Golden Gate University Law Review

Volume 20
Issue 1 *Ninth Circuit Survey*

Article 6

January 1990

Commercial Law - Interpreting the Uniform Commercial Code: Methodologies Used, Misused and Unused

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COMMERCIAL LAW

INTERPRETING THE UNIFORM COMMERCIAL CODE: METHODOLOGIES USED, MISUSED AND UNUSED

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I. INTERPRETING THE CODE

A. Methodologies for Interpreting the Uniform Commercial Code

There are two contrasting methodologies for interpreting provisions of the Uniform Commercial Code.[1] They reflect disagreement as to both the source of the law and the technique to be used in interpreting Code provisions. One approach, referred to herein as the "intra-Code" methodology, treats the U.C.C. as a self-contained whole and requires that the answers to interpretive questions must be found within the Code itself.[2] Under this

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1. The Uniform Commercial Code is hereinafter referred to as the Code or the U.C.C. For simplicity, references and citations herein are to U.C.C. sections rather than to their state law counterparts. State law is noted where it differs from the U.C.C.

2. Professor Grant Gilmore explained the concept of a code as a self-contained whole in the following manner:

> A "statute," let us say, is a legislative enactment which goes as far as it goes and no further: that is to say, when a case arises which is not within the precise statutory language, which reveals a gap in the statutory scheme or a situation not foreseen by the draftsmen (even though the situation is within the

intra-Code methodology the primary technique is to interpret provisions according to the relevant purposes and policies found within the Code.[3] The interpretation most consistent with the purposes of a Code provision or with the general purposes of the Code will prevail. A secondary intra-Code technique is to interpret each provision so that it is consistent with other provisions of the Code.[4]

At the other end of the spectrum is the "extra-Code" methodology, which permits the U.C.C. to be interpreted with free

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> general area covered by the statute), then the court should put the statute out of mind and reason its way to decision according to the basic principles of the common law. A "code," let us say, is a legislative enactment which entirely pre-empts the field and which is assumed to carry within it the answers to all possible questions: thus when a court comes to a gap or an unforeseen situation, its duty is to find, by extrapolation and analogy, a solution consistent with the policy of the codifying law; the pre-Code common law is no longer available as an authoritative source. We may take another, subsidiary distinction between "statute" and "code." When a "statute," having been in force for a time, has been interpreted in a series of judicial opinions, those opinions themselves become part of the statutory complex: the meaning of the statute must now be sought not merely in the statutory text but in the statute *plus* the cases that have been decided under it. A "code," on the other hand, remains at all times its own best evidence of what it means: cases decided under it may be interesting, persuasive, cogent, but each new case must be referred for decision to the undefiled code text.

Gilmore, *Legal Realism: Its Cause and Cure*, 70 YALE L.J. 1037, 1043 (1961).

3. In intra-Code methodology a distinction should be drawn between the source of interpretation, which is the U.C.C. itself, and the interpretive technique employed. Several techniques are possible utilizing the wisdom embodied in the Code. The most commonly employed technique has been to interpret according to the relevant purposes and policies. *See infra* notes 27-108 and accompanying text. The natural affinity between the technique of purpose reasoning and the source of the Code has been noted:

> Under the true code approach, then, a court should look no further than the code itself for solution to disputes governed by it—its purposes and policies should dictate the result even where there is no express language on point. Problems in interpreting code language not defined within the code explicitly also would be resolved by reference to the Code's purposes and policies.

Hillman, *Construction of the Uniform Commercial Code: UCC Section 1-103 and "Code" Methodology*, 18. B.C. L. REV. 655, 657 (1977).

4. In some decisions reviewed herein, courts have justified their interpretation on the ground that one Code provision expressly determines the interpretation of another. Other courts have held that implications from one or more Code provisions determine the interpretation of another. *See infra* notes 109-158 and accompanying text.

recourse to outside, non-Code law.[5] The extra-Code approach, rather than proceeding from sources within the Code, emphasizes the importance of common law[6] and statutory law[7] as pri-

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5. For example, non-Code law has been used to change rights and priorities otherwise created by Article 9 of the Code. In T & O Mobile Homes, Inc. v. United California Bank, 40 Cal. 3d 441, 220 Cal. Rptr. 627 (1985), the California Supreme Court applied principles of real property law to change the result otherwise applicable under Article 9 in a priority dispute between the buyer of a motor home and a secured party therein. *See infra* notes 180-187 and accompanying text. In Producers Cotton Oil Co. v. Amstar Corp., 197 Cal. App. 3d 638, 242 Cal. Rptr. 914 (1988), the California Court of Appeal applied the doctrine of unjust enrichment to change the priorities otherwise applicable under Article 9 between a buyer of goods and a secured party. *See infra* notes 209-212 and accompanying text.

6. Professor Gilmore opined that the common law is an appropriate source of law for interpreting the U.C.C.

> Surely the principle function of a Code is to abolish the past. At least a common lawyer assumes that that was the theory on which the great civil law codes were based. From the date of the Code's enactment, the pre-Code law is no longer available as a source of law. The gaps, the ambiguities, the unforeseen situations cannot be referred for decision to the accumulated wisdom of the past. There is a fresh start, a new universe of legal discourse, in which the only permissible way of solving a problem is to find (or pretend to find) the answer in the undefiled, the unconstrued, the uncontaminated text of the Code itself. How well the theory worked in practice, or whether it worked at all, you, as civilians, are much better equipped to say than I. The Uniform Commercial Code, so-called, is not that sort of Code—even in theory. It derives from the common law, not the civil law, tradition. We shall do better to think of it as a big statute—or a collection of statutes bound together in the same book—which goes as far as it goes and no further. It assumes the continuing existence of a large body of pre-Code and non-Code law on which it rests for support, which it displaces to the least possible extent, and without which it could not survive. The solid stuff of pre-Code law will furnish the rationale of decision quite as often as the Code's own gossamer substance.

Gilmore, *Article 9: What It Does for the Past*, 26 LA. L. REV. 285, 285-86 (1966)

7. Extra-Code statutory law has been applied to resolve a matter left unresolved by the Code. In SCT, USA, Inc. v. Mitsui Manufacturers Bank, 155 Cal. App. 3d 1059, 202 Cal. Rptr. 547 (1984), the California Court of Appeal employed California Code of Civil Procedure § 12, which provides that the "time in which any act provided by law is to be done is computed by excluding the first day, and including the last," to compute the five-year effective period of a financing statement under U.C.C. § 9-403(2). *See infra* notes 171-175 and accompanying text. Such a resort to extra-Code statutory law is untroubling because § 9-403(2) does not resolve the computation issue. On the other hand, it would be more troublesome if statutory law were held to supersede the U.C.C. on an issue to which the U.C.C. speaks. Thus, in Nunes Turfgrass, Inc. v. Vaughn-Jacklin Seed Co., Inc., 200 Cal. App. 3d 1518, 246 Cal. Rptr. 823 (1988), the California Court of Appeal refused to supersede U.C.C. § 2-719 with CAL. CIV. CODE § 1668. Both sections deal with contractual limitations on damages, but the U.C.C. provision was held to be applicable to

mary sources in resolving doubtful cases under the Code. Under this approach outside law can be used to create an exception to a Code provision[8] or to supersede a Code provision.[9] The extra-Code approach is premised on the notion that the Code drafters could not foresee all possible contingencies and that courts, being better able to take account of the factors in a particular case, should recognize and cure unfairness in the application of a Code provision by applying non-Code law.[10]

The U.C.C. authorizes both intra-Code methodology and extra-Code methodology. The intra-Code approach, with its emphasis on reasoning from purpose and policy, finds support in section 1-102(1), which provides:

> This Act shall be liberally construed and applied to promote its underlying purposes and policies.[11]

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the exclusion of the Civil Code provision. *See infra* notes 176-179 and accompanying text.

8. *See, e.g.*, Morgan Guaranty Trust Co. v. American Savings and Loan Assoc., 804 F.2d 1487 (9th Cir. 1986), *cert. denied*, 482 U.S. 929 (1987), wherein the New York right of restitution for mistaken payment creates an exception to the final payment rule of U.C.C. § 3-418.

9. *See, e.g.*, Connecticut Printers, Inc. v. Kroesen, 134 Cal. App. 3d 54, 184 Cal. Rptr. 436 (1982) (common law accord and satisfaction supersedes U.C.C. § 1-207); Citizens Bank of Roseville v. Taggart, 143 Cal. App. 3d 318, 191 Cal. Rptr. 729 (1983) (common law rule supersedes Code regarding rights of lien creditor vis-a-vis cash seller); Joffe v. United California Bank, 141 Cal. App. 3d 541, 190 Cal. Rptr. 443 (1983) (tort negligence rules supersede U.C.C. in action by depositor against depository bank).

10. The intra-Code reliance on Code sources is undermined by two limitations inherent in statutory drafting. First, it is impossible to draft a statute to cover all contingencies. Second, even if the drafters foresaw a contingency, their statutory language may be ambiguous. These two factors led one commentator to argue that extra-Code equitable principles are usually an appropriate source for interpreting the U.C.C.

> Yet the extent to which *legislators* can write rules to take account of equity in the particular case is limited. It is not just that contingencies are not always foreseeable—it would be cumbersome to formulate law even for every foreseeable contingency. In addition, language is imperfect. And legislators, unlike judges, are not well-suited to take account of circumstantial details that generate equities.

Summers, *General Equitable Principles Under Section 1-103 of the Uniform Commercial Code*, 72 Nw. U.L. Rev. 906, 907 (1978).

11. U.C.C. § 1-102 not only requires intra-Code purpose reasoning according to underlying purposes and policies, but also defines those underlying purposes and policies according to which the Code is to be construed. U.C.C. § 1-102 (2) provides:

> (2) Underlying purposes and policies of this Act are
>
> (a) to simplify, clarify and modernize the law governing commercial transactions;
>
> (b) to permit the continued expansion of commercial

Not only do the purposes and policies underlying the Code[12] provide interpretive guidance, but also the purposes and policies underlying each provision of the Code likewise provide a basis for interpretation. The Official Comment to section 1-102 provides:

> The Act should be construed in accordance with its underlying purposes and policies. The text of each section should be read in light of the purpose and policy of the rule or principle in question, as also of the Act as a whole, and the application of the language should be construed narrowly or broadly, as the case may be, in conformity with the purposes and policies involved.[13]

In addition to section 1-102, there are other aspects of the Code that lend support for the primacy of intra-Code methodology. Recent scholarship indicates that the Code was drafted according to a "patent reason" technique to include reason, purpose and policy in each section with the conscious goal that Code provisions should be applied and interpreted accordingly.[14] In fact, some Code sections are solely policy statements which can be used to solve interpretive questions.[15] Even where it was

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practices through custom, usage, and agreement of the parties;

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

12. *Id.*

13. Official Comment 1 to § 1-102. This comment also provides that "the proper construction of the Act requires that its interpretation and application be limited to its reason." *Id.*

14. Gedid, U.C.C. Methodology: Taking a Realistic Look at the Code, 29 WM. & MARY L. REV. 341 (1986) [hereinafter, Gedid].

15. For example, U.C.C. § 1-106, which adopts the expectation measure of damages as the favored measure of damages under the Code, can be used to interpret ambiguities in the application of other damages provisions. It can even have a substantive effect of its own, as in Allied Canners & Packers, Inc. v. Victor Packing Co., 162 Cal. App. 3d 905, 209 Cal. Rptr. 60 (1984), where U.C.C. § 1-106 was held to supersede U.C.C. § 2-713 as the measure of damages. *See infra* notes 47-53 and accompanying text. Section 1-106 provides:

> § 1-106. Remedies to be Liberally Administered.
> (1) The remedies provided by this Act shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special nor penal damages may be had except as specifically provided in this Act or by other rule of law.
> (2) Any right or obligation declared by this Act is enforceable

inconvenient to draft policy on the face of the statute, such policy can often be found in the relevant Official Comments. Thus, the comments are an important aspect of the patent reason device, because they provide the reason, policy and purpose necessary for interpreting Code provisions under the intra-Code methodology.[16]

On the other hand the extra-Code approach finds ample support in the Code as well. Section 1-103 provides:

> Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.[17]

This section instructs courts to apply extra-Code principles unless such law is "displaced" by the Code. Therefore, where extra-Code principles are not displaced, courts are to use them. Conversely, where extra-Code principles are displaced by the Code, courts may not use them. Unfortunately, the Code does not explain when an extra-Code principle is displaced and when it is not.

B. Examples Of Interpretive Disputes

Numerous types of interpretive disputes have arisen wherein the choice of interpretive methodology can affect the result. For example, the parties might dispute whether a particular Code provision applies to their dispute.[18] If the court is recep-

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> by action unless the provision declaring it specifies a different and limited effect.

16. *See* Gedid, *supra* note 14, at 382-83.

17. To the same effect is Official Comment 1 to U.C.C. § 1-103, which provides that section 1-103 "indicates the continued applicability to commercial contracts of all supplemental bodies of law except insofar as they are explicitly displaced by this Act. . . ."

18. *See, e.g.*, In re Pacific Trencher, 735 F.2d 362 (9th Cir. 1984) (issue of whether U.C.C. § 9-402(8) applies or whether extra-Code doctrine of reformation for mistake preempts it); T & O Mobile Homes, Inc. v. United California Bank, 40 Cal. 3d 441, 220 Cal. Rptr. 627 (1985) (issue of whether Article 9 priority scheme applies against buyer of

tive to extra-Code methodology, it is more likely to hold that an appealing principle of extra-Code law supersedes the Code provision than if the court reasons according to intra-Code methodology. A related interpretive problem occurs where the parties dispute whether one of them is entitled to an exception to an otherwise applicable Code provision. The party urging an exception might prevail if the court will use extra-Code law such as fraud, mistake or estoppel to create the exception, whereas such party might lose if the court reasons solely from within the Code according to the logic of the Code and the purposes of the Code provisions involved.[19]

An example of such a situation might be found in an oral contract for the sale of goods where the seller sues the buyer and the buyer defends on the ground that the statute of frauds[20] is not satisfied. Assume that the buyer represented to the seller that the buyer would perform, and in reliance thereon the seller missed resale opportunities that are now permanently lost because the goods have spoiled.[21] Under extra-Code methodology, it might be possible to apply the doctrine of promissory estoppel to create an extra-Code exception to the statute of frauds. The buyer would thereby be estopped from asserting the statute of frauds because of the buyer's promise to the seller.[22] On the other hand, under intra-Code methodology, the result in this

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motor home where filing officer omitted indication of security interest on certificate of title); Ford Motor Credit Co. v. Price, 163 Cal. App. 3d 745, 210 Cal. Rptr. 17 (1985) (issue of whether notice requirements of CAL. COM. CODE § 9504(3) apply or whether substantial compliance is sufficient).

19. Examples of cases where courts have used extra-Code law to create exceptions to Code provisions are: Morgan Guaranty Trust Co. v. American Savings and Loan Assoc., 804 F. 2d 1487 (9th Cir. 1986), *cert. denied*, 482 U.S. 929 (1987) (common law restitutionary remedy held to be an exception to § 3-418 final payment rule); Allied Grape Growers v. Bronco Wine Co., 203 Cal. App. 3d 432, 249 Cal. Rptr. 872 (1988) (non-Code promissory estoppel held an exception to § 2-201 statute of frauds); Producers Cotton Oil Co. v. Amstar Corp., 197 Cal. App. 3d 638, 242 Cal. Rptr. 914 (1988) (unjust enrichment held to create exception to priorities otherwise dictated by Article 9).

20. U.C.C. § 2-201, *infra* note 189.

21. These facts are suggested by Allied Grape Growers v. Bronco Wine Co., 203 Cal. App. 3d 432, 249 Cal. Rptr. 872 (1988).

22. Courts in other jurisdictions using extra-Code methodology have applied the doctrine of promissory estoppel as an exception to the statutue of frauds. *See, e.g.*, Atlantic Wholesale Co., Inc. v. Solondz, 320 S.E. 2d 720 (S.C. App. 1984); Northwest Potato Sales, Inc. v. Beck, 208 Mont. 310, 678 P. 2d 1138 (1984); Potter v. Hatter Farms, Inc., 56 Ore. App. 254, 641 P. 2d 628 (1982); Ralston Purina Co. v. McCollum, 611 S.W. 2d 201 (Ark. App. 1981). *See generally*, Metzger and Phillips, *Promissory Estoppel and Section 2-201 of the Uniform Commercial Code*, 26 VILL. L. REV. 63 (1980).

case would be to bar the seller because the Code's statute of frauds for goods is not otherwise satisfied and contains no exception for promissory estoppel.[23]

In another type of interpretive dispute, the parties might disagree over which of two conflicting Code provisions applies to their dispute.[24] In this situation one Code provision is more favorable to the plaintiff and the other Code provision more favorable to defendant. If the court chooses according to which provision better comports with a favored extra-Code principle, a different result may be had than if the choice is made by resort to the internal logic of the Code and the purpose of the relevant provisions.

Another type of interpretive problem involves interpreting ambiguities in the meaning of Code provisions. Assuming that a Code provision does apply, the parties might dispute what it means when applied to the facts of the parties' case. Such ambiguities often arise due to definitional gaps or inconclusive drafting.[25] Where such ambiguities are interpreted to give a result conforming to extra-Code law, the result might differ from an interpretation based on conformity with the purpose of the relevant Code provision or with some other Code provision.

C. The Problem

The Code authorizes both intra-Code and extra-Code methodology. The choice of methodology may be an important factor in determining the interpretation. Yet the Code does not resolve the questions of how to apply these methodologies, whether

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23. The Ninth Circuit reflected this view when it rejected an estoppel exception to U.C.C. § 2-201 in C.R. Fedrick, Inc. v. Borg-Warner Corp., 552 F.2d 852 (9th Cir. 1977).

24. *See, e.g.*, Farmers & Merchants State Bank v. Western Bank, 841 F.2d 1433 (9th Cir. 1987) (possible applicability of § 4-213(1) superseded by § 3-418); Allied Canners & Packers, Inc. v. Victor Packing Co., 162 Cal. App. 3d 905, 209 Cal. Rptr. 60 (1984) (possible applicability of § 2-713 superseded by § 1-106).

25. *See, e.g.* Connolly v. Bank of Sonoma County, 184 Cal. App. 3d 1119, 229 Cal. Rptr. 396 (1986) (whether a guarantor is a "debtor" entitled to protections under § 9-504(3)); In re Black & White Cattle Co., 783 F.2d 1454 (9th Cir. 1986) (what is "commercially reasonable time" under § 2-402(2)); In re Borba, 736 F.2d 1317 (9th Cir. 1984) (when has a transfer been "concealed" under § 6-111); In re World Financial Services Center, Inc. 78 B.R. 239 (9th Cir. BAP 1987) (what form of the debtor's name is required to satisfy § 9-402(1)).

courts must choose between them, and if a choice must be made, how to choose. Because it is possible to disagree on the answers to these questions,[26] it is predictable that the courts' approach to Code methodology has been uncertain. The purpose of this article is to examine the methodologies actually used by the courts in construing the U.C.C., to critique that methodology and to suggest a methodological approach for the future. The cases examined are decided by the Ninth Circuit and the California courts.

II. DECISIONS INTERPRETING THE UNIFORM COMMERCIAL CODE

In interpreting provisions of the U.C.C., the courts have used a bewildering array of intra-Code methodology, extra-Code methodology, and no articulated methodology at all. In addition,

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26. Commentators have argued various positions along the spectrum running from pure intra-Code methodology to pure extra-Code methodology. For example, Professor Gedid has recently argued for the intra-Code approach. He argues that Karl Llewellyn's understanding of the judicial process led him to exert his great influence to cause the U.C.C. to be drafted in Code form. It was Llewellyn's goal to explain within the Code the policy, purpose and reason behind the Code's provisions. Professor Gedid concludes that the source of Code interpretation should therefore be from within the Code and the technique for interpreting a Code provision should be to consider the purpose of that provision and the relationship of that provision to other Code provisions. *See* Gedid, *supra* note 14.

Professor Hillman has argued for a modified "true code" approach that permits resort to extra-Code rules where neither Code language nor Code purposes and policies are useful. This approach, while still favoring intra-Code interpretation, is positioned along the spectrum at a point closer to extra-Code methodology than the methodology favored by Professor Gedid. Hillman, *Construction of the Uniform Commercial Code: UCC Section 1-103 and "Code" Methodology*, 18 B.C. L. REV. 655 (1977) [hereinafter, Hillman].

Professor Nickles takes a position in the middle of the spectrum. He argues that, because neither approach is ideally suited to interpreting the U.C.C., courts should have the option either to use common law principles or to reason from within the U.C.C. based on purposes and analogies to other U.C.C. provisions. Whichever approach is taken, however, must be consistent with the purposes of the U.C.C. expressed in § 1-102(2). Nickles, *Problems of Sources of Law Relationships Under the Uniform Commercial Code -Part II: The English Method and Solution to the Methodological Problem*, 31 ARK. L. REV. 171 (1977) [hereinafter, Nickles].

Professor Summers has taken a position closer to the end of the spectrum represented by extra-code methodology. He recommends giving great weight to common law equitable principles to supplement, modify and explain U.C.C. provisions. Under his approach common law equitable principles are available not only to fill gaps created by Code silence, but also to modify and create exceptions to Code provisions. Summers, *General Equitable Principles Under Section 1-103 of the Uniform Commercial Code*, 72 NW. U.L. REV. 906, 934-35 (1978).

the courts have failed to articulate a standard for electing which methodology to apply.

A. INTRA-CODE METHODOLOGY

Courts have employed numerous intra-Code techniques. Some courts have adopted an interpretation because such interpretation advances the purpose of the interpreted provision. Similarly, courts have rejected interpretations which are at odds with the purpose of the interpreted provision. Courts have also used the intra-Code technique of interpreting one Code provision by resort to other Code provisions. Sometimes such other Code provisions are held expressly to resolve interpretive questions. In other instances, Code provisions resolve interpretive questions by implication. The following are examples of these techniques.

1. Interpretation To Advance Purpose of Provision

The pattern of reasoning in these cases can be described summarily. The court establishes the purpose of the provision[27] and then determines whether an arguable interpretation is in harmony with that purpose. If so, the court adopts the interpretation as the law of the case. Using such reasoning, courts have filled in definitional gaps, interpreted ambiguous provisions, and chosen between conflicting provisions.

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27. A court need not expressly state the purpose of the interpreted provision in order to reason from that purpose. Purpose reasoning may proceed from the unstated purpose of the provision. For example, in In re World Financial Services Center, Inc., 78 B.R. 239 (9th Cir. BAP 1987), the court used purpose reasoning to fill in a definitional gap in U.C.C. § 9-402(1) but did not expressly articulate the purpose of the provision. Section 9-402(1) provides that a proper financing statement must contain the name of the debtor, but does not elaborate on the name required. Although not expressly articulated by the court, the purpose of this debtor-name requirement is to protect the subsequent creditors by insuring that they can find a financing statement after it has been indexed by the name of the debtor appearing thereon. Thus the debtor-name requirement should be interpeted to require that the name of the debtor must be indentified in the financing statement in such a way that a reasonable search of the recorded financing statements would disclose the financing statement. In *World Financial Services Center* the financing statement identified the debtor as "Margaret Howe, dba Bargain Furn/ World Finance" whereas the debtor's actual name was "World Financial Servies Center, Inc." This language was held not to satisfy § 9-402(1) because the financing statement would not be found by subsequent creditors due to the faulty debtor name. *Id.* at 242.

In *Connolly v. Bank of Sonoma County*,[28] the California Court of Appeal used such purpose reasoning to fill in a definitional gap in the Code regarding the question of whether a guarantor should be treated as a "debtor" under Article 9, thereby giving the guarantor the protections of a debtor. Such protections include the right of the debtor to receive notice of a sale of collateral by the secured party[29] and a prohibition against the debtor's pre-default waiver of its right to such notice.[30] It is unclear from the Code whether a guarantor is a debtor entitled to

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28. 184 Cal. App. 3d 1119, 229 Cal. Rptr. 396 (1986).

29. The secured party must notify the debtor of the intended disposition of collateral. U.C.C. § 9-504(3) provides:

> (3) Disposition of the collateral may be by public or private proceedings and may be made by way of one or more contracts. Sale or other disposition may be as a unit or in parcels and at any time and place and on any terms but every aspect of the disposition including the method, manner, time, place, and terms must be commercially reasonable. Unless collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, reasonable notification of the time and place of any public sale or reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor, if he has not signed after default a statement renouncing or modifying his right to notification of sale. In the case of consumer goods no other notification need be sent. In other cases notification shall be sent to any other secured party from whom the secured party has received (before sending his notification to the debtor or before the debtor's renunciation of his rights) written notice of a claim of an interest in the collateral. The secured party may buy at any public sale and if the collateral is of a type customarily sold in a recognized market or is of a type which is the subject of widely distributed standard price quotations he may buy at private sale.

In California, if the secured party fails to give the required notice, the secured party is barred from recovering a deficiency judgment from the debtor. Barber v. LeRoy, 40 Cal. App. 3d 336, 344, 115 Cal. Rptr. 272, 277-78 (1974). Some jurisdictions have taken a different view of such secured party non-compliance and have in such circumstances imposed on the secured party a rebuttable presumption that the value of the collateral is equal to the debt. *See* Foss, *The Noncomplying Secured Party's Right to a Deficiency*, 21 U.C.C. L. J. 226 (1989).

30. U.C.C. § 9-504(3) imposes the notice requirement only where the debtor "has not signed after default a statement renouncing or modifying his right to notification of sale." U.C.C. § 9-501(3) provides that such protection from pre-default waiver may not be waived:

> To the extent that they give rights to the debtor and impose duties on the secured party, the rules stated in the subsections referred to below may not be waived or varied. . . . [followed by reference to § 9-504(3)]"

such protection, because the term "debtor" is not defined with reference to the term guarantor.[31] The *Connolly* court held that a guarantor is a debtor entitled to the foregoing debtor's protections, and grounded its result on advancing the purpose of the debtor-protective provisions.[32] Reasoning with regard to the notice requirement, the court determined that the purpose of the notice requirement is to protect the obligor from potential liability for a deficiency judgment by giving the obligor an opportunity to bid at the sale and by preserving the obligor's right to redeem the collateral.[33] Once the guarantor becomes the likely primary obligor and the likely target of the creditor (i.e., upon the debtor's default), the purpose of the notice requirement is best served by treating the guarantor as a debtor entitled to such notice. As the primary obligor, the guarantor's interest in receiving notice of sale is at least as great as the debtor's.[34] The same reasoning applies to the anti-waiver provision. Once its debtor-protective purpose applies to the guarantor, the guarantor should be treated as a debtor entitled to its protections.[35] Two subsequent decisions of the California courts have embraced the *Connolly* reasoning.[36]

Courts have used purpose reasoning to interpret ambiguities in Code provisions.[37] An example of such an ambiguous provi-

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31. U.C.C. § 9-105(1)(d) defines the term "debtor" as follows:

> "Debtor" means the person who owes payment or other performance of the obligation secured, whether or not he owns or has rights in the collateral, and includes the seller of accounts or chattel paper. Where the debtor and the owner of the collateral are not the same person, the term "debtor" means the owner of the collateral in any provision of the Article dealing with the collateral, the obligor in any provision dealing with the obligation, and may include both where the context so requires;

32. *Connolly*, 184 Cal. App. 3d at 1124-25, 229 Cal. Rptr. at 399-400.

33. *Id.* at 1124, 229 Cal. Rptr. at 399.

34. *Id.* at 1124-25, 229 Cal. Rptr. at 399.

35. *Id.* at 1125, 229 Cal. Rptr. at 400.

36. American National Bank v. Perma-Tile Roof Co., 200 Cal. App. 3d 889, 246 Cal. Rptr. 381 (1988); C.I.T. Corp. v. Anwright Corp., 191 Cal. App. 3d 1420, 237 Cal. Rptr. 108 (1987). Another California decision held that a guarantor is not a debtor for purposes of the prohibition against pre-default waiver. Rutan v. Summit Sports, Inc., 173 Cal. App. 3d 965, 219 Cal. Rptr. 381 (1985). This court did not disclose its reasoning but simply cited one case from another jurisdiction. *See infra* notes 224-227 and accompanying text.

37. For example, the facts of Procyon Corp. v. Components Direct, Inc., 203 Cal. App. 3d 409, 249 Cal. Rptr. 813 (1988), create an ambiguity in § 2-201(2), the Code's

sion is section 5-114(2)(b),[38] under which the issuer of a letter of

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statute of frauds for goods, *infra* note 189. That section provides that a written confirmation of a contract which is "sufficient against the sender" will satisfy the requirements of the statute of frauds against the recipient of a confirmation, if the recipient does not give written notice of objection to the confirmation within ten days after it is received. Thus, if a seller of goods fails to deliver, the statute of frauds ordinarily would require the plaintiff buyer to produce a writing signed by the seller to satisfy the statute of frauds. However, if the buyer sends a written confirmation to the seller and that writing is sufficient to satisfy the statute of frauds against the buyer, then under § 2-201(2) the buyer may use the same confirmation to satisfy the statute of frauds against the seller. In the *Procyon* case, the issue was whether a letter of credit issued by the buyer's bank at the buyer's request and delivered to the seller satisfied the statute of frauds against the buyer, so as to be "sufficient against the sender" under § 2-201(2). If so, the buyer could use the letter of credit to satisfy the statute of frauds against the seller. Procyon Corp. had a contract to purchase computer chips from Components. In order to assure itself that Procyon would be bound to the contract, Components had required that Procyon procure a letter of credit in favor of Components. Procyon's bank issued a letter of credit which included the contract terms. When Components failed to deliver, Procyon sued for breach of oral contract. Components defended on the ground that, because Components had not signed any contract, the statute of frauds precluded Procyon from suing for a breach.

The Court of Appeal held that the letter of credit was "sufficient against the sender" under § 2-201(2). The Court of Appeal justified its broad interpretation of "sufficient against the sender" by resort to two of the purposes of § 2-201(2). According to the court, one purpose of that section is to expedite confirmation of oral contracts among commercial traders. *Id.* at 412, 249 Cal. Rptr. at 816. A second purpose is to equalize the position of both sides and avoid giving the recipient of a confirmation the advantage of being able to watch a fluctuating market knowing he can bind but not be bound. *Id.* at 413, 249 Cal. Rptr. at 816. It is apparent that both purposes are served by permitting the letter of credit to operate against Procyon under § 2-201(2). The contrary result would defeat those purposes by giving Components the advantage of holding Procyon to the contract while not being held itself.

In holding that the letter of credit was "sufficient against the sender" the Court of Appeal addressed two problems raised by the facts. First, the letter of credit had not been signed by Procyon, as would be required to make the letter of credit sufficient against Procyon under § 2-201(1). In reply to this argument the Court of Appeal stated that the Bank had acted as Procyon's agent for the letter of credit and that the Bank's signature on the letter had been adopted by Procyon. Therefore, based on the broad definition of "signed" in § 1-201(39) ("any symbol . . . adopted by a . . . party . . . to authenticate a writing"), the Court of Appeal held that Procyon had "signed" the letter as required to make the letter of credit sufficient against it. Second, the Court also held that the letter of credit contained a sufficient memorial of the contract to satisfy § 2-201(1). *Id.* at 413, 249 Cal. Rptr. at 815-16.

38. U.C.C. § 5-114(2) provides:

> (2) Unless otherwise agreed when documents appear on their face to comply with the terms of a credit but a required document does not in fact conform to the warranties made on negotiation or transfer of a document of title (Section 7-507) or of a certificated security (Section 8-306) or is forged or fraudulent or there is fraud in the transaction:
>
> (a) the issuer must honor the draft or demand for payment if honor is demanded by a negotiating bank or other holder of the draft or demand which has taken the draft or

credit may refuse to honor it if "there is fraud in the transaction". The facts of *FDIC v. Bank of San Francisco*[39] demonstrate the ambiguity in the quoted language. In that case there was fraud alleged in the underlying transaction between the customer and the beneficiary of the letter of credit.[40] The defendant issuer refused to honor the letter of credit on the ground that, by reason of fraud in the underlying transaction, there was "fraud in the transaction" within the meaning of section 5-114(2)(b).[41] However, if "fraud in the transaction" refers to fraud in the presentation of the required documents to the issuer, rather than fraud in the underlying transaction, then the issuer would not have the option under section 5-114(2)(b) to dishonor the letter of credit because the documents presented to the issuer in *FDIC V. Bank of San Francisco* were the correct and unforged documents.

The Ninth Circuit interpreted section 5-114(2)(b) so that "fraud in the transaction" refers to fraud in the presentation of documents to the issuer and not fraud in the underlying deal between the customer and the beneficiary. The court reasoned that this result advanced an important purpose of letters of credit, i.e., to guarantee assured payment to the beneficiary. An interpretation that permits an issuer to avoid payment on the grounds of fraud in the transaction between the issuer's customer and the beneficiary would defeat that purpose and invite uncertainty and litigation instead of assured payment.[42]

> demand under the credit and under circumstances which would make it a holder in due course (Section 3-302) and in an appropriate case would make it a person to whom a document of title has been duly negotiated (Section 7-502) or a bona fide purchaser of a certificated security (Section 8-302); and
>
> (b) in all other cases as against its customer, an issuer acting in good faith may honor the draft or demand for payment despite notification from the customer of fraud, forgery or other defect not apparent on the face of the documents but a court of appropriate jurisdiction may enjoin such honor.

The distinction between paragraph (a), where the issuer must honor the letter of credit, and paragraph (b), where the issuer may refuse to honor the letter of credit, is that in the latter situation no innocent third parties would be hurt by the issuer's refusal to honor. Official Comment 2 to § 5-114.

39. 817 F.2d 1395 (9th Cir. 1987).

40. *Id.* at 1397.

41. *Id.* at 1399.

42. *Id.* The court also reasoned from an extra-Code source. It cited the statement of the Comptroller of the Currency, 12 C.F.R. § 7.7016, that "as a matter of sound banking

In *In re Shooting Star Enterprises, Inc.*[43] the Bankruptcy Appellate Panel of the Ninth Circuit interpreted the term "proceeds" according to the court's view of the purpose of section 9-306,[44] wherein a security interest continues to operate in favor of a secured party in the proceeds of collateral. In this case, the debtor's trustee in bankruptcy had purported to sell only a so-called equity portion of the collateral and not the portion of collateral necessary to pay the debt owed to the secured party. The trustee argued that the payment received by the trustee for the portion of collateral representing the debtor's equity should not constitute proceeds of the collateral and that therefore the secured party's interest in such non-proceeds could not continue because such security interest only continues in proceeds.[45] Although proceeds is defined to include "whatever is received" when collateral is sold, the court held that the payment for the equity portion did not constitute proceeds and could not be reached by the secured party. The court justified its narrow interpretation of the term "proceeds" by the admonition of Official Comment 3 to section 9-306 prohibiting the secured party from a double recovery.[46] Applying this policy, the court reasoned that the secured party was sufficiently protected by its interest in the collateral and that to give the secured party an interest in the receipts for the equity portion might give it a double recovery.

When two Code provisions arguably apply to the same situ-

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policy" the issuer "must not be called upon to determine questions of fact or law between the account party and the beneficiary." *Id.*

43. 76 B.R. 154 (9th Cir. BAP 1987).

44. U.C.C. § 9-306(1) and (2) provide:

> (1) "Proceeds" includes whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds. Insurance payable by reason of loss or damage to the collateral is proceeds, except to the extent that it is payable to a person other than a party to the security agreement. Money, checks, deposit accounts, and the like are "cash proceeds". All other proceeds are "non-cash proceeds".
>
> (2) Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor.

45. *Shooting Star Enterprises*, 76 B.R. at 156.

46. *Id.* at 157.

ation, and they lead to different or contradictory results, a court must interpret which provision governs. Using purpose reasoning the California Court of Appeal recently made such an interpretation in *Allied Canners & Packers, Inc. v. Victor Packing Co.*[47] Section 2-713[48] establishes that the measure of damages for an aggrieved buyer is the difference between the market price of the goods and the contract price. On the other hand, section 1-106[49] provides that remedies are to be administered to the end that "the aggrieved party may be put in as good a position as if the other party had fully performed". These two provisions conflicted on the facts of the *Allied Canners* case. Damages under section 2-713 would have been approximately $150,000 whereas the actual loss suffered by the aggrieved buyer (and therefore the amount necessary to put the buyer in the same position as performance under section 1-106) was only $4,462.50.[50] The difference occurred because the buyer had a resale contract for the goods on which, because its forward buyer declined to sue it for breach, it lost only the smaller amount, whereas the market value of the goods exceeded the contract price by the larger amount.

The Court of Appeal analyzed the purpose behind each provision to determine which provision should govern. Unfortunately, this reasoning disclosed that the purposes of the two sections were in opposition. The purpose of section 2-713 is to disregard the buyer's actual loss, thereby disregarding the actual amount necessary to make the buyer whole, and instead to provide a convenient mechanism based on market value for liquidating the buyer's damages.[51] On the other hand, the purpose of section 1-106 is expressly to put the aggrieved party "in as good a position as if the other party had performed" and accomplish-

47. 162 Cal. App. 3d 905, 209 Cal. Rptr. 60 (1984).

48. U.C.C. § 2-713(1) provides:

> (1) Subject to the provisions of this Article with respect to proof of market price (Section 2-723), the measure of damages for non-delivery or repudiation by the seller is the difference between the market price at the time when the buyer learned of the breach and the contract price together with any incidental and consequential damages provided in this Article (Section 2-715), but less expenses saved in consequence of the seller's breach.

49. *See* U.C.C. § 1-106, *supra* note 15.

50. *Allied Canners*, 162 Cal. App. 3d at 912, 209 Cal. Rptr. at 64.

51. *Id.* at 912-14, 209 Cal. Rptr. at 64-65.

ing that purpose requires an award of the actual damages incurred rather than a convenient substitute such as market value damages.[52] The court applied section 1-106 in preference to section 2-713, although it did not articulate why the policy of the former prevails over the policy of the latter, and held that the buyer was entitled only to the lesser amount of damages.[53]

2. Interpretation Where Purpose of Provision Inapplicable

In this situation, the purpose of the Code provision would neither be advanced nor contradicted by its application to the facts of the case. Despite the seeming neutrality of this situation, courts have interpreted Code provisions to be inapplicable where the purpose of the provision appears aimed at circumstances different from those before the court. There is no need to apply the Code provision in such circumstances.

For example, in *Nevada National Leasing Co. v. Hereford*[54] the California Supreme Court held inapplicable the "forced sale" provision of section 2-328(4).[55] Under section 2-328(4) the buyer at an auction for the sale of goods is generally protected from undisclosed bidding by a seller of the auctioned goods, but an exception to this rule is applied in the case of a "forced sale." Because the term "forced sale" is not defined in the U.C.C., the court had to interpret its applicability to the facts of the case. The court reasoned from the purpose of the forced sale exception. That purpose is to give the seller the mechanism of undisclosed bidding in order for the seller to avoid the unfair, low prices often received by sellers in a distress sale environment.[56] On the facts of *Nevada National Leasing Co.*, where the owner of leased equipment decided to auction it off after two lessees

52. *Id.*
53. *Id.* at 915, 209 Cal. Rptr. at 66.
54. 36 Cal. 3d 146, 203 Cal. Rptr. 118 (1984).
55. U.C.C. § 2-328(4) provides:

> (4) If the auctioneer knowingly receives a bid on the seller's behalf or the seller makes or procures such a bid, and notice has not been given that liberty for such bidding is reserved, the buyer may at his option avoid the sale or take the goods at the price of the last good faith bid prior to the completion of the sale. This subsection shall not apply to any bid at a forced sale.

56. *Nevada National Leasing*, 36 Cal. 3d at 152, 203 Cal. Rptr. at 121.

had defaulted,[57] this purpose was inapplicable because the seller voluntarily conducted the sale, could have made alternative arrangements for disposing of the equipment, and was protected from an unfair price in any event because the auction was conducted "with reserve."[58] In addition the sale was not the execution sale typically associated with unfairly low prices. Because the purpose of the forced sale exception did not apply, the court held the forced sale exception inapplicable.[59]

Another example of the inapplicability of a Code provision based on the inapplicability of its purpose can be found in *Security Pacific Bank v. Geernaert*.[60] There the court created an exception to the requirement under section 9-504(3)[61] that the secured party must notify the debtor concerning the sale of collateral. The purpose of the notice requirement is to guarantee fairness in the resale, but in *Geernaert* such fairness was automatically guaranteed without requiring the secured party to notify the debtor of the sale, because a court-ordered receiver conducted the sale. The reason for the notice requirement not being present, an exception to such requirement was created for the situation where collateral is sold by a court-ordered receiver.[62]

Courts sometimes disagree as to the inapplicability of the purpose of a Code provision. When this happens, those courts may reach conflicting conclusions and results. One such conflict recently arose regarding California's variation of section 5-114.[63]

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57. *Id.* at 148, 203 Cal. Rptr. at 119.

58. *Id.* at 152-53, 203 Cal. Rptr. at 121-22.

59. *Id.* at 153, 203 Cal. Rptr. at 122.

60. 199 Cal. App. 3d 1425, 245 Cal. Rptr. 712 (1988).

61. U.C.C. § 9-504(3) *supra* note 29. The California version differs, although the differences are not relevant in the context of Security Pacific Bank v. Geernaert. *See* CAL. COM. CODE § 9504(3), *infra* notes 85 and 86.

62. *Geernaert*, 199 Cal. App. 3d at 1431, 245 Cal. Rptr. at 715-16.

63. The Uniform Commercial Code and the California Commercial Code conflict on the question of whether a court may enjoin the honor of a letter of credit. U.C.C. § 5-114(2)(b) provides:

> (2) Unless otherwise agreed when documents appear on their face to comply with the terms of a credit but a required document does not in fact conform to the warranties made on negotiation or transfer of a document title (Section 7-507) or of a certificated security (Section 8-306) or is forged or fraudulent or there is fraud in the transaction:
>
> . . . .
>
> (b) in all other cases as against its customer, an issuer acting

California intentionally prohibits courts from enjoining the honor of a letter of credit. The question arose whether the California version, although generally preventing courts from enjoining the honor of a letter of credit, could be interpreted as subject to an exception that a court may enjoin the beneficiary of a letter of credit from seeking payment even though the court could not enjoin the issuer from paying. Although the practical effect of enjoining the beneficiary is the same as enjoining the issuer (i.e., no payment under the letter of credit), the California Court of Appeal in *Mitsui Manufacturers Bank v. Texas Commerce Bank-Fort Worth*[64] held that a lower court could enjoin the beneficiary from seeking payment. The court reasoned that the purpose of the California version of section 5-114 is inapplicable where the beneficiary is enjoined. The purpose is disclosed in the California Code Comment to section 5-114, namely that

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> in good faith may honor the draft or demand for payment despite notification from the customer of fraud, forgery or other defect not apparent on the face of the documents but a court of appropriate jurisdiction may enjoin such honor.

On the other hand California Commercial Code § 5114(2)(b) reads identically except for the deletion of the phrase "but a court of appropriate jurisdiction may enjoin such honor." The purpose for the California deletion is stated in California Code Comment 6:

> The phrase "but a court of appropriate jurisdiction may enjoin such honor," which appears at the end of subdivision 2(b) of the 1962 Official Text is omitted.
>
> This provision for a protective injunction was omitted because:
>
> "By giving the courts power to enjoin the honor of drafts drawn upon documents which appear to be regular on their face, the Commissioners on Uniform State Laws do violence to one of the basic concepts of the letter of credit, to wit, that the letter of credit agreement is independent of the underlying commercial transaction. . . ."
>
> The reasons for this change in the California version are stated even more strongly by the State Bar Committee:
>
> "The State Bar Committee and the Advisory Committee believe this part of section 15114 [5114] would undermine the parties' basic understanding of a letter of credit transaction, namely that the seller is assured of payment upon tender of the called for documents, and that the buyer must sue the seller in his own country for any claimed breach of contract. To permit a court to enjoin the honor of the draft would throw the burden on the seller of litigating in the buyer's country whenever the buyer raised a claim of 'fraud'. For this reason, this provision is contrary to one of the basic concepts of the letter of credit: its independence of the underlying commercial transaction. . . ."

64. 159 Cal. App. 3d 1051, 206 Cal. Rptr. 218 (1984).

the "power to enjoin the honor of drafts drawn upon documents which appear to be regular on their face" does "violence to one of the basic concepts of the letter of credit, to wit, that the letter of credit agreement is independent of the underlying commercial transaction."[65] The purpose of the California version is thus to protect the issuer from becoming involved in the underlying transaction, as would necessarily happen if the issuer's customer could enjoin the issuer from payment on the grounds of fraud in the underlying transaction. This purpose is not served with respect to the beneficiary, however, because the beneficiary is already involved in the underlying transaction (typically as the seller in a buy-sell transaction). Therefore, the Court of Appeal held that the beneficiary could be enjoined.[66]

On the other hand, the Ninth Circuit has rejected the exception created in *Mitsui Manufacturers Bank*. The Ninth Circuit's reasoning was also based on the purpose of the California rule. However, the Ninth Circuit reached the opposite conclusion regarding the applicability of that purpose to the beneficiary. In *Trans Meridian Trading Inc. v. Empresa Nacional de Comercializacion de Insumos*,[67] the court reasoned that the purpose for California's version is broader than merely protecting the issuer from becoming exposed to the underlying transaction. Rather, it reflects a "seemingly strong policy honoring letters of credit"[68] and providing the "certainty that should accompany letter of credit transactions."[69] Such a policy is best furthered by prohibiting all injunctions against honor, not just those brought against the issuer, because certainty of payment will be eroded if the beneficiary can be enjoined.[70] Hence, the Ninth Circuit reached a contrary result to that of the Court of Appeal, even though both courts reasoned according to the purpose of the California provision. The *Trans Meridian Trading* case also

65. *Id.* at 1058, 206 Cal. Rptr. at 222.

66. *Id.* at 1059, 206 Cal. Rptr. at 222-23.

67. 829 F.2d 949 (9th Cir. 1987).

68. *Id.* at 956.

69. *Id.* at 955.

70. *Id.* at 956. In *Trans Meridian Trading*, the Ninth Circuit also distinguished the facts of *Mitsui Manufacturers Bank*, *supra* note 64, on the unpersuasive ground that in the *Mitsui Manufacturers Bank* case the letter of credit specifically referenced the underlying contract, thereby bringing the underlying contract into issue, whereas the letter of credit in the *Trans Meridian Trading* case did not mention the underlying contract. *Trans Meridian Trading*, 829 F.2d at 957.

demonstrates that purpose reasoning can be used to reject proposed exceptions to Code provisions as well as to create them.[71]

3. Interpretation to Avoid Contradicting Purpose of Provision

Courts have interpreted Code provisions in order to avoid contradicting or defying the purpose of the provision. Such reasoning can cause a court to create an exception to a Code provision in order to avoid applying the provision to facts where its purpose would be defied. Conversely, a court might refuse to create an exception to a provision where the exception would

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71. In S & R Metals, Inc. v. C. Itoh & Co. (America), 859 F.2d 814 (9th Cir. 1988), the Ninth Circuit rejected another proposed exception to a Code provision where the purpose of such an exception did not apply to the facts of the case. The relevant provision was continued in U.C.C. § 2-608(1) whereby a buyer who satisfies certain conditions "may revoke his acceptance of a lot or commercial unit." Both "lot" and "commercial unit" are defined in such a way that revoking acceptance of a lot means revoking acceptance of an entire delivery, whereas revoking acceptance of a commercial unit means revoking acceptance of a portion of a delivery. Thus, an aggrieved buyer qualifying under § 2-608(1) has the option to revoke as to either all the goods delivered or a portion thereof. In the *S & R Metals* case the seller argued for an exception to the buyer's § 2-608(1) option whereby, due to the facts of the case, the buyer would be required to revoke only as to a commercial unit and not allowed to revoke as to the whole lot. In this case, plaintiff bought various gauges of steel from defendant. Plaintiff could establish that the 14-gauge steel delivered by defendant, constituting one-fourth of the total tonnage under the parties' contract, was defective. Nevertheless, plaintiff revoked its acceptance of the entire delivery of steel of all gauges. Defendant argued that, on these facts, plaintiff should be allowed to revoke only as to the defective 14-gauge steel and not as to the entirety. Despite the seemingly clear option given to a buyer to revoke either a lot or a commercial unit under § 2-608(1), defendant argued that plaintiff could not revoke as to the entire "lot" but only the lesser "commercial unit" of 14-gauge steel, because it would be unfair to permit plaintiff to revoke the entirety when such a small proportion was defective. Under this logic, the entire shipment consisted of two commercial units, defective 14-gauge steel and non-14 gauge steel. Because plaintiff could not prove that the non-14-gauge steel was defective, plaintiff should not be allowed to revoke as to that commercial unit. Thus an exception to the buyers right to revoke as to a whole lot should be created when the defective portion is small.

The Ninth Circuit rejected the defendant's proposed exception to the buyer's right to revoke as to the whole lot under § 2-608(1). The court reasoned that the purpose of the "commercial unit" option is to prevent a buyer who has elected not to revoke a whole lot from taking advantage of the situation by returning to the seller *less than* a commercially resalable unit. Under the "commercial unit" option, a buyer may not return components of an item that have a reduced market value compared to the item itself and thereby leave the seller in an unfair position. In the *S & R Metals* case, by contrast, the buyer returned more than a commercial unit and did not prejudice the seller by returning too little. Therefore, because the purpose of the commercial unit option is not served in this situation, it is not necessary or even logical to impose that option on the buyer, especially to the exclusion of the buyer's alternate remedy of revoking as to the whole lot.

defy the purpose of the provision. A court using such reasoning might also interpret gaps and ambiguities in the statutory language in such a way as to avoid contradicting the purpose of the provision.[72]

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72. Another Code provision which has been interpreted to avoid contradicting its purpose is California Commercial Code § 6111, which provides that the one-year statute of limitations for defrauded creditors of a bulk transferor begins to run when the transferee takes possession of the goods, but where "the transfer had been concealed" the one-year statute does not begin to run until the creditors discover the bulk transfer.

California Commercial Code § 6111 provides a one-year limitations period as does the newly revised U.C.C. § 6-110 (1988 Official Text). The two versions both provide that where the transfer has been concealed, the limitations period runs from the date when the person bringing the action discovers the bulk transfer. Revised U.C.C. § 6-110 (1988 Official Text) provides:

> § 6-110. Limitation of Actions.
> (1) Except as provided in subsection (2), an action under this Article against a buyer, auctioneer, or liquidator must be commenced within one year after the date of the bulk sale.
> (2) If the buyer, auctioneer, or liquidator conceals the fact that the sale has occurred, the limitation is tolled and an action under this Article may be commenced within the earlier of (i) one year after the person bringing the action discovers that the sale has occurred or (ii) one year after the person bringing the action should have discovered that the sale has occurred, but no later than two years after the date of the bulk sale. Complete noncompliance with the requirements of this Article does not of itself constitute concealment.
> (3) An action under Section 6-107(11) must be commenced within one year after the alleged violation occurs.

California Commercial Code § 6111 provides in relevant part:

> (a) No action under this division shall be brought nor levy made more than one year after the date on which the transferee took possession of the goods unless the transfer has been concealed. If the transfer has been concealed, an action may be brought or levy made within one year after its discovery by the creditor bringing such action or making such levy or after it should have been discovered by such creditor in the exercise or reasonable diligence, whichever first occurs.

In In re Borba, 736 F. 2d 1317 (9th Cir. 1984), the facts cast doubt on when a transfer had been concealed. There the transfer had been concealed in the sense that the bulk transferee had not complied with the notice requirements of Article 6. However, no additional affirmative acts of fraud or concealment had taken place. Therefore, the Ninth Circuit had to interpret whether the transfer had been "concealed" solely by reason of the transferee's failure to comply with the bulk transfer notice requirements. Because the transfer had taken place more than a year prior to the transferor's bankruptcy, the cause of action in *In re Borba* would be barred if the transfer had not been "concealed."

The Ninth Circuit Court of Appeals held that the special statute of limitations for concealment situations does not apply where the "concealment" consists only of a failure to comply with the requirements of the Bulk Sales Article. The Court reached its result in order to avoid contradicting the purpose of the usual statute of limitations (commencing on the date the transferee took possession). The purpose of the usual statute of limitations is to require prompt action by the aggrieved creditors, whereas the "conceal-

In *Bank of the West v. Commercial Credit Financial Services, Inc.*[73] the Ninth Circuit created an exception to a Code provision because the application of the provision to the facts of the case would contradict the purpose behind the provision. The first-to-file rule of section 9-312(5)(a)[74] provides that where two perfected secured parties have an interest in the same collateral, the first of the secured parties to have properly filed a financing statement on the collateral has priority over the other. In *Bank of the West* the following situation occurred: (1) perfected secured party A filed first in time on debtor A's accounts receivable, including after-acquired receivables; (2) perfected secured party B filed subsequently in time on debtor B's accounts receivable, and (3) debtor B transferred its accounts receivable to debtor A.[75] Because both secured party A and secured party B on these facts have a perfected security interest in the collateral in the hands of debtor A,[76] it is necessary to determine which

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ment" statute of limitations is intended to permit such creditors extra time. To treat a failure of notice as a concealment would contradict the purpose of the usual statute of limitations by permitting all creditors who failed to receive notice to elect the more generous "concealment" statute of limitations. *In re Borba*, 736 F.2d at 1320. This result is consistent with the provision of the newly revised U.C.C. § 6-110(2) that "[c]omplete noncompliance with the provision of this Article does not of itself constitute concealment."

73. 852 F.2d 1162 (9th Cir. 1988).

74. U.C.C. § 9-312(5)(a) codifies the first-to-file rule. Actually, the rule is more accurately stated as preferring the first secured party who either files or perfects in preference to other secured parties. U.C.C. § 9-312(5)(a) provides:

> (5) In all cases not governed by other rules stated in this section (including cases of purchase money security interests which do not qualify for the special priorities set forth in subsection (3) and (4) of this section), priority between conflicting security interests in the same collateral shall be determined according to the following rules:
>
> (a) Conflicting security interests rank according to priority in time of filing or perfection. Priority dates from the time a filing is first made covering the collateral or the time the security interest is first perfected, whichever is earlier, provided that there is no period thereafter when there is neither filing nor perfection.

75. *Bank of the West*, 852 F.2d at 1164-66.

76. Secured party A has a perfected security interest in the disputed collateral by virtue of its after-acquired collateral clause. U.C.C. § 9-204(1) provides, with exceptions, that "a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral." Therefore, when debtor A subsequently acquired the collateral, secured party A, having previously filed on such collateral, gets a perfected security interest it. On the other hand, secured party B is perfected in such collateral, even in the hands of debtor A, by virtue of U.C.C. § 9-306(2), which provides:

has priority. Between these two perfected secured parties the first-to-file rule would indicate that secured party A would prevail over secured party B because secured party A filed first in time on the accounts receivable. This was the result reached by the district court in this case.[77]

Reasoning that the purpose of the first-to-file rule is at odds with its application to this situation, the Ninth Circuit Court of Appeals reversed the district court on this issue and created a new exception to section 9-312(5)(a) whereby the later filing transferor's secured party prevails over the earlier filing transferee's secured party who claims under an after-acquired collateral clause. One purpose of the first-to-file rule that would be defeated by its application in *Bank of the West* is to give assurance to the first filer on a particular debtor that it will enjoy priority with respect to that debtor's collateral. This is the carrot to guarantee prompt filing. When the transferor's secured party (secured party B) has complied with the filing requirements with respect to the transferor (debtor B), it would violate this purpose to deny priority to the transferor's secured party. Secured party B filed first on debtor B and thus gave notice to subsequent creditors of debtor B; yet its deserved reward of priority is lost if the first-to-file rule applies after debtor B transfers the collateral to debtor A.[78] Another purpose of the first-to-file rule which would not be served here is to ensure that record notice of security interests is given to future creditors of a debtor. This "notice-giving" function is not achieved in the *Bank of the West* situation because a filing by secured party A against debtor A imparts no notice to the creditors of debtor B, including secured party B, because debtor B's creditors will search the record for filings against debtor B, not debtor A.[79]

Another decision creating an exception to a Code provision

> (2) Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor.

77. Bank of the West v. Commercial Credit Financial Services, Inc., 655 F. Supp. 807, 817 (N.D. Cal. 1987).

78. *Bank of the West*, 852 F.2d at 1173.

79. *Id.* at 1172-73.

in order to avoid contradicting the purpose of the provision is *Great Southwest Life Ins. Co. v. Frazier.*[80] The provision at issue was section 3-606(1)(b),[81] which provides for the discharge of "any party to the instrument" when the holder "(u)njustifiably impairs collateral for the instrument given by . . . the party." When the holder of a note impairs collateral by exchanging it for less valuable collateral, the maker's liability will increase to the extent that more debt will be left owing after application of the substituted collateral than would have been owing if the original collateral were still available. By the literal wording of section 3-606(1)(b) it would seem that the maker ought to be discharged in this situation. Certainly the maker would seem to qualify as "any party to the instrument." Yet in *Great Southwest Life* the Ninth Circuit recently recognized an exception to section 3-606(1)(b) by holding that "any party to the instrument" does not include the maker.[82] The court determined from Official Comment 1[83] to section 3-606 that this provision is intended to protect parties in the position of a surety (e.g., a guarantor or accommodation maker). The court reasoned that it would conflict with this purpose to permit the maker, who is not a surety, to be discharged. Therefore "any party" does not include the maker. Although it would seem that "any party" simply does not mean "any party but the maker," by reasoning that the drafter's purpose is not to benefit the maker, it is logical to except the

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80. 860 F.2d 896 (9th Cir. 1988).

81. U.C.C. § 3-606(1)(b) provides:

> (1) The holder discharges any party to the instrument to the extent that without such party's consent the holder
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> . . . .
>
> (b) unjustifiably impairs any collateral for the instrument given by or on behalf of the party or any person against whom he has a right of recourse.

82. *Great Southwest Life*, 860 F.2d at 900-01. The holding that "any party" to the instrument does not include the maker of the instrument, is in accord with that of most other jurisdictions. *See* e.g., FDIC v. Blue Rock Shopping Center, 766 F.2d 744, 749-51 (3d Cir. 1985); United States v. Vahlco Corp., 720 F.2d 885, 890 (5th Cir. 1983); *see also* Annotation, 93 A.L.R. 3d 1283 (1979 and supp. 1988).

83. Official Comment 1 to U.C.C. § 3-606 provides:

> The words "any party to the instrument" remove an uncertainty arising under the original section. The suretyship defenses here provided are not limited to parties who are "secondarily liable," but are available to any party who is in the position of a surety, having a right of recourse either on the instrument or dehors it, including an accommodation maker or acceptor known to the holder to be so.

maker from the term "any party to the instrument."

A court might also refuse to recognize an exception to a Code provision on the ground that the exception would contradict the purpose of the provision, as in *Ford Motor Credit Co. v. Price*.[84] In this case, Ford Motor Credit argued for an exception to the statutory requirements for notice of sale of collateral based on its substantial compliance with those requirements. The California Commercial Code contains a unique variation from the Uniform version with regard to the required notice of sale of collateral under section 9-504(3),[85] so that, among other things,[86] notice of a public sale must appear in a newspaper published in the county where the sale is to be held, whereas the U.C.C. requires only that the secured party give "reasonable" notice of such sale.[87] Ford had published notice in the wrong county and sought to argue that it had nevertheless substantially complied with section 9-504(3). The California Court of Appeal reasoned that an exception based on Ford's substantial compliance would undermine the very purpose of the California provision. That purpose is to prevent undue litigation as to what notice is required for a valid foreclosure sale by instructing the foreclosing secured party exactly how to proceed with notice.[88] This is in contrast to the more general "reasonable" notice stan-

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84. 163 Cal. App. 3d 745, 210 Cal. Rptr. 17 (1985).

85. California Commercial Code § 9504(3) provides in part:

> Notice of the time and place of a public sale shall also be given at least five days before the date of sale by publication once in a newspaper of general circulation published in the county in which the sale is to be held.

No such requirement appears in the U.C.C. *See* U.C.C. § 9-504(3), *supra* note 29.

86. In addition to the requirement of notice of sale by publication, California Commercial Code § 9504(3) varies from the U.C.C. by more carefully defining the required notice of sale to be given to the debtor:

> Such notice must be delivered personally or be deposited in the United States mail postage prepaid addressed to the debtor at his address as set forth in the financing statement or as set forth in the security agreement or at such other address as may have been furnished to the secured party in writing for this purpose, or, if no address has been so set forth or furnished, at his last known address, and to any other secured party at the address set forth in his request for notice, at least five days before the date fixed for any public sale or before the day on or after which any private sale or other disposition has been made.

87. See U.C.C. § 9-504(3), *supra* note 29.

88. *Ford Motor Credit*, 163 Cal. App. 3d at 750-51, 210 Cal. Rptr. at 20-21.

dard of the U.C.C., which invites litigation by its uncertainty. The suggested exception for substantial compliance would reintroduce the uncertainty and potential for litigation that the California notice provisions are intended to remove. Therefore, the court refused to create such an exception.[89]

The Ninth Circuit recently interpreted a gap in the conceptual scheme of section 2-207[90] in order to avoid contradicting the purpose of that section in *Diamond Fruit Growers, Inc. v. Krack Corp.*[91] Under section 2-207 a contract may be formed even though the terms of the acceptance vary those of the offer. However, if the acceptance expressly conditions acceptance on the offeror's assent to the offeree's varying terms contained in the acceptance, the parties differing forms do not result in a contract unless the offeror assents to the varying terms in the acceptance. If the offeror assents, the parties have a contract and the offeree's varying terms are part of that contract. If the offeror does not assent, there will be no contract unless the parties proceed with the transaction, in which case their performance

89. *Id.* at 751, 210 Cal. Rptr. at 21.

90. The court applied and interpreted Oregon law identical to U.C.C. § 2-207, which provides:

> § 2-207. Additional Terms in Acceptance or Confirmation.
> (1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.
> (2) The additional terms are to 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 otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this Act.

91. 794 F.2d 1440 (9th Cir. 1986).

results in the formation of a contract by conduct.[92] Within this framework there lurks an ambiguity. When the acceptance is conditioned on the offeror's assent to the offeree's varying terms, it is unclear what constitutes the offeror's assent that would form a contract on the offeree's terms. Such assent might arguably be interpreted to include an implied assent based on the offeror's performance of the deal after the offeree has made known its varying terms, or such assent might arguably be interpreted more narrowly to require the offeror's express assent.

In *Diamond Fruit Growers*, the Ninth Circuit held that the offeror's assent must be express and cannot be implied from the offeror's performance of the parties' deal. The court reasoned that the purpose of section 2-207 is to achieve neutrality between offeror and offeree by expunging the "last shot" rule.[93] Under that rule, where the parties' performance results in a contract by conduct, the party who sends the last form in the exchange of forms gets all of its terms included in the contract. To interpret section 2-207 so that the parties' performance constitutes the offeror's implied assent to the offeree's terms violates the neutrality principle of section 2-207 by reinstating the last shot principle. Such an interpretation would permit the party with the last form (here the offeree) to have its terms govern through the fiction of the offeror's impled assent. In order to avoid undermining this purpose of section 2-207, the court held that where the offeree has conditioned its acceptance on assent to its terms, only an express assent by the offeror could bind the offeror to the offeree's terms.[94]

4. Interpretation Adopted Because Supported by Purposes of Code Generally

Sometimes courts have interpreted an ambiguous Code provision by resort to the more general purposes of the Code, rather than the purpose of the provision at issue. These general pur-

92. *Id.* at 1443-44. Such a contract by conduct is recognized by U.C.C. § 2-207(3). Under § 2-207(3) the terms of such a contract are "those terms on which the parties agree, together with any supplementary terms incorporated under any other provisions of [the U.C.C.]." *See* U.C.C. § 2-207(3), *supra* note 90.

93. *Diamond Fruit Growers*, 794 F.2d at 1444.

94. *Id.* at 1445.

poses include the accommodation of commercial practices,[95] the goal of uniformity among the jurisdictions,[96] and the promotion of good faith.[97] It is also possible to interpret a provision according to the more general purposes of an Article of the Code.

The Ninth Circuit recently interpreted an ambiguous provision in order to accomplish the general Code purpose of accommodating commercial practices in *In re Black & White Cattle Co.*[98] The provision at issue was section 2-402(2)[99] whereby a merchant-seller may retain possession of goods sold for a "commercially reasonable time" without violating the Fraudulent Conveyance Act.[100] Ordinarily, a seller may not retain possession of goods sold because such retention would mislead creditors as to the ownership of the goods, but an exception to this requirement occurs when retention is only for a "commercially reasona-

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95. According to U.C.C. § 1-102(2)(b), *supra* note 11, one of the underlying purposes of the U.C.C. is to "permit the continued expansion of commercial practices through custom, usage and agreement of the parties." The court in In re Black & White Cattle Co., 783 F.2d 1454 (9th Cir. 1986) found in U.C.C.§ 1-102(2)(b) a broad Code purpose to accommodate commercial practices. *Id.* at 1460. *See infra* text accompanying notes 98-102.

96. According to U.C.C.§ 1-102(2)(c), *supra* note 11, one of the underlying purposes of the U.C.C. is "to make uniform the law among various jurisdictions." An example of a decision where a court adopted an interpretation at least in part to conform to the majority view of other jurisdictions, and thereby further the purpose of making the law uniform among the jurisdictions, is Connolly v. Bank of Sonoma County 184 Cal. App. 3d 1119, 1125, 229 Cal. Rptr. 396, 400 (1986). For a discussion of the purpose reasoning in *Connolly, see supra* text accompanying notes 28-36.

97. U.C.C. § 1-203 provides:

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

In Allied Grape Growers v. Bronco Wine Co., 203 Cal. App. 3d 432, 442, 249 Cal. Rptr. 872, 877 (1988), the court reasoned in part that its interpretation of the statute of frauds was justified because it was consistent with the general Code purpose of fostering good faith.

98. 783 F.2d 1454 (9th Cir. 1986).

99. U.C.C. § 2-402(2) provides:

> (2) A creditor of the seller may treat a sale or an identification of goods to a contract for sale as void if as against him a retention of possession by the seller is fraudulent under any rule of law of the state where the goods are situated, except that retention of possession in good faith and current course of trade by merchant-seller for a commercially reasonable time after a sale or identification is not fraudulent.

100. The relevant fraudulent conveyance legislation was CAL. CIV. CODE § 3440, which provides that a transfer is void against the transferor's creditors where the transfer is "not accompanied by an immediate delivery followed by an actual and continued change of possession" of the property transferred.

ble time." In *Black & White Cattle Co.*, the court interpreted the meaning of a "commercially reasonable time" for retention in a way to achieve the general Code purpose of accommodating commercial practices.[101] So interpreted, a commercially reasonable time is a length of time consistent with accomplishing the legitimate business practices involved. Because the seller, a cattle feed lot operator, had retained possession of cattle sold to the buyer in order for the seller to feed and fatten the cattle in preparation for delivering them to the buyer's customers and because such a feeding arrangement was alleged to be common in the cattle feeding industry, the court held that summary judgment against the buyer on the issue of a commercially reasonable time for the seller's retention would be improper.[102]

Similar reasoning was employed in *In re Hawaii Corp.*[103] where the court interpreted U.C.C. section 8-207(1)[104] which provides that the issuer of stock may treat the registered owner as the true owner in preference to an unregistered transferee. In *Hawaii Corp.* the perfected secured party had not registered the stock collateral in its name. Therefore, it was argued that the issuer could ignore the secured party's interest in a liquidating dividend paid by the issuer.[105] The court reasoned in part that an exception to section 8-207(1) for the neglected secured party was consistent with the fundamental Code purpose "to permit the continued expansion of commercial practices through custom, usage, and agreement of the parties."[106] It would be contrary to this purpose to apply section 8-207(1) on these facts because such an interpretation would interfere with the utility of stock certificates as collateral by imposing on secured parties the extra burden of registering their stock.[107]

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101. *Black & White Cattle Co.*, 783 F.2d at 1460. *See supra* note 95.

102. *Id.* at 1461.

103. 829 F.2d 813 (9th Cir. 1987).

104. U.C.C. § 8-207(1) provides:

> (1) Prior to due presentment for registration of transfer of a certificated security in registered form, the issuer or indenture trustee may treat the registered owner as the person exclusively entitled to vote, to receive notifications, and otherwise to exercise all the rights and powers of an owner.

105. *Hawaii Corp.*, 829 F.2d at 815. The facts of *Hawaii Corp.* are more fully described *infra* notes 137-141 and acccompanying text.

106. U.C.C. § 1-102(a), *supra* note 11.

107. *Hawaii Corp.*, 829 F.2d at 816-17.

The court also relied on the overall purpose of Article 8 of the Code. The court determined that application of section 8-207(1) to the facts of *Hawaii Corp.* would run counter to the purpose and spirit of Article 8, which is to confer negotiability upon securities.[108] That purpose would be negated if the registered owner retained rights that could frustrate the rights of the transferee secured party.

5. Interpretation Held Resolved Expressly by Code Provisions

Courts have used one Code provision to fill a gap or resolve an ambiguity in another provision. The reasoning is that, given the express terms of provision A, the court has no choice but to interpret provision B according to provision A. This reasoning need not rely on furthering the purpose of either provision. Rather, it is simply that the existence of provision A expressly resolves the interpretive issue in provision B, even though neither provision refers to the other. Following this approach, courts have relied on the Official Comments,[109] operative Code sections and Code definitions to interpret other Code provisions.

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108. *Id.*

109. In Keith v. Buchanan, 173 Cal. App. 3d 13, 220 Cal. Rptr. 392 (1985), the Court of Appeal interpreted U.C.C. § 2-313 by resort to Official Comments 3 and 8 thereto. Under section 2-313, dealing with express warranties, it is provided that, in order to be considered an express warranty a seller's statement may not be "merely the seller's opinion or commendation of the goods." If a statement is merely an opinion or commendation then an express warranty is not created. U.C.C. § 2-313(2). Furthermore, to constitute an express warranty, a statement must be "part of the basis of the bargain." The interpretive difficulty is that the Code does not define the terms "opinion or commendation" or "basis of the bargain". A court must therefore interpret in order to distinguish a warranty-creating "affirmation of fact or promise" from a non-warranty-creating "opinion or commendation". Similarly, a court must interpret the meaning of the phrase "basis of the bargain."

In *Keith v. Buchanan*, the Court of Appeal interpreted the foregoing terms to determine whether an express warranty was created where a sales brochure described the seller's boat as "a picture of sure-footed seaworthiness" and as "a carefully well-equipped and very seaworthy vessel." In holding that this language constituted an express warranty rather than an opinion, the court was also guided by Official Comment 8 to section 2-313, which creates a presumption in favor of warranty unless good reasons are shown to the contrary based on the objective circumstances surrounding the sale. *Id.* at 21, 220 Cal. Rptr. at 396. The court also was guided by the provision of Official Comment 3 that the buyer need not show any particular reliance on the seller's affirmations in order to make them part of the basis of the bargain and that the burden is on the seller to prove that such affirmations were not part of the agreement. *Id.* at 22-23, 220 Cal. Rptr. at 397-98. On the facts of *Keith v. Buchanan*, the seller had not carried its burden to prove that the representations in the sales brochure were opinions rather than warranties and that such representations were not part of the basis of the bargain.

Two recent decisions have used section 1-205(4)[110] to resolve interpretive issues in other provisions. Section 1-205(4) provides that the express terms of an agreement control over the parties' course of dealing. In *In re Ellsworth*[111] the issue was the interpretation of section 9-306(2),[112] which provides that when a debtor sells or disposes of collateral, the secured party's security interest continues in that collateral in the hands of the new buyer "unless the disposition was authorized by the secured party in the security agreement or otherwise. . . ." In *Ellsworth*, the security agreement required the secured party's prior written consent to the debtor's sale of collateral, while the parties had established a course of dealing whereby the secured party had previously permitted such sales without its written consent.[113] The issue was whether a subsequent sale of collateral could be deemed authorized "otherwise" by reason of the parties course of dealing. The Ninth Circuit held that such a course of dealing did not "otherwise" authorize the sale of collateral. The court relied mainly[114] on the general rule of section 1-205(4) that express terms control course of dealing. Hence the express term requiring written consent would control the course of dealing dispensing with written consent.[115]

The Ninth Circuit also relied on section 1-205(4) to decide whether an "at will" acceleration clause in a note could be waived by the holder's past course of dealing where the note expressly provided against such waiver. Usually section 1-208[116]

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110. U.C.C. § 1-205(4) provides:

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

111. 722 F.2d 1448 (9th Cir. 1984).

112. U.C.C. § 9-306(2), *supra* note 44. In *Ellsworth*, the court interpreted ARIZ. REV. STAT. § 44-3127.B, which is the same as U.C.C. § 9-306(2).

113. *Ellsworth*, 722 F.2d at 1450.

114. The court also employed purpose reasoning. Because the purpose of U.C.C. § 9-306(2) is to protect the unpaid secured party ("That is what § 44-3127.B is all about."), and because the situation in *Ellsworth* was "the very situation in which it [§ 9-306(2)] was designed to protect [the unpaid secured party]," it would be "going too far" to find an implied consent by an unpaid secured party on these facts. *Id.* at 1451.

115. It is possible to reach a different conclusion on this issue, however. *See infra* notes 231-235 and accompanying text.

116. U.C.C. § 1-208 provides:

governs at will acceleration terms, but that section is silent on the question of waiver. In *U.S. v. Grayson*[117] the guarantor of a note argued that the payee had waived its right to accelerate at will because of the payee's unwritten assurances and its generally lenient collection policy. The court held that section 1-205(4) resolved the question of waiver against the guarantor where the note required a written waiver and there was none.[118]

By way of further example, two other recent decisions have used section 9-402(1)[119] to interpret ambiguities in other Code provisions. Section 9-402(1) provides that, in order to perfect a security interest, a financing statement must "contain a statement indicating the types, or describing the items, of collateral." The required description of collateral is further elaborated in U.C.C. section 9-110 which provides that the description of collateral does not have to be specific if it "reasonably identifies" the collateral.[120] There is an ambiguity on the face of this provision in the phrase "reasonably identifies." In order to apply section 9-110 a court must necessarily interpret this phrase because the court must determine whether any given description "reasonably identifies" the collateral. Similarly, section 9-402(8) permits a financing statement to be effective if it is "substantially

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§ 1-208. Option to Accelerate at Will.

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

117. 879 F.2d 620 (9th Cir. 1989)

118. *Id.* at 624.

119. U.C.C. § 9-402(1) provides in part:

> A financing statement is sufficient if it gives the names of the debtor and the secured party, is signed by the debtor, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral.

120. U.C.C. § 9-110 provides:

> § 9-110. Sufficiency of Description.
>
> For the purposes of this Article any description of personal property or real estate is sufficient whether or not it is specific if it reasonably identifies what is described.

complying" and "not seriously misleading."[121] This provision requires interpretation because it is not certain in any case whether the language used in the financing statement is "substantially complying" and "not seriously misleading."

In *In re Boogie Enterprises, Inc.*[122] the Ninth Circuit held that the phrase "personal property" was not a sufficient description of collateral. In reaching its result, the court interpreted the requirement of section 9-110 that collateral be reasonably identified. The court reasoned that what constitutes a reasonable description under section 9-110 can be gleaned by consulting section 9-402(1). Because the latter section requires a description of collateral to potential creditors by "type" or "item,"[123] it is also necessary to describe collateral by item or type in order to reasonably identify collateral under the former section. A description of collateral as "personal property" does not satisfy this requirement and so cannot reasonably identify the collateral under section 9-110.[124]

In *In re Softalk Publishing Co. Inc.*,[125] the Ninth Circuit interpreted section 9-402(8)[126] to mean that where no description of collateral was given in a filed financing statement the mere filing of the financing statement, although giving inquiry notice to potential creditors of the debtor, was not "substantially complying" and was "seriously misleading."[127] As in *Boogie Enterprises*, the court put content into these ambiguous phrases by referring to the requirement of section 9-402(1) that collateral must be defined by "type" or "item". Thus, failure so to describe the collateral could not be "substantially complying" and must be "seriously misleading," inquiry notice notwithstanding.[128]

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121. U.C.C. § 9-402(8) provides:

> (8) A financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading.

122. 866 F.2d 1172 (1989).
123. *See* U.C.C. § 9-402(1), *supra* note 119.
124. *Boogie Enterprises*, 866 F.2d at 1175.
125. 856 F.2d 1328 (9th Cir. 1989).
126. *See* U.C.C. § 9-402(8), *supra* note 121.
127. *Softalk Publishing*, 856 F.2d at 1330-31.
128. *Id.*

Sometimes the use of Code definitions may resolve an interpretive issue,[129] as in *Fundin v. Chicago Pneumatic Tool Co.*[130] At issue was the applicability of Code section 2-725,[131] which states that an "action for breach of any contract for sale must be commenced within four years after the cause of action has accrued." A cause of action for breach of warranty usually accrues

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129. In two recent decisions the definition of "proceeds" created an interpretive issue. The term "proceeds" is defined in section 9-306(1) to include "whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds." This definition is important because, when the debtor sells or disposes of collateral, the secured party may have to look to the proceeds for satisfaction. Despite the careful definition, two recent cases have required the courts to interpret whether, under the facts involved, the definition of proceeds is satisfied. In Johanson Transportation Service v. Rich Pk'd Rite, Inc., 164 Cal. App. 3d 583, 210 Cal. Rptr. 433 (1985) (case name also identified as Johanson Transportation Service v. Jimmy Grizzard Sales, Inc. at 210 Cal. Rptr. 433), the California Court of Appeal interpreted the term "proceeds" to mean that where the collateral was strawberries sold by the debtor and the buyers' payment included freight charges incident to shipping the strawberries, the freight charges were part of the proceeds of the collateral to which the secured party was entitled under section 9-306(2). To reach this conclusion the court emphasized that proceeds are defined so that *whatever* is received upon the sale of collateral constitutes proceeds. By emphasizing the word "whatever," the court stated that an exception for freight charges is expressly rejected by the definition of proceeds. *Id.* at 592, 210 Cal. Rptr. at 438.

In Producers Cotton Oil Co. v. Amstar Corp., 197 Cal. App. 3d 638, 242 Cal. Rptr. 914 (1988), the court used the definition of "account" to justify an expansive interpretation of the term "proceeds." Proceeds are defined as "whatever is received" upon the sale of collateral, but this definition does not specify who must receive the proceeds. In *Producers Cotton Oil* the debtor sold crop collateral. The debtor did not receive the monies paid for the collateral, but such amounts were paid to third parties for their expenses in harvesting the crop. If the payments were proceeds, the secured party would be entitled to them. It was argued that the payment could not be proceeds because proceeds must be "received" by the debtor. The court rejected this argument because under Division 9 an "account" had arisen in favor of the debtor when the collateral was sold even though the debtor never received payment. Hence, because the unpaid account is proceeds in any event, the court declined to impose a requirement that the debtor must receive payment in order for proceeds to have arisen. *Id.* at 651, 242 Cal. Rptr. at 921.

130. 152 Cal. App. 3d 951, 199 Cal. Rptr. 789 (1984).

131. U.C.C. § 2-725 provides in relevant part:

> § 2-725. Statute of Limitations in Contracts for Sale.
>
> 1) An action for breach of any contract for sale must be commenced within four years after the cause of action has accrued. By the original agreement the parties may reduce the period of limitation to not less than one year but may not extend it.
>
> (2) A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach. A breach of warranty occurs when tender of delivery is made, except that where a warranty explicitly extends to future performance of the goods and discovery of the breach must await the time of such performance the cause of action accrues when the breach is or should have been discovered.

when tender of delivery is made.[132] Thus if section 2-725 applies in a breach of warranty action the plaintiff will have a four year limitation period commencing upon the tender of delivery of the goods. In *Fundin* a well driller purchased a drill rig from a machine company after reviewing the manufacturer's brochure and other material. The manufacturer was not a party to the contract between the well driller and the machine company. When the well driller sued the manufacturer for breach of warranty, the manufacturer demurred on the ground that the three and a half year interval between the contract date and the date the complaint was filed required dismissal under the two-year statute of limitations applicable under California Code of Civil Procedure section 339.[133] The buyer argued for the standard four year limitation under section 2-725.

On these facts the interpretive issue is whether there was a "contract for sale" between the driller and the manufacturer as required by section 2-725. The Court of Appeal determined this issue by reference to the Code definition of contract[134] and the Code definition of sale.[135] There was no "contract for sale" between the parties according to the Code definition, because the title to the drill rig and the purchase price were not exchanged between the parties as required by the Code definitions. Using such reasoning, the court determined that section 2-725 was inapplicable and instead applied the two year statute of limitations.[136]

6. Interpretation Adopted By Implication From Other Code Provisions

This technique, like the previous one, relies on one Code provision as the source to interpret another provision. However, in this situation, the source provision does not expressly answer

132. U.C.C. § 2-725(2).

133. CAL. CODE CIV. PRO. § 339(3) provides a two-year statute of limitations for an "action based upon the rescission of a contract not in writing." Unlike U.C.C. § 2-725(2), however, the two-year limitations period begins to run "from the date upon which the facts that entitle the aggrieved party to rescind occurred." CAL. CODE CIV. PRO. § 339(3).

134. A "contract" is "the total legal obligation which results from the parties' agreement . . . ." U.C.C. § 1-201(11).

135. A "sale" consists of "the passing of title from the seller to the buyer for a price." U.C.C. § 2-106(1).

136. *Fundin*, 152 Cal. App. 3d at 959-60, 199 Cal. Rptr. at 795-96.

the interpretive issue. Rather, the court draws an inference from some aspect of the source and interprets the other provision from that inference.

In *In re Hawaii Corp.*[137] the Ninth Circuit relied on inferences drawn from several other Code provisions[138] in order to interpret Code section 8-207(1)[139] The latter provides that until a transfer of securities is registered with the issuer, the issuer may "treat the registered owner as the person exclusively entitled to vote, to receive notifications and otherwise to exercise all the rights and powers of an owner." This section gives the issuer the general right to deal with the registered owner when a transferee has failed to register the transfer. In *Hawaii Corp.* the issuer of registered securities had declared bankruptcy and had obtained from a registered owner of its stock a release of that owner's interest in the issuer. However, at the time of the release the stock had already passed to a creditor of the registered owner with a perfected security interest in the stock. The perfected secured party had not registered the stock in its name. When the trustee in bankruptcy of the issuer paid a liquidating dividend to the shareholders of the issuer, the trustee refused to pay the unregistered perfected secured party on the ground that the registered owner had already released its interest.[140] The trustee argued that under the literal wording of section 8-207(1) the issuer had the absolute right to "treat the registered owner as the person exclusively entitled to . . . exercise all the rights and powers of an owner." According to the trustee, because the registered owner, exercising all the rights and powers of an owner, had released its interest, the issuer could treat that release as effective despite the secured party's unregistered interest.[141]

The Ninth Circuit interpreted section 8-207(1) to make it inapplicable on these facts. The court looked to other provisions of Article 8 which although not directly controlling, carry an im-

137. 829 F.2d 813 (9th Cir. 1987).

138. In addition to reasoning from the implications supplied by other Code provisions, the Ninth Circuit in *Hawaii Corp.* also used purpose reasoning. *See supra* notes 103-108 and accompanying text.

139. U.C.C. § 8-207(1), *supra* note 104.

140. *Hawaii Corp.*, 829 F.2d at 815.

141. *Id.*

plication that section 8-207(1) should not be interpreted to cover the facts of *Hawaii Corp.* For example, the presumption of enforceability of an instrument under section 8-105(3)(c)[142] would be thwarted by applying section 8-207(1). Another provision creating such an implication is section 8-103(3)(a)[143] which prevents an issuer from creating in its own favor a secret lien on a security by requiring the issuer's lien to be noted on the certificate. Thus, there is an implication that in order to be consistent with section 8-103(3)(a), the issuer in this case should not be allowed to create a secret right with respect to shares after the registered owner has used those shares to obtain credit from a lender.[144] Furthermore, section 8-405, dealing with lost, destroyed or stolen certificates, creates an implication that some risk of loss should be on the issuer[145] and thus indicates against applying section 8-207(1) to completely insulate the issuer. In addition, the literal interpretation would run counter to Article 9 of the Code because the perfected secured party's expected superior protection under Article 9 would be defeated if section 8-207(1) were allowed to render the collateral valueless in bankruptcy.[146] The Ninth Circuit held that the interpretation of section 8-207(1) most in harmony with the rest of the Code is that section 8-207(1) protects the issuer against an unregistered owner only in the normal course of business and not where the unregistered owner is a secured party asserting its interest in the stock of a bankrupt issuer.

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142. *Id.* The court mistakenly refers to U.C.C. § 8-105(2)(c). 829 F. 2d at 815. The intended reference is to U.C.C. § 8-105(3)(c) which provides:

> (c) if signatures on a certificated security are admitted or established, production of the security entitles a holder to recover on it unless the defendant establishes a defense or a defect going to the validity of the security;

143. U.C.C. § 8-103(a) provides:

> A lien upon a security in favor of an issuer thereof is valid against a purchaser only if: (a) the security is certificated and the right of the issuer to the lien is noted conspicuously thereon . . . .

144. *Hawaii Corp.*, 829 F.2d at 815.

145. If the registered owner sells his stock to a bona fide purchaser and then presents a claim to the issuer that the stock is lost, and if the issuer issues a new security to the registered owner without notice of the existence of the bona fide purchaser, the issuer must register the old certificates when presented by the bona fide purchaser. As against the bona fide purchaser, the risk is on the issuer. The issuer's recourse is against the prior owner. *Id.* at 816.

146. *Id.* at 815-16.

In *Farmers & Merchants State Bank v Western Bank*[147] the Ninth Circuit resorted to implications drawn from the Code comments to decide which of two potentially applicable Code provisions governed. In that case both plaintiff and defendant were victims of a check kiting scheme. Defendant had taken thirteen third-party checks from plaintiff in exchange for defendant's cashier's check; but because the thirteen checks were part of the kite, defendant refused to pay on its cashier's check.[148] The district court held that defendant was precluded from asserting its defenses to payment because it had "finally paid" the thirteen checks with its cashier's check and therefore under Code section 4-213(1)[149] had become "accountable" to plaintiff regardless of any possible defenses.[150]

The provision potentially in conflict with the district court's analysis is section 3-418.[151] Under its "final payment" rule, in contrast to section 4-213(1), defendant could raise its defenses unless plaintiff were a holder in due course. Whereas the district court held in effect that section 4-213(1) supersedes section 3-

147. 841 F.2d 1433 (9th Cir. 1987).

148. *Id.* at 1434-1437.

149. Oregon law applied. Oregon has codified U.C.C. § 4-213 as OR. REV. STAT. § 74.2130, but has not changed the relevant language. U.C.C. section 4-213(1) provides in part:

> (1) An item is finally paid by a payor bank when the bank has done any of the following, whichever happens first:
>
> (a) paid the item in cash; or
>
> (b) settled for the item without reserving a right to revoke the settlement and without having such right under statute, clearing house rule or agreement; or
>
> (c) completed the process of posting the item to the indicated account of the drawer, maker or other person to be charged therewith; or
>
> (d) made a provisional settlement for the item and failed to revoke the settlement in the time and manner permitted by statute, clearing house rule or agreement.

150. *Farmers & Merchants State Bank*, 841 F.2d at 1437-38.

151. Oregon has codified U.C.C. § 3-418 as OR. REV. STAT. § 73-4180 but has not changed any of the relevant language. U.C.C. § 3-418 provides:

> § 3-418. Finality of Payment or Acceptance.
>
> Except for recovery of bank payments as provided in the Article on Bank Deposits and Collections (Article 4) and except for liability for breach of warranty on presentment under the preceding section, payment or acceptance of any instrument is final in favor of a holder in due course, or a person who has in good faith changed his position in reliance on the payment.

418,[152] the Ninth Circuit interpreted section 4-213(1) as having no independent substantive effect on the issue of finality.[153] Even though defendant had "finally paid" and was "accountable" to plaintiff under section 4-213, the "final payment" rule of section 3-418 was applicable and defendant could assert its defenses unless plaintiff were a holder in due course.[154]

The Ninth Circuit reasoned by implication. It found nothing in the Official Comments indicating the drafters intended section 4-213 to supersede section 3-418.[155] On the other hand, the court drew an inference from certain Official Comments that section 3-418 should govern final payment issues in preference to Article 4 provisions such as section 4-213. For example, the comments to section 4-403 provide that banks retain "common law rights, e.g., to recover money paid under mistake (section 1-103) in cases where the payment is not made final by section 3-418."[156] This evidently convinced the court to consider the issue of final payment under section 3-418 to be an exception to the general rule of section 4-102(1) that Article 4 provisions govern those of Article 3.[157] Another inference of the drafters' intent to have section 3-418 govern the consequences of final payment on the facts of this case was drawn from the comments to section 3-418 which state that its final payment rule applies "to the payment of overdrafts, or to any other payments made in error as to the state of the drawer's account." [158]

7. Interpretation by Analogy

This style of reasoning is: the current situation is like situation X; situation X is governed by provision Y; therefore the current situation is governed by provision Y. A court may use this technique to determine whether a Code provision applies or to determine which of two competing Code provisions applies.

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152. *Farmers & Merchants State Bank*, 841 F.2d at 1438.

153. *Id. Accord*, Morgan Guaranty Trust Co. v. American Savings and Loan Assoc., 804 F.2d 1487, 1499 (9th Cir. 1986), *cert. denied*, 482 U.S. 929 (1987).

154. *Id.* at 1438.

155. *Id.*

156. Official Comment 8 to U.C.C. § 4-403.

157. *Farmers & Merchants State Bank*, 841 F.2d at 1438.

158. Official Comment 2 to U.C.C. § 3-418.

An example of this technique arose in *Bank of the West v. Commercial Credit Financial Services, Inc.*[159] At issue was which of two competing provisions of section 9-402(7)[160] should apply. One aspect of section 9-402(7) provides that where a filed financing statement becomes seriously misleading due to the debtor's change of "name, identity or corporate structure", the financing statement loses its effectiveness as to collateral acquired by the debtor more than 4 months after the change. On the other hand, section 9-402(7) also provides that a filed financing statement "remains effective with respect to collateral transferred by the debtor."[161] In *Bank of the West*, a parent corporation caused one of its wholly owned subsidiaries to transfer encumbered collateral to a second wholly owned subsidiary as part of a restructuring plan. The transfer was accomplished by a bookkeeping entry rather than a formal structural change such as a merger.[162] These facts raise the question of whether the change-of-structure language governs the transaction or whether the transfer-of-assets language governs the transaction.[163] The court reasoned by analogy that such an asset-shifting transfer between wholly owned subsidiaries, done at the behest of the

159. 852 F.2d 1162 (9th Cir. 1988).

160. U.C.C. § 9-402(7) provides:

> (7) 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. Where the debtor so changes his name or in the case of an organization its name, identity or corporate structure that a filed financing statement becomes seriously misleading, the filing is not effective to perfect a security interest in collateral acquired by the debtor more than four months after the change, unless a new appropriate financing statement is filed before the expiration of that time. A filed financing statement remains effective with respect to collateral transferred by the debtor even though the secured party knows of or consents to the transfer.

161. Even though collateral has been transferred by the debtor, the security interest continues in the transferred collateral under U.C.C. § 9-306(2), unless the secured party authorized the transfer. U.C.C. § 9-306(2), *supra* note 44.

162. *Bank of the West*, 852 F.2d at 1169.

163. If the transaction is characterized as a change of structure, a secured party of the transferor corporation would be perfected as to the transferred collateral and as to collateral acquired by the transferee within four months after the transfer; but the transferor's secured party would have to make a new filing in order to be perfected on assets acquired by the transferee corporation more than four months after the transfer. If the transaction is characterized as a transfer of assets, the transferor's secured party would be perfected in the transferred collateral without a new filing, but would not be perfected in any assets subsequently acquired by the transferee. U.C.C. § 9-402(7), *supra* note 160.

parent corporation, was like a change of structure and therefore invoked the change-of-structure rule of section 9-402(7).[164]

B. Extra-Code Methodology

Extra-Code methodology has been used to fill gaps in Code provisions, to create exceptions to Code provisions, and to resolve ambiguities in Code provisions. The source of law for extra-Code methodology has been both non-Code statutes and non-Code general principles. Sometimes, courts have refused to interpret according to extra-Code sources. Although extra-Code methodology depends on section 1-103, not all courts have articulated their extra-Code reasoning in terms of section 1-103.

1. Non-Code Law Adopted Without Resort to Section 1-103

Some courts have interpreted Code provisions based on extra-Code sources without attempting to justify the result under section 1-103. One court refused to apply an extra-Code source, but did not explain its refusal in terms of section 1-103.[165] Another court used an extra-Code statute of limitations to supersede the relevant Code provisions.[166]

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164. *Bank of the West*, 852 F.2d at 1170-71. Part of the court's reasoning was semantic. The change-of-structure rule requires a refiling where the "debtor" effects a change in structure. "Debtor" is defined in U.C.C. § 9-105(1)(d), *supra* note 31. Based on Official Comment 2 to U.C.C. § 9-105, the court determined that the transferor subsidiary qualified as a debtor. Comment 2 provides that "sometimes property is transferred subject to a secured debt of the transferor which the transferee does not assume; in such cases, under the second sentence of the definition, the term 'debtor' may, depending upon the context, include either or both such persons." Because both the transferor and the transferee were commonly owned, the court held that the transferor should be considered a debtor in the circumstances of the case. *Id.* at 1170.

165. *See infra* notes 176-179 and accompanying text.

166. In the decertified opinion of Werber v. Mercedes-Benz, Inc, 152 Cal. App. 3d 1039, 199 Cal. Rptr. 765 (1984), Ordered Not Published, May 24, 1984, the Court of Appeal held that the statute of limitations of California Code of Civil Procedure § 337 superseded the Code statute of limitations of U.C.C. § 2-725. Under U.C.C. § 2-725(2) the statute of limitations for breach of warranty begins to run upon delivery of the defective goods "regardless of the aggrieved party's lack of knowledge of the breach." On the other hand, the superseding non-Code statute of limitations begins to run when the plaintiff should, by exercise of reasonable diligence, have discovered the defect. In *Werber*, the court held that because of the difficulty of discovery the statute of limitations had not expired on the buyer even though more than four years had passed after delivery. Since the court's result seems directly to contradict § 2-725(2), the court's reasoning is instructive. U.C.C. § 1-103 was not the justification for this holding. Instead the court relied on the language of § 2-725(4) and Official Comment 4 thereto for the proposition that § 2-

In *Carnation Co. v. Olivet Egg Ranch*[167] a court resorted to outside law without mention of section 1-103 to fill in a gap in the Code scheme regarding consequential damages for an aggrieved buyer of goods. Section 2-715(2)(a)[168] authorizes the buyer to recover consequential damages if the buyer's loss was foreseeable and "could not reasonably be prevented by cover or otherwise." It does not resolve the issue of who bears the burden of proof regarding the adequacy of the buyer's efforts, required under section 2-715(2)(a), to prevent such loss by cover or otherwise.[169] In *Carnation* the court resorted to non-Code contract case law and there found a general policy that the burden of proof is on the breaching party to establish mitigation. The court then applied this non-Code rule to section 2-715(2)(a).[170] Although the result is sensible, no effort was made to explain the propriety of using such non-Code authority. In particular, the court did not address whether section 1-103 authorizes the use of non-Code case law in this context.

Similar resort to extra-Code sources occurs in *SCT, USA, Inc., v. Mitsui Manufacturers Bank*.[171] There the court used outside law to interpret the meaning of Code section 9-403(2)

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725 is not intended to "alter the law on tolling of the statute of limitations." Because no change in tolling is intended, and because the delayed discovery rule has been "traditionally" applied to implied warranty cases, the court reasoned that § 2-725(2) could be superseded by the delayed-discovery rule of CAL. CODE CIV. PRO. § 337 without offending U.C.C. § 2-725. Apparently this reasoning was based on the misconception that the purpose of § 2-725(4) is to negate the express provision of § 2-725(2) that the statute begins to run regardless of a buyer's lack of knowledge of defect. It seems more likely that § 2-725(4) has no impact at all in § 2-725(2), but rather purports not to alter the law regarding such "tolling" issues as the effect of seller's assurances of cure on the running of the statute of limitations.

167. 189 Cal. App. 3d 809, 229 Cal. Rptr. 261 (1986).

168. U.C.C. § 2-715(2)(a) provides:

> (2) Consequential damages resulting from the seller's breach include
>
> (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; . . . .

169. A related issue is who bears the burden of proof with respect to the extent of consequential damages. In the *Carnation* case the court resolved this issue based on Official Comment 4 to U.C.C. § 2-715, which specifically places the burden of proof with respect to the extent of consequential damages on the buyer. *Carnation*, 189 Cal. App. 3d at 815, 229 Cal. Rptr. at 264.

170. *Id.* at 816-19, 229 Cal. Rptr. at 264-66.

171. SCT, USA, Inc. v. Mitsui Manufacturers Bank, 155 Cal. App. 3d 1059, 202 Cal. Rptr. 547 (1984).

which provides that a financing statement is effective for "a period of five years from the date of filing" and that it "lapses on the expiration of such five year period unless a continuation statement is filed prior to such lapse."[172] The issue was whether a security interest had lapsed where a secured creditor perfected a security interest by filing a financing statement on January 25, 1977 with the California Secretary of State but did not file a continuation statement until January 25, 1982. If the five year effective period of the financing statement ran from January 25, 1977, to January 24, 1982, then the continuation statement would be ineffective to achieve continuous perfection because it was filed at a time which was not prior to the lapse of the financing statement. Even if the financing statement did not lapse until January 25, 1982, the continuation statement, filed on the same day as the expiration of the financing statement, was arguably not filed "prior to" the lapse as required by section 9-403(2). The Court of Appeal applied California Code of Civil Procedure section 12 to resolve the matter.[173] That section provides that "[t]he time in which any act provided by law is to be done is computed by excluding the first day, and including the last . . . ."[174] Accordingly, the court interpreted section 9-403(2) to mean that the five year effective period of a financing statement filed on January 25, 1977 lasts until midnight of January 25, 1982.[175] A continuation statement filed at any time prior to

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172. U.C.C. § 9-403(2) provides:

> (2) Except as provided in subsection (6) a filed financing statement is effective for a period of five years from the date of filing. The effectiveness of a filed financing statement lapses on the expiration of the five year period unless a continuation statement is filed prior to the lapse. If a security interest perfected by filing exists at the time insolvency proceedings are commenced by or against the debtor, the security interest remains perfected until termination of the insolvency proceedings and thereafter for a period of sixty days or until expiration of the five year period, whichever occurs later. Upon lapse the security interest becomes unperfected, unless it is perfected without filing. If the security interest becomes unperfected upon lapse, it is deemed to have been unperfected as against a person who became a purchaser or lien creditor before lapse.

173. *SCT, USA, Inc.*, 155 Cal. App. 3d at 1064, 202 Cal. Rptr. at 550.

174. CAL. CODE CIV. PRO. § 12.

175. *SCT, USA, Inc.*, 155 Cal. App. 3d, at 1066, 202 Cal. Rptr. at 551. The court also relied on CAL. GOV. CODE § 6806, which defines a day as the period from midnight to the following midnight. *Id.*

midnight on January 25, 1982 is timely because it is filed "prior to" the expiration of the five year period. However, no reference is made to Code section 1-103 or to any other authority to authorize the use of such outside law.

Even when a court refuses to apply extra-Code law, it may fail to explain itself under section 1-103. In *Nunes Turfgrass, Inc. v. Vaughn-Jacklin Seed Co., Inc.*,[176] a California Court of Appeal refused to apply California Civil Code section 1668[177] to resolve a dispute regarding a contractual limitation on damages. If applicable, Civil Code section 1668 would arguably have invalidated the parties' contractual limitation on damages because that section prohibits waiver of liability for the kinds of seller negligence alleged in *Nunes Turfgrass*.[178] However, if U.C.C. section 2-719(3) applied to the exclusion of the Civil Code section, such limitation on damages would be effective because the limitation met the section 2-719(3) standard of being not unconscionable. In rejecting Civil Code section 1668, the court did not express the reasons for its interpretation in terms of section 1-103. Rather, the court reasoned that the more specific statute should control the more general statute and that in the commercial setting at hand the relevant Code provision was more specific.[179]

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176. 200 Cal. App. 3d 1518, 246 Cal. Rptr. 823 (1988).

177. CAL. CIV. CODE § 1668 provides:

> § 1668 Contracts Contrary to Policy of Law
>
> CERTAIN CONTRACTS UNLAWFUL. All contracts which have for their object, directly or indirectly to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, in violation of law, whether willful or negligent, are against the policy of law.

178. In *Nunes Turfgrass*, regarding a cause of action for breach of warranty regarding the sale of seeds, the buyer had contracted to limit the seller's liability for negligence, breach of warranty or breach of contract to the purchase price of the seeds. The buyer had suffered consequential damages in its sod business because of defective seed supplied by the seller. Consequently, the contractual limitation on damages was at issue. Under U.C.C. § 2-719(3) such limitation would be effective if not unconscionable, and indeed the Court of Appeal held that the limitation was not unconscionable. However, the buyer argued for the application of CAL. CIV. CODE § 1668, which prohibits waiver of liability for negligent violations of statutory law. The buyer argued that the seller had negligently violated federal and state seed acts, and could not contract away its liability therefor because of CAL. CIV. CODE § 1668. *Nunes Turgrass*, 200 Cal. App. 3d at 1534, 246 Cal. Rptr. at 833.

179. *Id.* at 1539, 246 Cal. Rptr. at 836.

2. Non-Code Law Adopted on Authority of Section 1-103

Many courts have employed extra-Code methodology by explicit reference to section 1-103. Although these courts have relied on section 1-103 as authority, their approaches to invoking section 1-103 and their explanations of when section 1-103 applies have been varied.

For example, in *T&O Mobile Homes, Inc. v. United California Bank*,[180] the California Supreme Court used section 1-103 to authorize the adoption of non-Code priority rules in lieu of the Code priority scheme for secured transactions. At issue was the effect of the filing officer's mistaken failure to indicate defendant's security interest on the certificate of ownership covering a mobile home subsequently bought by plaintiff.[181] In order that a good faith purchaser be bound by a previous security interest, the California Vehicle Code "full title" system would, if applicable, require that the security interest must be listed on the certificate of ownership.[182] A mistaken omission by the filing officer would operate against the secured party under the Vehicle Code. On the other hand, under the U.C.C. system once the filing officer has received the necessary documents from the secured party, the secured party achieves perfection and the risk of a mistake by the filing officer is on the subsequent purchaser.[183] On the authority of section 1-103, the Supreme Court applied the principle of California real property law that where a filing officer fails to record a mortgagee's interest, the filing officer's error may be attributed to the mortgagee. Thus, the court concluded that responsibility for insuring that the security interest in a mobile home is recorded is properly placed on the secured

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180. 40 Cal. 3d 441, 220 Cal. Rptr. 627 (1985).

181. An ambiguity arises because in connection with the perfection of a security interest in a vehicle, boat, mobile home or commercial coach, CAL. COM. CODE § 9302(3)(b) defers to the California Vehicle Code and the Health and Safety Code for the rules regarding perfection of security interests. However, § 9302(3)(b) does not expressly so defer with respect to priority disputes. CAL. COM. CODE § 9302(3)(b).

182. *T & O Mobile Homes*, 40 Cal. Rptr. 3d at 449-50, 220 Cal. Rptr. at 630-31. *See* CAL. VEH. CODE §§ 1800(a), 6301, 6302.

183. *T & O Mobile Homes*, 40 Cal. 3d at 457-58, 220 Cal. Rptr. at 636. Official Comment 1 to U.C.C. § 9-407 states that "the secured party does not bear the risk that the filing officer will not properly perform his duties . . . ." This language indicates that the legislature did anticipate the problem of the security interest that does not appear on the certificate of title.

party.[184] In other words, the "full title" system of the Vehicle Code supersedes the Commercial Code system and the interest of a good faith purchaser prevails over a security interest not disclosed on the certificate of ownership.[185]

The Court explained the applicability of section 1-103. As paraphrased by the court, section 1-103 provides that "[w]here the Legislature has failed to anticipate a problem, the UCC provides for the application of common law and equitable principles."[186] By this reading, section 1-103 authorizes the use of extra-Code law to resolve a problem where the legislature did not anticipate the problem. Finding that the legislature did not address the issue at hand,[187] the court applied extra-Code law.

In *Allied Grape Growers v. Bronco Wine Co.*,[188] the California Court of Appeal used section 1-103 to justify an estoppel exception to the Code's statute of frauds for the sale of goods under section 2-201.[189] Section 2-201 generally requires that a

184. *T & O Mobile Homes*, 40 Cal. 3d at 452, 220 Cal. Rptr. at 632.
185. *Id.* at 455, 220 Cal. Rptr. at 634.
186. *Id.* at 452, 220 Cal. Rptr. at 632.
187. *Id.* at 451, 220 Cal. Rptr. at 632.
188. 203 Cal. App. 3d 432, 249 Cal. Rptr. 872 (1988).
189. U.C.C. § 2-201 is the Code's statute of frauds for the sale of goods. It provides:

> § 2-201. Formal Requirements; Statute of Frauds.
> (1) Except as otherwise provided in this section a contract for the sale of goods for the price of $500 or more is not enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his authorized agent or broker. A writing is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable under this paragraph beyond the quantity of goods shown in such writing.
> (2) Between merchants if within a reasonable time a writing in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, it satisfies the requirements of subsection (1) against such party unless written notice of objection to its contents is given within 10 days after it is received.
> (3) A contract which does not satisfy the requirements of subsection (1) but which is valid in other respects is enforceable
> (a) if the goods are to be specially manufactured for the buyer and are not suitable for sale to others in the ordinary course of the seller's business and the seller, before notice of repudiation is received and under circumstances which reasonably indicate that the goods are for the buyer, has made either

contract for sale of goods must be evidenced by a writing signed by the party to be charged, subject to express statutory exceptions for part performance (e.g., seller has delivered and buyer has accepted goods) and specially manufactured goods. In *Allied Grape Growers*, defendant had orally agreed to purchase grapes from plaintiff but later repudiated.[190] In reliance on defendant's promise to buy, plaintiff cancelled a contract to sell to another buyer. When defendant repudiated, plaintiff suffered a loss on resale. The court held that the trial court could properly have enforced defendant's oral promise under the doctrine of promissory estoppel, even though section 2-201 does not expressly provide such a basis of enforcement.[191]

The court invoked section 1-103 as intra-Code authority to import the principle of promissory estoppel into section 2-201.[192] According to the court's paraphrase of section 1-103, principles of law and equity "not otherwise covered by the Code shall supplement the Code's provisions."[193] Borrowing from Professors White and Summers for additional authority, the court reasoned that it is inconsistent with the general Code requirement of good faith under section 1-203 to permit one party to mislead another and then plead the statute of frauds.[194] Section 1-103 thus provided the theoretical means for importing the estoppel principle from outside law into the Code's statute of frauds, and section 1-203 was used to prove that such an interpretation of the statute of frauds is consistent with Code principles.

In *Morgan Guaranty Trust Co. v. American Savings and*

> a substantial beginning of their manufacture or commitments for their procurement; or
>
> (b) if the party against whom enforcement is sought admits in his pleading, testimony or otherwise in court that a contract for sale was made, but the contract is not enforceable under this provision beyond the quantity of goods admitted; or
>
> (c) with respect to goods for which payment has been made and accepted or which have been received and accepted (Sec. 2-606).

The California version is the same as U.C.C. § 2-201, except that California did not adopt U.C.C. § 2-201(3)(b). CAL. COM. CODE § 2201.

190. *Allied Grape Growers*, 203 Cal. App. 3d at 444, 249 Cal. Rptr. at 878-79.

191. Id. at 444-45, 249 Cal. Rptr. at 879.

192. Id. at 442, 249 Cal. Rptr. at 877.

193. *Id.*

194. *Id.*

Loan Association,[195] the Ninth Circuit, interpreting New York law, used section 1-103 to create a restitutionary exception to the final payment rule under section 3-418.[196] The latter section provides in relevant part that "payment or acceptance of any instrument is final in favor of a holder in due course." In *Morgan Guaranty Trust*, plaintiff mistakenly made provisional settlement (i.e., payment on two notes) to the agent of defendant, then mistakenly failed to make timely revocation of settlement.[197] These facts prompt the application of the final payment rule of section 3-418.[198] Application of the final payment rule would make plaintiff's payment final in favor of defendant so that the matter could not be reopened by plaintiff on the ground that plaintiff's payment had been mistaken. On the other hand, ignoring the effect of section 3-418, under extra-Code case law in New York a payor is allowed an equitable restitutionary remedy where it would be unfair to allow a payee to retain a windfall resulting from the payor's mistake.[199] On the facts of *Morgan Guaranty Trust*, New York's right of restitution would arguably allow plaintiff to recover on the grounds of mistaken payment. The Ninth Circuit held that in New York the extra-Code right of restitution is an exception to section 3-418.[200]

The Ninth Circuit in *Morgan Guaranty Trust* introduced a further factor into its analysis: whether section 3-418 has "displaced" the New York restitutionary remedy for mistaken payment. Such an inquiry is necessary because section 1-103 will not import outside law where the relevant Code provision has "displaced" the outside law. Specifically, if section 3-418 has displaced the New York right of restitution for mistaken payment, then section 1-103 will not import such right of restitution as an exception to section 3-418. The Ninth Circuit in *Morgan Guar-*

195. 804 F.2d 1487 (9th Cir. 1986), *cert. denied*, 482 U.S. 929 (1987).

196. Section 3-418 of the New York Commercial Code is identical to U.C.C. § 3-418. *See* U.C.C. § 3-418, *supra* note 151.

197. *Morgan Guaranty Trust*, 804 F.2d at 1490, 1493.

198. *Id.* at 1495.

199. *See, e.g.*, Paramount Film Distributing Corp. v. State, 30 N.Y. 2d 415, 334 N.Y.S. 2d 388 (1972), *cert. denied*, 414 U.S. 829 (1973); In re Leland Fox & John Murphy, Inc., 490 N.Y.S. 2d 71 (1985); Manufacturers Trust Co. v. Diamond, 17 Misc. 2d 909, 186 N.Y.S. 2d 917 (Sup. 1959); Valley Bank of Nevada v. Bank of Commerce, 74 Misc. 2d 195, 343 N.Y.S. 2d 191 (N.Y. City Civ. Ct. 1973). None of these cases involve the mistaken payment of notes that is at issue in *Morgan Guaranty Trust Co.* case.

200. *Morgan Guaranty Trust*, 804 F.2d at 1496.

anty Trust approached the question of displacement by asking whether the final payment rule of section 3-418 was intended to ban the application of the New York restitutionary remedy.[201] The court determined from the Official Comments[202] that the rule is intended to apply when the payee is an innocent party and thus has a legitimate expectation of finality upon receipt of payment. On the facts of *Morgan Guaranty Trust* the payee knew it was not entitled to payment and therefore had no legitimate expectation of closing the transaction. Therefore, on the facts of *Morgan Guaranty Trust* the final payment rule is not intended to apply and cannot ban the application of the New York restitutionary remedy. Another reason for the inapplicability of the final payment rule is that the maker of the note had declared bankruptcy. In the usual application of the final payment rule the payor at least has a present right to recover against the maker or drawer of the instrument, but here the payor's said right was cut off by the bankruptcy of the maker.[203] Because the final payment rule was not intended to apply to the facts of *Morgan Guaranty Trust*, the final payment rule did not displace the New York restitutionary remedy; and under section 1-103 that remedy applied.[204]

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201. *Id.* at 1495. The court there stated that its "inquiry is whether 3-418 was intended to bar a restitutionary remedy to a payor bank against a holder in due course that had knowledge of the bankruptcy of the maker at the time the instrument was presented."

202. *Id. at 1495.* Official Comment 1 to § 3-418 indicates that the final payment rule is limited to the situation where the parties believe the payment to be rightful. In such a situation, the benefits of not upsetting the innocent payee's expectations after the payor has made payment, as well as not upsetting any subsequent transactions based on that payment, outweigh the benefits of reopening the transaction. Official Comment 1 to § 3-418 provides in part:

> 1. The section follows the rule of Price v. Neal, 3 Burr. 1354 (1762), under which a drawee who accepts or pays an instrument on which the signature of the drawer is forged is bound on his acceptance and cannot recover back his payment. Although the original Act is silent as to payment, the common law rule has been applied to it by all but a very few jurisdictions. The traditional justification for the result is that the drawee is in a superior position to detect a forgery because he has the maker's signature and is expected to know and compare it; *a less fictional rationalization is that it is highly desirable to end the transaction on an instrument when it is paid rather than reopen and upset a series of commercial transactions at a later date when the forgery is discovered.* [Emphasis added].

203. *Morgan Guaranty Trust*, 804 F.2d at 1496.

204. *Id.*

In *In re Pacific Trencher & Equipment, Inc.*[205] the Ninth Circuit took a different approach to determining whether a Code provision explicitly displaces non-Code law. It emphasized the specificity of the Code provision. In *Pacific Trencher* the issue was whether a secured party could use the doctrine of reformation based on mistake where it had inadvertently filed a termination of its security interest even though it intended to file a continuation of the security interest. The court held that the provisions of section 9-402(8),[206] providing that the financing statement can be effective "even though it contains minor errors which are not seriously misleading," were sufficiently specific to constitute a displacement of the doctrines of mistake and reformation.[207] Hence, those extra-Code doctrines were not available and the security interest was terminated because the erroneous termination was seriously misleading under section 9-402(8).[208]

Another example of the use of section 1-103 to import outside law is *Producers Cotton Oil Co. v. Amstar Corp.*[209] There the issue was whether a claim based on principles of unjust enrichment could reverse the priorities which would otherwise be dictated by Article 9 of the Code.[210] In *Producers Cotton Oil* a properly perfected secured party would otherwise have been entitled to priority in the proceeds of a crop over the buyer of the crop. However, the California Court of Appeal reversed this result by application of the doctrine of unjust enrichment.[211] The opinion mentions section 1-103,[212] but it does not address the issue of whether the Code priority scheme displaces the doctrine of unjust enrichment.

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205. 735 F.2d 362 (9th Cir. 1984).

206. U.C.C. § 9-402(8), *supra* note 121.

207. *Pacific Trencher*, 735 F.2d at 364.

208. *Id.* The Bankruptcy Appellate Panel previously decided this case in part according to purpose reasoning. The court held that the doctrines of reformation and mistake were not available because their application to these facts would contradict the fundamental purpose of Article 9, *i.e.*, to promote certainty in secured transactions. In re Pacific Trencher 27 B.R. 167, 170 (9th Cir. BAP 1983).

209. 197 Cal. App. 3d 638, 242 Cal. Rptr. 914 (1988).

210. *Id.* at 659, 242 Cal. Rptr. 927.

211. Id. at 660, 242 Cal. Rptr. 927.

212. *Id.*

C. Methodology Unclear

1. Interpretation by Fiat

Some decisions resort to interpretation by pronouncement. These cases are not expressly reasoned from intra-Code sources or from extra-Code principles. Their methodology is hidden. An example of such a decision is *In re Kirkland*,[213] in which the court interpreted the anti-waiver provisions of sections 9-501(3) and 9-504(3).[214] Section 9-501(3) prohibits pre-default waivers. Section 9-504(3), although generally requiring the secured party to notify the debtor of the sale of collateral, excuses such notice if the debtor has signed a waiver of notice "after default." On their face these provisions do not seem to need interpretation. It is only necessary to know whether the debtor waived its right prior to default or after default in order to decide the validity of such a waiver. However, in *Kirkland* the United States Bankruptcy Appellate Panel of the Ninth Circuit was required to apply these provisions to an unusual set of facts. The following simplified version of the facts raises the issue. The debtor had defaulted three times. After each of the first two defaults the secured party worked out an arrangement with the debtor to grant an extension of time to pay, and the debtor purposely renounced any right to notice of sale of the collateral. At no time following the third default did the debtor renounce its right to notice of sale.[215] The question raised by these facts is whether the debtor had waived notice of sale "after default" as required by section 9-504(3) or whether the debtor waived notice before default as prohibited by section 9-501(3).[216] One interpretation is that the debtor's waiver of notice, because it came after each of the first two defaults, satisfied the requirement that a waiver

213. 91 B.R. 551 (9th Cir. BAP 1988).

214. U.C.C. § 9-501(3), *supra* note 30; U.C.C. § 9-504(3), *supra* note 29.

215. *Kirkland*, 91 B.R. at 552-53.

216. *Kirkland* is further complicated because the bankrupts were not debtors. They were guarantors who had given collateral for their obligation and had waived notice of sale after the debtor's initial defaults but before the debtor's final default. However, the guarantors were treated as standing in the shoes of the debtor. Therefore, the issue remained the same for both the guarantors and the debtor. If the debtor's third default was the relevant default, then neither the debtor nor the guarantors had waived the notice of sale after default. If the first or second default was the relevant event, then they had waived notice of sale after default. The parties admitted this by agreeing that the debtor's default was the event that determined whether a waiver of notice of sale by the guarantor was after default. *Id.* at 553.

of the right to notice of sale must be "after default". Another interpretation is that because the waiver came prior to the third default, it was not an effective waiver. The court held that there was no effective waiver after the third default, and therefore the secured party still was required to give notice of sale.[217] It is not explained why the court interpreted the "after default" requirement to mean "after the last default."

Another example of such a failure to explain reasoning arises in *Northern Trust Co. v. Community Bank*[218] with regard to the possible requirement of presentment of documents under a letter of credit to a confirming bank where the beneficiary seeks to hold the confirming bank liable.[219] In *Northern Trust*, the letter of credit required presentment of certain documents to the issuer but did not mention presentment to the confirming bank.[220] Section 5-107(2) provides that a confirming bank is not only obligated on the letter of credit, but also "acquires the rights of an issuer."[221] In *Northern Trust*, the ambiguity to be resolved was whether the defendant confirming bank, in acquiring the rights of an issuer pursuant to section 5-107(2), had acquired the right of the issuer under the letter of credit to receive proper presentment of the documents as a pre-condition to payment. The Ninth Circuit held that, in the absence of a contractual agreement, independent presentment of documents to a confirming bank is not required.[222] The court gave no explanation as to the methodology or reasoning it used to reach that result.[223]

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217. *Id.* at 555.

218. 873 F.2d 227 (9th Cir. 1989).

219. A confirming bank is by definition a bank that has engaged to honor another issuer's letter of credit. U.C.C. § 5-103(1)(f) provides:

> (f) A "confirming bank" is a bank which engages either that it will itself honor a credit already issued by another bank or that such a credit will be honored by the issuer or a third bank.

220. *Northern Trust*, 873 F.2d at 228. Under U.C.C. § 5-114(1) the issuer's liability would arise upon proper presentment to it of the documents specified in the letter of credit.

221. U.C.C. § 5-107(2) provides:

> (2) A confirming bank by confirming a credit becomes directly obligated on the credit to the extent of its confirmation as though it were its issuer and acquires the rights of an issuer.

222. *Northern Trust*, 873 F.2d at 229.

223. The court cited to H. HARFIELD, BANK CREDITS AND ACCEPTANCES, 324-25 (5th ed. 1974), evidently because a form provided therein allows the parties to specify inde-

2. Case Law Citation Without Further Reasoning

These decisions are not expressly reasoned according to intra-Code policies or provisions nor extra-Code law. They simply purport to follow case law precedent. The court does not disclose its interpretive reasoning.

An example of a decision following case law precedent without explaining its reasoning is *Rutan v. Summit Sports, Inc.*,[224] which dealt with the previously discussed issue of whether a guarantor is to be treated as a debtor under section 9-501(3) in order to receive that provision's protection from pre-default waiver.[225] Unlike the other courts that considered whether a guarantor should be treated as a debtor for purposes of this provision and the other debtor-protective provisions of Article 9,[226] this court did not disclose its reasoning. It simply cited one case - a minority position - decided in another jurisdiction.[227]

A similar resort to case authority without reasoning can be found in *Kirby v. Palos Verdes Escrow Co.*[228] which interprets section 9-318(3).[229] Where a debt is assigned, section 9-318(3) protects the debtor if the debtor pays the assignor (i.e. original

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pendent presentment to the confirming bank. *Id.* From this thin reed the court determined that independent presentment is not required without a contractual agreement by the parties.

224. 173 Cal. App. 3d 965, 219 Cal. Rptr. 381 (1985).

225. U.C.C. § 9-501(3), *supra* note *30.*

226. See *supra* notes 28-36 and accompanying text.

227. *Rutan*, 173 Cal. App. 3d at 973, 219 Cal. Rptr. at 386. The authority cited was U.S. v. Kurtz, 525 F. Supp. 734 (E.D. Pa. 1981). Such a resort to minority case law not only hides reasoning, but also would seem inconsistent with the fundamental purpose of the Code stated in U.C.C. § 1-102(2)(c) "to make uniform the law among the various jurisdictions." Indeed, to the extent case law from other jurisdictions is a valid basis for interpreting the Code, § 1-102(2)(c) indicates the opposite interpretation in this case because the weight of authority has held that a guarantor is a debtor. *See* cases collected in Connolly v. Bank of Sonoma County, 184 Cal. App. 3d at 1124, 229 Cal. Rptr. at 399.

228. 183 Cal. App. 3d 57, 227 Cal. Rptr. 785 (1986).

229. U.C.C. § 9-318(3) provides:

> (3) The account debtor is authorized to pay the assignor until the account debtor receives notification that the amount due or to become due has been assigned and that payment is to be made to the assignee. A notification which does not reasonably identify the rights assigned is ineffective. If requested by the account debtor, the assignee must seasonably furnish reasonable proof that the assignment has been made and unless he does so the account debtor may pay the assignor.

creditor) before receiving notice of the assignment. This provision authorizes the debtor to pay the assignor "until the . . . debtor receives notification that the amount due or to become due has been assigned and that payment is to be made to the assignee." There is no resolution of whether the notice required is actual notice rather than constructive notice. In *Kirby*, the question was whether constructive notice imparted by recordation of an assignment of a note and deed of trust was sufficient to inform a debtor of the assignment and thereby require the debtor to pay the assignee. Based entirely on an appeal to case law precedent, the court held that actual notice, not constructive notice, is required.[230]

Another example of the use of case-law precedent is the decision in *Producers Cotton Oil Co. v. Amstar Corp.*[231] The court addressed the issue, also addressed in *In Re Ellsworth*,[232] of whether a debtor's sale of collateral can be deemed authorized under section 9-306(2)[233] by the secured party's past conduct. If so, the secured party's interest cannot be carried forward against the third party buyer under section 9-306(2). The Court of Appeal relied on case authority[234] but not reasoning to hold that the secured party's past conduct in dispensing with contractually required written consent for the debtor's sales of collateral constituted an effective authorization for a subsequent sale under the "or otherwise" provision of section 9-306(2).[235]

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230. *Kirby*, 183 Cal. App. 3d at 63, 227 Cal. Rptr. at 788.

231. 197 Cal. App. 3d 638, 242 Cal. Rptr. 914 (1988).

232. *See Ellsworth*, *supra* notes 111-115 and accompanying text.

233. U.C.C. § 9-306(2), *supra* note 44.

234. *Producers Cotton Oil*, 197 Cal. App. 3d at 646, 242 Cal. Rptr. 918. The authority cited was Central Cal. Equip. Co. v. Dolk Tractor Co., 78 Cal. App. 3d 855, 144 Cal. Rptr. 367 (1978).

235. *Producers Cotton Oil*, 197 Cal. App. 3d at 646, 242 Cal. Rptr. 918. Another example of the case law approach can be found in Ingersoll-Rand Financial Corp. v. Miller Mining Co., Inc., 817 F.2d 1424 (1987), where the court interpreted the "commercially reasonable" sale requirement of U.C.C. § 9-504(3). Under that provision a foreclosing secured party may sell collateral, but every aspect of the sale must be "commercially reasonable". The Ninth Circuit used a case law approach to interpretation instead of reasoning from policies and principles found within the Code. The court determined, based on case law precedent, that the factors indicating that a sale is not "commercially reasonable" include the secured party's failure to prepare collateral for resale, failure to maintain the collateral, and gross inadequacy of price. Because plaintiff had failed all of these standards, the court held that it had not conducted the sale in a commercially reasonable manner. 817 F.2d at 1427-28.

III. APPLYING THE METHODOLOGIES

A. Criticism of Case Law Methodology

The case law reviewed herein has not articulated consistent guidelines as to how to reason under intra-Code methodology, how to reason under extra-Code methodology, and how to choose which methodology to employ. Those cases interpreting Code provisions without any reasoning at all contribute nothing toward creating such guidelines.[236] Almost as unhelpful in this endeavor is an interpretation justified by citations to case law without explanation of why those past interpretations by other courts are justified on the facts of the present case.[237] Even where the interpretive result is justifiable in the present case, an unexplained methodology offers no guidance for interpreting the relevant Code provision in future cases. Futhermore, interpretation without methodological explanation offers no guidance for interpreting Code provisions generally. Such cases represent lost opportunities to de-mystify the interpretive process.

Another class of cases that fail to de-mystify are those that decide whether to apply extra-Code law without even discussing section 1-103. For example, in the *Fundin* case the issue was whether to apply an extra-Code statute of limitations instead of section 2-725.[238] In *Nunes Turfgrass* the issue was whether to apply a non-Code rule regarding waiver of liability.[239] In the *Diamond Fruit Growers* case the issue was whether to apply the common law "last-shot principle" to determine the terms of a contract.[240] Yet, in none of those cases was section 1-103 even mentioned. Although it is possible to reach a justifiable result regarding the application of non-Code law without invoking section 1-103, a proper result would be more likely if reached in accordance with the requirements of section 1-103. Furthermore,

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236. *See, e.g.*, In re Kirkland, *supra* notes 213-217 and accompanying text; Northern Trust Co. v. Community Bank, *supra* notes 218-223 and accompanying text.

237. *See, e.g.*, Rutan v. Summit Sports, Inc., *supra* notes 224-227 and accompanying text; Kirby v. Palos Verdes Escrow Co., *supra* notes 228-230 and accompanying text; Producers Cotton Oil v. Amstar Corp., *supra* notes 231-235 and accompanying text.

238. *See* discussion of *Fundin supra* notes 130-136 and accompanying text.

239. *See* discussion of *Nunes Turgrass, supra* notes 176-179 and accompanying text.

240. *See* discussion of *Diamond Fruit Growers, supra* notes 90-94 and accompanying text.

the considered, articulated exploration of that section in as many contexts as possible would lead to a better understanding of how to use extra-Code methodology and whether to do so.

Even decisions that have articulated extra-Code methodology have failed to establish adequate guidelines for the use of that methodology and for the choice between methodologies. For example, the decisions that have discussed section 1-103 have not created a consistent and useful standard for determining whether an extra-Code principle is "displaced by the particular provisions" of the Code. Such a standard is crucial because according to section 1-103 extra-Code principles are not available where they have been displaced. For example, in the *Producers Cotton Oil* case, on authority of section 1-103 the court imported the extra-Code doctrines of unjust enrichment and quasi-contract to alter the normal Code priority scheme but did not explain why such doctrines were not displaced by the Code security provisions.[241] The same criticism may be made of the *Allied Grape Growers* case, wherein the court used the extra-Code doctrine of promissory estoppel to supplement the Code statute of frauds but did not expressly address the issue of whether the doctrine of promissory estoppel was displaced by the Code's statute of frauds.[242]

The *Allied Grape Growers* opinion does, however, provide by inference a standard for determining when extra-Code law is not displaced by a Code provision. The court stated that under section 1-103 the principles of law and equity "not otherwise covered by the Code" shall supplement the Code's provisions.[243] This reading of the section likely means that where the Code does not cover a matter, the Code does not displace extra-Code principles. Thus a possible standard for the displacement issue appears to be whether the Code covers the issue at hand. The California Supreme Court in *T & O Mobile Homes*,[244] although

241. *See* Producers Cotton Oil Co. v. Amstar Corp., *supra* notes 209-212 and accompanying text; see also E.F. Hutton & Co., Inc. v. City National Bank, 149 Cal. App. 3d 60, 69, 196 Cal. Rptr. 614, 620 (1983) (raises displacement issue but does not explain its conclusion that no provision of U.C.C. displaces tort negligence theory).

242. *See* discussion of *Allied Grape Growers*, *supra* notes 188-194 and accompanying text.

243. *Allied Grape Growers*, 203 Cal. App. 3d at 442, 249 Cal. Rptr. 877 (1988).

244. *See* discussion of *T & O Mobile Homes*, *supra* notes 180-187 and accompanying text.

not holding specifically on the matter, provides a similar standard in its paraphrase of section 1-103. According to this court, extra-Code law is available under section 1-103 where the legislature has failed to anticipate a problem.[245] Presumably then, where the legislature has left a gap in the coverage of the Code, extra-Code law is not displaced and may supplement the Code.

A standard for displacement based on whether the Code covers or overlooks the matter at hand is as uncertain as the displacement issue it seeks to clarify. We are left with no reliable way to know whether the Code covers or overlooks the issue. The unreliability of such a standard is exemplified by the court's inept application of it in the *T & O Mobile Homes* case. There the California Supreme Court concluded that the legislature had not anticipated the problem of a filing officer's oversight as it applies to a subsequent buyer of a mobile home.[246] Yet this conclusion is highly debatable in light of the Code comment that the secured party does not bear the risk of a filing officer's oversight[247] and in light of the provision of California Vehicle Code section 6301 that "the rights of all persons in the vehicle shall be subject to the provisions of the Uniform Commercial Code."[248]

In re Pacific Trencher & Equipment, Inc. has the virtue of expressly addressing the issue of displacement and expressly defining a standard.[249] In this sense, its methodology is better than the previous two cases. However, the standard defined is no more useful. In *Pacific Trencher* the court stressed the specificity of the relevant Code provisions in holding that they displaced the common law principles of reformation and mistake.[250] However, such an approach is no more workable than the "coverage" approach. Still lacking is a reliable standard for determining when a Code provision is specific enough to displace an extra-Code principle, or when a Code provision is to be labeled specific or non-specific.

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245. *See supra* note 186 and accompanying text.

246. *See supra* note 187.

247. *See* Official Comment 1 to U.C.C. § 9-407, *supra* note 183.

248. CAL. VEH. CODE § 6301. This statute is cited by the dissent in *T & O Mobile Homes*, 40 Cal. 3d at 459, 220 Cal. Rptr. at 637.

249. *See* discussion of *Pacific Trencher*, *supra* notes 205-208 and accompanying text.

250. *See supra* note 207 and accompanying text.

Courts have not always used intra-Code methodology properly either. Sometimes courts have made the methodological mistake of ignoring or de-emphasizing purpose reasoning while relying on other intra-Code interpretive techniques. A court might use the technique of interpreting one Code provision based on implication from other Code provisions without considering whether the resulting interpretation violates the purpose of the interpreted provision. By way of example, in the *Farmers & Merchants State Bank* case the court reasoned based on implications from other Code provisions that section 3-418 supersedes section 4-213(1).[251] However, there is a contrary indication in section 4-102(1), which provides that the provisions of Article 4 govern those of Article 3.[252] Given the uncertainty created by this conflict in implications, the court should have considered whether its result is consistent with the relevant purposes.

Similarly, where a court uses the technique of reasoning by analogy, it is methodologically mistaken not to consider whether the principles involved would be offended by drawing such an analogy. For example, in *Bank of the West*, the court determined that a transaction between subsidiaries was sufficiently like a change of structure to invoke the change-of-structure provision of section 9-402(7).[253] However, such reasoning is only valid if the purpose of the change-of-structure provision is consistent with its application to the transaction in *Bank of the West.* The court failed to make that determination, at least expressly.[254]

Failure to consider the purpose of a provision is a methodological lapse that can readily lead to misinterpretation. In *Wilson v. Steel*,[255] for example, the court misapplied section 3-

251. *See* discussion of *Farmers & Merchants State Bank*, *supra* notes 147-158 and accompanying text.

252. *See supra* note 157 and accompanying text; *see also* U.C.C. § 4-102(1).

253. *See supra* 159-164 and accompanying text.

254. In *Bank of the West* the court did not articulate purpose reasoning on the issue of whether a transfer between two commonly owned subsidiaries constitutes a change of structure under U.C.C. § 9-402(7). However, the court did state that such a "transaction has the same effect as a merger of the transferor into the transferee with the transferee as the surviving corporation. . . ." 852 F.2d at 1162. From this premise, the court might have impliedly reasoned that whatever the purpose of the change-of-structure provision might be, that purpose must be satisfied by its application to this merger-like transaction.

255. 211 Cal. App. 3d 1053, 259 Cal. Rptr. 851 (1989).

305(2)(b)[256] by ignoring its purpose. That section provides that a holder in due course, although not normally subject to contract defenses, is subject to the defense that the transaction giving rise to the instrument was illegal to the point of rendering the underlying obligation a "nullity." In *Wilson* the illegality was that the instrument had been issued to an unlicensed contractor in payment for contracting services.[257] The court concluded that the obligation was a "nullity" because this particular illegality rendered the obligation unenforceable under local law.[258] Thus the court evidently interpreted "nullity" to mean "unenforceable," so that an obligation is a nullity when it is unenforceable. Yet the purpose of Section 3-305(2)(b) indicates a different interpretation of nullity. The section is designed to permit only the most severe types of illegality to be asserted against a holder

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256. U.C.C. § 3-305 provides:

> § 3-305. Rights of a Holder in Due Course.
> To the extent that a holder is a holder in due course he takes the instrument free from
> (1) all claims to it on the part of any person; and
> (2) all defenses of any party to the instrument with whom the holder has not dealt except
> (a) infancy, to the extent that it is a defense to a simple contract; and
> (b) such other incapacity, or duress, or illegality of the transaction, as renders the obligation of the party a nullity; and
> (c) such misrepresentation as has induced the party to sign the instrument with neither knowledge nor reasonable opportunity to obtain knowledge of its character or its essential terms; and
> (d) discharge in insolvency proceedings; and
> (e) any other discharge of which the holder has notice when he takes the instrument.

257. Actually, it is only assumed for purposes of discussion in *Wilson* that the note was issued in payment for contracting services. The lower court had failed to determine the reason for which the note had been issued. The Court of Appeal remanded for a determination of this factual question. 211 Cal. App. 3d at 1063-64, 259 Cal. Rptr. at 856-57.

258. *Wilson*, 211 Cal. App. 3d at 1059-60. 259 Cal. Rptr. at 854. The court based its holding that the obligation was unenforceable on CAL. BUS. & PROF. CODE § 7031 which provides in part:

> No person engaged in the business of acting in the capacity of a contractor, may bring or maintain any action . . . in any court of this state for the collection of compensation for the performance of any act or contract for which a license is required by this chapter without alleging and proving that he . . . was a duly licensed contractor at all times during the performance of that act or contract . . . .

CAL. BUS. & PROF. CODE § 7031.

in due course.[259] Therefore, the unenforceability that normally accompanies an illegal transaction should not automatically render the obligation a nullity. Instead, the purpose of the section indicates that an illegality should render the obligation a nullity only when the illegality is so severe as to be strongly violative of public policy.[260] Because the contracts of an unlicensed contractor have been held by the California courts to be only *malum prohibitum*, not *malum in se*,[261] the illegality in *Wilson* is not sufficiently grave to render the obligation a nullity under California law. Consequently, in this case, the purpose of section 3-305(2)(b) indicates that the licensing illegality should not be assertable against a holder in due course. By ignoring this purpose, the court misinterpreted the meaning of nullity and misapplied the relevant section.

Even where courts have expressly considered the purpose of a provision, they have sometimes erred because they misunderstood that purpose and therefore misinterpreted or misapplied the provision. For example, in *Shooting Star Enterprises*, the court interpreted the term proceeds under section 9-306 to exclude payment for a so-called equity portion of collateral (i.e., that portion of the value of the collateral supposedly not needed by the secured party because it exceeded the amount of the debt) sold by the debtor's trustee in bankruptcy.[262] The court based its holding on a perceived policy to avoid double recovery by the secured party.[263] The result might be questioned because the primary purpose of section 9-306(2) is to give the secured

259. Official Comment 5 to U.C.C. § 3-305 provides with respect to illegality that "[i]f under the local law the effect is to render the obligation of the instrument entirely null and void, the defense may be asserted against a holder in due course. If the effect is merely to render the obligation voidable at the election of the obligor, the defense is cut off." The requirement that the illegality must render the obligation "entirely null and void" under local law indicates a policy that only the most severe illegality may be asserted as a defense against a holder in due course.

260. *See, e.g.*, Pacific National Bank v. Hernreich, 220 Ark. 114, 398 S.W. 2d 221 (1966).

261. *See, e.g.*, Steinwinter v. Maxwell, 183 Cal. App. 2d 34, 39, 6 Cal. Rptr. 496, 499 (1960); S & Q Constr. Co. v. Palma Ceia Development Organization, 179 Cal. App. 2d 364, 367, 3 Cal. Rptr.. 690, 692 (1960). Both cases held that an unlicensed contractor may assert a set-off based on a contract for building services emphasized that the set-off was justified because an unlicensed contractor's illegality is only *malum prohibitum*, not *malum in se*.

262. *See supra* notes 43-46 and accompanying text.

263. The source of the policy on which the court relied was Official Comment 3 to U.C.C. § 9-306, *supra* note 46.

party the right to look to both proceeds and collateral.[264] That purpose is thwarted by denying the secured party the right to the payment for the equity portion of collateral because the secured party is then left to look only to the remaining collateral. The way to accommodate both policies is to interpret the payment to constitute proceeds, thus continuing the security interest in the payment, but to limit the secured party's recovery from the collateral so that he is not overpaid.

The purposes underlying a provision may conflict, and when this happens courts utilizing purpose reasoning have an especially difficult task. The possibility of conflicting purposes does not constitute a methodological mistake by the courts. Rather, it is simply a complication inherent in purpose reasoning. For example, the conflicting purposes underlying the California version of section 5-114, prohibiting courts from enjoining the honor of a letter of credit, led two courts to disagree on the question of whether that provision, while concededly preventing the issuer from being enjoined, also prohibits enjoining the beneficiary.[265] The *Mitsui Manufacturers Bank* court, by emphasizing the policy of keeping the issuer independent of the underlying transaction, permitted an injunction of the beneficiary because enjoining the beneficiary would not offend a policy aimed at protecting the issuer.[266] On the other hand, the *Trans Meridian Trading* court, by emphasizing the policy in favor of honoring letters of credit, did not permit an injunction of the beneficiary because that policy would be offended by such injunction.[267] Both courts used a valid methodological approach notwithstanding their opposite results. The remaining question that will have to be decided when courts are faced with the issue of enjoining the beneficiary is which policy is more compelling on the facts of the case at hand.

A final pitfall in purpose reasoning is the possibility that a court might invent a purpose in order to achieve a desired inter-

264. Official Comment 3 to U.C.C. § 9-306 provides that the "secured party may claim *both proceeds and collateral*, but may of course have only one satisfaction." [Emphasis added]. *See supra* note 46.

265. *See supra* notes 63-71 and accompanying text.

266. *See* discussion of *Mitsui Manufacturers Bank*, *supra* notes 63-66 and accompanying text.

267. *See* discussion of *Trans Meridian Trading*, *supra* notes 67-71 and accompanying text.

pretation. In order to avoid the problem of result-oriented purpose reasoning, courts must document the source of the purpose on which they rely. No obvious examples of disingenuous reasoning were found in the cases reviewed. However, in *FDIC v. Bank of San Francisco*, where the court relied on the Article 5 policy of guaranteeing assured payment to a beneficiary in order to interpret the phrase "fraud in the transaction" under section 5-114(2)(b), the court did not document the source of the policy.[268] The case is therefore wrong in form, although correct in substance because such documentation is readily available within the Code.[269]

B. Suggested Methodological Approach

The purposes and policies underlying a Code provision may not be contradicted or defied by its interpretation regardless of which methodology is applied. Such underlying purposes and policies include not only those of the provision to be interpreted but also those of the relevant Article and of the Code itself. Subject to this restriction, courts should be free to choose either intra-Code methodology or extra-Code methodology.[270] If a court employs intra-Code techniques such as applying other Code sections, the resulting interpretation must be consistent with the

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268. *See* discussion of *FDIC v. Bank San Francisco*, supra notes 38-42 accompanying text.

269. The policy in favor of assured payment on letters of credit regardless of the underlying business deal is evidenced in Official Comment 1 to U.C.C. § 5-114, which provides in part:

> In view of [the] independent nature of the letter of credit engagement, the issuer is under a duty to honor the drafts or demands for payment which in fact comply with the terms of the credit without reference to their compliance with the terms of the underlying contract. . . . The duty of the issuer to honor where there is factual compliance with the terms of the credit is also independent of any instructions from its customer once the credit has been issued and received by the beneficiary.

270. *See* Hillman *supra* note 26. Professor Nickles has suggested that courts should be allowed to use either extra-Code or intra-Code methodology, at the court's option, on condition that the interpretation so achieved is consistent with the underlying Code purposes expressed in U.C.C. § 1-102(2). *See* Nickles, *supra* note 26. The approach suggested herein differs in that the purposes underlying individual Code provisions are entitled to the same dignity that Professor Nickles has granted to Code-wide purposes. In effect, the approach suggested herein subordinates other techniques to purpose reasoning, and elevates that aspect of intra-Code methodology above other forms of intra-Code methodology and above extra-Code methodology.

relevant purposes and policies. If a court uses extra-Code methodology, the application of extra-Code law must not create an interpretive result in conflict with the purpose of the relevant Code provision.

As a first step a court must therefore determine and document the purposes and policies underlying the interpreted Code provision. Where such purposes and policies affirmatively require an interpretation, that interpretation should be adopted without resort to further interpretive techniques. In fact, even where the ordinary meaning of the language of the provision indicates a different result from that suggested by the purpose, the latter should prevail. Thus, the *Great Southwest Life* case correctly held that a co-maker is not entitled to discharge under section 3-606(1)(b), despite the language of that section stating that "any party" to an instrument is entitled to be discharged thereunder, because the purpose of the provision indicates that it actually refers to any party except a co-maker.[271]

Under the suggested methodology, the issue of pre-default waiver in the *Kirkland* case[272] would be resolved according to this first step. The purpose of the section 9-501(3) prohibition against a debtor's pre-default waiver of rights is to safeguard the vulnerable debtor's post-default rights from pre-default overreaching by the secured party.[273] The facts of *Kirkland* are precisely those at which this purpose is directed. The debtor defaulted twice, and as the price for renegotiating its loan, it had no economic choice but to agree to a waiver of notice of sale. Subsequently, upon a third default, it would contravene the debtor-protective purpose of section 9-501(3) to deny the debtor,

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271. *See* discussion of *Great Southwest Life*, *supra* notes 80-83 and accompanying text.

272. *See* discussion of *Kirkland*, *supra* notes 213-217 and accompanying text.

273. The purpose of the prohibition against a debtor's pre-default waiver of rights is disclosed in Official Comment 4 to U.C.C. § 9-501, which provides in part:

> In the area of rights after default our legal system has traditionally looked with suspicion on agreements designed to cut down the debtor's rights and free the secured party of his duties . . . . The default situation offers great scope for overreaching; the suspicious attitude of the courts has been grounded in common sense.
>
> Subsection (3) of this section contains a codification of this long-standing and deeply rooted attitude: the specified rights of the debtor . . . may not be waived . . . except as stated.

or the guarantors standing in the debtor's shoes, the protections of section 9-501(3) by holding that they had waived their rights post-default. Even though the waiver followed two defaults, the interpretation consistent with the purpose of section 9-501(3) is to interpret the waiver as a pre-default waiver.

Where the relevant purposes and policies do not affirmatively require a particular result, then as a second step a court may proceed to apply intra-Code methodology or extra-Code methodology, or both. Assuming that the court uses intra-Code methodology, it may interpret according to intra-Code techniques but must determine that the interpretive result so obtained does not conflict with any relevant policies and purposes. Thus, the decision in *In re Hawaii Corp.* is methodologically correct. The court interpreted section 8-207(1) according to inferences drawn from Code provisions (e.g., sections 8-105(3)(c) and 8-103(a))[274] and also determined that its interpretive result was consistent with the relevant purposes.[275] On the other hand, the methodology of the *Farmers & Merchants State Bank* case is incorrect because it reasons from other provisions without considering whether the interpretive result so obtained (i.e., that the final payment rule of section 3-418 supersedes that of section 4-213) conflicts with the relevant purposes as they apply to the facts of the case.[276]

In the case of extra-Code methodology, the court may apply whatever extra-Code laws and principles are not inconsistent with the relevant purposes and policies. The court must make a self-conscious effort to determine that application of an extra-Code rule will not defy such purposes and policies. An example of a decision correctly employing such an approach is the *Morgan Guaranty Trust Co.* case, where the court adopted an extra-Code restitutionary remedy as an exception to the final payment rule of section 3-418.[277] The court carefully examined the situations to which the final payment rule was intended to apply, determined that it was not intended to apply to the facts of the

274. *See supra* notes 137-146 and accompanying text.

275. *See supra* notes 103-108 and accompanying text.

276. *See* discussion of *Farmers & Merchants State Bank*, notes 147-158 and accompanying text.

277. *See* discussion of *Morgan Guaranty Trust*, *supra* notes 195-204 and accompanying text.

case, and therefore held that the intent behind the final payment rule would not be offended by the creation of an extra-Code exception to section 3-418.[278] Although the court articulated its reasoning in terms of the intended application of the final payment rule rather than its purposes and policies,[279] the result is the same. The court double-checked its extra-Code interpretation to ascertain that the spirit of the final payment rule was not violated.

The relevant purposes and policies can also resolve the extra-Code methodological issue under section 1-103 of whether the Code displaces an extra-Code principle, thereby making the extra-Code principle inapplicable. Where the application of an extra-Code principle creates an interpretation that is offensive to the relevant purposes and policies, the extra-Code principle should be deemed to be displaced and therefore inapplicable; but where its application to a Code provision is inoffensive to the relevant purposes and policies, the extra-Code principle is not displaced and can be applied. In this way, the displacement language of section 1-103 can be harmonized with the purposes underlying Code provisions.

The foregoing approach still leaves one unresolved situation. Assume that the purposes and policies underlying the provision to be interpreted do not themselves compel a result. Assume further that intra-Code techniques suggest an interpretation different from extra-Code techniques. Finally, assume that neither the intra-Code interpretation not the extra-Code interpretation violates the relevant purposes and policies. Under the suggested methodological approach, the court is free to use either intra-Code or extra-Code methodology where neither offends the relevant purposes and policies. In choosing between two inoffensive but contrary interpretations, a court should be free to choose the more equitable. Although it has been argued that judges may generally interpret the Code in this way,[280] it is preferable that a

278. *Morgan Guaranty Trust*, 804 F.2d at 1495-1496.

279. *Id.* at 1495. The court described its inquiry as "whether 3-418 was intended to bar a restitutionary remedy to a payor bank against a holder in due course that had knowledge of the bankruptcy of the maker at the time the instrument was presented." *See supra* note 201.

280. *See* Summers, *General Equitable Principles Under Section 1-103 of the Uniform Commercial Code*, 72 Nw. U.L. Rev. 906 (1984).

judge's generalized concepts of fairness should be determinative only in the narrow situation described above. Otherwise, the purposes and policies of the legislature as reflected in the Code drafting will be overridden.

An instructive example of the suggested methodology can be based on the section 9-306(2) issue of whether a debtor's disposition of collateral "was authorized by the secured party in the security agreement or otherwise," thereby cutting off the secured party's rights in the collateral.[281] If the security agreement prohibits the debtor from disposing of the collateral, or prohibits the debtor from doing so without written permission from the secured party, an interpretive issue arises when the secured party has created a course of dealing whereby it has previously allowed the debtor to sell collateral. On these facts, even though the debtor's subsequent disposition is not authorized in the security agreement, it might be considered authorized "otherwise" (i.e., by implication) under section 9-306(2).

Both the *Ellsworth* decision and the *Producers Cotton Oil Co.* decision addressed the foregoing interpretive issue, but both employed unsatisfactory methodology. Neither court considered the purpose behind the "otherwise authorized" provision. *Ellsworth* used the intra-Code device of relying on another Code provision — section 1-205(4) which states that express contract terms govern the course of dealing — to hold no authorization under section 9-306(2).[282] Even more unsatisfactory, *Producers Cotton Oil* simply cited case authority to reach the opposite result on the same facts.[283]

The suggested approach would require first that the court consider the purpose of section 9-306(2), as well as any relevant more general purposes that might resolve the matter. Such an inquiry does not reveal any purpose or policy that would directly resolve the interpretation of whether, on these facts, the disposition was "otherwise" authorized under section 9-306(2). Therefore, as a next step, a court would be free to use intra-Code methodology or extra-Code methodology. It could use the intra-

281. U.C.C. § 9-306(2), *supra* note 44.

282. *See* discussion of *Ellsworth, supra* notes 111-115 and accompanying text.

283. *See* discussion of *Producers Cotton Oil, supra* notes 231-235 and accompanying text.

Code device of relying on section 1-205(4) if it determined that no relevant purpose or policy is offended thereby. It appears that none is. Conversely, a court could use the extra-Code doctrines of estoppel or waiver to impose an authorization on the secured party based on its conduct. Under this approach the secured party's conduct would estop it from denying it had authorized the disposition, or in the alternative such conduct would constitute its waiver of the contract term prohibiting disposition without consent. Again it would appear that no relevant purpose would be offended thereby even though this result is opposite from the intra-Code result. Because both interpretations are inoffensive to the relevant purposes, the court could choose its interpretive method and result based on its sense of justice. The facts of the case would therefore become decisive. For example, if the buyer of the collateral knew of the restrictions on it, that would weigh against an interpretation of section 9-306(2) cutting off the secured party. If the secured party knew of the impending transfer but failed to warn the transferee, that would be a factor weighing in favor of an interpretation cutting off the secured party.

Under the proposed approach it is possible that the courts' interpretation of whether a disposition was authorized "otherwise" under section 9-306(2) will vary according to the facts of the case. Sometimes a past course of dealing by the secured party authorizing dispositions will constitute authorization of a subsequent disposition. Sometimes it will not. Furthermore, where purposes are not defined, other Code provisions may also be subject to different interpretive methodologies and diverse interpretations varying with the facts. But this would be the exception rather than the rule, because the relevant policies provide the boundaries beyond which interpretation may not go.

IV. CONCLUSION

The Code creates a tension between intra-Code methodology and extra-Code methodology. The case law reviewed herein does not adequately resolve this methodological dilemma. The best way to do so is to recognize purpose reasoning as the primary interpretive technique. Where that is indecisive, courts should flexibly employ other interpretive techniques so long as the result is consistent with the relevant purposes and policies.