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Annual Survey of Virginia Law: Commercial Law

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COMMERCIAL LAW

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I. Introduction

This survey of commercial law discusses all Supreme Court of Virginia cases interpreting Virginia's version of the Uniform Commercial Code (the "Code" or the "U.C.C.") during the previous year, as well as statutory changes made to the Code in the most recent session of the General Assembly. It also reviews significant Code cases decided in the Virginia circuit courts and in the various federal courts sitting in Virginia. It is current as of about May 1, 1990.

II. General Provisions (Article 1)

Article 1 of the Code contains various general provisions applicable to all or most Uniform Commercial Code transactions. Among these general provisions is the good faith requirement. Although there are a number of specific good faith requirements scattered throughout the Code, Article 1 sets out good faith as a basic principle applicable even in the absence of a specific requirement: "Every contract or duty within this act imposes an obligation of good faith in its performance or enforcement."[1] This obligation is central to the whole concept of contractual obligations under the Code. The parties to a U.C.C. contract are expected to act within the spirit of the contract. Thus, for example, understandings between the parties created by a usage of trade or a course of dealing are ordinarily as much a part of the contract as the explicit language.[2]

One of the issues arising under this general good faith requirement is whether the requirement is interpretive or substantive. In other words, does the general good faith requirement merely estab-

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1. Va. Code Ann. § 8.1-203 (Add. Vol. 1965).
2. *Id.* official comment; *id.* § 8.1-205.

lish a standard by which contractual obligations and the exercise of contractual rights are measured, or is it an independent obligation? If it is merely the former, then there is no cause of action for failure to act in good faith; good faith merely determines whether some specific express or implied contractual obligation has been properly performed and whether the enforcement of a particular contractual right was in fact permissible under the circumstances. If it is the latter, then there is a separate cause of action for the failure to act in good faith, even though the complaining party cannot point to any specific breach of the substantive terms of the contract. Obviously, adoption of this latter view opens up potentially broad and poorly defined avenues for litigation.

Until recently, it could safely be said that the courts nationwide had rejected the notion that good faith created a free-standing cause of action. However, in the past few years a number of courts have arguably adopted that very position, and have held that a party to a U.C.C. contract may seek court relief for the failure of the other party to act in good faith.[3] It is not clear that these cases are really as significant as they may appear to be at first blush; many of the cases could have been decided in much the same way under the traditional, more limited view of good faith. They may, however, be at least the opening wedge for more vigorous judicial policing of contract performance.

No such wedge exists in Virginia. A recent Virginia circuit court opinion squarely adopts the traditional rule that good faith is not an independent obligation, and thus there is no independent cause of action. Quoting an earlier federal case which examined Alabama law, the Virginia court said:

> Failure to act in good faith in the performance or enforcement of contracts or duties under [Alabama's U.C.C.] does not state a claim for which relief may be granted . . . . There is no indication, either in the text or the comments, that Section 1-203 was intended to be remedial rather than directive.[4]

The net result of all this is that, in Virginia, issues derived from

3. *See, e.g.*, Colorado Interstate Gas Co. v. Natural Gas Pipeline Co. of Am., 661 F. Supp. 1448 (D. Wyo. 1987) *rev'd in part and aff'd in part*, 885 F.2d 683 (10th Cir. 1989).

4. Central Virginia Bank v. Bell, 16 Va. Cir. 209, 211 (Chesterfield 1989) (quoting Management Assistance, Inc. v. Computer Dimensions, Inc., 546 F. Supp. 666, 677 (N.D. Ga. 1982)).

the Code's general good faith requirement will continue to be determined only in the context of disputes over other contract terms.

III. Sales (Article 2)

A. *Statute of Frauds—The Admissions Exception*

Section 8.2-201(3)(b) of the Code[5] contains a significant limitation on the general requirement that contracts for sales of goods must be evidenced by a writing if the price is $500 or more. Even if there is no writing, the oral agreement will be an enforceable contract if the existence of the agreement has been admitted in litigation:

> A contract which does not satisfy the [writing] requirements of subsection (1) but which is valid in other respects is enforceable
>
> . . . .
>
> (b) if the party against whom enforcement is sought admits in his pleading, testimony or otherwise in court that a contract for sale was made, but the contract is not enforceable under this provision beyond the quantity of goods admitted. . . .[6]

This "admissions exception" to the statute of frauds has sparked a great deal of discussion in the cases and the law reviews over the years. However, it has not resulted in reported litigation in Virginia. Thanks to W. Hamilton Bryson's *Virginia Circuit Court Opinions*, a rather old but very useful admissions exception case has now been unearthed.

Climatemakers, Inc. v. Bryant Heating and Air Conditioning, Inc.[7] involved an alleged oral agreement between Climatemakers and Bryant, pursuant to which Bryant was to supply heating and air conditioning equipment. Bryant noted that there was no writing sufficient to satisfy the statute of frauds. Climatemakers argued that there was an admission by Bryant sufficient to permit the oral agreement to be enforced.[8] The court agreed.

The important point in the case is that the witness for Bryant

5. Va. Code Ann. § 8.2-201(3)(b) (Add. Vol. 1965).
6. *Id.*
7. 16 Va. Cir. 418 (Norfolk 1970). Note that the reported version incorporates two decisions—the first overruled a demurrer; the second decided the merits of the case.
8. *Id.* at 418-19.

never said in so many words "we had a contract" or "we had an agreement." Indeed, it appears that there may have been some minor details of the agreement left to be ironed out.[9] However, the clear indication of the testimony as a whole was that a deal had been struck, even though some aspects of it may have been left open.

This is significant for two reasons. First, it is reflective of the nature of Article 2 contracts. It is *not* necessary that all terms of the contract be settled in advance; the fact that terms—even significant terms—may be left open or left fluid does not prevent the creation of a contract.[10] Second, the admissions exception is triggered by a showing that an agreement had in fact been struck—even if the word agreement or contract is never used.

One aspect of the case is less clear and more controversial: it appears that the case was tried on the merits. It is not at all clear that the admissions exception should be read to permit a plaintiff to force a trial in the hope that an admission might be elicited at trial. The case law in other states is divided.[11] Indeed, some courts have held that a plaintiff's oral contract case should be dismissed if the defendant states under oath that there was no oral agreement. For example, one widely cited case held that an oral contract cause of action could not go forward once the defendant submitted an affidavit in which she denied that an oral agreement had been made.[12] There the court was concerned that the purpose of the statute of frauds would largely be lost if a plaintiff was able to force trial on the merits on the mere hope that the defendant might eventually admit to the existence of the agreement.[13] Since the issue is not directly discussed in *Climatemakers*, the question remains an open one in Virginia.

B. *Privity of Contract*

One of the major traditional limitations on recovery for breach of contract is the requirement of privity. In general, the only persons who can sue on a contract are those who are parties to the contract or who have succeeded to the rights of parties to the con-

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9. *Id.* at 420-22.
10. VA. CODE ANN. § 8.2-204(3) (Add. Vol. 1965).
11. *See* J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE 84-86 (3d ed. 1988).
12. DF Activities Corp. v. Brown, 851 F.2d 920 (7th Cir. 1988).
13. *Id.* at 922-23.

tract. Generally speaking, incidental third party beneficiaries of contracts have no rights under the contract; they cannot recover for breach, even though they have been indirectly injured by the breach.[14]

This traditional rule has largely been limited or abolished insofar as products liability is concerned. Third parties who have been injured by defective products can in many circumstances recover from the retailer, distributor or manufacturer. In Virginia, privity is generally not a defense with regard to breach of Article 2 warranties[15] or for any action for personal or property damage caused by negligence.[16]

This leaves the traditional structure intact for most suits in which the plaintiff seeks recovery for economic loss. In *Apac-Virginia, Inc. v. Department of Highways & Transportation,*[17] the Court of Appeals of Virginia reaffirmed this. In *Apac-Virginia,* a general contractor sought to recover from the Department of Highways and Transportation additional compensation allegedly owed by the Department to a subcontractor.[18] (The case gives no reason why the contractor, rather than the subcontractor, sought the recovery). The court held that the relevant statute did not permit non-privity plaintiffs to recover, because *unlike* section 8.2-318, it did not *expressly* eliminate the privity requirement.[19]

C. *Duration of Express Warranties; Statute of Limitations*

Under Article 2, the general statute of limitations period is four years.[20] The time at which the four year period begins to run, however, varies. Usually the time period begins to run when the seller tenders delivery of the goods.[21] However, if the seller makes a warranty which explicitly extends to *future* performance of the goods, and a breach of the warranty cannot be detected until such performance occurs (or more likely does not occur), then the four year

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14. An extended discussion of the current state of the law of third party beneficiaries can be found in a recent Supreme Court of Virginia case, Copenhaver v. Rogers, 238 Va. 361, 384 S.E.2d 593 (1989).

15. VA. CODE ANN. § 8.2-318 (Add. Vol. 1965).

16. *Id.* § 8.01-223 (Repl. Vol. 1984).

17. ___ Va. App. ___, 388 S.E.2d 841 (1990).

18. *Id.* at ___, 388 S.E.2d at 842.

19. *Id.* at ___, 388 S.E.2d at 842-43.

20. VA. CODE ANN. § 8.2-725(1) (Add. Vol. 1965).

21. *Id.* § 8.2-725(2).

period does not begin to run until the breach of warranty is or should have been discovered by the buyer.[22] This means that the effective limitations period for certain express warranties is much longer than it is for other Article 2 promises.

Two Virginia cases touched on these issues during the last year. A Supreme Court of Virginia case, *Luddeke v. Amana Refrigeration, Inc.*,[23] discusses the issue but was actually decided on defects in the buyers' pleadings. A Virginia circuit court case, *Ukrop's Super Markets, Inc. v. U.S. Mineral Products Co.*,[24] deals with what statements by a seller are warranties of future performance.

In *Ukrop's*, the seller stated that roofing material it sold "will give long-term performance for years beyond our guarantee."[25] The court held that this statement was too vague to constitute a warranty of future performance.[26] The question is one which has caused considerable division of authority in other states. Some out-of-state courts, like the *Ukrop's* court, require fairly definite statements regarding future performance; others do not. One of the most intriguing cases in the latter category dealt with a description of goods as "[house] siding." It held that, since everyone expects house siding to last for the life of the house, the mere use of the term "siding" to describe the goods created a warranty of future performance.[27]

IV. Personal Property Leases (Article 2A)

Several years ago, the National Conference of Commissioners on Uniform State Laws ("National Conference") and the American Law Institute ("ALI") promulgated a new U.C.C. Article to cover leases of personal property. Article 2A has had considerable problems in the state legislatures, largely because of perceived deficiencies in the official draft.[28] Because of this, it has been adopted by only a few states, and has undergone extensive unofficial revi-

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22. *Id.*
23. 239 Va. 203, 387 S.E.2d 502 (1990).
24. 17 Va. Cir. 368 (Richmond 1989).
25. *Id.* at 368.
26. *Id.*
27. Moore v. Puget Sound Plywood, Inc., 214 Neb. 14, 332 N.W.2d 212 (1983). For a discussion of this issue, see Herbert, *What's in a Name?: The Implied Content of Express Warranties*, 12 U. Dayton L. Rev. 297 (1986).
28. The author's favorite discussion of these deficiencies can be found in Herbert, *A Draft Too Soon: Article 2A of the Uniform Commercial Code*, 93 Com. L.J. 413 (1988).

sion. Since the latter part of 1989, Article 2A has been under review in Virginia by a joint committee of the Virginia State Bar and the Virginia Bar Association. The tentative conclusions of that committee are that Article 2A does indeed need revision and that Virginia should to a large degree conform its revisions to those promulgated in the most important commercial states.

Recently, the National Conference has agreed to make sweeping amendments to the Official Text of Article 2A. (It is assumed that the ALI will accept the National Conference's amendments.) These amendments reflect many of the amendments already proposed by the various states and improve upon them in some respects. It appears likely that many major commercial states, such as New York, will accept these official amendments or something very like them.

If this occurs within the reasonably near future, there is a significant possibility that the General Assembly will consider Article 2A, with its official amendments, in the 1991 session. Although it is not possible to predict the likelihood of passage, it is unlikely that there will be organized opposition. Thus, there is a good chance that Virginia will soon adopt Article 2A.

V. Commercial Paper (Article 3)

A. *Definition of a Note*

Article 3 contains a complex set of rules defining negotiable instruments. As a general rule, Article 3 only applies to two particular kinds of documents, "notes" and "drafts." A 1989 Supreme Court of Virginia case, in the midst of untangling a number of insurance law questions, briefly addressed the definition of an Article 3 note.

CUNA Mutual Insurance Society v. Norman[29] involved a dispute over credit life insurance. One of the issues presented was whether or not an extension agreement executed by a debtor was an Article 3 promissory note. The extension agreement merely said, "I, Robert Norman do agree to pay off my share secured loan on October 1, 1982."[30] The court correctly held that the document was not an Article 3 note.[31] The court did not state specifically why

29. 237 Va. 33, 375 S.E.2d 724 (1989).
30. *Id.* at 35, 375 S.E.2d at 725.
31. *Id.* at 37-38, 375 S.E.2d at 726.

it was not a note; however, at a minimum it was fatally deficient because it failed to state the sum of money Norman was to pay.[32]

B. *"Payment in Full" Checks*

When two parties to a contract have a dispute over the total amount owed by one party to the other, the party who owes money will sometimes send the other party a check which includes language to the effect that the check is "payment in full" for the disputed obligation. Typically, the check is in the amount which the sender believes it owes, not the amount which the recipient believes it is owed. Numerous cases have held that if the recipient cashes or deposits the check, there may be an accord and satisfaction which discharges the disputed obligation.[33] This may be so even if the recipient endorsed the check with words such as "under protest" or "with reservation of rights."[34]

In *John Grier Construction Co. v. Jones Welding & Repair, Inc.*,[35] the Supreme Court of Virginia ruled on a related issue: does the Code rewrite the basic contract rules of accord and satisfaction? John Grier Construction and Jones Welding were arguing over the amount which Grier owed Jones Welding for work done on a construction project. Grier sent Jones Welding a check for the amount it admittedly owed. On the back of the check it put "these monies reflect payment in full on the Carillon project."[36] Jones Welding deposited the check in its bank account.[37]

Ordinarily, the fact that Jones Welding had deposited the check would trigger discharge of the debt.[38] However, it did not do so in this case because Jones Welding (which deposited the check without endorsement) *did not know* that the "full payment" language

32. VA. CODE ANN. § 8.3-104(1)(b) (Add. Vol. 1965). It is also likely, but less certain, that the document would not be found to be in either order form or bearer form. *Id.* § 8.3-104(1)(d). It is also possible, although unlikely, that the language regarding payment would not be construed as an unconditional promise to pay. *Id.* § 8.3-104(1)(b).

33. J. WHITE & R. SUMMERS, *supra* note 11, at 607-08.

34. Most, but by no means all, courts have held this. *See* Rhone v. State Auto Mut. Ins. Co., 858 F.2d 507 (11th Cir. 1988); Ennia Gen. Ins. Co. v. Auld, 506 So. 2d 62 (Fla. Dist. Ct. App. 1987); Weidensaul v. Greenhouse Restaurant of Lawrence, 13 Kan. App. 2d 95, 762 P.2d 196 (1988); White & Summers, who do not like the majority rule, persist in ignoring it. J. WHITE & R. SUMMERS, *supra* note 11, at 608-10.

35. 238 Va. 270, 383 S.E.2d 719 (1989).

36. *Id.* at 271-72, 383 S.E.2d at 720.

37. *Id.*

38. *See id.* at 270, 383 S.E.2d at 719.

appeared on the back of the check.[39] In the court's view, an accord and satisfaction requires a conscious relinquishment of the claim. Since the offeree, Jones Welding, was not aware of the fact that an accord was being offered, the mere fact that it deposited the check did not create a contract. "[M]utual assent was lacking, and the parties could not have reached an accord."[40] Nothing in the Code changes the basic contract principles underlying accord and satisfaction.[41]

Grier also argued that there should have been an accord and satisfaction because, even if Jones Welding never saw the "full payment" language, its bank did. This argument is based on section 8.4-205, which makes a bank its customer's agent for the purpose of endorsing a check deposited in the customer's account.[42] Grier argued that this agency relationship should result in imputing the *bank's* knowledge of language on the back of the check to its principal, Jones Welding. The court properly rejected this argument, noting that the scope of the bank's agency under section 8.4-204 is very limited—it exists only for the purpose of facilitating collection of checks.[43]

The only quibble one might have with the *John Grier Construction* decision is that it does not deal with the possibility that Jones Welding could have known that the check was an offer of an accord even if it did not read the writing on the back of the check. If two parties are involved in a dispute, and one party sends the other a check for the exact amount it says it owes, it is arguable that the recipient understands that this is an offer of an accord. The facts stated in the *John Grier Construction* decision, however, do not suggest that Jones Welding should have known that the check was an offer of an accord. Jones Welding's claim was for three separate change orders. Grier admitted that it owed Jones Welding for the amount claimed on one of the three change orders, but not for the other two.[44] The fact that Jones Welding received payment for one of three somewhat independent claims severely undercuts any argument that it should have known what Grier was

39. *Id.* at 271-74, 383 S.E.2d at 720-22. There is no reason to believe that Jones Welding was disingenuous about its lack of knowledge; both parties stipulated that Jones Welding was unaware of the "full payment" language. *Id.* at 272-74, 383 S.E.2d at 721.

40. *Id.* at 271-74, 383 S.E.2d at 720-21.

41. *Id.* at 271-74, 383 S.E.2d at 721-22.

42. VA. CODE ANN. § 8.4-205(1) (Add. Vol. 1965).

43. 238 Va. at 273 n*, 383 S.E.2d at 721 n*.

44. *Id.* at 271-72, 383 S.E.2d at 720.

doing. However, in cases which involve a single, indivisible claim, a court might well conclude that the recipient of a check for an amount equal to the undisputed part of the claim knew that the sender was offering an accord.

C. *Discharge by Reason of Fraudulent, Material Alteration*

If a party to a negotiable instrument alters the instrument in a way that is both material and fraudulent, any party whose contract is changed by the alteration is discharged.[45] In other words, suppose that A makes a note in the amount of $1,000 and negotiates it to B. B alters the amount of the note to $10,000. A is no longer obligated to pay even the original $1,000 (unless the instrument reaches the hands of a holder in due course).[46]

In *Business Bank v. Plank*,[47] the court examined, at some length, the standard for determining whether an alteration is "fraudulent." The case involved a promissory note which had been altered by the addition of a "cognovit" (confession of judgment) provision.[48] The specific question before the court was whether "fraudulent" as used in the discharge statute requires "actual" fraud or merely "constructive" fraud; that is, whether the mere fact that the holder attempted to add an obligation to the note is fraud or whether the holder had to have deceitful intent. The court reviewed the relevant Virginia and non-Virginia precedents, and ruled that Virginia conformed to the majority rule, which is that there must be a showing of actual fraud—that is "dishonesty or deceit"—to trigger discharge.[49] Thus, the mere fact that an obligation on a negotiable instrument has been changed does not discharge the obligor.

D. *Forthcoming Statutory Changes*

The National Conference and the ALI are completing work on extensive amendments to Articles 3 and 4. These amendments, if and when adopted in Virginia, will make significant changes to many existing rules regarding checks, drafts and the bank collection process when the amendments are presented to the General

45. VA. CODE ANN. § 8.3-407(2) (Add. Vol. 1965).
46. *Id.* § 8.3-407(3).
47. 710 F. Supp. 619 (E.D. Va. 1989).
48. *Id.* at 620.
49. *Id.* at 621-22.

Assembly, they will be reviewed in a future edition of this annual survey.

VI. Wire Transfers (Article 4A)

The General Assembly has adopted new Article 4A, which deals with the "wire transfer" (more accurately, electronic transfer) of money. This new article deals primarily with wholesale commercial transfers of money through electronic media.[50] Although the amount of money involved is immense,[51] the number of lawyers who will need to be concerned with the new Article is small, especially because it excludes most aspects of consumer transactions.[52] Because of this, and because a discussion of Article 4A's complexities would push the length of this survey article beyond acceptable limits, it is not discussed further. However, if and when significant cases are decided under Article 4A, they will be included in future editions of this annual review.

VII. Secured Transactions (Article 9)

A. *Sale of Collateral; Deficiency Judgments*

Article 9 imposes only two basic obligations on a secured party who seeks to sell its collateral. In most cases, notice of the sale must be given to the debtor.[53] In addition, the sale must be commercially reasonable.[54]

Previous editions of this survey have discussed whether a breach by the secured party of either of these obligations precludes the secured party from obtaining a deficiency judgment against the debtor. Out-of-state courts are divided, and the Supreme Court of Virginia has not ruled on the issue. The consensus of opinion among federal courts in Virginia and its circuit courts is that Virginia would follow an "intermediate" rule. Under this rule, if the secured party breaches either of its duties, it is presumed that the collateral was worth the amount of the debt. This creates a presumption that the secured party should have received enough money to cover the debt in full, and if it did not, the loss occurred

50. U.C.C. Article 4A Prefatory Note (1989).
51. About one trillion dollars per day is transferred by wire. *Id.*
52. Va. Code Ann. § 8.4A-108 (Cum. Supp. 1990).
53. *Id.* § 8.9-504(3).
54. *Id.*

through its own fault. If the secured party fails to rebut the presumption, it cannot get a deficiency judgment against the debtor; if it does rebut the presumption it can get a deficiency judgment.[55]

There is now further support for the proposition that the intermediate rule is the law in Virginia. In a narrow opinion, the Federal Bankruptcy Court for the Western District of Virginia held that the intermediate rule (also known as the "no harm no foul" rule) would be applied if (1) the only violation of the secured party's duty was the failure to give notice, and (2) there was no indication that the failure to give notice did any harm.[56] This of course leaves open the possibility that in different circumstances a *per se* denial of a deficiency judgment might be appropriate.

A Virginia circuit court case, *Chrysler Credit Corp. v. Fabrizio*,[57] also provides some support for the intermediate rule. More interesting, however, was the court's ruling that, to obtain a deficiency judgment, the secured party must put on detailed evidence regarding the notice and the method, manner, time, place and terms of the sale.[58] The case was apparently an uncontested one, since the only evidence presented was an affidavit of the plaintiff.[59] The court was, quite properly, unwilling to enter a judgment based solely on unsupported conclusory statements in the affidavit.

B. *Formal Sufficiency of Financing Statements*

Article 9's rules regarding the content of financing statements are emphatically non-technical. Only a few requirements are imposed, and even these are read loosely. The only purpose of the financing statement is to give notice and initiate inquiry. As long as that purpose is met, the financing statement is adequate, even if it contains minor errors.[60]

A recent Fairfax County Circuit Court case contains a helpful discussion of the basic philosophy underlying Article 9 financing statements. *Teel Construction, Inc. v. Lipper, Inc.*[61] examined an erroneous financing statement filed by Riggs National Bank on

55. See Herbert, *Commercial Law: Annual Survey of Virginia Law*, 23 U. RICH. L. REV. 523, 538-39 (1989).
56. *In re* Parrish, 110 Bankr. 229, 231-32 (W.D. Va. 1989).
57. 17 Va. Cir. 181 (Fairfax 1989).
58. *Id.* at 183.
59. *Id.* at 181.
60. VA. CODE ANN. §§ 8.9-110, -402(8) (Cum. Supp. 1990).
61. 18 Va. Cir. 397 (Fairfax 1990).

property of Lipper which was claimed by Teel. The financing statement had two errors. It misstated the debtor's address.[62] It also incorporated the incorrect address (which did not in fact exist) in its description of collateral.[63] The court correctly held that neither error was fatal.

C. *Formal Sufficiency of Security Agreements*

The Article 9 rules regarding the formal sufficiency of security agreements are about as loose as those regarding financing statements. There are some limits, however, and these were explored in *Moore v. First Virginia Bank—Damascus*.[64] In 1987, Zane Moore and Nina Moore executed a $7,000 note and security agreement under which they granted First Virginia Bank a security interest in a bulldozer. In 1988, Zane Moore borrowed $2,504.29 from the bank and executed a note. The second note included a preprinted section headed by the words SECURITY INTEREST. Beneath the heading was a block for a checkmark and a space to describe collateral. The block was not checked and no collateral was described. There was, however, another block which contained a preprinted "X" beside the following phrase: "property securing other loans with you may also secure this loan."[65] The same language and the same preprinted "X" appeared in the first note as well.[66] This language is referred to in this article as the "catchall" language.

The bank argued that the second note was secured on two alternative theories. First, the bank argued that the catchall language in the first note meant that the original security interest covered future advances (such as the $2,504.29 loan). Second, it was argued that the catchall language in the second note incorporated by reference the description of collateral in the first note.[67] The court rejected both arguments.[68]

62. *Id.* at 397.
63. *Id.* at 397, 400.
64. 16 Va. Cir. 111 (Washington 1989).
65. *Id.* at 111-12.
66. *Id.*
67. There was also language on the back of the note which granted a security interest in accessions. The court properly held that this added nothing to the bank's basic argument, since, unless the document was sufficient to create a security interest in some original collateral, there could be no security interest in accessions to the original collateral. *Id.* at 117.
68. *Id.* at 114-17.

The court was probably correct. The requirements for a security interest are a statute of frauds; they are intended to provide written evidence that the debtor agreed to give collateral for an obligation. The writings were, at best, extremely ambiguous. Nothing was typed or handwritten on the form which indicated that collateral was given to secure the second note. The only indication that collateral was taken appeared in preprinted form. Moreover, it appears that the form used was not merely for secured loans, but rather for both secured and unsecured loans.[69] It was thus at best unclear from the documents whether the bank asked for collateral, let alone whether the debtor agreed to provide it. In addition, Zane Moore's intent could not be determined by oral evidence—he was dead.[70] While that fact does not formally enter into the court's reasoning, it underscores the policy underlying all statutes of frauds—that certain contracts should not be established solely on the oral testimony of one party.

D. *Effect of Negligent Release of Collateral on Co-obligor*

In *Central Virginia Bank v. Bell*,[71] discussed above,[72] Bell and Harlan had obtained credit from Central Virginia Bank. The debt was secured by Bell's truck. When Bell and Harlan defaulted, the bank repossessed the truck, then subsequently returned it to Bell, who absconded with it.[73]

Harlan argued that the bank had been negligent in returning the truck to Bell. This type of issue usually arises under the Article 3 provisions dealing with the rights of accommodation parties and other sureties; in general, an unjustified impairment of collateral (which the bank's actions might have been) will discharge any surety.[74] However, it appears that Harlan was not a surety but rather a co-principal. It is well-established in most courts that co-principals do not have the benefit of the Article 3 rules regarding impairment of collateral.[75] Consequently, Harlan asked for relief

69. For example, the provision relating to accessions, discussed *supra* note 67, was contained in a section captioned "ADDITIONAL TERMS—SECURED LOANS ONLY." *Id.* at 117. The wording of the caption indicates that the form had a dual secured/unsecured loan function.

70. *Id.* at 111.

71. 16 Va. Cir. 209 (Chesterfield 1989).

72. *See supra* note 4 and accompanying text.

73. 16 Va. Cir. at 209.

74. VA. CODE ANN. § 8.3-606(1)(b) (Add. Vol. 1965).

75. *See* J. WHITE & R. SUMMERS, *supra* note 11, at 588-90.

under section 8.9-207, which imposes upon a secured party in possession the obligation of due care. This provision states, in part: "(1) A secured party must use reasonable care in the custody and preservation of collateral in his possession. . . . (3) A secured party is liable for any loss caused by his failure to meet any obligation imposed by the preceding subsections but does not lose his security interest."[76]

Generally, the secured party's duty under this provision has been limited to the preservation of the physical integrity of the collateral.[77] However, there is some support for the proposition that it can be used to protect a co-obligor from the secured party's improper return or release of the collateral.[78] The *Central Virginia Bank* court adopted this rule and held that the bank could be liable to Harlan for any damages caused by negligent return of the truck to Bell.[79]

E. *Changes in Filing Office Procedures*

One of the eternal complaints of commercial lawyers is the difficulties encountered in dealing with filing offices. Generally, a secured party who has filed proper financing statements in the right places is protected against third party claimants, even if the financing statements get lost in a bureaucratic morass. Potential buyers and prospective lenders hope to find any financing statements that are filed on the goods they want to buy or lend against, so that they do not subsequently discover that Friendly Finance or Bob's Bank has rights superior to theirs. Tracking those financing statements down, however, can occasionally be quite a challenge.

While it is undoubtedly true that the Commonwealth's filing offices are the envy of the world, the General Assembly in 1990 tinkered with a few provisions of Article 9 for the purpose of facilitating access to Article 9 filings. The new requirements are:

1. The index of financing statements must now include the year in which each financing statement was filed;[80]

2. All subsequent filings which affect the initial filing must be

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76. VA. CODE ANN. § 8.9-207(1), (3) (Add. Vol. 1965).
77. *See, e.g.*, Tepper v. Chase Manhattan Bank, 376 So. 2d 35 (Fla. Dist. Ct. App. 1979).
78. Signer v. First Nat'l Bank & Trust, 455 F.2d 382 (6th Cir. 1971).
79. 16 Va. Cir. 209, 212 (Chesterfield 1989).
80. VA. CODE ANN. § 8.9-403(4) (Cum. Supp. 1990).

indexed in the same manner as the initial financing statement. These subsequent filings include continuation statements, termination statements, assignments, and releases of collateral;[81] and

3. Financing statements (which generally lapse five years after they are filed) must be retained for at least one year after they lapse or are terminated, and must be retained after that one year period if "litigation is threatened or pending and written notice [of the litigation] has been filed with the court."[82]

There are two obvious purposes for these reforms. First, they help insure that changes in initial filings can be traced. Second, they provide for longer retention of existing filings. The latter is significant because a filing may still be important even if it has lapsed; e.g., in litigation relating to a pre-lapse disposition of the collateral by the debtor.

81. *Id.*; *see also id.* §§ 8.9-404(2), -405(2), -406(1).
82. *Id.* § 8.9-403(7).