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Annual Survey of Virginia Law: Commercial Law

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I. Introduction

It has been a fairly busy year for Commercial Law in Virginia courts, but not in the legislature. This may not last; there are already legislative efforts underway to extend the coverage of Virginia's Uniform Commercial Code (the "Code") to electronic fund transfers and personal property leasing. If those efforts are successful, the General Assembly will soon have on its hands the consider-
able task of evaluating the first major overhaul of the Code in a decade.¹

By contrast, 1987 produced only one major, and constitutionally defective, amendment to the Code concerning the obligations of farmers who sell farm products that are subject to a security interest.² And of the relatively large number of cases that kept the courts busy, most were fairly routine. Some of the most interesting case law developments occurred in Virginia’s circuit courts, the decisions of which are now being published on a regular basis.

This article covers all important changes made to the Code during the 1987 session of the General Assembly. It also covers all significant Virginia Supreme Court cases dealing directly with the Code, together with significant reported Virginia law cases from the Court of Appeals for the Fourth Circuit, the various federal district and bankruptcy courts sitting in Virginia, and the Virginia circuit courts. Highly unsystematic attention is given to some developments that indirectly affect the Code. The cases reviewed were for the most part decided between April, 1986 and April, 1987, although a few earlier circuit court cases that were not previously published are included.

The goals of this article are twofold: to give practitioners ready access to recent commercial law developments and to encourage a deeper understanding of the policies underlying, and the intricacies of, the Code.

II. SALES

A. Scope of Article Two

Article Two of the Code, although denominated “Sales,” applies by its terms to “transactions in goods.”³ Despite the use of the broad word “transactions” it is reasonably clear that the Article itself is generally limited, as its title suggests, to sales transactions. (However, its provisions are increasingly being subsumed into the

2. See infra notes 183-217 and accompanying text.
monthly, it is quite clear that, to be subject to the provisions of Article Two, a transaction must have a close relationship to a transfer of title in "goods", which are defined as "all things . . . which are moveable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities . . . and things in action."

Much ink, if little blood, has been spilled over the exact scope of Article Two. The question is not an insignificant one, because Article Two in a number of respects modifies traditional contract law and these modifications have not yet been fully accepted into the common law. In any marginal or doubtful case, the party who would benefit from the differences between Article Two and the older common law rules obviously wishes to bring the contract under the Article.

Two major flashpoints exist: (1) personal property leases; and (2) "mixed" contracts for goods and services or goods and other property. The former deals with the "sales" requirement; the latter with the "goods" requirement. One Virginia circuit court case has been decided on each issue. Those issues, and the cases, are addressed in order.

1. Leases

Personal property leases, especially long-term leases, are not entirely distinct from sales. A lessee receives certain rights to property; a purchaser receives more. The most significant distinction is time: the purchaser acquires the property "forever," or more precisely, for as long as it exists; the lessee for a set period of time.

This distinction is not always clear-cut. A person who leases property for its entire useful life receives practically the same thing as a person who purchases the property. Of course, the lessee cannot resell or destroy the property, but these limitations may also be imposed on a purchaser who has acquired the property on credit and has given the seller a security interest; this is known as acquiring the property "on time." Leases and sales are thus not


5. Va. Code Ann. § 8.2-105(1) (Add. Vol. 1965); The definition of a sale is "the passing of title from the seller to the buyer for a price . . . ." Id. § 8.2-106(1).
wholly separate species; they both lie along a continuum of property rights. These rights range from the evanescent rights of a person who briefly borrows a pencil to the virtually unlimited rights of the person who owns that pencil free and clear of any claims or liens, subject only to the obligation not to use the pencil to maim, murder, or publish obscenity. Because of this relationship between sales and leases, it has long been argued that long-term personal property leases should be brought under the aegis of Article Two. The courts have to a limited degree applied at least some parts of Article Two to some types of leases, by finding that the Article applied either "directly" or "by analogy." Most courts have attempted to distinguish between "true" leases and "financing" leases. "Financing" leases are not really leases, but are in fact sales and thus subject to Article Two. Some courts have gone further. They have held that, although Article Two as a whole does not apply to true leases, some of its provisions should be extended to such leases by analogy.

In a remarkable opinion, the Circuit Court of the City of Richmond has adopted a form of the second approach of partial application by analogy. Gentry v. Ryder Truck Rental, Inc. involved a long-term truck lease between Ryder Truck Rental, Inc. ("Ryder") and Allied Chemical Corporation ("Allied"). Gentry, an employee of Allied, was injured when a "grab bar" he tried to use to exit the truck broke off. Ryder defended on three grounds: (1) there were no express warranties regarding the trucks; (2) there were no applicable implied warranties regarding the trucks; and (3) Gentry was not in privity with Ryder.

Both parties agreed that the warranty and privity provisions of Article Two did not apply, noting Leake v. Meredith. Thus, the issue was whether parallel common-law principles should be applied. More precisely, the question was whether pre-Code case

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9. 8 Va. Cir. 360 (Richmond 1987).
10. Id. at 360.
11. Id. at 361.
14. Gentry, 8 Va. Cir. at 361.
law that prohibited suits of the type brought by Gentry would still be followed by the Virginia Supreme Court.\textsuperscript{15}

In the view of the \textit{Gentry} court, it would not.\textsuperscript{16} The court stated:

\begin{quote}
Lessors of motor vehicles stand in a place similar to, and sometimes the same as, sellers. They place the vehicle into the hands of a party who has little or no ability to discover that the product is defective or, more importantly, to protect himself from such defects. Third parties are even further removed from any ability to detect and protect themselves from a defective vehicle. The parties best able to detect and protect from such defects are the manufacturers and the lessors of the product.\textsuperscript{17}
\end{quote}

For the reasons stated, \textit{Gentry} created a common law implied warranty made by the lessor “to Allied and all who used [the truck] that it was safe for use.”\textsuperscript{18}

While there is considerable logic to the \textit{Gentry} decision, the case reflects a willingness to expand the traditional boundaries of warranty law to an extent that is unusual in Virginia. While it is certainly true that \textit{Leake v. Meredith}\textsuperscript{19} did not explicitly rule out the creation of a common-law lease warranty structure parallel to the sales warranty structure of Article Two, there is likewise nothing in the opinion that supports such a creation. It should also be noted that \textit{Gentry} does not explicitly limit its new warranty rules to long-term leases. Indeed, the central point made in the case—the lessee’s relative inability to protect against injury—could apply with greater force to a casual, short-term consumer lessee than to an experienced, long-term commercial lessee.\textsuperscript{20} To this extent,

\begin{itemize}
\item \textsuperscript{15} Id. The cases cited were General Bronze Corp. v. Kostopulos, 203 Va. 66, 122 S.E.2d 548 (1961); Harris v. Hampton Roads Tractor & Equip. Co., 202 Va. 958, 121 S.E.2d 471 (1961); and Colonna v. Rosedale Dairy Co., 166 Va. 314, 186 S.E. 94 (1936). All three cases address the privity question.
\item \textsuperscript{16} This despite the contrary view of the Fourth Circuit in \textit{Ely v. Blevins}, 706 F.2d 479 (4th Cir. 1983), a case distinguished by \textit{Gentry} because it did not deal with personal property leases. \textit{Gentry}, 8 Va. Cir. at 361.
\item \textsuperscript{17} 8 Va. Cir. at 362.
\item \textsuperscript{18} Id. at 363.
\item \textsuperscript{19} 221 Va. 14, 267 S.E.2d 93 (1980).
\item \textsuperscript{20} This may be reinforced by a fact, noted but not directly discussed in \textit{Gentry}, that Ryder completely controlled the maintenance of the trucks. 8 Va. Cir. at 360. If the lessor's liability is predicated on the fact that its control of maintenance limits or eliminates the lessee's ability and incentive to protect against injury, then a short term lessee who has essentially no control over maintenance should be more protected than a long-term lessee who has at the very least a greater opportunity to detect problems and either correct them.
\end{itemize}
Gentry goes even beyond those cases that have applied Article Two by analogy to long-term leases.

Gentry may thus prove a bit too forward for Virginia tastes. Even so, it opens an important debate over the appropriate scope of a lessor’s liability. Whether in the General Assembly or the courts, this debate should continue.

2. Mixed Contracts

Many contracts provide for the acquisition of both goods and other property or goods and services. For example, a person who buys the assets of a manufacturing business buys goods (machinery, office equipment, motor vehicles), realty (land and building), and intangibles (accounts receivable). Similarly, a person who has a roof added to his or her home acquires goods (shingles) and services (attachment of the shingles to the house). Should these contracts be governed by the Article Two rules or the common-law rules?

Most courts apply what is usually called the “predominant purpose” test. Under this test, if the “goods” portion of the contract predominates, Article Two applies. However, if the “other property” or “services” portion predominates, the common law applies.21 A smaller number of courts apply an “allocation” test in which the court treats the deal as creating two contracts: one for sale of goods subject to Article Two; one for sale of other property or services subject to common law.22 As is true with leases, this relatively simple structure is made more complex by the willingness of some courts, in some incompletely defined circumstances, to develop common-law provisions, applicable to non-goods contracts or to the non-goods portion of a mixed contract, that are identical or at least parallel to those of Article Two.23

The Circuit Court of the City of Alexandria, in Steingaszner v. Paramount Termite Control Co.,24 succinctly dealt with the problems of Article Two eligibility and analogy. The plaintiff, Ste-

\[\text{or force the lessor to correct them.}\]


22. See, e.g., Foster v. Colorado Radio Corp., 381 F.2d 222 (10th Cir. 1967).


ingaszner, had obtained pest control services from Paramount Termite Control Co., Inc. ("Paramount"). In providing those services, Paramount used chemicals it had obtained from Velsicol. Stein-gaszner alleged injury and sued Paramount and Velsicol on a number of grounds, including breach of warranty. Paramount demurred and Velsicol moved to dismiss or strike the pleadings.

In rejecting the demurrer and the motion, the court made three determinations. The first, which is not controversial, was that the predominant purpose test would be used to determine the applicability of Article Two. Since the contract was primarily for the provision of pest control services, Article Two did not apply.

The second determination somewhat parallels Gentry. The court held, also uncontroversially, that the Code does not preclude the development of non-sales contract law. It went on to find an implied warranty which it described only obliquely but which can be paraphrased as a warranty that the goods provided would not, at the time they left the seller's control, be unreasonably dangerous for their ordinary or foreseeable uses.

This part of the case is a bit puzzling. Clearly, the court meant to impose some form of merchantability warranty although there existed no Article Two contract. However, rather than creating a merchantability warranty for services, it implied a warranty with regard to the goods provided in conjunction with the services. Further, that implied warranty was not identical to the goods merchantability warranty of Article Two. Instead, it was phrased in terms of "strict liability" under section 402A of the Second Restatement of Torts.

It would have perhaps made more sense to allocate the contract between its goods and services portion and place the goods portion under the Article Two warranty of merchantability standards.

25. Id. at 309-312.
26. Id. at 309.
27. Id.
28. Id.
29. Id. at 310.
30. Id.
31. Id.; see Restatement (Second) of Torts § 402A (1965).
32. Another alternative existed as well. With regard to Velsicol, the court could have held that, since the Velsicol-Paramount contract was obviously an Article Two contract, the Article Two warranties applied to it (unless they were disclaimed by Velsicol, an issue not discussed by the court) and should be extended to Steingaszner through the anti-privity provision of Va. Code Ann. § 8.2-318 (Add. Vol. 1965). See infra notes 38-39 and accompanying text.
Steingaszner in effect creates two different merchantability warranties for goods: (1) the Code warranty applicable to contracts in which the predominant purpose is the sale of goods; and (2) the Restatement-based warranty applicable to contracts in which the predominant purpose is the sale of other property or services. There is no obvious reason for creating two different warranties.

Much of the court's confusion is attributable to the earlier Virginia Supreme Court case of Logan v. Montgomery Ward & Co. upon which Steingaszner relied. Logan was an entirely run-of-the-mill Article Two case in which a defective gas stove exploded. It should have been analyzed under the merchantability provisions of the Code. It was not. There is not a single reference in Logan either to the Code or to the Code's standards of merchantability. Rather than rely upon the statutory standards, the court, for no perceptible reason, created its own standard, stating that:

Under either the warranty theory or the negligence theory the plaintiff must show, (1) that the goods were unreasonably dangerous either for the use to which they would ordinarily be put or for some other reasonably foreseeable purpose, and (2) that the unreasonably dangerous condition existed when the goods left the defendant's hands.

This rule, which was copied almost verbatim in Steingaszner, seriously misstates the seller's merchantability obligations under Article Two.

34. Id. at 426-27, 219 S.E.2d at 686.
35. Id. at 428, 219 S.E.2d at 687.
36. 5 Va. Cir. at 310.
37. Article Two's implied warranty of merchantability imposes significantly different obligations on the seller than the Restatement-based warranty used in Logan and Steingaszner. It states:

Goods to be merchantable must at least be such as
(a) pass without objection in the trade under the contract description; and
(b) in the case of fungible goods, are of fair average quality within the description; and
(c) are fit for the ordinary purposes for which such goods are used; and
(d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and
(e) are adequately contained, packaged, and labeled as the agreement may require; and
(f) conform to the promises or affirmations of fact made on the container or label if any.

The third determination made in *Steingaszner* also parallels *Gentry*. The court held that the anti-privity provision of Article Two applied, which permitted Steingaszner to sue Velsicol, even though he had not dealt with Velsicol himself. It is difficult to reconcile this with the court's decision that Article Two did not apply to the contract. It would have been more appropriate to hold, as did *Gentry*, that the common law no longer required privity in this type of action. Of course, such a determination would have left the *Steingaszner* court, like the *Gentry* court, subject to the criticism that it was articulating a change in common law neither mandated by the General Assembly nor permitted by existing precedent. It would, however, have removed an unnecessary internal contradiction.

B. *Express Warranties*

One of the chronic problems of contract law is that of deciding the content of the contract. This is not just a matter of interpreting the words of the contract. It is equally a matter of determining what words are "in" the contract and what sources will be used to define the words that are "in" the contract. For example, suppose ABC Co. and XYZ, Inc. are negotiating a contract for sale of wombats. During the course of the negotiation, various letters, forms, telephone messages and telegrams are exchanged. The terms in the documents do not precisely match. Terms of art are used in these documents that have meanings in the wombat industry which differ from their "dictionary" meanings. Some terms are used that are understood one way by ABC and quite a different way by XYZ. A mass of words, creating a complex of understandings and expectations, has been generated. Which words and what understandings are legally part of the content of the parties' agreement?

It is a rough but fair generalization that "classical" contract law (more precisely, the academic contract law of the late 19th and early 20th centuries) severely restricted the sources of contract terms in a perhaps foredoomed effort to ensure certainty and avoid the imposition of unanticipated obligations. It is an equally accurate generalization that modern contract law has significantly re-

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40. See *supra* notes 27-28 and accompanying text.
laxed prior limitations and invites more wide-ranging exploration of the various indices of the parties' intentions and expectations. In short, the goal of "classical" contract law was a document that spelled out exactly what each party had to do, sometimes without regard to whether that document accurately described what the parties understood to be their duties. The goal of modern contract law is the enforcement of the parties' expectations regarding the deal, sometimes without regard to what they formally agreed. The difference reflects, not an overthrow of prior law, but a shift in emphasis; it is not that contract documents have become unimportant but that they are treated with slightly less reverence. Even today, in transactions that involve sophisticated parties and require a high degree of certainty, the courts tend to adhere strictly to the traditional, narrow view of the scope of obligation.

The proper relationship between the parol evidence rule and express warranties is a major battleground in this eternal struggle between certainty and expectation. The parol evidence rule\(^4\) seeks certainty by limiting the search for contract terms to the parties' last written version of their contract. The law regarding express warranties\(^2\) protects expectation by including in the contract "[a]ny affirmation of fact or promise made by the seller to the buyer . . . [a]ny description of the goods [and] . . . [a]ny sample or model [of the goods] . . . ."\(^3\)

In its attempt to reconcile these two provisions, the Code manages only an uneasy and uncertain compromise. In theory, express warranties cannot be unilaterally disclaimed by the seller.\(^4\) They can, however, be eliminated from the contract by the operation of the parol evidence rule if the express warranty is not included in the written version of the contract and either the express warranty is inconsistent with the written terms or the written terms are intended to be "complete and exclusive".\(^5\) The distinction between a

\(^2\) Id. § 8.2-313.
\(^3\) Id.
\(^4\) The Code provides:
Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but subject to the provisions of this [Article] on parol or extrinsic evidence (§ 8.2-202) negation or limitation is inoperative to the extent that such construction is unreasonable.
Id. § 8.2-316(1).
\(^5\) Id. §§ 8.2-202(b), -316(1).
mere disclaimer that does not affect parol express warranties, and a complete integration that does, is, to put it mildly, an evanescent one.

This was the issue tackled in Hoover Universal, Inc. v. Brockway Imco, Inc. Hoover Universal, Inc. ("Hoover") purchased a plastic bottle manufacturing process (called the "ORB VI") from Brockway Imco, Inc. ("Brockway"). One of the documents given by Brockway to Hoover was a handout that unintentionally misstated the number of bottles the machine would produce during each "cycle."47

The signed version of the agreement was "a lengthy written contract" that contained a disclaimer of all warranties other than those specifically designated in the written document. There was no mention in the document of the number of bottles the ORB VI would produce per cycle. The document also contained the following integration clause:

This Agreement represents the entire understanding and agreement between the parties hereto with respect to the subject matter here and cannot be amended, supplemented or changed, nor can any provision hereof be waived, except by written instrument signed by the party against whom enforcement of any such amendment, supplement, modification or waiver is sought.50

The court held that the integration clause was sufficient to bar any parol proof of the express warranty that allegedly was created by the handout.51

The case, like many such cases, gives little rationale for its leap from the integration clause to the conclusion that the parol evidence rule applied. Section 8.2-202 only operates to bar parol evidence if the writing is "intended by the parties as a final expression of their agreement . . . ." Even then, consistent additional terms are permitted unless the parties intended a complete integration; i.e., unless they intended the writing to be "a complete

46. 809 F.2d 1039 (4th Cir. 1987).
47. Id. at 1041.
48. Id. at 1041-42.
49. Id. at 1042.
50. Id.
51. Id. at 1043-44.
and exclusive statement of the terms of the agreement.” Moreover, a course of dealing, usage of trade, or course of performance can explain or supplement even a complete integration.

The intent requirement of the parol evidence rule is curiously contradictory to one of the requirements for creation of an express warranty. An express warranty comes into existence only if some promise, affirmation, description, sample or model regarding the goods became part of “the basis of the bargain.” Although the exact scope of that requirement is somewhat uncertain, it is clear that it requires at least some very general form of reliance. By definition, a buyer who is relying on a promise, expecting the goods to conform to that promise, does not intend a document that excludes that promise to be a complete and exclusive expression of agreement. The court should thus have focused on the relationship between the basis of the bargain rule and the intent aspect of the parol evidence rule. In other words, an integration clause should bar parol evidence of an express warranty only if the buyer’s agreement to the integration clause manifested his or her decision not to make the express warranty part of the basis of the bargain. More concretely, an integration clause contained in a document prepared by the buyer, or jointly by the buyer and the seller, should ordinarily bar such parol evidence because the reasonable interpretation of the buyer’s acquiescence in such a document is that prior statements are not part of the basis of the bargain. An integration clause buried in preprinted boilerplate that probably neither party read should not ordinarily have the effect of barring parol evidence, because it does not ordinarily evidence a willingness to forego the warranty.

Even less explanation was given for the court’s peremptory dismissal of Hoover’s assertion that a usage of trade was applicable and admissible. It merely stated that “[i]t is readily apparent that Hoover intended to introduce trade usage not to explain or supplement the meaning of a contract term, but rather to contradict the limitation of warranties . . . .” This statement is in curious con-

53. Id. § 8.2-202(b).
54. Id. § 8.2-202(a).
55. Id. § 8.2-313(1).
57. One reason it may not have done so is procedural. By classifying the issue as parol evidence rather than basis of the bargain, the court created an issue for the trial court judge to decide rather than for the jury. Hoover Universal, 809 F.2d at 1042-43.
58. Id. at 1043.
Contrast to the Fourth Circuit’s earlier, and much more expansive, view of the admissibility of trade usage in the teeth of the contract’s express terms and the parol evidence rule.\(^{60}\)

C. Statute of Limitations

Two relatively minor cases discuss aspects of the statute of limitations applicable to Article Two contracts. In *Roy Stone Transfer Corp. v. Budd Co.*,\(^{60}\) the Fourth Circuit noted that a party can be estopped from raising the statute of limitations if it lulls the other party “into inaction to its detriment by . . . assurances and attempted repairs.”\(^{61}\) However, since the plaintiff failed to produce any evidence of the alleged lulling, the court upheld the district court’s determination that the defendant was not estopped.\(^{62}\)

In *Stone v. Ethan Allen, Inc.*,\(^{63}\) the Virginia Supreme Court examined the interrelationship of three different statutes of limitations. The first was the general four-year statute of limitations applicable in Article Two transactions.\(^{64}\) The second was the five-year statute of limitations for personal injury and property damage in products liability actions.\(^{65}\) The third was the then-applicable five-year property damage statute of limitations for negligence actions.\(^{66}\)

The plaintiff had purchased a refrigerator, which was delivered to their home on February 8, 1975. It allegedly caused a fire on July 20, 1977. Suit was filed by the plaintiff on September 28, 1981.\(^{67}\)

The court held that the five-year products liability statute of

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59. Columbia Nitrogen Corp. v. Royster Co., 451 F.2d 3 (4th Cir. 1971) (inclusion of price in written contract with integration clause did not preclude parol evidence of trade usage that no firm price was set by the parties).
60. 796 F.2d 720 (4th Cir. 1986).
61. Id.
62. Id. at 721-22.
65. The provision states, in pertinent part:
   Provided that as to any action to which § 8.2-725 of the Uniform Commercial Code is applicable, that section shall be controlling except that in products liability actions for injury to person and for injury to property, other than the property subject to contract, the limitation prescribed in § 8.01-243 [five years] shall apply.
   Id. § 8.01-246 (Repl. Vol. 1984).
67. Id. at 366, 350 S.E.2d at 630.
limitations did not apply, because it did not go into effect until October 1, 1977.68 Since the Article Two cause of action was in warranty, it accrued on the date of tender of delivery—February 8, 1975.69 Thus, the warranty cause of action was not timely.70 However, since the negligence cause of action did not accrue until the injury occurred on July 20, 1977, and the applicable negligence limitations period was five years, the negligence cause of action was timely.71

D. Damages

Several cases made routine statements about Article Two damages. The first noted that, although absolute certainty is not required, there must be more than vague, indefinite and speculative evidence of damages to create a jury question.72 The second case reiterated the measure of damages for breach of warranty with regard to accepted but non-conforming goods; the difference, measured at the time and place of acceptance, between the actual value of the goods accepted and the value they would have had if they had been as warranted.73

The third case is rather more interesting. In Wharton, Aldhizer & Weaver v. Savin Corp.,74 the plaintiff purchased an allegedly defective photocopier from the defendant. Since the goods were accepted by the buyer, the measure of damages for their non-conformity to the contract was that noted just above, the difference between the value of the goods and the value they would have had if they had been as warranted. The only evidence presented by the plaintiff regarding the actual value of the photocopier was two vague statements made by partners in the plaintiff firm: "I guess I could graphically describe it this way. If the defendants offered it to us for fifty dollars, I would not want it. It has no value to our firm." and "[t]hat machine has absolutely no value to our firm or to me individually." The Virginia Supreme Court held that this evidence was entitled to no weight whatsoever; thus, as a matter of

68. Id. at 368-69, 350 S.E.2d at 631.
71. Id. at 369-70, 350 S.E.2d at 631-33.
75. Id. at 377, 350 S.E.2d at 636.
law, the plaintiff had failed to prove damages. This case is significant because it virtually requires a party attempting to prove the value of accepted goods to either sell the goods or to present expert testimony regarding their value.

III. Commercial Paper

A. Negotiability

One of the central concepts in Commercial Paper law is of course negotiability. Although virtually any document or obligation is transferable, only a few types of documents are negotiable, meaning that the document "embodies" rights extraneous to the document itself (e.g., the right to payment of money). To be negotiable, a writing must be in a particular form. With regard to drafts, such as checks, and notes, the form is that set out in Article Three of the Code. In general, Article Three requires the draft or note to be complete within its four corners; that is, to include all the terms necessary to express the obligation with no surplusage. Those bits of paper that do not meet the requirements of Article Three are not negotiable as that term is defined in Article Three and, with one very limited exception, drafts and notes that are not in Article Three negotiable form are not subject to the rules of Article Three.

Article Three negotiability is significant for a number of reasons. One of the most important is that the transferee of a negotiable instrument can become a "holder-in-due-course." Unlike most transferees, a holder-in-due-course can actually receive more than the transferor had; that is, the holder-in-due-course takes free of most defenses on, and all claims to, the instrument, even though the holder-in-due-course's transferor may have been subject to them.

Needless to say, there have been many reported cases interpreting virtually every one of the Article Three negotiability require-
ments. The Virginia Supreme Court added two more cases during 1986. Both cases were concerned with the requirement that, to be negotiable, the draft or note contain an unconditional promise or order to pay money and, more specifically, that the draft or note not incorporate any extraneous agreement. A note or draft may, on the other hand, refer to an extraneous document or agreement.

In Salomonsky v. Kelly, the court reviewed promissory notes that, by their terms, were “payable as set forth in that certain agreement dated March 15, 1976, an executed copy of which is attached hereto and made a part hereof by this reference.” The court held that the notes were non-negotiable, because the quoted statement incorporated, rather than merely referenced, the other document:

The distinction is between a mere recital of the existence of the separate agreement or a reference to it for information . . . and any language which, fairly construed, requires the holder to look to the other agreement for the terms of payment. The intent of the provision is that an instrument is not negotiable unless the holder can ascertain all of its essential terms from its face.

Since one essential term of a negotiable instrument is that it be payable on demand or at a definite time, the holder of the notes would have to look to the other document to determine exactly what was held. This in turn meant that the notes were non-negotiable.

The case is not controversial. However, some caution should be exercised in reading the statement that “an instrument is not negotiable unless the holder can ascertain all of its essential terms from its face.” There is nothing in the Code that prohibits the use of both sides of a page, or indeed multiple pages, in a negotiable instrument. What is prohibited is the incorporation of terms

81. Id. § 8.3-104(1)(b).
82. Id. § 8.3-105(2)(a).
83. Id. § 8.3-105(1)(b)-(e).
85. Id. at 263, 349 S.E.2d at 359 (emphasis omitted).
86. Id. at 264, 349 S.E.2d at 360 (emphasis omitted)(citing Va. Code Ann. § 8.3-105(c) comment 8).
88. 232 Va. at 264, 349 S.E.2d at 360.
89. Id.
from an independent document, even if that document is attached to the note or draft. This is a sensible rule if for no more esoteric reason than that the attached document might at some point become detached.

The second case, McLean Bank v. Nelson, provides a neat contrast to Salomonsky. In McLean Bank, a note was issued to the order of L. Blaine Liljenquist. Below the signature lines on the note appeared the following language:

This Note is hereby accepted this 20 day of June, 1974, pursuant to Paragraph 4 of the Contract of Settlement dated the 10th day of June, 1974, as to terms and amount.

Liljenquist signed below this statement.

The statement appeared to be a mere acknowledgement of receipt; the court noted that it was not an “acceptance” in the Article Three sense (that is, a promise by a drawee to honor a draft as if it were a note). Thus, the language was surplusage with no legal effect as regards the obligation expressed in the note itself. The court went on to say that, even if the acceptance was a part of the note, the statement “pursuant to Paragraph 4 of the Contract of Settlement dated the 10th day of June, 1974, as to terms and amount” was a mere reference, not an incorporation of an extraneous document.

The court’s decision is undoubtedly correct. Some question should be raised, however, about the court’s willingness to address an issue that was in no way necessary to the resolution of the case. Since the acceptance was irrelevant to the negotiability of the instrument, it was not necessary to determine whether the language it used was an incorporation or a reference. Thus, although the

90. 5 R. ANDERSON, supra note 4, § 3-104:5.
92. Id. at 422-23, 350 S.E.2d at 654.
93. Id.
94. Id. at 423, 350 S.E.2d at 654.
95. Id. at 429, 350 S.E.2d at 658. The court did not discuss explicitly whether the surplusage might have violated the requirement that the instrument contain no “promise, order, obligation or power” other than the promise to pay money and a few specifically permitted additional provisions. Id.; Va. Code Ann. §§ 8.3-104(1)(b), -112 (Add. Vol. 1965). This is not a serious problem, because that limitation relates only to promises, orders, obligations or powers given by the maker or drawer and the “acceptance” was made by the payee, not the maker. 232 Va. at 430, 350 S.E.2d at 658.
court explicitly stated that it was deciding on the basis of the incorporation issue rather than the relevancy issue, it is difficult to see the statement about incorporation as anything more than mere dicta.

B. Holder-In-Due-Course

As noted above, one of the major functions of negotiability is to permit certain transferees to be "holders-in-due-course." A holder-in-due-course is given special status by Articles Three and Four. The most significant, but by no means the only benefit, is that the holder-in-due-course takes free of so-called "personal" defenses of any party to the instrument. This means, for example, that a holder-in-due-course can recover on an instrument even though the maker, drawer, or other party had a defense such as failure of consideration, breach of warranty, or fraudulent inducement.

There is one major limitation on this freedom from personal defenses. The holder-in-due-course does not take free of defenses if the holder-in-due-course "dealt with" the person who is asserting the defense. The basic idea is that only a person who takes the instrument without participation in the underlying transaction should be able to escape defenses rooted in that transaction.

*Village Motors, Inc. v. American Federal Savings and Loan Association* explores the significance of the "dealt with" limitation. Village Motors, Inc. ("Village Motors") agreed to sell a car to Deondra Burnette ("Burnette") but required her to pay in cash or by a "bank check." American Federal Savings and Loan Association ("American Federal"), Burnette's bank, issued a check for the purchase price. It withdrew the amount from Burnette's account but drew the check in its own name. The drawee was United Virginia Bank; the payee was Village Motors.

Burnette was dissatisfied with the car. She returned it to Village Motors and asked American Federal to stop payment on the check. American Federal directed United Virginia Bank to stop payment,

97. *Id.* at 430, 350 S.E.2d at 658.
98. See *supra* note 79 and accompanying text.
100. *Id.*
102. *Id.* at 410, 345 S.E.2d at 289.
which it did. Village Motors sued American Federal and Burnette.\footnote{Id. at 411, 345 S.E.2d at 289.}

Village Motors claimed that it was a holder-in-due-course and, as such, took free of any personal defenses American Federal might have.\footnote{Id. at 411, 345 S.E.2d at 290.} It correctly noted that a payee can be a holder-in-due-course,\footnote{Va. Code Ann. § 8.3-302(2) (Add. Vol. 1965).} provided that the holder meets the basic statutory requirements, which are taking the instrument "for value," "in good faith," and "without notice" of claims or defenses.\footnote{Id. § 8.3-302(1).} Apparently Village Motors had no notice of the problems with the car at the time it took the check; in any event, both sides agreed that Village Motors was a holder-in-due-course.\footnote{Village Motors, 231 Va. at 411, 345 S.E.2d at 290.} The critical question was thus whether Village Motors had "dealt with" American Federal.

The Code is remarkably unhelpful on this point. The Official Comments specifically describe the Village Motors type of transaction as one in which a payee can be a holder-in-due-course.\footnote{Va. Code Ann. § 8.3-302 comment 2(a); see Village Motors, 231 Va. at 412, 345 S.E.2d at 290.} However, neither the comments nor the Code state whether such a payee takes free of the drawer's personal defenses. A smattering of pre-Code caselaw said that the payee did take free;\footnote{See, e.g., Boston Steel & Iron Co. v. Steuer, 183 Mass. 140, 66 N.E. 646 (1903); see also Poirier v. Morris, 118 Eng. Rep. 702 (Q.B. 1853).} at least two Code commentaries assume, without analysis, that the result would remain the same.\footnote{J. White & R. Summers, supra note 4, § 14-7, at 568; Note, The Concept of Holder in Due Course in Article III of the Uniform Commercial Code, 68 Colum. L. Rev. 1573, 1582 (1968).} Based on those commentaries, the court ruled that Village Motors took free of American Federal's personal defenses.\footnote{Village Motors, 231 Va. at 413, 345 S.E.2d at 291.}

What is missing from those commentaries is a rationale. Why should the payee take free of the defenses? Obviously, if Burnette had issued the check to Village Motors, it would have taken subject to her defenses. Why should the use of American Federal as a conduit change things?

One possible rationale is that American Federal was performing
a service comparable to that performed by the issuer of a letter of credit. The whole purpose of obtaining either a letter of credit or a "bank check" rather than a personal check is to ensure payment. The most obvious payment risk eliminated by use of a bank check is the risk that the check will be dishonored for lack of sufficient funds in the drawer's account. Village Motors permits payees to avoid another payment risk, customer dissatisfaction. The risk avoidance is narrow since the payee must qualify as a holder-in due-course which, among other things, means that the payee must not have had notice of the customer's dissatisfaction when it took the instrument. Thus, if Village Motors had notice that the car was a clunker, it would not have taken free of American Federal's defense.

This is all very well. However, the suggested theory does not adequately justify the imposition of the countervailing obligation on a perhaps unsophisticated consumer. No sound reason was advanced by the court or is perceived by this author for stripping the consumer of his or her ability to stop payment if the goods purchased prove unsatisfactory. It is a fair guess that most consumer buyers anticipate, as a part of their bargain, the right to stop payment on a check given for a lemon. There is no overwhelming reason why this expectation should not be honored. Thus, while the Village Motors rule is a sensible one in context of a commercial transaction, it should not have been applied to the facts of the Village Motors case.

C. Discharge

Two routine cases explored the provisions of Article Three relating to discharge of a party's obligation. The first of these, Gullette v. Federal Deposit Insurance Corp. involved a note that was stamped "paid by renewal." The Article Three issue was whether the stamped language cancelled the note and thus discharged obligors on the note. The relevant Code provision states:

112. See infra notes 132-161 and accompanying text.
113. VA. CODE ANN. § 8.3-302(1)(c) (Add. Vol. 1965). It should also be noted that Virginia has a very restrictive view as to what constitutes notice: "In any event, to constitute notice of a claim or defense, the purchaser must have knowledge of the claim or defense or knowledge of such facts that his action in taking the instrument amounts to bad faith." Id. § 8.3-304(7).
115. Id. at 490-91, 344 S.E.2d at 923.
The holder of an instrument may even without consideration discharge any party
(a) in any manner apparent on the face of the instrument or the indorsement, as by intentionally cancelling the instrument or the party's signature by destruction or mutilation, or by striking out the party's signature...

The court held that the “paid by renewal” language was not sufficient to evidence an intentional cancellation, but was rather an acknowledgement of the conditional payment of the debt by the issuance of a new note.

The second case illustrated an extremely basic, but extremely important, principle of commercial paper law. In Lambert v. Barker, William and Barbara Barker (“Barkers”) issued a note to Robert Davis (“Davis”). Davis indorsed and transferred the note to Katherine W. Lambert, trustee for Cecil-Waller & Sterling, Inc. (“Lambert”). Davis subsequently signed a fraudulent affidavit in which he stated that the note had been lost. In reliance on that affidavit, the amount owing on the note was paid to Davis. The court correctly held that this payment did not discharge the Barkers.

The reason is simple. The negotiable instrument “embodies” the right to be paid. Thus, payment of a negotiable instrument can only constitute a discharge if it is made to a holder. To be a holder, one must be in possession of the instrument. Davis was not in possession of the instrument at the time of the payment and thus was not a holder. To protect themselves, payors can (and should) demand production of the instrument and refuse payment until the instrument is produced or the payors are properly indemnified against the risk that the instrument still exists and has come into the possession of another holder.

117. Gullette, 231 Va. at 491, 344 S.E.2d at 923.
118. 232 Va. 21, 348 S.E.2d 214 (1986).
119. Id. at 22-23, 348 S.E.2d at 214-15.
120. Id. at 26-27, 348 S.E.2d at 216-17.
122. Id. §§ 8.1-201(20), 8.3-202(1).
123. Lambert, 232 Va. at 26, 348 S.E.2d at 216-17.
D. Statute of Limitations

The final case in this section of the Commercial Law Survey, Harris & Harris v. Tabler, merely reiterated a well-established principle regarding the statute of limitations. The cause of action against the maker of a demand note accrues the date of the note or, if the note is undated, on the date the note was issued. Thus, Virginia's five-year limitations period runs from the date of the note or its issuance.

IV. Bank Collection

The General Assembly made one minor change to Article Four. It amended section 8.4-106 to state that "A branch or separate office of a bank is a separate bank for the purpose of computing the time within which and determining the place at or to which action may be taken or notices or orders shall be given . . . ." Prior to this amendment, only branches that maintained their own deposit ledgers were treated as separate banks. This change will slightly increase the permissible time for some transactions by some banks.

V. Letters of Credit

Article Five, which governs letters of credit, is one of the most obscure parts of the Code. It engenders relatively little reported litigation, and tends to be the province of comparatively few lawyers. In part, this is because there is so little "law" involved in letters of credit. Both Article Five and the parallel Uniform Customs and Practice for Documentary Credits ("UCP") provide only a very brief sketch of the parties' rights and obligations. By and large, those obligations are determined by the letter of credit itself. However, there are some significant legal issues, and a re-

131. Id. § 8.4-106 (Add. Vol. 1965).
132. J. White & R. Summers, supra note 4, § 18-3, at 715-21; see also Va. Code Ann. § 8.5-102(3) which states:

This title deals with some but not all of the rules and concepts of letters of credit as such rules or concepts have developed prior to this act or may hereafter develop. The

Put simply, a letter of credit is an arrangement under which an “issuer” agrees to pay money to a “beneficiary” on behalf of a “customer” if and when the beneficiary meets the conditions set out in the letter of credit.\(^{134}\) For example, Seller Co. might be the beneficiary of a letter of credit issued by Sixth National Bank for Sixth National’s customer, Buyer, Inc. When and if Seller Co. presents Sixth National with a sight draft and a bill of lading covering the goods Seller Co. is shipping to Buyer, Inc., Sixth National will pay Seller Co. the amount of the sight draft (which of course is ordinarily the amount of the purchase price for the goods).

In *United Virginia Bank*, United Virginia Bank ("UVB") was the beneficiary of a letter of credit issued by The Bank of Alexandria ("Alexandria") to C. Michael Simpson ("Simpson"). The letter of credit was used not to pay for goods, but as a security device to ensure payment of certain loans.\(^{135}\) The letter of credit was in the amount of $39,900.\(^{136}\) It imposed, as a condition of payment, a requirement that UVB present several documents: a sight draft, the letter of credit, the promissory note it secured, and a demand letter.\(^{137}\) Demand had to be made prior to December 31, 1984.\(^{138}\)

There was a mistake in the letter of credit. At the bottom of the first page was an incomplete sentence fragment which began, "[a]ll drafts must be . . . ."\(^{139}\) The parties agreed that the sentence, if completed, would have said, "[a]ll drafts must be marked ‘Drawn under the Bank of Alexandria, LC #83-120, which expires December 31, 1984.’"\(^{140}\) They disagreed as to whether or not the parties had agreed to the inclusion of this additional term in the letter of credit.\(^{141}\)

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*fact that this title states a rule does not by itself require, imply or negate application of the same or a converse rule to a situation not provided for or to a person not specified by this title.*

133. 8 Va. Cir. 178 (Alexandria 1986).
135. 8 Va. Cir. at 178.
136. Id.
137. Id. at 179.
138. Id.
139. Id. at 182.
140. Id.
141. Id.
Sometime after the issuance of the original letter of credit, Simpson had Alexandria replace it with two $19,950 letters of credit. On December 6, 1985, UVB made demand under the original letter of credit, which Alexandria refused. Alexandria asserted that the $19,950 letters of credit replaced the $39,900 letter of credit and that the $39,900 letter of credit was invalid because of the error. UVB then demanded payment under the two $19,950 letters of credit which was refused by Alexandria on the ground that UVB failed to present the necessary documentation.

The court examined three major issues. First, was the original letter of credit supplanted by the subsequent letters of credit? Second, did UVB make effective demand on the letter of credit? Third, was UVB bound by the requirement that would have been contained in the incomplete sentence?

The first issue is the simplest. The credit was an “irrevocable” one, and once the beneficiary received an irrevocable letter of credit or an authorized written advice of its issuance, the credit could not be modified or revoked without the beneficiary’s consent. The reason is obvious: the letter of credit serves as a device to ensure payment of an obligation, and would be poor insurance indeed if the issuer and customer could freely change its terms or cancel it.

The second issue is also a fairly simple one. In essence, it is the degree of compliance with the terms of the letter of credit required for the beneficiary to receive payment. Must the beneficiary do exactly as the letter of credit demands, or is substantial compliance sufficient?

The problem is significant because of the nature of the letter of credit. The letter is a device designed to ensure an entirely separate transaction in which the issuer is in no way involved. The issuer thus has little information about the transaction and little opportunity to determine whether both parties are satisfied.

In consequence, a rule of strict compliance has evolved and been

142. Id. at 179.
143. Id.
144. Id.
145. Id.
146. Id. at 180; see VA. CODE ANN. § 8.5-106(2) (Add. Vol. 1965); U.C.P., Form and Notation of Credits Art. 3(e) (1974).
147. See United Va. Bank, 8 Va. Cir. at 181.
almost universally accepted. The beneficiary must do exactly what is required by the letter of credit. This in turn obligates the issuer to honor the letter of credit. This strict rule (a/k/a the “New York Rule”) was adopted by United Virginia Bank.

The third issue, which is related to the second, was the most difficult. UVB had complied with all the purported requirements for payment except, apparently, the requirement that would have been stated in the incomplete sentence. The drafts apparently did not include a specific reference to the letter of credit. If that requirement was part of the letter of credit, UVB was not entitled to payment.

The court held that the letter of credit was subject to the common-law parol evidence rule. Thus, extrinsic evidence of additional obligations could not be admitted unless the writing were incomplete or ambiguous. The court defined “complete” as meaning that the writing contained all of the material terms; in context of a letter of credit, it further refined “material terms” to mean all of the elements needed for enforceability. Since even without the incomplete sentence the letter of credit contained all the terms necessary for it to be enforced, the letter of credit was not an incomplete writing.

The court also rejected the assertion that the incomplete sentence created an ambiguity. It defined ambiguity narrowly, to mean a term that “‘admit[s] of two or more meanings [or] of being understood in more than one way, or of referring of [sic] two or more things at the same time.’” Since the provision in question was critically incomplete, the court held that it was “mere surplus-

148. J. White & R. Summers, supra note 4, § 18-6, at 731-32.
149. 8 Va. Cir. at 181.
150. Id.
151. Id. at 182. The court based this holding on the Code which states:
    Unless displaced by the particular provisions of this act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.
153. Id.
154. Id. at 183. The court further noted that the specific subject matter of the incomplete sentence (the terms of presentment) was dealt with elsewhere in the document, which further suggested that the document was not incomplete. Id. at 182.
155. Id. at 183 (quoting WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY (3d ed. 1976)).
age susceptible of no interpretation. It means absolutely nothing.\textsuperscript{156}

This extremely restrictive view of the parol evidence rule was justified by the court as a corollary of the strict compliance rule noted above.\textsuperscript{157} In other words, just as the beneficiary is obligated to comply strictly with the exact and explicit requirements of the letter of credit, the issuer is obligated to make the conditions it wishes to impose definite and clear.\textsuperscript{158} These paired requirements of precision and strict compliance were viewed by the court as central to the notion that the letter of credit is entirely independent of the obligation it facilitates.\textsuperscript{159} In any event, the court found the approach appropriate in light of the fact that Alexandria had drafted the letter of credit: “In essence, [Alexandria] urges this Court to read a condition into the credit which is not literally there and thereby permit [Alexandria] to profit from its own sloppy drafting and proofreading.”\textsuperscript{160}

In light of the nature of letters of credit, which are instruments used exclusively (or almost exclusively) by reasonably sophisticated businesses advised (one hopes) by reasonably sophisticated lawyers, the rigid structure adopted by the court is a thoroughly sensible one, even though its stated rationale is a bit debatable.\textsuperscript{161} The whole purpose of the letter of credit is to provide maximum predictability at minimum cost. The simplest and most efficient way to accomplish this twin goal is to do what the court in \textit{United Virginia Bank} did—limit the obligations of the beneficiary to those explicitly set out in the document that the parties designated as their contract and require perfect adherence by the beneficiary to those stated obligations.

\textsuperscript{156} \textit{Id.}

\textsuperscript{157} See supra notes 147-49 and accompanying text.

\textsuperscript{158} \textit{United Va. Bank}, 8 Va. Cir. at 183.

\textsuperscript{159} \textit{Id.}

\textsuperscript{160} \textit{Id.} at 184.

\textsuperscript{161} It is a bit difficult to see why the letter of credit cannot survive as an independent obligation even though its terms may require interpretation or permit substantial compliance. The independence of the letter of credit depends upon its separation from the underlying transaction, not upon any special rules regarding interpretation of the letter of credit itself.
VI. Bulk Sales

Article Six of the Code, which governs bulk sales, is even more of an orphan than Article Five. It is designed to protect creditors of a business that primarily sells from inventory when that business sells its assets to a third party. It does so by giving those creditors notice of the sale. However, in most states (including Virginia), Article Six gives no special substantive rights to the creditors to block or undo the transaction if the required notice is given. Thus, there is considerable doubt that it provides any effective protection to creditors. In any event, the Article has engendered very little reported litigation.

One issue that has cropped up with fair frequency is the applicability of Article Six. This breaks into two subdivisions: (1) the nature of the business; and (2) the nature of the transfer. Only businesses whose primary business is sale from inventory are covered. Even if the business is covered, the transaction is covered only if it is a “transfer in bulk and not in the ordinary course of the transferor’s business of a major part of the materials, supplies, merchandise or other inventory . . . ”

Thus, one interpretive issue is whether a “major part” of inventory can be less than half of the inventory. A ten-year-old, but just reported, Virginia circuit court opinion adopts the majority rule that “major part” means more than half of the inventory. The court further noted that this is a change in pre-Code Virginia law, under which the bulk transfer requirements applied, if “any part” of the inventory was sold out of the ordinary course of business.

VII. Secured Transactions

A. Formal Requisites of a Security Agreement

One of the purposes of Article Nine was to simplify the formalities involved in obtaining a security interest in personal property. Generally, the security interest is created—“attaches”—when

163. Id. at 767.
165. Id. § 8.6-102(1). Further, some such transfers are excluded. Id. § 8.6-103.
167. Id. at 519-20.
three events occur: (1) the debtor executes a written security agreement; (2) the debtor has or obtains rights in the collateral; and (3) the secured party gives value. The agreement can be extraordinarily simple. It only need contain “a description of the collateral and in addition, when the security interest covers crops growing or to be grown or timber to be cut, a description of the land concerned . . . .” Despite the simplicity of these requirements, careless drafting has led to a wealth of cases examining just how informal a security agreement can be.

In <em>Whitmore & Arnold, Inc. v. Lucquet</em>, France and Bruno Lucquet (“Lucquets”) executed two notes in favor of Farmers & Merchants National Bank of Hamilton (“bank”). The proceeds of the loans evidenced by the notes were used to purchase fertilizer and other goods from Whitmore & Arnold, Inc. (“Whitmore”). Both notes were endorsed by Whitmore. Both notes contained security agreements, one in a soybean crop, the other in a corn crop. In addition, each security agreement contained the following statement: “The collateral subject to this agreement is more particularly described on the front of this note, but may also be described and supplemented by other security agreements or financing statements executed by the Makers and/or Endorsers of this note.”

Shortly after the two notes were executed, the Lucquets signed, and Whitmore filed, a financing statement. The financing statement named Whitmore as “secured party” and “assignee of secured party.” It covered certain farm equipment and a wheat crop. Some time later, the Lucquets defaulted on the notes. Whitmore paid the balance due to the bank, at which time the bank assigned the notes and security agreements to Whitmore. Whitmore then sought to seize the equipment and wheat crop.

The question was a simple one: did the security interest attach to the equipment and the wheat crop, or only to the corn and soybean crops? The court noted that, ordinarily, two documents are used in a secured transaction—the security agreement document,
which satisfies the filing of which is one of the requisites for attachment, and the financing statement, the most common method of perfection. Attachment gives the secured party rights against the debtor; perfection protects those rights against most subsequent third-party claims. Since the two documents serve different functions, the courts have held that a financing statement, standing alone, is not a security agreement and thus cannot create a security interest. The more complex problem has been whether a financing statement, in conjunction with other documents evidencing agreement, can be sufficient to satisfy the Code's requirement of a written security agreement. The courts are split on this issue.

Whitmore & Arnold, Inc. at least partially adopts the better-reasoned view that, in appropriate circumstances, a financing statement can provide part of the necessary contents of the security agreement. Specifically, the court held that the statement in the security agreements permitting the addition of collateral in the financing statement was enforceable, especially in light of the fact that the Lucquets signed the financing statement as well. Thus, Whitmore had a security interest in the equipment and the wheat crop.

B. Sale of Farm Products

Last year, the General Assembly, responding to the federal Food Security Act of 1985, abolished the former “farm products exception” that left a purchaser of farm products from one engaged in farming operations subject to certain security interests in those farm products. This abolition meant that such purchasers would now take free of those security interests. To prevent naughtiness

175. Id.
177. Id. § 8.9-301.
180. The court left open the question of whether the requirements could be met by a group of documents, none of which were formally designated a security agreement. Whitmore & Arnold, Inc., 233 Va. at 110 n.4, 353 S.E.2d at 767 n.4.
181. Id. at 110, 353 S.E.2d at 767.
182. Id.
184. See generally Herbert, supra note 126, at 758-60.
by farmer-debtors, the General Assembly also strengthened a law which made the fraudulent conversion of farm product collateral larcenous. In 1987, the General Assembly returned to this problem and, as a result, inserted into Article Nine of the Code a few bits of criminal law and criminal procedure. It also has enacted a law that is, in at least several respects, probably unconstitutional, because it conflicts with the Food Security Act and thus violates the Supremacy Clause of the United States Constitution.

Nine new and original subsections were added to the statutory provision providing protection for buyers in ordinary course of business. They are designed to punish farmers who improperly sell farm product collateral, and to reinstate partially the farm product exception. In essence, these provisions limit (1) the persons to whom the seller can sell farm products and (2) the conditions under which a buyer can buy the farm products free and clear of the secured party’s security interest in them.

Four parties are identified: the secured party, "a debtor engaged in farming operations who gives a security interest in farm products . . . " [hereinafter "a farmer" or "the farmer"]; a buyer in ordinary course of business (a/k/a "a person buying farm products" [hereinafter the "buyer"]); and "a commission merchant or selling agent." If the commission merchant or selling agent "sells farm products in the ordinary course of business for a person engaged in farming operations" he or she is treated as a buyer for most, but not all, purposes.

Upon request of the secured party, the farmer must provide the

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185. Id. at 759 & n.71.
186. U.S. CONST. art. VI, cl. 2.
188. Presumably the secured party to whom the farmer has granted the security interest, although the provisions do not explicitly so state.
190. These terms are not defined in the Virginia Code, but are defined in the Food Security Act as follows: "The term 'commission merchant' means any person engaged in the business of receiving any farm product for sale, on commission, or for or on behalf of another person." 7 U.S.C. § 1631(c)(3) (Supp. 1985). "The term 'selling agent' means any person, other than a commission merchant, who is engaged in the business of negotiating the sale and purchase of any farm product on behalf of a person engaged in farming operations." Id. § 1631(c)(8).
191. It is not clear whether the person selling farm products referred to in this definitional subsection needs to be the farmer who has granted the security interest in the goods at issue.
secured party a written list identifying potential buyers and "points of delivery" of "the farm products." Presumably the farm products means the farm products subject to the security interest of the secured party. "If a potential buyer has more than one point of delivery, each additional point of delivery [counts] as a potential buyer" and must be included in the list. The Food Security Act permits the secured party to require a similar list from the debtor; however, the Food Security Act provision does not require the debtor to list points of delivery. Since the Virginia law adds only a minor, non-conflicting requirement to the Food Security Act, it may be permissible. However, the Food Security Act states that the security agreement must include the buyer list requirement; Virginia's law permits the secured party to impose this requirement on the farmer at any time, which probably conflicts unconstitutionally with the parallel provision of the federal law.

Once the farmer has provided the buyer list to the secured party, the farmer cannot sell farm product collateral to any buyer who is not on the list without the prior written consent of the secured party. This too is probably unconstitutional. The Food Security Act permits the farmer to make sales to unlisted buyers if the farmer either notifies the secured party of the unlisted buyer in writing at least seven days prior to the sale or accounts to the secured party for the proceeds of the sale within ten days after the sale is made.

The constitutionality of the Virginia buyer list requirements is likely to be challenged, because violation of those requirements by the farmer is a Class 1 misdemeanor. If the secured debt is paid

193. Id. § 8.9-307(5).
194. Id. This provision is redundant, since the farmer is already required by the preceding sentence in the subsection to include all points of delivery in the list.
196. Of course, even a non-conflicting state law may be unconstitutional under the Supremacy Clause if regulation of the entire matter at issue is preempted by federal law. The problem of implied preemption of non-conflicting state laws is a complex one, far beyond the scope of this article. For a short primer on the subject, see J. NOWAK, R. ROTUNDA & J. YOUNG, CONSTITUTIONAL LAW §§ 9.1-9.4 (3d ed. 1986).
197. 7 U.S.C. § 1631(h)(1).
199. Id. § 8.9-307(6).
201. Va. Code Ann. § 8.9-307(6) (Cum. Supp. 1987). Of course, the author hopes that due attention will be paid to the questions raised by this article and no such prosecutions will be attempted until the constitutional problems are resolved.
or the proceeds of sale are applied to the debt prior to the commencement of prosecution, however, the farmer has an absolute defense to the charge. Upon conviction, the court may grant probation, but only if it imposes restitution as a condition.

The secured party may notify anyone on the buyer list of its security interest, and may also notify other potential buyers if either the farmer so consents, the farmer fails to provide the list, or the secured party has reasonable cause to believe the debtor is about to sell farm product collateral to the person to whom the notice is sent. Unless the buyer and the secured party otherwise agree, the notice sent to the buyers must either comply with the provisions of the Food Security Act, be a valid financing statement, or be a statement that contains the full name and address of the debtor and secured party, a description of the collateral, the date and location of the filing of the financing statement, and “the date and signature [sic] of the secured party.”

If the debt secured by the security interest is paid and the farmer so requests, the secured party must notify each of the buyers that the debt has been satisfied. This notification must be given within twenty-one days of the farmer’s request. The notice termination provision does not state whether the twenty-one day period begins with the sending of the request by the farmer or its receipt by the secured party; presumably the latter.

The notice provision also violates the Food Security Act. Under the Act, additional information is required in the notice. For example, to be valid, the Food Security Act notice must include the social security number or taxpayer identification number of the farmer and a description of the property. The Food Security

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202. Id.
203. Id. The provision does not state whether restitution must be of the entire debt, the proceeds received, or some lesser amount.
204. Id. § 8.9-307(7).
205. Technically, “an original financing statement or a carbon, photographic or other reproduction of an original that is effective under § 8.9-402.” Id.
206. The “full name and address” is not defined. For example, it is unclear whether middle names must be spelled out.
208. Id. § 8.9-307(8).
209. Id.
210. 7 U.S.C. § 1631(e)(1)(A)(ii)(III). See also the parallel provision dealing with commission merchants and selling agents (they are not lumped together with buyers by the Food Security Act, although they are by the Virginia law). Id. § 1631(g)(2)(A)(ii)(III).
211. Id. § 1631(e)(1)(A)(ii)(IV); see also id. § 1631(g)(2)(A)(ii)(IV).
Act notice apparently must also include a description of any conditions imposed by the secured party for waiver or release of the security interest.\footnote{212} Nothing in the Food Security Act permits the substitute forms of notice permitted under Virginia law.

The purpose of the notice is to limit the ability of buyers to take free of the security interest. Under Virginia law, any buyer who receives the notice is required to make payment by check or other instrument which must be payable jointly to the farmer and the secured party.\footnote{213} There is one exception to this. If the farmer agrees in writing, the buyer may make payment directly to the secured party.\footnote{214} If the buyer fails to meet the joint check requirement, the buyer takes subject to the security interest.\footnote{215}

Again, this is probably invalid. The Food Security Act notice will also subject the buyer to the security interest, but the notice is effective against the buyer for only one year.\footnote{216} Moreover, the Food Security Act notice does not impose the joint check requirement on the buyer. Since, however, the joint check requirement at least does not contradict the Food Security Act, it may be permissible.\footnote{217}

Finally, the Virginia law imposes one restriction on most buyers (but not commission merchants or selling agents) that has no parallel in the Food Security Act. If the buyer withholds from the

\footnote{212}{Read literally, the relevant provision provides:}
A buyer of farm products takes subject to the security interest created by the seller if
... within 1 year before the sale of the farm products, the buyer has received from
the secured party or the seller written notice of the security interest organized ac-
cording to farm products that ... any payment obligations imposed on the buyer by
the secured party as conditions for waiver or release of the security interest ... .
\textit{Id.} § 1631(e)(1)(A)(v). This is gibberish of a level remarkable even in Washington. The pro-
vision should probably have been numbered § 1631(e)(1)(A)(ii)(V), which would have read:
A buyer of farm products takes subject to the security interest created by the seller if
... within 1 year before the sale of the farm products, the buyer has received from
the secured party or the seller written notice of the security interest organized ac-
cording to farm products that ... contains ... any payment obligations imposed on
the buyer by the secured party as conditions for waiver or release of the security
interest ... .
\textit{Id.}, see also \textit{id.} § 1631(g)(2)(A)(v).
\footnote{214}{\textit{Id.}}
\footnote{215}{\textit{Id.}}
\footnote{216}{7 U.S.C. § 1631(e)(1)(A); see also \textit{id.} § 1631(g)(2)(A).}
\footnote{217}{In any event, the Food Security Act apparently would permit the secured party to
impose this as a requirement for sale in the security agreement, and apparently would make
the condition binding on the buyer if it were disclosed in the notice given to the buyer by
the secured party. \textit{See supra} note 212 and accompanying text.}
farmer all or part of the proceeds of the sale to satisfy a debt owed by the farmer to the buyer, the buyer generally takes subject to the security interest. This limitation does not apply if the debt was secured by a perfected security interest that had priority over that of the secured party; nor does it apply if the debt was for the cost of harvesting, processing, storing, or marketing the farm products, or transporting them to market.218 Whether this provision passes muster or not depends upon the breadth of the Food Security Act’s preemption of the field.

Even if the constitutional problems did not exist, the General Assembly should be faulted for inserting the non-commercial farm product provisions in the Code. The Code of Virginia already suffers severely from a lack of organization and coordination, especially with regard to procedural matters. The insertion by the General Assembly of both criminal procedure and substantive criminal law into so unlikely a place as the Virginia’s Uniform Commercial Code reflects a lack of due concern for the ability of Virginians (or at least Virginia lawyers and judges) to find Virginia law. If and when the General Assembly returns to the farm product problem, it should more carefully place the commercial, criminal, and procedural provisions of its farm product law into the appropriate Titles of the Virginia Code.