White & Summers: Handbook of the Law Under the Uniform Commercial Code

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BOOK REVIEWS


I may well be an inappropriate reviewer for James J. White and Robert S. Summers' *Handbook of the Law Under the Uniform Commercial Code* *(Handbook)*. As the authors indicate in their preface (p. xiii), they chose to address themselves to two audiences—law students and practitioners. I am neither, except in the sense that Arthur Corbin urged us all to remain, as he was throughout his life, a student of the law.

The task that Professors White and Summers set for themselves in this one-volume treatise is an extraordinarily demanding one. To discuss in only 1,000 pages the large variety of transactions for which the Uniform Commercial Code *(Code)* is the governing law requires choices and syntheses that most academicians would find a nightmare. As the general literature illustrates, most of us who write seriously about the Code take delight in extended exegeses on a few well-chosen, ill-drafted sections. Professors White and Summers have courageously pursued an altogether different course. With remarkable success, they have provided an overview of the Code that is comprehensive in its coverage and critical in its analysis. The treatise draws upon and integrates both the case law and the secondary literature that has developed around the Code. It is bound to be a first-line resource of exceptional utility.

The basic organization of the *Handbook* follows the pattern of the Code itself; the major divisions of the *Handbook* mirror the various articles of the Code. However, within these divisions the chapters are, sensibly, organized around substantive issues rather than Code sections. From time to time, the treatise undertakes important excursions into related areas not covered by the text of the Code, such as the impact of strict liability in tort on the warranty provisions (pp. 295, 327-48, and 350-51) and the relevance of the Bankruptcy Act to secured transactions (ch. 24). The materials on documents of title contain an especially illuminating description of the federal statutes that govern bills of lading (ch. 21). The book's subject matter index serves as a reasonably useful backstop to the detailed table of contents, although I sorely miss an index by Code sections.

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[1487]
Inevitably, despite my admiration for the Handbook, I find myself from time to time in disagreement with it. My difficulties are of two very different sorts: On the one hand, there are specific issues on which I find the coverage of the treatise insufficiently helpful; on the other hand, there are general issues whose omission I find puzzling.

White and Summers' discussion of article 3 of the Uniform Commercial Code is marred, it seems to me, by the authors' failure to take up with clarity the fundamental problem of the definition of "holder" under articles 1 and 3. The construct of "holder" is, of course, crucial to an understanding, not only of due course holding, but also of payment and hence of discharge, all classically central aspects of the law of negotiable instruments. In the Code, this "holder" construct is muddled by the contradictory nature of the instructions contained in sections 1-201, 3-202, and 3-204.

The difficulty of defining who is a holder can best be appreciated in a specific context. Consider the proper characterization of an innocent purchaser for value of an instrument tainted by theft. Under section 1-201(20), the purchaser would qualify as a holder if he has bought paper that was, or has become, bearer paper, or was indorsed by his vendor, since he would then be "in possession of . . . an instrument . . . issued or indorsed to him . . . or to bearer or in blank." Section 3-202 does not conflict with section 1-201(20) if the paper is issued in bearer form. But if order paper (or paper indorsed in blank) contains a forged indorsement, no matter how remote, section 3-202 appears to deny holder status even to an innocent purchaser.

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3. Section 1-201(20) states:

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

4. Section 3-202, entitled "Negotiation," states:

(1) Negotiation is the transfer of an instrument in such form that the transferee becomes a holder. If the instrument is payable to order it is negotiated by delivery with any necessary indorsement; if payable to bearer it is negotiated by delivery.

(2) An indorsement must be written by or on behalf of the holder and on the instrument or on a paper so firmly affixed thereto as to become a part thereof.

(3) An indorsement is effective for negotiation only when it conveys the entire instrument or any unpaid residue. If it purports to be of less it operates only as a partial assignment.

(4) Words of assignment, condition, waiver, guaranty, limitation or disclaimer of liability and the like accompanying an indorsement do not affect its character as an Indorsement.

5. Bearer paper is negotiated by delivery alone, so possession satisfies both section 1-201 and section 3-202.

6. Section 3-202 conflicts with section 1-201(20)'s apparent protection of a person possessing paper (genuinely) indorsed to him or in blank, if section 3-202(1) defines exclusively the process by which one becomes a holder and if section 3-202(2) determines that only holders can negotiate. Each of these propositions is open to doubt. The text of subsection 1 could also be construed as stating only one method of negotiation. The official comment's cross-citation, without qualification, to the article 1 definition of
In fact, the best argument for the conclusion that the innocent taker of bearer paper can always be a holder, while the innocent taker of order paper frequently cannot, is not the obscure language of article 3, but the clear understanding of the law of negotiable instruments. That law has assumed, since the mind of man runneth not to the contrary, that a forged indorsement irretrievably and irrevocably breaks the chain of title;\(^7\) such law is not reversed by mere perversities of drafting.

Of course, Professors White and Summers attest to the Code's reaffirmation of this historical victory of the interests of ownership over good faith purchase. I do not quarrel with their conclusion but rather with their failure to appreciate how difficult it is for the average reader, if not for the average law student, to derive the correct result from the cited sections. Their treatment of the definition of "holder" in section 14-3 (p. 459) of the treatise not only fails to refer back to the theoretical underpinnings they themselves provide in section 13-10 (pp. 414-15), but also omits mention of the very important analytical discussion contained in the senior author's own earlier writing.\(^8\)

I am particularly troubled by so conclusory a treatment of the holder problem because I am very unclear about the proper resolution of new dilemmas raised by some of the Code's explicitly revisionist sections. Under the pre-Code law of negotiable instruments, a drawer or maker who wished \textit{ab initio} to assure himself of discharge upon subsequent good faith payment could do so by issuing paper in bearer form. But section 3-204(3) allows a holder to convert bearer paper into order paper and thus, unilaterally, to reintroduce into the payment process the risk of latent forged indorsements.\(^9\) Is the genuine indorsement of the specially designated indorsee necessary to qualify an innocent transferee as a holder in order to permit the

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\(^7\) See W. BRITTON, HANDBOOK OF THE LAW OF BILLS AND NOTES 463-64 (2d ed. 1961); Kessler, Forged Indorsements, 47 YALE L.J. 863 (1938).


\(^9\) Section 3-204, headed "Special Indorsement; Blank Indorsement," provides:

1. A special indorsement specifies the person to whom or to whose order it makes the instrument payable. Any instrument specially indorsed becomes payable to the order of the special indorsee and may be further negotiated only by his indorsement.

2. An indorsement in blank specifies no particular indorsee and may consist of a mere signature. An instrument payable to order and indorsed in blank becomes payable to bearer and may be negotiated by delivery alone until specially indorsed.

3. The holder may convert a blank indorsement into a special indorsement by writing over the signature of the indorser in blank any contract consistent with the character of the indorsement.
drawer or maker's payment to discharge him and to avoid his liability for conversion? Presumably, the answer to this question is yes. Presumably, the effect of section 3-204 is to elevate rights of ownership over rights of discharge, even though, from the point of view of the drawer or maker, the change made by the special indorsement is at least as material as those alterations deemed invidious under section 3-407. Still, an enterprising court, conscious of possible limitations on the domain of sections 3-202 and 3-204, might reach a different result.

My concern with defining and confining the construct of who is a holder may reflect an academician's preoccupation with matters "arcane" and "tedious." But there are other points too at which the authors seem to have leapt rather too quickly, and with insufficient attention to detail, to conclusions of policy. One of these is their treatment of the celebrated case of Maurice O'Meara Co. v. National Park Bank and its relationship to article 5, particularly section 5-114(2)(b). O'Meara is most often cited for the proposition that, in a letter of credit transaction, the sole determinant of the issuing bank's obligation to pay is the conformity of the tendered documents to the terms of the letter of credit, regardless of the conformity (or lack thereof) of the underlying goods to the specifications of the customer's contract with the beneficiary (p. 626). This absolute separation of documents from goods—a point on which all of the distinguished judges of the New York Court of Appeals were agreed—is restated in article 5 of the Uniform Commercial Code by sections 5-109 and 5-114.

10. Under section 3-407(1),

[a]ny alteration is material [and hence potentially discharging under subsection (2)] which changes the contract of any party thereto in any respect, including any such change in

(a) the number or relations of the parties; or
(b) an incomplete instrument, by completing it otherwise than as authorized; or
(c) the writing assigned, by adding to it or by removing any part of it.

11. For instance, a court might hold subsequent indorsers, but not the maker or drawer, bound by the instructions contained in the special indorsement.

12. Cf. HANDBOOK, at 415 n.53, 498 n.13, describing the senior author's earlier work in White, supra note 8.

13. 239 N.Y. 386, 146 N.E. 636 (1925).


15. Section 5-109, dealing with "Issuer's Obligation to Its Customer," states:

(1) An issuer's obligation to its customer includes good faith and observance of any general banking usage but unless otherwise agreed does not include liability or responsibility

(a) for performance of the underlying contract for sale or other transaction between the customer and the beneficiary; or
(b) for any act or omission of any person other than itself or its own branch or for loss or destruction of a draft, demand or document in transit or in the possession of others; or
(c) based on knowledge or lack of knowledge of any usage of any particular trade.

(2) An issuer must examine documents with care so as to ascertain that on their face they appear to comply with the terms of the credit but unless otherwise agreed.
But O'Meara was not a unanimous decision, and it is as instructive for its disagreements as for its consensus. In the context of a suit on behalf of the beneficiary seller, McLaughlin, for the majority, held that the National Park Bank was obligated to pay whether or not "the description of the merchandise contained in the documents presented is correct." Cardozo dissented. In his view, a letter of credit bank was entitled to refuse to pay a seller who had tendered "false" documents when the bank could establish defects in "relation to the description in the documents." How does section 5-114(2)(b) resolve this controversy? Clearly, the section allows the bank to pay, if it so chooses, despite the receipt of derogatory information from its customer; "good faith" is not likely to be a large constraint on freedom to pay. It is the converse conduct that is unclear. In the absence of an injunction, can the bank, if confident of its facts, refuse to pay because of misrepresentations in the tendered documents? A right of refusal under certain circumstances is certainly inferrable from section 5-114(2)(b): There may well be a breach

assumes no liability or responsibility for the genuineness, falsification or effect of any document which appears on such examination to be regular on its face.

A non-bank issuer is not bound by any banking usage of which it has no knowledge.

16. Section 5-114, titled "Issuer's Duty and Privilege to Honor; Right to Reimbursement," states:

1. An issuer must honor a draft or demand for payment which complies with the terms of the relevant credit regardless of whether the goods or documents conform to the underlying contract for sale or other contract between the customer and the beneficiary. The issuer is not excused from honor of such a draft or demand by reason of an additional general term that all documents must be satisfactory to the issuer, but an issuer may require that specified documents must be satisfactory to it.

2. Unless otherwise agreed when documents appear on their face to comply with the terms of a credit but a required document does not in fact conform to the warranties made on negotiation or transfer of a document of title (Section 7-507) or of a security (Section 8-306) or is forged or fraudulent or there is fraud in the transaction

(a) the issuer must honor the draft or demand for payment if honor is demanded by a negotiating bank or other holder of the draft or demand which has taken the draft or demand under the credit and under circumstances which would make it a holder in due course (Section 3-302) and in an appropriate case would make it a person to whom a document of title has been duly negotiated (Section 7-502) or a bona fide purchaser of a security (Section 8-302); and

(b) in all other cases as against its customer, an issuer acting in good faith may honor the draft or demand for payment despite notification from the customer of fraud, forgery or other defect not apparent on the face of the documents but a court of appropriate jurisdiction may enjoin such honor.

3. Unless otherwise agreed an issuer which has duly honored a draft or demand for payment is entitled to immediate reimbursement of any payment made under the credit and to be put in effectively available funds not later than the day before maturity of any acceptance made under the credit.

Subsections 4 and 5 are omitted here since they are optional.

16. 239 N.Y. at 397, 146 N.E. at 639.
16. 239 N.Y. at 402, 146 N.E. at 641.
19. I am indebted to Friedrich Kessler, Sterling Professor Emeritus at the Yale Law School, for having brought this ambiguity to my attention.
of warranty under section 7-507(b), or the document may be “fraudulent.” A refusal to pay that is premised upon nonconformity with the terms of the credit is, as section 5-114(1) requires, independent of conformity to the underlying contract of sale. Yet the latter observation begs the question of what kinds of discrepancies constitute noncompliance “with the terms of the relevant credit.” And a provision that an issuer “may honor” is not the equivalent of a provision that an issuer “need not” honor. Given the prominence of the O’Meara case in the literature of letters of credit, the draftman’s indirection should perhaps be read to leave New York law intact rather than reversed.

It is characteristic of the drafting style of article 5 that its provisions (much like those of the Uniform Customs and Practice for Commercial Documentary Credits) tend to emphasize what a bank may do rather than what it must do. Professors White and Summers recognize other instances of this drafting stance in their own discussion of wrongful dishonor in section 18-6 (pp. 620-23). Still, I would have welcomed an explicit examination of what it means to have a statute that is more precise about the immunities it confers than about the obligations it imposes. The broadly stated and repeated invitations to private variation that White and Summers discuss (pp. 609-15) do not, to my mind, make a statute’s points of departure trivial or irrelevant. The issues of policy buried in the language and style of section 5-114 in particular, and article 5 in general, would have benefitted from further elaboration.

20. Under section 7-507, on “Warranties on Negotiation or Transfer of Receipt or Bill,”

Where a person negotiates or transfers a document of title for value otherwise than as a mere intermediary under the next following section, then unless otherwise agreed he warrants to his immediate purchaser only in addition to any warranty made in selling the goods

(a) that the document is genuine; and
(b) that he has no knowledge of any fact which would impair its validity or worth; and
(c) that his negotiation or transfer is rightful and fully effective with respect to the title to the document and the goods it represents.

21. There is evidence that customers continue to request, and banks to issue, letters of credit that require documents containing detailed information against which demands for payment must be measured. See, e.g., Banco Espanol de Credito v. State Street Bank & Trust Co., 385 F.2d 230 (1st Cir. 1967), cert. denied, 390 U.S. 1013 (1968) (discussed in HANDBOOK, at 621, 625 n.108).

22. Such a reading would take the instructions contained in section 5-114(2)(b) to contain only two alternatives: Ordinarily the bank must pay, and will be deemed in good faith if it pays, despite suspicions of latent defects in the documents, but the customer may get an injunction to preclude payment on any of the grounds substantively stated. The statute would thus be merely an extension of the procedure developed in Sztejn v. J. Henry Schroder Banking Corp., 177 Misc. 719, 51 N.Y.S.2d 631 (Sup. Ct. 1941). That case assumed fraud in the factum; section 5-114(2)(b) allows judicial intervention on a broader set of allegations, such as forgery and ordinary fraud.

It is perhaps worth noting that Comment 2 to section 5-114 suggests a broader reading and adoption of the Cardozo position.
My difficulties with Professors White and Summers' treatment of particular problems under articles 3 and 5 reflect, I suppose, natural differences of opinion about what is worthy of emphasis and what can be briefly summarized. I am more puzzled by the authors' failure to treat at all certain issues of both historical and contemporary interest.

One of the precursors of article 9's detailed regulation of security arrangements is the protection afforded at common law to claims of ownership in chattels against the competing interests of good faith purchasers and levying creditors. The common law dealt with these irreconcilable claims through a variety of doctrines, such as fraudulent conveyance, ostensible ownership, cash sale, voidable title, and entrusting.23 Article 2, as did the Uniform Sales Act24 before it, re-statutes these principles and, inevitably, reshapes their contours. For example, while prior statutes and case law emphasized the fraudulent aspects of any seller's retention of possession of sold goods, section 2-403(2),25 in assessing the validity of a subsequent sale, looks instead to the seller's status and to the circumstances of the subsequent buyer's purchase. Under this section, only a merchant seller26 has power, after a prior sale, to pass good title, and then only to a buyer in the ordinary course of business.27 Ordinary purchasers in good

25. Section 2-403(2) states:
   Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business.
   Entrusting is defined in section 2-403(5):
   "Entrusting" includes any delivery and any acquiescence in retention of possession regardless of any condition expressed between the parties to the delivery or acquiescence and regardless whether the procurement of the entrusting or the possessor's disposition of the goods have been such as to be larcenous under the criminal law.
26. Section 2-104(1) defines merchant:
   "Merchant" means a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.
   The application of section 2-403(2) is limited to the class of merchants who deal in goods of the kind, excluding those otherwise holding themselves out as having special knowledge or skill.
27. Section 1-201(9) defines "buyer in the ordinary course of business" as a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. . . . "Buying" may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.
   The 1972 amendment to the Code added an intermediary sentence, after "pawnbroker": "All persons who sell minerals or the like (including oil and gas) at wellhead
faith from ordinary sellers are left to speculative arguments under section 2-403(1) involving either a distortion of “voidable title” or an even less likely extension of “fraud punishable as larcenous.” In contrast to section 2-403, however, section 2-402 protects any creditor who deals with any seller left in possession if the retention is fraudulent against him under state law, regardless of the seller’s professional status or of the creditor’s actual knowledge of the prior sale. This latter aspect of the creditor’s avoidance powers, because it differs from his upset powers under section 9-301(1)(b), creates interesting opportunities for jockeying between articles 2 and 9.

I find these article 2 provisions about third-party rights and their interrelationship with article 9 both interesting and confusing. Perhaps they represent a draftsman dealing, on the one hand, with back-or minehead shall be deemed to be persons in the business of selling goods of that kind.”

28. Section 2-403(1) provides:
(1) A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer a good title to a good faith purchaser for value. When goods have been delivered under a transaction of purchase the purchaser has such power even though
(a) the transferor was deceived as to the identity of the purchaser, or
(b) the delivery was in exchange for a check which is later dishonored, or
(c) it was agreed that the transaction was to be a “cash sale,” or
(d) the delivery was procured through fraud punishable as larcenous under the criminal law.

Section 2-403 concludes with:
(e) The rights of other purchasers of goods and of lien creditors are governed by the Articles on Secured Transactions (Article 9), Bulk Transfers (Article 6) and Documents of Title (Article 7).

29. Section 2-402, entitled “Rights of Seller’s Creditors against Sold Goods,” states:
(1) Except as provided in subsections (2) and (3), rights of unsecured creditors of the seller with respect to goods which have been identified to a contract for sale are subject to the buyer’s rights to recover the goods under this Article (Sections 2-502 and 2-716).

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

(3) Nothing in this Article shall be deemed to impair the rights of creditors of the seller
(a) under the provisions of the Article on Secured Transactions (Article 9); or
(b) where identification to the contract or delivery is made not in current course of trade but in satisfaction of or as security for a pre-existing claim for money, security or the like and is made under circumstances which under any rule of law of the state where the goods are situated would apart from this Article constitute the transaction a fraudulent transfer or voidable preference.

30. There is a minor exception for buyers who leave goods with a merchant seller for a commercially reasonable (presumably brief) period of time.

31. Under the 1962 Official Text, section 9-301(1)(b), defining those who could take priority over unperfected security interests, included “a person who becomes a lien creditor without knowledge of the security interest and before it is perfected.” The 1972 amended version of article 9 deletes the knowledge requirement, bringing article 9 into line with the section 2-402(2) formulation. The new section provides upset powers for, “a person who becomes a lien creditor before the security interest is perfected.”
stops and, on the other, with serious commercial problems; perhaps they reflect a change in attitude brought about as the Code's horizons expanded and its drafting style became more technical. In any case, I was disappointed that I could discover no mention in the *Handbook* of any of these problems, save for the brief comparison of sections 2-403 and 9-307 (pp. 944-46) and the elliptical observation that "[i]n certain respects, 2-403 is more generous to subsequent purchasers than is 9-307" (p. 945).

It may well be that the article 2 provisions on third-party claims do not loom large in the litigation under the Code. Yet they are illustrative of a larger question that the authors have been reluctant to explore. Sections 2-402 and 2-403 draw explicitly, as many sections of the Code draw implicitly, upon pre-existing common law. What is the role of a statute like the Code in a common law jurisprudence? In the absence of express incorporation or contradiction, to what extent should courts view the Code as a source of common law?

Earlier American statutes codifying parts of what we call commercial law were often swallowed whole by the common law. Just as Judge Mansfield subjugated English mercantile law by incorporating it into general common law, so the Uniform Sales Act well-nigh disappeared from view into the common law, despite its broad enactment. As John Honnold has noted, "Our courts have a loose way with statutes when they feel they understand the problem." A less kind commentator might have added, "whether or not they in fact understand."

Karl Llewellyn, the chief draftsman of the Code, was acutely conscious of, and essentially sympathetic toward, the "Common Law Tradition," as he entitled his last book. Grant Gilmore, a collaborator of long standing in the drafting of the Code, described Llewellyn's view: "He had clearly in mind the idea of a case-law Code, one that would furnish guidelines for a fresh start, would accommodate itself to changing circumstances, would not so much contain the law as free it for a new growth." Llewellyn's approach is sometimes traceable into the wording of certain operative sections,

32. In article 2, see, for example, the common law concepts of title (section 2-401), substantial impairment of value (sections 2-608 and 2-612), and proximate damages (sections 2-714 and 2-715).


36. For a particularly striking example of "looseness" with article 2's remedial sections, see the interpretation of sections 2-714 and 2-715 in *Keystone Diesel Engine Co. v. Irwin*, 411 Pa. 222, 191 A.2d 376 (1963).
for example, section 2-302 and sections 9-102 and 9-202. But it is principally memorialized by the general prescriptions in article I, which are designed to assure, as much as any statute can, capacities for flexibility and adaptation and growth. Professors White and Summers pass over these sections (pp. 14-16 and 19-20), as over the pre-Code case law (p. xiv), without sufficient attention to their implication for cases as yet undecided, problems as yet unlitigated, and issues as yet unappreciated. As Grant Gilmore has said:

We know enough about the experience of living with statutes or under Codes to know that the early opponents of codification were wrong in fearing that the result of codification would be to freeze the law as of the date of the Code's enactment. The law, codified, goes its merry way—which to the disgust of conservative practitioners—and at much the same pace as the law, uncodified.

A treatise about the Uniform Commercial Code should take seriously every article that the Code contains.

In the final analysis, however, it bears repeating that no two authors, not to speak of three, can be expected to take the same view of the field of commercial law or of the role of the Code in that law. Professors White and Summers' emphasis on the emerging case law under the Code, and their critical analysis of that case law, provide a sound and functional approach to a fascinating and complex field. The success of their treatise is as assured as it is well-deserved.

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38. These sections define the broad sweep of article 9 to be operative, under section 9-102(l)(a), for "any transaction (regardless of its form)," and, under section 9-202, "whether title to collateral is in the secured party or the debtor."


40. There is not even a reference to Professor Summers' own excellent article, Summers, "Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code, 54 Va. L. Rev. 195 (1968).


42. From time to time, the authors surface their own disagreement about particular problems in ways I found more amusing than their choice of nomenclature for hypothetical characters.