the preceding reasons, we affirm the judgment of the Appellate Division.

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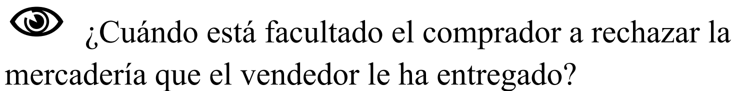
¿Cuándo está facultado el comprador a rechazar la mercadería que el vendedor le ha entregado?

ARTHUR R. WADDELL AND ROSWITHA M. WADDELL, Appellants, vs. L. V. R. V. INC., D/B/A WHEELER'S LAS VEGAS RV, Respondent. L. V. R. V. INC., D/B/A WHEELER'S LAS VEGAS RV, Appellant, vs. ARTHUR R. WADDELL; ROSWITHA M. WADDELL; AND COACHMEN RECREATIONAL VEHICLE COMPANY, INC., Respondents. SUPREME COURT OF NEVADA 125 P.3d 1160; 58 U. C. C. Rep. Serv. 2d 655 January 19, 2006, Decided

OPINION BY: GIBBONS [*17] [**1161] This is an appeal and cross-appeal from a district court judgment allowing revocation of acceptance of a contract and an order awarding attorney fees and costs. Respondent/cross-appellant L. V. R. V. Inc., D/B/A Wheeler's Las Vegas RV (Wheeler's) sold a 1996 Coachmen Santara motor home (the RV) to appellants/cross-respondents Arthur R. Waddell and Roswitha M. Waddell (the Waddells). The Waddells noticed numerous problems with the RV and "continually"had to return it to Wheeler's service department for repairs. Eventually, the Waddells stopped attempting to have Wheeler's make repairs and filed a complaint seeking to revoke their acceptance of the RV or, in the alternative, money damages. Wheeler's answered the complaint and filed a third-party complaint seeking indemnification from respondent Coachmen Recreational Vehicle Company, Inc. (Coachmen). After a bench trial, the district court granted judgment in favor of the Waddells and Coachmen.

On appeal, Wheeler's argues that (1) the district court erred in allowing the Waddells to revoke their acceptance, (2) the district court abused its discretion by admitting two

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[**1162] documents into evidence, (3) the district court erred in denying Wheeler's motion for attorney fees, and (4) the district court erred in denying indemnification from Coachmen. The Waddells argue on cross-appeal that the district court erred in denying them (1) computerized research costs and (2) post-judgment interest on their attorney fees award.

FACTS

In 1996, the Waddells served jointly as president of the Las Vegas area Coachmen Association Camping Club. During the course of that group's meetings, the Waddells spoke with Tom [*18] Pender, Wheeler's sales manager, about upgrading from the motor home they then owned to a "diesel pusher" motor coach. As a result of that conversation, Pender took the Waddells to the Wheeler's lot and showed them a 1996 Coachmen Santara model diesel pusher coach.

The Waddells test-drove and eventually agreed to purchase the RV and an extended warranty. Before they took possession of the RV, the Waddells requested that Wheeler's perform various repairs. The Waddells' request included a service on the RV's engine cooling system, new batteries, and alignment of the door frames. Wheeler's told Arthur Waddell that the repairs had been performed as requested. The Waddells took delivery of the RV on September 1, 1997.

The Waddells first noticed a problem with the RV's engine shortly after they took possession of it. They drove the RV from Las Vegas to Hemet, California. On the return trip, the entry door popped open and the RV's engine overheated while ascending a moderate grade to such a degree that Mr. Waddell had to pull over to the side of the road and wait for the engine to cool down.

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When the Waddells returned from California, they took the RV back to Wheeler's for repairs. Despite Wheeler's attempts to repair the RV, the Waddells continually experienced more problems with the RV, including further episodes of engine overheating. Between September 1997 and March 1999, Wheeler's service department spent a total of seven months during different periods of time attempting to repair the RV.

On June 9, 2000, the Waddells filed a complaint in district court seeking both equitable relief and money damages. Wheeler's answered the complaint and ultimately filed a third-party complaint against Coachmen seeking equitable indemnification and contribution.

Following a three-day bench trial, the district court issued its findings of fact, conclusions of law, and judgment. The district court concluded that the RV's nonconformities substantially impaired its value to the Waddells. The district court allowed the Waddells to revoke their acceptance of the RV and ordered Wheeler's to return all of the Waddell's out-of-pocket expenses, but further concluded that Wheeler's was not entitled to indemnification from Coachmen. Following entry of judgment, the district court awarded the Waddells $15,000 in attorney fees, entered supplemental findings of fact and conclusions of law, issued an amended judgment, entered a separate order denying post-judgment interest on the attorney fee award, and denied the Waddells' motion to retax their costs to include computerized research fees. This timely appeal and cross-appeal followed.

[*19] *DISCUSSION*

Wheeler's argues that the district court erred in allowing the Waddells to revoke their acceptance of the RV because the Waddells failed to prove that the RV suffered

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nonconformities that substantially impaired its value. We disagree.

The district court found that despite Wheeler's good-faith attempts to repair the RV, the nonconformities persisted and rendered the RV unfit for its intended use. Some of those nonconformities identified by the district court included: the bedroom air conditioning does not cool, the front air conditioning does not cool, the dash heater does not blow hot air, RV batteries do not stay charged, and chronic engine overheating. The district court concluded that these nonconformities and others substantially impaired the RV's value to the Waddells and [**1163] that the Waddells had revoked their acceptance of the RV within a reasonable time.

Substantial impairment

NRS 104.2608(1) provides that a buyer may revoke his acceptance if the item suffers from a "nonconformity [that] substantially impairs its value *to him*" and (a) the buyer accepted the goods on the understanding that the seller would cure the nonconformity or (b) the buyer was unaware of the nonconformity and the nonconformity was concealed by the difficulty of discovery or by the seller's assurances that the good was conforming. (Emphasis added.)

We have never before determined when a nonconformity substantially impairs the value of a good to the buyer. Other jurisdictions treat this determination as an issue of fact, [1] which "is made in light of the 'totality of the circumstances' of each particular case, including the number of deficiencies and type of nonconformity and the time and inconvenience spent in downtime and attempts at repair." [2]

1 *See*, *e. G.*, *Frontier Mobile Home Sales, Inc. v. Trigleth, 256 Ark. 101, 505 S. W.2d 516, 517 (Ark. 1974)*;

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Rester v. Morrow, 491 So. 2d 204, 209 (Miss. 1986); *McCullough v. Bill Swad Chrysler-Plymouth, 5 Ohio St. 3d 181, 5 Ohio B. 398, 449 N. E.2d 1289, 1294 (Ohio 1983)*.

2 *Fortin v. Ox-Bow Marina, Inc., 408 Mass. 310, 557 N. E.2d 1157, 1162 (Mass. 1990)* (quoting *Rester, 491 So. 2d at 210*).

The Supreme Court of Oregon has established a two-part test to determine whether a nonconformity, under the totality of the circumstances, substantially impairs the value of the goods to the buyer. The test has both an objective and a subjective prong:

[*20] Since [the statute] provides that the buyer may revoke acceptance of goods "whose nonconformity substantially impairs its value *to him*," the value of conforming goods *to the plaintiff* must first be determined. This is a subjective question in the sense that it calls for a consideration of the needs and circumstances of the plaintiff who seeks to revoke; not the needs and circumstances of an average buyer. The second inquiry is whether the nonconformity in fact substantially impairs the value of the goods to the buyer, having in mind his particular needs. This is an objective question in the sense that it calls for evidence of something more than plaintiff's assertion that the nonconformity impaired the value to him; it requires evidence from which it can be inferred that plaintiff's needs were not met because of the nonconformity. [3]

Since Nevada, like Oregon, adopted Uniform Commercial Code § 2-608 verbatim, we conclude that this test applies to *NRS 104.2608*. Accordingly, we adopt the Supreme Court of Oregon's two-part test for determining whether a nonconformity substantially affects the good's value to the buyer under *NRS 104.2608(1)*.

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3 *Jorgensen v. Pressnall, 274 Ore. 285, 545 P.2d 1382, 1384-85 (Or. 1976)* (footnote omitted), *quoted with approval in McGilbray v. Scholfield Winnebago, Inc., 221 Kan. 605, 561 P.2d 832, 836 (Kan. 1977)*; *see also Milicevic v. Mercedes-Benz USA, LLC, 256 F. Supp. 2d 1168, 1176 (D. Nev. 2003)* (applying a two-part test that addressed both objective and subjective considerations); *Haight v. Dales Used Cars, Inc., 139 Idaho 853, 87 P.3d 962, 966 (Idaho Ct. App. 2003)* (applying a similar two-part test).

Subjective value to the Waddells

Arthur Waddell testified that he purchased the RV to enjoy the RV lifestyle. Before purchasing the RV, the Waddells owned similar vehicles that they used both as a residence and for camping trips. In fact, Mr. Waddell testified that he and his wife intended to sell their house and spend two to three years traveling around the country.

Mr. Waddell further testified that he shopped at Wheeler's based on Wheeler's advertisements. Marlene Wheeler, president and chief operating officer, testified that Wheeler's advertising encouraged the purchase of an RV to find unlimited freedom. When Mr. Waddell spoke with Tom Pender, sales manager at Wheeler's, about upgrading to an RV for those purposes, Pender told him that he had an RV on the lot that would meet his needs.

[*21] Mr. Waddell's testimony demonstrates that the RV's subjective value to the Waddells was based on their ability to spend two [**1164] or three years driving the RV around the country. Thus, we must consider whether the RV's nonconformities substantially impaired the value of the RV based on the Waddells' particular needs. [4]

4 *Jorgensen, 545 P.2d at 1384-85*.

Objective impairment

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Mr. Waddell testified that as a result of the RV's defects, he and his wife were unable to enjoy the RV as they had intended. Mr. Waddell further testified that the RV's engine would overheat within ten miles of embarking if the travel included any climbing. As a result of the overheating, the Waddells were forced to park on the side of the road and wait for the engine to cool down before continuing. Consequently, the RV spent a total of 213 days, or seven months and one day, at Wheeler's service department during the eighteen months immediately following the purchase. This testimony is sufficient to demonstrate an objective, substantial impairment of value.

The Supreme Court of Ohio has stated that a nonconformity effects a substantial impairment of value if it "shakes the buyer's faith or undermines his confidence in the reliability and integrity of the purchased item." [5] The Supreme Judicial Court of Massachusetts has recognized that "even cosmetic or minor defects that go unrepaired or defects which do not totally prevent the buyer from using the goods, but circumscribe that use can substantially impair the goods' value to the buyer." [6] The United States District Court for the District of Nevada recently reiterated that "'the [seller's] inability to correct defects in [motor] vehicles creates a major hardship and an unacceptable economic burden on the consumer.'" [7]

5 *McCullough, 449 N. E.2d at 1294*; *see also Rester, 491 So. 2d at 210-11*.

6 *Fortin, 557 N. E.2d at 1162*.

7 *Milicevic, 256 F. Supp. 2d at 1176* (quoting *Berrie v. Toyota Motor Sales, USA, Inc., 267 N. J. Super. 152, 630 A.2d 1180, 1181 (N. J. Super. Ct. App. Div. 1993))*.

In this case, the chronic engine overheating shook the Waddells' faith in the RV and undermined their confidence in the RV's reliability and integrity. [8] Not only did this

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problem make travel in the RV unreliable and stressful to the Waddells, the overheating made travel in the vehicle objectively unsafe.

8 *See Rester, 491 So. 2d at 210-11*; *McCullough, 449 N. E.2d at 1294*.

Accordingly, we conclude that substantial evidence exists to support revocation of acceptance under *NRS 104.2608(1)*.

[*22] *Reasonable time for revoking acceptance*

Wheeler's argues that the Waddells should not have been allowed to revoke their acceptance because they did not attempt to revoke within a reasonable time after purchasing the RV. We disagree.

Under *NRS 104.2608(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." The statute further provides that revocation "is not effective until the buyer notifies the seller of it." [9] We have never before determined a reasonable timeline for revocation of acceptance. However, other jurisdictions have held that the reasonable time determination "depends upon the nature, purpose and circumstances of the transaction." [10] The reasonable time determination is generally considered to be an issue of fact for the trial court. [11]

9 *NRS 104.2608(2)*.

10 *DeVoe Chevrolet-Cadillac v. Cartwright, 526 N. E.2d 1237, 1240 (Ind. Ct. App. 1988)*; *see also Golembieski v. O'Rielly R. V. Center, Inc., 147 Ariz. 134, 708 P.2d 1325, 1328 (Ariz. Ct. App. 1985)* (noting that "reasonableness of the time for revocation is a question of fact unique to the circumstances of each case").

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11 *See*, *e. G.*, *Golembieski, 708 P.2d at 1328*; *Frontier Mobile Home Sales, Inc. v. Trigleth, 256 Ark. 101, 505 S. W.2d 516, 517 (Ark. 1974)*; *Chernick v. Casares, 759 S. W.2d 832, 834 (Ky. Ct. App. 1988)*; *Oda Nursery, Inc. v. Garcia Tree & Lawn, Inc., 103 N. M. 438, 708 P.2d 1039, 1042 (N. M. 1985)*; *Purnell v. Guaranty Bank, 624 S. W.2d 357, 359 (Tex. App. 1981)*.

[**1165] Here, the district court found that the Waddells were entitled to revoke their acceptance since they notified Wheeler's of their intent to revoke within a reasonable time. Mr. Waddell testified that he first noticed the RV's defects immediately after his purchase. Mr. Waddell took the RV to Wheeler's service department whenever he noticed a defect and Wheeler's always attempted, often unsuccessfully, to repair the RV. In September 1998, Mr. Waddell took the RV to Wheeler's after continued engine overheating. As a result of these defects, Wheeler's service department kept the RV for approximately seven months of the eighteen months that the Waddells owned the RV. Roger Beauchemin, a former employee of Wheeler's service department, testified that Wheeler's was unable to repair some of the defects, including the engine's chronic overheating problems. In January 1999, the Waddells again brought the RV to Wheeler's complaining of persistent [*23] engine overheating. The Waddells demanded a full refund of the purchase price in March 1999 and sought legal counsel. Through counsel, the Waddells wrote to Wheeler's during the summer of 1999 to resolve the matter. Wheeler's did not respond to these inquiries until early 2000. Unable to resolve the dispute with Wheeler's, the Waddells revoked their acceptance of the RV in June 2000.

The seller of nonconforming goods must generally receive an opportunity to cure the nonconformity before the buyer may revoke his acceptance. [12] However, as the

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Supreme Court of Mississippi has recognized, the seller may not "postpone revocation in perpetuity by fixing everything that goes wrong." [13] Rather, "there comes a time when [the buyer] is entitled to say, 'That's all,' and revoke, notwithstanding the seller's repeated good faith efforts to [cure] ." [14]

12 *See Rester, 491 So. 2d at 210*.

13 *Id.*

14 *Id.*

Furthermore, the seller's attempts to cure do not count against the buyer regarding timely revocation. The United States District Court for the District of Nevada has held that the "time for revocation of acceptance will be tolled while the seller attempts repairs." [15] Tolling the reasonable time for revocation of acceptance is appropriate given "the buyer's obligation to act in good faith, and to afford the seller a reasonable opportunity to cure any defect in the goods." [16]

15 *Sierra Diesel Injection Service v. Burroughs Corp., 651 F. Supp. 1371, 1378 (D. Nev. 1987)*.

16 *Id.*

The Waddells gave Wheeler's several opportunities to repair the defects before revoking their acceptance. Because Wheeler's was unable to repair the defects after a total of seven months, the Waddells were entitled to say "that's all" and revoke their acceptance, notwithstanding Wheeler's good-faith attempts to repair the RV. [17] Also, the reasonable time for revocation was tolled during the seven months that Wheeler's kept the RV and attempted to repair the defects. [18] Accordingly, the district court's determination is supported by substantial evidence and is not clearly erroneous. [19]

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17 *Rester, 491 So. 2d at 210.*

18 *Sierra Diesel, 651 F. Supp. at 1378.*

19 *Edwards Indus. v. DTE/BTE, Inc., 112 Nev. 1025, 1031, 923 P.2d 569, 573 (1996).*

[*24] *Wheeler's motion for attorney fees*

Wheeler's argues that the district court erred in denying its motion for attorney fees because the Waddells recovered only on equitable grounds and failed to obtain a money judgment in excess of the $25,000 offer of judgment that Wheeler's proffered before trial. We disagree.

Under *NRCP 68(a)*, [20] either party may serve an offer of judgment to settle the matter "at any time more than 10 days before trial." Further, *NRCP 68(f)* provides for penalties if the offeree rejects the offer, proceeds to trial, "and fails to obtain a *more* [**1166] *favorable judgment*." (Emphasis added.) Specifically, *NRCP 68(f)(2)* provides that "the offeree shall pay the offeror's post-offer costs, applicable interest on the judgment from the time of the offer to the time of entry of the judgment and reasonable attorney's fees, if any be allowed, actually incurred by the offeror from the time of the offer."

20 *NRCP 68* was amended effective January 1, 2005, during the pendency of this appeal. The amendments do not change our consideration of the appeal.

The district court must consider four factors in awarding penalties pursuant to *NRCP 68(f)*. [21] The third factor, which is most relevant to this case, requires a consideration of "whether the plaintiff's decision to reject the offer and proceed to trial was grossly unreasonable or in bad faith." [22]

21 *Beattie v. Thomas, 99 Nev. 579, 588-89, 668 P.2d 268, 274 (1983).*

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22 *Id.*

The district court properly concluded that the Waddells' decision to proceed to trial was neither unreasonable nor in bad faith. Further, the district court was not entitled to penalize the Waddells under *NRCP 68(f)(2)* because the Waddells failed to obtain a more favorable judgment than the $25,000 offer. Though the Waddells succeeded only on an equitable claim, their revocation of acceptance resulted in the recovery of $113,680.57 that they had spent on the RV. [23] This recovery is clearly more favorable to the [*25] Waddells than the offer of judgment because (a) they recovered more than $25,000 from Wheeler's and (b) they were not required to keep and make payments on the RV, which they could not use for the purposes they intended when they bought it. Accordingly, the district court properly denied Wheeler's motion for attorney fees.

23 This figure represents:

1. The sum of $78,857.22 which constitutes 78 payments made by the [Waddells] from the date of the purchase through April 1, 2004 .

2. The following sums of money:

a. $249.50 constituting the document fee paid at the time of purchase;

b. $5,313.45 constituting the sales tax paid at the time of purchase;

c. $20,080.40 constituting the net trade-in allowance at the time of purchase;

d. $3,576.00 constituting casualty insurance premiums paid on the vehicle;

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e. $2,589.00 constituting the Department of Motor Vehicles registrations;

f. $2,995.00 which constitutes the extended service contract; [and]

3. $20.00 which constitutes the title fee. .

Indemnification

Wheeler's argues that the district court erred in denying its claim for indemnification from Coachmen for its liability to the Waddells. We disagree.

We have repeatedly held that "findings of fact supported by substantial evidence, will not be set aside unless clearly erroneous." [24] The district court concluded that the indemnification contract between Coachmen and Wheeler's applied only to manufacture and design defects. The district court further concluded that the only defect relating to manufacture and design was a faulty mud flap that had been repaired without further incident.

24 *Edwards Indus., 112 Nev. at 1031, 923 P.2d at 573*.

Mr. Waddell testified that the front, left mud flap had melted during several trips, but that Wheeler's was eventually able to correct that problem. There is no evidence in the record demonstrating irreparable design or manufacturing defects. Accordingly, we conclude that the district court's decision is supported by substantial evidence and is not clearly erroneous. [25]

25 We have considered Wheeler's other assignments of error and find them without merit.

Computerized legal research costs

On cross-appeal, the Waddells argue that the district court abused its discretion by denying them computerized research costs. We disagree.

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"The determination of allowable costs is within the sound discretion of the trial court." [26] Only reasonable costs may be awarded. [27] "'Reasonable costs' must be actual and reasonable, 'rather than a reasonable [**1167] estimate or calculation of such costs.'" [28] The district court did not abuse its discretion in denying costs for [*26] computerized legal research because those costs were not sufficiently itemized.

26 *Bobby Berosini, Ltd. v. PETA, 114 Nev. 1348, 1352, 971 P.2d 383, 385 (1998)*.

27 *NRS 18.005*.

28 *Bobby Berosini, 114 Nev. at 1352, 971 P.2d at 385-86* (quoting *Gibellini v. Klindt, 110 Nev. 1201, 1206, 885 P.2d 540, 543 (1994))*.

Post-judgment interest on attorney fees

The Waddells argue that they were entitled to post-judgment interest on their attorney fees award. We agree.

NRS 17.130(1) provides for interest to be granted on "all judgments and decrees, rendered by any court of justice, for any debt, damages or costs." We have never directly addressed the issue of whether the recipient of an attorney fees award is entitled to post-judgment interest on that award. However, we have held that a district court "judgment" includes both damages and costs; thus, prejudgment interest is available for costs incurred by the prevailing party. [29]

29 *Id. at 1355, 971 P.2d at 387-88*; *Gibellini, 110 Nev. at 1209, 885 P.2d at 545*.

The prevailing view among other jurisdictions is that attorney fees awards are entitled to post-judgment interest. [30] The Supreme Court of Ohio recently recognized that "the modern trend favors the awarding of post-judgment interest

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on attorney fees as a general rule." [31] That court adopted the "modern trend" because "an award of post-judgment interest on attorney fees properly recognizes the time value of money by making the prevailing party truly whole and preventing the nonprevailing party from enjoying the use of money that no longer rightfully belongs to it." [32]

30 *See*, *e. G.*, *Isaacson Structural Steel Co. v. Armco Steel, 640 P.2d 812, 818 (Alaska 1982)*; *Fischbach & Moore, Inc. v. McBro, 619 So. 2d 324, 324-25 (Fla. Dist. Ct. App. 1993)*; *Nardone v. Patrick Motor Sales, Inc., 46 Mass. App. Ct. 452, 706 N. E.2d 1151, 1152 (Mass. App. Ct. 1999)*; *Parker v. I&F Insulation Co., 89 Ohio St. 3d 261, 2000 Ohio 151, 730 N. E.2d 972, 979 (Ohio 2000)*; *Aguirre v. AT & T Wireless Services, 118 Wn. App. 236, 75 P.3d 603, 605 (Wash. Ct. App. 2003)*.

31 *Parker, 730 N. E.2d at 977*.

32 *Id. at 978*; *see also Isaacson, 640 P.2d at 818*.

Further, in *Powers v. United Services Automobile Association*, we held that the prevailing party is entitled to post-judgment interest on punitive damages awards. [33] We explained that "the purpose of post-judgment interest is to compensate the plaintiff for loss of the use of the money awarded in the judgment" without regard to the various elements that make up the judgment. [34] For the same reason, we conclude that the prevailing party may recover post-judgment interest on an attorney fees award.

33 *114 Nev. 690, 705-06, 962 P.2d 596, 605-06 (1998)*.

34 *Id. at 705, 962 P.2d at 605*.

[*27] *CONCLUSION*

The district court did not err in allowing the Waddells to revoke their acceptance of the RV within a reasonable time because chronic engine overheating problems

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substantially impaired the RV's value to the Waddells. The district court also properly denied Wheeler's motion for attorney fees. Further, substantial evidence supports the district court's determination that Wheeler's was not entitled to indemnification from Coachmen.

Additionally, the district court did not abuse its discretion in denying the Waddells' computerized research costs. Finally, the Waddells are entitled to post-judgment interest on their attorney fees award. Accordingly, we affirm the district court's judgment with the exception of post-judgment interest. We reverse as to that issue only and remand for further proceedings consistent with this opinion.

¿Cuándo está facultado el comprador a revocar la aceptación de la mercadería que el vendedor le ha entregado?

II. ARTÍCULO 2A SOBRE EL ARRENDAMIENTO

A. EL CASO INSÓLITO DEL ARRENDAMIENTO FINANCIERO

In re Bruce A. WALLACE and Eileen T. Wallace, h/w, Debtors UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF NEW JERSEY 122 B. R. 222 February 1, 1990, Filed

OPINION BY: GAMBARDELLA The matter before this court is a motion filed on September 28, 1989 on behalf of creditor General Motors Acceptance Corporation ("GMAC" or "Creditor") to compel the debtors to assume or reject an unexpired lease. The motion seeks *inter alia* an order compelling debtors to assume or reject a lease for a 1987 Buick Century automobile, vehicle identification number ("VIN") 1 G4AH81W2H6435895, within ten (10) days of the entry of such order. In GMAC's application in support of its motion GMAC also seeks to compel the

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debtors' rejection and termination of the lease; modify the automatic stay under *Section 362*; and direct turnover of the leased automobile which is in the debtors' possession to GMAC. The following constitutes this court's findings of fact and conclusions of law.

On July 11, 1989 Debtors Bruce Wallace and Eileen Wallace ("Debtors") filed a Chapter 13 petition under the Bankruptcy [**2] Reform Act of 1978, as amended by the Bankruptcy Amendments and Federal Judgeship Act of 1984, and the Bankruptcy Judges, United States Trustees and Family Farmer Bankruptcy Act of 1986 ("Bankruptcy Code"). In conjunction with their petition, the Debtors filed a Chapter 13 plan which provides for the total payment of $377.82 monthly to the Chapter 13 Standing Trustee for sixty (60) months to cure mortgage arrearages to Beneficial Mortgage Corporation and Beneficial Financial Company on two residential mortgages. Also included in the plan was a "cramdown" of GMAC's claim in the subject vehicle to $11,906.25 payable in 60 monthly payments of $198.44 of the total monthly plan payment. The plan provided that unsecured creditors would receive no dividend. By Order dated October 19, 1989, the Debtors' Chapter 13 case was dismissed for failure to attend the confirmation hearing scheduled on October 18, 1989. At a hearing conducted on November 15, 1989, the Debtors' Chapter 13 case was subsequently reinstated upon verification of insurance on the subject vehicle. Proof of insurance was supplied to GMAC. By order dated January 11, 1990, the Chapter 13 petition was reinstated.

On July 2, [**3] 1987, Debtors and GMAC entered into an agreement entitled "Lease Agreement." Debtors were described as "Lessee (and Co-lessee if any)" and GMAC was described as "Lessor." The vehicle was described as a 1987 Buick Century ("leased vehicle"). The agreement provided for a total of 48 monthly payments of $280.62 for

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a total lease price of $13,469.76. On July 6, 1987 GMAC purchased the vehicle from Masson Buick, Inc. for the sum of $13,437.00.

Paragraph 8 of the lease agreement provided Debtors with an option to purchase the vehicle as follows:

8. OPTION TO PURCHASE. Provided you are not in default, you will have the option to purchase the vehicle at the scheduled termination of this lease (Item 6 above) for its Fair Market Value if you advise Lessor no later than 30 days prior to the scheduled termination. "Fair Market Value" will be the average of the retail and wholesale values stated in a then current vehicle guidebook selected by Lessor. For this purpose, the value established will be the "clean" or "average" value of a like vehicle including options and with the mileage that would have accrued if the vehicle had been operated in accordance with the Excess Mileage Charge provision [**4] of the lease. Upon early termination, you will have the option to purchase the vehicle for the greater of its Fair Market Value or the amount due Lessor under Paragraph 12(c)(i) in addition you will also be responsible for any fees and taxes in connection with the purchase of the vehicle.

Paragraph 12 entitled "Early Termination and Default" stated:

12. EARLY TERMINATION AND DEFAULT.

(a) Provided you are not in default, you may terminate this lease prior to its scheduled termination (Item 6 above) if you give the Lessor 15 days written notice. Upon early termination, your obligation [*225] will be determined under Paragraphs 12(c)(i) and 12(c)(ii).

(b) You will be in default if any of the following occur: (1) You do not make a payment when due; (2) You or your property are the subject of a proceeding in bankruptcy,

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receivership or insolvency or you make an assignment for the benefit of creditors; (3) You fail to comply with the insurance requirements of the lease; (4) You fail to maintain or repair the vehicle as required by the lease; (5) You have made any material misrepresentation on your Lessee Statement; (6) You fail to answer traffic summons or pay fines when due; or (7) You fail [**5] to comply with any other terms or conditions of the lease. If you are in default, Lessor may terminate this lease prior to the scheduled term. Your obligation to Lessor will then be determined in accordance with Paragraphs 12(c)(i) and 12(c)(ii).

(c)(i) Upon early termination, Lessor will calculate the remaining amount you owe by totalling the unmatured Fixed Monthly Rental Charges for the remaining scheduled term. Lessor then will add the residual value of $4,414.92 plus any past due Monthly Payments and additional amounts owed by you and subtract any unearned Charges. The unearned Charges will be determined by applying actuarial method to the amount of $3,685.44.

(c)(ii) If the vehicle is not purchased by you under the provisions of Paragraph 8 above, Lessor will sell it at wholesale in a commercially reasonable manner and apply the greater of the amount of the net proceeds as defined below or the residual value to the amount determined in Paragraph 12(c)(i). If there is a balance due, you agree to pay it promptly. Any surplus will be kept by Lessor. To arrive at the net proceeds of sale, Lessor will subtract from the proceeds of sale the reasonable costs of preparing the vehicle [**6] for sale and selling it. If Lessor terminated the lease pursuant to Paragraph 12(b), then Lessor also will subtract the costs of taking and storing the vehicle, and reasonable attorney's fee if permitted by law.

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(d) To the extent that the amount you owe is based on the value of the vehicle at the end of the lease term, if you disagree with the value Lessor assigns to the vehicle, you may obtain at your expense, from an independent third party agreeable to you and Lessor, a professional appraisal of the wholesale value of the vehicle which could be realized at sale. The appraisal value shall then be used as the actual value.

Paragraph 24 of the lease agreement provides:

24. OWNERSHIP. This is a lease only and Lessor remains the owner of the vehicle. You will not transfer, sublease, rent, or do anything to interfere with Lessor's ownership of the vehicle. You and Lessor agree that this lease will be treated as a true lease for Federal Income Tax purposes and elect to have Lessor receive the benefits of ownership (*IRC sec. 168(f)(8)*).

The two-page agreement contained in total 29 paragraphs the additional details of which will be discussed infra as they become relevant to the matter [**7] before this court. The certificate of title issued by the State of New Jersey Division of Motor Vehicles is in the name of GMAC.

GMAC brings this motion to compel Debtors to assume or reject the automobile lease. In response, Debtors argue that the lease agreement is no longer a "true lease", but rather a security agreement by virtue of Debtors exercising the option to purchase by filing a Chapter 13 petition and plan and proposing to pay to GMAC the fair market value of the vehicle. In essence, Debtors argue that the lease agreement was a "true lease" when it was executed on July 2, 1987, but that it was converted to a "sale" by the Debtors' filing of the Chapter 13 petition. The Debtors further assert that all of GMAC's rights and remedies must be in the context of a sale and that there was no agreement giving

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GMAC a security interest in the vehicle. The Debtors assert that since GMAC has not perfected a security interest [*226] in the vehicle pursuant to *N. J. S. A. 39:10-11*, its claim is unsecured and that a modification of the plan will follow pending the determination of this motion. In reply to Debtors' arguments, GMAC claims that under the lease itself and *§ 1322(b)(7) of the Bankruptcy* [**8] *Code*, Debtors cannot elect the option to purchase by the mere means of filing a petition and plan. GMAC argues that the lease agreement is a "true lease", that the question of GMAC's interest in the motor vehicle is not properly before this court by motion, and Debtors are required to bring an adversary complaint in order for this court to determine the question of GMAC's interest in the automobile.

It appears undisputed that the Debtors made 24 payments under the lease and that the last payment was received on June 21, 1989. The Debtors' Chapter 13 petition was filed on July 11, 1989. The Debtors are due, according to the GMAC, for all payments since July 2, 1989.

Preliminarily, GMAC raises certain procedural objections to the defenses raised by the Debtors to this motion. On September 14, 1989 GMAC filed its proof of claim asserting that the Debtors were liable to GMAC on account of an "Automobile Lease Agreement" in the amount of $9,571.27. GMAC takes the position that under *Bankruptcy Rule 3001(f)* "A proof of claim executed and filed in accordance with these rules shall constitute prima facie evidence of the validity and amount of the claim" and that Section 502(a) further provides [**9] that "A claim or interest, proof of which is filed under Section 501 of this title is deemed allowed, unless a party in interest objects." GMAC asserts that it has received no objection to its proof of claim. GMAC also contends that while *Bankruptcy Rule 6006(a)* provides that actions related to assumption or

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rejection of unexpired leases may be requested by motion under *Bankruptcy Rule 9014*, a determination of whether an executory lease exists in the first instance may be raised only by the filing of an adversary complaint under *Bankruptcy Rule 7001*.

This court finds that no basis for such requirement has been demonstrated by GMAC. The cases relied upon by GMAC are not analogous to the case at bar. *See e. G. In re Harry C. Partridge Jr. & Sons, Inc., 43 Bankr. 669 (Bankr. S. D. N. Y. 1984)* (debtor's cross-motion for a declaratory judgment declaring that there is no default by the debtor of an executory contract must be commenced by adversary proceeding); *In re McKay, 732 F.2d 44 (3d. Cir. 1984)* (where debtor seeks to avoid a judicial lien under § 522(f) the adversary proceeding rules are applicable); [1] *In re Commercial Western Finance Corp., 761 F.2d 1329 (9th Cir. 1985)* [**10] (Rules of Bankruptcy Procedure required trustee to file adversary proceedings against the investors whose partial assignments trustee sought to avoid pursuant to Section 544); *In re Mechanical Unlimited, Inc., 38 Bankr. 818 (Bankr. D. Hai. 1984)* (pursuant to *Bankruptcy Rule 7001* an action to avoid transfers under *Section 548 of the Bankruptcy Code* must be brought by an adversary proceeding).

1 Present *Bankruptcy Rule 4003(d)* effective August 1, 1987 now provides that "a proceeding by the debtor to avoid a lien or other transfer of property exempt under § 522(f) of the Code shall be by motion in accordance with *Rule 9014*."

Here the court is of the opinion that the threshold determination that it must make in the context of a motion to compel assumption or rejection of an executory lease -- that the movant properly claims an interest under a lease -- can be accomplished by motion pursuant to the procedures

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contained in *Bankruptcy Rule 9014* for disposing of contested matters.

The threshold question in the instant case [**11] is whether the lease is a "true lease" or a lease intended for security. In order to reach a determination as to the nature of the document in question, the court must first examine state law, here, *N. J. S. A. 12A:1-201(37)*, which provides in relevant part:

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 [*227] 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.

There are no absolute standards to distinguish a true lease from a security agreement, however, many courts have set forth factors deemed to be reflective of the parties' intentions. The court is left to balance these factors. If the proprietary interest in the property is weighed in favor of the party designated as lessee, the document is a security agreement. If the balance of incidents of ownership tips toward the party designed as lessor, the document is a lease. *See, In* [**12] *re Noack, 44 Bankr. 172, 174 (Bankr. E. D. Wis. 1984)*.

Certain factors point toward an agreement being a security agreement: (1) if the lessee is required to insure the items in an amount equal to the total rental payments; (2) if the risk of loss or damage is on the lessee; (3) if the lessee is to pay taxes, repairs, damage and maintenance; (4) if there are default provisions governing acceleration and resale of the item; (5) if there is a substantial nonrefundable

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deposit; (6) if the goods are selected from a third party by the lessee; (7) if the rental payments are a reasonable equivalent of the cost of the items plus interest; (8) if the lease is to be discounted with a bank, and; (9) if warranties generally found in a lease are excluded by the agreement. *See In re Noack, 44 Bankr. at 175*. Additional criteria identified by the courts to assist in the determination of whether a lease is a security agreement are:

(1) whether there was an option to purchase for a nominal sum,

(2) whether there was a provision in the lease granting the lessee an equity or property interest in the equipment,

(3) whether the nature of the lessor's business was to act as a financing agency,

(4) whether [**13] the agreement included a clause permitting the lessor to accelerate the payment of rent upon default of the lessee and granted remedies similar to those of a mortgagee,

(5) whether the equipment subject to the agreement was selected by the lessee and purchased by the lessor for this specific lessee,

(6) whether the agreement required the lessee to join the lessor, or permit the lessor by himself, to execute a UCC financing statement,

(7) whether there was a default provision in the lease inordinately favorable to the lessor,

(8) whether there was a provision in the lease for liquidated damages,

(9) whether there was a provision disclaiming warranties of fitness and/or merchantability on the part of the lessor,

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(10) whether the aggregate rentals approximate the value or purchase price of the equipment.

Matter of Brookside Drug Store, Inc., 3 Bankr. 120, 122-123 (Bankr. D. Conn. 1980).

Some court have recognized that the acquisition of equity in the leased property by the lessee and the payment of a nominal option price are the *critical* factors in determining that a lease is a security agreement. *See, In re Odell, 27 Bankr. 520 (Bankr. D. Ore. 1983)*; *In re Dunn Brothers,* [**14] *Inc., 16 Bankr. 42, 45 (Bankr. W. D. Va. 1981)*; *In re Ram Manufacturing, Inc., 45 Bankr. 663, 666 (Bankr. E. D. Pa. 1985)*, *modified, 56 Bankr. 769 (E. D. Pa. 1985)*.

Courts have recognized thatthe definition of "nominal consideration" may vary and so have adopted an "economic realities" test. These courts have held that if at the end of the term the only economically sensible course for the lessee is to exercise the option to purchase the property, then the agreement is a security agreement. *See e. G. In re Dunn Brothers, Inc., 16 Bankr. 42, 45 (Bankr. W. D. Vir. 1981)*. These courts have determined that if the price to the lessee is much less than the fair market value of the property, then the lessor has recognized an equity in the lessee, and the lease was intended as a security instrument. *Id.* Accordingly, even if an agreement provides for surrender of the [*228] property to the lessor at termination of the agreement, or upon a default of the lessee, an equity in the lessee may still be recognized, where for example the lessee is entitled to any surplus of proceeds after the lessor claims liquidated damages under the agreement. *Id. citing, In re Tillery, 571 F.2d 1361, 1365 (5th* [**15] *Cir. 1978)*. In determining whether the option to purchase may be exercised for a nominal consideration, some courts have focused on whether the lessee has no plausible alternative

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but to exercise the option either because of the substantially greater market value of the property at the date the option may be exercised, or because of other relevant factors such as the substantially less attractive option to continuing renting the property or purchase it outright for a comparatively nominal amount. *See, In re Sight & Sound of Ohio, Inc. v. Wright, 36 Bankr. 885, 890 (S. D. Oh. 1983)*.

In *BJL Leasing Corporation v. Whittington, Singer, Davis and Company, Inc., 204 N. J. Super. 314, 320-21, 498 A.2d 1262 (App. Div. 1985)*, the Superior Court of New Jersey, Appellate Division determined thatpursuant to *N. J. S. A. 12A:1-201(37)(b)*, a lease agreement which provides that upon compliance with the lease terms the lessee either becomes the owner or can exercise an option to purchase for no additional consideration or for nominal consideration, a security agreement is established as a matter of law.

In *Leasing Service Corp. v. American National Bank & Trust Co., 19 U. C. C. Rep. Serv. (Callaghan) 252, 259 (D. N. J. 1976)*, the court [**16] held that where the total rentals for the subject equipment over the five-year lease term, exceeded the cost of the equipment by approximately 37% that fact supported the conclusion that the transaction was a conditional sale and not a true lease. *Id. at 259*. *Accord Citi-Lease Company v. Entertainment Family Style, Inc., 825 F.2d 1497, 1500 (11th Cir. 1987)* (Contract was a conditional sale where among other factors the rental payments of $74,880.00 exceeded the purchase price of $60,000.00 for the subject video games; the court concluded that "the $74,880 total represented the fair market value of the "leased" property plus a financing charge.")

The decisive factor in distinguishing a lease intended as security from a true lease is whether the instrument in

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question will ultimately result in the purported lessee gaining *de facto* ownership of the subject matter of the lease. *See, In re Coors of the Cumberland, Inc., 19 Bankr. 313, 316 (Bankr. M. D. Tenn. 1980)*. In the *Coors* case, the court found that the lessee was obligated to purchase the subject vehicles upon the termination of the agreement.*19 Bankr. at 317*. The *Coors* court noted that absent a purchase price [**17] at a nominal figure, an intention to abandon its property cannot easily be imputed to the lessor, unless there is added to the facts a finding that the minimum term closely approximates the anticipated economic life of the equipment, in which case the intention is made obvious.*19 Bankr. at 318*.

Courts have considered whether agreements contain "residual guaranty" clauses which provide that at the expiration of the agreement, the equipment shall be sold and the lessor *guaranteed* a fixed sum referred to as the "residual value" of the equipment and whether the risk of disposing of the assets was truly upon the lessee since the lessor was assured of a fixed return regardless of what was ultimately received from the sale of the equipment. *See, In re Noack, 44 Bankr. at 176*.

In the *Noack* case, the agreement before the court contained neither an option to purchase nor a mandatory purchase clause. Neither party was entitled to possession of the equipment upon termination, instead the equipment had to be sold on the open market at which time the lessor was guaranteed a fixed sum referred to as the residual value of the equipment.*44 Bankr. at 175-76*. In that case, the court determined [**18] that the equipment lease was a security agreement since it conferred upon the debtor lessee therein indicia of ownership consistent with a proprietary interest in the equipment. I*d. at 176*. In so ruling, the court relied upon the fact that if the lease was fully completed the lessor under the agreement would receive a return equivalent

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[*229] to the full value of the equipment as of the inception of the agreement together with an effective interest rate of slightly more than nine (9%) percent supporting the conclusion that the agreement was a security agreement. *Id.*

In the case of *In re Farrell, 79 Bankr. 300 (Bankr. S. D. Oh. 1987)* the court was presented with the question of whether a lease was a "true" lease in the course of a Chapter 13 confirmation hearing. In *Farrell,* the Debtors' Amended Chapter 13 plan proposed to treat a claim by GMAC under a "Lease Agreement" as a fully secured claim which would be paid in full to the value of the collateral plus a discount factor equal to the current market value of the interest as required by *11 U. S. C. § 1325(a)(5)*. GMAC objected to the confirmation of the plan on the grounds that GMAC's claim was as a lessor not as a secured creditor. [**19] The court noted thatthe Bankruptcy Code provides for the assumption or rejection of a lease pursuant to *§ 365(b)(1)* but that the term "lease" is undefined by the Code. I*d. at 302*. The *Farrell* court observed that the legislative history following the Code definition of "security interest" in *§ 101(45)* indicates thatstate and local law should be applied to determine when a lease is a security instrument. *Id. (citing* H. R. No. 95-595, 95th Cong., 1st Sess. at 314 (1977), U. S. Code Cong. & Adm. News 1978, pp. 5787, 6271. The bankruptcy court applied the *Ohio Revised Code § 1301.01(kk)* which is identical to *N. J. S. A. 12A:1-207(37)*, and held that the lease agreement was a true lease. *Id.*

In *Farrell* the debtors were obligated to pay the total of $9,378.24 over the 48-month term of the lease. The agreement obligated the debtors to pay all costs associated with titling, maintenance, repair and operation costs, all taxes, and insurance with coverage limits as determined by GMAC. Under the agreement the debtors were obligated to return the vehicles at the end of the lease term. At lease

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maturity the debtors had the option to purchase the vehicle at a price GMAC determined to be [**20] the current fair market value of the vehicle. I*d. at 302*. In holding that the lease agreement was a true lease, the *Farrell* court found that absent some factual finding as to the relevant market value of the vehicle, the court could not find that the option price designated as the current fair market value as determined by GMAC was nominal. *Id. at 303*. The court also stated:

> On the contrary, the Court notes other factors, although not presented as formal evidence, tending to compel a conclusion that the option price would be a substantial sum. First, absent findings which would establish that depreciation of this vehicle should be accelerated more than normal due to high mileage, damage, or other factors, the Court is of the opinion that vehicles of this nature typically have a fair market value at the expiration of 48 months which is greater than a sum characterized as "nominal." Furthermore, the proof of claim filed by GMAC on September 9, 1986 lists the van as having a fair market value of $4153.24. Accordingly, the Court finds that the option price, determinable by GMAC, is not nominal. *Id. at 303*.

The *Farrell* court further found that while the agreement [**21] placed many incidents and burdens of ownership on the debtors such as risk of loss, tax liability, titling and registration fees, maintenance and repair expenses and the agreement provided for a sum certain to be paid over the life of the lease with an acceleration provision in the event of default. "the paramount attribute of a lease, retention of title", was expressly set forth in the Agreement, and the parties agreed that the Agreement would be treated as a "true lease" so that GMAC could receive the contemplated tax benefits. The court found on balance, based on the facts before it, that the agreement was

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not intended as a security interest, but was a lease. *Id. at 304*.

In the case of *In re Cole, 100 Bankr. 561, 564 (Bankr. N. D. Okla. 1989)*, the court held that where the lessor retained a meaningful residual interest in the subject vehicle the agreement should be construed as a true lease. *Id. at 564*. The *Cole* court noted there that although the debtor had an option to purchase the vehicle it was not [*230] a forgone conclusion that the debtor would exercise the option since the option price was the reasonably predictable fair market value of the vehicle at the end of the [**22] term so that there was no economic incentive compelling the debtor to purchase the vehicle. I*d. at 564*.

In *Cole,* the lease provided for a term of 48 months with a total payment of $9,789.30. At the end of the lease term the debtor had the option to purchase the vehicle for $4,710.97 or to return the vehicle without further obligation except for excess mileage and wear and tear charges if applicable. I*d. at 562*. The *Cole* court found that the lessor, Ford Motor Credit Company, retained a "meaningful residual interest in the vehicle with a value of approximately $4,710.97." *Id. at 564*. The *Cole* court further noted:

In a typical arms-length sale of goods, the buyer has a contractual obligation to pay the seller consideration with a present value approximating the fair market value of the goods at the time of sale. Where the present value of lease payments, and any other consideration or obligation under the lease, is significantly less than such fair market value, the transaction is probably a lease because the payment obligation is inconsistent with a buyer's obligation in a sale. In this case, assuming a 12% discount factor, the present value of the payments [**23] Debtor was obligated to make was roughly $11,150.00. The manufacturer's suggested

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retail price for the Vehicle, an amount reasonably approximating its fair market value, was $13,310.40. Therefore, under the Agreement, Debtor was obligated to pay consideration with a present value of approximately 84% of the fair market value of the Vehicle, which payment obligation is inconsistent with a sales transaction.

Id. at 565. (Emphasis in original).

GMAC has cited two contrary cases from the United States Bankruptcy Court Northern District of Oklahoma which considered the question of whether a lease was a "true lease" or secured transaction. *See In re Thompson, 101 Bankr. 658 (Bankr. N. D. Okla. 1989)*; *In re Harvey, 80 Bankr. 533, 537 (Bankr. N. D. Okla. 1987)*.

In the case of *In re Thompson,* the bankruptcy court for the purpose of that decision, consolidated nine adversary proceedings brought by the trustee under nine different Chapter 7 cases against Ford Motor Credit Corporation to determine ownership of or priority of conflicting interests in certain motor vehicles or their proceeds. T*hompson, 101 Bankr. at 660*. The *Thompson* court noted that its decision regarding these [**24] pre-1988 leases was based on "pre-1988" law [2] in Oklahoma.

2 The *Thompson* court noted that the 1988 amendments to Oklahoma Statutes 12A O. S. A. (1989 Supp.) Article 2A and related provisions (§§ 2A-102, 2A-103(1)(j), 9-102-(1)(a), (2) and 12A O. S. A. (1989 Supp.) § 1-201(37) do not apply to the transactions in this because they were entered into before the effective date of the amendments. Thus, in resolving the issue of whether a purported lease is a "true" lease or secured transaction, the court relied on the "prior law" in effect at the time of the transactions. I*d. at 668-669*.

The bankruptcy court determined that under existing pre-1988 Oklahoma law, secured transactions were shown

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by: (1) the concentration of all the incidents of ownership of the vehicles, save bare legal title in lessee; (2) the effect of termination provisions which established an equity in the vehicles in lessee and removed any reversionary interest from lessor; and (3) economic equivalence of the transaction with secured sales or loans. [**25] In respect to these three points, the court determined based on the following that the lease was equivalent to a secured transaction. *Id. at 670*.

In this regard, the *Thompson* court determined that as a practical matter a lease which allocates to the lessee all of the incidents of ownership (paying all fees, taxes, penalties, expenses of maintenance and repair) except bare title is equivalent to a secured transaction. *Thompson, 101 Bankr. at 670. Accord In re Harvey, 80 Bankr. 533, 539 (Bankr. N. D. Okla. 1987)* (incidents of ownership such as maintenance charges, license fees, taxes, repairs, insurance, both casualty and comprehensive, risk of loss, default provisions governing acceleration [*231] and resale, the ability of the lessee to select and have ordered the vehicle meeting the lessor's specific specifications, rental payments being equivalent to the costs of goods plus interest, less the residual value of the goods, indicate transaction to be a sale).

The *Thompson* court determined with regard to the termination provisions contained in each of the leases that since the lessor was not required to extinguish its reversionary interest in the vehicle, the lease was inconsistent [**26] with true ownership as a matter of law, thus the leases did not clearly establish an equity in the lessee nor extinguish the lessor's reversion. *Id. at 672*.

The court determined however that the transactions were economically equivalent to secured sales or loans. The court stated in this regard:

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In short, the transactions governed by these lease forms are secured credit sales or purchase-money loans, tailored to fit car and truck buyers who prefer to trade in their vehicles after a few years, pay off a large part of the sale price and finance charges at that time in a single large "balloon" payment, and acquire brand-new vehicles. The "lease" form contracts themselves are merely a cover, a charade, a sham -- a lie.

101 Bankr. at 675.

The *Thompson* court determined that the payments under these lease agreements were equivalent to a sales contract by virtue of the fact that the payment under the lease of the full purchase price of the car plus 40% would be consistent with a direct purchase of a car. I*d. at 676*. In *Thompson,* the court examined a contract similar to that examined in the case of *In re Cole, 100 Bankr. 561 (Bankr. N. D. Okla. 1989)* and stated in this regard:

[**27] When the contract [lease] is considered prospectively, it appears that FMCC as lessor in the Cole lease could expect to recover almost $14,092.32 rent plus $4,710.97 option purchase price for a total of $18,803.29 over four years, an increase of 41% over the manufacturer's retail price of $13,310.40. Thus, if the purchase option were exercised, Cole would pay the full purchase price of the car plus about 40% over four years -- which appears to be perfectly consistent with a sales transaction.

Id. at 676. This reasoning is unpersuasive. It assumes that a lessee is willing to pay the full purchase price plus over 40% to purchase the vehicle. It is not clear to this court that at the end of the term of the lease examined in *Thompson* the only economically sensible course for the lessee would be to exercise the option to purchase the property.

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In the case before this court, the parties have entered into a "Lease Agreement" for forty-eight months. Under the Lease, it is clearly set forth that the debtors are the "lessee and co-lessee", GMAC is the "lessor," and the 1987 Buick Century is the "leased vehicle." According to the lease, Debtors are responsible for the following: [**28] (1) obtaining the necessary insurance; (paragraph "A" and paragraph 14); (2) paying the initial costs of titling, licensing, and registering the vehicle in addition to sales tax, maintenance, repairs, and operating expenses (paragraph 1, 5 and 10); (3) costs of excess wear and use (paragraph 11); (4) costs of excess mileage (paragraph 13); (5) remittance of an initial security deposit (paragraph 16); (6) subsequent costs to license, register the vehicle, and taxes incurred during the term of the lease except those levied on the net income of GMAC, and annual state motor vehicle inspection (paragraph 20), and; (7) to indemnify lessor against claims and liability (paragraph 25).

Debtors argue that the above obligations coupled with the option to purchase in paragraphs 8 and 12 are incidents of ownership and thus the lease is not a true lease but rather a security agreement. This court does not dispute Debtors argument that the above list of obligations are incidents of ownership; however, this alone does not persuade the court that the lease is not a true lease. Courts have held thatplacing the incidents and burdens of ownership on the lessee such as the risk of loss, tax liability, [**29] titling, registration fees, maintenance [*232] and repair expenses are significant factors in determining the issue of whether a lease is a true lease or security agreement; however, these factors do not necessarily indicate an intent by the lessor to transfer ownership since such obligations are frequently the responsibilities of the lessee in a "true lease." *Farrell, 79 Bankr. at 304 (citing Jahn v. M. W. Kellogg Company, Inc., 822 F.2d 16 (6th Cir. 1987)*.

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The *Farrell* court noted that the paramount attribute of a lease is the retention of title by the lessor. *Farrell, 79 Bankr. at 304*. In the instant case, GMAC retained title to the 1987 Buick Century even though Debtor's were burdened by many of the incidents of ownership.

There are also several provisions of the present lease which strongly indicate that the lease is a true lease rather than a security interest.

(1) Debtors if they do not purchase the vehicle, must return the vehicle at the scheduled termination of the lease (Paragraph 19).

(2) Lessor GMAC, subject to certain provisions of Paragraph 12, obtains insurance proceeds in the event of theft or destruction of the vehicle during the lease (Paragraph 21).

(3) Upon [**30] default by debtors, lessor can take possession of the vehicle (Paragraph 23).

(4) Ownership of the vehicle is in the lessor (Paragraph 24).

(5) Only lessor can assign its rights under the lease, lessee cannot assign the lease (Paragraph 28).

The provision which most strongly indicates the existence of a "true lease" rather than a security agreement is Paragraph 8, the option to purchase provision, which provides that Debtors could exercise an option to purchase the vehicle for the "fair market value" of the vehicle as determined by lessor at the expiration of the lease. In *Farrell,* the court noted that the most significant factor to be considered is the status of the lessee at the end of the lease. *Farrell, 79 Bankr. at 304*. The *Farrell* court, quoting from *Jahn v. M. W. Kellogg Company, Inc., 822 F.2d 16 (6th Cir. 1987)* observed that:

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The most illustrative test to distinguish between a true lease and a lease intended as security is whether the "lessee" is "obligated to accept and pay for the property or [instead] is obligated only to return or account for the property according to the terms of the lease from which he may be excused if he exercises his privilege [**31] of purchasing it." If the former is true, then the lease is security instrument in a disguised sale, if the latter, then a true lease exists. *Id. at 304*.

The subject lease provides for a term of 48 months with a total rental payment of $13,469.76, including sales taxes, in addition to the initial license fee of $50.00. GMAC paid $13,437.00 for the original purchase of the vehicle.

Under Paragraph 12, the "Early Termination and Default" provision, provided the Debtors are not in default, they may purchase the vehicle by paying the greater of the fair market value of the vehicle at the date of actual termination or the amount determined by the specific formula contained in Paragraph 12(c)(i).

Under the provisions of Paragraph 12(c)(ii), if the vehicle is not purchased by the Debtors pursuant to Paragraph 8, GMAC may sell the vehicle at wholesale and apply the greater of the amount of net proceeds or the residual value to the amount determined by Paragraph 12(c)(i). If there remains a balance due, the Debtors must pay it. If there is a surplus, it ensures to the benefit of GMAC.

This court cannot find that the option price, whether calculated at the scheduled termination of the [**32] lease as the fair market value as determined by GMAC, or calculated prior to termination as the greater of the fair market value at the date of termination or the amount calculated pursuant to the formula contained in Paragraph 12(c)(i) is nominal.

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Accordingly, this court is satisfied that under *N. J. S. A. 12A:1-201(37)* and the authority cited above that the lease entered [*233] into between Debtors and GMAC is a true lease. While the lease does provide the Debtors with some of the attributes of ownership, the critical attribute of ownership at the end of the lease remains in GMAC and thus is a true lease.

The next issue for consideration is Debtors' argument that by filing their Chapter 13 plan and treating the lease as a sale in their Chapter petition, they have exercised their option to purchase the vehicle. Debtors do not cite any authority in support of the proposition that by the mere filing of its Chapter 13 petition it has exercised the option to purchase the subject vehicle. In response, GMAC asserts that the Debtors have not complied with the provisions for exercising the option to purchase under paragraph 8 and 12. GMAC further argues that under *§ 1322(b)(7) of the Bankruptcy Code*, [**33] the Debtors must comply with *§ 365* in order to exercise the option.

GMAC argues that the Debtors if they choose to exercise the purchase option must comply with the provisions of Paragraph 12 dealing with early termination and comply with the provisions of that paragraph which requires fifteen (15) days prior written notice and a determination of the price at which the lessee may purchase, which is the greater of the fair market value or the amount calculated under Paragraph 12(c)(i). GMAC asserts that until the Debtors raised the point in their brief filed in response to this motion, GMAC was not notified of the Debtors' intent to terminate the lease early and purchase the vehicle.

Under either Paragraphs 8 or 12 of the Lease Agreement, it is clear that at the date of the filing of the Debtors' Chapter 13 petition, even assuming that the option

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was properly exercised, which GMAC does not concede, the lease agreement remained an executory contract.

In the case of *Matter of Dunes Casino Hotel, 63 Bankr. 939, 948 (D. N. J. 1986)* the Honorable Stanley S. Brotman, U. S. D. J., held that an option to purchase certain real estate held by the debtor pursuant to a Real Estate Option Agreement [**34] between the debtor, the Dunes Casino Hotel and GNAC Corporation, was an executory contract at the time the debtor filed its Chapter 11 petition.

In so ruling, Judge Brotman stated:

The Code does not define "executory contract," but the legislative history identifies it as one "on which performance remains due to some extent on both sides." Notes of Committee on the Judiciary, S. R. Rep. No. 96-989, 95th Cong., 2d Sess. 58 (1978), contained in 1978 U. S. Code Cong. & Admin. News 5787, 5844. The bankruptcy court relied on an oft-cited definition of an executory contract provided by Professor Countryman:

[A] contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete the performance would constitute a material breach excusing the performance of the other.

Countrymen, Executory Contracts in Bankruptcy: Part I, 57 Minn. L. Rev. 439, 460 (1973), cited in September Opinion at 38; *In re Alexander, 670 F.2d 885, 887 (9th Cir. 1982)*; *In re Chicago, Rock Island & Pacific R. R. Co., 604 F.2d 1002, 1004 (7th Cir. 1979)*; *In re Knutson, 563 F.2d 916, 917 (8th Cir. 1977)*.* * * * the court [**35] finds that on July 26, 1985 "substantial performance" remained on both sides of the Dunes-GNAC Agreement. GNAC had tendered the deeds and title documents, but had not delivered them, at least in part due to Dunes' refusal to accept them. *See* September Opinion at 16. Thus, GNAC

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had not completed its performance. Of course, Dunes still owed the purchase price at that time. Consistent with its rights under the contract, GNAC notified Dunes that it was in default, thus triggering the "cure" provision. The contract would remain "executory" from July 26 to August 10, and the Chapter 11 filing on August 9 preserved that "executory" status pending reorganization. In sum, this court will uphold the bankruptcy court's determination that the [*234] contract was "executory" at the time of the filing.

63 Bankr. at 948-949.

The Debtors must comply with *§ 1322(b)(7)* and *§ 365 of the Bankruptcy Code* as well as Paragraphs 8 and 12 of the lease in order to assume the lease agreement or exercise the option to purchase.

Section 1322(b)(7) provides that a Chapter 13 plan may "subject to *Section 365* of this title, provide for the assumption, rejection, or assignment of any executory contract or unexpired [**36] lease of the debtor not previously rejected under such section." *11 U. S. C. § 1322(b)(7)*. In the instant case, the lease can be viewed as both an unexpired lease and an executory contract to exercise the purchase option contained in the lease.

Accordingly, the Debtors' plan is subject to *§ 365* of the Code.

Section 365 providesin relevant part:

(a) Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.

(b)(1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may

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not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee --

(A) cures, or provides adequate assurance that the trustee will promptly cure, such default;

(B) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or lease, for any actual pecuniary loss to such party resulting from such default; and

(C) provides adequate assurance of future performance under such contract or [**37] lease.

Debtors' argument that they have exercised the option simply by filing their Chapter 13 petition must fail. Under *§ 1322(b)(7)* of the Code, the Debtors are required to comply with *§ 365* which sets forth the means by which Debtors can assume the unexpired lease or the executory contract that being the option to purchase provision. Merely filing a Chapter 13 petition and plan is insufficient to assume an unexpired lease or executory contract. Under *§ 365(a)* the Debtors may assume an unexpired lease or executory contract only "subject to the court's approval." *11 U. S. C. § 365(a)*. The Debtors' filing of a petition and plan does not satisfy the *§ 365(a)* requirement of obtaining court approval. Additionally, if this court determines that Debtors are in default, as GMAC argues, the Debtors must satisfy the requirements of *§ 365(b)(1)(A)*, *(B)* and *(C)*; of curing the default; compensating GMAC for actual pecuniary loss resulting from the default; and providing GMAC with adequate assurance of future performance.

Because this court has determined that the subject lease is a "true lease" rather than a security agreement and that the lease is subject to *§§ 1322(b)(7)* and *365*, the Debtors [**38] must formally assume or reject the lease and satisfy the requirements of *§ 365*.

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Under *§ 365(d)(2) of the Bankruptcy Code*, in a Chapter 13 case, the debtor "may assume or reject an executory contract or unexpired lease of residential real property or of personal property of the debtor at any time before the confirmation of the plan." Upon the request of a party to such contract or lease, the court "may order" the debtor "to determine within a specified period of time whether to assume or reject such contract or lease. *11 U. S. C. § 365(b)(2)*. What constitutes a reasonable time is left to the bankruptcy court's discretion in light of the circumstances of the case. *See Matter of Dunes Casino Hotel, 63 Bankr. at 949*. The court in *Dunes, supra* noted that in determining what constitutes a reasonable time within which a debtor should assume or reject a contract, the court should consider a number of factors, including: the nature of the interests at stake, the balance of the hurt to the litigants, the safeguards afforded those litigants [*235] and whether the action to be taken is so in derogation of Congress' scheme that the Court may be said to be arbitrary. I*d. at 949*. The *Dunes* court [**39] recognizes that the court should interpret reasonable time considerations with the broad purposes of in that case a Chapter 11 proceeding, which is "to permit successful rehabilitation of debtors." *See id., citing, N. L. R. B. v. Bildisco & Bildisco, 465 U. S. 513, 79 L. Ed. 2d 482, 104 S. Ct. 1188 (1984)*.

In this case the debtors' stated intention to exercise the option to purchase the vehicle by the institution of this Chapter 13 case makes it incumbent upon the debtors to forthwith comply with the provisions of *§ 365*.

Accordingly, the Court shall grant the Debtors fifteen (15) days from the date of this opinion to file a motion for authority to assume or reject the lease in issue, including the option to purchase, and within that time period to file an amended plan which complies with the requirements of this

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opinion. If the debtors default in performing these acts, the court, upon certification by GMAC of such default shall enter an order deeming the lease rejected and modify the automatic stay of *Section 362* for "cause" to allow GMAC to obtain possession of the subject vehicle insofar as the court finds that GMAC's interest in the vehicle would not be adequately protected in the event of any further delay. [3]

3 Title *11 U. S. C. § 362(d)* provides:

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (1) of this section, such as by terminating, annulling, modifying, or conditioning such stay --

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest; or

(2) with respect to a stay of an act against property under subsection (a) of this section, if --

(A) the debtor does not have an equity in such property; and

(B) such property is not necessary to an effective reorganization.

[**40] An order shall be submitted in accordance with this opinion.

¿Hay que tener en cuenta que la gente que acude al arrendamiento con opción de compra, su objetivo es la compra?

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III. ARTÍCULO 3 SOBRE LAS OBLIGACIONES NEGOCIABLES

A. LOS REQUISITOS FORMALES DE LA NEGOCIABILIDAD Y EL TENEDOR DE BUENA FE

ROBERT J. TRIFFIN, Appellee, v. STACEY ANNE DILLABOUGH, AND AMERICAN EXPRESS TRAVEL RELATED SERVICES COMPANY, INC. AP-PEAL OF: AMERICAN EXPRESS TRAVEL RELATED SERVICES COMPANY, INC. ROBERT J. TRIFFIN, Appellee, v. ROBERT LYNN, AND AMERICAN EXPRESS TRAVEL RELATED SERVICES COMPANY, INC., Appellant SUPREME COURT OF PENNSYLVANIA 716 A.2d 605; 36 U. C. C. Rep. Serv. 2d 255 October 17, 1996, Submitted August 21, 1998, Decided

OPINION BY: NEWMAN [*553] [**606] Appellant American Express Travel Related Services Company, Inc. (American Express) asks this Court to decide whether certain of its money orders are negotiable instruments pursuant to the Pennsylvania version of the Uniform Commercial Code, *13 Pa. C. S. § 1101, et seq*., (Commercial Code) and if they are, whether appellee Robert J. Triffin (Triffin) has the rights of a holder in due course who may recover the face value of those money orders from American Express. We hold that the money orders in question are negotiable instruments and Triffin has the rights of a holder in due course, entitling him to recover the value of the money orders from American Express.

FACTS & PROCEDURAL HISTORY

American Express, among other endeavors, sells money orders through its authorized agents. In a typical transaction, an agent collects an amount of cash from the purchaser, also known as the sender, equal to the face value

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of the money order plus a small fee. The sender receives a partially completed money order embossed with the amount of the money order and blank spaces for the sender to fill in his or her own name and address, the name of the payee and the date.

On an unknown date, three American Express money orders were stolen from the premises of one of its agents, Chase Savings Bank. In an apparently unrelated incident, one hundred American Express money orders were stolen while being [*554] shipped to another agent, I. W. Levin & Company. When they were stolen, all of the money orders contained the pre-printed signature of Louis [**607] Gerstner, then Chairman of American Express, but they were blank as to amount, sender, payee and date.

On December 11, 1990, Stacey Anne Dillabough (Dillabough) presented two American Express money orders for payment at Chuckie Enterprises,Inc. (Chuckie's), a check cashing operation in Philadelphia. The money orders were in the amounts of $550.00 and $650.00, respectively, and listed Dillabough as the payee and David W. (last name indecipherable) of 436 E. Allegheny Avenue as the sender. On February 25, 1991, Robert Lynn (Lynn) presented one American Express money order at Chuckie's in the amount of $200.00, which listed himself as payee and Michael C. Pepe as the sender. In each instance, Charles Giunta (Giunta), the owner of Chuckie's, recognized Dillabough and Lynn from their previous visits to Chuckie's. Dillabough and Lynn provided photographic identification to Giunta and properly endorsed their money orders. Giunta paid the face amounts of the money orders to Dillabough and Lynn, less his standard 2 percent fee.

Giunta was unaware the American Express money orders that he cashed had been stolen. The two Dillabough money orders were stolen from the premises of Chase

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Savings Bank and the Lynn money order was stolen from the shipment to I. W. Levin and Company. After being cashed at Chuckie's, the money orders traveled the regular bank collection routes and were presented for payment at the United Bank of Grand Junction, Colorado. Because American Express had noted on its "fraud log" that the money orders were stolen, they were returned to Chuckie's bearing the stamp "REPORTED LOST OR STOLEN - DO NOT REDEPOSIT." American Express refused to pay Chuckie's the face amounts of the money orders. Chuckie's then sold the Dillabough and Lynn money orders to Triffin, a commercial discounter. [1] Pursuant to [*555] written agreements, Chuckie's assigned all of its right, title and interest in the money orders to Triffin.

1 Triffin testified that he regularly purchases various types of choses in action from members of the check cashing industry. Although a law school graduate, Triffin is not a member of the Pennsylvania Bar and he is proceeding *pro se* in this appeal.

Triffin filed separate complaints in the Court of Common Pleas of Philadelphia County (trial court) against Dillabough and American Express on July 16, 1992, and against Lynn and American Express on August 20, 1992, seeking payment of the money orders. The trial court consolidated the two actions. Triffin obtained default judgments against Dillabough and Lynn and proceeded to a non-jury trial with American Express. The trial court found that the money orders were not negotiable instruments and entered a verdict in favor of American Express. On appeal, the Superior Court reversed the trial court and held that the money orders were negotiable instruments and Triffin had the status of a holder in due course, entitling him to recover the face amount of the money orders from American Express. We granted American Express' Petition for

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Allowance of Appeal from the Order of the Superior Court, and we now affirm. [2]

2 Dillabough and Lynn did not appeal the default judgments entered against them to the Superior Court and they are not parties to the present appeal before this Court.

DISCUSSION

When this Court entertains an appeal originating from a non-jury trial, we are bound by the trial court's findings of fact, unless those findings are not based on competent evidence. T*hatcher's Drug Store v. Consolidated Supermarkets, Inc., 535 Pa. 469, 636 A.2d 156 (1994)*. The trial court's conclusions of law, however, are not binding on an appellate court because it is the appellate court's duty to determine if the trial court correctly applied the law to the facts. *Id*.

I. Negotiability

The Superior Court has described the purpose of negotiable instruments and the Commercial Code as follows:

[*556] A negotiable instrument is an instrument capable of transfer by endorsement or delivery. Negotiability provides a means of [**608] passing on to the transferee the rights of the holder, including the right to sue in his or her own name, and the right to take free of equities as against the assignor/payee. [Citations omitted] The purpose of the Commercial Code is to enhance the marketability of negotiable instruments and to allow bankers, brokers, and the general public to trade in confidence. [Citations omitted] As a matter of sound economic policy, the Commercial Code encourages the free transfer and negotiability of commercial paper to stimulate financial interdependence. *Manor Bldg. Corp. v. Manor Complex Assocs., 435 Pa. Super. 246, 252-253, 645 A.2d*

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843, 846(1994) (*en banc*). With these principles in mind, we turn to a discussion of the American Express money orders at issue here.

The threshold question is whether the money orders qualify as negotiable instruments under Division Three of the Commercial Code, 13 Pa. C. S. '3101, *et seq*., which governs negotiability. [3] Both parties agree that if the money orders are not negotiable instruments then Triffin's claims against American Express must fail. Initially, we note that the Commercial Code does not specifically define the term "money order", nor does it provide a descriptive list of financial documents that automatically qualify as negotiable instruments. Instead, 13 Pa. C. S. '3104(a) sets forth the following four part test to determine if a particular document qualifies as a negotiable instrument:

3 On July 9, 1992, the Pennsylvania General Assembly enacted amendments to the Commercial Code, effective July 9, 1993. All of the transactions in this case occurred before the effective date of the 1992 amendments, and therefore, the Commercial Code as it existed before the 1992 amendments controls this case. References in this Opinion to the Commercial Code are to the Act of November 1, 1979, P. L. 255, No. 86, § 1, unless otherwise noted. Although the Commercial Code has been revised, its basic provisions survived the 1992 amendments. We expect that this Opinion will provide guidance for transactions conducted pursuant to the Commercial Code as amended in 1992.

(a) Requisites to negotiability.-Any writing to be a negotiable instrument within this division must:

[*557] (1) be signed by the maker or drawer;

(2) contain an unconditional promise or order to pay a sum certain in money and no other promise, order,

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obligation or power given by the maker or drawer except as authorized by this division;

(3) be payable on demand or at a definite time; and

(4) be payable to order or to bearer.

13 Pa. C. S. § 3104(a).

The Superior Court described the face of the money orders in question as follows:

Prior to being stolen [,] the American Express money orders read: "AMERICAN EXPRESS MONEY ORDER CHASE SAVINGS BANK DATE (blank). PAY THE SUM OF (blank), NOT GOOD OVER $1,000, TO THE ORDER OF (blank). Louis V. Gerstner, Chairman. SENDER'S NAME AND ADDRESS (blank). Issued by American Express Travel Related Services Company, Inc., Englewood, Colorado. Payable at United Bank of Grand Junction, Downtown, Grand Junction, Colorado." The two Dillabough instruments were in this form. The third Lynn instrument was identical, except it did not bear an authorized agent's name, e. G., Chase Savings Bank, and was not good for over $200. T*riffin v. Dillabough, 448 Pa. Super. 72, 82, 670 A.2d 684, 689 (1996)*. When presented at Chuckie's, the sections for date, amount, payee and sender had been completed.

The first requisite of negotiability, a signature by the drawer or maker, "includes any symbol executed or adopted by a party with present intention to authenticate a writing." *13 Pa. C. S. § 1201*. "Authentication may be printed, stamped or written; it may be by initials or by thumbprint. The question always is whether the symbol was executed or adopted by the party with present intention to authenticate the writing." *13 Pa. C. S. § 1201*, Comment 39. Additionally, *section 3307(a)(2)* states that when the effectiveness of a signature is challenged, it is presumed to

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be genuine or authorized unless the signer has died or become incompetent. [*558] *13 Pa. C. S. § 3307(a)(2)*. Here, the [**609] drawer, American Express, affixed the pre-printed signature of Louis Gerstner, its then Chairman, to the money orders in question before forwarding them to its agents. American Express does not argue that Gerstner's signature was affixed to the money orders for any reason other than to authenticate them. Accordingly, the money orders satisfy the first requisite for negotiability.

The second requisite, American Express argues, is lacking because the money orders do not contain an unconditional promise or order to pay. Specifically, American Express claims that a legend it placed on the back of the money orders qualifies an otherwise unconditional order on the front directing the drawee to "PAY THE SUM OF" a specified amount "TO THE ORDER OF" the payee. The legend provides as follows:

IMPORTANT

DO NOT CASH FOR STRANGERS

THIS MONEY ORDER WILL NOT BE PAID IF IT HAS BEEN ALTERED OR STOLEN OR IF AN ENDORSEMENT IS MISSING OR FORGED. BE SURE YOU HAVE EFFECTIVE RECOURSE AGAINST YOUR CUSTOMER.

PAYEE'S ENDORSEMENT

According to American Express, this legend renders the order to pay conditional on the money order not being altered, stolen, unendorsed or forged and destroys the negotiability of the instrument.

We disagree. In a factually similar case, the Louisiana Court of Appeal construed a legend on the back of an American Express money order similar to the one at issue here. H*ong Kong Importers, Inc. v. American Express Co.,*

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301 So. 2d 707 (La. App. 1974). The legend there stated "CASH ONLY IF RECOURSE FROM ENDORSER IS AVAILABLE. [*559] IF THIS MONEY ORDER HAS NOT BEEN VALIDLY ISSUED OR HAS BEEN FRAUDULENTLY NEGOTIATED, IT WILL BE RETURNED." *Hong Kong Importers, 301 So. 2d at 708*. The money order also had the following language printed on its face: "KNOW YOUR ENDORSER CASH ONLY IF RECOURSE IS AVAILABLE." The Louisiana Court held that the legend on the back and the language on the front did not convert the money order into a conditional promise to pay, but merely operated as a warning to the party cashing the money order to protect himself against fraud. Although Hong Kong was decided before Louisiana adopted the Uniform Commercial Code, we find its rationale to be persuasive and applicable to *13 Pa. C. S. § 3104*.

American Express attempts to distinguish Hong Kong by asserting that the legend in this case is more specific because it explicitly conditions payment on the money orders not being altered, stolen, unendorsed or forged. This argument misses the point. "Any writing which meets the requirements of subsection [(a)] and is not excluded under *Section [3103*] is a negotiable instrument, and all sections of this [Division] apply to it, *even though it may contain additional language beyond that contemplated by this section*." *13 Pa. C. S. § 3104*, Comment 4 (emphasis added). An otherwise unconditional order to pay that meets the *section 3104* requirements is not made conditional by including implied or constructive conditions in the instrument.*13 Pa. C. S. § 3105(a)(1)*. Moreover, purported conditions on an otherwise negotiable instrument, that merely reflect other provisions of the law, do not vitiate negotiability. *State v. Phelps, 125 Ariz. 114, 608 P.2d 51 (Ariz. Ct. App. 1979)*; *see also Falk's Food Basket, Inc. v.*

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Selected Risks Ins. Co., 214 Pa. Super. 522, 257 A.2d 359 (1969); 4 William D. Hawkland & Larry Lawrence, Uniform Commercial Code Series § 3-105:03 (Clark Boardman Callaghan) (1994). Here, the alleged conditions on the back of the money orders are nothing more than a restatement of American Express' statutory defenses against payment because of alteration, *13 Pa. C. S. § 3407*, theft, *13 Pa. C. S. § 3306(4)*, absence of signature, *13 Pa. C. S. § 3401*, and forgery, *13* [*560] *Pa. C. S. § 3404*. Contrary to American Express' claims, expressing those statutory defenses in a legend with the conditional phrase "THIS MONEY ORDER WILL NOT BE PAID IF ." does not elevate the legend to a condition for the purposes of 13 Pa. C. S. '3104(a) because it is merely a restatement [**610] of the defenses present in the Commercial Code. *See 13 Pa. C. S. § 3104*, Comment 4; Phelps. The legend is simply a warning that American Express has reserved its statutory defenses. Whether these defenses are effective against Triffin is a separate question to be answered after resolving the issue of negotiability. *See 13 Pa. C. S § 3104*, Comment 4. We hold, therefore, that the money orders contain an unconditional order to pay, and satisfy the second requisite of negotiability.

The third requisite, that the writing be payable on demand or at a definite time, and the fourth requisite, that the writing be payable to order or bearer, are clear from the face of the money orders and are not disputed by the parties. Thus, the American Express money orders qualify as negotiable instruments pursuant to *13 Pa. C. S. § 3104*.

American Express contends that even if the money orders are facially negotiable, they should not be viewed as negotiable instruments because they were never issued or otherwise "placed in the stream of commerce." Issue is defined as "the first delivery of an instrument to a holder or a remitter." *13 Pa. C. S. § 3102*. Delivery is defined as the

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"voluntary transfer of possession." *13 Pa. C. S. § 1201*. American Express argues that because the money orders were incomplete when stolen and subsequently completed without authorization, the money orders were never delivered and it should have no liability for them.

Authorized completion and delivery, however, are not listed as requisites to negotiability in *section 3104.13 Pa. C. S. § 3104*. Moreover, *section 3115* specifically permits the enforcement of incomplete and undelivered instruments and provides as follows:

[*561] (a) General rule.-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.

(b) Unauthorized completion.-*If the completion is unauthorized the rules as to material alteration apply (section 3407), 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.

13 Pa. C. S.§ 3115 (emphasis added). *Section 3407* provides that the defense of unauthorized completion discharges a party from liability to any person *other than a holder in due course.13 Pa. C. S. § 3407(a)(2)*; *13 Pa. C. S. § 3407(b)*. "A subsequent holder in due course may in all cases enforce the [negotiable] instrument according to its original tenor, and when an incomplete instrument has been completed, he may enforce it as completed." *13 Pa. C. S. 3407(c)*; *see also National Loan Investors, L. P. v. Martin, 488 N. W.2d 163 (Iowa 1992)* (holder in due course can enforce notes completed without authorization where notes signed in blank); *Virginia Capital Bank v. Aetna Cas. &*

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Sur. Co., 231 Va. 283, 343 S. E.2d 81 (Va. 1986) (subsequent holder in due course can enforce note as completed even though completion unauthorized). Additionally, *section 3305* provides that a holder in due course takes a negotiable instrument free from the defense of non-delivery. *See 13 Pa. C. S. § 3305*, Comment 3.

When read together, *sections 3115*, *3407* and *3305* demonstrate that unauthorized completion and non-delivery do not prevent enforcement of an otherwise negotiable instrument. Instead, the three sections permit a holder in due course to enforce the undelivered instrument as completed. The Comment to *section 3115* explains the rationale for this rule as follows:

Since under this [Division] (*Sections 3305* and *3407*) neither non-delivery nor unauthorized completion is a defense against a holder in due course, it has always been illogical [*562] 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 [**611] check stolen and afterwards filled in to be estopped from setting up the non-delivery against an innocent party.

13 Pa. C. S. § 3115, Comment 5; *see also 13 Pa. C. S. § 3407*, Comment 4. The next question then, is whether Triffin has the rights of a holder in due course who can enforce the negotiable money orders.

II. Triffin's Status As A Holder In Due Course

Section 3302(a) describes a holder in due course as follows:

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(a) General rule.-A holder in due course is a holder who takes the instrument:

(1) for value;

(2) in good faith; and

(3) 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.*13 Pa. C. S. § 3302(a)*. Because the trial court held that the money orders were not negotiable instruments, it never answered the question of Triffin's status as a holder in due course. Ordinarily, determining the elements of holder in due course status is a task for the trier of fact. B*udget Charge Accounts, Inc. v. Mullaney, 187 Pa. Super. 190, 144 A.2d 438 (1958)*; *Northside Bank v. Investors Acceptance Corp., 278 F. Supp. 191 (W. D. Pa. 1968)*. In this case, however, where the facts are undisputed and conclusive, we can determine Triffin's holder in due course status as a matter of law. *See* UAW-CIO Local # *31 Credit Union v. Royal Ins. Co., 594 S. W.2d 276* [*563] *(Mo. 1980)*; *see also Manufacturers and Traders Trust Co. v. Murphy, 369 F. Supp. 11, 13 (W. D. Pa. 1974)*, *aff'd*, *517 F.2d 1398 (3d Cir. 1975)*.

Triffin obtained the money orders from Chuckie's pursuant to a written agreement by which Chuckie's assigned all of its right, title and interest in the money orders to Triffin. Triffin could not become a holder in due course in his own name because he had notice of American Express' defenses when he took the money orders from Chuckie's. *13 Pa. C. S § 3302(a)(3)*. However, Triffin could acquire the *status* of a holder in due course from Chuckie's through the assignment if Chuckie's was a holder in due course because a transferee acquires whatever rights the transferor had, even if the transferee is aware of the defenses to enforcement.*13 Pa. C. S. § 3201*; *see also Finalco, Inc. v. Roosevelt, 3 Cal. Rptr. 2d 865 (Ct. App.*

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1991); *DH Cattle Holdings Co., v. Kuntz, 165 A. D.2d 568, 568 N. Y. S.2d 229 (App. Div. 1991)*; *Great Western Bank and Trust Co. v. Pima Sav. and Loan Ass'n, 149 Ariz. 364, 718 P.2d 1017 (Ariz. Ct. App. 1986)*. Therefore, the focus of our inquiry is whether Chuckie's was a holder in due course.

The parties do not dispute that Chuckie's took the money orders for value. Giunta testified that he paid Dillabough and Lynn the face value of the money orders, minus a two percent fee. Thus, *section 3302(a)(1)* is satisfied. The second element of *section 3302(a)*, good faith, is defined as "honesty in fact in the conduct or transaction concerned." [4] *13 Pa. C. S. § 1201*. The evidence established that Giunta recognized Dillabough and Lynn from previous transactions and required them to present photographic identification. Additionally, although the trial court did not discuss each element of Chuckie's holder in due course status, it did opine in a [*564] discussion of its legal conclusions on the record that Chuckie's acted in good faith. Notes of Testimony, September 14, 1994 at 115-16. Moreover, American Express does not argue that Chuckie's failed to act in good faith. Based on Giunta's actions, we cannot say that the trial court erred in concluding that Chuckie's acted in good faith. Therefore, *section 3302(a)(2)* is satisfied. Regarding *section 3302(a)(3)*, there was no evidence presented that Chuckie's had any notice that the Dillabough and Lynn money orders were stolen when he cashed them. [**612] Accordingly, the record demonstrates as a matter of law that Chuckie's was a holder in due course. Because Triffin stands in Chuckie's shoes as its assignee, Triffin has attained the status of a holder in due course.*13 Pa. C. S. § 3201*.

4 The 1992 amendments to the Commercial Code define good faith specifically for use in Division Three as "honesty in fact and the observance of reasonable

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commercial standards of fair dealing." *13 Pa. C. S. § 3103(a)* (1992). The added requirement of "the observance of reasonable commercial standards of fair dealing" to the definition of good faith appears to impose a stricter test on prospective holders in due course than did the previous definition. We offer no opinion, however, about whether Giunta's conduct satisfies this new good faith standard.

American Express further contends that even if Triffin qualifies as a holder in due course, the money orders are still not enforceable because the legend on their backs limits the "tenor" of the instruments. Pursuant to *13 Pa. C. S § 3413(a)*, American Express claims that it is only obligated to pay an instrument "according to its tenor." The 1979 Commercial Code does not define "tenor." The 1992 amendments to *section 3413(a)*, however,substitute the word "terms" for the word "tenor." *13 Pa. C. S. § 3413(a)* (1992). The Comments accompanying the 1992 amendments to *section 3413* indicate that new subsection (a) is consistent with its predecessor. Therefore, it appears that no substantive change was intended by the substitution of the word "terms" for the word "tenor" and we will treat these words synonymously. Thus, American Express is essentially arguing that each money order should be enforced according to its terms, which state that the money order "WILL NOT BE PAID IF IT HAS BEEN ALTERED OR STOLEN OR IF AN ENDORSEMENT IS MISSING OR FORGED."

As previously discussed, the legend on the back of the money orders is merely a warning that restates American Express' defenses against persons other than holders in due course in the event of alteration, theft, lack of endorsement or forgery. These defenses are ineffective against a holder in [*565] due course.*13 Pa. C. S. § 3305*; *13 Pa. C. S. § 3407(c)*. Because Triffin has attained holder in due course status through the assignment of the money orders from

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Chuckie's, American Express cannot enforce the defenses against him. Accordingly, American Express is liable to Triffin for the face value of the money orders.

The Order of the Superior Court is affirmed and this matter is remanded to the trial court for the entry of an order consistent with this Opinion.

Mr. Justice Castille files a dissenting opinion in which Mr. Justice Cappy joins.

DISSENT BY: CASTILLE The majority concludes that appellee Robert J. Triffin ("appellee") is entitled to recover the value of the money orders at issue because the money orders were negotiable instruments and because appellee was a holder in due course of those negotiable instruments. However, since the money orders at issue contained express conditional language which precluded negotiability under the relevant statute, I must respectfully dissent from the majority's conclusion.

The requirements for negotiability are set forth at *13 Pa. C. S. § 3104*, which provides: [1]

1 In 1992, subsequent to the transactions at issue in this case, *section 3104* was clarified by amendment.

Requisites to negotiability.--Any writing to be a negotiable instrument within this division must:

be signed by the maker or drawer;

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 division;

be payable on demand or at a definite time; and [*566] be payable to order or to bearer.

13 Pa. C. S. § 3104 (emphasis added).

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At issue here is the second of the four statutory prerequisites to negotiability, the requirement of an "unconditional" promise or order. Regarding this prerequisite, *section 3105* provides: [2]

2 In 1992, subsequent to the transactions at issue in this case, *section 3105* was clarified and replaced by *13 Pa. C. S. § 3106*.

Unconditional promise or order.**--**A promise or order otherwise unconditional is not made conditional by the fact that the instrument:

is subject to implied or constructive conditions;

. .

[**613] The comment to *section 3105* states:

. Nothing in [paragraph (a) subsection (1)] 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.

Thus, the statute clearly distinguishes between language which creates an implied condition and language which creates an express condition. The latter renders a promise or order non-negotiable while the former does not. This conclusion derives further support from the revised *§ 3106(a)*, which provides that

". a promise or order is unconditional unless it states (1) an express condition to payment .". [3]

3 Although *section 3106* was not revised until 1992, it is axiomatic that where new legislation is merely declaratory of existing law or clarifies existing law, it may be given retroactive effect. B*anic v. Workmen's Compensation Appeal Bd. (Trans-Bridge Lines), 705 A.2d 432, 437, 550 Pa. 276 (Pa. 1997)*; *Simmonds v. State Employees Retirement System, 548 Pa. 219, 226, 696 A.2d*

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801, 804 (1997); Sutherland, Statutes and Statutory Construction § 22.34 (5th ed. 1993). The official comment to the revised section points out that the section is not changing the law. Therefore, the revised section may be given retroactive effect insofar as it provides further evidence that express conditions to payment serve as a bar to negotiability.

Here, the operative language in the money orders at issue clearly created an "express" condition and thereby rendered the money orders non-negotiable. The language at issue states:

[*567] IMPORTANT

DO NOT CASH FOR STRANGERS

THIS MONEY ORDER WILL NOT BE PAID IF IT HAS BEEN ALTERED OR STOLEN OR IF AN ENDORSEMENT IS MISSING OR FORGED. BE SURE YOU HAVE EFFECTIVE RECOURSE AGAINST YOUR CUSTOMER.

PAYEE'S ENDORSEMENT

This language explicitly conditions payments on the money orders' not being altered or stolen and the endorsements' not being missing or forged. The use of the word "if" renders the condition an express one, since "if" by definition means "on **condition** that; in case that; supposing that." Webster's New World Dict., 2d College ed. (emphasis added).

Furthermore, the official comment to revised *section 3106* explains what the code intends by drawing the distinction between implied and express conditions:

If the promise or order states an express condition to payment, the promise or order is not an instrument. For example, a promise states, "I promise to pay $100,000 to

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the order of John Doe **if** he conveys title to Blackacre to me."The promise is not an instrument because there is an express condition to payment. However, suppose a promise states, "In consideration of John Doe's promise to convey title of Blackacre I promise to pay $100,000 to the order of John Doe. That promise can be an instrument if *[section 3104*] is otherwise satisfied.

13 Pa. C. S. § 3106 (1992 amended version)(emphasis added). Accordingly, the use of the word "if" creates an express condition which otherwise might be lacking, and thereby precludes a money order from being a negotiable instrument under the statute. The language at issue in this case created the same type of express condition which is embodied in the [*568] Comment; consequently, the language precludes the money orders from being negotiable instruments. [4]

4 Additionally, I note that if there was any doubt about this conclusion, the doubt would be resolved against negotiability. See *United States v. Gonzalez, 797 F.2d 1109, 1113 (1st Cir. 1986)*("when a writing is ambiguous with respect to negotiability, the conclusion to be reached is that it is not negotiable")(emphasis added)(other citations omitted).

The reasons proffered by the majority to justify its departure from this seemingly inescapable statutory logic are strained. First, the majority cites a case, decided by the Louisiana Court of Appeal in 1974, in which a condition incorporating the word "if" was construed not to bar negotiability. [5] In that [**614] case, the Louisiana Court did not evaluate the significance of the word "if" or the significance of the condition which that word introduced. Moreover, in 1974, Louisiana had not yet adopted Article III of the Uniform Commercial Code ("UCC"). Hence, it appears that the Louisiana decision was decided against the

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backdrop of the Code of Napoleon. See 9 to 5 *Fashions, Inc. v. Petr L. Spurney, 538 So. 2d 228, 233 (La. 1989)*(discussing roots of Louisiana's civil code in the Napoleonic code). Pennsylvania, on the other hand, has adopted Article III of the UCC, which speaks directly to the issue presented in this case, as explained supra. A decision by an intermediate Louisiana appellate court interpreting French legal principles should not override the explicit statutory guidance furnished by the Pennsylvania legislature on an issue of Pennsylvania law.

5 Specifically, the condition provided: CASH ONLY IF RECOURSE FROM ENDORSER IS AVAILABLE. IF THE MONEY ORDER HAS NOT BEEN VALIDLY ISSUED OR HAS BEEN FRAUDULENTLY NEGOTIATED, IT WILL BE RETURNED. KNOW YOUR ENDORSER (sic) CASH ONLY IF RECOURSE IS AVAILABLE." *Hong Kong Importers, Inc., v. American Express Co., 301 So. 2d 707, 708 (La. App. 1974)*.

The majority also seizes on Comment 4 to *13 Pa. C. S. § 3104*, which states that "any writing which meets the requirements of subsection [(a)] and is not excluded under *Section [3103*] is a negotiable instrument, and all sections of this [Division] apply to it, even though it may contain additional language beyond that contemplated by this section" [*569] (emphasis added by majority). Since, as explained supra, the money orders contained language which precluded them from satisfying subsection (a), the quoted language from Comment 4 does not further the majority's argument.

Finally, the majority attempts to support its conclusion by referring to the principle that "purported conditions on an otherwise negotiable instrument, that merely reflect other provisions of the law, do not vitiate negotiability." Slip Op. at 9 (citations omitted). The majority contends that

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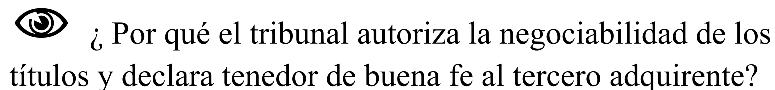
the language at issue amounts merely to a restatement of appellant's statutory defenses against payment where there has been alteration (*13 Pa. C. S. § 3407*), theft (*§ 3306(4)*), absence of signature (*§ 3401*) and forgery (*§ 3404*). The majority overlooks the fact that all of these statutory defenses are, by their own terms, ineffective against holders in due course. On the other hand, the language at issue here - which categorically states that the money order will not be paid if it was stolen -- is operative even against holders who have taken in due course. As noted in the Comment to *section 3105(a)(1)*, conditional language may be fairly construed to mean what it says. By its plain terms, the language at issue here sweeps beyond the scope of appellant's statutory defenses, and therefore does more than simply "reflect other provisions of the law."

In sum, the statute at issue in this case is devoid of ambiguity, and the application of that statute to these facts compels a conclusion contrary to that reached by the majority. Consequently, I respectfully dissent.



¿ Por qué el tribunal autoriza la negociabilidad de los títulos y declara tenedor de buena fe al tercero adquirente?

IV. ARTÍCULO 4 SOBRE DEPÓSITOS BANCARIOS

A. LA LEGISLACIÓN COMERCIAL VIGENTE Y EL CONTRATO CELEBRADO ENTRE EL DEUDOR Y EL ACREEDOR

CRESCENT WOMEN'S MEDICAL GROUP, INC., plaintiff, v. KEYCORP, D. B. A. KEYBANK, defendant. STATE OF OHIO, COURT OF COMMON PLEAS, HAMILTON COUNTY 127 Ohio Misc. 2d 93; 806 N. E.2d 201 April 4, 2003, Decided

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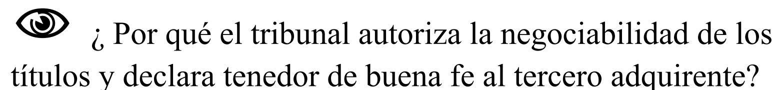
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OPINION BY: CRUSH [**P1] This matter is before the court upon motion for summary judgment filed on behalf of defendant.

[**P2] In January 1977, Mary Kurtz was hired as executive director of Crescent Women's Medical Group, Inc., with authority to fill out, sign, and issue checks on behalf of Crescent. From August 1999 to March 2001, Kurtz and Mary Suhr, a subordinate employee, used ATM machines to deposit to their own accounts 40 Crescent checks made payable to various corporate Crescent creditors. All of the checks were unendorsed, six of them having the words "for deposit only" written on the back. Apparently, defendant KeyBank did not check the name of the payee on any of these checks.

%%03] [**P3] Various theories of defense have been asserted by defendant, one of them pertaining to a contractual limitations period.

[**P4] The KeyBank "business non-personal signature card", executed September 30, 1997, authorizing KeyBank to accept the signature of Mary Kurtz (and others) on checks, reads:

"KeyBank *** is authorized to recognize any of the signatures subscribed above for the transaction of any business for the Account in connection with funds belonging to the Entity for whom this Account is titled. ***

"It is agreed that all transactions on this Account shall be subject to the existing Deposit Agreement and Disclosures. *** By executing this signature [*95] card each signer shall be bound by the terms and conditions of said Deposit Agreement and Disclosures. ***"

[**P5] The relevant deposit account agreement, effective June 17, 1996, reads, at pages 5 and 5:

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"10. Account Statements: Limitation on Time to Report Forgers and Errors. You should review and balance your Account statements promptly after you receive them. *** You must review your statements to make sure that there are no errors in the Account information.

"On Accounts with check-writing privileges, you must review your statement and any canceled checks we send you and report forgeries, alterations, *missing signatures*, *** or other information which might lead you to conclude that the check was forged. *** You should notify us as soon as possible if you think there is a problem. ***"

"You must notify us as soon as possible if you believe there is an error, forgery or other problem with the information shown on your Account statement. You agree that fourteen (14) days after we mailed a statement *** is a reasonable amount of time for you to review your Account statement and report any errors, forgeries or other problems. In addition, you agree not to assert a claim against us concerning any error, forgery or other problem relating to a matter shown on an Account statement unless you notified us of the error, forgery or other problem within sixty (60) days after we mailed you the statement. *** This means, for example, that you cannot bring a lawsuit against us, even if we are at fault, for paying checks bearing a forgery of your signature unless you reported the forgery within sixty (60) days after we mailed you the statement *** listing the check we paid." (Emphasis added.)

[**P6] An agreement reducing the statutory time for bringing an action against a bank can be legally enforceable:

"As noted, although *§ 404.406(4), Stats., 1991-2*, provided that the notice must be made 'within one year from the time the statement and items are made available to the customer,' Firstar Bank contends that this one-year

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period was lawfully reduced to fourteen days by the clauses quoted above from Borowski's agreements with Firstar Bank. *** Borowski *** asserts that the attempted modification was ineffective because *§ 404.406(4), Stats., 1991-2*, prevents any agreement between a bank and it customer from 'disclaiming a bank's responsibility for its own lack of good faith or failure to exercise ordinary care or *** limiting the measure of damages for such lack or failure.' We disagree -- it is not the *agreement* *** that gives the bank immunity even if it is negligent ***; all the agreement does is reduce the time within which the customer must notify the bank of an unauthorized signature %%04] or alteration from one year to fourteen days. ***"

[*96] "The only other reported case that we were able to find that addresses the precise question at issue here, *Parent Teacher Ass'n v. Manufacturers Hanover Trust Co., 138 Misc. 2d 289, 524 N. Y. S.2d 336*, *** approved a reduction from one year to fourteen days without regard to whether or not the bank was negligent. ***"

"Conditions precedent as shortened periods of limitation similar to those at issue here have been routinely accepted in the banking relationship. *** Such provisions are not only compatible with statute and case law; they are in accord with public policy by limiting disputes in a society where millions of bank transactions occur every day." *Borowski v. Firstar Bank Milwaukee (1998), 217 Wis.2d 565, 574, 578, 579 N. W.2d 247*.

[**P7] In the instant matter, it is undisputed that no notice was given to KeyBank of the missing endorsements for well over 60 days. KeyBank claims that it is entitled to summary judgment pursuant to the foregoing authority.

[**P8] The court finds that the contractual obligation placed upon the check writer to check for "missing signatures" pertains to signatures missing on the face of the

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check, not to missing endorsements, and further finds that the contractually shortened limitation period does not apply in this case. These findings are based upon several considerations:

[**P9] First, *R. C. 1304.35* (UCC 4-406) reads:

"(C) If the bank sends *** a statement of account or items *** the customer must exercise reasonable promptness in examining the statement or the items to determine whether any payment was not authorized because of an alteration of an item or because a purported signature by or on behalf of the customer was not authorized. ***"

[**P10] The official comments to the Uniform Commercial Code regarding this section read:

"Section 4-406 imposes no duties on the drawer to look for unauthorized endorsements."

[**P11] There is no reason to believe that the contractual requirements for examining the statement exceed those required by statute. Thus, the phrase "missing signatures" should not be interpreted to include a lack of endorsement.

[**P12] Second, a significant number of unendorsed Crescent checks were processed by both KeyBank, and later Fifth Third Bank. This processing indicates that such processing was common and, in itself, no evidence of misappropriation.

[**P13] Third, it is legally permissible to pay a check to the payee without the payee's endorsement, and thus lack of endorsement is not, in itself, evidence of misappropriation:

"***An endorsement in and of itself does not make a check properly payable. Concededly, it is in the best

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interest of the receiving banks to obtain the payee's endorsement because the effect of no endorsement is to prevent negotiation of the check (*R. C. 1303.23* [*UCC 3-202*]), to deny holder status to subsequent possessors of the check (*R. C. 1303.30* [*UCC 3-301*]), and to prevent obtaining the protected status as holders in due course (*R. C. 1303.34 [UCC 3-305*]). Furthermore, if a bank negligently fails to obtain an endorsement, it may be liable in negligence for any loss sustained as a proximate cause of the breach of its duty to obtain an endorsement. ***Where the party intended by the drawer does, in fact, receive the%%05] funds, *** no breach has occurred as between the bank and its customer as the bank has followed the order of its customer by paying the proper and named payee. In other words, payment to the payee or to someone authorized by the payee to receive the proceeds for the payee's benefit, albeit without formal endorsement, satisfies *R. C. 1304.24(A)* as a proper payment of the drawer's funds." (Emphasis added.) *Ohio Bell Tel. Co. v. BancOhio Natl. Bank (1985), 27 Ohio App. 3d 8, 9, 27 Ohio B. 8, 499 N. E.2d 327.*

[**P14] Fourth, nothing on the back of the unendorsed checks involved in the instant matter indicated that the check funds were deposited in the wrong account:

"3. *** We saw no irregularities. *** All checks appeared to be written to legitimate vendors or creditors, and expenditures were generally within the parameters anticipated by Crescent in its annual budgets. ***

"4. *** The items on the front of the checks appear to correspond to the information contained in the check register. There is nothing on the back of the checks that indicate to us that the checks were deposited to any account other than the named payees." Affidavit of Thomas J. Ruberg.

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[**P15] Fifth, *Parent Teacher Assn.,* supra, provided the precedent for the *Borowski* rationale. *Parent Teacher Assn.* holds:

"The code permits parties to a contract of deposit to agree between themselves as to their duties, and the legal consequences to flow from breach, *provided that the agreement does not disclaim the bank's responsibility for its own *** failure to exercise ordinary care. ***"*

"The certificate *** provides the following condition precedent to suit in paragraph 8: 'Unless this association shall notify the Trust Company in writing with 14 calendar days of the delivery *** of any statement of account and cancelled vouchers, of any claimed errors *** said Trust Company shall not [*98] be liable for any payments made and charged to the account *** or for any other error. ***"

"*Neither provision constitutes an unlawful disclaimer* of the bank's liability." (Emphasis added.) *Parent Teacher Assn. v. Manufacturers Hanover Trust Co. (1988), 138 Misc. 2d 289, 292, 524 N. Y. S.2d 336*.

[**P16] The deposit account agreement in the instant matter, quoted from above, contains the following statement:

"This means, for example, that you cannot bring a lawsuit against us, *even if we are at fault*, for paying checks bearing a forgery of your signature unless you reported the forgery within sixty (60) days. ***" (Emphasis added.)

[**P17] The language "even if we are at fault," in effect, disclaims the bank's responsibility for its own failure to exercise ordinary care. Such a disclaimer would invalidate the shortened, contractual period of limitations, according to *Parent Teacher Assn.*

[**P18] In short, there was no contractual or statutory duty upon plaintiff to search for lack of endorsement on

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checks, and no inference that the check funds were placed in the wrong account could reasonably be inferred from lack of endorsement. The contractual limitation period, excusing KeyBank for its own negligence, is invalid.

[**P19] A second theory of defense arises out of the "imposter rule". The imposter rule is described as follows:

"If an impostor, by use of the mails or otherwise, induces the issuer of an instrument to issue the instrument to the%%06] impostor.. By impersonating the payee of the instrument.. An indorsement of the instrument by any person in the name of the payee is effective as the indorsement of the payee in favor of a person who, in good faith, pays the instrument. ***" *R. C. 1303.44(A)* -- analogous in part to former *R. C. 1303.41*.

"The padded-payroll or fictitious-payee defense, also known as the imposter rule, validates a forged payee's indorsement whenever the drawer or his employee has designated as payee someone who is not really intended to have an interest in the instrument. In such a case, good title passes to a subsequent transferee and the instrument will be properly payable out of the drawer/employer's bank account, despite a forged payee indorsement. *Ed Stinn Chevrolet, supra, 28 Ohio St. 3d at 227-228, 28 Ohio B. at 310-311, 503 N. E.2d at 530-532*;*Hinkle v. Cornwell Quality Tool Co. (1987), 40 Ohio App.3d 162, 169, 532 N. E.2d 772, 779*.

"The theory behind *R. C. 1303.41(A)* is that the risk of loss caused by a dishonest employee should be placed on the employer rather than the subsequent holder bank because the employer is normally in a better position to [*99] prevent such forgeries by reasonable care in the selection or supervision of employees, or, if not, is at least in a better position to cover the loss by fidelity insurance. *Ed Stinn Chevrolet, supra, 28 Ohio St.3d at 228, 28 Ohio*

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B. at 311, 503 N. E.2d at 531-532; White & Summers*, supra*, at 794, Section 16-4. Furthermore, under *R. C. 1303.41(A)*, the negligence of a bank in accepting an instrument with a forged payee indorsement is immaterial, as the statute is silent on the issue of the bank's lack of care. *Hinkle, supra, 40 Ohio App.3d at 172, 532 N. E.2d at 781-782*; White & Summers*, supra*, at 801-802, Section 16-4." *Golden Years Nursing Home (No. 2), Inc. v. Gabbard (1994), 94 Ohio App.3d 430, 435, 640 N. E.2d 1186.*

[**P20] In the court's opinion, the impostor rule is not relevant to the instant matter. The impostor rule is based on the concept that the employer is normally in a better position than a bank to prevent forgeries by exercising reasonable care in the selection and supervision of employees. In other words, it is more convenient and practicable for an employer to stop forgeries by careful hiring and supervision than it is for a bank to detect forgery. This reasoning does not apply, however, to the situation where there is no forgery but only a deposit into the wrong account. It is certainly a simpler and more logical requirement for a bank to read the name of the payee and deposit funds accordingly than for an employer to intuit somehow that the bank is neither reading the name of the payee nor depositing the funds into the account of the payee. That is arguably why the imposter statute refers to an endorsement and not to a lack of endorsement. Additionally,the rationale behind the impostor rule as explained in *Golden Years Nursing Home, supra*, involves a situation where the designated payee is not the person really intended to have an interest in the instrument. In the instant matter, the designated payees were, in every case, exactly the persons who were intended to receive the funds. They simply were not given the funds.

[**P21] The basic problem here is that KeyBank, and perhaps other banks as well, simply do not read the names

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of the payees of checks deposited in an ATM machine. Such a procedure would be intolerable if practiced by tellers at the counter. The failure by banks to read the names of the payees of checks is a calculated%%07] risk, accepted for purposes of expediency.

[**P22] The evidence presented in this motion indicates carelessness on both sides. The plaintiff, among other things, was careless in not properly checking the background of prospective employees and in giving the same employees check-writing authority as well as the receipt, review, and reconciliation of all checks, bank statements, and accounts. The defendant, as a calculated risk, engaged in conduct that eliminated basic precautions. The court may not weigh the relative degree of negligence of each party:

"*** [*100] If an issue is raised on summary judgment, which manifestly turns on the credibility of a witness because his testimony must be believed in order to resolve the issue, and the surrounding circumstances place the credibility of the witness in question, the matter should be resolved at trial, where the trier of facts has an opportunity to observe the demeanor of the witness." *Killilea v. Sears, Roebuck & Co. (1985), 27 Ohio App.3d 163, 27 Ohio B. 196, 499 N. E.2d 1291*, headnote two.

"It is not the province of the trial court in ruling on a motion for summary judgment to weigh evidence, assess its probative value, decide factual issues, or choose among reasonable inferences." *Monitor-Rentenbach v. Bethlehem Steel Corp. (June 20, 1990), Hamilton App. Nos. C-890354 and C-890373, 1990 Ohio App. LEXIS 2443, 2*.

"When a trial court uses summary judgment to terminate litigation, it cannot assess the credibility of the witnesses or the weight of the evidence in determining if there is an actual need for a trial. See *Perez v. Scripps-*

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Howard Broadcasting Co. (1988), 35 Ohio St.3d 215, 218, 520 N. E.2d 198, 202; *Dunville v. Physician-Care, Inc. (Aug. 23, 1989), Hamilton App. No. C-880342, 1989 Ohio App. LEXIS 3249, 1989 WL 97445*." *Smith v. Cincinnati Gas & Elec. Co.(1991), 75 Ohio App.3d 567, 571, 600 N. E.2d 325*.

"It is improper to render summary judgment if the court would be required to pass upon the credibility of witnesses or to weigh their testimony before reaching its conclusion. *Killilea v. Sears, Roebuck & Co. (1985), 27 Ohio App.3d 163, 27 OBR 196, 499 N. E.2d 1291*.'The purpose of summary judgment is not to try the issues of fact, but rather to determine whether triable issues of fact exist.' * * * *Viock v. Stowe-Woodward Co. (1983), 13 Ohio App. 3d 7, 15, 13 Ohio B. 8, 16, 467 N. E.2d 1378, 1386*. It is generally inappropriate to consider either 'the quantum' or the 'superior credibility' of evidence in considering summary judgment. *Hirschberg v. Albright (Ohio App. 1974), 67 Ohio Op. 2d 219, 322 N. E.2d 682, 683*." *Halley v. Grant Trucking, Inc. (1990), 67 Ohio App.3d 357, 364, 587 N. E.2d 305*.

[*P23] [**P23] For all of the foregoing reasons, the court finds that the motion for summary judgment is not well taken.

[**P24] This matter is set for a scheduling conference on April 17, 2003, 8:45 a. M., at or before which time counsel shall present an entry, properly endorsed, denying summary judgment. The court will, in the meantime, have this decision journalized.

Judgment accordingly.

¿Hasta qué punto estará el juez facultado para ajustar los contratos que los bancos realicen con sus clientes?

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V. ARTÍCULO 4A SOBRE LA TRASFERENCIA DE FONDOS

A. LA TRANSFERENCIA ELECTRÓNICA DE FONDOS

CORFAN BANCO ASUNCION PARAGUAY, a foreign banking corporation, Ap-pellant, vs. OCEAN BANK, a Florida bank, Appellee. COURT OF APPEAL OF FLORIDA, THIRD DISTRICT 715 So. 2d 967; 35 U. C. C. Rep. Serv. 2d 132 June 10, 1998, Opinion Filed

OPINION BY: SORONDO [*968] Corfan Banco Asuncion Paraguay, a foreign banking corporation (Corfan Bank), appeals the lower court's entry of a Final Summary Judgment in favor of Ocean Bank, a Florida bank.

On March 22, 1995, Corfan Bank originated a wire transfer of $72,972.00 via its intermediary Swiss Bank to the account of its customer, Jorge Alberto Dos Santos Silva (Silva), in Ocean Bank. The transfer order bore Silva's name as the recipient and indicated that his account number was 01007**0**21**0**40**0** (in fact, this was a nonexistent account). Upon receipt of the wire transfer, Ocean Bank noticed a discrepancy in this number and before depositing the money, confirmed with Silva that his [**2] correct account number was 01007**6**21**6**40**6**. [1] Ocean Bank did not, however, inform Corfan Bank or Swiss Bank of the error. Once the correct number was confirmed by Silva, Ocean Bank accepted the wire transfer and credited Silva's account.

1 As indicated by the bold, underlined numbers, the three sixes in the account number had been replaced with zeros on the transfer order.

The next day, Corfan Bank became aware of the account number discrepancy and, without first checking with either Silva or Ocean Bank, sent a second wire transfer of $72,972.00 to Silva's correct account number at

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Ocean Bank. The second transfer order did not indicate that it was a correction, replacement or amendment of the March 22nd transfer. Because the information of the transfer was correct, it was automatically processed at Ocean Bank and was credited to Silva's account. Several days later, Corfan Bank inquired of Ocean Bank regarding the two transfers, maintaining that only one transfer was intended. By [**3] that time, Silva had withdrawn the proceeds of both wire transfers. [2] When Ocean Bank refused to repay $72,972.00 to Corfan Bank, this litigation ensued. Corfan Bank proceeded on two claims, one based on the *section 670.207, Florida Statutes* (1995), which codifies as Florida law section 4A-207 of the Uniform Commercial Code (UCC), and one based on common law negligence. Ocean Bank answered denying liability under the statute and also contending that the negligence claim was precluded by the preemptive statutory scheme.

2 Eventually, Silva acknowledged that he owed Corfan Bank $72,972.00 and gave Corfan a series of post-dated checks to repay that amount, plus interest. However all the checks bounced.

The trial court, emphasizing that Florida's adoption of the UCC sections concerning wire transfers did not abrogate the basic tenets of commercial law, found that Ocean Bank had not contravened *section 670.207* by crediting the erroneous March 22nd wire transfer to Silva's account. Finding that Corfan Bank was [**4] the party best situated to have avoided this loss, the court held that [*969] Corfan Bank must bear that loss and, therefore, the court granted Ocean Bank's motion for summary judgment as to count one (the UCC count). Additionally, the court dismissed count two (the negligence count).

We begin with a review of the exact language of *section 670.207(1), Florida Statutes*:

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(1) Subject to subsection (2), if, in a payment order received by the beneficiary's bank, the name, bank account number, or other identification of the beneficiary refers to a nonexistent or unidentifiable person or account, no person has rights as a beneficiary of the order and acceptance of the order cannot occur.

Corfan Bank argues that this language is clear and unambiguous, where a name or bank account number, or other identification refers either to a nonexistent or unidentified person or a nonexistent account, the order cannot be accepted. Ocean Bank responds that such a "highly technical" reading of the statute is "contrary to commercial and practical considerations and common sense." It suggests that we look to the legislative intent and conclude that the "or" in the statute should be given conjunctive [**5] rather than disjunctive effect. [3] We respectfully decline Ocean Bank's invitation to look behind the plain language of the statute and conclude that given its clarity it must be read as written.

3 See *Byte Int'l Corp. v. Maurice Gusman Residuary Trust No. 1, 629 So. 2d 191 (Fla. 3d DCA 1993)*; *Harper v. Cooper, 226 So. 2d 878 (Fla. 4th DCA 1969)*; *Infante v. State, 197 So. 2d 542 (Fla. 3d DCA 1967)*; *Dotty v. State, 197 So. 2d 315 (Fla. 4th DCA 1967)*.

In *Capers v. State, 678 So. 2d 330 (Fla. 1996)*, the Florida Supreme Court stated:

The plain meaning of statutory language is the first consideration of statutory construction. *St. Petersburg Bank & Trust Co. v. Hamm, 414 So. 2d 1071, 1073 (Fla. 1982)*. Only when a statute is of doubtful meaning should matters extrinsic to the statute be considered in construing the language employed by the legislature. F*lorida State Racing Comm'n v. McLaughlin, 102 So. 2d 574, 576 (Fla. 1958)*. *678 So. 2d at 332*. See also *Starr Tyme, Inc. v. Cohen,*

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[**6] *659 So. 2d 1064 (Fla. 1995)*; *C. W. v. State, 655 So. 2d 87 (Fla. 1995)*; *Baker v. State, 636 So. 2d 1342 (Fla. 1994)*; *State v. Jett, 626 So. 2d 691 (Fla. 1993)*; *Weber v. Dobbins, 616 So. 2d 956 (Fla. 1993)*; *In re McCollam, 612 So. 2d 572 (Fla. 1993)*; *Aetna Cas. & Sur. Co. v. Huntington Nat'l Bank, 609 So. 2d 1315 (Fla. 1992)*; *Taylor Woodrow Constr. Corp. v. Burke Co., 606 So. 2d 1154 (Fla. 1992)*; *Streeter v. Sullivan, 509 So. 2d 268 (Fla. 1987)*. These cases preclude the analysis urged by Ocean Bank. Although Ocean Bank's position has been noted in the legal literature, [4] "unambiguous language is not subject to judicial construction, however wise it may seem to alter the plain language." *Jett, 626 So. 2d at 693*. Then Chief Justice Rosemary Barkett explained the reasoning [*970] behind this principle in *Weber v. Dobbins, 616 So. 2d 956 (Fla. 1993)*:

4 One respected treatise on the Uniform Commercial Code analyzes the code provision, 4A-207(a), which is identical to the statute in question, as follows:

The requirements of subsection 4A-207(a) are stated in the disjunctive. Thus, apparently, if the payment order name and bank account number provide an identifiable or known person but "other identification of the beneficiary" refers to a nonexistent or unidentifiable person or account, subsection 4A-207(a) is literally applicable. The express deference in subsection 4A-207(a) to subsection 4A-207(b) does not appear to resolve this conundrum. Subsection 4A-207(b) provides rules only for payment orders in which the beneficiary is identified "by both name and an identifying or bank account number" in the instance in which the name and the number identify different persons.

It does not appear that this anomaly in subsection 4A-207(a) was intended; nonetheless, the subsection 4A-207(a) suggests only one preventive mechanism for

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avoiding this conundrum: the sender should include no "other identification of the beneficiary" which might "refer to a nonexistent or unidentifiable person or account." Then subsection 4A-207(a) would be harmonized with subsection 4A-207(b) as long as the name and account number refer to the same identifiable person or account. If they refer to different identifiable persons or accounts then subsection 4A-207(b) controls. If either the name or account number refers to a nonexistent or unidentifiable person then subsection 4A-207(a) is again applicable.

William D. Hawkland & Richard Moreno, Uniform Commercial Code Series, § 4A-207:01 (1993)(emphasis added).

[**7] The reason for the rule that courts must give statutes their plain and ordinary meaning is that only one branch of government may write laws. Just as a governor who chooses to veto a bill may not substitute a preferable enactment in its place, courts may not twist the plain wording of statutes in order to achieve particular results. Even when courts believe the legislature intended a result different from that compelled by the unambiguous wording of a statute, they must enforce the law according to its terms. A legislature must be presumed to mean what it has plainly expressed, and if an error in interpretation is made, it is up to the legislature to rewrite the statute to accurately reflect legislative intent. *616 So. 2d at 959-60* (Barkett, C. J., dissenting)(citations omitted).

The Supreme Court of Florida has fashioned only one exception to this general rule: "this Court will not go behind the plain and ordinary meaning of the words used in the statute unless an unreasonable or ridiculous conclusion would result from failure to do so." *Holly v. Auld, 450 So. 2d 217, 219 (Fla. 1984)*. The plain and ordinary meaning of

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the words of the statute under review do not lead to either [**8] an unreasonable or ridiculous result. As discussed more thoroughly below, one of the critical considerations in the drafting of Article 4A was that parties to funds transfers should be able to "predict risk with certainty, to insure risk with certainty, to adjust operational and security procedures, and to price funds transfer services appropriately." See 19A Fla. Stat. Ann. 15 (U. C. C. cmt. 1995). All of these goals are reasonable and assured by the plain statutory language.

In the present case, although the payment order correctly identified the beneficiary, it referred to a nonexistent account number. Under the clear and unambiguous terms of the statute, acceptance of the order could not have occurred. As the Florida Supreme Court stated in Jett:

We trust that if the legislature did not intend the result mandated by the statute's plain language, the legislature itself will amend the statute at the next opportunity. *Jett, 626 So. 2d at 693*.

As indicated above, the trial court dismissed count two of the complaint which sounded in negligence. The court concluded that the statutory scheme preempts the common law remedy of negligence. It is not clear whether the [**9] adoption of Article 4A of the UCC abrogated the common law cause of action for negligence relating to a wire transfer, as raised in count two of the complaint. The Uniform Commercial Code Comment following *section 670.102, Florida Statutes* (1995), which delineates the subject matter for chapter 670, provides in part:

In the drafting of Article 4A, a deliberate decision was made to write on a clean slate and to treat a funds transfer as a unique method of payment to be governed by unique rules that address the particular issues raised in this method

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of payment. A deliberate decision was also made to use precise and detailed rules to assign responsibility, define behavioral norms, allocate risks and establish limits on liability, rather than to rely on broadly stated, flexible principles. In the drafting of these rules, a critical consideration was that the various parties to funds transfers need to be able to predict risk with certainty, to insure against risk, to adjust operational and security procedures, and to price funds transfer services appropriately. This consideration is particularly important given the very large amounts of money that are involved in funds transfers.

[**10] Funds transfers involve competing interests -- those of the banks that provide funds transfer services and the commercial and financial organizations that use the services, as well as the public interest. These competing interests were represented in the drafting process and they were thoroughly considered. ***The rules that emerged represent a careful and delicate balancing of those interests and are intended to be the exclusive means of determining the rights, duties and liabilities of the affected parties in any situation covered by particular provisions of the Article.*** Consequently, resort [*971] to principles of law or equity outside of Article 4A is not appropriate to create rights, duties and liabilities inconsistent with those stated in this Article.

(Emphasis added). See U. C. C. § 4A-102 cmt. (1977); see also, 19A Fla. Stat. Ann. 15 (U. C. C. cmt. 1995)(emphasis added). This comment suggests the exclusivity of Article 4A as a remedy. Although the commentary to the UCC is not controlling authority, see *Solitron Devices, Inc. v. Veeco Instruments, Inc., 492 So. 2d 1357, 1359 (Fla. 4th DCA 1986)*; 1 Ronald A. Anderson, Anderson on the [**11] Uniform Commercial Code, §§ 1-102:34-:37 (1995 Revision), we are persuaded by the expressed intent of the drafters.

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In addressing this issue we restrict our analysis to the pleadings and facts of this case. In pertinent part, count two reads as follows:

Ocean Bank owed Corfan Bank a duty of care to follow the accepted banking practice of the community, and to return the funds from the first transfer to Corfan Bank upon receipt due to the reference in the first transfer to a non-existent account number.

The duty claimed to have been breached by Ocean Bank in its negligence count is exactly the same duty established and now governed by the statute. Under such circumstances we agree with the trial judge that the statutory scheme preempts the negligence claim in this case and affirm the dismissal of count two. [5] We do not reach the issue of whether the adoption of Article 4A of the UCC preempts negligence claims in all cases.

5 We note that allowing a negligence claim in this case would "create rights, duties and liabilities inconsistent" with those set forth in *section 670.207*. In a negligence cause of action, Ocean Bank would be entitled to defend on a theory of comparative negligence because Corfan Bank provided the erroneous account number which created the problem at issue and then initiated the second transfer without communicating with Ocean Bank. *Section 670.207* does not contemplate such a defense. (Oddly enough, allowing Corfan Bank's negligence claim in this case might actually inure to Ocean Bank's benefit). As explained in the comment, one of the primary purposes of the section is to enable the parties to wire funds transfers to predict risk with certainty and to insure against risk. The uniformity and certainty sought by the statute for these transactions could not possibly exist if parties could opt to sue by way of pre-Code remedies where the statute has specifically defined the duties, rights and liabilities of the parties.

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[**12] We reverse the Final Summary Judgment entered by the trial court in favor of Ocean Bank as to count one of the complaint and affirm the dismissal of count two. We remand this case for further proceedings consistent with this opinion.

DISSENT BY: NESBITT I respectfully dissent. I would affirm final summary judgment for Ocean Bank. In my view, the trial court's well-reasoned and pragmatic approach to the interpretation of *section 670.207, Florida Statutes* (1995), was the best solution to the disagreement between these parties. Corfan Bank itself was negligent in handling the wire transfer in question. Corfan Bank incorrectly listed Silva's account number on the first wire transfer order and, compounding that error, Corfan sent the second wire transfer order with no indication that it was a correction of the first. These errors caused Corfan's loss.

More important, the language of *section 670.207* does not proscribe the actions taken by Ocean Bank. *Section 670.207* precludes acceptance of a wire transfer order only if "the name, account number, or other identification of the beneficiary refers to a nonexistent or unidentifiable person or account." [**13] Considering this section in its entirety as statutory construction requires, see *Fleischman v. Department of Professional Regulation, 441 So. 2d 1121, 1123 (Fla. 3d DCA 1983)*, it seems apparent that the part of the statute that permits the receiving bank to look to "other identification" surely allows more flexibility than the majority here would permit.

In my view, the statute question should neither be construed in the disjunctive or the conjunctive. As stated above, the construction of a statute that will reject part of it should be avoided. See *Snively Groves, Inc. v. Mayo, 135 Fla. 300, 184 So. 839 (1938)*; or, as sometimes stated, "A court should avoid [*972] reading the statute so that it will

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render part of the statute meaningless." *Unruh v. State, 669 So. 2d 242, 245 (Fla. 1996)*. There are segments of this statute that plainly permit a receiving bank to look at other identification, thus affording the receiving bank more flexibility in making the correct identification than the court recognizes today.

Ocean Bank's actions seem to better comport with the overall statutory scheme relating to funds transfers [6] than the avenue supported by the court. The primary purpose [**14] of using a wire transfer of funds is to enable the beneficiary to get the funds quickly. Indeed, commercial or contract deadlines may be adversely impacted if the wire transfer does not go through quickly, as anticipated. We should recognize that the importance of speed in a wire transfer becomes even more critical in transactions involving different countries with, perhaps, different time zones. For example, if transmitting bank Corfan was closed by the time the funds were received by Ocean Bank, Ocean Bank would not have been in a position to rectify the error until the next business day--which might well render the entire reason for the transfer moot.

6 *Chapter 670, Florida Statutes* (1995).

Ocean Bank chose to use the beneficiary's name (which was properly included on the first wire transfer order) and "other identification of the beneficiary"--the fact that the account number given was similar to that of the beneficiary, as well as verification that the beneficiary was expecting the transfer--in order to [**15] accept the wire transfer and properly credit the beneficiary's account. Ocean Bank decided that there was enough information in the first wire transfer order for it, after verification, to credit the transfer to the beneficiary's account. The order contained the beneficiary's name and account number, with a few zeros replacing the correct "6"s. This information

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referred not to a "nonexistent or unidentifiable person or account" but rather to an existing customer--the intended beneficiary--and to an identifiable (through "other identification") account.

I can find no common sense reason to prohibit Ocean Bank or other banks from accepting the responsibility that goes with choosing to use "other identification" in order to deposit funds into a customer's account. Basically, by verifying with Silva that he was the intended beneficiary, Ocean Bank was correcting Corfan Bank's error. Ocean Bank was seeking to aid its customer, the intended beneficiary of the funds, in getting the funds in an expeditious manner. Had Ocean Bank erroneously deposited the funds into the wrong account, it would have to face the liability associated with that decision. However, it should not face liability [**16] because it deposited the funds into the correct account--the intended beneficiary's account. Indeed, it was only because of Ocean Bank's actions that the intended beneficiary, Mr. Silva, received the funds from the first transfer.

Moreover, as the trial court emphasized, Florida's enactment of the U. C. C. did not abrogate other common law principles applicable to commercial transactions. A longstanding equitable tenet of Florida law is that, as between two innocent parties, the party best suited to prevent the loss caused by a third party wrongdoer must bear that loss. See *Exchange Bank of St. Augustine v. Florida Nat'l Bank of Jacksonville, 292 So. 2d 361, 363 (Fla. 1974)* ("If one of two innocent parties is to suffer a loss, it should be borne by the one whose negligence put in motion the flow of circumstances causing the loss.") See also *In re International Forum of Florida Health Benefit Trust, 607 So. 2d 432, 437 (Fla. 1st DCA 1992)* ("if two innocent parties are injured by a third party, either by negligence or fraud, the one who made the loss possible

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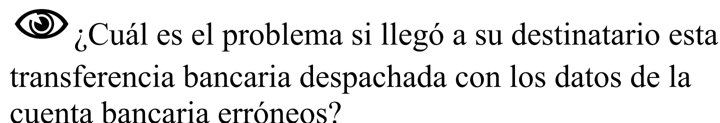
must bear legal responsibility"); *Cheek v. McGowan Electric Supply Co., 483 So. 2d 1373, 1377 (Fla. 1st DCA 1986)* [**17] ("as between [two] innocent parties, the responsibility for [a third party's fraud] rests with the party who was in the better position to protect himself .")

In a federal case applying Florida law and the U. C. C. to a "lost check" situation, a U. S. District Court held that: "a negligent defendant will prevent a plaintiff from recovering for damages under [U. C. C.] Article 4 if the defendant can demonstrate that the plaintiff [*973] was negligent and that the plaintiff's negligence played a substantial role in the plaintiff's loss." *Norstar Bank of Upstate New York v. Southeast Bank, 723 F. Supp. 187, 191-92 (N. D. N. Y. 1989)*.

Here, Corfan put in issue the question of the correlative negligence of its and Ocean's actions. It is undisputed that Corfan was initially negligent in transmittal of the first wire transfer. It realized its mistake the following business day, and sent a second wire transfer with no indication it was a correction of the former. It was entirely unnecessary to transmit additional funds merely to correct the previous days error. If it had not sent the additional funds, it is unlikely there would ever have been a dispute bringing the matter before [**18] us. Simply, Corfan Bank was in a better position to prevent the loss and, indeed, Corfan's negligence played a "substantial role" in that loss. These facts should prevent its recovery from Ocean Bank. See *Exchange Bank, 292 So. 2d at 363*; *Cheek, 483 So. 2d at 1377*; *Norstar, 723 F. Supp. at 191-92*.

For the above-mentioned reasons, I would affirm.


¿Cuál es el problema si llegó a su destinatario esta transferencia bancaria despachada con los datos de la cuenta bancaria erróneos?

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B. LA OPERACIÓN ELECTRÓNICA CON TARJETA DE CRÉDITO

FRANCIS H. AZUR, Appellant v. CHASE BANK, USA, NATIONAL ASSOCIA-TION formerly known as CHASE MANHATTAN BANK, USA, NATIONAL ASSOCIATION formerly known as FIRST USA BANK, N. A. UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT 601 F.3d 212 January 27, 2010, Argued April 1, 2010, Filed

OPINION BY: FISHER [*213] Francis H. Azur filed suit against Chase Bank, USA, alleging violations of *15 U. S. C. §§ 1643* and *1666 of the Truth in Lending Act* (TILA) and a common law negligence claim after Azur's personal assistant, Michele Vanek, misappropriated over $1 million from Azur through the fraudulent use of a Chase credit card over the course of seven years. The District Court granted Chase's motion for summary judgment, and Azur appealed. We are presented here with three discrete issues for our review. [**2] First, we must determine whether *§ 1643 of the TILA* provides the cardholder with a right to reimbursement. [*214] Second, we must evaluate whether Azur's *§§ 1643* and *1666* claims are precluded because Azur vested Vanek with apparent authority to use the Chase credit card. Third and finally, we must decide whether Azur's negligence claim is barred by Pennsylvania's "economic loss doctrine." For the reasons stated herein, we will affirm, on partly different grounds, the District Court's order granting Chase's motion for summary judgment.

I.

A.

ATM Corporation of America, Inc. (ATM) manages settlement services for large national lenders. Azur, the

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founder of ATM, served as its president and chief executive officer from 1993 until September 2007, when ATM was sold. In July 1997, ATM hired Vanek to be Azur's personal assistant. Vanek's responsibilities consisted of picking up Azur's personal bills, including his credit card bills, from a Post Office Box in Coraopolis, Pennsylvania; [1] opening the bills; preparing and presenting checks for Azur to sign; mailing the payments; and balancing Azur's checking and savings accounts at Dollar Bank. According to Azur, it was Vanek's job alone to review Azur's [**3] credit card and bank statements and contact the credit card company to discuss any odd charges. Azur also provided Vanek with access to his credit card number to enable her to make purchases at his request.

1 Azur had never been to the P. O. Box and did not have a key to it.

From around November 1999 to March 2006, Vanek withdrew without authorization cash advances of between $200 and $700, typically twice a day, from a Chase credit card account in Azur's name. [2] Azur was the sole cardholder and only authorized user on the account. Although Azur recalls opening a credit card account in or around 1987 with First USA, Chase's predecessor, [3] Azur was unaware that he had a Chase credit card.

2 When the misappropriation began in 1999, the account was at First USA Bank, National Association (First USA), Chase's predecessor. In April 2003, First USA became Bank One, Delaware, National Association (Bank One); in February 2006, Bank One merged with Chase.

3 Chase has possession of a letter dated July 20, 1999, and signed by Azur that authorizes First USA to "discuss and/or release information with my assistant Michelle Vanek." (App. at 1443A.)

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Each fraudulent transaction included a fee of approximately [**4] $2.00 and a finance charge that corresponded to the amount withdrawn, ranging from $4.00 for a $100 advance, to $21.06 for a $700 advance. The fraudulent charges were reflected on at least 65 monthly billing statements sent by Chase to Azur, and Vanek paid the bills by either writing checks or making on-line payments from Azur's Dollar Bank checking account. When writing checks, Vanek forged Azur's signature. Over the course of seven years, Vanek misappropriated over $1 million from Azur.

The transactions occasionally triggered Chase's fraud strategies. [4] On April 16, 2004, Chase detected its first potentially fraudulent transaction, made outbound calls to the account's home telephone number, and left an automated message on the number's answering machine. Chase received [*215] no response. On April 23, 2004, one week later, Chase detected a second potential problem and left another automated message at the same telephone number. Three days later, Chase received a call from someone that was able to verify the account's security questions and validate the card activity. Although Chase's records indicate that the caller was female, Chase did not use voice recognition or gender identification [**5] as a means of security verification. Finally, on May 14, 2005, approximately one year later, Chase detected a third potentially fraudulent transaction and called the home telephone number. As before, five days later, a return caller once again verified the account activity. The account was paid in full without protest after each incident. [5]

4 Chase employed a computerized fraud detection system known as FALCON, which Chase claimed was the best fraud detection tool in the industry. In addition to FALCON, Chase reviewed authorizations in real time and employed other authorization controls, including placing

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limitations on the number of ATM transactions completed in a day and on the dollar amounts of withdrawals.

5 Chase's records indicate that the calls were not made from the telephone number listed on the account.

On or about March 7, 2006, Azur discovered a suspicious letter requesting a transfer of funds from his checking account. After investigating, Azur and ATM discovered Vanek's fraudulent scheme and terminated her employment. On March 8, 2006, Azur notified Chase by telephone of the fraudulent use of the Chase account and closed the account. Thereafter, Azur sent Chase three pieces [**6] of correspondence relevant to this appeal: (1) a letter dated April 7, 2006; (2) an executed Affirmation of Unauthorized Use dated April 21, 2006; and (3) a letter dated May 17, 2006.

In the letter dated April 7, 2006, Azur notified Chase of the fraudulent use of the card, stated that he "is formally disputing that he is responsible for the payment of any unpaid charges and accompanying finance charges on [the] account" (App. at 48A), and requested statements, correspondence, and other documents regarding the account.

The Affirmation of Unauthorized Use, which Chase drafted and sent to Azur for execution, stated, "Any transaction(s) occurring on or after 10/09/2001 is/are also unauthorized." (*Id*. at 50A.) The Affirmation listed three credits, titled "unauthorized transactions," to Azur's account: (1) a "returned payment" in the amount of $10,000; (2) a "returned payment" in the amount of $20,000; and (3) a "fraudulent transaction" in the amount of $28,717.38. (*Id*.) Azur executed the document and returned it to Chase on April 21, 2006.

Finally, in the letter dated May 17, 2006, Azur once again notified Chase that he "continues to dispute any and

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all unpaid charges stemming from the [**7] [Chase account], as well as all prior fraudulent transactions on that account, which have been the subject of prior communications between you and Mr. Azur and/or his representatives." (*Id*. at 52A.)

Because Azur closed the account on March 8, 2006, the account's final billing period ended on March 6, 2006. Chase has a "policy and practice" of mailing billing statements within two days of the close of each billing cycle.

B.

On February 22, 2007, [6] Azur filed an amended complaint against Chase under *§§ 1643* and *1666 of the TILA*, *15 U. S. C. §§ 1601 et seq. (2006)*, and common law negligence. [7] On April 8, 2008, Chase filed [*216] under seal a motion for summary judgment seeking dismissal of all three of Azur's claims.

6 Azur filed his original complaint on August 16, 2006.

7 Azur's requested relief included (a) " [d] amages in the amount of all payments collected by Chase for money misappropriated and [fraudulent] purchases;" (b) " [a] n injunction restraining Chase from collecting or attempting to collect, from Mr. Azur, amounts representing money misappropriated and [fraudulent] purchases;" (c) " [a] n order requiring Chase to request the removal of the adverse credit reports that Chase made to credit reporting [**8] agencies concerning Mr. Azur's credit status, and restraining Chase from submitting any further adverse credit reports concerning Mr. Azur;" and (d) " [c] ompensatory and punitive damages for Chase's unlawful submission of adverse credit reports concerning Mr. Azur's credit status." (App. at 80A-83A.)

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On October 24, 2008, the Magistrate Judge issued a Report and Recommendation (R&R) suggesting that Azur's *§ 1643* claim proceed to trial but that Azur's other two claims be dismissed. Both parties filed objections, and Chase filed an additional motion for judgment on the pleadings for the *§ 1643* claim, arguing, based on this Court's decision in *Sovereign Bank v. BJ's Wholesale Club, Inc., 533 F.3d 162 (3d Cir. 2008)*, that *§ 1643* does not provide the cardholder with a right to reimbursement.

On January 7, 2009, the Magistrate Judge vacated his first R&R and issued a Supplemental R&R recommending that all three of Azur's claims be dismissed. The Magistrate Judge found that (1) Azur's *§ 1643* claim failed because Vanek had apparent authority to use Azur's credit card; (2) Azur's *§ 1666* claim failed because Azur did not send Chase a timely, written notice properly identifying the specific charges [**9] and amounts he was disputing; and (3) Azur's negligence claim was barred by Pennsylvania's economic loss doctrine. In light of this finding, the Magistrate Judge recommended that Chase's motion for judgment on the pleadings be dismissed as moot. On February 3, 2009, the United States District Court for the Western District of Pennsylvania adopted the Supplemental R&R, granted Chase's motion for summary judgment on all three counts, and dismissed Chase's motion for judgment on the pleadings as moot. Azur filed a timely notice of appeal.

II.

The District Court had jurisdiction pursuant to *28 U. S. C. §§ 1331* and *1367*, and we have jurisdiction pursuant to *28 U. S. C. § 1291*. "We review an order granting summary judgment de novo, applying the same standard used by the District Court." *Nicini v. Morra, 212 F.3d 798, 805 (3d Cir. 2000)* (en banc). "Summary judgment is proper where the

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pleadings, depositions, answers to interrogatories, admissions, and affidavits show there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law." *Id. at 805-06* (citing *Fed. R. Civ. P. 56(c)*). "Once the moving party points to evidence demonstrating no issue of material [**10] fact exists, the non-moving party has the duty to set forth specific facts showing that a genuine issue of material fact exists and that a reasonable factfinder could rule in its favor." *Ridgewood Bd. of Educ. v. N. E. ex rel. M. E., 172 F.3d 238, 252 (3d Cir. 1999)*. We may affirm the District Court's order granting summary judgment on any grounds supported by the record. *Nicini, 212 F.3d at 805*. "To the extent that the District Court made conclusions of law, our review is de novo." *In re Merck & Co., Inc. Sec., Derivative & ERISA Litig., 493 F.3d 393, 399 (3d Cir. 2007)* (italics omitted).

III.

Azur appeals the District Court's order granting Chase's motion for summary judgment. Azur argues that the District Court erred in dismissing (1) his *§ 1643* claim based on its conclusion that Vanek had apparent authority to make the credit [*217] card charges as a matter of law; (2) his *§ 1666* claim based on its determination that Azur failed to meet the section's notice requirement; and (3) his negligence claim as barred by Pennsylvania's economic loss doctrine. Chase, in contrast, asks that we affirm the District Court's order. In addition, Chase contends that Azur does not have a right to reimbursement [**11] under *§ 1643* and that Vanek's apparent authority also precludes Azur's *§ 1666* claim. [8] We will begin by addressing, as an initial matter, whether *§ 1643* provides Azur with a right to reimbursement. Then, we will turn to Vanek's alleged apparent authority and Azur's negligence claim, respectively. [9]

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8 Chase also argues that Azur's contributory negligence bars his negligence claim. Chase, however, likely waived this defense by failing to raise it in front of the Magistrate Judge or District Court. *See In re Ins. Brokerage Antitrust Litig., 579 F.3d 241, 262 (3d Cir. 2009)* ("For an issue to be preserved for appeal, a party must unequivocally put its position before the trial court at a point and in a manner that permits the court to consider its merits." (quotations and citations omitted)). Regardless, because we hold that Azur's negligence claim is barred by Pennsylvania's economic loss doctrine, *see* Section C, *infra*, we do not need to reach this issue.

9 Because we find that Vanek's apparent authority precludes both Azur's *§ 1643* and *§ 1666* claims, we decline to reach the issue of notice.

A. Right to Reimbursement

Chase argues that Azur cannot recover the money already paid to Chase under [**12] *§ 1643 of the TILA*. We agree. *Section 1643* does not provide the cardholder with a right to reimbursement. This is clear from the statute's language: "A cardholder shall be liable for the unauthorized use of a credit card only if ." *15 U. S. C. § 1643(a)*. "Liable" means " [r] esponsible or answerable in law" or "legally obligated." *Black's Law Dictionary* 998 (9th ed. 2009). *See also Webster's Third New Int'l Dictionary* 1302 (1993) (defining "liable" as "bound or obliged according to law or equity"). Accordingly, the statute's plain meaning places a ceiling on a cardholder's obligations under the law and thus limits a card issuer's ability to sue a cardholder to recover fraudulent purchases. The language of *§ 1643* does not, however, enlarge a card issuer's liability or give the cardholder a right to reimbursement.

We already reached this conclusion in *Sovereign Bank, 533 F.3d 162*. *Sovereign Bank* concerned, among other

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things, an indemnification action by Sovereign Bank, a card "Issuer," against Fifth Third Bank, an "Acquirer," and BJ's Wholesale Club, Inc., a "Merchant," based on Sovereign Bank's assertion that it had a duty under *§ 1643* to reimburse a cardholder's account for all fraudulent [**13] charges in excess of $50. *Id. at 164, 174*. We disagreed:

"*TILA § 1643* does not impose any obligation on issuers of credit cards to pay the costs associated with unauthorized or fraudulent use of credit cards. It simply limits the liability of cardholders, under certain circumstances, to a maximum of $50 for unauthorized charges. Indeed, *§ 1643* does not address, nor is it even concerned with, the liability of an Issuer or any party other than the cardholder for unauthorized charges on a credit card. *Section 1643* imposes liability only upon the cardholder."

Id. at 175. Faced here with the same issue in a new context, we arrive at the same outcome: *§ 1643 of the TILA* does not provide the cardholder with a right to reimbursement. [10] Accordingly, to the extent [*218] that Azur requests reimbursement under *§ 1643* for money already paid to Chase, his claim fails.

10 Although other federal courts of appeals have assumed that a right to reimbursement exists, they have done so without analysis. *See Minskoff v. Am. Exp. Travel Related Servs. Co., Inc., 98 F.3d 703, 707, 710 (2d Cir. 1996)* (holding that the "appropriate resolution" on remand of a cardholder's *§ 1643* reimbursement claim is that " [the card [**14] issuer] is liable for [the user's] fraudulent purchases from the time the credit card was issued until [the cardholder] received the first statement from [the card issuer] containing [the user's] fraudulent charges plus a reasonable time to examine that statement."); *DBI Architects, P. C. v. Am. Express Travel-Related Servs. Co.,*

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Inc., 388 F.3d 886, 888, 894, 363 U. S. App. D. C. 365 (D. C. Cir. 2004) (remanding a cardholder's *§ 1643* reimbursement claim to determine at what point the cardholder created apparent authority in the fraudulent user). *See also Asher v. Chase Bank USA, N. A., 310 F. App'x 912, 919 (7th Cir. 2009)* (stating, for statute of limitations purposes, that "a violation [of *§ 1643*] occurs when the card issuer notifies the cardholder that despite the cardholder's claim of fraud, the card issuer will not reimburse the cardholder for the disputed amount" in a nonprecedential opinion, which we cite solely due to Azur's reliance on the case at oral argument and in a subsequent Rule 28(j) letter) *and Carrier v. Citibank (S. D.), N. A., 383 F. Supp. 2d 334, 338, 341 (D. Conn. 2005)* (assuming a right to reimbursement under a card issuer's policy of "$0 liability for unauthorized use" but holding that [**15] the fraudulent user had apparent authority).

B. Apparent Authority

Vanek's alleged apparent authority is a more difficult issue. Relying on three cases, *Minskoff v. American Express Travel Related Services. Co., Inc., 98 F.3d 703 (2d Cir. 1996)*, *DBI Architects, P. C. v. American Express Travel-Related Services. Co., Inc., 388 F.3d 886, 363 U. S. App. D. C. 365 (D. C. Cir. 2004)*, and *Carrier v. Citibank (S. D.), N. A., 383 F. Supp. 2d 334 (D. Conn. 2005)*, the Magistrate Judge recommended that Azur's *§ 1643* claim be dismissed because Azur vested Vanek with apparent authority to make charges to the Chase account as a matter of law:

" [T] he plaintiff vested Michele Vanek with apparent authority to use the account, as the repeated payment of billed charges led Chase to reasonably believe the charges were authorized. Furthermore, the plaintiff's failure to

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review his account statements and his lax supervision of Vanek, in whom he delegated authority to review his statements, prepare checks on the account, and discuss routine questions with the card issuer, constituted a negligent omission that created apparent authority in Vanek to incur the charges."

(App. at 17A.) The District Court agreed and dismissed Azur's *§ 1643* claim. [**16] On appeal, Azur argues that whether he clothed Vanek with apparent authority is an issue of fact to be decided by a jury.

The application of both *§§ 1643* and *1666 of the TILA* depend, in part, on whether the fraudulent user had apparent authority to use the credit card. As stated above, *§ 1643* provides that " [a] cardholder shall be liable for the unauthorized use of a credit card" in certain circumstances. *15 U. S. C. § 1643(a)*. The term "unauthorized use" is defined as the "use of a credit card by a person other than the cardholder who does not have actual, implied, or apparent authority for such use and from which the cardholder receives no benefit." *15 U. S. C. § 1602(o)*. Relatedly, *§ 1666(a)* sets forth the procedures a creditor must follow to resolve alleged billing errors. *15 U. S. C. § 1666(a)*. Like the phrase "unauthorized use," the phrase "billing error" includes " [a] reflection on or with a periodic statement of an extension of credit that is not made to the consumer or to a person who has actual, implied, or apparent authority to use the consumer's credit card or open-end credit plan." *12 C. F. R. § 226.13(a)(1)*.

[*219] To determine whether apparent authority exists, we turn to applicable [**17] state agency law. *See* 12 C. F. R. Pt. 226, Supp. I ("Whether such [apparent] authority exists must be determined under state or other applicable law."); *Minskoff, 98 F.3d at 708* ("'Congress apparently contemplated, and courts have accepted, primary reliance

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on background principles of agency law in determining the liability of cardholders for charges incurred by third-party card bearers.'" (quoting *Towers World Airways v. PHH Aviation Sys., 933 F.2d 174, 176-77 (2d Cir. 1991)))*. In this case, the parties do not refute the application of Pennsylvania law. Citing the Restatement (Second) of Agency, the Pennsylvania Supreme Court has explained as follows:

"Apparent authority is power to bind a principal which the principal has not actually granted but which he leads persons with whom his agent deals to believe that he has granted. Persons with whom the agent deals can reasonably believe that the agent has power to bind his principal if, for instance, the principal knowingly permits the agent to exercise such power or if the principal holds the agent out as possessing such power."

Revere Press, Inc. v. Blumberg, 431 Pa. 370, 246 A.2d 407, 410 (Pa. 1968). Similarly, we have stated that under Pennsylvania [**18] law " [t] he test for determining whether an agent possesses apparent authority is whether a man of ordinary prudence, diligence and discretion would have a right to believe and would actually believe that the agent possessed the authority he purported to exercise." *In re Mushroom Transp. Co., Inc., 382 F.3d 325, 345 (3d Cir. 2004)* (quotations and citations omitted). [11]

11 Pennsylvania agency law is comparable to general agency law principles. Restatement (Second) of Agency § 8 provides that " [a] pparent authority is the power to affect the legal relations of another person by transactions with third persons, professedly as agent for the other, arising from and in accordance with the other's manifestations to such third persons," and § 27 explains that the "apparent authority to do an act is created as to a third person by written or spoken words or any other conduct of the

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principal which, reasonably interpreted, causes the third person to believe that the principal consents to have the act done on his behalf by the person purporting to act for him." Restatement (Second) of Agency §§ 8 and 27 (1958). Agency Third, adopted in 2005 and published in 2006, is similar: "apparent authority" [**19] is "the power held by an agent or other actor to affect a principal's legal relations with third parties when a third party reasonably believes the actor has authority to act on behalf of the principal and that belief is traceable to the principal's manifestations." *Restatement (Third) of Agency § 2.03* (2006).

Although the articulation of the proper agency law standard is fairly easy, the application of that standard is difficult. Two decisions of the Second and D. C. Circuits, respectively, are instructive. In both cases, the Second and D. C. Circuits held that a cardholder's negligent omissions clothed the fraudulent card user with apparent authority under facts similar to those present in the instant case.

The Second Circuit in *Minskoff* was the first court of appeals to address this issue. Minskoff served as the president and chief executive officer of a real estate firm. *98 F.3d at 706*. In 1988, the firm opened an American Express corporate credit card account and issued one card in Minskoff's name. *Id*. In 1992, Minskoff's assistant, whom the firm had recently hired, applied for and obtained an additional card to the account in her own name without Minskoff's or the firm's knowledge. [**20] *Id*. From April 1992 to March 1993, the assistant charged a total of $28,213.88 on the corporate card. *Id*. During this period, American Express sent twelve monthly billing statements to the firm's address; each statement listed both Minskoff and the assistant as cardholders and separately [*220] itemized their charges. *Id*. At the same time, American Express was paid in full by a total of twelve forged checks drawn on bank accounts maintained by either Minskoff or

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the firm at Manufacturers Hanover Trust (MHT), which also periodically mailed statements to the firm showing that the payments had been made. *Id. at 706-07, 710*. The assistant used the same system to misappropriate another $300,000 after applying for a platinum account. *Id. at 707, 710*. After discovering the fraud, Minskoff filed suit against American Express under the TILA. *Id. at 707*.

In determining whether or not the assistant had apparent authority to use the credit card, the Second Circuit began by differentiating between the acquisition and use of a credit card obtained through fraud or theft: " [W] hile we accept the proposition that the *acquisition* of a credit card through fraud or theft cannot be said to occur under the apparent [**21] authority of the cardholder, [that] should not preclude a finding of apparent authority for the subsequent *use* of a credit card so obtained." *Id. at 709*. Then, noting that " [n] othing in the TILA suggests that Congress intended to sanction intentional or negligent conduct by the cardholder that furthers the fraud or theft of an unauthorized card user," the court held that "the negligent acts or omissions of a cardholder may create apparent authority to use the card in a person who obtained the card through theft or fraud." *Id*. Applying that reasoning to the facts before it, the Second Circuit found that Minskoff's and the firm's failure to examine any of the credit card or bank statements created, as a matter of law, "apparent authority for [the assistant's] continuing use of the cards, especially because it enabled [the assistant] to pay all of the American Express statements with forged checks, thereby fortifying American Express' continuing impression that nothing was amiss with the Corporate and Platinum Accounts." *Id. at 710*. [12]

12 The Second Circuit relied in part on a New York law obligating consumers to exercise reasonable care and promptness in examining bank statements [**22] for errors.

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Minskoff, 98 F.3d at 709. According to the court, the law derived from common law obligations. *Id*.

In *DBI Architects*, the D. C. Circuit took a narrower approach. DBI was a corporation with an AMEX [13] credit card account. *388 F.3d at 888*. In 2001, DBI appointed a new account manager of its D. C. and Virginia offices. Soon thereafter, the new manager requested that AMEX add her as a cardholder on DBI's corporate account without DBI's knowledge, although AMEX sent DBI an account statement reflecting the change. *Id*. From August 2001 to May 2002, the manager charged a total of $134,810.40 to the credit card. *Id*. As in *Minskoff*, AMEX sent DBI ten monthly billing statements -- each listing the manager as a cardholder and itemizing her charges -- and the manager paid AMEX with thirteen DBI checks. *Id*. Most of the checks were signed or stamped in the name of DBI's president; none were signed in the manager's own name. *Id*. Like Minskoff, DBI eventually filed suit against AMEX under the TILA. *Id. at 888*.

13 "AMEX" is the abbreviation used by the *DBI Architects* court to refer to American Express Travel-Related Services Company. *388 F.3d at 887*.

Acquainted with the Second Circuit's decision [**23] in *Minskoff*, the D. C. Circuit decided its case on narrower grounds. Rather than fault the cardholder for merely failing to inspect monthly credit card statements, the court focused on the cardholder's continuous payment of the fraudulent charges without complaint:

[*221] "DBI is correct that its failure to inspect its monthly billing statements did not clothe [the manager] with apparent authority to use its corporate AMEX account. [However,] AMEX is correct that DBI clothed [the manager] with apparent authority to use its corporate AMEX account by repeatedly paying without protest all of

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[the manager's] charges on the account after receiving notice of them from AMEX."

Id. at 891. The court later explained its reasoning as follows:

"By identifying apparent authority as a limit on the cardholder's protection under *§ 1643*, Congress recognized that a cardholder has certain obligations to prevent fraudulent use of its card. DBI's troubles stemmed from its failure to separate the approval and payment functions within its cash disbursement process. [The manager] had actual authority both to receive the billing statements and to issue DBI checks for payment to AMEX. While DBI did not voluntarily relinquish [**24] its corporate card to [the manager], it did mislead AMEX into reasonably believing that [the manager] had authority to use the corporate card by paying her charges on the corporate account after receiving AMEX's monthly statements identifying her as a cardholder and itemizing her charges."

Id. at 893. Although the court acknowledged that payment might not always create apparent authority, it held that such authority existed as a matter of law in that case:

" [T] his is not a case involving an occasional transgression buried in a welter of financial detail. [] Nor is this a case involving payment without notice, as might occur when a cardholder authorizes its bank to pay its credit card bills automatically each month. Where, as here, the cardholder repeatedly paid thousands of dollars in fraudulent charges for almost a year after monthly billing statements identifying the fraudulent user and itemizing the fraudulent charges were sent to its corporate address, no reasonable juror could disagree that at some point the cardholder led the card issuer reasonably to believe that the fraudulent user had authority to use its card."

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Id. at 893-94 (quotations and citation omitted). Ultimately, the [**25] court remanded the case to determine at what point the manager's apparent authority began. *Id. at 894*.

We agree with the D. C. Circuit's more nuanced analysis. "Apparent authority is power to bind a principal which the principal has not actually granted but which he leads persons with whom his agent deals to believe that he has granted." *Revere Press, 246 A.2d at 410*. A cardholder may, in certain circumstances, vest a fraudulent user with the apparent authority to use a credit card by enabling the continuous payment of the credit card charges over a period of time. As the D. C. Circuit reasoned, by identifying apparent authority as a limitation on the cardholder's protections under *§ 1643*, Congress recognized that the cardholder is oftentimes in the best position to identify fraud committed by its employees.

Here, Azur's negligent omissions led Chase to reasonably believe that the fraudulent charges were authorized. Although Azur may not have been aware that Vanek was using the Chase credit card, or even that the Chase credit card account existed, Azur knew that he had a Dollar Bank checking account, and he did not review his Dollar Bank statements or exercise any other oversight over [**26] Vanek, his employee. Instead, Azur did exactly what the D. C. Circuit in *DBI Architects* cautioned [*222] against: he "fail [ed] to separate the approval and payment functions within [his] cash disbursement process." *388 F.3d at 893*. Had Azur occasionally reviewed his statements, Azur would have likely noticed that checks had been written to Chase. Because Chase reasonably believed that a prudent business person would oversee his employees in such a manner, Chase reasonably relied on the continuous payment of the fraudulent charges.

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Many of Azur's counter-arguments are beside the point. Azur asserts that *Minskoff* and *DBI Architects* are distinguishable because the fraudulent users in those cases were cardholders on the accounts. This distinction is irrelevant: Chase's belief that the fraudulent charges were authorized did not depend on whether the fraudulent charges were made by a second cardholder; Chase's belief was contingent upon the continuous payment of the fraudulent charges -- regardless of which card they were on -- without objection. Azur also focuses on Chase's failure to identify the fraud. [14] The issue, however, is whether Azur led Chase to believe that Vanek had authority to make [**27] the charges, not whether Chase's fraud-detecting tools were effective. Moreover, Vanek's ability to answer the account security questions over the telephone and the fact that Chase's fraud-detecting tools identified relatively few problems reinforce the conclusion that Chase was reasonable in believing, and did in fact believe, that the charges were authorized. In short, none of the arguments Azur has advanced persuade us to disturb the District Court's apparent authority determination.

14 First, Azur argues that Chase could not have reasonably believed that the charges were authorized because (1) Vanek's telephone calls were made from telephone numbers that did not match the number listed on the account, and (2) Vanek was female, when the account indicated that the only cardholder was male. Second, Azur contends that Chase's fraud-detecting tools, including FALCON, were ineffective because only three out of hundreds of fraudulent transactions triggered a response.

Accordingly, we hold that Azur vested Vanek with apparent authority to use the Chase credit card, thus barring his *§§ 1643* and *1666* claims.

C. Economic Loss Doctrine

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Lastly, the District Court adopted the Magistrate Judge's recommendation [**28] and held that Pennsylvania's economic loss doctrine bars Azur's common law negligence claim against Chase. On appeal, Azur contends that the Pennsylvania Supreme Court case *Bilt-Rite Contractors, Inc. v. The Architectural Studio, 581 Pa. 454, 866 A.2d 270 (Pa. 2005)*, created an exception to the doctrine that applies to Azur because Azur does not have a contractual remedy. In response, Chase argues that the *Bilt-Rite* exception is narrow and does not cover Azur's claim.

Pennsylvania's economic loss doctrine "'provides that no cause of action exists for negligence that results solely in economic damages unaccompanied by physical or property damage.'" *Sovereign Bank, 533 F.3d at 175* (quoting *Adams v. Copper Beach Townhome Cmtys., L. P., 2003 PA Super 30, 816 A.2d 301, 305 (Pa. Super. 2003))*. The doctrine "'is concerned with two main factors: foreseeability and limitation of liability.'" *Id.* (quoting *Adams, 816 A.2d at 307*). The first Pennsylvania appellate court to discuss the doctrine explained,

"To allow a cause of action for negligent cause of purely economic loss would be to open the door to every person in the economic chain of the negligent person or business to bring a cause of action. Such an outstanding burden [**29] is clearly [*223] inappropriate and a danger to our economic system."

Aikens v. Baltimore & Ohio R. R. Co., 348 Pa. Super. 17, 501 A.2d 277, 279 (Pa. Super. 1985). The Pennsylvania Supreme Court has recognized the doctrine's existence. *See Excavation Techs., Inc. v. Columbia Gas Co. of Pa., 985 A.2d 840, 841-43 (Pa. 2009)*.

The Pennsylvania Supreme Court crafted a narrow exception to the doctrine in *Bilt-Rite*, where a building contractor filed a negligent misrepresentation claim against

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an architect after its reliance on the architect's allegedly incorrect plans in its winning bid resulted in economic loss. *866 A.2d at 272*. Adopting *Section 552 of the Restatement (Second)*, which "sets forth the parameters of a duty owed when one supplies information to others, for one's own pecuniary gain, where one intends or knows that the information will be used by others in the course of their own business activities," *id. at 285-86*, the court refused to apply the economic loss doctrine to claims of negligent misrepresentation under *Section 552*: "to apply the economic loss doctrine in the context of a *Section 552* claim would be nonsensical: it would allow a party to pursue an action only to hold that, once the elements of [**30] the cause of action are shown, the party is unable to recover for its losses," *id. at 288*.

The Pennsylvania Supreme Court emphasized the narrow scope of the *Bilt-Rite* exception in *Excavation Techs*., where an excavator filed a negligent misrepresentation claim against a utility company pursuant to *§ 552* after the excavator sustained economic damages because the utility company erred in marking the locations of some of the gas lines. *985 A.2d at 841, 844*. In applying the economic loss doctrine, the court distinguished the case from *Bilt-Rite* on the grounds that, unlike architects, " [a] facility owner [] does not engage in supplying information to others for pecuniary gain. [Therefore], *§ 552(1)* and *(2)* do not apply here." *Id. at 843* (quotations and citations omitted). The court also declined to expand the exception: " [P] ublic policy weighs against imposing liability here. Permitting recovery would shift the burden from excavators, who are in the best position to employ prudent techniques on job sites to prevent facility breaches." *Id. at 844*.

We agree with Chase that the Pennsylvania Supreme Court would likely hold that the economic loss doctrine

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bars Azur's negligence claim: Azur's [**31] economic damages are unaccompanied by physical or property damage and, because Chase is not in the business of providing Azur with information for pecuniary gain, this is not the *§ 552* negligent misrepresentation case contemplated by *Bilt-Rite*. Rather, like *Excavation*, we find that Pennsylvania public policy weighs against imposing liability because cardholders, and not card issuers, are in the best position to prevent employees with access to security information from committing fraud.

Azur's main argument against the imposition of the economic loss doctrine focuses on Azur's assertion that he does not have a contractual remedy. However, we already rejected an identical argument in *Sovereign Bank*, where we applied the doctrine in a case concerning a card issuer's negligence claim against other financial institutions with which it had no contractual relationship. We explained,

"*Bilt-Rite* did not hold that the economic loss doctrine may not apply where the plaintiff has no available contract remedy. [T] he Bilt-Rite Court simply carved-out an exception to allow a commercial plaintiff to seek recourse from an 'expert supplier of information' with whom the plaintiff has no contractual [**32] relationship, in very narrow circumstances not relevant here. [] The Pennsylvania [*224] Supreme Court emphasized that its holding was limited to those 'businesses' which provide services and/or information that they know will be relied upon by third parties in their business endeavors."

Sovereign Bank, 533 F.3d at 180 (citing *Bilt-Rite, 866 A.2d at 286*). Therefore, Azur's contention that the *Bilt-Rite* exception encompasses all cases in which the plaintiff has no contractual remedy is without support.

IV.

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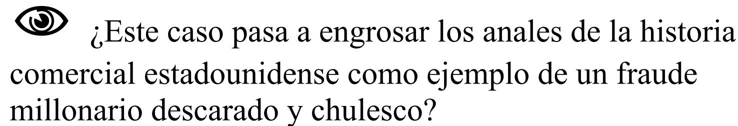
For the foregoing reasons, we will affirm, on partly different grounds, the order of the District Court. [15] As an initial matter, we hold that *§ 1643 of the TILA* does not provide the cardholder with a right to reimbursement. With regards to the specifics of the instant case, we find that Azur vested Vanek with apparent authority to use the Chase card and thus that Azur's *§§ 1643* and *1666* claims cannot stand. Finally, we hold that Pennsylvania's economic loss doctrine bars Azur's common law negligence claim.

15 We decline to reach the issue of notice under *§ 1666*. *See* note 9, *supra*.



¿Este caso pasa a engrosar los anales de la historia comercial estadounidense como ejemplo de un fraude millonario descarado y chulesco?

VI. ARTÍCULO 9 SOBRE LA PRENDA MOBILIARIA

A. LA CONSTITUCIÓN Y LA PERFECCIÓN DE LA PRENDA

LA CLASIFICACIÓN DE LOS BIENES, DERECHOS O ACCIONES QUE PUEDEN SER OBJETO DE GARANTÍA MOBILIARIA

IN RE: ROBERT O. TROUPE, DAWN LYNN TROUPE, Debtors, LYLE R. SELSON, TRUSTEE, Plaintiff, vs. JOHN DEERE CREDIT a/k/a DEERE & COMPA-NY, Defendant. UNITED STATES BANKRUPTCY COURT FOR THE WESTERN DISTRICT OF OKLAHOMA 340 B. R. 86; 59 U. C. C. Rep. Serv. 2d 23 March 10, 2006, Decided March 10, 2006, Filed

OPINION BY: Weaver [*88] Presented by the parties' cross-motions for summary judgment is the issue of whether the debtors' tractor, in which the defendant has a purchase money security interest, is consumer goods under

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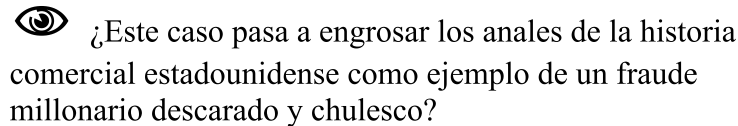
For the foregoing reasons, we will affirm, on partly different grounds, the order of the District Court. [15] As an initial matter, we hold that *§ 1643 of the TILA* does not provide the cardholder with a right to reimbursement. With regards to the specifics of the instant case, we find that Azur vested Vanek with apparent authority to use the Chase card and thus that Azur's *§§ 1643* and *1666* claims cannot stand. Finally, we hold that Pennsylvania's economic loss doctrine bars Azur's common law negligence claim.

15 We decline to reach the issue of notice under *§ 1666*. *See* note 9, *supra*.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Article 9 of the UCC. If it is, the defendant's security interest is perfected even though the defendant did not file a financing statement. If not, the defendant's security interest is unperfected and subject to avoidance. Because of representations in the security agreement regarding the debtors' intended personal use of the tractor, and for the other reasons herein stated, the court concludes that the tractor is consumer goods and that the defendant has a perfected security interest.

The Chapter 7 Trustee (the "trustee" or "plaintiff") brought this action against the defendant (the "creditor" or "Deere") seeking to avoid Deere's security interest in the tractor pursuant to *Sections 544* [**2], *549* and *550* of the Bankruptcy Code. [1] The trustee contends that Deere's admitted failure to file a financing statement renders Deere's purchase money security interest unperfected. The trustee asserts that the tractor was used and intended to be used for business, rather than personal, purposes and thus was not consumer goods under Article 9. The defendant maintains that the debtors' primary intended and actual use of the tractor was for personal, family and household purposes and hence was consumer goods. The parties acknowledge that a purchase money security interest in consumer goods is perfected upon attachment, without filing a financing statement. Conversely, they agree that with respect to non consumer goods, the filing of a financing statement is required for perfection of a non-possessory purchase money security interest.

1 Unless otherwise specified, all references are to Title 11 of the United States Code (the" Code").

Standard of Review

Summary judgment [**3] is appropriate "if the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show

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that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." *Fed. R. Bankr. P. 7056*. On a summary judgment motion, the court is required to pierce the pleadings and evaluate the actual proof to determine whether summary judgment is appropriate. *Id.* at Advisory Committee Notes. Where, as here, the parties file cross-motions for summary judgment, the court is entitled to assume that no evidence needs to be considered other than that filed by the parties. See *James Barlow Family Ltd. Partnership v. David M. Munson, Inc., 132 F.3d 1316 (10th Cir. 1997)* (citing *Harrison Western Corp. v. Gulf Oil Co., 662 F.2d 690 (10th Cir. 1981))*.

Undisputed Facts

The following material facts are undisputed:

[*89] 1. On September 24, 2004 (the "petition date"), the debtors filed their voluntary chapter 7 bankruptcy petition.

2. On the petition date, Robert O. Troupe and Dawn Lynn Troupe (the "debtors") owned a 2001 John Deere 4300 [**4] MFWD tractor, with loader and blade, (collectively, the "tractor").

3. The debtors purchased the tractor from Deere's dealer on or about July 13, 2001.

4. At the time of the purchase, the debtors lived on a 10 acre tract of land in Colorado.

5. Prior to the purchase of the tractor, the debtors applied for credit with Deere and submitted a credit application dated July 2, 2001.

6. The credit application signed by the debtors stated that the debtor Robert O. Troupe ("Robert") was not self employed but was employed in a management position

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with an automotive company earning a gross salary of $4,500 per month. The credit application also stated that the debtor Dawn Lynn Troupe ("Dawn") was employed as a professional auto body estimator earning a gross income of $36,000 per year.

7. The debtors each worked at least 60 hours per week at their respective places of employment. Dawn testified on deposition that she worked approximately 75 hours per week at her job as an estimator and two other part time jobs that she held at the same time.

8. Before purchasing the tractor, the debtors told the Deere's dealer's salesman that the debtors wanted to purchase a tractor to be used to fill [**5] irrigation ditches on their land. They also stated they wanted the tractor to be small enough to go through the gate of a horse stall. Dawn testified on deposition that she also represented to the salesman that they wanted to use the tractor for moving dirt, hay and snow.

9. Deere financed the debtors' purchase of the tractor. In connection with the financing, the debtors and Deere executed a security agreement by which the debtors granted to Deere a purchase money security interest in the tractor.

10. At the top of the first page of the executed security agreement, there were boxes labeled "Personal" and "Commercial", respectively. An "x" was placed in the box labeled "Personal", while the "Commercial" box was left blank.

11. The security agreement contained the following provision on the first page:

"Unless I otherwise certify below, this is a consumer credit transaction and the Goods will be used primarily for personal, family or household purposes." (bold type on security agreement).

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12. The security agreement also contained on the first page a conspicuous rectangular box running the entire width of the printed page within which appeared the following:

[**6] "COMMERCIAL PURPOSE AFFIDAVIT. I/We being first duly sworn, affirm and represent to Seller and its assignees that this is a commercial credit transaction, as the Goods listed above will be used by the undersigned in his/her/its business primarily for commercial purposes and will not be used primarily for personal, family or household use.

Buyer's (Debtor's) Signature

Buyer's (Debtor's) Signature

The above signature lines were left blank.

13. The purchase price of the tractor was $16,539.00.

14. At the time of their purchase of the tractor, and for the several years thereafter, [*90] the debtors boarded horses and raised cattle and pigs on their acreage. This activity was done while they were working at their full time jobs.

15. The debtors testified that they intended their farming and ranching activity on their acreage to be profitable financially.

16. On the debtors' tax returns for the years 2001, 2002 and 2003, the debtors took a deduction for depreciation on the tractor. The tax returns reflected that the tractor was used 100 percent for business.

17. The debtors' tax returns for each of the above years showed a substantial loss from ranching.

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18. Marketing information [**7] on the website of the defendant shows the subject tractor to be in the category of residential equipment.

19. In their affidavits submitted in support of the trustee's motion for summary judgment, the debtors represented that their actual use and intended use of the tractor was for the business purpose of farming and ranching.

20. The debtors' deposition testimony is that the tractor was used 90 percent of the time for personal purposes and 10 percent for business. They considered personal use as being work performed on the homestead as opposed to work done to make a living.

Conclusions of Law and Discussion

This court has jurisdiction over this adversary proceeding pursuant to *28 U. S. C. § 157*, *1334* and *11 U. S. C. § 544* and *550*. This is a core proceeding under *28 U. S. C. § 157(b)(2)(F)*.

The trustee brings this action asserting his rights under the "strong arm clause" of *§ 544(a)(1)*. Under this provision, the trustee has the rights and powers of a hypothetical lien creditor who held a judicial lien on the property in question at the time of the commencement of the [**8] bankruptcy case, whether or not there actually is such a creditor. By exercising these rights, a trustee may avoid liens on property that a lien creditor without notice could avoid. *Id.*

In bankruptcy proceedings, state law governs issues of validity and priority of security interests. *United States v. LMS Holding Company (In re LMS Holding Company), 50 F.3d 1526 (10th Cir. 1995)*; *In re Copper King Inn, Inc., 918 F.2d 1404 (9th Cir. 1990)*. The parties do not dispute that Colorado law applies here. [2] Under *C. R. S. § 4-9-*

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317(a)(2), the holder of an unperfected security interest is subordinate to the rights of one who became a lien creditor before the security interest was perfected. A lien creditor includes a trustee in bankruptcy. *C. R. S. §4-9-102(a)(52)*. Thus, Deere must have held a perfected security interest to prevail over the trustee in bankruptcy. It is not disputed that if the tractor is classified as consumer goods under the UCC, Deere held a perfected purchase money security interest despite the fact that a financing statement was not filed. *C. R. S. §4-9-309(1)* [**9] If the tractor is not consumer goods, however, Deere is not perfected. *C. R. S. §4-9-310*.

2 The State of Colorado has adopted the Uniform Commercial Code. *See C. R. S. § 4-1-101 et seq.*

Consumer goods are "goods that are used or bought for use primarily for personal, family or household purposes." *C. R. S. §4-9-102(a)(23)*. The other possible classification for the tractor, and the one [*91] supported by the trustee is that of equipment. Equipment is defined as "goods other than inventory, farm products or consumer goods" *C. R. S. § 4-9-102(a)(33)*.

The classification of collateral is to be determined as of the time of the creation of the security interest. The classification does not change because of a later change in the manner in which the collateral is used. *Franklin Investment Co. v. Homburg, 252 A.2d 95 (D. C. 1969)*; *First Wisconsin Nat'l Bank v. Ford Motor Credit (In re Voluntary Assignment of Watertown Tractor & Equipment Co.), 94 Wis. 2d 622, 289 N. W.2d 288 (Wis. 1980)*; [**10] *Sears, Roebuck & Co. v. Integra Nat'l Bank (In re Fiscante), 141 B. R. 303 (Bankr. W. D. Pa. 1992)*. If the law were otherwise, a secured party would be required to continually monitor the use that was being made of the collateral.

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From reviewing the affidavits of the debtors submitted in support of the trustee's motion for summary judgment, and their deposition testimony, it is not completely clear what oral representations the debtors may have made to Deere's dealer regarding their intended use of the collateral. Robert says he told the salesman that he needed a tractor that was large enough to move dirt to fill irrigation ditches on his land, but small enough to get through a horse stall door. Dawn says she told the salesman they wanted the tractor to do a number of other things on their land in addition to filling the irrigation ditches. Yet nowhere in the debtors' sworn testimony is there any evidence that they told Deere's representative that the tractor was to be used in any type of commercial activity.

The debtors state that they were in the farming and ranching business on their 10 acre tract. They testified that they boarded horses and raised some livestock. [**11] Their intention was to make a profit, they said. Their income tax returns reflected that they were involved in ranching, although it was not a profitable endeavor. While the tax returns indicated that the tractor was used 100 percent for business purposes, the debtors' deposition testimony is that 90 percent of the use was personal. [3] Assuming that all of this testimony is true, it nevertheless relates to events subsequent to the attachment of the security agreement. The focus, however, must be on the intended use of the collateral when the security interest was granted.

3 The debtors attempted to explain that they intended "personal" to mean work done on their homestead as opposed to work done to make a living.

At the outset, the debtors gave no indication to Deere that they were engaged in a business activity. Their credit application represented that they were both employed,

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together earning $90,000 per year. Robert represented in the credit application that he was not self employed. They worked long hours [**12] at their jobs - Robert 60 hours per week and Dawn about 75 hours per week.

The security agreement that the debtors signed reflected that it was a "Personal" rather than a "Commercial" transaction. The body of the document stated unequivocally that it was a consumer credit transaction and that the tractor was intended to be used for personal, family or household purposes.

The case law is clear that where a debtor makes an affirmative representation in loan documents that he or she intends to use goods primarily for personal, family or household purposes, the creditor is protected even if the representation turns out to be erroneous. 1 Barkley Clark, THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE P12-02 [*92] [3] (rev. Ed. 2005). (". just about every case that has dealt with this issue holds that the dealer can rely on the debtor's written 'consumer representation'"). In *Sears, Roebuck & Co. v. Pettit (In re Pettit), 18 B. R. 8 (Bankr. E. D. Ark. 1981)*, the debtor bought goods for use in his rental business. Yet the debtor did not inform the seller of his intended use. The security agreement "affirmatively and unambiguously represented" that the [**13] debtor was purchasing the collateral for personal, family or household purposes." *Id. at 9*. The bankruptcy court rejected the admission of extrinsic evidence to contradict the unambiguous representation in the security agreement of the debtor's intended use of the collateral. The *Pettit* court held that the seller's purchase money security interest was properly perfected without filing a financing statement, observing that the secured party was not required by the UCC to monitor the debtor's use of the collateral in order to determine its proper classification. In accord is *McGehee v.*

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Exchange Bank & Trust Co., 561 S. W.2d 926, 930 (Tex. App. 1978) ("the intent of the debtor-purchaser at the time of the sale when. [the] security instrument attached to the collateral is controlling, and no creditor is required to monitor the use of the collateral in order to ascertain its proper classification.")

The rationale of *Pettit* is compelling. A debtor who makes representations in a security agreement regarding the intended use of the collateral should be bound by those representations. That is especially true where the debtors fail to inform the [**14] creditor that they intend to use the collateral for other than personal, family or household purposes. The classification of the collateral, for purposes of perfection of the security interest, is determined when the security interest attaches. The later use of the collateral for another purpose than as stated in the security agreement is irrelevant in determining whether the security interest is perfected.

According to the security agreement here, the debtors intended to use the tractor as consumer goods. Deere was entitled to rely on the debtors' representation. The debtors did not inform Deere of a different intended use. Therefore, Deere's purchase money security interest was perfected when it attached, and the filing of a financing statement was not required. The security interest remains perfected despite any subsequent use for purposes other than consumer, if indeed there was such other use.

The trustee argues that he should not be bound by the debtors' representations in the security agreement because the debtors did not know of the representations. However, one who signs an agreement is bound by its terms, although ignorant of them, absent fraud or false representation. [**15] *Elsken v. Network Multi-Family Security Corporation, 49 F.3d 1470 (10th Cir. 1995)*. As there is no

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allegation of fraud or false representation regarding the security agreement, this argument is without merit.

For these reasons, the court holds that Deere has a perfected purchase money security interest in the tractor. Accordingly, the defendant's motion for summary judgment is granted, and the plaintiff's motion for summary judgment is denied.

The court will enter a judgment consistent with the foregoing.

¿En qué sentido emplea el derecho estadounidense el término técnico-jurídico del *security interest*?

B. LA PRIORIDAD EN EL PAGO A LOS ACREEDORES PRIVILEGIADOS

LA OPERACIÓN DEL DERECHO REGISTRAL

In re: JOHN'S BEAN FARM OF HOMESTEAD, INC., Debtor. UNITED STATES BANKRUPTCY COURT FOR THE SOUTHERN DISTRICT OF FLORIDA, MIAMI DIVISION 64 U. C. C. Rep. Serv. 2d (Callaghan) 454 November 1, 2007, Decided

OPINION BY: ISICOFF Order granting trustee's motion for summary judgment and granting in part and denying in part William Klein's cross-motion for summary judgment

INTRODUCTION

This matter came before the Court on the Trustee's Motion for Partial Summary Judgment on Trustee's Objection to Claim No. 1 Filed by Bill Klein (CP # 36), and William Klein's Response and Cross-Motion for Summary Judgment (CP # 55). The matter under consideration is one of first impression in this district and concerns the degree of error necessary to render a financing statement

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"seriously misleading" under revised *Uniform Commercial Code section 9-506*, as adopted in Florida. For the reasons set forth below, [*386] the Court finds that William Klein's financing statement is seriously misleading and, therefore, ineffective to perfect Klein's asserted security interest. Summary judgment is accordingly granted in favor of the Trustee on his motion for summary judgment. Summary judgment [**2] is granted to Klein on his cross-motion with respect to his holding an allowed unsecured claim; the balance of the cross-motion is denied.

JURISDICTION

The Court has jurisdiction over this matter pursuant to *28 U. S. C. §1334(b)*. This is a core proceeding within the meaning of *28 U. S. C. §157(b)(1)*.

BACKGROUND

On March 20, 2007, John's Bean Farm of Homestead, Inc. (the "Debtor") filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code. William Klein (the "Creditor" or "Klein") filed a proof of claim on April 6, 2007, asserting a total claim in the amount of $152,000, claiming $120,000 was secured and $32,000 was an unsecured priority claim (Tr. Mot. Summ. J. Ex. B). On May 9, 2007, Barry E. Mukamal, in his capacity as Chapter 7 Trustee (the "Trustee"), filed an objection to the proof of claim and moved for summary judgment in his favor. Klein filed a cross-motion for summary judgment. From the affidavits, exhibits, and pleadings filed in connection with the motion and cross-motion, the material undisputed facts are as follows:

The Debtor, a Florida corporation, owned and operated a commercial bean farm in Homestead, Florida. (Tr.'s Mot. Summ. J. P 3.) On or about October [**3] 2005, Klein made a loan to the Debtor in the amount of $197,255.33, which the Debtor used to purchase a John Deere Spray

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Machine Model No. 4720 (the "Equipment"). (Tr.'s Mot. Summ. J. P 4; Klein Resp. PP 1-3.) The loan was never memorialized in writing. (Tr.'s Mot. Summ. J. P 4.) When the Debtor defaulted and was unable to make full payment by the repayment date, Klein purported to take a security interest in the Equipment, evidenced by a Security Agreement and Secured Promissory Note dated July 28, 2006. (Tr.'s Mot. Summ. J. P 4; Klein Resp. PP 4-8.) In an attempt to perfect his security interest, Klein filed a UCC-1 Financing Statement with the Florida Secured Transaction Registry [1] on August 9, 2006, which identified the Debtor as "John Bean Farms, Inc." instead of the Debtor's actual name of incorporation, "John's Bean Farm of Homestead, Inc." (Tr.'s Mot. Summ. J. Ex. A; Klein Resp. P 10.) In fact, all of the documents evidencing the transaction used the name "John Bean Farms, Inc." Subsequently, the Debtor filed a Chapter 7 petition and, shortly thereafter, Klein filed his proof of claim. (Tr.'s Mot. Summ. J. Ex. B; Klein Resp. PP 13, 15.)

1 On October 1, 2001, Florida privatized [**4] its UCC filing office and designated the Florida Secured Transaction Registry as the office in which to file a financing statement to perfect a security interest. *Fla. Stat. §679.5011*.

The Trustee filed an objection to the claim (CP # 24) contending that Klein's financing statement, which misidentified the Debtor, fails to comply with the general rule governing the sufficiency of debtor names on financing statements [2] and the concomitant safe harbor provision [3] for minor errors, and that therefore Klein's claim, if any, is unsecured. The Trustee also objected to the Klein's priority claim of $32,000. Finally, the Trustee objected to the entire claim subject to Klein providing [*387] sufficient proof that the loan was actually funded. Trustee seeks summary judgment on the first two grounds of his objection -- that is,

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that Klein's claim, if any, is neither secured nor entitled to priority status.

2 *Fla. Stat. §679.5031*

3 *Fla. Stat. §679.5061*

Klein filed a response to Trustee's motion arguing that while his financing statement failed to comply with the requirements for filing under the Debtor's actual name, the filing was, in fact, not seriously misleading and therefore, the financing statement [**5] was adequate to perfect his security interest in the Equipment. [4] Klein seeks, in his cross-motion for summary judgment, a determination that he did, in fact, fund the loan to the Debtor.

4 Klein conceded in his response that he is not entitled to a priority claim and therefore that issue is resolved in the Trustee's favor. (Klein Resp. n. 2).

It is undisputed that the Debtor's correct name was not provided on the financing statement filed. (Klein Resp. P 10.) Thus, the primary issue this Court must determine is whether the financing statement filed by Klein conforms with Florida's safe harbor provision or is seriously misleading. If the former, then Klein's lien is perfected; [5] if the latter, then Klein's lien is unperfected. A second issue is whether Klein's lien if perfected can be avoided, and the third, whether Klein has a claim at all.

5 This assumes the loan was funded since a creditor can only perfect a lien when the security interest attaches, and a security interest cannot attach until the loan is funded. *Fla. Stat. §679.2031(2)(a)*.

STANDARD OF REVIEW

Summary judgment is governed by *Fed. R. Civ. P. 56*, made applicable to bankruptcy cases pursuant to *Fed. R. Bankr. P. 7056*. Summary [**6] judgment is appropriate

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where the "pleadings, depositions, answers to interrogatories, and admissions on file, taken together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a summary judgment as a matter of law." *Fed. R. Civ. P. 56(c)*; *Celotex Corp. v. Catrett, 477 U. S. 317, 323-24, 106 S. Ct. 2548, 91 L. Ed. 2d 265 (1986)*. In determining whether a genuine issue of material fact remains for trial, the court must construe the facts and draw all reasonable inferences therefrom in the light most favorable to the party opposing summary judgment. *Cuesta v. Sch. Bd., 285 F.3d 962, 966 (11th Cir. 2002)*; *Loren v. Sasser, 309 F.3d 1296, 1301-1302 (11th Cir. 2002)*; *Andreini & Co. v. Pony Express Delivery Servs., 440 F.3d 1296, 1300 (11th Cir. 2006)*. However, the mere existence of a "scintilla of evidence" in support of the nonmovant's position will be insufficient to forestall summary judgment; "there must be enough of a showing that the jury could reasonably find for that party." *Loren v. Sasser, 309 F.3d at 1302* (quoting *Walker v. Darby, 911 F.2d 1573, 1577 (11th Cir. 1990))*; *Anderson v. Liberty Lobby, Inc., 477 U. S. 242, 252, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986)*. [**7] Summary judgment relief under *Bankruptcy Rule 7056* applies in contested matters. *Fed. R. Bankr. P. 9014*.

PERFECTION OF SECURITY INTERESTS IN FLORIDA

With certain exceptions not applicable here, perfection of a security interest in Florida occurs only when a financing statement is filed in the appropriate place. *Fla. Stat. §679.5011*. All financing statements must be filed with Florida's official filing office, the Florida Secured Transaction Registry (the "Registry"). *See Fla. Stat. §679.5011(1)(b)*. The financing statement [*388] must provide three pieces of information to be considered sufficient for perfection: (1) the name of the debtor, (2) the

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name of the secured party, and (3) the collateral covered. *Fla. Stat. §679.5021(1)*. Financing statements are indexed by debtor name; the debtor's name is the essential element to locating the financing statement. *Fla. Stat. §679.5031* cmt. 2 ("The requirement that a financing statement provide the debtor's name is particularly important. Financing statements are indexed under the name of the debtor and those who wish to find financing statements search for them under the debtor's name."). The Registry offers an online database that searchers [**8] can use to explore financing statements by the debtor name. A search under a debtor's name displays an alphabetical name list with twenty (20) entries and the exact or nearest match at the top of the Search Results screen. The commands "Previous" and "Next" appear on the results screen and direct a searcher to utilize the buttons to view "additional search results."

Section 679.5031 of the Florida Statutes sets forth the specific rules on how to sufficiently provide a debtor's name. For a debtor corporation this requirement is satisfied "only if the financing statement provides the name of the debtor indicated on the public record of the debtor's jurisdiction of organization which shows the debtor to have been organized." *Fla. Stat. §679.5031(1)(a)*.

Although the Florida statute requires that the debtor's name be precise, Florida law contains a safe harbor provision:

> A financing statement substantially complying with the requirements [of *Section 679.5031*] is effective, even if it has minor errors or omissions, unless the errors or omissions make the financing statement seriously misleading.

Fla. Stat. §679.5061(1) (the "Safe Harbor provision"). An error is minor, and the financing statement [**9]

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effective to perfect a creditor's security interest, " [i] f a search of the records of the filing office under the debtor's correct name, using the filing office's standard search logic, if any, would disclose" the creditor's financing statement. *Fla. Stat. §679.5061(2)*. Conversely, an erroneous debtor name makes a financing statement "seriously misleading" and precludes perfection if a search under the debtor's correct name would not disclose the financing statement. [6]

6 In fact, even if a financing statement using the debtor's incorrect name, is "disclosed by (i) using a search logic other than that of the filing office to search the official records, or (ii) using the filing office's standard search logic to search a data base other than that of the filing office," the financial statement would nonetheless be seriously misleading, and therefore, ineffective. *U. C. C. Code §9-506 cmt. 2 (2002)*.

"Perfect" Financing Statements before Article 9 was Revised

Under the prior statute, former *Fla. Stat. §679.402*, [7] a financing statement, in order to be effective, was sufficient if it included "the names of the debtor and the secured party, is signed by the debtor, gives an address of the secured [**10] 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. .." *Fla. Stat. §679.402(1)* (repealed). The "seriously misleading" standard applied in determining if a mistake in the name of a debtor made a financing statement unenforceable but the statute provided no formal definition of what constituted seriously misleading. [8] [*389] So long as a financing statement substantially conformed to the requirements of the statute, minor errors were not presumed to be seriously misleading. [9]

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7 (repealed Jan. 1, 2002), a codification of *former U. C. C. §402*.

8 *Fla. Stat. §679.402(7)* (repealed).

9 "(6) A financing statement sufficiently shows the name of the debtor if it gives the individual, partnership, or corporate name of the debtor, whether or not it adds other trade names or names of partners. .. (7) A financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading." *Fla. Stat. §679.402(6)-(7)*(repealed).

Absent a statutory definition, Florida courts, as well as [**11] many other courts around the country, implemented the 'reasonably diligent searcher' standard, a standard that required the reviewing court to determine, on a case-by-case basis, whether a hypothetical reasonable searcher would have been able to discover the non-conforming financing statement despite the error in a debtor's name. This "allowed judges to second-guess what searchers should or should not have been able to discover had they tried hard enough." Margit Livingston, "A *rose by any other name would smell as sweet" (or would it?); Filing and searching in Article 9's Public Records, 2007 B. Y. U. L. Rev. 111, 124 (2007)*. This standard created extensive litigation and fragmented or contradictory decisions. *See, e. G., Brushwood v. Citizens Bank of Perry (In re Glasco, Inc.), 642 F.2d 793 (5th Cir. 1981)* (holding that a financing statement that listed the debtor by the trade name in which it did business rather than its corporate name was not seriously misleading.).

Perfect Financing Statements Under Revised Article 9

A primary purpose of revised *section 9-506 of the UCC*, adopted in Florida as *Fla. Stat. §679.5061*, [10] was to replace the former reasonableness standard with a clearer standard

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[**12] based on the computerized search logic of the filing office. This represents a significant shift from the prior law. Enacted to clarify the sufficiency of debtors' names in financing statements, the revision was "designed to discourage the fanatical and impossibly refined reading of statutory requirements in which courts occasionally have indulged themselves." *Fla. Stat. §679.5061* cmt. 2. *See In re Kinderknecht, 308 B. R. 71, 75 (B. A. P. 10th Cir. 2004)* ("The intent to clarify when a debtor's name is sufficient shows a desire to foreclose fact-intensive tests, such as those that existed under former *Article 9 of the UCC*")

10 *Article 9 of the Uniform Commercial Code* (the "UCC") was substantially revised in the 1990's. The changes to *Article 9* took years to develop, but within two years after the Uniform Rule was adopted by the National Conference of Commissioners on Uniform State Laws in 1998, virtually all states adopted these changes, albeit with some modifications, as states are wont to do when adopting a uniform rule.

Courts in other states that have adopted revised *Article 9* have recognized and emphasized the purpose and importance of this change in the search standard. The Supreme [**13] Court of Kansas analyzed its own state's adoption of revised *UCC sections 9-503* and *9-506* (which adoption is virtually identical to the Florida language) and noted the importance of the accuracy of the name and the reasons behind the shift in focus of the revised *Article 9*:

[T] he express provisions of the revised amendments read *in para materia,* and the Official UCC Comments are all in accord that the primary purpose of the revision of the name requirement is to lessen the amount of fact-intensive, case-by-case determinations that plagued earlier versions of the UCC, [*390] and to simplify the filing system as a whole. The object of the revisions was to shift the

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responsibility to the filer by requiring the not too heavy burden of using the legal name of the debtor, thereby relieving the searcher from conducting numerous searches using every conceivable name variation of the debtor.

Pankratz Implement Co. v. Citizens Nat'l Bank, 281 Kan. 209, 227, 130 P.3d 57, 68 (Kan. 2006). Accord In re F. V. Steel and Wire Co., 310 B. R. 390, 393-94 (Bankr. E. D. Wis. 2004) ("A rule that would burden a searcher with guessing at misspellings and various configurations of a legal name would not provide creditors [**14] with the certainty that is essential in commercial transactions.")

Under revised *Article 9* what debtor misnomer is "seriously misleading" is statutorily defined as that which would not be discovered using the state's standard search logic. Thus, under the Safe Harbor provision, the discoverability of a financing statement expressly delimits permissible error. A financing statement is effective if a computer search run under the debtor's correct name produces the financing statement with the incorrect name. If it does not, then the financing statement is ineffective as a matter of law. This new standard is intended to

reflect [] a balance between the need for some flexibility to allow for human error on the part of filers.. And the avoidance of a rule that would cast an altogether inappropriate burden on searchers to have to try to divine potential errors and make searches under not only the correct name but also "foreseeable" or "likely" errors that a filer might have made [.]

Harry C. Sigman, [11] *Twenty Questions About Filing Under Revised Article 9: The Rules of the Game Under New Part 5, 74 CHI. KENT L. REV. 861, 862-63 (1999). See also* Steven O. Weise, [12] *An Overview of Revised Article* [**15] *9, in the New Article 9 Uniform Commercial Code 7* (Corinne Cooper, ed., 2d. ed. 2000).

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Revised *Article 9*contains a statutory rule to determine when a mistake [sic] the debtor's name is so incorrect as to make the financing statement ineffective. The financing statement is effective if a computer search run under the debtor's correct name turns up the financing statement with the incorrect name. If it does not, then the financing statement is ineffective as a matter of law. The court has no discretion to determine that the incorrect name is 'close enough'.

Id. (as quoted in *In re F. V. Steel and Wire Co., 310 B. R. at 393-94*).

11 Mr. Sigman was a member of the Revised Article 9 Drafting Committee.

12 Mr. Weise was the ABA advisor to the Article 9 Drafting Committee.

Post-revision case law is fairly well settled that the burden is squarely on the creditor to correctly identify the name of the debtor. [13]

[*391] Revised *Article 9* requires more accuracy in filings, and places less burden on the searcher to seek out erroneous filings. The revisions to *Article 9* remove some of the burden placed on searchers under the former law, and do not require multiple searches using variations on the debtor's name. *Revised Article 9* [**16] rejects the duty of a searcher to search using any names other than the name of the debtor indicated on the public record of the debtor's jurisdiction of organization.

In re Summit Staffing Polk County, Inc., 305 B. R. 347, 354-55 (Bankr: M. D. Fla. 2003). See Receivables Purchasing Co. v. R&R Directional Drilling, LLC, 263 Ga. App. 649, 652, 588 S. E. 2d 831, 833 (Ga. 2003) (" [A] party filing a financing statement now acts at his peril if he files the statement under an incorrect name.")

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13 The change in law has also altered the burdens in litigation. Under the former statute, a financing statement that contained errors of any kind, but was otherwise substantially compliant, was presumed enforceable unless those errors were found to be seriously misleading. The revised statute provides a financing statement that contains errors in the debtor's name is presumed unenforceable unless those errors are found not to be seriously misleading. The reversal of the presumption also switches the burden of persuasion. The former statute required the party contesting the enforceability of the financing statement to prove that the errors were seriously misleading. However, under the revised statute, [**17] once the contesting party meets his or her burden of production by showing the financing statement does not conform to the statute, the party advocating the efficacy of the financing statement must prove that those errors do not make the statement seriously misleading.

The majority of cases decided under revised *Article 9* are unforgiving of even minimal errors. [14] *In In re Tyringham Holdings, Inc., 354 B. R. 363 (Bankr. E. D. Va. 2006)*, the creditor filed a financing statement covering 65 pieces of jewelry totaling $310,925 worth of consigned inventory. However, the creditor listed the name of the debtor as "Tyringham Holdings" rather than the debtor's legal corporate name, "Tyringham Holdings, Inc." Although the name error merely omitted the corporate suffix "Inc.", an official search under the debtor's actual name did not reveal the creditor's financing statement and the court held that, therefore, the financing statement was ineffective to perfect the security interest. The *Tyringham* court reasoned:

[w] hile application of the filing office's standard search logic may lead to situations where it appears a relatively minor error in a financing statement leads to a security

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interest becoming [**18] unperfected, it is not that difficult to ensure that a financing statement is filed with the correct name of the debtor. Little more is asked of a creditor than to accurately record the debtor's name, and according to the statute, failure to perform this action clearly dooms the perfected status of a security interest.

354 B. R. at 368. Similarly, in *Pankratz Implement Co. v. Citizens Nat'l Bank, 281 Kan. 209, 130 P.3d 57*, the debtor purchased a tractor from the creditor, signed a security agreement, and the creditor misspelled the debtor's name on the financing statement by omitting a "d"--listing the debtor as "Roger House" instead of his legal name "Rodger House." The Supreme Court of Kansas upheld summary judgment invalidating the prior interest represented by the faulty financing statement. In *Host Am. Corp. v. Coastline Fin., Inc., 2006 U. S. Dist. LEXIS 35727, 2006 WL 159614 (D. Utah 2006)* the court held that a financing statement was seriously misleading where the debtor, whose name was "K. W. M. Electronics Corporation" was identified in the financing statement as "K W M Electronics Corporation." [15]

14 The "single search" standard has been criticized as being hypertechnical and too unforgiving of minor errors. *See,* [**19] *generally, 2007 B. Y. U. L. Rev. 111*; Meghan M. Sercombe, Note, *Good Technology and Bad Law: How Computerization Threatens Notice Filing Under Revised Article 9, 84 TEX. L. REV. 1065 (2006)*.

15 Klein argues that cases from other states are inapposite because the search logic of those states is different than the Florida search logic. While the manner in which the searches are conducted may be different, the underlying purpose of the statutory change in each state, and the recognition that the bright line test may result in excluding what might have previously been considered

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"minor" errors, are both illustrative of, and authoritative on, the issues presented in this case.

[*392] This canvas of history, commentary and application sets the background against which the adequacy of Klein's financing statement must be judged.

THE KLEIN FINANCING STATEMENT IS SERIOUSLY MISLEADING

Both the Trustee and Klein rely on *In re Summit Staffing Polk County, Inc., 305 B. R. 347*. In that case Chief Judge Glenn determined that a financing statement that identified the debtor as "Summit Staffing, Inc." rather than by the debtor's correct name of "Summit Staffing of Polk County, Inc." was not seriously misleading because, [**20] although using the standard search logic for Florida did not produce a page on which the financing statement appeared, the searcher only had to push the "previous" button one time and the financing statement was listed. Chief Judge Glenn held that the 'reasonably diligent searcher' standard survives in some part. "Although Revised *Article 9* does not require that a searcher exercise reasonable diligence in the selection of the names to be searched or the number of searches to conduct, the revisions to *Article 9* do not entirely remove the duty imposed on a searcher to be reasonably diligent." *Id. at 355*. In Chief Judge Glenn's view, some burden is placed on the searcher to employ "reasonable diligence in examining the results of the search." *Id.*

In the *Summit Staffing* case, a creditor, Associated Receivables, filed a financing statement listing the debtor as Randy A. Vincent and "Summit Staffing," a sole proprietorship, as an additional debtor. Summit Staffing was subsequently incorporated as "Summit Staffing of Polk County, Inc." The corporation later filed for relief under Chapter 7 of the Bankruptcy Code. The Chapter 7 Trustee

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conducted a UCC search through the Florida Secured Transaction [**21] Registry website using the actual corporate name of the debtor, Summit Staffing of Polk County, Inc., and found no financing statement relating to the debtor's assets. The name "Summit Staffing" appeared at the top of the page displayed when a search under the debtor's correct name was made. By selecting the "previous" command to display the results page with alphabetical listings immediately prior to the page displayed, the Associated Receivables financing statement appeared. In determining the financing statement was not seriously misleading, and that Florida's standard search logic revealed the faulty financing statement, Chief Judge Glenn wrote:

When a search is conducted in the Florida Secured Transaction Registry, a listing of debtors' names is produced. The listing is an alphabetical listing, and 20 names are displayed. If the debtor's actual name is produced, it is at the top of the list. If the debtor's name is not found, the next succeeding name on the alphabetical list is at the top of the list. To see the next preceding name on the alphabetical list, the searcher must use the "Previous" command on the screen. In fact, at the top of the list is the statement: "Use the Previous [**22] and Next buttons *to display additional search results*." (Emphasis supplied.) This statement directs the searcher to use the "Previous" command to see the immediately preceding names on the alphabetical list.

Certainly the searcher should do this. Since the name immediately following Summit Staffing of Polk County, Inc. is [*393] produced at the top of the alphabetical list, and since the filing office's directions state that the searcher should use the "Previous" command to display additional search results, clearly a searcher should check the preceding names on the alphabetical list.

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305 B. R. at 353-354. However, Chief Judge Glenn noted that the obligation to push the "previous" button is not limitless.

Although it is clear that a searcher should check the immediately preceding names as well as the immediately succeeding names on an alphabetical list if there is not an exact match of the debtor's correct name, the issue of "reasonableness" develops at some point because the listing is an alphabetical listing. Although only three names begin with "Summit Staffing," there are several screens of debtors' names, with 20 names per screen, that begin with "Summit." Moreover, since the listing is [**23] an alphabetical listing, it is conceivable that one could use the "Previous" command to go to back to the beginning of the alphabetical list. I*d. at 354*.

Here, the Trustee conducted a search of the Registry's online database. [16] Using the Debtor's correct name, the Trustee's search yielded no matches. (Tr.'s Mot. Summ. J. Ex. C P 3.) It is undisputed that when the Debtor's correct name was inputted as the search term, the listing of 20 names on the initial search result screen did not disclose the Klein financing statement. (Tr.'s Mot. Summ. J. P 21; Klein Resp. n. 25.) Klein's financing statement was only found by striking the "previous" command 60 times. (Tr. Mot. Summ. J. P 22; Dubon Aff. PP 4-5; Klein Resp. n. 25.)

16 The online database is not the official "records of the filing office." http://www. Floridaucc. Com/search_disclaimer, however, a search of the database certainly is a search of the Registry's records. Both the Trustee and Klein have relied on the online database search as the basis and support for the relief they seek, and accordingly, for the purposes of this case, are deemed to have stipulated that the search of the online database is the "search of the records of the [**24] filing office."

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The Trustee relies on *Summit Staffing* arguing the case demonstrates that only the initial search result screen generated when the Debtor's correct name is input counts as the search result and, since Klein's financing statement did not appear on the initial page displayed, the financing statement is seriously misleading. Moreover, the Trustee argues, even if the search result goes beyond the initial result screen, then, as Chief Judge Glenn stated in *Summit Staffing,* the obligation to expand the search beyond the initial page displayed must be reasonable.

Klein also relies on *Summit Staffing*. Klein correctly points out that in *Summit Staffing,* the disputed financing statement did not appear on the initial page displayed, but rather the page displayed when the searcher pushed the "previous" command once. Thus, Klein argues, the results of "standard search logic" in Florida means something other than the initial result screen. However, Klein goes on to argue that Chief Judge Glenn improperly imposed a "reasonableness" requirement on the searcher's duty, that the statute is unambiguous, and has no "reasonableness" limitation. Since, by pushing the "previous" command (60 [**25] times) the Klein financing statement did eventually appear, Klein argues the financing statement is not seriously misleading.

The Trustee argues " [t] o require a secured creditor to search through numerous pages of names would defeat the salutary purpose of revised *Article 9* and set dangerous [*394] precedent." (Tr. Mot. Summ. J. P 23.) Klein counters that since the plain language of the statute has no reasonableness requirement the court cannot impose a requirement that the statute doesn't provide. "Adding a reasonableness requirement would inevitably result in a situation where courts would have to delve into a host of case by case factual issues that were never contemplated by the legislative, and indeed, would require the courts to

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effectively rewrite the Safe Harbor Provision [*Fla. Stat. §679.5061*] in a manner that conflicts with the plain language." (Klein Resp. 11.) Thus, according to Klein's interpretation of the statute, any financing statement filed, no matter how far it may appear from the proper listing, would be sufficient so long as the statement could be found at some point in the pages preceding or following the initial displayed page. Under this interpretation, absent any reasonableness [**26] as to the distance between a proper and improper listing, a searcher would have to look through every page of the online database to determine whether or not a financing statement exists.

The crux of the dispute between the Trustee and Klein is what constitutes the search result using Florida's standard search logic. If my answer to this question is something other than the initial displayed page, then I must determine whether there is a limit on how much a searcher must search past the original display page. The debate between the Trustee and Klein centers on the meaning of "a search of the records of the filing office under the Debtor's correct name, using the filing office's standard search logic .." As noted, the Trustee argues this refers to the initial page result; Klein argues there is a difference between a "search result" and a "display".

The only "search logic" in Florida is statutorily defined as a search by the debtor's name or document number. [17] In order to determine what is the result of inputting that search logic, it is necessary and appropriate to understand what the Registry explains is a "result". The Registry, at its website, www. Floridaucc. Com, has a list of frequently [**27] asked questions. [18] One of the questions listed is "How do I do my own search on the Internet". The answer to that question is:

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You can access the UCC filed records for the Florida Secured Transaction Registry on the Internet at: www. Floridaucc. Com. Click on the "Search" option. Choose one item in the "Select Search Type" box, then enter the appropriate data in the "Name/Document Number" box, and click on "search". *The exact name or number or the nearest alphabetical or numeric entry will be displayed.* Click on the number of the entry(ies) you are interested in

Florida Secured Transaction Registry, UCC Frequently Asked Questions, http://www. Floridaucc. Com/faq. Html (emphasis added). The same website has a Help menu that explains "UCC Filing Inquiry [*395] by Debtor Name". That section states in pertinent part:

These transactions provide a list of UCC filings on the Florida Secured Transaction Registry beginning with the name that is closest to the key entered. This list also includes the document number and the type of each record. There are several inquiry functions available using the Debtor's Name, all of these inquiry functions will provide the user with an alphabetic listing beginning with [**28] the name closest to the key entered.

17 Although proposed Model Administrative Rules for secured transactions have been promulgated by the International Association of Commercial Administrators, Florida has not adopted any type of rule or Administrative Code section to expand the statutory search logic.

18 The Court may take judicial notice of the Registry website, *Fed. R. Evid. 201*. A court ruling on summary judgment may rely on judicially noticed facts. *See Fed. Election Comm'n. v. Hall-Tyner Election Campaign Comm., 524 F. Supp. 955 (S. D. N. Y. 1981). Accord Brown v. Brock, 169 Fed. Appx. 579 (11th Cir. 2006)*; *Bankers Ins. Co. v. Fla. Residential Prop. & Cas. Joint Underwriting Ass'n, 137 F.3d 1293 (11th Cir. 1998)*.

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I agree with Klein that the statute is unambiguous. Moreover, I agree with Klein that the statute does not include a reasonableness requirement. Indeed, as explained in great detail above, the very purpose of this statute was to eliminate the need for, indeed, the ability of, a judge to inject himself or herself in the determination of what is seriously misleading. However, I disagree with Klein's assertion that the initial [**29] page displayed is not the result of applying Florida's standard search logic. Florida's standard search logic is set by statute. The search logic clearly leads to one result -- a single page on which names appear. For those, including Klein, that argue the search result is something more, the Registry website makes clear they are wrong. The Registry's own website unambiguously describes the page displayed when the search data is input as the result of the search. Nothing in the Registry's information page mentions the use of the "previous" or "next" page key in connection with conducting a search using the search criteria. Since it is undisputed that Klein's financing statement did not appear in the search result when the Debtor's correct name was input, the financing statement is seriously misleading and summary judgment in the Trustee's favor is appropriate.

Although I have found that *Fla. Stat. §679.5061* is unambiguous, and that there is no implicit or explicit obligation of a searcher to go beyond the search result, I feel compelled to address what I view as Klein's incredible argument that the Florida statute unambiguously requires a searcher to scroll through the pages of the [**30] UCC search until the nonconforming financing statement is located. If Klein is correct, that the "search result" means something other than the page displayed when the required data is input, it does not follow that the statute requires a limitless search through the UCC database.

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Klein argues that the case law is clear -- when a statute is unambiguous on its face, it must be applied as written. However, Klein cavalierly casts aside as inapplicable the equally long and well established case law on statutory construction that reminds us -

When applying the plain and ordinary meaning of statutory language "produces a result that is not just unwise but is clearly absurd, another principle comes into the picture. That principle is the venerable one that statutory language should not be applied literally if doing so would produce an absurd result."

Miedema v. Maytag Corp., 450 F.3d 1322, 1326 (11th Cir. 2006) (quoting *Merritt v. Dillard Paper Co., 120 F.3d 1181, 1188 (11th Cir. 1997))*.

Klein's argument that Florida's Safe Harbor provision clearly recognizes his financing statement was not seriously misleading, notwithstanding that it was listed 60 pages prior to the displayed search result [**31] (that is 1,200 entries), asks this Court to apply a meaning to the Safe Harbor provision that is "clearly absurd". Such an interpretation would eviscerate [*396] the purpose of the statute -- that is, to create a framework for the perfection of security interests that is less arbitrary, that includes statutory guidance for simplifying the search, while allowing for "minor" errors.

Accordingly, if I am incorrect, and in fact, the Florida search result includes more than the initial page displayed, then, in order to interpret *section 679.5061* so as to avoid an absurd result, I would be compelled alternatively to hold, as did Chief Judge Glenn, that there is a reasonable limit to the search, which I find is no more than one page "previous" or "next" from the initial result screen. Since Klein's financing statement appears 60 pages from the initial display, not one page, it is seriously misleading.

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KLEIN'S CROSS MOTION FOR SUMMARY JUDGMENT

Klein seeks a determination that he is entitled to a claim in the amount of $152,000. In support of his cross-motion, Klein submitted the affidavits of John Sizemore, the manager of the Debtor, and his own affidavit. Both affidavits attest that Klein lent the [**32] Debtor $197,255.33, by endorsing and transferring to Debtor three checks made payable to William Klein by DiMare Homestead, Inc. (Klein Aff. PP 2, 4-5; Sizemore Aff. P 3.) [19] The affidavits further state that, in July 2006, the Debtor executed a promissory note in the amount of $152,000 representing the unpaid balance of the loan. (Klein Aff. P 11; Sizemore Aff. P 8.) Both affidavits state that the Debtor never made any payments on the Note. (Klein Aff. P 15; Sizemore Aff. P 11.)

19 The Klein affidavit states one check was lost and replaced. (Klein Aff. at P 4.)

In response, the Trustee argues that because the checks (copies of which were attached to the Klein Affidavit) appear to have been deposited by Klein, rather than endorsed to Debtor, that "Klein has not made a sufficient showing .. that he actually provided any funds to the Debtor and a genuine issue of material fact exists with respect to whether the DiMare checks were actually transferred by Klein to the Debtor." (Tr.'s Reply and Resp. 8.) The Trustee does not provide any other information or affidavits regarding this issue.

Fed. R. Civ. P. 56(e), made applicable to this contested matter by virtue of *Fed. R. Bankr. P. 7056*, [**33] requires that when a party seeking summary judgment has provided affidavits in support of such relief as required by *Rule 56* "an adverse party may not rest upon the mere allegations or denials of the adverse party's pleading, but the adverse

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party's response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. If the adverse party does not so respond, summary judgment, if appropriate, shall be entered against the adverse party."

Klein has demonstrated that summary judgment in his favor is appropriate. The Trustee has failed to meet his burden under *Rule 56(e)*. Accordingly, Klein is entitled to summary judgment on the issue of his entitlement to an unsecured claim in the amount of $152,000.

CONCLUSION

Based on the foregoing, it is ORDERED and ADJUDGED as follows:

a. The Trustee's motion for summary judgment is granted. Klein does not hold a secured or priority claim. Because I have found that, as a matter of law, Klein does not hold a secured claim, I do not need to reach the third issue on the Trustee's motion for summary judgment regarding [*397] the avoidability of Klein's asserted lien on the Equipment.

b. Klein's [**34] cross motion for summary judgment is denied in part and granted in part. Although Klein does not hold a secured claim, he is entitled to summary judgment that he holds an unsecured claim in the amount of $152,000.00.

¿Cuán serio fue el error en el nombre del deudor a momento de realizarse el registro?

LA SUSPENSIÓN CAUTELAR DE TODA FORMA DE EJECUCIÓN DE LA PRENDA

IN THE MATTER OF: GERALD LEWIS TARNOW, Debtor. COMMODITY CREDIT CORPORATION, Appelant UNITED STATES COURT

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OF APPEALS FOR THE SEVENTH CIRCUIT 749 F.2d 464; 12 Bankr. Ct. Dec. 783 October 29, 1984, Argued December 3, 1984

OPINION BY: POSNER [*464] The facts, slightly simplified, are as follows. The Commodity Credit Corporation, a federal agency, made a farmer named Tarnow a loan secured by a lien on his crops and equipment. Tarnow went broke before the loan was repaid. He filed a petition for bankruptcy under Chapter 11 of the Bankruptcy Code, *11 U. S. C. §§ 1101 et seq.*, and the bankruptcy court fixed a deadline, the validity of which is not contested, for the filing of claims against the bankrupt estate. Although the Commodity Credit Corporation knew about the bankruptcy proceeding, it filed its claim against Tarnow two months after the deadline had passed. [**2] The bankruptcy judge not only disallowed the claim because it was late, but, for the same reason, declared the Corporation's lien extinguished. The district court, *35 Bankr. 1014*, affirmed the bankruptcy judge's order, and the Corporation has appealed the district court's judgment to us. But it has limited its appeal to the question whether the lien has been extinguished; it does not contest the disallowance of its claim as untimely.

The bankruptcy judge's order ended an adversary proceeding, and so was appealable to the district court; and the district court's order affirming the bankruptcy [*465] judge was a final order appealable to us. See the versions of *28 U. S. C. §§ 1293* and *1334* made applicable to this case by the Bankruptcy Act of 1978, Pub. L. 95-598, tit. IV, § 405(c)(2), 92 Stat. 2685.(The current provisions, *28 U. S. C. §§ 158(a)*, *(d)*, enacted last summer, carry the former ones forward with no changes relevant to this case.)

A long line of cases though none above the level of bankruptcy judges since the Bankruptcy [**3] Code was

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overhauled in 1978, allows a creditor with a loan secured by a lien on the assets of a debtor who becomes bankrupt before the loan is repaid to ignore the bankruptcy proceeding and look to the lien for the satisfaction of the debt. See *Long v. Bullard, 117 U. S. 617, 620-21, 29 L. Ed. 1004, 6 S. Ct. 917 (1886)*; *Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555, 582-85, 79 L. Ed. 1593, 55 S. Ct. 854 (1935)*; *United States Nat'l Bank v. Chase Nat'l Bank, 331 U. S. 28, 33, 91 L. Ed. 1320, 67 S. Ct. 1041 (1947)* (dictum); *In re Woodmar Realty Co., 307 F.2d 591, 594-95 (7th Cir. 1962)*; *Dizard & Getty, Inc. v. Wiley, 324 F.2d 77, 79-80 (9th Cir. 1963)*; *Clem v. Johnson, 185 F.2d 1011, 1012-14 (8th Cir. 1950)*; *DeLaney v. City and County of Denver, 185 F.2d 246, 251 (10th Cir. 1950)*; *In re Bain, 527 F.2d 681, 685-86 (6th Cir. 1975)*; *In re Honaker, 4 Bankr. 415, 416 and n.3 (Bankr. E. D. Mich. 1980)*; cf. I*n re Rebuelta, 27 Bankr. 137, 138-39 (Bankr. N. D. Ga. 1983)*; *In re Hines, 20 Bankr. 44, 48 (Bankr. S. D. Ohio 1982)*. [**4] Of course if there is some doubt whether the collateral is adequate for this purpose the creditor may want to file a claim with the bankruptcy court, so that in the event the collateral falls short he will have a claim against the estate (though just as an unsecured creditor) for the shortfall. See *11 U. S. C. § 506(a)*. But unless the collateral is in the possession of the bankruptcy court (or trustee -- but there was no trustee here), which it was not in this case, the secured creditor does not have to file a claim. See 1 Norton, Bankruptcy Law and Practice § 28.27, at p. 28-18 (1983). It would be no favor to either the debtor or the other creditors to force him to do so on pain of losing his lien; it would just mean (unless as here the creditor was careless, and forgot to file) adding another unsecured creditor to the list.

The wrinkle here is that the secured creditor did file a claim. (This was true in *Dizard & Getty* also, but

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apparently only in response to an order to show cause why the secured creditor's lien should not be voided; the court treated the case as one in which the secured creditor wanted to bypass the bankruptcy proceeding completely. [**5] See *324 F.2d at 79-80*.) If the filing had been timely but the bankrupt or his (other) creditors had contested the claim on the ground that the loan had never been made, or that it had been completely repaid, or that repayment could not be enforced because the loan was usurious, and if the bankruptcy judge had agreed that the bankupt had no legally enforceable obligation to the creditor and his decision was not disturbed on appeal, the lien would be extinguished by operation of the doctrine of collateral estoppel; the proceeding before the bankruptcy judge would have established facts and legal conclusions showing that the lien could not possibly be valid. We shall see that, since 1978, this possibility has been expressly recognized by the Bankruptcy Code. But it is not a possibility presented by this case. The Commodity Credit Corporation's claim was rejected for no other reason than that it was late, and this ground of rejection does not call into question the validity of the lien -- unless rejecting a claim, on whatever ground, automatically rejects the lien that secures it. As a matter of principle we would be very surprised if it did (we are even more surprised, [**6] however, that there are no cases dealing with the question). The destruction of a lien is a disproportionately severe sanction for a default that can hurt only the defaulter. Once the deadline for filing claims had passed, Tarnow and his (other) creditors did not have to worry that still other creditors might pop up later and try to establish a claim on the assets of the bankrupt estate; any late-filing creditors would be time-barred. They did have [*466] to worry (unless late filings really do extinguish liens) that Tarnow's secured creditors might try to seize and sell the security; but we have seen that secured creditors are allowed to

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ignore the bankruptcy proceeding without endangering their liens.

So the Corporation could not have been trying to pull a fast one by its late filing; in any event its delay hurt only itself; and in these circumstances we cannot see why so drastic a sanction as was decreed here was necessary to protect anybody's interests. While no one wants bankruptcy proceedings to be cluttered up by tardy claims, the simple and effective method of discouraging [**7] them is to dismiss the claim (that is, the claim against the bankrupt estate, as distinct from the claim against the collateral itself), out of hand, because it is untimely -- which was done here, and about which the Commodity Credit Corporation does not now complain. If an ordinary plaintiff files a suit barred by the statute of limitations, the sanction is dismissal; it is not to take away his property. And a lien is property. See, e. G., *United States v. Security Industrial Bank, 459 U. S. 70, 76-77, 74 L. Ed. 2d 235, 103 S. Ct. 407 (1982)*.

However, the relevant statutory language that was in effect during the proceedings in the bankruptcy court, and the commentary on that language by the leading treatise, see 3 Collier on Bankruptcy para. 506.07, at p. 506-49 (15th ed. 1984), provide some, though only superficial, support for Tarnow's position. A provision added to the Bankruptcy Code in 1978, *11 U. S. C. § 506(d)*, provides that "to the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, [**8] unless -- (1) a party in interest has not requested that the court determine and allow or disallow such claim under section 502 [regulating the allowance of claims against the bankrupt estate] ." One purpose of *section 506(d)(1)* is simply to codify the rule of *Long v. Bullard* -- which previously had been purely a judge-made rule of bankruptcy law -- permitting liens to pass through

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bankruptcy unaffected. See H. R. Rep. No. 595, 95th Cong., 2d Sess. 357 (1978); see also *id.* at 361; S. Rep. No. 989, 95th Cong., 2d Sess. 76 (1978); 3 Collier on Bankruptcy, *supra*, para. 506.07, at p. 506-49. But, read literally, the statute also seems to say that if someone requests the bankruptcy court to disallow a claim, and the court does so, the lien that secures the claim is voided; and Tarnow did request the bankruptcy court to disallow the Commodity Credit Corporation's claim, and the court did disallow it. But this is not the intended meaning. All that was sought to be accomplished was to allow the bankruptcy court to determine whether a creditor has a valid secured claim, and if he does not to make the lien -- the security -- fall with the claim. This makes perfectly good sense; [**9] if you do not have a good secured claim, you do not have a valid lien (security for the claim). But the Commodity Credit Corporation was not seeking confirmation of its status as a secured creditor; it was content to realize on its collateral outside the bankruptcy proceeding. All it wanted was to be an unsecured creditor for the amount by which Tarnow's debt to it might exceed its collateral. And while Tarnow or other creditors may well have thought the Corporation's lien invalid and may have wanted the bankruptcy judge to use his powers under *section 506(d)* to determine that it was invalid, the judge didn't do this. The basis for disallowing the Corporation's claim was not that the Corporation was not a genuine secured creditor of the bankrupt but that its claim against the bankrupt estate -- that is, its claim to be an unsecured creditor for so much of Tarnow's debt as could not be realized from the sale of the crops and equipment on which the Corporation had a lien -- had been filed too late." [A] party in interest may seek the allowance or disallowance of the claim *and the court will then determine the validity of the lien*." 1 Norton, *supra*, § 28.27, at p. 28-18 (emphasis [**10] added; footnote

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omitted). The validity of the lien was not determined in this case.

There are two further if modest supports for our interpretation. First, the Senate version of *section 506(d)* had provided "that [*467] to the extent a secured claim is not allowed, its lien is void unless the holder had neither actual notice nor knowledge of the case ." S. Rep. No. 598, *supra, at 68*. This could have been read to mean that the lien would be extinguished whatever the basis for disallowing the claim. But Congress enacted the House version, see 124 Cong. Rec. 33997 (1978), which is less hospitable to such a reading. Second, in 1984 Congress enacted a new *section 506(d)(2)*, replacing the former 506(d)(1), and the new section preserves the lien if the claim "is not an allowed secured claim due only to the failure of any entity to file a proof of such claim ." Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. 93-353, § 448(b), 98 Stat. 374. The change was intended "to make clear that the failure of the secured creditor to file a proof of claim is not a basis for avoiding the lien of the secured creditor." S. Rep. No. 65, 98th Cong., 1st Sess. 79 [**11] (1983). As there is still no explicit reference to the situation where a claim is filed -- only late -- maybe the amendment does no more than codify (or recodify) the long-established rule of the *Long v. Bullard* line of cases. But at least it deprives Tarnow of his anyway rather threadbare textual argument based on the former version of *section 506(d)* and on Collier's brief and unilluminating commentary on that language -- provided we are allowed to look to the legislative history of an amendment to illuminate the meaning of the original statute. We are -- see, e. G., *Red Lion Broadcasting Co. v. FCC, 395 U. S. 367, 380-81* and n.8, *23 L. Ed. 2d 371, 89 S. Ct. 1794 (1969)* -- though there are pitfalls to this procedure. If a legislature decides to change a statute, some

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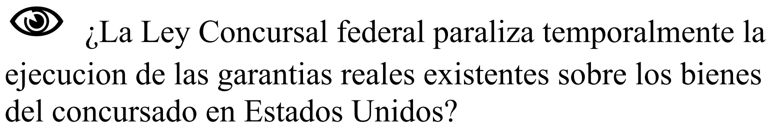
of the legislators may wish to give its change retroactive force, by describing it on the floor or in a committee report as a merely "clarifying" change, though formally the change is only prospective and a majority of the legislature would not have voted to make it retroactive. But no one has suggested that this is what was going on when *section 506(d)* was amended last summer. The previous statutory [**12] language really was unclear, and the amendment merely brings it into phase with the logical implications of the *Long v. Bullard* line of cases, which we know Congress meant to approve when it first enacted *section 506(d)* in 1978.

REVERSED AND REMANDED.



¿La Ley Concursal federal paraliza temporalmente la ejecucion de las garantias reales existentes sobre los bienes del concursado en Estados Unidos?

EL FINANCIAMIENTO NUEVO CON EL OBJETIVO DE EVITAR LA INSOLVENCIA

MBANK ALAMO NATIONAL ASSOCIATION, (Deposit Insurance Bridge Bank, substituted in the place and stead of MBank Alamo National Association), Plain-tiff-Appellee, v. RAYTHEON COMPANY d/b/a Raytheon Medical Systems, De-fendant-Appellant. MBANK ALAMO NATIONAL ASSOCIATION, (Deposit In-surance Bridge Bank, substituted in the place and stead of MBank Alamo National Association), Plaintiff, E. I. DuPont De Nemours Company, Plaintiff-Appellee, v. RAYTHEON COMPANY d/b/a Raytheon Medical Systems, Defendant-Appellant UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT 886 F.2d 1449; 10 U. C. C. Rep. Serv. 2d 35 October 31, 1989

OPINION BY: REAVLEY [*1450] MBank Alamo National Association ("MBank") and E. I. DuPont de

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Nemours Company, Inc. ("DuPont") pressed this conversion action against Raytheon Company ("Raytheon"), claiming that Raytheon collected certain accounts receivable, in which MBank and DuPont had security interests superior to those of Raytheon. Raytheon's defense was that it had a purchase money security interest in the accounts receivable. Concluding that Raytheon [**2] had no purchase money security interest in the accounts, the district court held that Raytheon's security interests were subordinate to those of MBank and DuPont, and granted MBank's and DuPont's motions for summary judgment. We affirm.

I. Background

MBank and DuPont entered various security agreements with Howe X-ray ("Howe"). By January 10, 1983, in accordance with these agreements, both DuPont and MBank held perfected liens in Howe's present and future accounts receivable. MBank also held a perfected security interest in Howe's present and after acquired inventory.

Beginning in January 1983, Raytheon, an x-ray equipment manufacturer, entered a series of transactions with Howe who was one of its distributors. Raytheon agreed to ship x-ray equipment to Howe after Howe contracted with one of its customers for the sale, delivery, and installation of certain Raytheon equipment. In exchange, Howe agreed to assign the specific accounts receivable to Raytheon. Subsequent to the assignments, Raytheon filed financing statements in specific accounts receivable of Howe. Between July 1983 and December 1984, Raytheon collected over $850,000.00.

By November 1984, Howe had defaulted [**3] on its obligations to MBank and DuPont. MBank and DuPont, pursuant to their security interests, demanded payment

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from Raytheon from the accounts receivable that it had collected. Raytheon refused, claiming that it had a purchase money security [*1451] interest ("PMSI") in the accounts receivable and that its interests were therefore superior to those of MBank and DuPont.

In addition to its contention that it had a PMSI in the accounts receivable, Raytheon claimed that even if it did not have a PMSI in those accounts, MBank waived its security interest in the accounts. The district court granted MBank's and DuPont's motions for summary judgment, deciding that Raytheon had no PMSI in the accounts receivable and that Raytheon had not raised an issue of MBank's alleged waiver.

Raytheon appeals the district court's determination that it did not have a PMSI in the accounts receivable. In the alternative, Raytheon contends that if our construction of the PMSI statutory provisions excludes the Raytheon -- Howe transaction, the ruling should not apply to this case under the doctrine of nonretroactivity. Raytheon also appeals the district court's finding that Raytheon failed to produce [**4] sufficient evidence of waiver to overcome MBank's motion for summary judgment.

II. Analysis

A. Purchase Money Security Interests

The rules governing the rights of creditors are set out in Chapter 9 of the Texas Business and Commerce Code ("Code"), which essentially adopted the provisions of the Uniform Commercial Code -- Secured Transactions. *See Tex. Bus. & Com. Code Ann. § 9.101 et seq.* (Vernon 1989). [1] These provisions were enacted "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." *§ 9.101*, 1972 Official U. C. C. Comment. In keeping with

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these goals, rules were enacted prioritizing conflicting security interests in the same property.

1 All statutory references in this opinion are to the Texas Business & Commerce Code unless otherwise indicated.

The general rule provides [**5] that the first perfected security interest to be filed has priority and other perfected interests stand in line in the order in which they were filed. *See § 9.312(e)*. PMSIs are excepted from the first-to-file rule and take priority over other perfected security interests regardless of the filing sequence. *§ 9.312(c)*, *(d)*. The district court found that Raytheon did not fall within the PMSI exception, that MBank had priority as the first to file, under *§ 9.312(e)(1)*, and that DuPont takes second priority since it filed next. [2]

2 The district court also found that because MBank had a continuously perfected interest in the inventory since January 17, 1980, MBank has priority in the accounts as proceeds of inventory under § 9.306(c). Because we reach our decision under *§ 9.312(e)(1)*, we need not discuss this finding.

Raytheon claims the district court erred by not recognizing its priority in the accounts receivable [**6] as a PMSI under *§ 9.312(d)*. [3] *Section 9.312(d)* provides that "[a] purchase money security interest in collateral other than inventory has priority over a conflicting security interest in the same collateral or its proceeds if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within 20 days thereafter."

3 Raytheon claims a PMSI in the accounts receivable and not in the inventory. Raytheon cannot claim a PMSI in this inventory because it did not comply with § 9.312(c)(2), which requires a PMSI holder to notify in writing the

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holder of a conflicting security interest in the same inventory.

As a threshold matter, Raytheon must establish that it meets the statutory definition of a PMSI. Raytheon contends that it fits the statutory requirements of a PMSI under [**7] *§ 9.107(2)*, which provides:

A security interest is a "purchase money security interest" to the extent that it is

(2) 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.

To meet these requirements Raytheon must show: (1) that it gave value; (2) that [*1452] the value given enabled Howe to acquire rights in the accounts receivable; and (3) that the accounts receivable qualify as collateral within the meaning of the statute.

The value requirement is satisfied by any consideration sufficient to support a simple contract. *See Thet Mah and Assoc. v. First Bank of North Dakota, 336 N. W.2d 134, 138 (N. D. 1983)*; § 1.201(44)(D) (Vernon 1968). Assuming *arguendo* that Raytheon gave value by extending credit to Howe in exchange for Howe's promise to assign the accounts receivable to Raytheon, *see Thet Mah, 336 N. W.2d at 138*, Raytheon has failed to satisfy the other two requirements.

[**8] To create a PMSI, the value must be given in a manner that enables the debtor to acquire interest in the collateral. This is accomplished when a debtor uses an extension of credit or loan money to purchase a specific item. *See Ingram v. Ozark Prod. Credit Assoc., 468 F.2d 564, 565 (5th Cir. 1972)*; *In re Dillon, 18 Bankr. 252, 254 (Bkrtcy. E. D. Cal. 1982)* (PMSI lien attaches to item

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actually purchased); Jackson & Kronman, *Secured Financing and Priorities Among Creditors*, 88 Yale L. J. 1143, 1165 (1979) (PMSI priority limited "to loans that can be traced to identifiable, discrete items of property.").

The collateral at issue here is the accounts receivable. In an attempt to force its interest into the PMSI mold, Raytheon has characterized the transaction as follows: "Raytheon, by agreeing to extend credit on its equipment, enabled Howe X-Ray to enter into subsequent contracts of sale with its customers, [**9] thereby acquiring rights in the contract accounts which, upon the specific advance and delivery of equipment, blossomed into a right to the collateral accounts receivable." Raytheon, however, cannot force this transaction to fit. To accept this characterization, we would have to close our eyes to the true nature of the transaction.

Raytheon, in essence, is claiming that it advanced x-ray machines to Howe on credit, which then enabled Howe to purchase accounts receivable from its customers. This, however, does not comport with our view of commercial reality. While, as Raytheon suggests, it may be theoretically possible to create a PMSI in accounts receivable by advancing funds for their purchase, *see Northwestern Nat'l Bank Southwest v. Lectro Systems, 262 N. W.2d 678, 680 (Minn. 1977)*; Gilmore, *The Purchase Money Priority*, 76 Harv. L. Rev. 1333, 1372 (1963), the same cannot be done by advancing x-ray machines. We view this as a two-step transaction in which Raytheon first advanced machines to Howe for retail sale and, once these machines were sold, Howe then assigned the accounts receivable to Raytheon. Through the credit advance, Howe acquired an [**10] interest in the machines, not the accounts receivable. Raytheon's credit advance, therefore, did not enable Howe to acquire an interest in the accounts receivable, as collateral within the meaning of the statute.

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Additionally, in its characterization of the transaction, Raytheon is attempting to benefit from the PMSI's preferred status in a manner that was not contemplated by the U. C. C. drafters. PMSIs provide an avenue for heavily burdened debtors to obtain credit for specific goods when creditors who have previously loaned money to the debtor may be unwilling to advance additional funds. Jackson & Kronman, *Secured Financing and Priorities Among Creditors*, 88 Yale L. J. 1143, 1145 & n. 9 (1979). By giving a PMSI holder a priority interest in the specific goods purchased, there is some incentive for a lender to advance funds or credit for the specific transaction. The scope of a PMSI holder's preferred interest, however, is specifically limited by the Code.

Under *§ 9.312(c)*, a PMSI inventory is limited to that inventory or to "identifiable cash proceeds received on or [**11] before the delivery of the inventory to a buyer. ." The drafters noted that general financing of an inventory business is based primarily on accounts resulting from inventory, chattel paper and other proceeds. *§ 9.312*, Official U. C. C. Reasons for 1972 Change comment (4). Reasoning that "accounts financing is more important in the economy than the financing of the [*1453] kinds of inventory that produce accounts, and [that] the desirable rule is one which makes accounts financing certain as to its legal position," *id.*, they specifically excluded accounts resulting from the sale of inventory from the protections of a PMSI. Thus, financing statements that are filed on a debtor's accounts take precedence over any subsequent claim to accounts as proceeds of a PMSI in inventory. Additionally, to protect lenders who make periodic advances against incoming inventory, the PMSI holder is required to notify other secured parties before it can take priority. *§ 9.312(c)(2)*; *see id.*, 1972 Official U. C. C. Comment comment 3.

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The priority scheme, however, differs in the context of [**12] collateral other than inventory. Under *§ 9.312(d)*, a PMSI in collateral other than inventory entitles the holder to a superior interest in both the collateral and its proceeds regardless of any intervening accounts. The differing entitlement to proceeds is due to differences in the expectations of the parties with respect to the collateral involved.

Collateral other than inventory generally refers to equipment used in the course of business. *See id.*, Official U. C. C. Reasons for 1972 Change comment (4); Gilmore, *The Purchase Money Priority*, 76 Harv. L. Rev. 1333, 1385 (1963). Since, unlike inventory, "it is not ordinarily expected that the collateral will be sold and that proceeds will result, [the drafters found it] appropriate to give the party having a purchase money security interest in the original collateral an equivalent priority in its proceeds." *§ 9.312*, Official U. C. C. Reasons for 1972 Change comment (3).

Howe's business primarily involved the sale of inventory, [**13] which included the Raytheon x-ray machines. *See* § 9.109(4). [4] The accounts receivable are proceeds resulting from the sale of the machines. MBank and DuPont took security interests in the accounts receivable, in accordance with their expectation that sale of the inventory would generate the accounts. If we were to accept Raytheon's argument that it holds a PMSI in Howe's accounts receivable, we would be giving Raytheon a priority interest in the proceeds of inventory, in direct contravention to the express intent of the drafters. Additionally, Raytheon would have successfully avoided the notice requirements of *§ 9.312(c)(2)*.

4 "The principal test to determine whether goods are inventory is that they are held for immediate or ultimate

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sale." § 9.109(4), 1972 Official U. C. C. Comment comment 3.

Raytheon argues, however, that the policies underlying PMSIs actually favor recognizing Raytheon's priority interest [**14] in Howe's accounts. It points out that Howe could find no other source of financing besides Raytheon and that "MBank and DuPont benefited by the financing arrangements because the extension of [credit] by Raytheon helped Howe X-ray stay in business thereby servicing its debts." Raytheon also contends that if the Code is interpreted to limit the security interests of creditors, such as Raytheon, to a mere promise of repayment and the grant of a PMSI in inventory, a "valuable source of credit" to similarly encumbered debtors would "dry up." This is because the risk of default is too great in the face of prior liens on the debtor's accounts.

The Code itself, however, answers this argument. The drafters were apparently well aware that the failure to extend a PMSI holder's priority status to the resulting accounts would provide less incentive for inventory financiers to provide credit. *See § 9.312*, 1972 Official U. C. C. Comment comment 8. Yet, they did not extend the protections of a PMSI and merely noted that "many parties financing inventory are quite content to protect their first security interest in the inventory itself, realizing that when inventory is sold, someone else will [**15] be financing the accounts and the priority for inventory will not run forward to the accounts." *Id.* The drafter's recognition of the problem and the statutory favoring of accounts financing demonstrate that the drafters were not overly concerned that this source of financing would "dry up."

Additionally, Raytheon had alternative means of securing its right to receive payment. Besides obtaining a PMSI in the [*1454] inventory by complying with the §

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9.312(c)(2) notice requirements, it could have entered subordination agreements with MBank and DuPont on the specific accounts resulting from the sale of Raytheon's x-ray machines. It also could have sold the machines to Howe's customers who would have paid Raytheon directly, with Howe receiving a commission on the sale. If Raytheon had followed either of these courses, it would not have subverted the notice and filing requirements of the Code. As this transaction goes beyond that contemplated by the PMSI provisions, we decline "to expand the scope of special protection afforded a purchase money security interest, lest in so doing we defeat the underlying purposes of the Code: to bring predictability to commercial transactions. [**16] " *Mark Prod. U. S., Inc. v. Interfirst Bank Houston, N. A., 737 S. W.2d 389, 393* (Tex. App. -- Houston [14th Dist.] 1987).

Since Raytheon did not have a PMSI in Howe's accounts receivable, the first-to-file priority rules govern. *See Ford Motor Credit Co. v. First State Bank of Smithville, 679 S. W.2d 486, 487 (Tex. 1984)*. As the last to file, Raytheon's interest is subordinate to those of MBank and DuPont.

B. The Doctrine of Nonretroactivity

Having concluded that Raytheon did not have a PMSI, Raytheon now contends that because this case presented a novel question of law, the doctrine of nonretroactivity should apply. Under the doctrine of nonretroactivity a court deciding a question of first impression, in a manner that was not clearly foreshadowed, makes the ruling inapplicable to the parties before it. *See Chevron Oil Co. v. Huson, 404 U. S. 97, 92 S. Ct. 349, 355, 30 L. Ed. 2d 296 (1971)*. This is no case for nonretroactivity. The holding that Raytheon did not have a PMSI in the accounts receivable is required by the statute and commentary, given

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the PMSI restrictions and the Code's clear mandate that first-to-file rules [**17] establish the priorities in accounts resulting from the sale of inventory. The goal of providing predictability in commercial transactions is furthered by the present application of our holding. Moreover, we find no inequity in applying the rule to Raytheon. Raytheon's credit managers were well aware of the first-to-file rule yet, at no time, attempted to notify MBank or DuPont about its purported interest in the accounts. It did not pursue alternative means of securing payment, but merely claimed a priority right in the absence of any authority to do so.

C. Waiver

Lastly, Raytheon contends that the district court erred in holding that Raytheon failed to produce sufficient evidence that MBank waived its security interest in the accounts to overcome MBank's motion for summary judgment. To support its claim, Raytheon presented evidence that MBank was informed that Howe and Raytheon were engaged in ongoing credit negotiations and that Howe was assigning the accounts receivable to Raytheon. Additionally, while MBank was aware that it was not receiving full payment of Howe's accounts receivable, MBank never requested that the accounts proceeds be segregated or held in trust for [**18] the bank.

Waiver is a valid defense to an action to enforce a security interest. *Weisbart & Co. v. First Nat'l Bank of Dalhart, Texas, 568 F.2d 391, 396 (5th Cir. 1978)*; *Montgomery v. Fuquay-Mouser, Inc., 567 S. W.2d 268, 270 (Tex. Civ. App. 1978)*. Under Texas law, "waiver is the intentional relinquishment of a known right or intentional conduct inconsistent with claiming it, with full knowledge of the material facts." *Montgomery, 567 S. W.2d at 270*.

Although Raytheon's evidence suggests that MBank knew about the assignment of the accounts receivable, the

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assignment alone did not interfere with MBank's rights, because any assignment would be subordinate to MBank's security interest. MBank's rights were not infringed until Raytheon collected the accounts receivable. To raise the issue of whether MBank intended to relinquish its security interest in the accounts receivable, Raytheon would at least have to present evidence that MBank knew Raytheon [**19] was collecting the accounts. Raytheon did not do so. The district [*1455] court properly granted the motions for summary judgment. *See Anderson v. Liberty Lobby, Inc., 477 U. S. 242, 248-49, 106 S. Ct. 2505, 2510-11, 91 L. Ed. 2d 202 (1986)*; *Washington v. Armstrong World Indus., 839 F.2d 1121, 1122-23 (5th Cir. 1988)* (per curiam). The judgments for MBank and DuPont are AFFIRMED.

DISSENT BY: GOLDBERG What we confront today is another nettle in the thicket of the Texas Uniform Commercial Code. A thorny question of statutory interpretation that could cause scratch and abrasion if not reconnoitered under the illumination provided by the Texas Supreme Court. After examining the relevant statutes and commentaries, however, I believe that the majority has not construed the code as would the Texas Supreme Court in the face of the same problem. So because the scratch of a thorn may cause infection if not properly treated, I must respectfully DISSENT.

The nettle of this case is whether an account receivable should be considered "collateral" in the words of the purchase money security interest statute so that [**20] the purchase money interest has priority over a security interest previously perfected in an identical account. My belief is that accounts receivable are an appropriate form of collateral because they can be used to invigorate marginal businesses. I would thus hold that Raytheon established a purchase money security interest in the specified accounts of Howe x-ray.

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I. THE FACTS

Both MBank and DuPont had loaned money to Howe, a dealer in medical equipment including expensive x-ray machines. To guard themselves against the possibility that Howe would default on these loans, MBank, whose loan was made before DuPonts, perfected a security interest in Howe's accounts receivable then existing and subsequently arising and also perfected a similar security interest in Howe's inventory. DuPont's security interest was also perfected in Howe's accounts receivable then existing and subsequently arising but was filed after MBank's interest.

While the MBank/DuPont loans were outstanding, Raytheon entered into a series of transactions with Howe. Each transaction was executed according to a preexisting distribution agreement which allowed Howe to contract with customers for the sale of Raytheon [**21] x-ray machines. Under this agreement, Raytheon promised to supply an x-ray machine to Howe in exchange for Howe's promise to assign the account receivable that arose from the sale of the machine to Raytheon. Raytheon gave notice of its security interest in each account by filing a financing statement within the applicable 20 day period after the creation of the account. The structure of this agreement between Howe and Raytheon arose because Howe had begun to experience difficulty in obtaining additional financing and was spiraling down toward bankruptcy, its final fate.

II. DISCUSSION

Before I get involved in the details of Raytheon's purchase money security interest, however, a momentary step back is in order to scan the general landscape of security interests. As a general observation, the usual method for growth in the area of commercial law has been the daring creativity of a company pushing out beyond the

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boundaries of "normal practice" in response to business exigencies. The history of trust receipts, the factor's liens, and the eventual adoption of Article 9 of the Uniform Commercial Code illustrates this general observation in the area of security interests. *See* G. [**22] Gilmore, *Security Interests in Personal Property*, Ch. 1-8 (1965).

"The idea which the draftsmen [of Article 9] started with was that the system of independent security devices [developed in different area of commerce] had served its time; that the formal differences which separated one device from another should be scrapped and replaced with the simple concept of a security interest in personal property; that *all types of personal property*, whether held for use or for sale, should be recognized [*1456] as available for security." *Id. at 290* (emphasis added).

Article nine was thus intended to be a flexible statute that could respond to divergent commercial needs.

The facts of this case present exactly the type of problematic situation which demands a creative solution. Raytheon, as a manufacturer of expensive x-ray equipment, often does not seek out customers itself but instead uses local distributors such as Howe to make sales. But Howe had to borrow money for it to function as a merchant of medical equipment. MBank and DuPont provided this money protecting themselves by with security interests in the collateral Howe had available, Howe's [**23] present and future accounts receivable and inventory. This type of security interest in a borrower's intangibles such as accounts receivable is extremely common. The key to who has priority is to determine who filed the security interest in the collateral first. First in time, first in line goes the rhyme.

The problem with this situation is that a manufacturer will not loan or give a heavily indebted merchant any goods to sell on credit because once the merchant sells the goods,

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the banker, not the manufacturer, will have priority in the resulting accounts under the first in time first in line principle. Raytheon would thus not advance any x-ray machines to Howe because MBank and DuPont would have priority in any accounts that arose from the sale of the machines. Yet it is these very sales which would enable Howe to make profits to pay off its loans to MBank and DuPont. So how does an indebted merchant, who is unable to pay a manufacturer for goods that the merchant must sell to service the banker's loan, stay in business? Often what occurs is a scenario where the banker's loan is not paid, the merchant goes out of business, and the manufacturer loses an opportunity to distribute [**24] its goods on the market.

Article 9 provides a solution: the purchase money security interest. This device, with its root in the Railroad Car Trusts of the Nineteenth Century, has priority over security interests filed earlier because of its specific transaction oriented function. *Id. at 743-53* (citing *U. S. v. New Orleans R. R., 79 U. S. (12 Wall.) 362, 364-65, 20 L. Ed. 434 (1871)* (pre *Erie* commercial case giving priority to the later in time party)). The purchase money security interest operates outside the notice principle which favors early interest holders over later ones. Notice is not the driving force behind the purchase money security interest.

It was this purchase money device that allowed Howe an opportunity to continue doing business to the benefit of MBank, DuPont and Raytheon. Howe did not have enough money to purchase a $140,000 x-ray machine for inventory but Raytheon would not advance a machine on credit to Howe. A creative alternative was necessary. Raytheon agreed to advance a machine to Howe in exchange for Howe's enforceable purchase order or account receivable. Raytheon thus used the account as a vehicle to ensure Howe's payment for [**25] the machine. It was a creative solution to the meeting of two creditors, a manufacturer of

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expensive equipment, and a heavily indebted retailer, that allowed commerce to continue to flow.

But for the law to recognize this creativity, it must be determined whether Raytheon has complied with the elements of the Texas purchase money security interest statute. Admittedly this arrangement does not present a paradigmatic purchase money security interest, but I believe that creativity, when in harmony with the statutory requirements, should be encouraged.

A. THE VALUE REQUIREMENT

Purchase money security interests are defined in *section 9.107* of the Texas Uniform Commercial Code. [1] *Section 9.107*, states, in pertinent part:

A security interest is a "purchase money security interest" to the extent that it is (2) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire [*1457] rights in or the use of collateral if such value is in fact so used.

1 *Tex. Bus. & Comm. Code Ann. Section 9.107* (Vernon 1968 and West Supp. 1989).

[**26] Under the statute, Raytheon must satisfy three requirements. Raytheon must demonstrate that: (1) it gave value to Howe by making advances or incurring an obligation; (2) its extension of value enabled Howe to acquire rights in the collateral -- the account receivable in each particular transaction; and, (3) the Texas U. C. C. recognizes an account receivable as collateral for the purposes of a purchase money security interest.

There is no question that Raytheon extended value. Raytheon gave value when it shipped, according to the purchase order, an x-ray machine that a particular customer had ordered. This interpretation of the value requirement is consistent with the definition of value as set out in section

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1.201(44) of the Texas Uniform Commercial Code. Section 1.201(44) is applicable through the direction of the definitional cross reference of *section 9.107*. It states in pertinent part, that: " [a] person gives 'value' for rights if he acquires them (D) generally, in return for any consideration sufficient to support a simple contract." Raytheon satisfied section 1.201(44) because the advance of the x-ray machine in exchange for a promise from Howe to assign an accounts [**27] receivable arising from the sale of that x-ray machine is consideration sufficient to support a contract. Moreover, under *section 9.107(2)* itself, "'A secured party may give value by committing to supply goods or [by] actually supply [ing] the goods.'" *Thet Mah and Associates Inc. v. First Bank of North Dakota, 336 N. W.2d 134, 138 (N. D. 1983)* (citing 1 Bender U. C. C. Service, Secured Transactions, section 4.05(4) p. 304 (1983). [2]

2 *See* Gilmore, *The Purchase Money Security Priority*, 76 Harv. L. Rev. 1333, 1375 (1963) ("The something [given as value] need not be a purse of gold or its present day negotiable equivalent.").

This advance also satisfied the limitation on the type of value that may be given as defined in comment 2 of *section 9.107*. [3] Comment 2 states, in pertinent part:

"this section provides that the purchase money party must be one who gives value "'by making advances or incurring an obligation'": the quoted language excludes from [**28] the purchase money category any security interest taken as security for or in satisfaction of a preexisting claim or antecedent debt."

This antecedent debt limitation is satisfied here because Howe's debt to Raytheon was not preexisting but was instead created by the advance of the machine. Only then was Howe indebted to Raytheon for the machine's value. In

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turn, the debt was secured by the accounts receivable that Howe assigned to Raytheon pursuant to their agreement.

3 *Texas Bus. & Comm. Code Ann. section 9.107* (Vernon 1968 and West Supp. 1989).

B. THE ENABLING REQUIREMENT

The second element of a purchase money security interest is the requirement that Raytheon give value "to enable" Howe to acquire rights in the particular account receivable. [4] This requirement means that the advance made by Raytheon must have made it possible for Howe X-ray to obtain the collateral. [5] In the present case, the enabling requirement is satisfied because Raytheon's agreement with Howe, which preceded all of [**29] the particular transactions, was that Raytheon would advance an x-ray machine to Howe in exchange for an accounts receivable generated by Howe's sale of the machine to a customer. This preexisting agreement, together with the advance of the machine by Raytheon, enabled Howe to make the sale. At the same moment in time, in the twinkling of an eye, the sale created the particular account receivable payable to Howe which Howe then assigned to Raytheon pursuant to their preexisting agreement. "If the loan transaction appears closely allied to the purchase transaction, that should suffice. The [*1458] evident intent of paragraph (b) [*U. C. C. 9-107(b)*] is to free the purchase-money concept from artificial limitations; rigid adherence to particular formalities and sequences should not be required." G. Gilmore, I *Security Interests in Personal Property*, 782 (1965). [6]

4 Howe's rights in the collateral, the accounts receivable that Howe assigned to Raytheon, have not been contested.

5 *See* Gilmore, *supra* note 2 at 1373 (1963).

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6 *See In re McHenry, 71 B. R. 60, 62 (Bkrtcy. N. D. Ohio 1987)* (debtor acquires collateral based on preexisting agreement that funds will subsequently be advanced to pay for the collateral); *In re Sherwood, 79 Bankr. 399, 400 (Bkrtcy. W. D. Wis. 1986)* (preexisting loan agreement enabled debtor to acquire collateral even though loan funds disbursed after collateral acquired); *Thet Mah and Associates v. First Bank of North Dakota, 336 N. W.2d 134, 138 (N. D. 1983)* (enabling requirement satisfied by loan commitment which allowed debtor to purchase collateral even though the actual funds were received after the installation of the collateral). *But see Northwestern National Bank Southwest v. Lectro Systems, 262 N. W.2d 678, 680 (Minn. 1977)* (creditor did not establish a purchase money security interest because the funds were not used to acquire a receivable but were instead used for the performance of an already existing contract).

[**30] C. THE COLLATERAL REQUIREMENT

The thorny question in this case centers on whether accounts receivable should be considered collateral for the purpose of a purchase money security interest under *Section 9-107(b)*. To my mind, Raytheon has jumped this hurdle. [7]

7 MBank and DuPont argue that Raytheon does not have purchase money security interest in the accounts receivable of Howe. They contend that the proper way to characterize the transaction between Raytheon and Howe is to view Raytheon as having advanced credit to Howe. This credit, the argument continues, allowed Howe to purchase inventory from Raytheon in the form of the x-ray machine. Thus, according to MBank and DuPont, the x-ray machine served as collateral to secure the advance of the credit from Raytheon. Howe then sold the x-ray machines to its

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customers. The sales created accounts receivable which Howe assigned to Raytheon.

The implication of MBank and DuPont's characterization of the transaction between Raytheon and Howe is that MBank and DuPont have priority in the accounts receivable over Raytheon because Raytheon would not be able to claim a valid purchase money security interest. Raytheon would not be able to claim a purchase money security interest under *section 9.312(d)* because this section requires that the interest be taken in collateral other than inventory. *Section 9.312(d)* states that "A purchase money security interest in collateral other than inventory has priority over a conflicting security interest in the same collateral or its proceeds if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within 20 days thereafter."

Raytheon would thus have to claim a purchase money security interest under another section because according to MBank and DuPont, the collateral in the transaction was inventory. The purchase money security interest would have to be justified under *section 9.312(c)* which applies to purchase money security interests in inventory. *Section 9.312(c)(2)* requires "the purchase money secured party [to give] notification in writing to the holder of conflicting security interests if the holder has filed a financing statement covering the same type of inventory." Raytheon, however, failed to give any notice to MBank or DuPont and could not, therefore, establish a valid purchase money security interest under this section.

Because Raytheon would be precluded from claiming a purchase money security interest under *section 9.312(c)* or *section 9.312(d)*, MBank and DuPont would have priority over Raytheon in the accounts receivable of Howe under *section 9.312(e)*. *Section 9.312(e)* states that "conflicting

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security interests rank according to priority in time of filing or perfection." Therefore, because both MBank and DuPont filed notice of their claims prior to Raytheon, they would have superior interests under *section 9.312(e)*.

This analysis, however, suggested by MBank and DuPont begs the question. The question is whether Raytheon established a purchase money security interest in the accounts receivable of Howe not whether Raytheon properly perfected a purchase money security interest in the inventory of Howe. The analysis of whether Raytheon properly perfected a security interest in the inventory of Howe assumes that MBank and DuPont's characterization of the transaction is correct. But the very question to be decided is how to characterize the transaction for the purposes of defining a purchase money security interest. Nothing in the code mandates that Raytheon to claim a purchase money security interest in Howe's inventory. Raytheon claimed a purchase money security interest in the accounts receivable of Howe. The question is thus whether accounts receivable may be considered collateral for the purposes of a purchase money security interest.

[**31] Under section 9.105(a)(3), which is listed in the definitional cross references of *section 9.107*, collateral is defined as "the property subject to a security interest and includes accounts and chattel paper which have been sold. ." Moreover, under section 9.106, which is also listed in the definitional cross references of *section 9.107*, [*1459] "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, whether or not it has been earned by performance." The comment to 9.106 states that the section is referring to "ordinary commercial accounts receivable." By reading these two definitional sections in tandem, it is clear that an account receivable can be

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collateral for the purposes of a purchase money security interest under *section 9.107*.

There is, however, no other authority to our knowledge that expressly states that accounts receivable should be considered collateral for the purpose of a purchase money security interest. The Supreme Court of Minnesota has suggested that a purchase money security interest in accounts could validly arise. *See Northwestern National Bank Southwest v. Lectro Systems, 262 N. W.2d 678, 680 (Minn. 1977)* [**32] ("This is not a case in which funds were advanced and used for purchase of a receivable."). And, Professor Grant Gilmore, one of the original drafters of article 9, has stated in his treatise on security interests, that the purchase money concept might apply to intangible property in occasional cases. G. Gilmore, I *Security Interests in Personal Property*, 781 (1965) ("There seems to be no reason, however, why the term 'collateral' should have other than its normal meaning: the purchase-money concept may thus, in an occasional case, apply to intangible property. .").

MBank and DuPont have asserted that accounts receivable should not be considered collateral for the purpose of defining a purchase money security interest under *Section 9.107(2)*. Their argument, adopted by the majority, is that because accounts receivable financing has been accorded a special importance by the Texas Uniform Commercial Code, its legal position should not be made less certain by the operation of *Sections 9.107(2)* and *9.312(d)*. Once a security interest has been created under *section 9.107(2)*, *section 9.312(d)* grants it special status. *Section 9.312(d)* states that "a purchase money security interest [**33] in collateral other than inventory has priority over a conflicting security interest in the same collateral or its proceeds if the purchase money security

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interest is perfected at the time the debtor receives possession of the collateral or within 20 days thereafter." [8]

8 *Tex. Bus. & Comm. Code Ann. section 9.107* (Vernon 1988 and West Supp. 1989).

The significance of this special priority granted to purchase money security interests in subsection (2) becomes apparent when compared to the general priority rule in *section 9.312(e)*. Under *section 9.312(e)(1)*, conflicting security interests in the same collateral rank according to the time of filing. The first party to file notice of its interest in an account has priority over any subsequently filed interests in the identical account.

Because of the operation of *section 9.312(d)*, however, the first party to file notice of a security interest in an account would not necessarily have priority under *section 9.312(e)(1)*. *Section 9.312(d)* would grant priority [**34] over any interest filed previously in the same account if purchase money status in the account was first established under *section 9.107*. The legal position of accounts receivable financing might thus be made less certain if a purchase money security interest could be claimed in accounts receivable under *section 9.107(2)*. Diminished certainty could result in the sense that the first party to file notice of its interest in an account under *section 9.312(e)* would be uncertain as to whether it had priority in the account or whether another party has priority because the latter established purchase money status in the same account under 9.107(2).

MBank and DuPont argue that this uncertainty in the legal position of accounts receivable financing should be prohibited because of the special importance accorded to accounts receivable financing under the code. They find this importance in the history of *section 9.312(c)* which prohibits the establishment of purchase money security

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interests in accounts receivable, derivatively, as proceeds of inventory. The argument points out that this prohibition was created due to the importance of accounts [*1460] receivable financing in the economy. [**35] Based on these premises, the argument concludes that the possibility of a purchase money security interest in accounts receivable under *section 9.107(2)* should also be prohibited. The fallacy of this logic, however, is that it equates the value of accounts receivable as applied to a problem that arose in the area of inventory financing with the values behind the *section 9.107* purchase money security interest.

The argument thus rests upon MBank and DuPont's interpretation of *section 9.312(c)*. *Section 9.312(c)* provides that "a perfected purchase money security interest in inventory has priority over a conflicting security interest in the same inventory and also has priority in any identifiable cash proceeds received on or before the delivery of inventory to a buyer." [9] This section of the code was changed in 1972 to address the problem of priority conflicts between a claim to accounts receivable derivatively as proceeds of inventory and a claim to the accounts established by the filing of a direct security interest. [10] The conflict arose between inventory financiers who claimed priority in the accounts as proceeds of the inventory that they helped the debtor to acquire and lenders [**36] who had taken a direct security interest in the accounts as collateral for money loaned to the debtor.

9 *Tex. Bus. & Comm. Code Ann. section 9.312(c)* (Vernon 1988 and West Supp. 1989).

10 *Id.*

Section 9.312(c) offered a solution to this conflict. It states that a prior right to the inventory of a debtor does not confer a prior right to any proceeds that arise from the sale of the inventory except for identifiable cash proceeds.

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There is no prior right to accounts receivable as proceeds from the sale of the inventory. Under this section, it would not be possible to establish a purchase money security interest in inventory and then claim a purchase money security interest in any of the accounts that arose from the sale of that inventory. This exclusion of accounts receivable as proceeds of inventory under *section 9.312(c)* rests upon the assumption that accounts receivable financing is more important in the economy than the financing of the types of inventory that produce accounts when sold.

MBank [**37] and DuPont thus argue that a purchase money security interest in accounts receivable should not be permitted under *section 9.107(2)* because a purchase money security interest in accounts receivable may not be claimed derivatively as proceeds of the sale of inventory under *section 9.312(c)*. However, when this argument is examined in light of the policy interests underpinning *section 9.107(2)*, the argument's core assumption, the importance of accounts receivable financing in the economy, dictates precisely the opposite result.

The most important policy justification for a purchase money security interest under *section 9.107(2)* is the protection that it gives to a debtor who is unable to raise additional funds to remain in business. Creditors who have previously loaned money to the debtor and taken a security interest in the debtor's goods may be unwilling to advance additional value or funds. [11] These additional funds, however, could enable a debtor to purchase goods, make sales, and in turn, generate profits. Profits which could not only be used to create more business, but also, to allow the debtor to pay off the creditor's loans. The purchase money security provisions thus enable [**38] a leveraged debtor who is able to find a new lender to give that new lender a

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first claim on the new collateral purchased notwithstanding a prior filing by another creditor. [12]

11 Jackson and Kronman, *Secured Financing and Priorities Among Creditors*, Yale L. J. 1143, 1165 (1979) (economic analysis suggesting that purchase money security interests may be used to free debtor from creditor's situational monopoly).

12 White and Summers, *Uniform Commercial Code*, 1043 (1972).

The arrangement between Raytheon and Howe exemplifies the use of accounts receivable to advance the policy rationale behind the purchase money security interest. It was the use of the accounts receivable by Raytheon as collateral for the x-ray [*1461] machines that allowed Howe to continue to do business. The additional business that Howe was able to generate with the advance of the x-ray machines, at minimum, gave Howe an additional opportunity to stay in business. This opportunity was a benefit to creditors such as MBank [**39] and DuPont whose loans would not be repaid unless Howe had the ability to generate profits. It also demonstrates the importance of accounts receivable financing in another forum, the creation of purchase money security interests.

The use of accounts receivable as collateral in this case also benefited MBank and DuPont as creditors because the consequences of an unpaid account were relatively greater to Raytheon. Raytheon, MBank and DuPont would each have been harmed if Howe's customers failed to pay their accounts. If an account receivable were to remain unpaid, Raytheon would lose the entire value of the x-ray machine advanced to Howe. In contrast, it is unlikely that the failure of one account would drive Howe into bankruptcy so that Howe would be unable to repay MBank and DuPont. Yet it is this additional risk taken by Raytheon which allowed

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Howe a profit that could be used to fund its business to the advantage of MBank and DuPont.

Finally, any obligation imposed on MBank and DuPont to determine whether Howe was using its accounts receivable to collateralize purchase money security transactions is diminished in two respects. First, as stated, it is these very purchase money [**40] transactions that allowed Howe an additional opportunity to service its debts to these creditors. Second, MBank and DuPont as creditors had already established relationships with Howe. In future transactions, it would not have been difficult for them to ascertain whether Howe was using any accounts to collateralize purchase money transactions with other creditors and draft the loan contracts accordingly.

D. THE LIMIT OF RAYTHEON'S PURCHASE MONEY SECURITY INTEREST

I would, however, posit a serious limit on the extent of Raytheon's purchase money security interest. Under *section 9.107*, a security interest has purchase money character only to the extent of the value given to acquire the collateral. In the present case, the value given by Raytheon was the price of the x-ray machine as measured by the difference in the price Howe charged customers and the price Raytheon charged Howe. This price measures the extent of Raytheon's purchase money security interest in the specific accounts receivable of Howe. I do not mean to imply that the value given to a distributor such as Howe will always be measured by the wholesale price. In some situations, it could be the retail price depending [**41] upon what the debtor was meant to gain by the transaction. I would leave these transactional details for the district court.

The difference between the price Raytheon charged Howe and the price Howe charged its customers would

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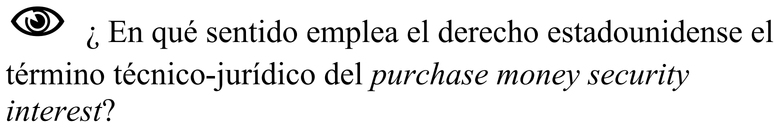
thus not be a part of Raytheon's purchase money security interest. There is evidence to the effect that Howe used a portion of this difference, Howe's profit margin, to pay a preexisting debt owing from Howe to Raytheon. This money could not be a part of Raytheon's purchase money security interest because a purchase money security interest may not be used to secure a preexisting debt. [13]

13 *Tex. Bus. & Comm. Code Ann. section 9.107* (Vernon 1988 and West Supp. 1989) (comment 2).

There is also evidence which suggests that Raytheon may have loaned money to Howe to cover Howe's costs of installing the x-ray machine. Any such money would not be a part of Raytheon's purchase money security interest. There should not be any additional opportunities created under the code to give simple [**42] loans purchase money character. [14]

14 White and Summers, *infra* note 12 at 1045 n. 5 (1972).

To my mind, Raytheon has established a valid purchase money security interest under *section 9.107(2)* of the Texas Uniform [*1462] Commercial Code. The x-ray machine advanced by Raytheon constituted the value that enabled Howe to acquire accounts receivable, the collateral, for the purposes of *section 9.107(2)*. As such, this case should be reversed and remanded, where the issue of waiver could be examined with a headlight's incandescence and the retroactivity issue appropriately explored. I therefore respectfully DISSENT.



¿ En qué sentido emplea el derecho estadounidense el término técnico-jurídico del *purchase money security interest*?

IN RE: JOSEPH D. WHITE and SUSIE J. WHITE, Debtors. UNITED STATES BANKRUPTCY COURT

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FOR THE SOUTHERN DISTRICT OF INDIANA, NEW ALBANY DIVISION 417 B. R. 102; 70 U. C. C. Rep. Serv. 2d 522 September 29, 2009, Decided September 29, 2009, Filed

OPINION BY: LORCH This matter comes before the Court on the Objection to Proof of Claim filed by the Debtors on March 16, 2009 [Docket No. 22], and the Response to Objection to Claim filed by AmeriCredit Financial Services, Inc. on April 14, 2009. The parties subsequently submitted the issue to the Court's discretion based upon a Joint Stipulation of Facts filed on August 31, 2009.

Background

The facts, as stipulated by the parties, are fairly straightforward. The Creditor, AmeriCredit Financial Services, Inc. ["AmeriCredit"] holds a secured claim dated January 7, 2009, in the principal amount of $22,081.96. That claim represents amounts financed to purchase a vehicle for the Debtors' personal use within 910 days of the bankruptcy filing and it includes $7,000.00 which represents a "negative trade-in" in that transaction. AmeriCredit asserts that the entire amount of $22,081.96 is a purchase-money secured interest ["PMSI"] by virtue of *section 1325(a) of the Bankruptcy Code*. [**2] The Debtors object to AmeriCredit's claim and have filed an Amended Plan which proposes to bifurcate the claim into secured and unsecured parts, treating the negative equity as an unsecured claim.

Discussion

This Court previously considered the treatment of negative equity under the "hanging paragraph" of *section 1325(a)* in *In re Gibson, Case No. 07-90752-BHL-13, 2007 Bankr. LEXIS 4621 (October 25, 2007)*. In that case, it was held that *section 1325(a)* protects only those funds

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advanced toward the purchase price of the vehicle as a PMSI. The creditor was therefore found to have a PMSI in the vehicle only to the extent of the purchase price and excluding any amounts used to pay for negative equity on the debtors' trade-in or insurance. Because case law is rapidly evolving on this issue, however, it seems prudent to revisit the matter in light of developing precedent.

Various circuit courts or B. A. P. S have recently considered this question and a definite trend appears to be emerging as to the treatment of negative equity. The earliest court to rule on the issue was *In re Penrod, 392 B. R. 835 (B. A. P. 9th Cir. 2008)*, which held that negative equity is not part of the PMSI protected by the 910-day rule in *section 1325(a)*. [**3] Since then, every other circuit which has weighed in on this point has concluded otherwise. *In re Callicott, 580 F.3d 753, 2009 WL 2870501 (8th Cir.)*; *In re Dale, 582 F.3d 568, 2009 U. S. App. LEXIS 20065, 2009 WL 2857998 (5th Cir.)*; *In re Ford, 574 F.3d 1279 (10th Cir. 2009)*; *In re Price, 562 F.3d 618 (4th Cir. 2009)*; *In re Padgett, 408 B. R. 374 (B. A. P. 10th Cir. 2009)*; *In re Graupner, 537 F.3d 1295 (11th Cir. 2008)*; [*104] *In re Peaslee, 547 F.3d 177 (2nd Cir. 2008) cert'd, Matter of Peaslee, 913 N. E.2d 387, 13 N. Y.3d 75, 885 N. Y. S.2d 1, 2009 WL 1766000 (N. Y. 2009)*.

Courts within the Seventh Circuit, however, are split. Some bankruptcy courts, including this one, have found that the negative equity is not part of the purchase-money security interest. *See, e. G., In re Gibson, supra; In re Crawford, 397 B. R. 461 (Bankr. E. D. Wis. 2008)*; *In re Hernandez, 388 B. R. 883 (Bankr. C. D. Ill. 2008)*. Yet other courts have found to the contrary. *See, e. G., In re Myers, 393 B. R. 616, 2008 WL 2445214 (Bankr. S. D. Ind. 2008)*; *In re Dunlap, 383 B. R. 113 (Bankr. E. D. Wis. 2008)*; *In re Smith, 401 B. R. 343, (Bankr. S. D. Ill. 2008)*;

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In re Morey, 414 B. R. 473, 2009 Bankr. LEXIS 2757, 2009 WL 2916685 (Bankr. E. D. Wis. Sept. 9, 2009).

Taking a fresh look at the question, this court continues to believe that the minority position, so well expressed by [**4] Judge Markell in *In re Penrod,* [1] is the better reasoned course. That position is essentially premised on the finding that negative equity simply does not fit within the U. C. C. definition of a "purchase-money obligation" or "price" of the collateral, in light of Official Comment 3 to the U. C. C., [2] which reads in part:

[T] he definition of "purchase-money obligation," the "price" of collateral or the "value given to enable" includes obligations for expenses incurred in connection with acquiring rights in the collateral, sales taxes, duties, finance charges, interest, freight charges, costs of storage in transit, demurrage, administrative charges, expenses of collection and enforcement, attorney's fees, and other similar obligations.

The concept of "purchase-money security interest" requires a close nexus between the acquisition of collateral and the secured obligation. Thus, a security interest does not qualify as a purchase-money security interest if a debtor acquires property on unsecured credit and subsequently creates the security interest to secure the purchase price.

Admittedly, the foregoing list of obligations "incurred in connection with acquiring rights in the collateral" is illustrative [**5] and not exhaustive. But it is noteworthy that it does not include value given to pay off an existing debt, which is a significant and ever-recurring theme in the business of new-car financing. [3] The Comment is silent as to existing debt, it would seem, because the drafters did not intend to include that type of expense within the confines of the statute. Negative equity is clearly not in the nature of or in any way similar to the types of expenses cited in the

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Comment. It is neither an expense "incurred in connection with acquiring rights in the collateral" nor is it similar to sales taxes, finance charges, freight, or administrative charges. As noted by another court, the nature of the expense items listed in Official Comment 3 are closely connected with the purchase of the vehicle itself and include costs normally associated with the enforcement of the security interest. *In re Sanders, 377 B. R. 836, 855* [*105] *(Bankr. W. D. Tex. 2007)*. [4]

1 *392 B. R. 835*.

2 See, e. G., *In re Callicott, 386 B. R. 232 (Bankr. E. D. Mo. 2008)*; *In re Riach, 2008 Bankr. LEXIS 461, 2008 WL 474384 (Bankr. D. Or. 2008)*; *In re Look, 383 B. R. 210 (Bankr. D. Me. 2008)*; *In re Johnson, 380 B. R. 236 (Bankr. D. Or. 2007)*; *In re Acaya, 369 B. R. 564 (Bankr. N. D. Cal. 2007)*; [**6] *In re Bray, 365 B. R. 850 (Bankr. W. D. Tenn. 2007)*.

3 Judge Markell notes that between 26% to 38% of all new car financing involves "negative equity" per GMAC. *In re Penrod, 392 B. R. at 842* (citing *In re Peaslee, 358 B. R. 545, 554 (Bankr. W. D. N. Y. 2006)*).

4 *Rev'd* by *In re Sanders, 403 B. R. 435 (W. D. Tex. 2009)*.

This court, together with the minority, finds that negative equity is merely the debtor's antecedent debt which is assumed by the auto seller.

Context thus bolsters the conclusion that "price of the collateral" need not be given some exotic meaning or treated as some peculiar argot to sweep up more than the common understanding of the phrase is intended to convey. One may borrow money to buy something *(e. G,* a new vehicle), and also borrow additional money for some other purpose *(e. G.,* to pay off the balance of a loan for the

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trade-in vehicle). The part used to buy something is purchase money obligation. The part used for some other purpose is not. We can tell what part was used to buy something by simply looking at the price of the thing purchased.

In re Sanders, 377 B. R. at 853. *See also, In re Wear, 2008 Bankr. LEXIS 208, 2008 WL 217172 (Bankr. W. D. Wash. 2008)*; *and see, In re Westfall, 365 B. R. 755, 762 (Bankr. N. D. Ohio 2007)*(questioning [**7] whether a doctor's fee could be viewed as an enabling expense if a debtor would not have made it to the dealer's lot without an emergency appendectomy"). As stated by the Court in *Padgett,* [5] "without the payment of items such as taxes, title fees, duties and freight charges, an individual generally cannot acquire title to a vehicle. The same cannot be said about the payment of negative equity in a vehicle that is to be traded in." "Negative equity", as the dissent noted in *Ford,* [6] "is not a transaction cost, but a transfer of money for value. Much like a home equity loan used to pay a preexisting credit card debt, the portion of the auto loan attributed to negative equity is not used for the purchase of some new piece of collateral or the costs inherent in the purchase. It is used for another purpose altogether."

5 *389 B. R. 203, 210 (Bankr. D. Kan. 2008)*, *rev'd, 408 B. R. 374 (B. A. P. 10th Cir. 2009)*.

6 *574 F.3d at 1289*.

Courts that include negative equity as part of the purchase price for purposes of *section 1325(a)*'s "hanging paragraph" often rely upon the concept of *in pari materia* as support for their position. Those courts create a hybrid definition of "price" by borrowing from state sales [**8] and finance laws and grafting it onto the UCC. The state statutes which those courts draw from, however, are designed to inform consumers of the true cost of credit and

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have absolutely nothing to do with secured transactions or the function of the cited bankruptcy statute, which is to establish relative preferences among creditors. As the court concluded in *In re Acaya, 369 B. R. 564, at 568-71 (Bankr. N. D. Cal. 2007)*, " [w] ith such different effects and goals, the two provisions -- one based on disclosure and the other on preference -- are not in pari materia." *See also, In re Mierkowski, 580 F.3d 740, 2009 WL 2853586 (8th Cir. 2009)* (Bye. J., dissenting).

Still other courts assert that the financing of negative equity is "value given to enable the debtor to acquire rights in the collateral" under *UCC § 9-103(a)(2)*. But this court finds that such monies are not "in fact so used" as further required by the statute. The monies are used to extinguish a pre-existing debt. Although the financing may be part of a single transaction and both rolled into one amount, such a reading elevates form over substance. Financing negative equity may well be made "integral" to the purchase agreement, [*106] depending on the circumstances [**9] or preferences of the parties, but that does not change the character of the transaction. That "package deal" approach utilized by some of the majority courts, [7] taken to its logical conclusion, bears illogical results. For instance:

If the [debtors] were unable to drive themselves to the dealership, we would not consider the cost of a taxi as part of the price of the new truck, even if the dealer were willing to pay for it and fold it into the sales contract. If [they] did not qualify for a car loan because their resources were strained by too much credit card debt at high interest rates, they could not fold those debts into the PMSI for a new car even if the attendant lower interest rate solved their credit problem and enabled them to obtain the car loan.

In re Ford, 574 F.3d 1279, 1291 (Tymkovich, J., dissenting). It still remains both a refinancing of pre-

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existing debt and the extension of credit for the purchase price of the new car.

7 *In re Graupner, 537 F.3d at 1302*; *In re Price, 562 F.3d at 625*; *In re Ford, 574 F.3d 1279*.

Admittedly, the hanging paragraph was drafted with a view toward providing protection to those creditors who extend credit to the debtor within 910 days of the [**10] bankruptcy for the purchase of a vehicle. It does that by preventing the "cramdown" of a debt owed to a purchase-money secured creditor if they have financed a vehicle for the debtors' personal use within 910 days of filing bankruptcy. But, given that the statute does not define a "purchase-money security interest", the protection it affords must necessarily be interpreted in deference to Article 9 of the Uniform Commercial Code. Because Congress chose not to alter or expand the traditional meanings of purchase money obligation and PMSI, this Court has no authority to expand that meaning to include negative equity financing. In considering this issue, it is well to remember that a "purchase money security is an exceptional category in the statutory scheme that affords priority to its holder over other creditors, but only if the security is given for the precise purpose as defined in the statute." *Matthews v. Transamerica Fin. Servs. (In re Matthews), 724 F.2d 798 (9th Cir. 1984)*.

The majority opinions, by including negative equity within the formula for PMSI, essentially transform one creditor's unsecured claim into a secured claim at the expense of the debtor's general unsecured creditors. [**11] Lenders are given an incentive to roll in as much negative equity as possible in constructing "package" transactions. Such a reading of the statute, giving a "super purchase-money secured claim" to the lender, totally upends the existing priority scheme in bankruptcy. By artificially

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enlarging the Article 9 concept of a purchase money obligation, these courts have allowed the lenders to take a higher percentage of plan payments and have undercut the distribution scheme designed by Congress.

Conclusion

Based upon a careful review of existing case law, this Court continues to hold that negative equity is not protected by the "hanging paragraph" of *section 1325(a) of the Bankruptcy Code*. It is neither "all or part of the price" of a new car nor is it "value given to enable the debtor to acquire rights in or the use of" a new car. As such, it does not fit within the definition of a PMSI under applicable Article 9 guidelines. The Debtor's Objection to the Claim of AmeriCredit is, therefore, SUSTAINED. [*107] The Debtor's Amended Plan which bifurcates the claim into secured and unsecured portions is, accordingly, approved. The Trustee is hereby ordered and directed to file an Order Confirming the [**12] Debtor's Amended Plan, in accordance with the foregoing findings of the court.

IT IS SO ORDERED.

¿ Por qué tiene el *puchase money security interest* una prelación preferente frente a otros acreedores privilegiados?

VAN DIEST SUPPLY CO., Plaintiff-Appellant, v. SHELBY COUNTY STATE BANK, Defendant-Appellee. UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT 425 F.3d 437; 59 U. C. C. Rep. Serv. 2d 1089 September 15, 2004, Argued October 3, 2005, Decided

OPINION BY: WILLIAMS [*438] Van Diest Supply Co. and Shelby County State Bank ("Shelby") both assert a security interest in proceeds of accounts resulting from inventory Van Diest sold to Hennings Feed and Crop Care

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("Hennings"). This case arose after Hennings filed for bankruptcy and was unable to pay for certain inventory it had purchased from Van Diest. Pursuant to a loan agreement with Hennings, Shelby had received the proceeds of many Hennings accounts receivable. Van Diest claimed a first, perfected purchase money security interest in proceeds of inventory it sold to Hennings and sued Shelby for conversion, seeking to recover the proceeds of inventory it sold to Hennings. The district [**2] court, in granting Shelby's motion for summary judgment, ruled that Van Diest had not presented evidence sufficient to carry its burden of identifying the proceeds. We agree and so affirm the decision of the district court.

I. BACKGROUND

At issue here are the proceeds of certain inventory that Van Diest Supply Co. sold to Hennings Feed and Crop Care. Hennings was a retail dealer in agricultural products, including chemicals, fertilizer, and limestone who purchased inventory from multiple suppliers, including Van Diest. In 1983, Van Diest and Hennings executed an agreement that granted Van Diest a purchase money security interest in inventory supplied by Van Diest, and the proceeds from such inventory. We concluded in an earlier case that the security interest did not extend to all Hennings inventory; instead, it was limited to inventory Van Diest supplied to Hennings. *Shelby County State Bank v. Van Diest Supply Co., 303 F.3d 832, 840 (7th Cir. 2002).*

Although Hennings had multiple suppliers, it did not (1) segregate inventory by supplier, (2) track inventory by supplier, or (3) know on any given day how much inventory it had on hand from any supplier. On May 16, 1998, Hennings [**3] and Shelby signed a "Draw Note-Fixed Rate" agreement that allowed Hennings to draw up to $4 million at a time, and Shelby made advances to

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Hennings under the Note in exchange for Hennings's accounts receivable. Shelby then collected the receivables. Shelby purchased Hennings's receivables from May 1998 until either December 14, 1998 or January 7, 1999 and received payments totaling over $2 million.

In late March or early April 1999, Van Diest received a financial statement from Hennings dated September 30, 1998. Based on the financial statement, Van Diest's credit manager believed Hennings was insolvent. Van Diest had already shipped additional product to Hennings, and payment was not due until June 11, 1999. Hennings was still current on its obligations, and Van Diest did not take any steps to enforce its rights under its security agreement with Hennings.

April 1999 also marked the first time that Hennings conducted a physical inventory. At the time, Hennings's computer records listed an inventory of approximately $7 million, but a check of the physical inventory revealed a missing $2.5 million in inventory.

Hennings first defaulted on a payment to Van Diest on June 11, 1999 and [**4] that day, Van Diest sent a demand letter to Hennings requesting payment in full. Van Diest did not learn of Shelby's factoring arrangement with Hennings until July 1, 1999. Hennings filed for bankruptcy the next month, on August 23, 1999. Van Diest then demanded payment of the funds [*439] paid to Shelby from the accounts factored under the Note, and Shelby refused to pay Van Diest.

Van Diest filed suit against Shelby, alleging that Shelby converted its property. The district court granted summary judgment in favor of Shelby, and Van Diest now appeals.

II. ANALYSIS

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Our review of a district court's grant of summary judgment is de novo. *Dumas v. Infinity Broad. Corp., 416 F.3d 671, 676 (7th Cir. 2005)*. Summary judgment is proper only when "there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law." *Fed. R. Civ. P. 56(e)*; *Celotex Corp. v. Catrett, 477 U. S. 317, 322, 91 L. Ed. 2d 265, 106 S. Ct. 2548 (1986)*. We will review all the facts and draw all reasonable inferences in favor of Van Diest, the non-moving party. *Dumas, 416 F.3d at 676*. To defeat a motion for [**5] summary judgment, the non-moving party cannot rest on the mere allegations or denials contained in his pleadings, but "must present sufficient evidence to show the existence of each element of its case on which it will bear the burden at trial." *Robin v. Espo Eng'g Corp., 200 F.3d 1081, 1088 (7th Cir. 2000)* (citations omitted). "However, neither presenting a scintilla of evidence, nor the mere existence of some alleged factual dispute between the parties or some metaphysical doubt as to the material facts, is sufficient to oppose a motion for summary judgment The party must supply evidence sufficient to allow a jury to render a verdict in his favor." *Id. at 1088* (internal citations omitted).

Van Diestsued Shelby under a theory of conversion, a dispute governed by state law. In diversity cases, we apply the substantive law of the state in which the district court sits. *Erie R. R. Co. v. Tompkins, 304 U. S. 64, 82 L. Ed. 1188, 58 S. Ct. 817 (1938)*. Here, Illinois law governs the dispute. In order to recover for conversion in Illinois, a plaintiff must show: (1) a right to the property; (2) an absolute and unconditional right to the immediate [**6] possession of the property; (3) a demand for possession; and (4) that the defendant wrongfully and without authorization assumed control, dominion, or ownership

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over the property. *Cirrincione v. Johnson, 184 Ill. 2d 109, 703 N. E.2d 67, 70, 234 Ill. Dec. 455 (Ill. 1998)*.

Van Diest held a perfected, first priority purchase money security interest in the inventory it sold to Hennings. Shelby, also a secured party, claimed a security interest in all inventory, accounts receivable, and equipment of Hennings. Van Diest contends that Shelby converted its property when Shelby received the proceeds from the sale of inventory Van Diest had supplied to Hennings. Van Diest does not challenge the district court's finding that the funds Hennings paid to Shelby directly by check written on Hennings's bank accounts are not at issue. Still at issue, though, are the direct payments to Shelby from Hennings's customers which did not pass through Hennings's bank account. After Hennings drew on the Note, and Shelby received accounts, Hennings customers either paid Shelby directly or wrote checks to Hennings, which Hennings delivered to Shelby. Van Diest contends it can show that each of [**7] these payments came from the sale of its collateral by showing the proportion of Hennings's inventory on the date of each transaction that was attributable to product that Van Diest had provided to Hennings.

The conduct that forms the basis of Van Diest's complaint occurred before July 1, 2001 and before the Illinois legislature enacted a revised version of Article 9 to its Uniform Commercial Code. *See* Ill. P. A. [*440] 91-893 § 5 (July 1, 2001). The parties do not dispute that the Code as it existed prior to July 1, 2001 applies in this case. At the time relevant here,the Code defined "proceeds" to include "whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds." *810 ILCS § 5/9-306(1)* (West 1994). Significantly here, the Code also provided that a party continued to have a security interest in the proceeds of the sale of inventory to the extent that the

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proceeds were "identifiable." *810 ILCS § 5/9-306(2)* (West 1994).

It is clearin Illinois that commingling does not necessarily make proceeds unidentifiable. First,*810 ILCS § 5/9-205* (West 1994) [**8] specifically provides that "a security interest is not invalid by reason of liberty in the debtor to use, commingle, or dispose of all or part of the collateral or to use, commingle, or dispose of proceeds."In addition, *section 9-306(2)* (West 1994) states that a security interest "continues in any identifiable proceeds." Finally,the Illinois Supreme Court recognized in *C. O. Funk & Sons, Inc. v. Sullivan Equip., Inc., 89 Ill. 2d 27, 431 N. E.2d 370, 372, 59 Ill. Dec. 85 (Ill. 1982)* that a security interest could continue in a commingled account if the proceeds were identifiable. *See also Brown & Williamson Tobacco Corp. v. First Nat'l Bank, 504 F.2d 998, 1001-02 (7th Cir. 1974)*. Therefore, so long as the proceeds were identifiable, Van Diest's security interest in the proceeds of the sale of the inventory it supplied to Hennings continued.

The Code does not define the term "identifiable." It does, however, direct that its provisions should be supplemented by "principles of law and equity." *810 ILCS § 5/1-103* (West 1994). Like many other courts, the Illinois Supreme Court has construed this provision to allow a party to identify proceeds [**9] using a tracing theory known in the law of trusts as the "lowest intermediate balance rule." *See Funk, 431 N. E.2d at 372-73*.

In this case, the district court concluded that Van Diest did not present evidence sufficient to allow it to identify its proceeds. Therefore, it concluded that Van Diest had not presented evidence that it had an ownership interest in the proceeds Shelby received from the sale of Hennings's inventory, an immediate right to possession of those proceeds, or that Shelby assumed wrongful control over

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those proceeds. Because Van Diest had not presented sufficient evidence on elements for which it had the burden at trial, the district court granted Shelby's motion for summary judgment.

On appeal, Van Diest contends the district court erred when it found it could not trace its proceeds. Unfortunately, Hennings's commingling of the inventory it purchased from multiple suppliers makes this case difficult. Hennings purchased the same product from more than one supplier, but it did not segregate the inventory it received by supplier. In addition, although Hennings maintained records of the products it sold, these records did not track the company that [**10] had supplied Hennings with the product sold.

Funk is the only Illinois Supreme Court case to consider whether proceeds of collateral were sufficiently identified to subject them to a security interest. In that case, the court placed the burden of identification on the party seeking to identify the proceeds, stating, "Since Funk is claiming a prior security interest in property which is otherwise identified as collateral belonging to the bank under its after-acquired *property clause*, the burden of identifying the proceeds is properly upon Funk." *431 N. E.2d at 373*. The court then found that Funk failed to identify the proceeds, stating:

[*441] Funk argues that it established a *prima facie*case by showing that secured property was sold, that the proceeds were deposited into an account, and that other items of inventory were purchased from that account, and that upon such showing the burden should shift to another to segregate the wrongfully commingled funds. Were we concerned here with the rights of Funk against Sullivan this argument would have considerable merit. The bank, however, was neither responsible for Funk's position nor

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for the commingling and is at least [**11] as innocent as Funk. We find no principles in law or equity which dictate that the innocent third party must suffer the consequences of Funk's predicament. *Section 9-306* says that the security interest attaches to identified proceeds Funk failed to offer the proof required to identify the claimed proceeds and is not now entitled a second opportunity to do so. *Id.*

Funk makes clear that Van Diest has the burden of identifying the proceeds from the sale of the inventory it supplied. *See id.* Van Diest has admitted that it "cannot at this time state the amount of its pro rata share in the mass of inventory." It contends, however, that the amount of its pro rata share is an issue of fact for trial or relevant only to damages. We disagree thattracing of Van Diest's proceeds is only a means to calculate damages and is not relevant to liability, as *Funk* clearly states that a security interest continues only in "identifiable proceeds." *431 N. E.2d at 372*. When it recently considered the same argument, the Eighth Circuit explained,"tracing is not a measure of damages. It is the primary means of demonstrating the plaintiff's rights, and therefore [**12] the defendant's liability, in cases involving commingled accounts Without equitable tracing, [the plaintiff] cannot make out a claim for conversion because it cannot establish that the funds allegedly converted were identifiable proceeds in which it had a security interest." *General Elec. Capital Corp. v. Union Planters Bank, N. A., 409 F.3d 1049, 1059 (8th Cir. 2005)*.

We also disagree with Van Diest that it has presented sufficient evidence to survive summary judgment and that only an issue of fact as to the amount of its pro rata share remains. To carry its burden of identifying proceeds, Van Diest has chosen to employ a pro rata tracing method that it contends was used in *In re San Juan Packers, Inc., 696 F.2d 707 (9th Cir. 1983)*, and *GE Bus. Lighting Group v.*

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Halmar Distribs., Inc. (In re Halmar Distribs., Inc.), 232 B. R. 18 (Bankr. D. Mass. 1999). Although Illinois courts have not considered whether proration is an appropriate means of tracing where more than one creditor has a security interest in commingled proceeds, *cf. Funk, 431 N. E.2d at 372-73* (recognizing lowest intermediate balance rule as an appropriate method of tracing), other courts have [**13] recognized that proration can be used to trace commingled proceeds. *See Halmar, 232 B. R. at 26*; *Gen. Motors Acceptance Corp. v. Norstar Bank, N. A., 141 Misc. 2d 349, 532 N. Y. S.2d 685 (N. Y. Sup. Ct. 1988)*; *Bombardier Capital, Inc. v. Key Bank of Maine, 639 A.2d 1065 (Me. 1994)*. Shelby agrees that, as a general matter, the pro rata method of tracing is an acceptable methodology for tracing collateral. It contends, however, that the method is not appropriate here.

The court in *Halmar* describedthe proration method of tracing proceeds as an approach where "a court may consider identifiable proceeds as a prorata share of the commingled account, the share being determined by the percentage of collateral owned by the secured creditor before the proceeds were commingled." *232 B. R. at* [*442] *26*. In this case, as a result of the Note agreement between Hennings and Shelby, Hennings's customers either paid Shelby directly or wrote checks to Hennings which Hennings delivered to Shelby. Van Diest maintains it can demonstrate that each payment resulted from the sale of its collateral by showing the proportion of Hennings's inventory [**14] on the date of each transaction attributable to inventory Van Diest had supplied to Hennings. As the district court explained, Van Diest's approach posited that if, "for example, on October 1, 1997, Van Diest had supplied Hennings with 10% of its inventory in Product A, then Van Diest would have had a security interest in 10%

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of the total inventory in Product A on that day, and 10% of the proceeds from the sale of Product A on that day."

The problem with the methodology Van Diest has employed is that it requires it to present evidence at some point in time of the percentage of Hennings inventory supplied by Van Diest. Van Diest, however, has presented no such evidence. To the contrary, Van Diest acknowledges that "It was not possible to know the total amount of any particular product that was on hand on any particular day. No records exist that show the various percentages of products supplied by different suppliers as of any particular day." (Undisp. Facts 11.)

If there was evidence of the proportion of Hennings inventory attributable to Van Diest, then to show the proportion of sale attributable to Van Diest product on any given day, Van Diest could present evidence of increases [**15] and decreases in Hennings's inventory over time as Hennings purchased more inventory from suppliers and sold inventory to customers. Without an initial percentage, however, Van Diest's methodology fails.

In an effort to present the necessary evidence, Van Diest submitted the affidavit of Douglas Main, a paralegal, numerous records, and reports Main produced from these records. Main selected October 1, 1997 as the starting point for determining Van Diest's interest in inventory it supplied to Hennings. He then created reports, including a report summarizing Hennings's purchases by product during the period from October 1, 1997 through December 9, 1998. This report detailed the total dollars of all purchases, the total dollar of purchases from Van Diest, and the resulting percentage of Van Diest's purchases to the total of all purchases. For each product detailed, Main then multiplied this percentage against every account for which an invoice appeared on Shelby's records, regardless of when the

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account was generated or whether the account had been paid by check from an account debtor or by Hennings from its general deposit account. Main concluded that Shelby received $5,095,034.15 [**16] from the sale of Hennings's inventory and that 18.66%, or $950,477.55, was the proportionate share subject to Van Diest's security interest.

Main stated that in arriving at his conclusions, he made several assumptions. These assumptions included that the data he received concerning Hennings's purchases of inventory was accurate and that "Van Diest's shares of the beginning product inventories were in the same proportion to its shares of those same products which it supplied during the period of 10/1/97 through 12/9/98." The district court concluded that neither assumption had support in the record.

Van Diest contends that the district court's determination that the records were unreliable constituted a factual or credibility determination not proper at the summary judgment stage. It is undisputed, however, that on any given day in 1998 or 1999, Hennings did not know how much inventory it had in its warehouse from any supplier. Moreover, Hennings did not [*443] check its records against a physical inventory until April 1999. It is also undisputed that the physical inventory count revealed that the computer records used by Main, which listed inventory of $7 million, overstated the actual [**17] inventory by $2.5 million.

Significantly, even if Hennings's records accurately recorded the inventory as of October 1, 1997, Van Diest has not presented any evidence of the amount of that inventory that was subject to its security interest. Main assumed that Van Diest's proportion of Hennings's inventory on that date was the same as the proportion in which it supplied Hennings thereafter, but there is nothing

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in the record to support that assumption. Van Diest cannot overcome a motion for summary judgment with speculation. *See Packman v. Chi. Tribune Co., 267 F.3d 628, 637 (7th Cir.2001)*. Because the starting balances of each product necessarily affect later percentages, speculation as to the starting proportions means that all future percentages Main calculated were also merely speculative. Showing the amount of product supplied to Hennings after October 1, 1997 is not sufficient when there is no evidence of the starting proportion.

Although the court in *Halmar* found a creditor had identified proceeds using the pro rata method, *Halmar* does not help Van Diest. In *Halmar*, the parties agreed on the quantity of inventory before commingling and agreed on [**18] the proportion of starting inventory subject to the secured creditor's claim. *232 B. R. at 25*. From there, the secured creditor presented evidence of the total product shipped to a company and calculated the percentage attributable to it. *Id.* Unlike the plaintiff in *Halmar*, however, Van Diest has presented no evidence of the percentage of inventory it supplied before the goods were commingled.

In short, Van Diest had the burden of identifying its proceeds, and it has not presented evidence to show that it could do so under the only methodology it presented. Of course, this is a difficult result for Van Diest, as Hennings, one of its long-time customers, failed to pay it for inventory it had ordered. Noticeably absent from this case, of course, is Hennings. Hennings's inability to pay its debts means that there are insufficient funds to pay both Van Diest and Shelby. Under Illinois law, however, the burden fell to Van Diest to identify its proceeds. *See Funk, 89 Ill. 2d at 33* ("We find no principles in law or equity which dictate that the innocent third party must suffer the consequences of Funk's predicament Funk failed to offer the proof [**19]

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required to identify the claimed proceeds and is not now entitled a second opportunity to do so.") Because Van Diest did not present evidence that it could do so, we are compelled to affirm.

III. CONCLUSION

For the foregoing reasons, the decision of the district court is AFFIRMED.

¿Cuál fue el impedimento exacto parase proceda a la ejecución del derecho real de prenda?

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TABLA DE LOS CASOS

AZUR v. CHASE BANK, 395
BAUM TEXTILE MILL v. MILAU, 25
BAYWAY REFINING v. TOSCO, 102
BELL SPORTS v. YARUSSO, 220
BRYON MOORE v. PRO-TEAM CORVETTE SALES, 172
BVS v. CDW DIRECT, 81
CASSERLIE v. SHELL OIL, 146
CATE v. DOVER CORPORATION, 244
COLUMBIA NITROGEN v. ROYSTER, 124
COOK SPECIALTY v. RANDOLPH SCHRLOCK, 163
COOLEY v. BIG HORN HARVESTORE SYSTEMS, 270
CORFAN BANCO ASUNCION PARAGUAY v. OCEAN BANK, 383
CRESCENT WOMEN'S v. KEYBANK, 372
DIAMOND FRUIT GROWERS v. KRACK, 88
FRENCH LUMBER v. COMMERCIAL REALTY & FINANCE, 5
HILL v. GATEWAY, 117
IN RE JOHN'S BEAN FARM, 426
IN RE WALLACE v. PUTNEY, 326
IN RE WHITE, 483
IN THE MATTER OF TARNOW, 449
KEY v. BAGEN, 169
LEAL v. HOLTVOGT, 183
MBANK ALAMO v. RAYTHEON, 455
RAMIREZ v. AUTOSPORT, 298
ROTTNER v. AVG TECHNOLOGIES USA, 33
SARA GRAIN COMPANY v. FIRST NATIONAL BANK OF MERCEDES, 9
SHAFFER v. VICTORIA STATION, 177

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ST. ANSGAR MILLS v. DUANE J. STREIT, 69
TRIFFIN v. AMERICAN EXPRESS, 353
TROUPE v. SELSON, 416
VAN DIEST SUPPLY v. SHELBY COUNTY STATE BANK, 490
WADDELL v. L. V. R. V., 311
WILSON TRADING v. FERGUSON, 262
WISCONSIN KNIFE WORKS v. NATIONAL METAL CRAFTERS, 51

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