AN INTRODUCTION TO THE UNIFORM COMMERCIAL CODE

INTRODUCTION

The enactment of the Uniform Commercial Code in Arizona will result in sweeping changes in the law which no attorney can afford to overlook or disregard. Few, if any, members of the Bar can even hope to master the four-hundred-odd sections of this almost universally adopted statute[1] without spending a considerable amount of time and effort both studying it and putting it to practical use. Since the Code will be in effect long before most attorneys will be able to become intimately familiar with it, we felt that it might be beneficial to present an article devoted to the more significant aspects of the Code's impact on commercial law.

Space limitations preclude treatment of all eight substantive areas of law dealt with by the Code. Four of these general topics have been included — Sales (Article 2); Letters of Credit (Article 5); Bulk Transfers (Article 6); and Secured Transactions (Article 9). Sales and secured transactions were selected because the large number of transactions which they affect make them of daily importance to lawyers and businessmen; the Code effects significant changes from prior law in these areas. Bulk transfers are treated because of the very significant changes in law made in this area and the involvement of attorneys in most of these transactions. Letters of credit are treated in the hope of familiarizing the Bar with this long-neglected, but highly useful commercial device. The topics not covered here — Commercial Paper (Article 3); Bank Deposits and Collections (Article 4); Documents of Title (Article 7); and Investment Securities (Article 8) — are of more limited significance to most attorneys. Hopefully, the Code sections treating them will be mastered by the persons who are most likely to be affected by them.

It is essential to realize that this article in no way constitutes an exhaustive treatment even of the subjects it contains. The article is intended to be only a survey of the salient features of the Code. *Attorneys must not rely on this article for solving commercial problems, but should use it only as a starting point from which to gain basic familiarity with the Code.*

In any consideration of the Code, two factors must be kept in mind. First, the purpose and policies of the statute are: (a) to simplify,

[1] Louisiana is the only state that has not adopted the Code.

clarify and modernize commercial law, (b) to permit continued expansion of commercial practice through custom, usage and agreement, and (c) to create uniformity.[2] For these reasons, most, if not all, prior Arizona statutes affecting the areas of commercial law treated by the Code have been specifically repealed and are replaced by the Code's provisions;[3] other statutes or parts of statutes found to be inconsistent with Code provisions are generally repealed.[4] Subsequent legislation is not to be interpreted as implicitly repealing any Code provision unless such an interpretation is unavoidable.[5] However, principles of prior law which are not displaced by particular Code provisions, remain effective and supplement the Code's treatment of commercial law.[6]

The second important factor is that the provisions of the Code may be altered by agreement of the parties, except where there is a specific provision to the contrary or where the obligations of good faith, diligence, reasonableness or care are required. These latter obligations cannot be disclaimed although the parties may prescribe the standards by which they are to be measured.[7]

Arizona did not adopt a section numbering scheme parallel to that of the official text of the Code. This makes cross-reference a tedious research chore. We have given both citations throughout the article. All citations to the Code sections are to the section number of the Uniform Commercial Code 1962 Official Text, followed by the Arizona Revised Statutes Annotated section number in parentheses.

Reference is made throughout the article to the official Comments of the draftsmen, appended to the particular sections of the 1962 Official Text. The Comments do not appear in the Arizona Revised Statutes and *are not law,* but are helpful in understanding the purpose of the Code's provisions and are persuasive of their proper interpretation.

We wish to acknowledge our deep gratitude and appreciation to Professor William E. Boyd of the University of Arizona College of Law, for the immeasurable amount of time and effort he devoted to guiding

[2] 9-102(2) (44-2202 B).
[3] 10-102 (Ariz. Laws 1967, ch. 3, § 6). This law specifically repeals the Uniform Bills of Lading Act, the Uniform Bulk Sales Act, the Uniform Conditional Sales Act, the Uniform Negotiable Instruments Act, the Uniform Sales Act, the Uniform Stock Transfer Act, and the Uniform Warehouse Receipts Act as they were enacted in Arizona. The section also repeals other statutes dealing with chattel mortgages, pledges, secured transactions, sales of accounts, contract rights, and chattel paper.
[4] 10-102 (Ariz. Laws 1967, ch. 3, § 6).
[5] 1-104 (44-2204).
[6] 1-103 (44-2203).
[7] 1-102(3) (44-2202 C).

the staff writers who contributed to this project. What value the article has is due to his suggestions; the errors are the sole responsibility of the Review.

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ARTICLE 2 — SALES

Because of the length of the new Sales Article, which comprises approximately one-fourth of the entire Code, the purpose of this article is necessarily restricted to consideration of some of the sections that will be of primary interest to the practicing attorney faced with the recent enactment of the Code. Before delving into some of the particular problem areas, however, certain basic features of the Code in general and of the Sales Article in particular should be considered.

GENERAL FEATURES

GOOD FAITH REQUIREMENT

Every contract or duty within the scope of the Code imposes an obligation of good faith in its performance or enforcement,[8] which obligation cannot be waived by the parties.[9] Good faith in the case of non-merchant sellers and buyers is defined by section 1-201(19) (44-2208(19)) as honesty in fact[10] in the conduct or transaction concerned, which is substantially the same standard set forth by the Uniform Sales Act § 76(2) (44-276 B) as applicable to all persons whether merchants or not.

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[8] 1-203 (44-2210).

[9] 1-102(3) (44-2202 C). This is one of the few exceptions to the general rule set out in this section that the effect of the provisions of Article 2 are subject to express agreement by the parties.

[10] *See* First Nat'l. Bank v. Anderson, 7 Pa. D. & C.2d 661 (C.P. 1954); Nicklaus v. Peoples Bank & Trust Co., 258 F. Supp. 482 (E.D. Ark. 1965), *aff'd*, 369 F.2d 683 (8th Cir. 1966).

MERCHANT — NON-MERCHANT DISTINCTION

The second basic principle which permeates Article 2 is the distinction in certain cases between merchants and non-merchants.

> [T]he sales article recognizes that in many instances the legal consequences of conduct by a skilled business professional would be different from the consequences of the conduct by the casual buyer unfamiliar with the trade.[11]

Thus, Article 2 contains a number of provisions which set forth two standards for like sets of circumstances, one for the non-merchant and another higher standard for the merchant or for transactions between merchants.[12] Illustrative of this distinction is the Code's definition of good faith in the case of a merchant, which includes both honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.[13] Before giving any advice, an attorney should determine the merchant or non-merchant status of the parties involved. To do this the practitioner must be aware that under the definition in section 2-104(1) (44-2304 A) a merchant may be not only "a person who deals in goods of the kind" involved, but also one who "otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved."[14]

UNCONSCIONABILITY

The Code brings into the law of sales the equitable concept of the unconscionable contract. Section 2-302(1) (44-2319 A) provides that:

> If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

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[11] Hogan, *The Highways and Some of the Byways in the Sales and Bulk Sales Articles of the Uniform Commercial Code*, 48 CORNELL L.Q. 1, 2 (1962).

[12] 2-103(1)(b) (44-2303 A(2)) ("good faith"); 2-104(1), (3) (44-2304 A, C) ("merchant", "between merchants"); 2-201(2) (44-2308 B) (formal requirements, Statute of Frauds); 2-205 (44-2312) (firm offers); 2-207(2) (44-2314 B) (additional terms in contract acceptance); 2-209(2) (44-2316 B) (agreement to modify or rescind); 2-314(1) (44-2331 A) (implied warranty of merchantability); 2-327(1)(c) (44-2344 A(3)) (merchant's obligations upon election to return goods received under sale on approval); 2-402(2) (44-2347 B) (retention of possession of goods by seller after sale or identification); 2-403(2) (44-2348 B) (merchant's power to transfer entrusted goods); 2-509(3) (44-2357 C) (passage of risk of loss when seller is a merchant); 2-603(1) (44-2366 A) (merchant buyer's duties as to rightfully rejected goods); 2-605(1)(b) (44-2368 A(2)) (waiver of buyer's objections by failure to particularize); 2-609(2) (44-2372 B) (right of adequate assurance of performance between merchants).

[13] 2-103(1)(b) (44-2303 A(2)).

[14] *See also* 2-104 (44-2304), Comment 2, which suggests that the definition of merchant may vary depending upon the section of the Code involved.

The purpose of this section is merely to allow the courts to do directly what they already do indirectly by making it possible for them explicitly to invalidate the unconscionable contract or clause without having to resort to manipulation of legal concepts or tortured construction of the language of the contract.[15]

Subsection (2) (44-2319 B) makes it clear that when the question of unconscionability arises, the parties will have an opportunity to present evidence of the commercial setting of the contract, its purpose and effect, to aid the court in making its determination. Claims of unconscionability frequently arise in cases involving disclaimers of implied warranties and unreasonable liquidated damages or other agreed remedies.[16] The basic principle is the prevention of oppression and unfair surprise where a party has not been fully informed or, if informed, has no real choice under the circumstances.[17] It should also be noted that since this section is not intended to change the results of case law concerning unconscionable contracts, its effect may be gauged by looking to the cases in which the courts have indirectly applied the equitable doctrine of unconscionability.[18]

FORMATION OF THE SALES CONTRACT

Courts traditionally have resorted to simple contract rules to answer questions involving the formation of sales contracts.[19] Although simple contract rules adequately can govern many aspects of sales transactions, there are many instances in which the needs of professional businessmen engaged in buying and selling goods require more sophisticated answers. The Code has attempted to provide solutions to these problems by departing from many accepted principles of contract law in recognition of actual commercial practices.[20] Before proceeding with a discussion of the scope and effect of some of the more significant of these departures, it should be noted that under section 1-103 (44-2203), unless otherwise displaced, general principles of law, including contract law, continue to apply to sales transactions and supplement the Code provisions. It should also be pointed out that underlying each of the Code solutions is its basic policy to recognize the existence of a

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[15] 2-302 (44-2319), Comment 1.

[16] *See* 2-316 (44-2333); 2-718 (44-2397); 2-719 (44-2398).

[17] *Cf.* Campbell Soup Co. v. Wentz, 172 F.2d 80 (3d Cir. 1948) (pre-Code litigation in which the court heard evidence as to the question of unconscionability and held that the output contract was too one-sided to be enforced in equity).

[18] *See, e.g.*, Hassenpflug v. Hart, 89 Ariz. 235, 360 P.2d 481 (1961); Marshal v. Patzman, 81 Ariz. 367, 306 P.2d 287 (1957); Shreeve v. Greer, 65 Ariz. 35, 173 P.2d 641 (1946); Steinfeld v. Nelson, 15 Ariz. 424, 139 P. 879 (1914).

[19] *See generally* L. VOLD, SALES ch. 2 (2d ed. 1959).

[20] *See* Corman, *The Law of Sales Under the Uniform Commercial Code*, 17 RUTGERS L. REV. 14 (1962); Hawkland, *Major Changes Under the Uniform Commercial Code in the Formation and Terms of Sales Contracts*, 10 PRAC. LAW. 73 (1964); Whiteside, *Major Changes in Sales Law*, 49 KY. L.J. 165 (1960).

contract whenever it is clear that the parties intended to enter into a binding agreement and there is a reasonably certain basis for granting an appropriate remedy.[21]

STATUTE OF FRAUDS

Section 2-201 (44-2308) involves a substantial alteration in the Statute of Frauds governing sales transactions.[22] Its coverage is restricted to "goods," thereby excluding choses in action which were within the prior statute.[23] In general, less formality is required to satisfy the Statute of Frauds than under the Uniform Sales Act. A writing need merely (1) evidence a contract for sale, (2) be signed by the party to be charged, and (3) specify a quantity.[24]

The Code solves a problem which often arose under prior law when an honest business man would confirm, by letter, an oral contract made by telephone. The Uniform Sales Act precluded the signer of such a letter of confirmation from invoking the Statute of Frauds but not the recipient who could sit back and watch the market conditions and declare the contract enforceable or unenforceable as he wished.[25] Under subsection (2) (44-2308 B), when a letter of confirmation is employed *between merchants,* the recipient must give *written notice of objection* within ten days after receipt or he is precluded from setting up the Statute of Frauds.[26] Thus, before incurring expense in performance of what may be an unenforceable agreement, either party may forward a confirmatory memorandum to the other party which, if not objected to in writing, is sufficient to satisfy the Statute of Frauds. Buyers and sellers should confirm all oral contracts by letter and should reply immediately (accepting or rejecting) upon receipt of such memoranda from the other party.

Consistent with prior law,[27] subsection (3) (44-2308 C) sets forth a number of exceptions to the formal requirements of the Statute of

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[21] 2-204 (44-2311); *see* Ranch House Supply Corp. v. Van Slyke, 91 Ariz. 177, 182, 370 P.2d 661, 665 (1962) (implying a promise to pay from an order for shipment).

[22] *See* ARIZ. REV. STAT. ANN. § 44-204 (1956).

[23] ARIZ. REV. STAT. ANN. §§ 44-101(4), 44-204 A (1956). *See also* Mitchell v. Thorne, 73 Ariz. 396, 242 P.2d 282 (1952); Kibbey v. Kinney, 25 Ariz. 427, 218 P. 984 (1923). The Statute of Frauds provision for securities is contained in 8-319 (44-3034). A catchall provision for personal property other than goods is contained in 1-206 (44-2213).

[24] *See* 2-201(1) (44-2308 A). If the contract is for the sale of goods for a price less than $500, no writing is necessary.

[25] For a detailed discussion of the problems presented under prior law, *see* W. HAWKLAND, SALES AND BULK SALES 28 (2d ed. 1958).

[26] *See* Associated Hardware Supply Co. v. Big Wheel Distrib. Co., 355 F.2d 114 (3d Cir. 1965); Harry Rubin & Sons, Inc. v. Consolidated Paper Co., 396 Pa. 506, 153 A.2d 472 (1959).

[27] ARIZ. REV. STAT. ANN. §§ 44-204 A, B (1956).

Frauds. First, the Uniform Sales Act special manufacturing provision,[28] excluding transactions involving goods especially manufactured for the buyer which are not suitable for sale to others in the ordinary course of the seller's business, is reenacted with one minor change. Under the old Sales Act, it was not necessary that the seller have changed his position, whereas subsection (3)(a) (44-2308 C(1)) limits the exception by requiring either a substantial beginning of the manufacturing or commitments for procurement.

Subsection (3)(b) (44-2308 C(2)) changes prior law by permitting enforcement of a contract not otherwise enforceable under the Statute of Frauds if the defendant "admits in his pleading, testimony or otherwise in court that a contract for sale was made."[29] This exception, however, only operates to the extent of the quantity admitted in the judicial proceedings.

The third substitute for a writing provided by the Code involves part payment or actual acceptance. Under the Uniform Sales Act, the Staute of Frauds is satisfied when the buyer has accepted and actually received part of the goods or has made a partial payment of the price.[30] This rule has proved unsatisfactory, however, for although such conduct on the part of the buyer may indicate the existence of an agreement, it is no indication of the quantity agreed upon and it thus opens the door to fraudulent claims where the value of the goods involved has increased. To rectify this situation, the Code provides that part performance satisfies the Statute of Frauds *only to the extent of the goods which actually have been received and accepted or for which payment has been made and accepted.*[31]

FIRM OFFER

It is a well settled common law contract rule that in order to create an irrevocable offer, the promise to keep the offer open must be supported by consideration. Without the requisite consideration, the offeror retains the power to revoke at will.[32] However, under some circumstances, this rule has had the undesirable effect of disappointing reason-

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[28] ARIZ. REV. STAT. ANN. § 44-204 B (1956).

[29] For an illustration of how far this rule has been applied, *see* Garrison v. Piatt, 113 Ga. App. 94, 147 S.E.2d 374 (1966), where, in a suit upon an oral contract, the court refused to sustain a demurrer to the petition which showed upon its face that the contract was within the Statute of Frauds because it may have become enforceable by acts occurring after the filing of the petition.

[30] ARIZ. REV. STAT. ANN. § 44-204 A (1956). *See also* Brown v. Beck, 68 Ariz. 139, 202 P.2d 528 (1949); Mosher v. Williams, 25 Ariz. 46, 212 P. 498 (1923); Platt v. Union Packing Co., 33 Cal. App. 2d 329, 89 P.2d 662 (1939).

[31] *See* 2-201(3)(c) (44-2308 C(3)).

[32] Prather v. Vasques, 162 Cal. App. 2d 198, 204, 327 P.2d 963, 967 (1958); Sargent & Co. v. Heggen, 195 Iowa 361, 364, 190 N.W. 506, 508 (1922); Small v. Paulson, 187 Ore. 76, 79, 209 P.2d 779, 782 (1949).

able expectations created by reliance upon a promise to keep an offer open and of ignoring the manifest intention of the parties to make a current firm offer binding. Section 2-205 (44-2312) changes this rule by providing that such an offer *when made by a merchant* and expressed *in a signed writing* shall be given legal effect, despite the absence of consideration, for the period of time specified or, if no time is stated, for a reasonable time, but in no event for longer than three months.[33] The Code provision protects the offeror from inadvertently signing a firm offer contained in a form supplied by the offeree by requiring that the firm offer clause be separately authenticated by the offeror in order to be binding.

Problems Involved in Acceptance

Mode of Acceptance

It is basic contract law that, since the offeror is master of his offer and can prescribe the method of acceptance, any attempt by the offeree to accept in some other manner is ineffective. In some cases, however, as where the offer is ambiguous as to the mode of acceptance, such a rule results in penalizing the innocent offeree rather than the offeror whose indefinite wording caused the difficulty. Recognizing the unfairness of this result, the draftsmen of the Code qualified the rule and provided instead that if the mode of acceptance is not clearly prescribed, the acceptance may be made in any manner and by any medium reasonable under the circumstances.[34]

Acceptance By Shipment

Another question under prior law was whether an offer to buy goods calling for prompt or current shipment could be accepted by shipment itself. Section 2-206(1)(b) (44-2313 A(2)) adopts the view that since such an offer impliedly invites acceptance by shipment, either shipment itself or a prompt promise to ship is a proper means of acceptance.

When acceptance is made by shipment, but of non-conforming goods, a serious problem arises which was not even considered by the Uniform Sales Act. The courts generally have taken the position that an offeree's shipment of non-conforming goods does not constitute an acceptance, but merely operates as a counteroffer.[35] Such a rule, however, allows the offeree-seller to avoid liability for breach by alleging

[33] *See* E. A. Coronis Associates v. M. Gordon Const. Co., 90 N.J. Super. 69, 216 A.2d 246 (Super. Ct. 1966) which held that the offer must give assurance that it will be held open in order for a firm offer to arise.

[34] *See* 2-206(1)(a) (44-2313 A(1)).

[35] *See generally* Restatement of Contracts § 59 (1932); 1 S. Williston, Contracts § 73 (3d ed. 1957).

that there is no contract because his attempted acceptance does not conform to the terms of the offer. Section 2-206(1)(b) (44-2313 A(2)) destroys this defense in the unilateral contract situation by making a non-conforming shipment both an acceptance and a breach[36] unless the seller seasonably notifies the buyer that the shipment is offered only as an accomodation to the buyer. Thus, to avoid liability, the seller who ships non-conforming goods should clearly specify that the shipment is offered only as an accommodation to the buyer where that is his intention.

ACCEPTANCE BY BEGINNING PERFORMANCE

Where an offeree, in response to an offer to enter into a unilateral contract, begins the requested performance, such conduct usually has barred the offeror from revoking the offer.[37] This gave the offeree an opportunity to either complete performance and thereby bind the offeror or, at his election, to stop performance, watch the market and prevent consummation of the contract. Section 2-206(2) (44-2313 B) avoids this lopsided result by providing that the beginning of performance by an offeree can be effective as an acceptance so as to bind the offeror only if it is followed within a reasonable time by notice to the offeror. If notice is not given seasonably, the offeror may treat the offer as having lapsed before acceptance. This requirement does not change the common law rule that the beginning of performance may bar revocation, but it greatly limits the time which the offeree has to decide whether or not to complete performance, thereby protecting the offeror from being held at the mercy of the offeree in a fluctuating market.

THE BATTLE OF THE CONFLICTING FORMS

It is familiar contract law that an attempted acceptance which changes or adds to any of the terms of the offer in any material respect does not result in an enforceable contract. This doctrine, which requires an unconditional assent to the offer to be operative as an acceptance, has had an unfortunate effect on commercial transactions. Typically, a buyer will forward a purchase order subject to certain terms and the seller will respond with a form of his own accepting the offer subject to certain conditions. By commercial understanding there is a binding agreement, but because the forms conflict, there is no contract under common law rules. Thus, if either the buyer or seller wishes to avoid performance, he may do so without liability for breach.

Adopting the premise that both parties are relying on the understanding that there is an enforceable contract despite the conflicting

[36] 2-206 (44-2313), Comment 4.
[37] *See* RESTATEMENT OF CONTRACTS § 45 (1932); 1 S. WILLISTON, CONTRACTS §§ 60, 60A (3d ed. 1957).

forms, section 2-207(1) (44-2314 A) provides that a contract is formed under such circumstances unless the "acceptance is expressly made conditional on assent to the additional or different terms." Under subsection (2) (44-2314 B), the additional terms are to be construed as proposals for addition to the contract and, *between merchants*, become part of the contract unless they materially alter it, or notification of objection to them has already been given or is given within a reasonable time, or the offer expressly limits acceptance to the terms of the offer.[38]

Subsection (3) (44-2314 C) deals with the situation where clauses on confirming forms sent by both parties conflict. In such a case, if both parties by their conduct recognize the existence of a contract, this is sufficient to establish a contract for sale. Since each party must be assumed to object to any clauses conflicting with those on his form, the notice requirement of subsection (2) is satisfied and the conflicting terms do not become a part of the contract. The contract then consists of those terms on which the writings of the parties agree and terms supplied by appropriate provisions of the Code. Thus, where the sale is "between merchants," the offeror should promptly object in writing to all additional terms supplied by the offeree which are not satisfactory. When the offeree is not satisfied with all the terms of the offer, he should either reject the offer prior to forwarding his counteroffer or make his acceptance expressly conditional on the exclusion of objectionable terms.

Modification of the Sales Contract

Under general contract law, an agreement once made cannot thereafter be modified unless the modification is supported by consideration.[39] Most courts have frustrated attempts to modify sales contracts by applying the "pre-existing duty" rule which provides that performance of, or a promise to perform, a pre-existing duty is not sufficient consideration for a return promise.[40] Thus, one party to a sales contract may agree to a good faith modification proposed by the other party and either party subsequently may renege as to the modified agreement. In such a case, the reneging party cannot be held to the terms as modified, but the original terms of the agreement can be enforced.

Section 2-209(1) (44-2316 A) has done away with this technicality, which has hampered necessary and desirable adjustments of sales contracts, by providing that modifications to the contract are binding

[38] If the additional terms are such as materially to alter the original agreement or are objected to within a reasonable time they will not be incorporated.

[39] Miller Cattle Co. v. Mattice, 38 Ariz. 180, 189, 298 P. 640, 643 (1931); *see* Annot., 34 A.L.R. 511 (1925). *See also* Stockton, *Sales Under the Uniform Commercial Code: Significant Changes*, 20 Ala. Law. 357 (1959).

[40] *See generally* 1 A. Corbin, Contracts § 143 (1963).

without additional consideration. However, modifications made under the Code must meet the requirements of good faith. To protect against false allegations of oral modifications, subsections (2) and (3) (44-2316 B and C) establish certain safeguards. First, if the original agreement provides that all modifications must be made by a signed writing, they cannot be otherwise modified; second, the Statute of Frauds must be satisfied if the contract as modified is within its provisions. To mitigate the rigors of these safeguards, subsection (4) (44-2316 D) provides that although an attempted modification proves ineffective as such, it can operate as a waiver of contract rights.[41]

THE GAP FILLING RULES

An agreement must be sufficiently definite to enable a court to determine the obligations of the parties.[42] In modern sales transactions, however, terms of an agreement are often deliberately left open with the understanding that there is a binding contract and that the omission is to be filled in at some later date. Thus, construing only the language of the agreement to determine its enforceability may well frustrate the intentions of the parties.

To rectify this situation, various provisions in Article 2 bring about a closer correlation between commercial practice and law by permitting the parties to make agreements somewhat indefinite, but still enforceable.[43] Of primary significance is the provision relating to open price agreements.

If the parties so intend, they can conclude a contract for sale *even though the price is not settled.*[44] If nothing is said as to the price at the time of delivery or if the price is left to be agreed upon by the parties and they fail to agree, or if the price is to be fixed in terms of some agreed standard as set or recorded by a third person or agency and it is not set or recorded, an agreement to pay a "reasonable price" will be implied. This changes prior law which provided that if a third person were to fix the price and did not do so, through no fault of the parties, the contract was avoided.[45]

Where the price is to be fixed by one of the parties, the notion that such party may fix any price he may wish is rejected by the express qualification that the price so fixed must be fixed in good faith.[46] If

[41] *See also* 1-107 (44-2207) which makes consideration unnecessary for an effective waiver of rights arising out of an alleged breach of a commercial contract where such waiver is in writing and signed and delivered by the aggrieved party.
[42] *See* RESTATEMENT OF CONTRACTS § 32 (1932); 1 S. WILLISTON, CONTRACTS § 37 (3d ed. 1957).
[43] *See* 2-305 (44-2322) to 2-311 (44-2328).
[44] 2-305(1) (44-2322 A).
[45] ARIZ. REV. STAT. ANN. § 44-210 A (1956).
[46] 2-305(2) (44-2322 B).

one party wrongfully interferes with the agreed method of fixing the price, the other, at his option, may treat this as a repudiation justifying cancellation or may fix a reasonable price himself.[47] Also, since the purpose of this section is to give effect to the agreement *which has been made*, subsection (4) (44-2322 D) makes it clear that if the parties do not intend to be bound "unless the price be fixed or agreed and it is not fixed or agreed, there is no contract."

WARRANTIES

In every sales transaction, the seller makes certain warranties to the buyer relating to the goods which are sold. These warranties may be express or implied and, in many instances, can be disclaimed by the seller in an effort to limit his liability. The Code's warranties are generally stronger and much more difficult to disclaim than were the warranties under prior law.

WARRANTY OF TITLE

Section 2-312 (44-2329) adopts the generally accepted view that there is in every sale contract, unless otherwise negatived (by specific language or by circumstances), a warranty of title,[48] but enlarges the warranty of a merchant-seller to cover claims of patent, trademark or other infringement. As pointed out in Comment 4, this section also "rejects the cases which recognize the principle that infringements violate the warranty of title but deny the buyer a remedy unless he has been expressly prevented from using the goods."

The implied warranty of quiet possession[49] is eliminated as a separate provision and is included as part of the warranty of title.[50] This section provides that in each sale contract, the seller warrants that the title shall be good and its transfer rightful, and that "the goods shall be delivered free from any security interest or other lien or encumbrance of which the buyer at the time of contracting has no knowledge."

EXPRESS WARRANTIES

Express warranties are created by (1) an affirmation of fact or

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[47] 2-305(3) (44-2322 C).

[48] Comment 6 of section 2-312 points out that the warranty of title is not designated as an "implied" warranty and hence is not subject to the disclaimer provision of section 2-316(3) (44-2333 C), but is governed instead by subsection (2) (44-2333 B).

[49] ARIZ. REV. STAT. ANN. § 44-213(2) (1956).

[50] This change may present a Statute of Limitations problem under section 2-725(2) (44-2404 B) which provides:

> 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. (emphasis added)

promise made by the seller to the buyer which becomes part of the basis of the bargain; (2) any description of the goods which is made part of the basis of the bargain; or (3) any sample or model which is made part of the basis of the bargain.[51] No specific intention to make a warranty is necessary if any of these factors is made part of the basis of the bargain. Nor are formal words such as "warranty" or "guarantee" necessary, although a statement of the value of the goods or one merely purporting to be the seller's opinion or commendation, does not create a warranty.[52] This section of the Code will still leave room to litigate whether certain representations are merely opinions or "puffing" or have become warranties.

Under the Uniform Sales Act, the buyer had to rely on the statements of the seller in order for an express warranty to arise.[53] Thus, any statements made after the sale could not become part of the bargain because they could not have been relied upon in making the sale. Under the Code rule abolishing the requirement of consideration for agreements modifying a sales contract, section 2-209(1) (44-2316 A), *statements made even after a contract has been consummated may result in warranty liability.* The only requirement for a warranty to become a modification after the sale is that language, samples, or models creating the warranty fairly be regarded as part of the contract.[54] This rule should avoid the harsh result of the Sales Act, which refused to protect a buyer who reasonably relied on post contractual assurances made by the seller.

IMPLIED WARRANTIES

There are two major implied warranties of quality set forth by the Code. Section 2-314 (44-2331) deals with the warranty of merchantability which is implied in a contract for the sale of goods if the seller is a merchant with respect to goods of that kind.[55] This section establishes criteria for determining whether or not the warranty of merchantability has been breached. For example, consumer goods must be "fit for the ordinary purposes for which they are used."[56] The language of the Sales Act, providing that the warranty of merchantability is created only in a sale by description[57] is abandoned by the Code. Also, under

[51] 2-313(1) (44-2330 A). In order to become part of the "basis of the bargain" an affirmation, promise, description, sample or model must so effect the "dickered" aspects of the individual bargain as clearly to go to the essence of that bargain.

[52] 2-313(2) (44-2330 B).

[53] ARIZ. REV. STAT. ANN. § 44-212 (1956). *See also* Murphy v. National Iron & Metal Co., 71 Ariz. 323, 227 P.2d 219 (1951). Under the Code it need be shown only that the promise, affirmation, etc., was made part of the "basis of the bargain". Whether this means something other than reliance is an open question.

[54] *See* 2-313 (44-2330), Comment 7.

[55] For the Code's definition of "merchant", see 2-104(1) (44-2304 A).

[56] 2-314(2)(c) (44-2331 B(3)).

[57] ARIZ. REV. STAT. ANN. § 44-215(2) (1956).

the Code provision, *the serving for value of food or drink to a consumer either on the premises or elsewhere is a sale.* This resolves the conflict in the cases as to whether the serving of food in a restaurant or hotel is a sale of food or merely a service to the individual customer, in which case the restaurant or hotel owner's liability would depend on finding either wilful fault or negligence.[58]

The other major implied warranty of quality is the warranty of fitness for a *particular* purpose. Under section 2-315 (44-2332), where the seller has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there arises an implied warranty that the goods will be fit for that purpose. The most important change from the Uniform Sales Act is the elimination of the "patent or other trade name" exception.[59] Under the old Sales Act, when a trade name was used by the buyer in the sale of a certain article, no warranty of fitness for a particular purpose arose because the buyer was presumed to rely on the skill or judgment of the manufacturer and not of the seller. The Code abandons this position. However, even though it is no longer decisive of the issue, the use of a trade name remains one of the facts to be considered to determine whether the buyer actually relied on the seller.[60]

Disclaimers

The Code makes a substantial alteration in the prior law relating to limitation of warranty liability.[61] Section 2-316 (44-2333) attempts to protect the buyer from an unexpected disclaimer clause by denying effect to such a clause when inconsistent with language of an express warranty and by allowing exclusion of implied warranties only by conspicuous language or other circumstances which protect the buyer from surprise.

Subsection (2)(44-2333 B) permits disclaimer of the implied warranty of merchantability only if merchantability is specifically mentioned and, if there is a writing, the disclaimer is conspicuous.[62] On the other hand, disclaimer of the implied warranty of fitness for a particular purpose may be made by general language, but only if it is in writing and conspicuous. These rather technical restrictions are, however, subject to and modified considerably by subsection (3) of section 2-316 (44-2333 C), which provides that all implied warranties are excluded by

[58] *See generally* L. Vold, Sales § 94 (2d ed. 1959); 1 S. Williston, Sales § 242b (rev. ed. 1948).
[59] *See* Ariz. Rev. Stat. Ann. § 44-215(4) (1956).
[60] *See* 2-315 (44-2332), Comment 5.
[61] *See* Ariz. Rev. Stat. Ann. § 44-271 (1956).
[62] For the Code's definition of "conspicuous", see 1-201(10) (44-2208(10)).

general language such as "as is,"[63] "with all faults" or other terms which in ordinary commercial usage fairly apprise the buyer that he takes the entire risk as to the quality of the goods involved. Apparently, this language need not be in writing to disclaim either of the implied warranties of quality.

PRIVITY

There has been a great deal of litigation in the modern law of sales on the requirement of privity.[64] The Code does not take a position on the question of liability to a consumer not in privity with the manufacturer or retailer. Section 2-318 (44-2334) merely extends the seller's warranty to the buyer's family, household and guests (in the home), thereby freeing any such beneficiary from the technical rules of privity. Comment 3 of this section makes it clear, however, that "the section is neutral and is not intended to restrict the developing case law on whether the seller's warranties, given to his buyer who resells, extend to other persons in the distributive chain." Moreover, this limited extension of privity by the Code does not mean that other classes of third parties who may be prospective plaintiffs will not be able to recover under a theory of negligence, misrepresentation, or strict liability in tort.[65]

TITLE

DECLINE OF THE TITLE CONCEPT

The Code's "contract" approach to the solution of sales problems differs substantially from the prior "property" or "title" approach.[66] Although a sale is defined as "the passing of title from the seller to the buyer for a price,"[67] the solution of a sales problem depends not on where title is vested but rather on the step in the contract's performance at which the problem has arisen.[68] The Code scheme favors a narrow issue approach which details specific legal consequences for different fact situations. If goods are destroyed, the Code provisions relating to risk of loss apply irrespective of who has title.[69] Rights of creditors may be determined not by the location of title but by the provision relating to creditors' rights.[70] In general, *only when no provi-*

[63] For a case involving interpretation of such language, see Boeing Airplane Co. v. O'Malley, 329 F.2d 585 (8th Cir. 1964).
[64] *See* Annot., 75 A.L.R.2d 39 (1961).
[65] *See* Epstein, *Personal Injuries From Defective Products — Some "Dots and Dashes,"* 9 ARIZ. L. REV. 163 (this issue).
[66] *See* 2-401 (44-2346), Comment 1.
[67] 2-106(1) (44-2306 A).
[68] Park County Implement Co. v. Craig, 397 P.2d 800 (Wyo. 1964).
[69] *See* 2-401 (44-2346), Comment 1.
[70] *Id.*

sion of the Code bears on the particular issue should the Code's title section be consulted.[71]

Frequently, results under the Code and the prior Uniform Sales Act are the same. There is real danger, however, in looking to the similar outcomes and failing to appreciate that the very different Code approach renders the Uniform Sales Act "title" concept incompetent to solve most problems. The Code:

> . . . does not conceive of the seller's interest in the goods as an entity passing to the buyer at one moment, but as a conglomeration of rights, risks and duties which can be and are transferred from the seller to the buyer at different times.[72]

Nevertheless, title must not be disregarded, for where incidents of ownership are not covered by the Code, parties' rights still depend on the location of title. Property taxes, price regulation, and public regulations generally, are other matters critically affected by the location of title but not within the purview of the Code.[73]

Under the Uniform Sales Act, title passed when the parties so intended,[74] and elaborate presumptions were outlined to aid the courts in ascertaining their intention.[75] The Code abandons all such presumptions, and unless the parties *explicitly* agree otherwise, title passes according to the rules of law set out in the title section, except that title to unidentified goods, such as future goods, cannot pass.[76] Intent, unless expressed, is irrelevant. If the seller is to ship goods, title passes upon shipment. If the seller is to deliver the goods at destination, title passes upon tender at destination. If the goods are not to be moved, title passes with delivery of the document of title; but if no document of title is involved, then title passes at the time of contracting, provided the goods are then identified to the contract. Generally, title passes whenever "the seller completes his performance with reference to the physical delivery of the goods,"[77] and any reservation of title by the seller is effective only to secure payment or performance from the buyer.[78] Title will re-vest in the seller by operation of law if the buyer rejects the goods, either rightfully or wrongfully, or justifiably revokes his acceptance of them.[79]

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[71] 2-401 (44-2346).
[72] Comment, *The Status of the Concept of Title in Article II of the Uniform Commercial Code*, 37 ST. JOHN'S L. REV. 178, 180 (1962).
[73] *See* 2-401 (44-2346), Comment 1.
[74] ARIZ. REV. STAT. ANN. § 44-218 (1956).
[75] ARIZ. REV. STAT. ANN. § 44-219 (1956).
[76] 2-401(1) (44-2346(1)).
[77] 2-401(2) (44-2346(2)); *see* Semple v. State Farm Auto. Ins. Co., 215 F. Supp. 645 (E.D. Pa. 1963); Wickham v. Levine, 47 Misc. 2d 1, 261 N.Y.S.2d 702 (Sup. Ct. 1965).
[78] 2-401(1) (44-2346(1)).
[79] 2-401(4) (44-2346(4)).

CREDITORS AND GOOD FAITH PURCHASERS

Two other sections dealing with the seller's ability to transfer an interest in goods make significant changes in the prior law. The usual rule that a creditor of the seller may treat any sale unaccompanied by immediate delivery as prima facie fraudulent and void as to him is modified.[80] When a *merchant* seller in *good faith* and in *current course of trade*[81] retains the goods for a *commercially reasonable time,* the buyer's interest prevails over that of the seller's unsecured creditor.[82] The laws concerning fraudulent transfers and voidable preferences still apply to sales *not* in the current course of trade, for example, transactions in satisfaction of pre-existing obligations.[83] What is a commercially reasonable time "depends on the nature, purpose and circumstances" of each action.[84] This new provision recognizes the widespread commercial practice of brief retention of possession by sellers in the legitimate course of trade.

The prior general rule that "the buyer acquires no better title to the goods than the seller had"[85] is now much less strict. Under section 2-403(1) (44-2348 A), a buyer with voidable title can still transfer title good against even the seller, and if the buyer obtained delivery of the goods in a *purchase transaction,*[86] he can transfer good title to a good faith purchaser for value even though the buyer acquired delivery (1) through larcenous fraud, (2) where goods were delivered on a cash sale but payment was not made concurrently, (3) by passing a bad check, or (4) by misrepresenting his identity in some way.[87] These are major innovations in the law of fraudulent transactions. For example, under prior law, if payment was made by check, it was often held that no title would pass until the check was honored;[88] the purchaser's power to pass good title was, therefore, conditional on the honoring of his check. Also, under the prior law, a purchaser misrepresenting his identity through the mails acquired only void title, and therefore had no power to transfer title, because the seller's intention was not to pass title to the imposter but to the person indicated in the letter.[89] Suggested rationales behind these changes are that a seller can check credit easier than the buyer can check title, and that the seller is in a

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[80] ARIZ. REV. STAT. ANN. § 44-1061 A (1956).
[81] Transactions in the "current course of trade" are distinguished by the Code from those which create voidable preferences or which are fraudulent. *See* 1-402 (44-2347) and Comments 1 and 2.
[82] The buyer's interest is stipulated by 2-502 (44-2350) and by 2-716 (44-2395).
[83] 2-402(2) (44-2347 B).
[84] 1-204(2) (44-2211 B).
[85] ARIZ. REV. STAT. ANN. § 44-233(1) (1956).
[86] A purchase is defined in 1-201(32) (44-2208(32)).
[87] 2-403(1) (44-2348 A).
[88] 2 S. WILLISTON, SALES § 346a (rev. ed. 1948).
[89] 3 S. WILLISTON, SALES § 635 (rev. ed. 1958).

better position to spread the risk.[90] It must be noted, too, that the class of protected persons is extended well beyond ordinary buyers. A "purchaser" within the meaning of the Code is a person who takes "by sale, discount, negotiation, mortgage, pledge, lien, issue or re-issue, gift or any other voluntary transaction creating an interest in property."[91]

Moreover, any *merchant* who has been entrusted with goods *of the kind in which he deals* has power to transfer all rights of the entruster to a *buyer in the ordinary course of business.* The trust receipt transaction no longer has to be "with liberty of sale," as under the Uniform Sales Act.[92] Any acquiescence by an entruster in bare possession, whether there is an accompanying sale or not, empowers the merchant trustee to pass all of the entruster's rights in the goods.[93] A frequently given illustration is a merchant-jeweler's wrongful sale of a watch left with him for repairs. Under the Code, the sale will cut off the rights of the entruster against a good faith buyer.[94] Thus, a merchant who continues in possession of goods after a sale may sell to a subsequent buyer all of the first buyer's rights; however, a merchant who sells goods entrusted to him by a thief can sell only the thief's interest, which is none, so the true owner may recover the goods from the buyer.[95] It is important to emphasize that the party protected by section 2-403(2), (3) (44-2348 B, C) is a *buyer,* who in the *ordinary course of business,* in *good faith,* and *without knowledge of an entruster's interests,* buys from a merchant who deals in goods of that kind but not from a pawnbroker,[96] and that these sections may apply where section 2-403(1) (44-2348 A) does not. The interests of a consignor of goods for sale are subordinate to those of such a buyer even though the consignor has taken the steps to protect his ownership prescribed in section 2-326(3) (44-2343 C).[97]

PERFORMANCE

IDENTIFICATION OF GOODS TO THE CONTRACT

Consistent with de-emphasis of the concept of title, the Code gives

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[90] Note, *The Good Faith Purchaser of Goods and "Entrusting" to a Merchant under the Uniform Commercial Code: Section 2-403,* 38 IND. L.J. 675, 683 (1963).

[91] 1-201(32), (33) (44-2208(32), (33)).

[92] The Code would reach the same result as the holdings in *Luhrs v. Valley Ranch Co.,* 27 Ariz. 306, 232 P. 1014 (1925) (holding seller had apparent authority to sell) and *Patterson Motors, Inc. v. Cortez,* 2 Ariz. App. 298, 408 P.2d 231 (1965) (entruster estopped from asserting title).

[93] 2-403(2), (3) (44-2348 B, C).

[94] *See* Independent News Co. v. Williams, 293 F.2d 510 (3rd Cir. 1961).

[95] Superior Iron Works & Supply Co. v. McMillan, 325 Ark. 207, 357 S.W.2d 524 (1962) (title to stolen property remains in its rightful owner); Atlantic Finance Co. v. Fisher, 173 Ohio St. 387, 183 N.E.2d (1962); Hertz Corp. v. Hardy, 197 Pa. Super. 466, 178 A.2d 833 (1962).

[96] 1-201(9) (44-2208(9)); Evans Prods. Co. v. Jorgensen, 421 P.2d 978 (Ore. 1966) (buyer in the ordinary course of business is not a purchaser). *Compare* 1-201(9) (44-2308(9)) (buyer in the ordinary course of business) *with* 1-201(32), (33) (44-2208(32), (33)) ("purchase" and "purchaser").

the buyer an insurable interest at the earliest possible moment without shifting to him the accompanying burdens of title under former law, such as risk of loss. Upon the "identification" of goods to the contract, even though they may be non-conforming and subject to rejection or return, the buyer acquires a "special property and an insurable interest."[98] The *incidents of title do not necessarily pass with identification,* and the seller's remedies remain dependent on his not defaulting.[99] It is, therefore, important not to confuse "identification" with the Uniform Sales Act concept of "appropriation."[100]

Absent explicit agreement, goods already existing and identified are "identified to the contract" when the contract is made.[101] Otherwise, identification is achieved *unilaterally* by the seller when he designates goods as referring to the contract.[102] Assent of the other party, formerly required by the Uniform Sales Act,[103] is unnecessary, and the seller is free to substitute other conforming goods for those identified unless he has first defaulted, become insolvent, or notified the buyer of final identification.[104] Crops to be harvested within the year or the next normal harvest season, whichever is longer, are identified when planted, and animals to be born within a year are identified when conceived.[105] The Code also guarantees the *seller* an insurable interest as long as he has title or any security interest in the identified goods.[106]

BUYER'S RIGHT TO GOODS ON SELLER'S INSOLVENCY

In contrast to prior law, the buyer now has the right to identified goods upon the seller's insolvency, provided the buyer has paid an installment within the ten days preceding the seller's insolvency and tenders the balance due.[107] To prevent unjust enrichment, however, the Code provides that where the identification was by the seller alone, the buyer may not recover goods which do not conform to the contract.[108] Professor Williston believes that difficulty may arise under this section if the seller goes into bankruptcy.[109] Because the Bankruptcy Act vests

[97] *See* Charles S. Martin Distrib. Co. v. Banks, 111 Ga. App. 538, 142 S.E.2d 309 (1965); Sterling Acceptance Co. v. Grimes, 194 Pa. Super. 503, 168 A.2d 600 (1961).
[98] 2-501 (44-2349).
[99] 2-501 (44-2349) and Comments.
[100] ARIZ. REV. STAT. ANN. § 44-219(4) (1956).
[101] 2-501(1)(a) (44-2349 A(1)).
[102] 2-501(1)(b) (44-2349 A(2)).
[103] ARIZ. REV. STAT. ANN. § 44-219(4)(a) (1956).
[104] 2-501(2) (44-2349 A(3)).
[105] 2-501(1)(c) (44-2349 A(3)).
[106] 2-501(2) (44-2349 B).
[107] 2-502 (44-2350). The requirements of this section, especially that of the ten day limitation, may render this remedy practically useless. However, this is not necessarily an exclusive remedy; contrast the seller's rights upon the buyer's insolvency under 2-702 (44-2381), which are exclusive. *See* W. HAWKLAND, SALES AND BULK SALES 141-43 (1958).
[108] 2-502(2) (44-2350 B).
[109] Williston, *The Law of Sales in the Proposed Commercial Code,* 63 HARV. L.

"title" of the bankrupt in the bankruptcy trustee as of the day of filing of the petition,[110] the trustee's right to the goods should be those of title holder. At least one commentator has suggested that the Code could still be followed in such a situation by construing the "title" received by the trustee to be "only those rights which the bankrupt possessed under the Code."[111]

DELIVERY

In general, the tender of delivery includes placing conforming goods at the buyer's disposition, giving him any notice reasonably necessary to aid him in taking delivery, tendering goods at a reasonable hour and holding them available for a reasonable time. The buyer has the responsibility of furnishing whatever facilities he needs to take possession. As to goods in the possession of a bailee to be delivered without being moved, the seller completes tender by delivering a negotiable instrument of title or by procuring acknowledgment by the bailee of the buyer's right to possession. Delivery of either a non-negotiable document of title or a written direction to the bailee to deliver will complete the seller's tender and fix the buyer's rights against the bailee and all third persons unless the buyer objects. As between the buyer and seller, however, risk of loss remains on the seller, and any failure of the bailee to honor non-negotiable documents of title or to obey directions defeats the tender. Documents normally are unnecessary to the seller's delivery unless required by the contract, in which case the seller must tender *all* the documents required by the contract in *correct form.* Such documents may be tendered through banking channels, and the buyer's failure to honor an accompanying draft constitutes rejection.[112]

SHIPMENT

Where the seller is to ship goods but not to deliver them at any particular destination, he must make a proper contract for the transportation of the goods, deliver the goods to the carrier, notify the buyer and deliver to the buyer any documents necessary to obtain possession.[113] If the seller fails to make a proper shipment contract or to promptly notify the buyer, his failure "is a ground for rejection only if material delay or loss ensues."[114] It is no longer presumed, as it was under prior law,[115] that if the seller pays shipping costs, he agrees to delivery at a

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REV. 561, 568-69 (1950).

[110] Bankruptcy Act, 11 U.S.C. § 110 (1964).

[111] Comment, *The Status of the Concept of Title in Article II of the Uniform Commercial Code,* 37 ST. JOHN'S L. REV. 178, 194 (1962).

[112] 2-503 (44-2351).

[113] 2-504 (44-2352).

[114] *Id.*

[115] ARIZ. REV. STAT. ANN. § 44-219(5) (1956).

particular destination. The Code recognizes that "shipment," as distinguished from "destination," contracts are normal in commercial transactions and, therefore, gives effect to usual practice, considering the seller's obligations fulfilled upon shipment.[116] Of course, when the contract contemplates delivery at a particular destination, the seller's obligations do not terminate until he has tendered delivery at the destination.[117]

Although the seller may ship goods under reservation, a reservation, even if the seller intends to retain full ownership, is permissible only for the purpose of securing payment or performance and in no way affects the location of title generally.[118] A convenient manner of reserving a security interest is a bill of lading, either negotiable or non-negotiable, to the seller's or his nominee's order at destination. However, retaining possession of a non-negotiable bill of lading naming the *buyer* as consignee reserves no security interest unless delivery is made conditional upon payment.[119] But even if, by the terms of the contract, delivery is so conditioned, the buyer who is consignee of a non-negotiable bill can transfer full title to a sub-buyer in ordinary course.[120] A reservation in violation of the sales contract constitutes an improper contract for transportation which would be grounds for rejection in the event of material delay or loss[121] "but impairs neither the rights given to the buyer by shipment and identification of the goods to the contract nor the seller's power as a holder of a negotiable document."[122]

ACCEPTANCE OF PAYMENT

As under the Uniform Sales Act and common law, the buyer has a duty to accept and pay for goods upon tender of delivery by the seller unless the contract provides otherwise.[123] The buyer has no rights of retention or disposal of the goods until payment is made,[124] except where the seller waives this condition by failing to follow up his rights.[125] This latter condition is to be distinguished from the seller's possessory lien under the Uniform Sales Act,[126] which may supplement the Code provisions where it does not conflict with them.[127] Similarly, unless the parties otherwise agree, the seller has no duty to tender delivery until

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[116] 2-503 (44-2351), Comment 5.
[117] 2-503(3) (44-2351 C).
[118] 2-401(1) (44-2346(1)). *But see* R. L. Rothstein Corp. v. Kerr Steamship Co., 21 App. Div. 2d 463, 251 N.Y.S.2d 81 (1964).
[119] 2-505(1)(b) (44-2353 A(2)).
[120] 2-505 (44-2353), Comment 4.
[121] *See* 2-504 (44-2352).
[122] 2-505(2) (44-2353 B).
[123] 2-507(1) (44-2355 A); ARIZ. REV. STAT. ANN. §§ 44-241 to -42 (1956).
[124] 2-507(2) (44-2355 B); *see* Greater Louisville Auto Auction, Inc. v. Ogle Buick, Inc., 387 S.W.2d 17 (Ky. Ct. App. 1965).
[125] 2-507 (44-2355), Comment 3.
[126] ARIZ. REV. STAT. ANN. § 44-254 (1956).
[127] 1-103 (44-2203).

the buyer tenders payment.[128] Payment may be made in any current commercial manner except that the seller may demand payment in legal tender by allowing the buyer reasonable time in which to procure it.[129] Payment by check is the standard commercial practice; this provision was designed to prevent "commercial surprise,"[130] and, hence, forced breaches. *As between the parties,* payment by check is conditional upon honoring of the check and is defeated by dishonor of the check on due presentment.[131] Under section 2-403(1)(b) (44-2348 A(2)), however, the buyer can transfer the goods to a good faith purchaser whether or not his check is honored.

Seller's Cure of Improper Tender

Any tender made before the time for the contract's performance, which does not conform to the terms of the contract, may be cured at any time before performance is required if notice of intention to do so is given by the seller.[132] The seller is also protected from forced breaches where he has reasonable grounds, either from a course of prior dealing or from usages in the trade, to believe his tender of non-conforming goods will be accepted, and the buyer surprises him with a rejection.[133]

In such a situation, the seller has a right to a reasonable extension of time to substitute a conforming performance if he notifies the buyer of his intention.[134] A "reasonable extension" is a time reasonable considering the *buyer's* circumstances.[135] One reason for requiring the seller to give notice of his intention to cure a defective tender is that he has given the buyer reason to be apprehensive about the security of the performance and therefore has entitled him to demand adequate assurance of due performance.[136]

Buyer's Right to Inspect and Preservation of Evidence

The buyer always has a right to inspect the goods before making payment,[137] except where the contract requires payment before inspection.[138] The Code also specifies that there is generally no right of inspection before payment where payment is to be against documents of

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[128] 2-511(1) (44-2359 A).
[129] 2-511(2) (44-2359 B).
[130] 2-511 (44-2359), Comment 3.
[131] 2-511(3) (44-2359 C).
[132] 2-508(1) (44-2356 A).
[133] This section, 2-508(2) (44-2356 B), qualifies the rule of section 2-601 (44-2364), which allows the buyer to reject any or all non-conforming commercial units.
[134] 2-508(2) (44-2356 B). *See also* 2-508 (44-2356), Comment 2.
[135] 2-508 (44-2356), Comment 3.
[136] For the Code provision on the right to adequate assurance of performance, see 2-609 (44-2372).
[137] 2-513 (44-2361).
[138] 2-512(1) (44-2360 A), 2-310(b) (44-2327(2)).

title or where the contract provides for delivery "C.O.D.,"[139] which term, in addition to other common mercantile symbols, is carefully defined in sections 2-319 to 24 (44-2336 to 41). Where payment is to be before inspection, it does not constitute acceptance, nor does it impair the buyer's remedies or right to inspect.[140] If the goods are so defective that their non-conformity appears without inspection, then in spite of contract requirements for pre-inspection payment, payment is excused.[141]

An implied part of the seller's responsibility in making tender is to hold the goods available for a time reasonably necessary for the buyer to make an inspection. If the parties stipulate a place or method of inspection, the express stipulations are presumed exclusive.[142] Impossibility of compliance with the inspection stipulations will result in inspection according to the Code inspection section unless the stipulations were clearly intended to be indispensible conditions in which case the contract will be defeated.[143] Finally, costs of the inspection will be borne by the buyer, but they may be recovered from the seller in the event the goods are non-conforming.[144]

The last of the performance sections includes a new provision to preserve evidence of goods in dispute. For the purpose of settling a claim or dispute, either party, by giving reasonable notification, may inspect, test, and sample the goods including those in the other party's possession.[145] The parties may agree to a third party investigation of any such goods and between themselves specify what effect the third party inspection will have, for example, whether merely to find facts or to settle the dispute.[146]

RISK OF LOSS

Proper performance will bear directly on any question of risk of loss because one of two specific Code sections will apply depending on whether or not there has been a breach of contract. Absent breach, where the seller has made a shipment contract, risk of loss passes to the buyer when the seller has delivered the goods to the carrier and has made a proper contract for their transportation.[147] The rule is the same if the seller ships under reservation. But if the seller is required to deliver the goods at a destination, then risk of loss does not pass to the

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[139] 2-513(3) (44-2361 C).
[140] 2-512(2) (44-2360 B).
[141] 2-512(1)(a) (44-2360 A(1)).
[142] 2-513(4) (44-2361 D).
[143] *Id.*
[144] 2-513(2) (44-2361 B).
[145] 2-515(a) (44-2363(1)).
[146] 2-515 (44-2363), Comment 3.
[147] 2-509(1)(a) 44-2357 A(1)); *see* Harvey Probber, Inc. v. Kaufman, 181 Pa. Super. 281, 124 A.2d 699 (1956) (risk of damage to sofa passed to buyer when seller had delivered it to common carrier).

buyer until the goods have been duly tendered there.[148] Risk of loss of goods in the possession of a bailee, to be delivered without being moved, passes to the buyer when he receives a negotiable document of title, or when the bailee acknowledges the buyer's interest, or "after" the buyer receives a non-negotiable document of title or a written direction to the bailee to deliver.[149] These provisions are likely to produce the same result as would the Uniform Sales Act under similar circumstances[150] except that a term placing the cost of freight on the seller will not necessarily convert a shipment contract into a destination contract so as to extend the period during which the seller will bear the risk of loss.[151] The Uniform Sales Act provision that the risk of loss of deliverable goods passes to the buyer upon the making of an unconditional contract,[152] is changed to provide that in cases other than those described above, the risk of loss passes to the buyer only when he actually receives the goods, if the seller is a *merchant.*[153] If the seller is not a merchant, risk passes to the buyer upon tender of delivery.[154] Sales on approval place the risk on the seller until the buyer accepts the goods.[155] As with most Code sections, the provisions of this section are subject to contrary agreement.[156]

That the shifting of title approach is inapplicable to risk of loss problems is especially apparent in the Code section dealing with risk of loss when there has been a breach. In that event, the breaching party will bear the risk to the extent that the loss exceeds the aggrieved party's effective insurance coverage.[157] Both parties have an insurable interest throughout the contract's performance even though the goods may be non-conforming.[158] The distribution of risk of loss under this section is not intended to be disturbed by subrogation of an insurer.[159] Of course, a seller whose own performance remains non-conforming and unaccepted cannot take advantage of the buyer's breach to shift the burden of loss to the buyer.

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[148] 2-509(1)(b) (44-2357 A(2)). *See also* 2-503 (44-2351); 2-504 (44-2352) and Comments (distinction between "shipment" and "destination" contracts); 2-319 (44-2336) (F.O.B. and F.A.S. terms).

[149] Significantly, section 2-509(2)(c) (44-2357 B(3)) uses the word "after" rather than "on" to indicate the need to give the buyer a reasonable time to secure acknowledgment by the bailee or to present the document or direction. *See* 2-503(4)(b) (44-2351 D(2)).

[150] ARIZ. REV. STAT. ANN. §§ 44-219(4)-(5), 44-243 C (1956).

[151] *See* 2-503 (44-2351), Comment 5.

[152] ARIZ. REV. STAT. ANN. § 44-219(1) (1956).

[153] "Merchant" is defined in 2-104(1) (44-2304 A) and in 2-104 (44-2304), Comment 2.

[154] *Cf.* Levandoski v. Pacheco, 84 Ariz. 55, 323 P.2d 951 (1958) (perhaps a strained Uniform Sales Act decision that title to goods had not passed when they were vandalized).

[155] 2-327(1) (44-2344 A).

[156] 2-509(4) (44-2357 D).

[157] 2-510(2), (3) (44-2358 B, C).

[158] 2-501 (44-2349).

[159] 2-510 (44-2358), Comment 3.

BREACH, REPUDIATION AND EXCUSE

A sales transaction involves several basic steps: the formation of a valid sales contract, tender of goods by the seller, acceptance by the buyer, and payment. Parts 6 and 7 of the Sales Article come into play when, after the formation of the contract, a party's expectations are somehow disappointed. When this happens, and the contract is breached, the remedies provisions of Part 7 must be consulted. Before considering the remedies provisions, however, it is necessary to set forth the different forms of disappointment of contractual hopes. Failure of performance need not always constitute a breach; in certain cases performance may be excused. Further, the nature of the seller's breach or repudiation and the buyer's acceptance or rejection of the goods determines the remedies available to the aggrieved party.

EXCUSE

Impossibility. Where goods which were identified[160] *when the contract was made* are destroyed without fault on the part of either party to the contract before risk of loss has passed to the buyer, performance is excused.[161] The Code eliminates the old "divisible contract" test[162] and gives the buyer an option, where the goods are not totally destroyed, to treat the contract as avoided or to accept the goods and negotiate for an allowance which reflects the diminution of the value of the shipment.

Failure of Presupposed Conditions. A seller is excused for late delivery or non-delivery of goods upon the "failure of presupposed conditions," unless he has guaranteed that such failure would not occur.[163] "Failure of a presupposed condition" requires the occurrence of a contingency, the non-occurrence of which was a *basic assumption* of the contract, which makes performance impracticable. The seller is also excused by impossibility due to good faith compliance with a governmental regulation. Excuse under this section, 2-615 (44-2378), is subject to Section 2-614 (44-2377), on substituted performance, which provides that (1) a buyer must accept a "commercially reasonable substitute" where the agreed means of *shipment* becomes "commercially impracticable" and (2) a seller must accept a substantially equivalent manner of *payment* when the agreed method of payment fails because of a governmental regulation.

Obviously, increased cost, labor disputes, failure of the seller's source of supply, and dozens of other *contingencies* might make per-

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160 "Identification" is treated in section 2-501 (44-2349).
161 2-613 (44-2376).
162 ARIZ. REV. STAT. ANN. §§ 44-207 and 44-208 (1956).
163 2-615 (44-2378).

formance *impracticable.* The real test, however, is whether the parties actually or impliedly bargained for the assumption of the risk involved.[164] Engineering difficulties [165] or mere cost[166] have been held not to establish excuse. But where the seller's factory is destroyed, and the contract calls for specially manufactured goods, the seller should be excused.[167]

If the contingency affects only part of the seller's capacity, he is bound to distribute his remaining inventory and production among his customers.[168] The seller must give his buyer seasonable notice of delay or partial distribution,[169] and if the notice reveals a deficiency that "substantially impairs the value of the whole contract," the buyer may either terminate the contract or modify it by agreeing in writing to take the pro rata share offered.[170] The buyer's silence results in a lapse of the contract with respect to any deliveries affected.[171]

REPUDIATION

In applying the doctrine of anticipatory repudiation, many courts have adopted a "single test" approach, lumping together cases of installment contract breaches, cases where the promisor's ability to perform has materially declined, and cases where he unequivocally manifests his intention to repudiate.[172] The Code rejects the single test approach and treats repudiation under four separate sections.[173]

Assurance of Performance. The drafstmen of the Code recognized that parties bargain for performance, not for a promise and the right to win a lawsuit.[174] Therefore, under Section 2-609 (44-2372), a party is offered three measures of protection when he has reason to feel insecure regarding the other party's performance. He may (1) demand in writing "adequate assurance of due performance," (2) suspend any of his own performance for which he has not already received the agreed return, pending the outcome of his demand and (3) treat the contract as repudiated if he receives no adequate assurance within a reasonable time, not exceeding 30 days.

The obvious question is, when is one entitled to make this demand and suspend performance? Between *merchants* the reasonableness of

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[164] *See* 2-615 (44-2378), Comments 1 and 9.
[165] United States v. Wegematic Corp., 360 F.2d 674 (2d Cir. 1966).
[166] Transatlantic Financing Corp. v. United States, 363 F.2d 312 (D.C. Cir. 1966).
[167] 1 W. HAWKLAND, A TRANSACTIONAL GUIDE TO THE UNIFORM COMMERCIAL CODE § 1.380202 (1964).
[168] 2-615(b) (44-2378(2)).
[169] 2-615(c) (44-2378(3)).
[170] 2-616(1) (44-2379 A).
[171] 2-616(2) (44-2379 B).
[172] W. HAWKLAND, SALES AND BULK SALES 114 (1958).
[173] 2-609 (44-2372) to 2-612 (44-2375).
[174] 2-609 (44-2372), Comment 1.

the grounds for insecurity and the adequacy of the assurance are to be determined in light of commercial standards,[175] and the overriding concept of good faith must be considered in all cases. The above question, then, does not lend itself to a simple answer. The entire commercial setting of the contract must be considered. Where a buyer falls behind on his open account with the seller, though the account is not related to the particular sales contract in question, the seller may be justified in demanding assurance. Where the buyer learns that the seller is making defective shipments to buyers similarly situated, the buyer may be justifiably insecure. Even mere rumors, if reasonably relied upon by a party *in good faith,* may constitute a justifiable basis for insecurity.[176]

The test for the adequacy of the assurance itself is the same. The mere promise of a reputable dealer that defective shipments will not be repeated may be sufficient. On the other hand, where previous deliveries are so defective as to be of little use to the buyer, such a promise would not be adequate unless accompanied by replacement, money allowance or other such cure.[177]

Breach of Installment Contracts. The rules governing performance of installment contracts[178] represent one of two stated exceptions to the "perfect tender" rule of section 2-601 (44-2364), which requires the seller's tender of delivery to be perfect in all particulars.[179] The buyer may reject an installment of such a contract only if the non-conformity substantially impairs the value of the installment *and* cannot be cured, or if the defect goes to required documents.[180] Allowance against the price, further delivery or partial rejection will usually constitute the necessary cure where there are discrepencies in quantity.[181] The installment contract section provides that a defective installment is a breach of the whole contract *only where the defect substantially impairs the value of the whole contract.*[182]

The sales contract should specify the degree of conformity required as to each installment and should set out precisely what constitutes substantial impairment of the contract in order to establish a workable standard of performance and avoid disputes arising from the broad language of this section. It must also be noted that under section 2-612(3) (44-2375 C) the contract is reinstated if a non-conforming installment is accepted and the aggrieved party does not give seasonable notice of cancellation or otherwise treats the contract as still in force.

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[175] 2-609(2) (44-2372 B).
[176] *Id.,* Comment 3.
[177] 2-609 (44-2372), Comment 4.
[178] ARIZ. REV. STAT. ANN. § 44-245 B (1956); 2-612 (44-2365), Comment 1.
[179] The other stated exception is found in section 2-719 (44-2398 on remedies modification.
[180] *Cf.* ARIZ. REV. STAT. ANN. § 44-245 A (1956).
[181] 2-612 (44-2375), Comment 5.
[182] 2-612 (44-2375).

Anticipatory Repudiation. In the case of anticipatory repudiation, the aggrieved party may either await performance for a commercially reasonable time or resort to his remedy for breach, and, in either case, may suspend his own performance.[183] Section 2-610 (44-2373) treats anticipatory repudiation in its usual sense — an overt communication or action which demonstrates that performance is impossible or shows a clear determination not to perform.[184] In view of section 2-508 (44-2356) on the seller's right to cure and section 2-609 (44-2372) on adequate assurance of performance, anticipatory repudiation is probably more limited than under prior law.

Repudiation may be retracted under section 2-611 (44-2374), at any time before the repudiating party's next performance is due, unless the aggrieved party has changed his position, cancelled or otherwise indicated that he considers the repudiation final.[185] No specific method for retraction is set out, but if the aggrieved party demands assurance under section 2-609 (44-2372), such demand must be met. Failure to comply with such a demand is, by itself, a repudiation of the contract.[186]

Breach of the Sales Contract

"Acceptance is the key concept around which the Code remedies are ordered."[187] The buyer may either accept goods or reject them. His rejection may or may not be rightful. He may revoke acceptance. While the buyer does *not* lose his remedies for breach by bare acceptance of the goods, the nature of his rights and duties depends at the outset upon whether he has accepted. Likewise, the seller's rights and duties cannot be ascertained until it has been determined whether the buyer has accepted. Any consideration of remedies upon breach (as distinguished from excuse and repudiation) must be prefaced by a discussion of the nature and effect of acceptance and rejection.

The Perfect Tender Rule. The Code gives the buyer extremely broad powers of rejection. Subject to the section on installment contract breach, and unless otherwise agreed,[188]

> [I]f the goods or the tender of delivery fail in any respect to conform to the conract, the buyer may: (a) reject the whole; or (b) accept the whole; or (c) accept any commercial unit or units and reject the rest.[189]

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[183] 2-610 (44-2373). *See also* Boyd v. Second-hand Supply Co., 14 Ariz. 36, 123 P. 619 (1912) (aggrieved party given same choice of remedy).

[184] 2-610 (44-2373), Comment 1; *accord,* Diamos v. Hirsch, 91 Ariz. 304, 307, 372 P.2d 76, 78 (1962).

[185] *See* 2-610(b) (44-2373(2)).

[186] 2-609(4) (44-2372 D).

[187] 1 W. Hawkland, *supra,* note 167, at § 1.39.

[188] The perfect tender rule is also severely limited by sections 2-508 (44-2356), 2-609 (44-2372) and 2-610 (44-2373).

[189] 2-601 (44-2364).

Parts (a) and (b) of this section reiterate the perfect tender rule of prior law.[190] Partial acceptance *in good faith* is also allowed, although it is somewhat limited by the "commercial unit" concept.[191]

Forced Breach. Occasionally, because of an unfavorable market fluctuation, one party to a sales contract may attempt to force the other party to breach. A buyer might make a last minute surprise rejection on the basis of some minor non-conformity. A seller could ship at the last minute and unexpectedly demand cash, or if cash was tendered, refuse to give a receipt therefore, placing the buyer in breach in the event that he could not, or would not, pay cash.[192] The buyer's surprise rejection, while permitted by the perfect tender rule, is prevented by section 2-508 (44-2356), which allows the seller to *cure* a rejected tender of delivery by notifying the buyer of his intent to cure and doing so before his time for performance has elapsed. The seller may gain additional time to cure if he reasonably believed his non-conforming tender would be acceptable with or without a price reduction.[193]

Even in cases where the perfect tender rule is not limited by the Code sections mentioned above, the buyer should weigh carefully the value of rejecting because of a minor non-conformity under section 2-601 (44-2364), against the possibility of breaching the contract by wrongfully rejecting.[194]

Rejection. Section 2-602 (44-2365) on rightful rejection, while not substantively changing prior law,[195] makes it clear that a buyer cannot reject without taking affirmative action. The buyer is bound to notify the seller within a reasonable time after delivery or tender of non-conforming goods that he intends to reject, or he will be deemed to have accepted.[196] Any exercise of ownership over rejected goods is "wrongful as against the seller," *i.e.*, conversion, and rejection places upon the buyer the *duty* to hold and take reasonable care of goods in his possession pending the seller's timely removal of them.[197] If the seller does not give instructions as to the disposition of rightfully rejected goods within a reasonable time, the buyer *may* store the goods for the seller's account, ship them back, or resell them for the seller's account, although he has no *duty* to do so.[198]

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[190] *See* California Steel Prods. Co. v. Wadlow, 58 Ariz. 69, 118 P.2d 67 (1941); Boyd v. Second-hand Supply Co., 14 Ariz. 36, 123 P. 619 (1912).

[191] See 2-105(6) (44-2305 F) for a definition of commercial unit.

[192] These two forced breaches are prevented by sections 2-511 (44-2359), 1-205 (44-2212) and 3-505 (44-2561).

[193] 2-508(2) (44-2356 B).

[194] *See* 2-703 (44-2382).

[195] ARIZ. REV. STAT. ANN. § 44-250 (1956).

[196] 2-602(1) (44-2365 A). Acceptance of part of a commercial unit is acceptance of the whole unit. 2-606(2) (44-2369 B).

[197] 2-602(2) (44-2365 B).

[198] 2-604 (44-2367), 2-602(2)(c) 44-2365 B(3)).

The above sections apply to *all* buyers. Under section 2-603 (44-2366), a *merchant buyer* is held to a higher standard. This section imposes a *duty* upon the merchant buyer to follow any reasonable instructions from the seller regarding disposition of the rejected goods in his possession or control,[199] although the buyer may demand indemnity for expenses. If the goods "are perishable *or threaten to decline in value speedily,*" it is at least the buyer's duty to make reasonable efforts to sell the goods. This duty exists in certain cases under the Federal Perishable Agricultural Commodities Act,[200] but generally has not been recognized under prior sales law.[201] A real innovation in this section is the provision that decline in value of the goods is grounds for requiring the buyer to act.[202] It is important to note that the buyer is only required to exercise good faith in dealing with rejected goods in his possession.[203]

The buyer, of course, is entitled to reasonable expenses incurred in caring for and selling the goods, including a commission not to exceed ten percent of the resale proceeds, if such is usual in the trade. Such expenses may be included in the buyer's security interest in rejected goods under section 2-711(3) (44-2390 C).

Waiver of Objections by Buyer. Where the buyer rejects non-conforming goods but fails to specify defects "ascertainable by reasonable inspection," he waives the right to rely on those not specified which the seller could have *cured*[204] if given seasonable notice.[205] For instance, a buyer who orders 500 crates of number one cantalopes might jump at the chance to reject a shipment when the market has dropped. In his eagerness he may fail to specify grounds for his rejection. If the shipment was indeed defective, say only 490 crates were shipped, and this defect could have been cured, the bad faith buyer cannot later rely upon the defect. If, on the other hand, the cantalopes had a hidden defect which ordinary inspection would not uncover, the buyer would be entitled to rely upon such defect in a later suit for breach of the sales contract, even though the defect could have been cured at the time the buyer rejected. Between *merchants,* a seller, after rejection, may make a written request for a "full and final written statement" of

[199] Not applicable if the seller has an agent or place of business at the market of rejection. 2-603(1) (44-2366 A).

[200] 7 U.S.C. § 499(b)(3) (1964). *See also* L. Gillarde Co. v. Joseph Martinelli & Co., 168 F.2d 276 (1st Cir. 1948).

[201] L. Vold, Sales § 85 (2d ed. 1959); 3 S. Williston, Sales § 498 (rev. ed. 1948).

[202] Automobiles have been held to be a commodity which "declines in value speedily." Grucella v. General Motors Corp., 10 Pa. D. & C.2d 65 (C. P. 1956).

[203] 2-603(3) (44-2366 C). This section seems to qualify the strong language of section 2-602(2)(a) (44-2365 B(1)).

[204] *See* 2-508 (44-2356) (seller's right to cure).

[205] 2-605 (44-2368).

defects upon which the buyer plans to rely.[206] The merchant buyer is bound by such a statement and can rely only upon the defects therein enumerated, whether or not the defects could have been cured or were "ascertainable by reasonable inspection." A *non-merchant* buyer, however, may waive only unstated objections where failure to particularize prevents cure; he may not be required to submit a written list of objections.

Acceptance. The buyer may accept goods by informing the seller that he accepts, or by failing to make an effective rejection under section 2-602 (44-2365) after having had a reasonable opportunity to inspect. The buyer also may be deemed to have accepted by doing "any act inconsistent with the seller's ownership," in which case the seller is given the option to treat such wrongful acts as either acceptance or conversion.[207] The sections providing for storage, re-shipment, sale, or otherwise caring for or disposing of rejected goods for the seller's account, for recovery of expenses so incurred, and for inspection, sampling and testing to preserve evidence of breach,[208] specifically provide that such acts are deemed to be *not* inconsistent with the seller's ownership.

Once the buyer has accepted the goods, he must of course pay for them, and he may not thereafter reject; but *acceptance does not impair any other remedy the buyer may have for non-conformity of the goods or tender.*[209] All the buyer has lost by accepting the goods is his right to reject, and this loss may be overcome if he can qualify for revocation of acceptance.[210]

Under section 2-607(3) (44-2370 C), where the buyer accepts a tender, he must give timely notice to the seller of any claimed breach "or be barred from any remedy." The time factor involved in this section will vary greatly depending upon many circumstances. A merchant buyer should discover defects in a rather short time and should be sufficiently well informed to notify his seller quickly of the defects and otherwise proceed to protect his interests. On the other hand, where the buyer is a consumer, the filing of a breach of warranty action should constitute reasonable notice.[211] One who seeks to sue in warranty as a third party beneficiary under section 2-318 (44-2335) must also observe the notice requirement of the present section, but the "reasonable time" allowed for notice in such a case could be quite a long period.[212]

Revocation of Acceptance. Where the buyer accepts non-conforming goods, either without discovering a latent defect or reasonably expect-

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[206] 2-605(1)(b) (44-2368 A(2)).
[207] 2-606 (44-2369).
[208] 2-603 (44-2366), 2-604 (44-2367), 2-515 (44-2363).
[209] 2-607(1), (2) (44-2370 A, B).
[210] *See* 2-608 (44-2371).
[211] Dowdle v. Young, 1 Ariz. App. 255, 401 P.2d 740 (1965).
[212] *See* 2-607 (44-2370), Comment 5.

ing that a known defect will be cured, the cure not being effected, he may revoke his acceptance by so notifying the seller within a reasonable time and before the goods have substantially deteriorated from causes other than their defects.[213] The buyer may revoke acceptance only of "lots" and "commercial units," the non-conformity of which substantially impairs their value to the buyer.[214] A trivial defect, which may be grounds for rejection, will not support a revocation of acceptance.[215] Upon revoking, a buyer is in exactly the same position as if he had rejected the goods, and his rights and duties are the same.[216]

Remedies upon Breach of the Sales Contract

"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 . . ."[217] Both the buyer's and seller's remedies are specifically enumerated in the Code. Before consulting specific remedies sections, it is essential to determine whether the goods have been accepted, as different remedies are available for pre-acceptance and post-acceptance breach.

Buyer's Remedies

Buyer's Remedies Before Acceptance. Section 2-711 (44-2390) provides an index to the buyer's pre-acceptance remedies upon breach. It also gives him the right, upon rightful rejection, to a security interest in any goods in his control or possession, to secure amounts paid on the price as well as enumerated expenses incurred in caring for or disposing of the goods.

The most significant part of this section is the provision that a buyer need no longer "elect to rescind" and forego other remedies as under the Uniform Sales Act,[218] and prior Arizona case law;[219] instead, he may cancel the contract upon the seller's breach *without sacrificing his other remedies.* The elimination of the choice of remedies concept is furthered by section 2-720 (44-2399), which provides that damage claims may not be waived by the parties' expressing a desire to cancel or rescind after breach. (Such a waiver *can* be achieved by a *signed written waiver* under section 1-107 (44-2207)). The election of remedies concept is removed unequivocally from fraud cases.[220]

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[213] 2-608 (44-2371).
[214] 2-608(1) (44-2371 A).
[215] *Id.*
[216] 2-608(3) (44-2371 C).
[217] 1-106 (44-2206).
[218] Ariz. Rev. Stat. Ann. § 44-269 (1956).
[219] Authorized Supply Co. v. Swift & Co., 271 F.2d 242 (9th Cir. 1959); California Steel Prods. Co. v. Wadlow, 58 Ariz. 69, 118 P.2d 67 (1941); Yancy v. Jeffreys, 39 Ariz. 563, 8 P.2d 774 (1932).
[220] 2-721 (44-2400).

Buyer's Damages. If the buyer does not want the goods covered by the contract and rightfully elects either to reject them or revoke acceptance, he is then entitled to damages under section 2-713 (44-2392). The measure of damages is the difference between the price specified in the contract and the market price at the time *when the buyer learned of the breach,*[221] at the place where tender should have been made or where defective tender was refused.

Wherever market price is used as the measure of damages, and the determination must be made prior to the time for performance, section 2-723 (44-2402) must be consulted. In anticipatory repudiation cases, the time for determining market price is "the time when the aggrieved party learned of the repudiation."[222] In any case where market figures are not readily available, reasonable leeway is allowed in determining market price figures, as to both time and place, and transportation costs are allowed. A party relying upon this section must notify the other party so as to prevent surprise.

In most cases, the buyer is entitled to incidental and consequential damages.[223] Certain specific items of incidential damages are set forth,[224] such as expenses of inspection, care, custody and transportation of rejected goods, but it was not the intent of the draftsmen to limit incidental damages to those enumerated.[225] Consequential damages are any which the seller had reason to know would flow from his breach, but are *not allowable where they could have been migitated by cover.*[226] Damages for injury to persons or property are recoverable only when they are the "proximate" result of a breach of warranty.[227]

Buyer's Remedies After Acceptance. In the event the buyer does want the non-conforming goods, or has accepted them, he may recover losses resulting from "*any* non-conformity of tender."[228] In the case of a breach of warranty, the measure of damages is the difference between the value of the goods accepted and their value had they been as warranted, although if special circumstances exist, this measure is not exclusive.[229] The damages are calculated as of the time and place of *acceptance.* Damages are recoverable under this section for any non-conformity, including late tender or tender of an improper quantity,[230] and include

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[221] *Compare* ARIZ. REV. STAT. ANN. § 44-267 C (1956) where the crucial time was deemed to be the time of expected delivery or the time of refusal to deliver.
[222] 2-723(1) (44-2402 A).
[223] *See* 2-713(1) (44-2392 A).
[224] 2-715 (44-2394).
[225] *Id.*, Comment 1.
[226] For a discussion of "cover," see p. *infra.*
[227] 2-715(2)(b) (44-2394 B(2)).
[228] 2-714(1) (44-2393 A).
[229] 2-714(2) (44-2393 B).
[230] 2-714(1) (44-2393 A).

incidental and consequential damages, as in the case of rejected goods.[231] Failure to give reasonable notice of a breach will bar the buyer's remedy.[232]

The buyer who has accepted a non-conforming tender is offered special relief under section 2-717 (44-2396). Upon giving notice of his intent to do so, the buyer may *recoup* by deducting from the price still owing on the contract any damages resulting from the seller's breach. Three things must be borne in mind when considering recoupment: the buyer must give notice of his intent to recoup; the damages and the recoupment must relate to the same contract; and recoupment is available for any breach, not just breach of warranty.

The Buyer's Cover. Cases may arise where the buyer must have the goods yet he has rejected a non-conforming shipment, or the seller has repudiated or failed to ship. In such a case, the buyer in good faith may purchase like goods and recover from the seller damages amounting to the difference between the cost of this "cover" and the contract price, plus incidental and consequential damages.[233] This remedy is not mandatory, and the buyer loses no remedy by failing to cover, although his rights to consequential damages[234] and to specific performance or replevin[235] may be affected adversely if he does not cover. Both merchants and non-merchants are entitled to cover.[236]

Specific Performance and Replevin. Where the seller has breached by repudiation or non-shipment, the buyer may need to reach the specific goods covered by the contract. In the case of a seller's insolvency, the buyer may be able to reach the goods under section 2-502 (44-2350). The buyer also may be able to replevy goods that have been identified to the contract whether or not he has proceeded under the insolvency provision.[237] The right of replevin is available where the buyer has been unable to cover, or where the circumstances clearly indicate that such efforts would be futile, or where the buyer has made or tendered a satisfaction of the security interest demanded for goods shipped under reservation. *But if the buyer can cover, he cannot replevy.*

"Specific performance may be decreed where the goods are unique *or in other proper circumstances.*"[238] The Uniform Sales Act made specific performance available at the discretion of the court.[239] Most of the wording changes seem to accomplish nothing, but the require-

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[231] 2-714(3) (44-2393 C).
[232] 2-714(1) (44-2393 A).
[233] 2-712 (44-2391).
[234] 2-715(2)(a) (44-2394 B(1)).
[235] 2-716 (44-2395).
[236] 2-712 (44-2391), Comment 4.
[237] 2-716(3) (44-2395 C).
[238] 2-716(1) (44-2395 A).
[239] ARIZ. REV. STAT. ANN. § 44-268 (1956).

ment that the goods be "specific or ascertained" has been eliminated. The intent of the draftsmen appears to be to liberalize the remedy of specific performance,[240] and to introduce a "new concept" as to what constitutes unique goods.[241] Abandoning the old "heirloom" approach, they define the usual unique goods situation as involving output or requirement contracts in the limited or special market situation. Inability to cover is deemed strong evidence of the "other proper circumstances" that make specific performance available.[242]

SELLER'S REMEDIES

As we have seen, when the seller breaches, the nature of the buyer's remedy depends upon whether he has accepted or rejected the goods. Likewise the seller's remedy depends upon whether his buyer has accepted and refused to pay, or has rejected conforming goods. Of course, the seller's remedy does not depend invariably upon the act of the buyer; in many cases, as where the buyer has become insolvent or has repudiated, the seller will not want to give the buyer the opportunity to accept.

Seller's Pre-Acceptance Remedies. Section 2-703 (44-2382) sets forth the seller's remedies prior to acceptance. The remedies are cumulative. In addition to providing an index, this section allows the seller to withhold the goods and to cancel the contract when the buyer wrongfully rejects or revokes acceptance, fails to make payment due on or before delivery, or repudiates.

Stoppage in Transit. Whenever the buyer breaches the sales contract prior to acceptance,[243] the seller may stop delivery of goods in the possession of a carrier or other bailee.[244] Under the Uniform Sales Act, the seller could stop in transit only where the buyer was insolvent.[245] This limitation still applies under the Code where the shipment involves less than a carload, truckload or planeload, the draftsmen feeling that stoppage of small shipments places a great burden on the carrier and further, that the seller can protect himself in such cases by shipping C.O.D.[246] It should be noted that *improper* stoppage in transit constitutes a breach by the seller.

Identification, Completion, Salvage. In many cases a buyer will repudiate or otherwise breach the sales contract in whole or part before all the goods are identified to the contract or, in the case of a manufac-

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[240] 2-716 (44-2395), Comment 1.
[241] 2-716 (44-2395), Comment 2.
[242] *Id.*
[243] The breaches are enumerated in section 2-703 (44-2382).
[244] 2-705 (44-2384).
[245] ARIZ. REV. STAT. ANN. § 44-257 (1956).
[246] 2-705 (44-2384), Comment 1.

turing contract, before the goods are completed. Under the Uniform Sales Act,[247] the seller's damages were computed as of the date the seller received notice of the breach, and expenditures that enhanced damages thereafter were not recoverable. The seller's dilemma was obvious — he could cease production and sue the buyer for damages, but if the buyer was insolvent, the seller was stuck with partially finished goods which had little resale value. This problem is eliminated by section 2-704 (44-2383), which provides that conforming goods in the seller's possession or control may *at the time of breach* be identified to the contract, and may be resold under section 2-706 (44-2385), even if unfinished. The seller also has the option of completing goods partially manufactured or ceasing the manufacturing process and selling such goods for scrap, but he must exercise "reasonable commercial judgment *for the purpose of avoiding loss.*"

Seller's Damages. The seller's rights to cancel, withhold, stop in transit, or identify goods to the contract are not remedies, but rather unilateral acts designed to prevent harm, not make the seller whole. Having protected himself under the above provisions, the seller is now in a position to recover damages for the buyer's breach of the contract. Under section 2-708 (44-2387), the standard measure of damages is the difference between the unpaid contract price and the market price at the time and place for tender, less expenses saved as a result of the buyer's breach.[248] Obviously, if the seller keeps all or part of the goods, he must credit the buyer with their value. If the market price measure will not put the seller in as good a position as full performance, he is entitled to his expected profit. Consider the situation of an appliance dealer with an unlimited supply of standard priced goods, who sells a $500 washing machine to a buyer who breaches. Even where the dealer retains the machine and sells it to another for $500, he is entitled to his margin of profit from the first buyer, because the breach cost him the profit from another sale. The aggrieved seller is also entitled to commercially reasonable incidental damages under section 2-710 (44-2389).

Resale. The seller's right of resale is considerably expanded and simplified under the Code; *any breach by the buyer gives rise to this right.*[249] The right to resell is a permissive remedy. If the aggrieved seller chooses to sue for damages rather than attempt a resale, he is perfectly free to do so. The measure of damages applicable where the seller chooses to resell is the difference between the resale price and the contract price, plus incidental damages, and less expenses saved. *The*

[247] ARIZ. REV. STAT. ANN. § 44-264 D (1956).
[248] Where market price must be determined prior to the time for performance, consult section 2-723 (44-2402).
[249] 2-706 (44-2385).

actual resale price is used; reference is made to market price only to determine the commercial reasonableness of the resale. If the seller does not comply in good faith with the provisions of the resale section, however, his damages should be measured by the standard set forth in section 2-708 (44-2387).[250] Even where the seller does not comply, however, a good faith purchaser at resale takes title good against the original buyer.

Action for the Price. Even where the goods have not been accepted by the buyer, an aggrieved seller may be entitled to maintain an action for the price plus incidental damages where the buyer fails to pay the price when due, provided a reasonable effort to resell at a reasonable price has failed, or where such effort obviously would be futile.[251]

Seller's Remedy Where Buyer Insolvent. Upon discovering that the buyer is insolvent, the seller may withhold delivery or stop delivery in transit pending cash payment for all sums due under the contract.[252] If the seller merely suspects that his buyer is insolvent, he should demand assurance of performance under section 2-609 (44-2372). Upon receipt of adequate assurance, the seller must continue performance.

Seller's Remedies After Acceptance: Action for the Price. After acceptance, the buyer's only obligation is to pay the contract price, provided he does not wrongfully revoke the acceptance. If the buyer breaches after acceptance, the seller's obvious remedy is an action for the price under section 2-709(1)(a) (44-2388 A(1)). The seller is entitled to the contract price for "goods accepted or *conforming* goods lost or damaged within a commercially reasonable time after risk of their loss has passed to the buyer." An action for the price may be maintained, in addition, only where non-accepted goods cannot be resold.

Reclamation. A suit for the price obviously would be futile if the buyer were insolvent. Under section 2-702(2) (44-2381 B) the seller is given the right to reclaim goods shipped to an insolvent buyer by demanding reclamation within ten days after the buyer receives the goods.[253] The draftsmen felt that receipt of goods on credit by an insolvent buyer is fradulent as against the seller.[254] Reclamation based upon fraud, where allowed by state law, generally is allowed under the Bankruptcy Act,[255] although it is possible that the bankruptcy court would demand more proof of fraud than mere receipt of goods on credit by an insolvent buyer. The seller's right of reclamation is expressly made subject to

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[250] 2-706 (44-2385), Comment 2.
[251] 2-709 (44-2388).
[252] 2-702(1) (44-2381 A).
[253] The ten day limit does not apply if the seller has misrepresented his solvency to the buyer in writing within three months before delivery. (2-702(2) (44-2381 B).
[254] 2-702 (44-2381), Comment 2.
[255] W. HAWKLAND, *supra* note 172, at 170, 180.

the rights of purchasers from the buyer and lien creditors of the buyer.[256] It is quite possible that the trustee in bankruptcy, as a lien creditor, will be able to defeat the seller's right of reclamation,[257] although this problem is by no means conclusively settled. Inasmuch as reclamation places the seller in a preferred position, all other remedies are lost as to goods successfully reclaimed.

CONTRACTUAL LIMITATION OF REMEDIES

Reasonable liquidated damages are allowed under section 2-718(1) (44-2397 A). Unreasonably large liquidated damage clauses are void as a penalty; unreasonably small amounts would be void as unconscionable under section 2-302 (44-2319).[258] Forfeitures are forbidden except as to small amounts deposited as security (20% of the value of the buyer's total performance or $500, whichever is smaller).[259]

The parties may provide for additional or different remedies under section 2-719 (44-2398). Where special remedies are agreed on by the parties, they must be reasonable. Consequential damages may be limited or excluded, but such clauses are subject to the test of unconscionability. Limitation in consumer goods contracts of consequential damages for personal injury is prima facie unconscionable. In the event that the particular remedy modification desired is a disclaimer of warranty, section 2-316 (44-2333) must be consulted. In many cases, disclaimer may produce a more desirable result than modification of remedies. Care should be taken, however, especially where the buyer is a consumer, not to limit his remedy in an unconscionable manner.[260] In drafting limitation of remedies clauses, it is important to designate the remedies as exclusive if the parties desire to be bound by the remedy specified. Unless the contract remedies are so designated, the parties will be entitled to rely upon all the Code remedies in addition to the special provisions in the contract.

ARTICLE 5 — LETTERS OF CREDIT

Frequently a buyer wishes to purchase goods from a distant seller but has no credit with the seller. The seller will not ship the goods because he is not assured that payment will be made upon their receipt by the buyer, and the buyer does not wish to arrange for payment prior to the arrival of the goods as ordered. The letter of credit device eliminates this impasse.

A letter of credit is a commitment made by an issuer (a bank or

256 2-702(3) (44-2382 C).
257 *See In re* Kravitz, 278 F.2d 820 (3d Cir. 1960).
258 2-718 (44-2397), Comment 1.
259 2-718(2) (44-2397 B).
260 *See* Henningson v. Bloomfield Motors, Inc., 32 N.J. 358, 161 A.2d 69 (1960).

a private person), at the request of the issuer's customer, that if certain requirements (usually the presentation of specified documents) are complied with by a third person (the "beneficiary"), the issuer will honor the beneficiary's demands for payment up to a stipulated amount. Prior to the Uniform Commercial Code, letters of credit had rarely been the subject of legislation, although they had long been utilized as a financing device. The applicable law has been developed by the courts. Article 5 sets forth the fundamental principles controlling letters of credit, but leaves many technical aspects to be developed by case law since the existing practices vary widely and the applicable law is still evolving.[261]

PARTIES AND RELATIONSHIPS INVOLVED

Because a letter of credit involves at least three parties, it creates at least three relationships. The relationships of issuer and customer and issuer and beneficiary are controlled by Article 5. Article 5 does *not* treat the relationship of customer and beneficiary since the underlying transaction between these parties is governed by other applicable sections of the Code. If the underlying transaction is a sale of goods, Article 2 governs the buyer-seller relationship; similarly, Article 8 would govern a sale of investment securities. The issuer is not a guarantor of the performance of the underlying transaction.[262] However, since he has so bound himself, he must honor a draft presented to him for payment if the documents designated in the letter of credit are presented, even though the beneficiary may have defaulted on the underlying agreement with the customer.[263] The contract between the customer and issuer need not be supported by consideration in order to establish the issuer's liability to the beneficiary.[264] Thus, the relationship between the customer and issuer need not concern the beneficiary.

The beneficiary may not be familiar with the issuing bank and may request that a second bank, usually one with which the beneficiary is familiar, guarantee the letter of credit. This second bank is known as a *confirming* bank and has the same liabilities as the issuing bank. A bank which merely gives notification of the issuance of a letter of credit is known as an *advising* bank and is liable only for the accuracy of its own statement.[265]

LETTERS OF CREDIT SUBJECT TO ARTICLE 5

Article 5 applies to a letter of credit issued by a bank only if pay-

[261] 5-102(3) (44-2702 C).
[262] 5-109(1)(a) (44-2709 A(1)).
[263] 5-114(1) (44-2714 A).
[264] 5-105 (44-2705).
[265] 5-107 (44-2707).

ment of the draft is conditioned upon presentation of a document (*any* paper); or to a letter of credit issued by a party other than a bank, only if the demand for payment is accompanied by a document of *title;* or to a credit issued by either a bank or other person which conspicuously states it is a letter of credit.[266] Engagements to honor drafts or make advances which do not fall into one of these three categories are not governed by Article 5.[267]

Revocable and irrevocable letters of credit. The Code provides for either revocable or irrevocable letters of credit.[268] An *irrevocable* letter of credit may not be amended without consent of both the customer and the issuer; a *revocable* letter of credit may be modified by the issuer without giving notice to or obtaining the consent of either the customer or the beneficiary.[269] Unless otherwise agreed, a credit is established as regards the *customer* as soon as the letter of credit is sent to him or notice of its issuance is sent to the beneficiary.[270] As regards the *beneficiary,* a credit is established when he receives notification of the letter's issuance.[271] A beneficiary should check the terms of an irrevocable letter carefully, since amendment is difficult, but he can rely on payment if he complies with the terms of the letter. A beneficiary has less security with a revocable letter, but may receive payment from any person authorized to honor a draft on the credit. The issuer is liable to any such authorized person who honors a draft before receiving notification of its cancellation or change.[272]

Notation and non-notation letters of credit. A letter of credit may be further classified as either "notation credit," in which case the person paying the beneficiary or purchasing a draft or demand for payment from him must indicate *on the letter* that a draft has been issued and its amount; or "non-notation credit" where no such indication is required. Where a non-notation letter of credit is used, conflicting claims may arise between competing good faith purchasers of drafts that were issued in reliance on the letter. In such cases, the first purchaser has priority over subsequent purchasers regardless of which draft was honored first. The issuer, however, is discharged upon honoring the first draft presented to him.[273] This problem does not arise with notation credit since the issuer may delay honoring the draft until it is satisfied that notation has been made.[274]

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[266] 5-102(1) (44-2702 A).
[267] 5-102(2) (44-2702 B).
[268] 5-103(1)(a) (44-2703 A(1)).
[269] 5-106(2), (3) (44-2706 B, C).
[270] 5-106(1)(a) (44-2706 A(1)).
[271] 5-106(1)(b) (44-2706 A(2)).
[272] 5-106(4) (44-2706 D).
[273] 5-108 (44-2708).
[274] 5-108(2)(b) (44-2708 B(2)).

RIGHTS OF ISSUER AND BENEFICIARY

The only duty owed by the issuer to the customer is to act in good faith and, in the case of a bank, also to observe general banking usage. The issuer, unless otherwise agreed, is not liable for the performance of the underlying contract between the customer and beneficiary, for knowledge or lack of knowledge of any usage of any particular trade, or for the genuiness of any document presented to it which appears regular upon its face.[275] Thus, an issuer who acts in good faith may honor a draft presented to it even though the customer notifies him of a possible forgery in the document accompanying the draft which is not apparent upon its face.[276] If the issuer does in fact honor such a draft, it is entitled to reimbursement from the customer. In such a case, however, the customer may enjoin the issuer from honoring the draft by suit in a competent court (provided honor is not demanded by a negotiating bank or other holder in due course).[277] By his demand for payment from the issuer, the beneficiary warrants that the conditions of the letter of credit have been complied with, together with any other warranties which may arise under Articles 3, 4, 7 and 8 of the Code.[278] If the demand for payment is wrongfully dishonored by the issuer, the person entitled to honor has, with respect to any documents, the rights of a seller under Article 2 of the Code and may recover from the issuer the face amount of the draft plus incidental damages and interest.[279] If the draft is only for a portion of the credit extended, a wrongful dishonor is considered anticipatory repudiation of the entire credit.[280] To further secure the beneficiary, if any funds or collateral of the customer are being held by the issuer to secure the honoring of the draft, payment will be made by the issuer (to the extent of the held collateral) even though the issuer has become insolvent. The beneficiary is therefore in a preferred position, with regard to the collateral, as against other creditors of the issuer.[281]

PRACTICAL USE OF THE LETTER OF CREDIT

While the letter of credit has been used in the past primarily in international trade, the enactment of Article 5 is intended to spur its use in domestic transactions, primarily in the sale of goods. The letter

[275] 5-109 (44-2709). Rosenfeld v. Banco Int'l, 27 App. Div. 2d 826, 278 N.Y.S.2d 160 (1967) (a bank having issued an irrevocable letter of credit is obliged to pay upon presentation of drafts accompanied by shipping documents as called for in the letter even though the documents allegedly contained false descriptions as a result of which the goods had been seized by a foreign government).
[276] 5-114(2)(b) (44-2714 B(2)).
[277] 5-114(2)(a) (44-2714 B(1)).
[278] 5-111(1) (44-2711 A).
[279] 5-115(1) (44-2715 A).
[280] *Id.*, Comment 2.
[281] 5-117(1)(a) (44-2717 A(1)).

of credit serves not only as an excellent vehicle for financing the sale itself, but also as a method of additionally financing the buyer, the seller or both. The following example should illustrate its use.

Seller, a wholesale vendor of machinery in Texas, contracts to sell certain machinery to Buyer, a retail dealer in Arizona. Buyer, who has no credit with Seller, contacts his bank, which issues to Seller a letter of credit in the amount of the purchase price of the machinery. The letter states that the bank will honor a draft in that amount if such draft is accompanied by a bill of lading describing the specific machinery. The use of the letter thus has facilitated the sale by substituting the credit of the bank for the credit of the buyer. Further assume that Seller, who plans to purchase the machinery from Manufacturer, wishes to finance this purchase. Seller may assign the proceeds of the letter of credit to his own bank as security for its issuing a second letter designating Manufacturer as beneficiary. Such an assignment of proceeds is permitted by section 5-116(2) (44-2716 B) *even though the original agreement between Buyer and his bank provides otherwise.* This transaction, referred to as a back-to-back letter of credit, thus has financed Seller's purchase as well as the original sale. To go one step further, assume that upon receipt of the machinery in Arizona, Buyer requires additional financing from his bank. The issuing bank, having honored the draft, would release the documents of title upon Buyer's execution of a security agreement in favor of the bank. Because the bank has provided new money for the purchase of the collateral (the machinery), it has a purchase money security interest with the advantages conferred on such an interest by Article 9 of the Code.

A letter of credit also might be substituted for an escrow agreement, serving the dual purpose of assuring payment to one party and relieving the other party of having to tie up his funds.

Possible Problems

Because Article 5 does not resolve many of the technical problems which may arise in the use of letters of credit, reference must be made to the case law of the particular jurisdictions concerned. The great majority of cases has arisen in New York. There are few reported cases from other jurisdictions and none from Arizona. Questions as to whether or not a given document complies with the terms of the letter of credit inevitably are issues of fact depending upon the circumstances of the particular case.[282] The nature of a credit not clearly labeled as either revocable or irrevocable is not settled by the Code. However, where

[282] Pacific Financial Corp. v. Central Bank and Trust Co., 296 F.2d 68 (5th Cir. 1961) (whether or not a particular document complies with the terms set forth in the letter of credit is a jury question).

ambiguity does exist as between the beneficiary and issuer, the words of the letter have been construed as strongly against the issuer as a reasonable reading would justify.[283] When enumerating the documents required for presentation to the issuing bank for honoring the draft, the customer should be as specific and complete as possible because the bank is entitled to reimbursement from the customer after honoring the draft in good faith.

The letter of credit may be used advantageously wherever one party desires assurance that a certain sum of money will be available to him at a future date.

ARTICLE 6 — BULK TRANSFERS

The basic purpose of Article 6 as adopted in Arizona is to protect those unsecured creditors of a business operation who have relied upon the inventory or stock in trade of their debtor for security and suddenly discover that the inventory has been sold to a third party without their knowledge. Such creditors bear the risk that the proceeds of the sale of their debtor's business will be dissipated by the seller before they are paid. The Code protects these creditors by requiring that they be given adequate and complete notice of impending bulk transfers.[284] With adequate notice, creditors have the opportunity to obstruct the sale, assert fraud, or follow the proceeds, as they see fit. The adoption of Article 6 repeals the prior Arizona Bulk Sales Article,[285] which also sought to protect such creditors by giving them notice. The Code, however, includes more specific provisions as to what transfers are included and excluded, provides for more direct and comprehensive notice to creditors, and also covers bulk transfers by auction sale.

INCLUDED TRANSACTIONS

"Major part" of inventory. Any transfer in bulk which is not in the ordinary course of the transferor's business and which consists of a *major part*[286] of the materials, supplies, merchandise, or other inventory of the enterprise is subject to Article 6.[287] Since the Code does not define what percentage of the inventory would be considered a "major part" and it is not clear whether "major part" refers to *value* or *quantity*, the requirements of the Code should be followed if there is any doubt as

[283] Fair Pavilions, Inc. v. First National Bank, 24 App. Div. 2d 109, 264 N.Y.S.2d 255 (1965).

[284] Arizona did not adopt the optional provision of 6-106 which would require the transferee to assure that the consideration given would be applied to pay the debts of the transferor.

[285] ARIZ. REV. STAT. ANN. § 44-1021 (1956).

[286] Prior Arizona law required that the sale consist of at least 75% of the stock in trade in order to be covered by the Bulk Sales Article of the Uniform Fraudulent Conveyance Act, ARIZ. REV. STAT. ANN. § 44-1021 (1956).

[287] 6-102(1) (44-2802 A).

to its applicability. Equipment is covered only if transferred in conjunction with a bulk transfer of inventory.[288] Whether three transfers to three purchasers, each consisting of one third of the total inventory, would be considered a bulk transfer, or whether the sale of all the assets of one of several separate operations (the transferred merchandise comprising less than 50% of the total merchandise at all locations) is a bulk sale, are problems not resolved by Article 6.

Sale of merchandise from stock. Only those enterprises whose principal business is the sale of merchandise from stock are covered by Article 6.[289] Those who manufacture what they sell are included. Thus, enterprises whose principal business is the sale of services rather than merchandise are not covered. Section 6-102 (44-2802), Comment 2 puts restaurants in this service class but at least one court has held otherwise.[290] The sale of intangibles is likewise excluded.

Special exclusions. There are certain transfers which, although falling into the bulk transfer category, are excluded.[291] Two major exclusions are those transfers which are made to give security and those transfers made to a solvent buyer who binds himself to pay the debts of the seller in full and who gives public notice of this fact.

NOTICE REQUIREMENTS

Creditors entitled to notice. If the transfer falls within the coverage of Article 6, notice of the sale must be given to the creditors of the transferor *by the transferee* at least ten days prior to the transferee's taking possession or paying for the goods, whichever happens first.[292] Upon request of the transferee, the transferor must furnish a sworn list of his creditors indicating their names and the amounts owed. The creditors entitled to notice are those creditors holding claims based on transactions occurring before the transfer; however, those who become creditors after notice is given are not entitled to notice.[293] The Code does not define the date of transfer — whether it is the date on which the contract for sale is made, the date the transferee takes possession, or the date the transferee makes payment. To be safe, the latest date should be considered governing. Creditors who are known by the

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[288] 6-102(2) (44-2802 B).
[289] 6-102(3) (44-2802 C).
[290] Uhr v. 3361, Inc., 21 Pa. D. & C.2d 348 (C.P. 1960). A later case, *Zini v. One Township Line Corp.*, 36 Pa. D. & C.2d 297 (C.P. 1965), did hold that restaurants are in the service class. Since it is quite possible that courts will differ as to whether a particular enterprise is in this service class and, in any event, may decide not to follow the Comments to the Code, care should be used in this area. It would be wise to comply with the Code's requirements if there is any question as to the applicability of Article 6.
[291] 6-103 (44-2803) (enumerates eight excluded transfers).
[292] 6-105 (44-2805).
[293] 6-109 (44-2808).

transferee to be asserting claims must be notified even if they do not appear on the transferor's list.

Those falling under the classification of creditor are many. An employee of the seller who has a claim for compensation,[294] *a government authority owed taxes,*[295] and a broker who negotiated the sale[296] have all been held to be creditors entitled to notice. Even though a claim is in dispute, the alleged creditor must be notified.[297]

Schedule of property. The seller and buyer together must prepare a schedule of the property to be sold.[298] The buyer must either preserve the schedule of property and list of creditors for inspection by any creditor for six months following the sale, or must record the lists in the office of the county recorder in each county where any of the transferred property is located.

Contents of notice. If the debts of the seller are to be paid in full as they fall due as a result of the transaction, the notice to each creditor need state only that a bulk transfer will be made, the names and addresses of the transferor and transferee and the address to which creditors should send bills.[299] This is the short form of notice. If the debts of the seller are not to be paid in full as they fall due or if the buyer is in doubt as to whether the transferor can or will pay the bills when due, the notice must also contain: the location and description of the property to be sold; the total amount of the debts owing; where the creditors' list and property schedule may be inspected; whether the transfer is to pay existing debts and if so the amount and to whom they are owed; and whether the transfer is for new consideration and if so, the amount, time, and place of payment.[300] Notwithstanding the above noted provision for a short form notice, the wise attorney will use the long form in all cases where it is not burdensome to comply with, and in doing so will avoid the question as to whether the transferee was in doubt as to the transferor's ability to pay the bills when due.

Form of notice. The transferee must either give the required notice of the impending sale to each creditor personally or by registered or certified mail.[301] Actual knowledge of the impending bulk transfer

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[294] Coffey v. McGahey, 181 Mich. 225, 148 N.W. 356 (1914).
[295] United States v. Goldblatt Bros., 128 F.2d 576 (7th Cir. 1942), *cert. denied,* 317 U.S. 662 (1942). The better practice is, therefore, to give notice to such taxing authorities where tax liability is uncertain or unkown.
[296] Blau v. Richman, 33 Pa. D. & C. 481 (C.P. 1938).
[297] 6-104(2) (44-2804 B).
[298] 6-104(1)(b) (44-2804 A(2)).
[299] 6-107(1) (44-2806 A).
[300] 6-107(2) (44-2806 B).
[301] 6-107(3) (44-2806 C). The prior Arizona Bulk Sales Article required recording, publication and posting of notice. ARIZ. REV. STAT. ANN. § 44-1021 A (1956).

might be sufficient notice to a creditor,[302] although the Code is silent on this point.

FAILURE TO COMPLY

Transaction ineffective as to unnotified creditors. As against any creditors entitled to notice who are not given notice, the sale is *ineffective.*[303] Responsibility for the completeness and accuracy of the list of creditors rests on the transferor and the transfer itself is not rendered ineffective by errors or omissions unless the transferee is shown to have had knowledge of them.[304] The prior Bulk Sales Article in Arizona rendered a noncomplying sale void as to all creditors if the notice requirements were not met; the Code protects only those who have not been notified.[305]

Remedies of creditors. Any creditor not given the required notice may disregard the transfer and levy on the goods as if they still belonged to the transferor.

Aggrieved creditors must act quickly, however, for there is a six month limitation on any action or levy brought under Article 6. The time starts to run on the date the transferee takes possession of the goods or on the date of discovery of the transfer if the transfer has been concealed.[306]

Subsequent purchasers. It should be noted that it is possible for a third party to purchase the goods from the transferee and take them free from any claims of the transferor's creditors even though Article 6 was not complied with. In order to be so protected, the third party must have acted in good faith, without knowledge of the bulk sale, and have paid value.[307]

SPECIAL DUTIES OF AUCTIONEER

If a bulk sale is made by auction, Article 6 imposes on the auctioneer burdens similar to those imposed upon the transferee in a private sale, if the auctioneer knows the sale is a bulk sale. There was no like provision under prior law. The transferor must furnish the list of creditors to the auctioneer who must then notify the transferor's creditors in the same manner as would a transferee in the case of a private sale. Should the auctioneer fail to follow this procedure, he will be liable to the creditors for the sums owing them, except that his liability is limited

[302] Brownson v. Lewis, 233 Ore. 152, 377 P.2d 327 (1962) (actual knowledge can, under some circumstances, dispense with formal notice required under the Bulk Sales Act).
[303] 6-105 (44-2805).
[304] 6-104(3) (44-2804 C).
[305] *Compare* ARIZ. REV. STAT. ANN. § 44-1021 B (1956) *with* ARIZ. REV. STAT. ANN. § 44-2805 (Supp. 1967).
[306] 6-111 (44-2810).
[307] 6-110(2) (44-2809(2)).

to the amount of the net proceeds of the auction. The purchasers at the auction receive good title to the merchandise purchased.[308]

ARTICLE 9 — SECURED TRANSACTIONS

DEFINITIONS AND CLASSIFICATIONS

Not all the definitions and classifications in Article 9 are either new or important, but some of them are both unfamiliar and essential to an understanding of the Code's treatment of secured transactions.[309] In particular, the classification of types of collateral[310] is fundamental to the subsequent treatment of perfection and priority. Moreover, material found in other parts of the Code must sometimes be consulted to ensure an accurate reading of Article 9.

IMPORTANT DEFINITIONS OUTSIDE ARTICLE 9

Besides the definitions included in Article 9, those found in Article 1 may be important. For example, "security agreement" and "secured party" are defined in terms of "security interest," which is defined only in Article 1.[311]

Security Interest. " 'Security interest' means an interest in personal property or fixtures which secures payment or performance of an obligation."[312] Pursuant to the Code's policy of eliminating non-functional distinctions, the term comprehends the interests of the conditional seller, the chattel mortgagee, the seller reserving title after delivery of goods to the buyer,[313] the buyer of accounts, chattel paper or contract rights[314] (when the sale is intended as a security transaction) and sometimes the interest of lessors of personality.[315] A "security agreement" is an agreement which creates or provides for a security interest,"[316] whether it is in the form of a loan agreement, contract of sale, or lease. A "secured party" is "a lender, seller or other person in whose favor there is a secur-

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[308] 6-108 (44-2807).

[309] *See, e.g.*, 9-105 (44-3105) to 9-109 (44-3109).

[310] 9-105 (44-3105), 9-106 (44-3106), 9-109 (44-3109).

[311] 1-201(37) (44-2208(37)).

[312] None of the critical terms of this definition are themselves defined, a lack that may create difficulties. For instance, the courts may or may not consider "an interest . . . which secures . . . an obligation" to comprehend an equitable lien.

[313] The security interest arising from a reservation of title, and also other security interests arising under Article 2 are governed both by Article 2 and by Article 9 unless and until the debtor obtains lawful possession of the goods. For the relationship of the provisions of the two Articles, see 9-113 (44-3113) and Comments.

[314] *See also* 9-102(1)(b) (44-3102 A(2)).

[315] Whether or not a lease is intended to create a security interest is to be determined by the facts of each case. An option to purchase does not necessarily create a security interest in the lessor, but "an agreement that upon compliance with the terms of the lease the lessee shall become or has the option to become the owner of the property for no additional consideration does make the lease one intended for security." 1-201(37) (44-2208(37)).

[316] 9-105(1)(h) (44-3105 A(8)).

ity interest," and includes even an outright buyer of accounts, contract rights or chattel paper.[317]

Buyer in Ordinary Course of Business. Another important definition outside Article 9 is that of "buyer in ordinary course of business."[318] Knowing the definition and realizing the possible existence of such a buyer may be critical, since under certain circumstances he can take free of even a perfected security interest.[319] One must turn to the "General Definitions" contained in Article 1 in order to find that he is a person "who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind, but does not include a pawnbroker."[320] Even actual knowledge of the existence of a perfected security interest will not subject such a buyer to the secured party's claim; the buyer must also know that the sale is in violation of some term in the security agreement to be subject to the claim.[321]

In short, it is important not to depend entirely on the definitions contained in Article 9. It is often necessary to check the cross-references given at the end of the official Comments in order to construe the sections correctly.

IMPORTANT DEFINITIONS AND CLASSIFICATIONS WITHIN ARTICLE 9.

Within Article 9, the definitions of classes of collateral are those most likely to be unfamiliar. The authors of the Code have chosen to vary legal consequences according to the type of collateral involved, rather than according to the form of the security agreement (such as chattel mortgage, conditional sale, or lease). The types of collateral are first divided into two main categories: "goods" and "intangible collateral."[322] "Goods" are defined as "things which are movable at the time the security interest attaches," or which are fixtures.[323] They are

317 9-105(1)(i) (44-3105 A(9)).
318 1-201(9) (44-2208(9)).
319 *See, e.g.*, 9-307 (44-3128).
320 1-201 (44-2208(9)).
321 9-307 (44-3128), Comment 2.
322 "Intangible collateral" is in turn subdivided into "the various categories of commercial paper which are either negotiable or to a greater or less extent dealt with as if negotiable," and "those choses in action . . . which are not evidenced by an indispensable writing." 9-106 (44-3106), Comment. For differences in treatment of the two types, see, *e.g.*, 9-302 (44-3123) and Comment 5 (filing needed to perfect security interest in chose not evidenced by indispensable writing), and 9-304 (44-3125) and Comment 1 (no filing needed to perfect interest evidenced by indispensable writing). Although the category characterized by the absence of an indispensable writing includes a class "general intangibles," it is important to notice that "intangible collateral" is the broader term, and that much "intangible collateral" is treated differently from "general intangibles."
323 The definition of "goods" included in Article 2 is not identical in wording with the Article 9 definition, but means essentially the same thing. *Compare* 9-105(1)(f) (44-3105 A(6)) *with* 2-105(1) (44-2305 A).

further defined by the method of exclusion: "goods" are *not* "money, documents, instruments, accounts, chattel paper, general intangibles, contract rights, and other things in action."[324]

GOODS

Goods are sub-divided into the mutually-exclusive categories of "consumer goods," "farm products," "equipment" and "inventory."[325]

Consumer Goods. Goods are "consumer goods" if they are "used or bought for use primarily for personal family or household purposes . . . ."[326] Notice that the classification is determined by the relationship of the *debtor* to the goods, and by the *primary* use to which the goods are put, rather than by the intrinsic nature of the item. For instance, the family refrigerator, and the eggs stored in it that the family is going to eat, are "consumer goods;" but, as the following sections will make clear, the same items may be farm products, equipment or inventory under other circumstances. Many consequences follow from the goods' classification as "consumer goods," including the following important examples. If the security agreement contains an after-acquired property clause, the operation of the clause on "consumer goods" will be limited to such goods acquired within ten days after the secured party gives value.[327] It has been said that this provision "will eliminate a practice which has been much criticized in the consumer finance field . . . of a seller of consumer goods taking a mortgage on the goods sold plus all other after-acquired property of a debtor . . . ."[328] Furthermore, a debtor's waiver of personal defenses against an assignee is invalid if the collateral is "consumer goods."[329] Except perhaps in his remedies, the debtor entering into a security agreement for which the collateral is "consumer goods" is given more protection than a debtor who gives a security interest in other classes of collateral.

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[324] 9-105(1)(f) (44-3105 A(6)). Since money will rarely be the collateral in a security transaction, Article 9 does not mention it further. The definition also provides that " 'goods' . . . include the unborn young of animals and growing crops," to which Arizona adds, "and standing timber which is to be cut and removed under a conveyance or contract for sale." This addition complements changes made by Arizona in Article 2 (*compare* 2-107 *with* 44-2307), and is accompanied by the deletion of "timber until it is cut" as one of the conditions of attachment (*compare* 9-204(2)(b) *with* 44-3117 B(2)).

[325] 9-109 (44-3109). Whether or not any of these types of goods are, or are intended to become fixtures also affects the characteristics of the security interest that attaches. *See, e.g.*, 9-313 (44-3134), 9-402(3)(c) (44-3141 C(3)).

[326] 9-109(1) (44-3109 A).

[327] 9-204(4)(b) (44-3117 D(2)).

[328] Weingarten, *Article 9 of the Uniform Commercial Code: Definitions and Rules of General Application*, 9 WAYNE L. REV. 537, 551 (1963).

[329] 9-206(1) (44-3119 A). *See also* ARIZ. REV. STAT. ANN. § 44-144 (1956), as interpreted in *San Francisco Securities Corp. v. Phoenix Motor Co.*, 25 Ariz. 531, 220 P. 229 (1923). However, the latter statute permits the debtor to sign a negotiable note at the time of entering into the security agreement even when the collateral is consumer goods, thus in effect waiving his personal defenses against an assignee.

Farm Products. "Farm products" are "crops or livestock or supplies used or produced in farming operations," or such things in their unmanufactured state if they are in the possession of a farmer or raiser of livestock.[330] Thus while eggs may be consumer goods in the hands of a family which is about to eat them, they are "farm products" in the hands of a farmer who intends to sell them or feed them to his mink. Most of the special requirements for the creation and perfection of a security interest in "farm products" perhaps can be explained by such products' close relation to a particular piece of land.[331]

Inventory. Goods are "'inventory' if they are held by a person who holds them for sale or lease or to be furnished under contracts of service or if he has so furnished them, or if they are raw materials, work in process or materials used or consumed in a business."[332] Although a refrigerator is consumer goods in the kitchen of a family using it for their private purposes, it is "inventory" when in the dealer's showroom. Eggs would be inventory in the hands of an egg wholesaler, or even in the hands of the refrigerator dealer, if he used them as part of a changing display. One important result of collateral being classified as "inventory" is that a buyer in ordinary course of business will take free of the security interest.[333] Lenders are expected to take this into account as one of the special risks of inventory financing.

Equipment. Goods are "equipment" if they are "used or bought for use primarily in business (including farming or a profession) or by a debtor who is a non-profit organization or a governmental subdivision or agency, or if the goods are not included in the definitions of inventory, farm products or consumer goods . . . ."[334] In other words, "equipment" is the catch-all category. What apparently distinguishes "equipment" from "inventory" is not that the latter is held out for sale, but that the former "are fixed assets or have, as identifiable units, a relatively long period of use."[335] A refrigerator is "equipment" if it dispenses milk for a factory employee's refreshment, and farm equipment if it cools milk from a farmer's cows.

Special rules are often applied to farm equipment. For example, a purchase money security interest in farm equipment valued under $2500 is identical, for purposes of perfection, to an interest in consumer goods.[336] Interests in farm equipment must be filed locally, although

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330 9-109(3) (44-3109 C).
331 9-203(1)(b) (44-3116 A(2)), 9-401 (1)(a) (44-3140 A(1)), 9-402(1) and (2) (44-3141 A and B). But *compare* 9-312(2) *with* 44-3133(B) for a substantive omission from the Arizona version of the Code.
332 9-109(4) (44-3109 D).
333 9-307(1) (44-3128 A).
334 9-109(2) (44-3109 B).
335 9-109 (44-3109), Comment 3.
336 9-302(1)(c), (d) (44-3123 A(3), (4)).

interests in other equipment are centrally filed.[337] These special rules for farm equipment are not the only provisions in Article 9 that differentiate within a given class of collateral. A purchase money security interest in any class of collateral has characteristics different from a non-purchase money interest in goods of the same class. If goods are, or are to become fixtures, different rules determine the characteristics of the interest secured by them. Therefore it is important not to assume, just because one has determined the class to which particular collateral belongs, that the interest it secures will have the same characteristics as any interest secured by collateral of the same class.

INTANGIBLE COLLATERAL

Intangible collateral consists of "instruments," "documents" and "chattel paper,"[338] and of "accounts," "contract rights" and "general intangibles."[339] The distinction between the two groups is that the first includes only types of collateral which are "evidenced by writings which are in the ordinary course of business transferred by delivery."[340] The second group includes types of intangible collateral which "are not evidenced by an indispensable writing."[341]

Documents and Instruments. "Documents" are "documents of title," which retain the meaning generally accepted under prior law.[342] An "instrument" is a "writing which evidences a right to payment of money and is not itself a security agreement or lease and is of a type which is in ordinary course of business transferred by delivery with any necessary indorsement or assignment."[343] Among other things, the Code's regulation of the perfection of interests secured by documents and instruments, and the priorities among those interests, makes legally effective present field warehousing practice.[344]

Chattel Paper. "Chattel paper" is "a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods."[345] If a dealer sells a refrigerator to a buyer under a conditional sales contract, and the dealer transfers the contract to his bank, either as a sale or as security for a loan, the bank's collateral is "chattel paper." Unlike the intangibles not represented by a writing (which can be per-

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[337] *Compare* 9-401(1)(a) (44-3140 A(1)) *with* 9-401(1)(c) (44-3140 A(3)).
[338] 9-105(1)(g), (e), (b) (44-3105 A(7), (5), (2)) and Comment 3.
[339] 9-106 (44-3106).
[340] 9-105 (44-3105), Comment 3.
[341] 9-106 (44-3106), Comment.
[342] 1-201(15) (44-2208(15)), 9-105(1)(e) (44-3105 A(5)).
[343] 9-105(1)(g) (44-3105 A(7)).
[344] *See, e.g.,* 9-304 (44-3125). In contrast to the earlier versions of the Code, these provisions reinstate the similar regulations of the Uniform Trust Receipts Act. *See* Goodwin, *Major Revisions in Article 9 of Uniform Commercial Code — Secured Transactions,* 31 PENN. B.A.Q. 261, 267 (1960).
[345] 9-105(1)(b) (44-3105 A(2)).

fected only by filing), and unlike instruments (which can be perfected only by possession), "chattel paper" may be perfected both by filing and possession.[346]

Accounts and Contract Rights. The three types of collateral within the second group of intangibles (accounts, contract rights and general intangibles), are not distinguished in order to indicate functional differences, but to clear up possible ambiguities.[347] "'Account' means any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper."[348] The Code's treatment of accounts and contract rights is usually identical: "Contract rights may be regarded as potential accounts [;] they become accounts as performance is made under the contract."[349] They are distinguished to make it "clear that this Article rejects any lingering common law notion that only rights already earned can be assigned."[350]

General Intangibles. "General intangibles" make up the "everything else" category, and are exemplified by goodwill, literary rights, and rights to performance which may be used as security. With one possible exception,[351] general intangibles are regulated in the same way as accounts and contract rights.

THE FLOATING LIEN

The sharpest breaks with pre-Code law involve the creation and protection of securiy interests in accounts and contract rights, and the freer implementation of inventory and equipment financing. Although prior law has recognized the interest of a lien-holder in accounts and in inventory, it has usually refused to do so where the debtor was left entirely free to collect the accounts or to dispose of the inventory. The Code has accomplished a major change in the law by permitting the use or disposition of collateral by the debtor without accounting to the secured party.[352] "It repeals the rule of *Benedict v. Ratner,* 268 U.S. 353 . . . (1925) . . . , which held such arrangements void as a matter of law because the debtor was given unfettered dominion or control over the collateral."[353] The relevant section reads in part as follows:

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[346] 9-304(1) (44-3125 A), 9-305 (44-3126).
[347] Notice, however, that the categories are not entirely parallel. 9-318(2) (44-3139 B) gives the right reasonably to modify an assigned contract to the extent that the right to payment has not become an account. Notice also that only contract rights "for goods sold or services rendered" become accounts. Others, such as contract rights arising under a contract for the sale of documents or goodwill, presumably become general intangibles.
[348] 9-106 (44-3106).
[349] *Id.,* Comment.
[350] *Id.*
[351] *See* note 347 *supra.*
[352] 9-205 (44-3118).
[353] *Id.,* Comment 1.

> A security interest is not invalid or fraudulent against creditors by reason of liberty in the debtor to use, commingle or dispose of all or part of the collateral . . . or to collect or compromise accounts, contract rights or chattel paper, or to accept the return of goods or make repossessions, or to use, commingle or dispose of proceeds, or by reason of the failure of the secured party to require the debtor to account for proceeds, or replace collateral.[354]

It has been demonstrated that extensive use of the new liberty offered by this section probably would not be prudent, and that lenders probably will continue to protect their security rights in accounts and inventory by overseeing their collection and disposition, but that wider use of riskier methods is at least possible in practice.[355]

AFTER-ACQUIRED PROPERTY INTERESTS

Prior case law has recognized that "an after-acquired property interest is not, by virtue of that fact alone, security for a pre-existing claim."[356] However, federal bankruptcy decisions have deemed many such interests as transfers for antecedent debt, and therefore voidable as preferences.[357] The Code attempts to change this result by providing that where a secured party "gives new value which is to be secured in whole or in part by after-acquired property his security interest in the after-acquired collateral shall be deemed to be taken for new value and not as security for an antecedent debt . . . ."[358] Since the federal courts usually look to state law to determine whether or not a transaction is a transfer for antecedent debt, it is hoped that inserting this section into state law will effect a change in the relative rights of a secured creditor and bankruptcy trustee.[359]

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354 9-205 (44-3118).

355 Gilmore, *Purchase Money Priority*, 76 HARV. L. REV. 1333, 1370 (1963). The effect of the repudiation of *Benedict v. Ratner* on Arizona law is not clear. ARIZ. REV. STAT. ANN. §§ 44-801 to 808 (1956) provided that a security interest arising from a sale or assignment of accounts receivable is valid if notice is properly filed, but § 44-801 can be read as restricting assignable accounts to those arising under an already existing contract, and § 44-805 B requires that any accounts collected by the assignor be turned over immediately to the secured party. ARIZ. REV. STAT. ANN. § 33-752 (1956) appears to codify the rule of *Benedict v. Ratner* in regard to inventory. Pre-Code law did, however, provide for a financing method contemplating disposition and control by the debtor if the collateral was "livestock, animal chattels and crops." *See* ARIZ. REV. STAT. ANN. §§ 33-771 to 776 (1956).

356 9-108 (44-3108), Comment 1.

357 *Id.*, Comment 1.

358 *Id.* Section 9-108 (44-3108) puts two important limitations on the effectiveness of after-acquired property clauses. An interest arising under such a clause will be considered merely as security for antecedent debt if the property is subsequently acquired out of the debtor's ordinary course of business, or not acquired within a reasonable time. Such an interest could therefore be attacked as a voidable preference.

359 For discussions of the problem of the trustee in bankruptcy, see Coogan and Gordon, *The Effect of the U.C.C. upon Receivables Financing*, 76 HARV. L. REV. 1529 (1963); Lee, *Perfection and Priorities Under the Uniform Commercial Code*, 80 BANKING L.J. 481 (1963); Spivack, *The Impact of Article 9 of the U.C.C. . . . on Creditors' Rights in Bankruptcy*, 80 BANKING L.J. 593 (1963).

However, this provision could be read as conflicting with subsequent sections of Article 9. One section provides that perfection cannot occur prior to attachment,[360] and another provides that a security interest cannot attach until the debtor has rights in the collateral. It follows that if the debtor does not acquire rights in the collateral until within four months of bankruptcy, the security interest cannot attach and therefore cannot be perfected until that time.[361] Under these circumstances, the secured party might be in the position of an unsecured creditor[362] as to the collateral acquired within the critical four months. Therefore a court could find a reason to attack such an interest perfected within the four-month period as a voidable preference. The decisions construing section 9-108 have not taken this line of argument, however, but have viewed inventory[363] and accounts [364] subjected to a security interest "as a single entity and not as a mere conglomeration of individual items each subject to a separate lien . . . ."[365] They therefore held "that under Section 60 the transfer was made when the security agreement was executed and not when each item of [collateral] was acquired by the debtor."[366]

Future Advances

Article 9 also validates a security interest in obligations arising from advances made subsequent to the security agreement, "provided only that the obligation be covered by the security agreement."[367] It is not necessary that the amounts of the future advances, or the times at which advances are to be made be specified in the agreement. The provision is added in order to counter the "vaguely articulated prejudice against future advance agreements,"[368] and to supersede the judicially imposed restrictions sometimes placed on the security interest arising from such advances. Security interests validated by this subsection are subject to the same limitations as those arising under the other after-acquired property provisions.

Purchase Money Security Interest

The major limitation on the protection offered by an after-acquired property clause or a floating lien is the priority given to the purchase money security interest. Such an interest arises under the usual condi-

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[360] 9-303(1) (44-3124 A).
[361] 9-204(1) (44-3117 A).
[362] See 9-301 (44-3122) for the rights of an unsecured creditor.
[363] Rosenberg v. Rudnick, 262 F. Supp. 365 (D. Mass. 1967).
[364] *In re* Portland Newspaper Publishing Co., 271 F. Supp. 395 (D. Ore. 1967).
[365] Rosenberg v. Rudnick, 262 F. Supp. 365, 380 (D. Mass. 1967), quoted in *In re* Portland Newspaper Publishing Co., 271 F. Supp. 395, 400 (D. Ore. 1967).
[366] *In re* Portland Newspaper Publishing Co., 271 F. Supp. 395, 400 (D. Ore. 1967).
[367] 9-204(5) (44-3117 E) and Comment 8.
[368] *Id.*, Comment 8.

tional sale transaction,[369] as well as in the following situations: "a financing agency has a purchase money security interest when it advances money to the seller, taking back an assignment of chattel paper, and also when it makes advances to the buyer . . . to enable him to buy, and he uses the money for that purpose."[370] Decisions under prior law did not agree whether or not an advance to a buyer should be accorded the priorities usually given a purchase money interest.[371] These priorities, generally recognized by existing case law as promoting economic expansion,[372] are explicitly provided for by the Code.[373]

ENFORCEABILITY

ATTACHMENT

Attachment is a pre-requisite both to enforceability and to perfection, and several steps must be taken before a security interest can attach. The parties must agree that it attach, the secured party must give value, and the debtor must acquire rights in the collateral.[374] In some circumstances, perfection may follow automatically, and in others, it may be necessary to perfect by filing or by the secured party taking possession of collateral.

STATUTE OF FRAUDS

Although a security interest may have attached and been perfected (except by possession), and have a high priority as a purchase money interest or otherwise, it may still be unenforceable against the debtor or against third parties. Article 9's "Statute of Frauds" sets out the prerequisites for enforceability: either the collateral must be in the possession of the secured party, or the debtor must have signed a security agreement sufficiently describing the collateral.[375] The first alternative, possession, satisfies the evidentiary purpose of the statute and follows the common law. The alternative requirement of a writing dispenses

[369] 9-107 (44-3107).
[370] *Id.*, Comment 1.
[371] Gilmore, *supra* note 355, at 1373-74.
[372] *See generally* Gilmore, *Purchase Money Priority*, 76 HARV. L. REV. 1333 (1963).
[373] *See* p. 281 *infra*.
[374] 9-204(1) (44-3117 A).
[375] If the security interest covers collateral connected with the land, such as crops or minerals (but not fixtures), a description of the land concerned must be included in the security agreement 9-203(1)(b) (44-3116 A(2)). An Arizona addition to section 44-3110 also requires "a legal description of real estate as provided for under the provisions of subsection E of 44-3142," but this latter statute is concerned only with the formal filing of a financing statement concerning goods which are or are to become fixtures. Therefore it would seem 1) that no description of the land to which a fixture is or is to be attached is required in the security agreement, 2) that only a reasonable description of the land to which crops and the like are connected is required in the security agreement, 3) that only a reasonable description of the land connected with crops is required in the financing statement, but 4) that a legal description of the land connected with fixtures is necessary in the financing statement. The reasons for these distinctions are not entirely clear.

with the technical requisites of some former legislation.[376] The description requirements, with one exception,[377] are liberal: "any description of personal property or real estate is sufficient whether or not it is specific if it reasonably identifies what is described . . . ."[378] The cases decided under this section have followed the guidelines laid down in the Comment to section 9-110, requiring only that the description "make possible the identification of the thing described,"[379] and eliminating the "serial number" test.[380]

Although the rules specifying what writing will render a security interest enforceable have been greatly simplified and liberalized, one precaution must be noted. The filed financing statement cannot in itself satisfy the statute, despite the fact that it too must describe the collateral and include the debtor's signature. Since the financing statement may be filed *before* the security agreement is entered into,[381] it does not necessarily indicate that a security interest exists. The parties must enter into a separate written security agreement in order to satisfy the "Statute of Frauds."[382]

SPECIAL PROBLEMS OF ASSIGNMENTS

The Code makes some significant changes in the law concerning the enforceability of certain terms (1) in the assignment contract creating the security interest, and (2) in the contract that is the subject of the assignment.

Defenses Against an Assignee. Where a buyer or lessee agrees not to assert defenses against an assignee of the seller, such a promise is enforceable by an assignee who gives value and takes in good faith, without notice of the defense.[383] This rule, however, applies only to a purchaser of non-consumer goods, and does not extend to defenses of the type which may be asserted against a holder in due course of a

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[376] *See, e.g.*, Arizona's chattel mortgage statutes, ARIZ. REV. STAT. ANN. §§ 33-752.01 to 756, *as amended*, (Supp. 1967).

[377] See note 375 *supra*.

[378] 9-110 (44-3110).

[379] Industrial Packaging Prods. Co. v. Fort Pitt Packaging, Inc., 399 Pa. 643, 161 A.2d 19 (1960); United States v. Antenna Systems, Inc., 251 F. Supp. 1013 (D.C.N.H. 1966); *In re* Drane, 202 F. Supp. 221 (W.D. Ky. 1962).

[380] *In re* Kowalski, 202 F. Supp. 897 (D.C. Conn. 1962).

[381] 9-402(1) (44-3141 A).

[382] Notice also the effect of certain conflicting, unrepealed statutes:

> A transaction, although subject to this article, is also subject to the pawnbrokers law, article 3 of chapter 11, title 44, the motor vehicle time sales disclosure law, article 1 of chapter 2.1, title 44, and the small loans law, article 1 of chapter 5, title 6, and in the case of conflict between the provisions of this article and any such statute, the provisions of such statute control. Failure to comply with any applicable statute has only the effect which is specified therein. ARIZ. REV. STAT. ANN. § 44-3116 B (Supp. 1967).

[383] 9-206 (44-3119).

negotiable instrument.[384] The Code takes no position as to the validity of such a promise where consumer goods are involved, stating that the applicable law, if any, still governs."[385] It appears that Arizona would regard as unenforceable a waiver of defenses made in a security agreement by a buyer of consumer goods.[386]

If an account debtor has not made an enforceable waiver of his right to assert defenses against the assignee, the assignee is subject to any defense of the account debtor against the assignor which arises before the account debtor is notified of the assignment.[387] If the defense arises from the contract between the account debtor and assignor, the assignee takes subject to it regardless of whether the breach creating the defense occurred before or after notice.[388] These provisions make no substantial change in Arizona law.

Term Prohibiting Assignment. Section 9-318(4) (44-3139 D), which differs markedly from prior law, provides that a term in any contract between an account debtor and an assignor which prohibits assignment of an account or contract right is ineffective. The rule is applicable even though the assignee takes with full knowledge of the prohibition. This is in conflict with the *Restatement of Contracts,* which states: "A right may be the subject of effective assignment unless . . . the assignment is prohibited by the contract creating the right."[389] The rationale underlying the Code rule is that "as accounts and contract rights have become the collateral which secures an ever increasing number of financing transactions, it has been necessary to reshape the law so that these intangibles, like negotiable instruments and documents of title, can be freely assigned."[390]

Modification of Contract After Notification of Assignment. The Code allows modification of an executory contract by the assignor and account debtor, regardless of whether the assignee has consented to the new agreement.[391] Modification may be made either before or after the account debtor receives notice of the assignment.[392] To be effective, the modification must be made in good faith and in accordance with rea-

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384 *Id.*
385 *Id.*
386 In *San Francisco Securities Corp. v. Phoenix Motor Co.,* 25 Ariz. 531, 220 P. 229 (1923), a provision in a conditional sales contract making defenses based on fraud, duress, mistake, want of consideration, or any other ground, unavailable to the buyer against the seller's assignee, was held void under what is now ARIZ. REV. STAT. ANN. § 44-144 (1956), which provides that an action by the assignee should be without prejudice to any set-off, or other defenses existing before notice of the assignment.
387 9-318(1)(b) (44-3139 A(2)).
388 9-318(1)(a) (44-3139 A(1)).
389 § 151 (1932).
390 9-318 (44-3139), Comment 4.
391 9-318(2) (44-3139 B).
392 *Id.*

sonable commercial standards.[393] If the account debtor has promised the assignee not to modify, his promise renders the modification ineffective.[394] The assignment contract may provide that modification is a breach by the assignor, but such provision does not render the modification ineffective.[395] Although, as the draftsmen point out, modification after notice of the assignment "may do some violence to accepted doctrines of contract law,"[396] it is a necessary rule in view of the realities of large scale contracts, where many subcontractors are involved, and the burden of obtaining consent from the many assignees is great.[397] Assignees are automatically given corresponding rights under the modified or substituted contract.[398]

PERFECTION

The practical value of a security interest depends upon the extent to which it can be protected against the rights and claims of right asserted by third parties. The Code uses the concepts of "perfection" and "priorities" in treating the problems which arise when third persons become involved with collateral subject to a valid security interest. The Code intertwines its treatment of these two concepts, thus making them all the more difficult to understand. The problem is emphasized by the fact that the same factors which effect perfection are often determinative of priorities. The two concepts will be treated separately here (insofar as possible) in an attempt to clarify these confusing, but all-important, aspects of the new law of secured transactions.

The Code provides neither a definition of the term "perfection" nor a precise explanation of its effects, but it does offer clues as to both. The term was adopted from the Federal Bankruptcy Act[399] and is intended to be used, as it was there, "to describe a security interest in personal property which cannot be defeated in insolvency proceedings or in general by creditors."[400]

The Code is only slightly more helpful in indicating the *effects* of perfection. Section 9-301 (44-3122) lists the interests to which an *unperfected* security interest is subordinate — those of: (a) any person with *priority* under the Code; (b) any person who becomes a *lien creditor of the debtor* without knowledge of the security interest and before

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393 *Id.*
394 *Id.* To avoid the possibility of lack of consideration problems, it might be wise for the assignee to procure such a promise from the account debtor at the time of the assignment.
395 9-318(2) (44-3139 B).
396 *Id.*, Comment 2.
397 *Id.*
398 9-318(2) (44-3139 B).
399 *See* 1 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 435 (1965).
400 9-301 (44-3122), Comment 1.

it is perfected; and (c) any person who is a *bulk transferee* or *buyer out of the ordinary course of business* of tangible collateral, or any *transferee* of intangible collateral, who gives value without knowledge of the security interest and before it is perfected and who receives delivery of the collateral if it is capable of being delivered.[401] A lien creditor is one who obtains a lien by attachment, levy, or similar process, and includes a trustee in bankruptcy, a receiver in equity and an assignee for the benefit of creditors.[402]

Once a security interest is perfected, it apparently ceases to be subordinate to the rights of persons falling into these three classes unless the Code provides otherwise. Therefore, perfection seems to be the method of gaining general protection against the interests of lien creditors and bulk transferees or buyers out of the ordinary course (or their equivalent where the collateral is not capable of possession.)

From a mechanical standpoint, perfection may be achieved by three different means: by operation of law, by possession of the collateral and by filing as to the collateral. No one of these means is available to effect perfection in every type of collateral, nor is there any type of collateral in regard to which all three means are available. As a result, it is essential to know which means of perfection may be relied upon to effect perfection in any given fact situation. Furthermore, it is important to keep in mind that section 9-303(1) (44-3124 A) requires that the *attachment* of a valid security interest is a prerequisite to perfection by *any* method.[403]

OPERATION OF LAW

Perfection by operation of law may be achieved in only a handful of cases. Usually such perfection results from the attachment of an enforceable security interest between the parties to the security agreement; as a result of such attachment the secured party is given correlative perfection rights. In a few instances, perfection by operation of law serves to continue existing perfection, even though the requirements which were fulfilled for the original perfection are no longer fully satisfied. In most cases, perfection by operation of law is effective only for a limited period of time.

A purchase money security interest in any type of collateral is temporarily perfected for ten days after it attaches *if the secured party further protects his interest by filing before the end of the ten day period.* The perfection is only partial because protection is afforded only against the rights of bulk transferees or lien creditors which may arise between

[401] 9-301(1) (44-3122 A).
[402] 9-301(3) (44-3122 C).
[403] See discussion of "attachment" at p. 270 *supra.*

the time of attachment and ultimate filing.[404] If the purchase money security interest relates to (a) consumer goods of any value or (b) farm equipment with a purchase price of $2500.00 or less, filing is unnecessary and perfection is absolute from the time of attachment and valid for an unlimited time.[405] The only exceptions to automatic perfection in consumer goods or farm equipment exist where the collateral is a motor vehicle or fixture. Security interests in these items of collateral must be perfected according to special rules discussed below.

In certain instances a security interest may be temporarily perfected by operation of law in instruments, negotiable documents, and goods held by a bailee who has *not* issued a negotiable document therefor. A security interest in instruments or negotiable documents is automatically perfected for 21 days from the time it attaches "to the extent it arises for new value under a written agreement."[406] In some cases, a previously perfected security interest in instruments, negotiable documents, or goods held by a bailee who has not issued a negotiable document therefor, *remains* perfected for 21 days although the formal requirements for perfection are no longer fulfilled.[407] This continuation of perfection by operation of law is effective only if the collateral is released for specified purposes. The release of negotiable documents or of goods held by a bailee may be for ultimate sale or exchange, loading, unloading, storing, shipping, transshipping, manufacturing, processing or otherwise dealing with them preliminary to sale or exchange.[408] Instruments may be released for purposes of ultimate sale or exchange, presentation, collection, renewal or registration of transfer.[409] When the 21-day period of temporary perfection ends the secured party must once again perfect in accordance with the usual requirements for the particular item of collateral.[410]

Finally, a security interest in proceeds is temporarily perfected for a period of ten days after the proceeds are received by the debtor;[411] after the ten day period, perfection must be continued by another means.

Possession

The Code allows perfection to be achieved by the secured party's taking possession of the collateral. This method of perfection is derived from the ancient pledge concept, and is deemed effective because the

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404 9-301(2) (44-3122 B).
405 9-302(1)(c), (d) (44-3123 A(3), (4)).
406 9-304(4) (44-3125 D).
407 9-304(5) (44-3125 E).
408 9-304(5)(a) (44-3125 E(1)).
409 9-304(5)(b) (44-3125 E(2)).
410 9-304(6) (44-3125 F).
411 9-306(3) (44-3127 C).

secured party's possession is regarded as giving *notice* to the world of his interest in the item of collateral. Possession, as a means of perfection, is limited to situations where the collateral is capable of being physically possessed. In cases where the secured party gains actual physical dominion over the collateral, few questions arise regarding the validity of the perfected security interest. But physical dominion by the secured party is not always necessary; where the collateral is goods held by a bailee who has not issued a negotiable document therefor, the secured party is regarded as having perfected his interest by possession as of the time the bailee receives notification of the security interest.[412]

In only one instance is possession the mandatory method of perfection; perfection must be accomplished by possession where the collateral is *instruments* which do not constitute part of chattel paper.[413] Of course this rule is modified by the provisions for temporary perfection contained in sections 9-304(4) and (5) (44-3125 D and E), noted above. Possession is a permissive means of perfection in all other collateral that is capable of delivery. Section 9-305 (44-3126) states that a security interest in goods, negotiable documents, chattel paper or goods held by a bailee for which no negotiable document has been issued, may be perfected by possession.

Perfection by possession is effective only during the time possession is retained, unless otherwise specified by the Code. A security interest may be otherwise perfected before, after and during the time possession is retained by the secured party.[414]

Perfection by possession appears to be an appealingly simple method by which a secured party can protect his interest. Where it is used, no written security agreement is necessary.[415] Instances will rarely arise in which the fulfillment of the possession requirement will present a difficult fact question. Yet possession is often unsatisfactory in practice. Where goods are involved, debtors will be reluctant to relinquish possession and thereby lose most or all of the benefits of ownership.[416] The most feasible use of possession as a means of perfection will be in dealing with intangible collateral evidenced by a necessary writing or writings (instruments, negotiable documents and chattel paper). The practical value of such intangible collateral does not lie in its day-to-day use and relinquishing possession rarely diminishes its value to the debtor.

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[412] 9-305 (44-3126), 9-304 (44-3125), Comment 3.
[413] 9-304(1) (44-3125 A).
[414] 9-305 (44-3126).
[415] 9-203(1)(a) (44-3116 A(1)).
[416] Lee, *Perfection and Priorities Under the Uniform Commercial Code*, 17 WYO. L.J. 1, 16 (1962).

FILING

The filing of a written instrument which gives notice of the secured party's interest in the collateral is the mode of perfection most often available under the Code. Section 9-302 (44-2123) dictates that, with certain exceptions, filing is required to perfect *all* security interests. The exceptions to this basic rule, however, are important. Filing is not necessary whenever a security interest is perfected by possession,[417] where a security interest in instruments, documents or proceeds is temporarily perfected,[418] or where purchase money security interests are automatically perfected in consumer goods or farm equipment.[419]

With respect to *all but one of the classes of collateral in which perfection may be obtained by possession, filing is an alternative method of perfection.* This includes all four types of goods; a specific provision designates permissive filing as an alternative method of perfection for negotiable documents and chattel paper.[420] The single exception is instruments which are not part of chattel paper, for which filing is not an effective method of perfection; perfection may be achieved in instruments only by taking possession of them[421] or temporarily by operation of law.[422]

Filing is the mandatory method of perfection in the three types of intangible collateral which are not capable of being possessed: accounts, contract rights and general intangibles. The Code provides no alternative method of perfecting a security interest in such collateral.[423]

Mechanics of Filing. Part 4 of Article 9[424] contains extensive provisions dictating filing procedures. Although these requirements are detailed, they are quite easily understood and only broad treatment of them is necessary here.

What Must be Filed. The instrument which is filed is referred to as a "financing statement."[425] By definition, a financing statement must contain the names, addresses and signatures of *both* parties to the security agreement and also "a statement indicating the types, or describing the items, of collateral."[426] If the financing statement "covers crops growing or to be grown, or timber to be cut, or goods which are or are to become

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[417] 9-302(1)(a) (44-3123 A(1)).
[418] 9-302(1)(b) (44-3123 A(2)).
[419] 9-302(1)(c), (d) (44-3123 A(3), (4)).
[420] 9-304(1) (44-3125 A).
[421] *Id.*
[422] 9-304(4) and (5) (44-3125 D and E).
[423] 9-302 (44-3123), Comment 5.
[424] 9-401 (44-3140) to 9-407 (44-3146).
[425] The Code "adopts the system of 'notice filing' . . . . What is required to be filed is not . . . the security agreement itself, but only a simple notice which . . . indicates merely that the secured party who has filed may have a security interest in the collateral described." 9-402 (44-3143), Comment 2.
[426] 9-402(1) (44-3141 A).

fixtures," it must also describe the real estate concerned.[427] Note that the information contained in the financing statement varies from that in the security agreement itself; it must contain the names, addresses and signatures of *both* parties, although it need only indicate the *type* of collateral securing the obligation. Therefore, in their most elemental forms, the security agreement and the financing statement are *not* equivalent and cannot be utilized interchangeably. But if a single instrument does meet the requirements of both, it may be used as either.[428]

An otherwise sufficient financing statement need be signed only by the secured party if: (a) it covers collateral subject to a security interest in another state which is brought into Arizona and it states the circumstances under which it was so transported, or (b) it covers proceeds where the security interest in the original collateral was perfected and it describes the original collateral.[429] A financing statement which contains minor errors which are not seriously misleading is nonetheless effective.[430]

Where to File. Familiarity with the proper places to file is essential where filing is to be used as a method of perfection; failure to file in the correct place usually prevents perfection and leaves the secured party unprotected.[431] In addition, third parties must be familiar with the Code's directives as to the proper places of filing in order to discover whether there is an existing and perfected security interest in a given item of collateral.

The correct place or places to file depend upon the class or classes of collateral involved. Arizona selected the second of three alternative filing schemes proposed by the Code. Under the scheme enacted in Arizona, the general rule is that all filings are made with the Secretary of State.[432] There are three exceptions to this rule. If the collateral is goods which are or are to become fixtures, or is timber to be cut, filing need be made only in the place where a mortgage on the real estate involved would be filed or recorded.[433] Where the collateral is crops (growing or to be grown) filing must be made in the office of the county recorder of the county where the land involved is located.[434] Finally, if the collateral is consumer goods, farm equipment or farm products, or accounts, contract rights or general intangibles arising from

[427] ARIZ. REV. STAT. ANN. § 44-3141 A (Supp. 1967). (This subsection adds the words "timber to be cut" to the official text version of 9-402(1)).
[428] 9-402(1) (44-3141 A).
[429] 9-402(2)(a), (b) (44-3141 B(1), (2)).
[430] 9-402(5) (44-3141 E).
[431] 9-401 (44-3140), Comment 5.
[432] 9-401(1)(c) [Second Alternative Subsection (1)] (44-3140 A(3)).
[433] ARIZ. REV. STAT. ANN. § 44-3140 A(2) (Supp. 1967). (This subsection adds the words "Timber to be cut" to the official text version of 9-401(1)(b) [Second Alternative Subsection (1)]).
[434] 9-401(1)(a) [Second Alternative Subsection (1)] (44-3140 A(1)).

or relating to the sale of farm products, filing is made in the county recorder's office in the county of the debtor's residence; if the debtor is a non-resident, filing is made in the county where the goods are kept.[435] It is clear that in general, local filing is required in cases where the collateral is quite closely associated with real estate or the use thereof.

In many cases a financing statement may cover several types of collateral; to be completely effective, it must be filed in the place or places required for each type.[436] Although a statement may not be filed correctly as to each type of collateral, it is effective in regard to those classes of collateral for which filing was made correctly. In such a case, the filing is *completely* effective "against any person who has knowledge of the contents of such financing statement."[437]

Circumstances Arising after Filing. A proper filing remains effective even though there is a subsequent change in the factor which dictated the propriety of the original filing.[438] The statement may be amended to include additional collateral, but such amendment is effective only from the date of its filing.[439] "A secured party may assign all or part of his rights under a financing statement,"[440] and after the completion of the formal requirements for such assignment[441] the "assignee is the secured party of record."[442] The secured party may release all or part of the collateral described in the financing statement by complying with specified requirements.[443] If the obligation secured is fulfilled, and there is "no commitment to make advances, incur obligations or otherwise give value," the debtor is entitled, on written demand, to a written termination statement from the secured party.[444] If the termination statement is not prepared and sent to the debtor within ten days after demand, the secured party is liable to the debtor for $100.00 plus "any loss caused to the debtor by such failure."[445] Filing is effective for a period of six years, after which it expires,[446] unless renewed by the filing of a continuation statement prior to expiration.[447]

SPECIAL RULES OF PERFECTION

There are three instances in which the Code's provisions cut across

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[435] *Id.*
[436] 9-401 (44-3140), Comment 5.
[437] 9-401(2) (44-3140 B).
[438] 9-401(3) (44-3140 C).
[439] 9-402(4) (44-3141 D).
[440] 9-405(2) (44-3144 B).
[441] 9-405(1), (2) (44-3144 A, B) set forth the formal requirements for an assignment of a security interest under the Code.
[442] 9-405(3) (44-3144 C).
[443] 9-406 (44-3145).
[444] 9-404(1) (44-3143 A).
[445] *Id.*
[446] 9-403(2) (44-3142 B).
[447] 9-403(3) (44-3142 C).

the basic rules for determining the sufficiency of perfection. In these situations, special rules for perfection are attributable to the peculiar nature of the circumstances involved, rather than the classification of the collateral.

Special Statute: Motor Vehicles. If a security interest in collateral is subject to a statute (a) of the United States, which calls for national filing or registration of all security interests in such property, or (b) of Arizona, which calls for central filing or an indication on a certificate of title of all security interests in such property, the filing provisions of the Code do not apply.[448] In such cases, perfection requirements are dictated by the applicable federal or state statute.[449] The most significant example of this general exemption is in the area of motor vehicles. Since Arizona requires motor vehicle liens to be noted on the certificate of title, perfection of security interests in motor vehicles is not governed by the Code. Perfection must be in accordance with the requirements of the statute.[450]

Proceeds. "'Proceeds' includes whatever is received when collateral or proceeds is sold, exchanged, collected or otherwise disposed of. . . . Money, checks and the like are 'cash proceeds.' All other proceeds are 'non-cash proceeds.'"[451] Where there is a disposition of the original collateral in which a security interest was perfected, the Code deems the perfection to continue in the resulting proceeds for a period of ten days.[452] The perfection may be further continued in proceeds in either of two ways. First, the Code allows the originally filed financing statement to cover all proceeds, as well as the original collateral. In this situation, the original filing is deemed to perfect the security interest in the proceeds.[453] Second, within the ten-day period of continued perfection, the secured party may maintain his perfected interest in the proceeds by the means of perfection authorized in regard to the particular type of collateral making up the proceeds.[454] The purpose of these special rules is to "make clear that the four-month period for calculating a voidable preference in bankruptcy begins with the date of the secured party's obtaining the security interest in the original col-

[448] 9-302(3)(a) and Alternative A(b) (44-3133 C(1)). See 9-302 (44-3123), Comment 8 for examples of federal statutes requiring national filing or registration.
[449] 9-302 (44-3123), Comment 8.
[450] ARIZ. REV. STAT. ANN. § 28-325 (1956) provides that all liens and encumbrances on motor vehicles, other than those dependent upon possession, must be noted on the certificate of title, the issuance of which constitutes constructive notice of all liens and encumbrances against the vehicle.
[451] 9-306(1) (44-3127 A).
[452] 9-306(3) (44-3127 C). It should be noted that the security interest often continues in the original collateral "notwithstanding sale, exchange or other disposition . . . unless [the] action was authorized by the secured party in the security agreement or otherwise." 9-306(2) (44-3127 B). But this only continues the obligation between the parties, not perfection of the security interest.
[453] 9-306(3)(a) (44-3127 C(1)).
[454] 9-306(3)(b) (44-3127 C(2)).

lateral and not with the date of his obtaining control of the proceeds."[455]

If the debtor undergoes insolvency proceedings, a party with a perfected security interest in proceeds is given a perfected interest in (a) *identifiable non-cash proceeds* and (b) *identifiable cash proceeds which have not been deposited in a bank account before the insolvency proceedings* and, if money, have been neither so deposited nor commingled with other money. The security interest is also deemed perfected in all cash and bank accounts in which cash proceeds have been commingled, subject to any set-off[456] and limited to the difference in the amount of cash proceeds received and deposited in the last ten days before insolvency proceedings were instituted and the amount paid to the secured party during the same period.[457]

Purchase Money Security Interest. A purchase money security interest exists (a) where a seller takes or retains a security interest to secure all or part of the price of collateral sold to the debtor, or (b) where a security interest is taken by one who makes advances or incurs an obligation allowing the debtor to acquire rights in or use of collateral, and the value of the advance or incurring of the obligation is actually used to acquire such rights in or use of the collateral.[458] Since this type of security interest promotes commerce, the secured party is given the right to perfect in a more lenient manner. For example, the purchase money security holder is given a ten-day grace period, beginning when the debtor takes possession of the collateral, in which to file;[459] and a purchase money security interest in consumer goods or in farm equipment costing $2500.00 or less (both excepting motor vehicles and fixtures) is perfected without anything more being done.[460]

Priorities

The Code's "priority" provisions are intended to solve the problems which arise where a third person has a conflicting claim in collateral subject to a security interest. Usually, conflicts arise where a third person (a) obtains a security interest in the same item of collateral, or (b) becomes a transferee of all or part of an interest in the collateral. A number of Code sections contain specific rules for determining which party has priority (*i.e.*, superiority) where conflicting interests in col-

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[455] 9-306 (44-3127), Comment b.
[456] *See* 4-201(1) (44-2610 A) and Comments for clarification of a bank's right to set-off.
[457] 9-306(4)(d) (44-3127 D(4)).
[458] 9-107 (44-3107). *But see* Comment 2 to the effect that a "security interest taken as security for or in satisfaction of a pre-existing claim or antecedent debt" is not a purchase money security interest.
[459] 9-301(2) (44-3122 B).
[460] 9-301(1)(c), (d) (44-3123 A(3), (4)).

lateral exist. General rules are set forth to determine questions of priority when no specific provision is applicable.[461]

It is important to realize that a security interest often cannot be protected against all possible conflicting claims. In these instances, the maximum protection available is something less than complete protection. Nevertheless, opportunities often do exist for the secured party to *increase* the protection of his interest. It is in accomplishing the latter that a thorough knowledge of the rules of priority is necessary.

ABSOLUTE PRIORITY IN THIRD PARTIES

Specific Code provisions clearly establish that in several instances, certain third party interests in collateral will always prevail despite any action taken by the secured party. Holders in due course of negotiable instruments, holders of duly negotiated documents of title and bona fide purchasers of securities *always* take priority over a perfected security interest; filing does not affect the rights of these parties.[462]

A purchaser in the ordinary course of business of all types of goods, except farm products sold by a farmer, always takes free of all security interests *created by his seller.* This rule holds true even though the security interest is perfected and the purchaser knows of its existence.[463] Where a security interest in chattel paper is claimed merely as proceeds of inventory subject to a security interest, a purchaser of the paper takes free of the conflicting security interest if he gives new value and takes possession in the ordinary course of business.[464]

When, in the ordinary course of his business, a person furnishes "services or material with respect to goods subject to a security interest," and a statute or rule of law gives such a person a lien on the goods in his possession, the lien has priority over the security interest. The only exceptions to this rule exist where the applicable statute provides to the contrary.[465] In Arizona, liens of artisans,[466] of persons furnishing labor or machinery on agricultural lands,[467] and of persons providing feed and

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[461] 9-312(5), (6) (44-3133 D, E).
[462] 9-309 (44-3130).
[463] 9-307(1) (44-3128 A). But note that 1-201(9) (44-2208(9)) defines "buyer in the ordinary course of business" as a person who buys without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party. If the purchaser knows that the sale violates the terms of the security agreement, he does not qualify for priority under this provision.
[464] 9-308 (44-3129). Note that this section deals with the rights of a purchaser of chattel paper in two distinct situations. In one case the security interest in the paper is perfected temporarily by operation of law; in the other, it is perfected in paper claimed as proceeds of inventory.
[465] 9-310 (44-3131).
[466] ARIZ. REV. STAT. ANN. § 33-1021 (1956).
[467] ARIZ. REV. STAT. ANN. §§ 33-901 to -908 (Supp. 1967).

pasturage[468] apparently enjoy priority. But garagemen's liens, at least to some extent, are subject to existing security interests in collateral.[469]

While goods are held by the issuer of a negotiable document of title therefor, a security interest perfected in the document always has priority over a security interest perfected in the goods themselves, provided the document remains outstanding.[470]

A collecting bank[471] has a security interest in any "item[472] and accompanying documents or the proceeds of either. . . ."[473] To the extent that the bank does not receive settlement for the item and does not give up possession of it or of the accompanying documents, its security interest has priority over all conflicting security interests in the item, the documents or the resulting proceeds.

SECURED PARTY CAN INCREASE PROTECTION

There are several instances in which a secured party can increase the value of his security interest by taking additional steps to protect it. For example, a purchase money security interest in collateral, other than inventory, has priority over a conflicting security interest if the purchase money interest is perfected within ten days after the debtor receives possession of the collateral.[474] A purchase money security interest in inventory will have priority over conflicting security interests if: (a) it is perfected, and (b) all other secured parties who have filed in regard to the inventory, or who are known to the purchase money secured party, have been given notice before the debtor receives possession of the collateral, and (c) the notice states that the person giving it expects to acquire a purchase money security interest in certain described inventory of the debtor.[475]

Where the collateral is consumer goods or farm equipment originally sold for $2500 or less, only a security interest perfected by filing has priority over the rights of a buyer who later purchases the collateral without knowledge of the security interest, for value and for consumer or farm uses.[476]

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[468] ARIZ. REV. STAT. ANN. § 33-921 (1956).
[469] ARIZ. REV. STAT. ANN. § 33-1022 C (1956) provides that a garageman's "lien shall not impair any other lien or conditional sale of record" at the time the services or materials were provided "unless furnished with the knowledge and consent of the record lienor or vendor."
[470] 9-304(2) (44-3125 B).
[471] The term "collecting bank" is defined by 4-105(d) (44-2605(4)) as "any bank handling the item for collection except the payor bank."
[472] 4-104(1)(g) (44-2604 A(7)) defines "item" as "any instrument for the payment of money even though it is not negotiable but does not include money."
[473] 4-208 (44-2617).
[474] 9-312(4) (44-3133 C).
[475] 9-312(3) (44-3133 B).
[476] 9-307(2) (44-3128 B).

A purchaser of chattel paper or non-negotiable instruments who gives new value and takes possession in the ordinary course of business and without knowledge of a security interest has priority over a conflicting security interest if it is perfected merely by permissive filing or temporary perfection by operation of law.[477] Thus, *possession* is the only means of *perfection* that will give the secured party priority over such a purchaser of these types of collateral. However, since such a purchaser must take without knowledge of the security interest, an indication on the face of the paper or instrument that such an interest exists will result in protection against any purchaser.[478]

SPECIAL RULES OF PRIORITY

Proceeds. Special priority rules exist in cases where chattel paper or accounts result as proceeds from a sale of goods already subject to a security interest and the goods are returned or repossessed after the chattel paper or accounts have been transferred to a secured party. If the goods served as collateral for an unpaid indebtedness of the seller when they were sold and the original debt is still unpaid, the original security interest attaches again to the returned or repossessed goods and continues to be perfected, if it was perfected when the goods were sold. If an original filing is still effective, nothing more need be done; otherwise, the secured party must again perfect his interest by taking possession or filing as to the goods.[479]

When such *chattel paper* is transferred by the debtor to an unpaid transferee, the transferee has a security interest in the goods with priority over both the transferor-original debtor and over the original secured party, whose interest re-attaches in the goods, to the extent that the transferee gives new value and takes possession in the ordinary course of his business.[480] But an unpaid transferee of such an *account* has a security interest in the goods with priority only over his transferor.[481] Unpaid transferees must perfect their security interests in both chattel paper and accounts before they are protected against creditors of the transferor or purchasers of the returned or repossessed goods.[482]

Fixtures and Accessions. A security interest in fixtures is subject to the rights of (a) a *later purchaser* for value of an interest in the real estate, (b) a *creditor with a subsequently obtained judicial lien* against the real estate, and (c) a *prior encumbrancer* of the real estate *who makes subsequent advances,* where these parties do not have actual knowledge

[477] 9-308 (44-3129).
[478] *Id.*, Comment 2.
[479] 9-306(5)(a) (44-3127 E(1)).
[480] 9-306(5)(b) (44-3127 E(2)).
[481] 9-306(5)(c) (44-3127 E(3)).
[482] 9-306(5)(d) (44-3127 E(4)).

of the security interest or there has been no proper filing[483] in regard to the security interest in the fixture.[484] In all other cases, a security interest which *attaches* to goods before they become fixtures has priority over every other interest in the real estate.[485] But if the security interest attaches *after* the goods become fixtures, it is valid only against persons who later acquire an interest in the realty or such persons with prior interests in the realty who have agreed in writing to subordinate their positions.[486]

Goods which are installed in or affixed to other goods are "accessions." The rules of priority in regard to accessions are virtually the same as those applicable to fixtures.[487]

Commingled or Processed Goods. In the event that goods become part of a product or a mass, a perfected security interest in the goods continues in the product or mass if (a) the identity of the original goods is lost, or (b) an original filing also covers the product which is manufactured.[488] If more than one such interest attaches to the product or mass, all rank equally and in the ratio that the cost of the original goods bears to the cost of the total product or mass.[489]

Unperfected Security Interests. An unperfected security interest, although valid between the parties to the agreement, is inferior to the rights of parties enumerated in section 9-301 (44-3122), discussed above at the beginning of the section on perfection.[490]

GENERAL RULES OF PRIORITY

To control all cases which are not covered by a special provision or provisions, the Code sets forth four basic rules which determine which security interests in collateral will prevail.

1. Priority exists in the order of filing, if both interests are perfected by filing. No consideration is given to the order of attachment.[491]

2. Priority exists in the order of perfection, if either interest is *not*

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[483] ARIZ. REV. STAT. ANN. § 44-3142 E (1967) requires that the financing statement include "a legal description of the real estate affected" by a fixture. (This requirement is an Arizona addition to the official text version of 9-403(5)).

[484] ARIZ. REV. STAT. ANN. § 44-3134 D (Supp. 1967). (This subsection is an Arizona addition to the official text version of 9-313).

[485] 9-313(2) (44-3134 B).

[486] 9-313(3) (44-3134 C). 9-316 (44-3137) allows contractual subordination of an interest with priority, although it is difficult to imagine cases in which a secured party would be willing to so subordinate his interest.

[487] 9-314 (44-3135).

[488] 9-315(1) (44-3136 A).

[489] 9-315(2) (44-3136 B).

[490] *See* p. 273 *supra.*

[491] 9-312(5)(a) (44-3133 D(1)).

perfected by filing. Again, no consideration is given to the order of attachment.[492]

3. Priority exists in the order of attachment if neither interest is perfected.[493]

4. For purposes of rules 1, 2 and 3, the original method of perfection is determinative in regard to an interest which was successively perfected by different means.[494]

SATISFACTION FROM THE COLLATERAL UPON DEFAULT

The primary objective of any security agreement is to minimize the creditor's loss upon default. The strength of a creditor's position upon default not only indicates his lawyer's ability to draft a security agreement, but also reflects the effectiveness of the Code. No matter how beautifully synthesized the scholar may consider the rules of the Code, unless they effectively promote an efficient, fair, and prompt means for satisfying the debt by resort to the collateral, they fail as a practical matter.[495]

The Code's rules on default are aimed at assuring the highest possible price upon sale of the collateral. To accomplish this goal, the Code confers upon the secured party considerable discretion in seeking the realization of the debt owed him from the collateral. To guard against possible abuse of discretion, the draftsmen imposed general, rather than specific, safeguards, thinking that the interests of both debtors and creditors would be served best in this way. As a result, many of the formalities of prior law, such as detailed public notices and prescribed public sales, have been discarded in favor of the broad requirement of "commercial reasonableness," which pervades every aspect of the default proceedings. Although the generality of the phrase causes uncertainty in its application, it promotes practicality by permitting the parties to deal according to the changing practices of the business community.[496]

DEFAULT

The Code does not provide a definition of "default," and, therefore, the parties must determine within the security agreement and any underlying obligation what acts or omissions will constitute a default.

The Code provides standards to govern the operation of what are

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[492] 9-312(5)(b) (44-3133 D(2)).
[493] 9-312(5)(c) (44-3133 D(3)).
[494] 9-312(6) (44-3133 E).
[495] *See* Hogan, *Default Proceedings*, 47 MINN. L. REV. 205, 207 (1963).
[496] The Code expressly states that one of its underlying purposes is to "permit the continued expansion of commercial practices through custom, usage and agreement of the parties." 1-102(2)(b) (44-2202 B(2)). Moreover, the Code is expected to "provide its own machinery for expansion of commercial practices" through its development by the courts in the light of new practices. 1-102 (44-2202), Comment 1.

commonly referred to as "acceleration clauses." Most difficulty with acceleration clauses has centered around provisions that the entire debt becomes due whenever the secured party "deems himself insecure." The Code recognizes the validity of such a clause, but states that the power to accelerate exists only if the secured party "in good faith believes that the prospect of payment or performance is impaired."[497] "Good faith" means "honesty in fact," and the burden of showing lack of good faith is on the debtor.[498]

GENERAL RIGHTS AND DUTIES OF THE SECURED PARTY

General Remedies of the Secured Party. Part 5 of Article 9 is the main source of rights and duties arising upon default. Although the provisions of Part 5 may not be varied by agreement, except where the Code expressly so provides,[499] the parties may determine the *standards* by which the fulfillment of these rights and duties is to be measured if such standards are not manifestly unreasonable.[500] Most of the rights and duties of Part 5 are spelled out in specific terms, but the *remedies* a secured party may pursue are stated in very general language.

> [The secured party] may reduce his claim to judgment, foreclose, or otherwise enforce the security interest by any available judicial procedure. If the collateral is documents, the secured party may proceed either as to the documents or as to the goods covered thereby.[501]

Where the collateral includes both real and personal property, the Code gives the secured party a choice of remedies. He may proceed either in accordance with the provisions of Article 9, Part 5 as to the personalty or in accordance with his rights and remedies in respect to real property, in which case the Code provisions do not apply.[502]

The Code explicitly provides that all the remedies of the secured party are cumulative.[503] This feature apparently abolishes the "election of remedies" doctrine under which an unsatisfied secured party who sued on the debt, rather than bringing an action to foreclose, was held to have waived his security interest.[504] In an effort to protect judgments in

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[497] 1-208 (44-2215).
[498] 1-201(19) (44-2208(19)); 1-208 (44-2215).
[499] For a compilation of the various Code provisions which specifically prohibit variation by mutual agreement *see* Bunn, *Freedom of Contract Under the Uniform Commercial Code*, 2 B.C. IND. & COM. L. REV. 59 (1960).
[500] 9-501(3) (44-3147 C).
[501] 9-501(1) (44-3147 A).
[502] 9-501(4) (44-3148 D).
[503] 9-501(1) (44-3148 A).
[504] ARIZ. REV. STAT. ANN. § 33-722 (1956) states: "If separate actions are brought on the debt and to foreclose the mortgage given to secure it, the plaintiff shall elect which to prosecute and the other shall be dismissed." It has been held, however, that the application of this statute is limited to the situation where both the action on the debt and the action to foreclose are pending simultaneously. If the action

the event of an intervening bankruptcy, section 9-501(5) (44-3147 E) provides that where the secured party reduces his claim to judgment (*i.e.* within four months of bankruptcy), a judgment lien upon the collateral relates back to the date of perfection of the security interest in such collateral.

Collateral in the Possession of the Secured Party. Section 9-207 (44-3120) enumerates the rights and duties of a secured party who has obtained possession of the collateral either before or after default. The primary duty is one of reasonable care. This duty may not be disclaimed by agreement, although the parties are free to agree upon the standards for determing reasonable care as long as the standards themselves are not patently unreasonable.[505] The section provides that in the case of an instrument or chattel paper, reasonable care includes taking necessary steps to preserve rights against prior parties.[506] This particular duty, however, may be waived or varied by agreement of the parties.[507]

The remaining rights and duties outlined in section 9-207 (44-3120) add nothing to common law precedents and may be varied by mutual agreement. As additional security, the secured party is entitled to any increase or profits received from the collateral except money, which must be remitted to the debtor or applied in reduction of the secured obligation.[508] The secured party may repledge the collateral as long as he does not impair the debtor's right to redeem.[509] He must keep the collateral identifiable, except for "fungible collateral," which may be commingled.[510] The secured party in possession is also allowed to use the collateral for the purpose of preserving it or its value, or in any manner pursuant to a court order, or, with the exception of consumer goods, to the extent and in the manner provided by the security agreement.[511] The reasonable expenses incurred in such use are chargeable to the debtor and secured by the collateral.[512]

Repossession. Absent an agreement to the contrary, the holder of a non-possessory security interest has the right to take possession of the collateral on default.[513] The Code follows the policy of prior legisla-

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on the debt is brought previous to foreclosure and remains unsatisfied at the time of the subsequent action, the right to foreclose is not waived. Smith v. Mangels, 73 Ariz. 203, 240 P.2d 168 (1952).

[505] 1-102(3) (44-2202 C).
[506] 9-207(1) (44-3120 A).
[507] *Id.*
[508] 9-207(2)(c) (44-3120 B(3)).
[509] 9-207(2)(e) (44-3120 B(5)).
[510] 9-207(2)(d) (44-3120 B(4)).
[511] 9-207(4) (44-3120 D).
[512] 9-207(2)(a) (44-3120 B(1)).
[513] 9-503 (44-3149).

tion[514] in allowing repossession by self-help if this can be accomplished without a breach of the peace; otherwise possession must be obtained through judicial process.

If the security agreement so provides, the secured party may require the debtor to assemble the collateral on default and make it available to him at a specified place that is reasonably convenient to both parties. If the secured party does not care to remove the collateral from the debtor's premises on default, he may render it unusable and dispose of it on the debtor's premises under the rules of section 9-504 (44-3150). This latter provision should be especially useful where there are unfavorable risks and expenses involved in getting possession of the collateral.

Rights of Collection. Either pursuant to an agreement, or in any event upon default, the secured party may notify an account debtor or an obligor on an instrument to make payment to him and the secured party is entitled to take control of the proceeds under section 9-306 (44-3127).[515] When an assignment transaction gives the assignee rights back against the assignor for unrealized collateral, the secured party must proceed in a commercially reasonable manner in making collection, although he may deduct his reasonable expenses of collection from the proceeds.[516] The Code's comments suggest what is meant by "commercially reasonable manner" in this context: "liquidation must be made with due regard to the interest of the assignor and of his other creditors."[517] If the underlying transaction constitutes a *sale* of accounts, contract rights, or chattel paper, the debtor is entitled to a surplus or is liable for a deficiency only if the security agreement so provides.[518] But where an assignment is made to secure an indebtedness, the secured party is entitled to recover a deficiency or is liable for a surplus as a matter of law, unless the security agreement provides otherwise.[519] If the secured party knows that the collateral is owned by a person who is not the debtor, the owner, not the debtor, is entitled to the surplus.[520]

Acceptance of the Collateral in Discharge of the Obligation. Except in the case of consumer goods for which the debtor has paid sixty percent of the purchase price or loan, a secured party in possession after default is permitted to propose to retain the collateral in satisfaction of the obligation.[521] The Code requires that written notice of this proposal be

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[514] UNIFORM TRUST RECEIPTS ACT § 6, ARIZ. REV. STAT. ANN. § 44-826 (1956); UNIFORM CONDITIONAL SALES ACT § 16, ARIZ. REV. STAT. ANN. § 44-316 (1956).
[515] 9-502(1) (44-3148 A).
[516] 9-502(2) (44-3148 B).
[517] *Id.*, Comment 3.
[518] 9-502(2) (44-3148 B).
[519] *Id.*
[520] 9-112 (44-3112).
[521] 9-505(2) (44-3151 B).

sent to the debtor and, except in the case of consumer goods, to any other secured party who has filed in Arizona or who has a security interest in the collateral known to the secured party.[522] If any of the parties entitled to notification objects in writing within thirty days from receipt of the notice, the secured party must sell the collateral.[523] If timely objection is made by a secured party not entitled to notification, disposition is also required.[524] If no objection is made, the secured party may keep the collateral and the installments already made in total satisfaction of the debt.[525] By placing the duty of initial notification upon the secured party the Code gives added protection to the debtor, who is often unaware of his right to object.

A problem exists in determining the time at which objection is deemed to have been made to the secured party. Although the thirty day period begins to run upon receipt of the notice, the Code does not specify whether an objection must be received to be effective, or whether merely sending it will be sufficient.[526] Until this question is judicially resolved, compliance with the stricter requirement is advisable; parties desiring to object ought to make sure that their objections are actually received by the secured party.

DISPOSITION

"A secured party after default may sell, lease or otherwise dispose of any or all collateral in its then condition or following any commercially reasonable preparation or processing. Any sale of goods is subject to Article 2 on Sales."[527] Disposition may be accomplished by either public or private proceedings and may be made in parcels or as a unit.[528] The choice between a public or private sale appears to be governed by the standard of "commercial reasonableness," since the Code makes this standard applicable to "every aspect of disposition."[529] The Code does not define "public sale," yet the term is significant because the secured

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[522] *Id.*
[523] *Id.*
[524] *Id.*
[525] *Id.*
[526] 9-505 (44-3151), Comment 2 appears to support the proposition that receipt of the objection must occur within thirty days to be effective. Moreover, there is much merit in the argument that the thirty day period is more than generous, and that making the dispatch of the written objection the effective date actually extends the thirty-day period. *See* Hogan, *Default Proceedings*, 47 MINN. L. REV. 205 n.56 (1963). However, a contrary argument might be made from the language of the Code itself. The Code uses the following wording: "If the debtor . . . objects" 9-505(2) (44-3151 B). It appears that such language requires only the act of objecting, indicating that receipt of the objection is not necessary. In addition, the word "proposal" used in the wording of the Code seems to imply an analogy to the rules pertaining to "offer and acceptance."
[527] 9-504(1) (44-3150 A).
[528] 9-504(3) (44-3150 C).
[529] *Id.*

party acquires certain rights only by selling at a public sale. It appears that the parties may create in the security agreement their own definition of "public sale" if it is not unreasonable. Prior law may still be influential in defining this term.[530]

"Commercial Reasonableness." The Code imposes the standard of "commercial reasonableness" on every aspect of the disposition proceedings.[531] Since the purpose of this requirement is to replace the rigidity of prior law with a new flexibility, the Code does not define "commercial reasonableness." It does, however, attempt to clarify the concept by presenting examples of various methods of disposition.

Any dispositon by judicial proceeding, by a bona fide creditors' committee or by a representative of creditors is conclusively deemed to be commercially reasonable.[532] Three types of sales are deemed to be made in a commercially, reasonable manner: (1) a sale made in a usual manner in a recognized market;[533] (2) a sale made at a price current in a recognized market; (3) a sale made in conformity with reasonable commercial practices among dealers in the type of property sold.[534] However, the "manner" of sales is not completely determinative of the outcome; sales falling into one of these three categories "may still be attacked as violating the standards of commercial reasonableness as to other aspects of the sale, including method, time, and place."[535] Although the Code specifies certain methods as "commercially reasonable," none of these should be considered as either required or exclusive. "Commercial reasonableness" is basically a question of fact, depending upon all the circumstances.[536]

Notice Requirements. Usually, the secured party must send the debtor "reasonable notification" of the time and place of any public sale, or of the time after which private sale is to be made.[537] Except where the collateral is consumer goods, such notice must also be sent to any other secured party who has filed in Arizona, or of whom the secured party

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[530] For a discussion of "public sale," see Annot. 4 A.L.R.2d 575 (1949).
[531] 9-504(3) (44-3150 C).
[532] 9-507(2) (44-3153 B).
[533] The purpose of including a sale in a recognized market is quite clear — such sales will be for a reasonable price because of the market function. However, what constitutes a "recognized market" is likely to be a source of difficulty. In *Norton v. National Bank of Commerce,* 240 Ark. 141, 398 S.W.2d 538, 540 (1966), the court held that there was no recognized market for used cars, and gave the following description:

> Thus, a 'recognized market' might well be a stock market or a commodity market, where sales involve many items so similar that individual differences are nonexistent or immaterial, where haggling and competitive bidding are not primary factors in each sale, and where the prices paid in actual sales of comparable property are currently available by quotation.

[534] 9-507(2) (44-3153 B).
[535] Hogan, *Default Proceedings,* 47 MINN. L. REV. 205, 221 (1963).
[536] 9-507 (44-3153), Comment 2.
[537] 9-504(3) (44-3150 C).

has knowledge.[538] This notice requirement is excused if the collateral is perishable or threatens rapidly to decline in value, or is of a type customarily sold on a recognized market.[539] The Code does not provide a precise definition of "reasonable notification," but "at a minimum, [notice] must be sent in such time that persons entitled to receive it will have sufficient time to take appropriate steps to protect their interests by taking part in the sale or other disposition if they so desire."[540] The parties might clarify these generalities by including specific, reasonable notice requirements within the security agreement.[541]

Except in certain consumer goods cases, the Code does not specify any definite time period within which disposition must be made, though the "good faith" and "commercial reasonableness" rules apply. This is in accord with the Code's policy to encourage disposition by private sales through regular commercial channels.[542]

Compulsory Disposition of Consumer Goods. Where the debtor has paid sixty percent of the cash price in the case of a purchase money security interest in consumer goods, or sixty percent of the loan in the case of any other type security interest in consumer goods, the collateral *must be disposed of* within ninety days after repossession.[543] Otherwise the debtor has an option to recover the goods under section 9-507(1) (44-3153 A) or to bring an action for conversion.[544] The requirement of compulsory disposition cannot be waived or varied by the security agreement, but it may be waived in a writing signed by the debtor after default.[545]

Rights of Purchasers at Disposition. A sale after default transfers to a purchaser for value all of the debtor's rights in the collateral and discharges not only the security interest under which the sale was made, but also any subordinate liens or interests.[546] Where the purchaser for

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[538] *Id.*

[539] *Id.*

[540] 9-504 (44-3150), Comment 5.

[541] A problem arises as to whether a failure to comply with the notice requirements precludes the right to recover a deficiency judgment. In *Boggard GMC Co. v. Abril*, 1 Ariz. App. 55, 399 P.2d 189 (1965), which involved a conditional sales contract, the right to recover a deficiency was denied. Arizona has not yet decided this question as to a chattel mortgage, but the rule for "lien" states appears to deny a deficiency judgment where the mortgagee has failed to comply with the statutory notice requirements. Metheny v. Davis, 107 Cal. App. 137, 290 P. 91 (1930). The Code is silent on this point, but a recent Code case, *Norton v. National Bank of Commerce*, 240 Ark. 131, 398 S.W.2d 538 (1966), held that the secured party's right to a deficiency was impaired only to the extent of damages caused by the improper default sale. The court, however, presumed that the true value of the collateral was the amount of the debt, thus placing the burden on the secured party to show that an amount less than the debt would have been realized from a proper sale.

[542] 9-504 (44-3150), Comment 6.

[543] 9-505(1) (44-3151 A).

[544] *Id.*

[545] *Id.* These waiver provisions do not change existing law under the Uniform Conditional Sales Act, *see* ARIZ. REV. STAT. ANN. §§ 44-319, 326 (1956).

[546] 9-504(4) (44-3150 D).

value buys at a *public* sale, he takes free of all the above interests unless he has knowledge of any defects in the sale or is guilty of collusion with the secured party, other bidders, or the person conducting the sale.[547] If disposition is effected by a *private* sale, a purchaser for value will take free of such interests if he qualifies in all respects as a "good faith purchaser," even if there are defects in the sale.[548] The rules are clarified by the following statement: "Thus, while the purchaser at a private sale is required to proceed in the exercise of good faith, the purchaser at public sale is protected so long as he is not actively in bad faith, and is put under no duty to inquire into the circumstances of the sale."[549]

The secured party's right to purchase the collateral depends upon both the type of sale and the types of collateral involved. The secured party may always buy at a public sale; but he may buy at a private sale only if the collateral is customarily sold in a recognized market or is the subject of widely distributed standard price quotations.[550]

Order of Application of Proceeds. The proceeds of a sale or other disposition are first applied to necessary expenses such as those incurred in retaking, storing, and selling.[551] Attorney's fees are recoverable only to the extent provided for in the security agreement and not prohibited by law.[552] The funds remaining after necessary expenses are to be applied towards the secured obligation.[553] The excess remaining after satisfaction of the secured party's debt must be applied towards satisfaction of junior security holders, provided such holders meet two conditions. First, junior creditors must make written notification of a demand for funds, which notice must be received by the secured party before distribution is completed. Second, the junior party seasonably must provide reasonable proof of his interest, if requested by the secured party.[554]

Redemption

The debtor or another secured party may redeem the collateral unless the secured party has disposed or contracted to dispose of it, or has retained the collateral in satisfaction of the debt.[555] The debtor's right to redeem may also be terminated by written agreement made after default.[556] Since, except for the special rule on consumer goods, the

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[547] 9-504(4)(a) (44-3150 D(1)).
[548] 9-504(4)(b) (44-3150 D(2)).
[549] 9-504 (44-3150), Comment 4.
[550] 9-504(3) (44-3150 C).
[551] 9-504(1)(a) (44-3150 A(1)).
[552] *Id.*
[553] 9-504(1)(b) (44-3150 A(2)).
[554] 9-504(1)(c) (44-3150 A(3)).
[555] 9-506 (44-3152).
[556] *Id.*

secured party need not dispose of the collateral within a specific time, the length of time available for redemption is not only indefinite, but also dependent upon the practices of the secured party and his duty to act with "commercial reasonableness."

To exercise his right of redemption, the debtor must tender satisfaction of all obligations due, plus all reasonable expenses incurred by the secured party in repossessing.[557] "Tendering performance" requires more than a mere promise to perform. It requires actual payment or other performance of obligations then due.[558] If unmatured obligations remain after such performance and redemption, their performance continues to be secured as if there had been no default.[559]

LIABILITY FOR FAILURE TO COMPLY WITH DEFAULT REQUIREMENTS

If a secured party fails to adhere to the statutory duties imposed upon him in default proceedings, the injured party is given two forms of redress by the Code. If the secured party is proceeding, or is about to proceed, in a manner contrary to the standards of Part 5, a court order may be obtained to restrain him from violating his duties and to order him to conduct the sale in an appropriate manner.[560] The second form of redress, available only after disposition is completed, is an action for damages.[561] The debtor, any person entitled to notice, and anyone whose security interest was made known before disposition, may maintain such an action.[562]

A special rule of damages is applicable where the collateral is consumer goods. In such a case, the debtor's recovery can be no less than the amount of "the credit service charge plus ten percent of the principal amount of the debt; or the time price differential plus ten percent of the cash price."[563] The reason for this special rule is that where con-

[557] *Id.*

[558] *Id.*, Comment.

[559] *Id.* With regard to redemption of a debt completely matured by reason of an acceleration clause, the comment to section 9-507 (44-3153) states: "If the agreement contains a clause accelerating the entire balance due on default in one installment, the entire balance would have to be tendered." There is good reason to believe that Arizona would not follow this policy. In *Street v. Commercial Credit Co.*, 35 Ariz. 479, 281 P. 46 (1929), which involved a conditional sale contract, the court interpreted "amount due under contract at time of retaking" as referring to the amount due without the acceleration clause.

[560] 9-507(1) (44-3153 A).

[561] *Id.*

[562] *Id.* In *Fort Knox National Bank v. Gustafson*, 385 S.W.2d 196 (Ky. Ct. App. 1964), the court pointed out that section 9-507(1) (44-3153 A) expressed the policy that the debtor is confined to recovery of any loss caused by a failure to comply; that "loss" related to actual compensatory damages, not nominal damages; and that punitive damages could be awarded only where the secured party was shown to be lacking in good faith.

[563] 9-507(1) (44-3153 A). This provision varies from its counterpart under the Uniform Conditional Sales Act, which provides that the buyer's recovery is not to be less than one-fourth the sum of all installments made plus interest. ARIZ. REV. STAT. ANN. § 44-325 (1956).

sumer goods are involved the losses are usually small and difficult to prove.

Scope of Article 9: Conflict of Laws

General Principle. The scope of Article 9 is broadly set forth in section 9-102 (44-3102), which makes its provisions applicable to any transaction intended to create a security interest in tangible or intangible personal property or fixtures located within Arizona and to any sale of accounts, chattel paper, or contract rights occurring within Arizona. Article 9 does not apply to statutory liens except as provided in section 9-310 (44-3131), which recognizes the priority of mechanic's, materialman's, and similar liens arising by operation of law. In effect, section 9-102 (44-3102) requires that where Arizona is the forum state, the courts will apply the rules of Article 9 to all security transactions which involve collateral physically located within Arizona, without regard to possible contacts in other jurisdictions.[564]

Exceptions. Section 9-103 (44-3103) states the exceptions to the general conflict of laws principle contained in section 9-102 (44-3102). If the collateral is contract rights or accounts, Article 9 will govern the validity and perfection of a security interest if the Code is the law of the state where the assignor keeps his records of such accounts or contract rights.[565] If the assignor keeps his records in several offices, the location of those records which control for his general accounting purposes determines which law governs.[566]

If the collateral is general intangibles or mobile equipment, Article 9 governs if it is effective within the state of the debtor's chief place of business.[567] "Mobile goods" are those of a type which are normally used in more than one state (automotive equipment, road building equipment) and which are classified as equipment or as inventory by reason of their being leased by the debtor to others (cars owned by a car rental agency).[568] But the description "goods normally used in more than one state" does not require that the goods in fact be used out of state.[569] The "chief place of business" is the place from which the debtor actually manages the main part of his business operation.[570]

If personal property is covered by a certificate of title issued under a statute of Arizona, or of any other state which requires the indication of an existing security interest on a certificate of title as a condition of

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[564] 9-102 (44-3102), Comment 3.
[565] 9-103(1) (44-3103 A).
[566] *Id.*, Comment 2.
[567] 9-103(2) (44-3103 B).
[568] *Id.*, Comment 4.
[569] *Id.*
[570] *Id.*, Comment 3.

perfection, the *perfection* is governed by the law of the state which issued the certificate.[571]

If personal property other than accounts, contract rights, general intangibles or mobile goods is already subject to a security interest when brought into Arizona, the validity of that interest is determined by the law of the state where the property was located when the security interest attached.[572] However, Arizona law will apply to determine validity if, at the time of attachment, the parties understood that the property would be kept in Arizona, and it was brought into Arizona within thirty days after attachment, for purposes other than transit through the state.[573]

Period of Validity of Out-of-State Perfection. A perfected security interest in property brought into Arizona automatically remains perfected in Arizona for four months.[574] After four months, the secured party must perfect under the Code. If the secured party fails to do so, his interest is subject to those interests which take priority over any unperfected security interest.[575] This rule is a departure from that of the Arizona Uniform Conditional Sales Act, under which the seller was required to file within ten days after he had received notice that the goods had been removed to another state.[576] The Code's four month rule applies regardless of whether or not the secured party knows his collateral has been removed to another state.[577]

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[571] 9-103(4) (44-3103 D).
[572] 9-103(3) (44-3103 C).
[573] *Id.*
[574] *Id.*
[575] 9-103 (44-3103), Comment 3. For the interests prior to an unperfected security interest, see 9-301 (44-3122).
[576] ARIZ. REV. STAT. ANN. § 44-314 (1956).
[577] 9-103(3) (44-3103 C).