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## Commercial Law (1959)

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SMALL SCHOOL.  
BIG VALUE.

# COMMERCIAL LAW

FREDERICK M. HART

COMMERCIAL law is not particularly vulnerable to explosions. Most cases are routine, or, at best, require the extension of settled doctrines to novel situations created by the ingenuity of aggressive businessmen struggling to maintain their existence in face of fierce competition. Codification has also played its part in stabilizing the law in this area.

Occasionally, however, litigants cry for the reexamination of a doctrine, claiming that it has outlived its usefulness and no longer mirrors reality. This is first seen in lower court cases. If the inferior courts are convinced that the cause is worthy, eventually one or more of the cases will reach the Court of Appeals.

The fuse to the bomb has been lit in New York for several years. It has now burned to its end. The issue: should privity of contract remain a requirement in warranty actions? The Court of Appeals' answer: still unknown.

## I

### SALES

Following the pattern of previous years, a sizeable proportion of the reported sales cases involved warranties. Although the most dramatic development in 1959 was the striking reversal of the recent trend discarding the privity requirement, several other interesting questions were also presented which indicate that privity of contract is not the only unsettled problem in warranty actions. Last to be discussed are the nonliability cases, the most important of which is one involving the Statute of Frauds.

*Vendor's Liability—Warranties—Privity.*—Last year's *Survey*<sup>1</sup> discussed at some length lower court decisions vehemently denouncing the "archaic notion that privity [of contract] is an essential to recovery in a breach of warranty action."<sup>2</sup> One of these, *Greenberg v. Lorenz*,<sup>3</sup>

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<sup>1</sup> 1958 *Survey of N.Y. Law*, 33 N.Y.U.L. Rev. 1146, 1153. For additional comments on the privity question during the past year, see Condon, *Progress of Products Liability Law*, 31 N.Y.S.B. Bull. 119 (1959); 23 Albany L. Rev. 451 (1959); 8 Buffalo L. Rev. 290 (1959); 44 Cornell L.Q. 608 (1959); and 9 Syracuse L. Rev. 326 (1958).

<sup>2</sup> *Parish v. Great Atl. & Pac. Tea Co.*, 13 Misc. 2d 33, 64, 177 N.Y.S.2d 7, 38 (N.Y.C. Munic. Ct. 1958).

<sup>3</sup> 14 Misc. 2d 279, 178 N.Y.S.2d 404 (N.Y. City Ct. 1957), modified, 12 Misc. 2d 883, 178 N.Y.S.2d 407 (Sup. Ct., App. T., 1st Dep't 1958), rev'd, 7 App. Div. 2d 968, 183 N.Y.S.2d 46 (1st Dep't 1959). The following cases also denied recovery on warranty

had reached the appellate term in the first department where a divided court affirmed a judgment in favor of an infant-plaintiff injured while eating food purchased by her parent. During the past year this decision was reversed by the appellate division with two of five judges dissenting.<sup>4</sup> The court wrote only a per curiam opinion citing *Chysky v. Drake*<sup>5</sup> and *Salzano v. First Nat'l Stores, Inc.*,<sup>6</sup> with neither of the dissenting judges stating reasons for his dissent.

The second department also followed the *Chysky* rule in *Papp v. Jackson Mfg. Co.*<sup>7</sup> Here a retailer, who was himself being sued for injuries sustained from an allegedly defective concrete cart which he sold to the plaintiff, cross-complained in warranty against the manufacturer. The court, in a memorandum decision, affirmed a dismissal of the cross-complaint on the ground that, since the defendant had purchased the cart not from the manufacturer but from a third party, he was not in privity. The Court of Appeals has granted a motion for leave to appeal and for a stay in this action.<sup>8</sup>

The third department had two opportunities to explore the privity question and in both cases it followed the maxim "no privity, no warranty." In *Burke v. Associated Coca-Cola Bottling Plants, Inc.*,<sup>9</sup> the plaintiff had purchased a bottled beverage from a vending machine and brought an action in warranty against the bottler for alleged injuries. The beverage was owned and offered for sale in the machine by third parties who had previously purchased it from the defendant-bottler. The plaintiff claimed that the defendant, because of advertising and the use of his name on the machine, was the "ostensible" seller and hence in privity with consumers. The court reversed a judgment in favor of the plaintiff holding that "the general invitation to the public to buy the beverage, and hence the contractual relationship arising from such an invitation . . . is not with the defendant, but with the actual vendors of the beverage."<sup>10</sup>

The plaintiff in *Krom v. Sharp & Dohme, Inc.*,<sup>11</sup> the other third department case, sued the processor of blood plasma for damages

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counts because of a lack of privity: *Peragine v. Esposito*, 17 Misc. 2d 621, 184 N.Y.S.2d 25 (Sup. Ct., App. T., 1st Dep't 1959); *Courter v. Dilbert Bros.*, 186 N.Y.S.2d 334 (Sup. Ct., App. T., 2d Dep't 1958); and *Shoopak v. United States Rubber Co.*, 17 Misc. 2d 201, 183 N.Y.S.2d 112 (Sup. Ct., Westch. Co. 1959).

<sup>4</sup> *Greenberg v. Lorenz*, 7 App. Div. 2d 968, 183 N.Y.S.2d 46 (1st Dep't 1959).

<sup>5</sup> 235 N.Y. 468, 139 N.E. 576 (1923).

<sup>6</sup> 268 App. Div. 993, 51 N.Y.S.2d 645 (2d Dep't 1944).

<sup>7</sup> 8 App. Div. 2d 637, 185 N.Y.S.2d 872 (2d Dep't 1959).

<sup>8</sup> 6 N.Y.2d 845, 160 N.E.2d 86, 188 N.Y.S.2d 551 (1959).

<sup>9</sup> 7 App. Div. 2d 942, 181 N.Y.S.2d 800 (3d Dep't 1959).

<sup>10</sup> *Ibid.*

<sup>11</sup> 7 App. Div. 2d 761, 180 N.Y.S.2d 99 (3d Dep't 1958).

resulting from the death of her intestate when he was administered plasma containing jaundice viruses by a hospital. The Court of Appeals, in the much cited case of *Perlmutter v. Beth David Hospital*,<sup>12</sup> had previously held that no warranty action would lie against a hospital where deleterious blood was given a patient because the contract between the institution and patient was one for services and not of sale. In the *Krom* case plaintiff argued that the hospital acted as agent for its patients when it purchased the blood from the processor. Noting that the *Perlmutter* case did not compel this conclusion, the court found none of the ordinary elements of agency present and affirmed an order dismissing the cause of action in warranty. It should be noted that the order appealed from had granted a motion made on the pleadings before proof had been offered. The court appears to have been influenced by the lack of any control which the deceased, who was unconscious during the treatment, could have exerted over the hospital's decisions. Although the difficulties which the plaintiff would have in proving an agency relationship are obviously great, the introduction of proof on this issue might have laid the basis for a warranty recovery.

With the prospects of a reexamination of the privity question by the Court of Appeals in the *Papp* case, the cases of the past year are valuable as illustrating the various factual situations in which privity may be in issue. In *Greenberg* the retailer, who was the final instrumentality in the commercial distributive process, was sued by one who lacked privity only because she had not purchased the product herself, being instead a donee from the final purchaser. In *Papp* a retailer, being sued in warranty himself, attempted to bypass one party in the line of distribution and directly sue the manufacturer. Both the *Burke* and *Krom* cases involved consumers directly suing a processor although they had obtained the product from a vendee of the processor.

Even in these last two cases, however, there are differences worth noting. In *Burke* recourse against the retailer was possible under existing law. In this case, it should also be noted, the product was highly advertised—apparently being sold in a vending machine more prominently marked with the trademark of the product than with the name of the seller. This allows the conclusion that the plaintiff relied upon the bottler, not the retailer who was owner of the machine. In *Krom* a warranty action against the hospital was foreclosed, but, in contrast to the *Burke* case, no reliance upon the defendant seems possible.

Both the commercial and legal differences in these four cases

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<sup>12</sup> 308 N.Y. 100, 123 N.E.2d 792 (1954).

demonstrate that careful consideration must be given by the Court of Appeals to any change in the privity requirement. The logical result of a decision simply stating that privity is no longer required in New York is that absolute liability for any product distributed would be imposed upon all vendors in favor of everyone no matter how remotely or tenuously they be connected with the original sale. If the court wishes to limit this broad rule, then lines must be clearly drawn as there is always a danger that the modification of a doctrine in one case will be extended to others. From the facts noted in the appellate division report, a reversal of the *Papp* case would necessarily involve a large step away from privity, one much further than has been proposed to the legislature in past years.<sup>13</sup>

Nor should the court overlook the effect which the Personal Property Law<sup>14</sup> has had in codifying the law of warranties. The concept of the common law as ever growing and evolving as needs change is not only attractive but sound. A distinction should be drawn, however, between those cases where the legislature has never taken any part in making the law and those in which, by indicating a desire to codify rights and obligations through statutory enactment, the legislature has confined the judicial function to an interpretation of what they have written. An excellent example of the former is *Woods v. Lancet*,<sup>15</sup> a negligence action where the right of an infant to recover for injuries allegedly suffered while he was *en ventre sa mere* was in issue. Here Judge Desmond said:

Of course, rules of law on which men rely in their business dealings should not be changed in the middle of the game, but what has that to do with bringing justice to a tort-feasor who surely has no moral or other right to rely on a decision of the New York Court of Appeals? Negligence law is common law, and the common law has been molded and changed and brought up-to-date in many another case. Our court has said, long ago, that it had not only the right, but the duty to re-examine a question where justice demands it . . . .<sup>16</sup>

This should be contrasted with the words of Judge Cardozo, who certainly cannot be said to have been unsympathetic to the view that

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<sup>13</sup> The Law Revision Commission has recommended the amendment of the Personal Property Law by the addition of a new section, 97-a, which would extend express and implied warranties to any natural person who is an employee, member of the household or guest of the buyer, if it is reasonable to expect that such persons may use, consume or be affected by the goods. N.Y. State Bar Ass'n, Circular No. 131 (Feb. 27, 1959). Such a proposal was before the legislature during 1959. S. Print 863; A. Print 1740. This is practically identical with Uniform Commercial Code § 2-318, except that the Code contains no reference to employees.

<sup>14</sup> N.Y. Pers. Prop. Law (1949). Sections 96 and 97 cover implied warranties.

<sup>15</sup> 303 N.Y. 349, 102 N.E.2d 691 (1951).

<sup>16</sup> *Id.* at 354, 102 N.E.2d at 694.

the common law is elastic, in *Manhattan Co. v. Morgan & Co.*<sup>17</sup> The outcome of this case depended upon whether an instrument was negotiable under the Negotiable Instruments Law and he said:

There is force in the argument that wider freedom of choice through the spontaneous flowerings of custom would work a social gain. One of the debit items to be charged against codifying statutes is the possibility of interference with evolutionary growth. It is the ancient conflict between flexibility and certainty. So far as the Negotiable Instruments Law is concerned, the remedy for the evil, if it be one, is an amendment of the statute . . . . Until such an amendment shall be adopted, the courts in their decisions must take for granted that the Legislature is content with the law as it is written.<sup>18</sup>

Unfortunately, the privity question defies any attempt to dichotomize the relationship between courts and the legislature in changing or modifying legal principles. The sections of the Personal Property Law covering warranties do speak of "buyers" and "sellers," but in no place do they specifically require privity. Hence it might be said that the legislators believe "that a change in a principle originated by judicial decision can safely be left to and effected by decisional law to achieve the most salutary advances."<sup>19</sup>

The answer can be interposed, however, that all of commercial law, including that of sales and warranties, was created by the judicial process, but that this did not restrain the legislature from interfering with its decisional development. Indeed, by passage of the Uniform Sales Act and other commercial law statutes, it indicated a desire to take from the courts the function of developing law in this area. Nor is its omission of any specific reference to privity difficult to explain. At the time of the passage of the Uniform Sales Act there was no question but that privity was required in an action *ex contractu*, and a suit in warranty was without serious doubt considered to sound in contract.

Perhaps a more pragmatic argument, and one which is more apropos of the privity question, is that the legislature, by virtue of its wide investigatory powers and abilities, is more suited to the task of refashioning the limits of liability imposed upon vendors of goods. As Judge Lewis expressed it in dissenting from the *Woods* decision:

Better, I believe, that the right should be the product of legislative action taken after hearings at which the Legislature can be advised . . . as to appropriate means—by time limitation for suits and otherwise—

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<sup>17</sup> 242 N.Y. 38, 150 N.E. 594 (1926).

<sup>18</sup> *Id.* at 52, 150 N.E. at 599.

<sup>19</sup> *Greenberg v. Lorenz*, 12 Misc. 2d 883, 888, 178 N.Y.S.2d 407, 412 (Sup. Ct., App. T., 1st Dep't 1958), modified, 7 App. Div. 2d 968, 183 N.Y.S.2d 46, leave to appeal granted, 8 App. Div. 2d 609, 185 N.Y.S.2d 740 (1st Dep't 1959).

for avoiding abuses which might result from the . . . [contemplated change].<sup>20</sup>

Seldom does a question as important as that involved in the privity dispute reach the Court of Appeals. If a modification of the requirement is made, it will have far reaching effects on the business world, but, perhaps of even greater significance, will be the court's position on the proper sphere of activities of the courts vis-a-vis the legislature in the commercial law area.

*Vendor's Liability—Warranties—Representations.*—Among the nonprivity warranty cases which deserve mention are three in which the court held that the vendor had neither expressly nor impliedly warranted the product against the alleged defect.<sup>21</sup> These cases, applying well settled law to their particular facts reemphasize the necessity of showing some representation, either expressly made or implied in law, in order to found a warranty action.

*Vendor's Liability—Warranties—Defect in Product.*—In *Zambino v. Colgate-Palmolive Co.*,<sup>22</sup> the court reversed a judgment in favor of a plaintiff allegedly injured by the application of a deodorant on the ground that no defect in the product had been proved. The apparent rationale of the decision leaves some doubt as to how cases of this type should be handled and classified. The facts showed that the plaintiff purchased the deodorant from the defendant, and that after using it she developed a contact dermatitis. A physician, in answer to a hypothetical question, opined that the skin condition was caused by the deodorant, but no evidence was introduced to explain why the product was harmful. Two possibilities troubled the court: either that the plaintiff was suffering from an allergy, or that she induced the irritation herself in applying the product.

If the plaintiff's disability was the result of an allergic reaction, a denial of recovery could be predicated on either of two theories: that the implied warranty of fitness or merchantability is limited to the assertion that the product is fit or suitable only if used by a normal nonallergic consumer, or that there was failure to show any causation between the use of the product and the damage, the causative factor of the injury being the plaintiff's own allergic condition.

The allergic reaction problem, one of the most interesting and

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<sup>20</sup> *Woods v. Lancet*, 303 N.Y. 349, 357, 102 N.E.2d 691, 695-96 (1951) (dissent).

<sup>21</sup> *Randy Knitwear, Inc. v. American Cyanamid Co.*, 7 App. Div. 2d 116, 180 N.Y.S.2d 471 (Sup. Ct., App. T., 1st Dep't 1958); *Elm Coated Fabrics Co. v. Krasnov*, 16 Misc. 2d 726, 185 N.Y.S.2d 145 (Sup. Ct., N.Y. Co. 1959); and *Vanity Fair Electronics Corp. v. Minitone, Inc.*, 11 Misc. 2d 861, 864, 178 N.Y.S.2d 263 (Sup. Ct., N.Y. Co. 1958).

<sup>22</sup> 8 App. Div. 2d 304, 187 N.Y.S.2d 25 (3d Dep't 1959).

difficult existing today, has given courts of other jurisdictions considerable trouble,<sup>23</sup> but, as yet, it has not been presented to the New York courts for any extensive consideration. Unfortunately because of the scarcity of facts shown at trial, the *Zambino* case offers little help in discerning the position of courts in this jurisdiction on this question.

*Vendor's Liability—Warranties—Plaintiff's Lack of Due Care.*—Connected, although perhaps somewhat subtly, with the allergy problem is the question of whether "contributory negligence" is a bar to recovery in warranty. This was considered in *Natale v. Pepsi-Cola Co.*<sup>24</sup> Here the plaintiff was injured when a bottle allegedly exploded while he was attempting to open it on a metal hasp of a fence. The court, finding it beyond the limits of credulity that a bottle would successfully contain a beverage under the pressure with which it had been bottled but explode after some of the gas had escaped, reversed a judgment in favor of the plaintiff.

Remanding the case, the court discussed the proof offered to show the history of the bottle subsequent to its sale. Its holding, in connection with such evidence, that one who improperly uses a product after its purchase will be denied recovery in warranty where the injury is occasioned by his own misuse, can be explained in three ways, each of which was haphazardly noted by the court. First, it can be said that the warranty is confined to an implied representation that the product is merchantable only if properly used. As the court expressed it, "the defendant did not warrant the bottle to be accident proof."<sup>25</sup> The reasoning may also be applied that the improper handling breaks the chain of causation between the alleged defect and the injury. In behalf of this theory the court said, "it is the breach of implied warranty of merchantability which gives rise to the liability and the evidence must affirmatively establish that it is causally related to the alleged injury."<sup>26</sup> Finally, one of the most basic rules of damages, that a party has a duty to minimize and avoid injury where possible, even if it legally stems from another's wrongful act, can be applied. As the *Natale* case puts it, "a party cannot recover for a loss that he could have averted by the exercise of reasonable care."<sup>27</sup>

Although it is difficult to perceive any variance in the result of the *Natale* case, it is possible that the acceptance or rejection of one of the

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<sup>23</sup> Annot., 26 A.L.R.2d 963 (1952). See also Condon, *The Progress of Products Liability Law*, 31 N.Y.S.B. Bull. 119 (1959).

<sup>24</sup> 7 App. Div. 2d 282, 182 N.Y.S.2d 404 (1st Dep't 1959). See also *Peragine v. Esposito*, 17 Misc. 2d 621, 184 N.Y.S.2d 25 (Sup. Ct., App. T., 1st Dep't 1959).

<sup>25</sup> 7 App. Div. 2d at 284, 182 N.Y.S.2d at 407.

<sup>26</sup> *Ibid.*

<sup>27</sup> *Ibid.*

theories will determine cases involving other facts.<sup>28</sup> Whichever rationale is correct, the temptation to classify the defense as one of "contributory negligence" should be rejected. Not only is the language alien to the concept of warranties, but it also leads to misunderstanding and confusion.

*Statute of Frauds—Goods Manufactured Specially for Buyer.*—One of the most important sales cases during the past year was *E. G. Young Lumber Co. v. New York Bondstone Corp.*<sup>29</sup> By an oral contract the defendant-buyer had ordered window frames of a special size from the plaintiff who in turn had them manufactured by a third party. Upon their completion the defendant refused to accept the goods and relied upon the Statute of Frauds as a defense to this action for the purchase price. The principal issue was whether Section 85 of the New York Personal Property Law applied. This section provides that where "goods are manufactured by the seller especially for the buyer" the contract is outside of the statute and hence need not be in writing.

The court, practically reading the words "by the seller" out of the statute, held that section 85 controlled, and affirmed a judgment in favor of the plaintiff. Justice Hart, in noting that the case is in direct conflict with *Eagle Paper Box Co. v. Gatti-M'Quade Co.*,<sup>30</sup> a decision of the first department, stated that his disagreement with the *Eagle* case was based upon the emphasis to be given particular words in the statute. The *Eagle* case had emphasized the words "by the seller," while he thought the greater emphasis should be placed on the words "for the buyer." However much one might be inclined to agree with the result in the *Young* case, either because of a general antagonism toward the Statute of Frauds or from a realization that businesswise it makes little difference to the buyer whether the seller manufactured the goods himself or had another make them for him, the decision cannot be harmonized with a clear reading of the statute. The court's basis for decision gives no effect whatsoever to the words "by the seller" nor does it offer any explanation as to why they were inserted, if not to cover the factual situation here presented to the court.

Criticism can be leveled at the decision not only because it illu-

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<sup>28</sup> An excellent example of this is found in *McSpedon v. Kunz*, 271 N.Y. 131, 2 N.E.2d 513 (1936). If the court, as urged by the dissenting opinion, had held that there was no warranty against the alleged defect, namely that pork was free from trichinae, an opposite decision would have resulted.

<sup>29</sup> 15 Misc. 2d 985, 179 N.Y.S.2d 45 (Sup. Ct., App. T., 2d Dep't 1958), 33 St. John's L. Rev. 392 (1959).

<sup>30</sup> 99 Misc. 508, 164 N.Y. Supp. 201 (Sup. Ct., App. T., 1st Dep't 1917), aff'd mem., 181 App. Div. 924, 167 N.Y. Supp. 1097 (1st Dep't 1917).

strates poor statutory construction, but also because it detracts from one of the purposes of uniform legislation. It is quite clear that the Uniform Sales Act intended to adopt the prior Massachusetts rule restricting the exemption from the Statute of Frauds to goods specially manufactured by the seller.<sup>31</sup> The *Eagle* case, which followed this rule, is a sound decision and the *Young* case offers no reasons for a contrary holding.

*Terms of Sales Contract—Offer—Counteroffer.—Matter of Arbitration Between Wachusett Spinning Mills, Inc. and Bluebird Silk Mfg. Co.*<sup>32</sup> involved a dispute over whether a contract between the buyer and seller included an arbitration clause. After oral negotiations the buyer sent four purchase orders which included arbitration provisions to the seller. The seller acknowledged these orders in due course and sent to the buyer a document entitled "Confirmation of Accepted Order" which referred specifically to the buyer's orders and contained a statement that "we have accepted your order subject to credit approval . . ." This document made no reference to arbitration but did embody a provision that Massachusetts law would govern in the event of any disagreement.

When a dispute arose, the buyer initiated arbitration proceedings and the seller moved for a stay on the ground that the final contractual agreement between the parties was to be determined solely by his "counteroffer" which contained no arbitration provisions. The court, distinguishing the case from the Court of Appeals decision in *Albrecht Chemical Co. v. Anderson Trading Corp.*,<sup>33</sup> held that the form of the document sent by the seller in reply to the buyer's order indicated an intention, not to convey a counteroffer, but to accept the offer to buy under the terms of the original orders.

A dissent was filed by Justice Valente in the *Wachusett* case. From his analysis of the fact situation, he would hold that the seller's "Confirmation of Accepted Order" constituted the final contract agreed upon by the parties. Once reaching this conclusion, he finds lacking the clear language necessary to incorporate by reference the original orders in this contract.

The case demonstrates the care which should be, but often is not,

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<sup>31</sup> Professor Williston, draftsman of the act, approves the rule in the *Eagle* case. "Under the Sales Act . . . goods, which are to be specially manufactured by a third person, and when manufactured sold to the buyer, [are] within the statute . . ." 1 Williston, Sales § 55a (rev. ed. 1948). See also 2 Williston, Contracts § 509A (rev. ed. 1936).

<sup>32</sup> 7 App. Div. 2d 382, 183 N.Y.S.2d 601 (1st Dep't), aff'd, 6 N.Y.2d 948, 161 N.E.2d 222, 190 N.Y.S.2d 1011 (1959). For another case involving the construction of a sales contract and arbitration, see *Matter of Stein Hall & Co.*, 13 Misc. 2d 547, 177 N.Y.S.2d 603 (Sup. Ct., N.Y. Co. 1958).

<sup>33</sup> 298 N.Y. 437, 84 N.E.2d 625 (1949).

taken in the drafting of forms which are to form the basis of contractual relationships, and the necessity of clearly indicating the refusal to accept an offer under the terms presented when some of its provisions are unacceptable.

## II

### BILLS AND NOTES

Legislation affecting the time during which notice of dishonor may be given by mail and several cases in which failure of consideration was raised as a defense to promissory notes are the most important items during the past year. Also noted is a case involving the liability which attaches to the use of a credit card.

*Notice of Dishonor Sent by Mail.*—Previously, where the parties resided in the same place and notice of dishonor of a negotiable instrument was sent by mail, it had to be sent to the party sought to be held so as to reach him in the usual course on the day following dishonor.<sup>34</sup> This requirement has been changed by the legislature so that the notice is valid if “deposited in the post-office in time to go by mail the day following, or if there be no mail at a convenient hour on that day, by the next mail thereafter.”<sup>35</sup> The legislation extends the time allowed for mailing of dishonor, but, as has been noted elsewhere,<sup>36</sup> not only fails to clarify previous ambiguities in this section, but also raises the question of the proper interpretation to be given the words “to go by mail.”

*Promissory Notes—Failure of Consideration—Maker's Liability.*—To be balanced against the commercial advances made possible by the concept of negotiability is the possibility which it affords the unscrupulous to shirk their responsibilities and pit two “innocent” parties against one another in a law suit. Several cases of this type reached the New York courts during the past year, all of them following a similar pattern. The dramatis personae included a contractor who accepted a note in payment for work yet to be performed, an innocent maker of the note and an equally innocent, or at least an allegedly blameless, financial institution. The plot has the contractor breaching his agreement sometime after the instrument has been sold to the bank or discountor and a subsequent suit by a transferee of the note against the maker. Failure of consideration is alleged as a defense and the holder counters with the claim that consideration is conclusively presumed as he is a holder in due course.

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<sup>34</sup> N.Y. Negotiable Inst. Law § 174 (Supp. 1959).

<sup>35</sup> N.Y. Negotiable Inst. Law § 174, as amended, N.Y. Sess. Laws 1959, ch. 155, § 1. In regard to notice sent by mail, this section now reads substantially the same as § 175, which covers notice sent when parties reside in different places.

<sup>36</sup> 23 Albany L. Rev. 473 (1959).

The New York courts have steered a straight course in handling these cases which seem to have become more prevalent since the end of World War II and the advent of the Home Improvement Loan.<sup>37</sup> In two cases, *Stratford Factors v. Liboria Corp.*<sup>38</sup> and *Stratford Credit Corp. v. Pettrone*,<sup>39</sup> summary judgment for the plaintiff was held to be unwarranted when the defendant raised a triable issue as to whether plaintiff had knowledge of the breach prior to the date on which he purchased the notes. However, in two others, *Franklin Nat'l Bank v. Kinsey*<sup>40</sup> and *Dave Snyder Lumber Co. v. Karlson Associates, Inc.*,<sup>41</sup> it was held that a breach *after* the holder had bought the instrument was no defense.

The *Franklin Nat'l Bank* case is of additional interest because of a novel defense raised by the maker. He admitted requesting a loan of \$1,235, with knowledge that he would have to repay \$27.65 each month for five years, and signing a note which was blank as to the amount due. The principal sum of \$1,659 (60 x \$27.65), representing the amount borrowed plus interest, was inserted, apparently by the payee, before the bank purchased the note. The question arose as to whether the payee had authority to fill in the blank. The defendant claimed that he never multiplied the monthly payments by the number of months and would not have agreed to repay a total amount of over \$1,600. The court denied the defense on the grounds that the defendant-maker, by authorizing the insertion of the installments knowing the amount to be paid each month and the number of payments, had impliedly authorized the payee to insert the total amount.

Two cases, *Eaton v. Laurel Delicatessen Corp.*<sup>42</sup> and *United States v. Brownlee*,<sup>43</sup> the former from the Second Circuit and the latter from the District Court for the Eastern District demonstrate the futility of attempting to insure that a maker obtains the bargained-for consideration. In the *Eaton* case the plaintiff, who had purchased defendant's notes from the payee, obtained a written agreement from the defendant-maker warranting that the notes were a true obligation without any offset or counterclaim. In face of this warranty the defendant claimed that a failure of consideration released him from

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<sup>37</sup> See Savage, *Commercial Law*, 33 N.Y.U.L. Rev. 506, 513, in 1957 Ann. Survey Am. L. 302, 309 (1958); and Savage, *Commercial Law*, 34 N.Y.U.L. Rev. 189, 209, in 1958 Ann. Survey Am. L. 387, 407 (1959).

<sup>38</sup> 6 App. Div. 2d 423, 178 N.Y.S.2d 703 (1st Dep't 1958).

<sup>39</sup> 11 Misc. 2d 65, 177 N.Y.S.2d 994 (Monroe County Ct. 1958).

<sup>40</sup> 17 Misc. 2d 742, 183 N.Y.S.2d 891 (Sup. Ct., Nassau Co. 1959).

<sup>41</sup> 7 App. Div. 2d 925, 183 N.Y.S.2d 493 (2d Dep't 1959).

<sup>42</sup> 5 N.Y.2d 1029, 158 N.E.2d 251, 185 N.Y.S.2d 551 (1959).

<sup>43</sup> 168 F. Supp. 42 (E.D.N.Y. 1958).

liability. The court correctly held that he was estopped from pleading the defense because of the express warranty to the contrary.

The *Brownlee* case involved a Federal Housing Administration Home Improvement loan. In these transactions, the FHA requires the borrower to sign a FHA Title I Completion Certificate wherein it is certified, by the borrower, that "all articles and materials have been furnished and installed by the contractor and the work satisfactorily completed."<sup>44</sup> The importance of this statement is clearly indicated to the signor in bold type, and notices are also included on the certificate informing the borrower that it is his responsibility to assure satisfactory compliance with the contract by the contractor and warning him of criminal penalties for making false statements thereon.

In the *Brownlee* case the defendant, a maker of the note in question, had signed the completion certificate although work had not commenced. After the loan had been granted, the note was negotiated by the contractor to a factor who in turn sold it to a bank. Subsequent to this last sale, the maker informed the factor of the contractor's default and his unwillingness to pay on the note. This was done prior to the date on which his first installment became due. Upon the maker's default, the United States Government reimbursed the final holder for his loss and here sued the maker. The court, admitting that "the position of the defendant is an appealing one,"<sup>45</sup> pointed out that his true grievance was against the contractor and held that the "inexorable operation of the law merchant"<sup>46</sup> required liability to be imposed on him as maker.

It is difficult to sympathize with the makers of the notes in these two cases. An appealing argument can probably be made that, as borrowers, they were coerced and obliged to follow the procedures demanded by those offering credit. But what more can be done, either by an individual, as in the *Eaton* case, or by the Government, as in the *Brownlee* case, to protect them? If they had elected, and had been able, to pay the contractor with cash from their own reserves prior to completion of the work, they would have no remedy except against the contractor. In effect, they are doing just that here, except that instead of obtaining the cash from their own resources, they are inducing a third party, the financial institution, to pay it for them.

The only question, as is indicated by the decisions of the past year, is whether the holder of the note was a bona fide purchaser of it in accordance with the requisites established by the Negotiable In-

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<sup>44</sup> 24 C.F.R. § 202.8(e) (1959).

<sup>45</sup> *United States v. Brownlee*, 168 F. Supp. 42, 45 (E.D.N.Y. 1958).

<sup>46</sup> *Ibid.*

struments Law,<sup>47</sup> although his relationship with the contractor bears scrutiny in determining whether he has met those requirements.

*Credit Cards—Liability of Holder.*—During the past few years the credit card has been firmly established as a means of payment. With its entry into the commercial world, it is certain to bring new legal problems requiring judicial determination, but as yet few cases<sup>48</sup> have been decided which furnish information about the legal obligations and liabilities attaching to the various parties involved in its use.

During the past year one case, *Franklin Nat'l Bank v. Kass*,<sup>49</sup> involved a dispute over a credit plan. The scheme here under consideration initially involved three parties: a credit club, an employer, and his employee. The employer was designated as a "company member" of the club and it was contemplated that he would have furnished to his employees credit cards enabling them to charge purchases. Billing would be to the "club member" who would reimburse the club for charges incurred by the employee.

The billing procedure operated thus: when the employee made a purchase he would present his card to the vendor and sign a charge slip. Thereafter the supplier of the goods would prepare a "Club Draft" which he signed and sent to the club for payment. Apparently the club would then pay the supplier. The "draft" was then "negotiated" by the club to a bank who in turn would demand payment from the club member.

In the *Franklin Nat'l Bank* case the company member had become insolvent prior to paying the bank and the bank demanded payment from an individual employee who had incurred the charges. The complaint was based upon the theory that these "club drafts" were bills of exchange within the meaning of the New York Negotiable Instruments Law, and that they had been accepted prior to being drawn. The allegation of acceptance was based upon a rule of the club to which assent had been given by the defendant when he signed the card with knowledge, constructive if not actual, of its existence. The club rule in question stated that "each of the card holders agrees to pay the charges incurred by him, and they agree to accept all drafts drawn on them for charges incurred . . ."<sup>50</sup> The court, holding this agreement to be the equivalent of an acceptance, found the defendant liable.

It is difficult to understand why the court, or the plaintiff for that

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<sup>47</sup> N.Y. Negotiable Inst. Law § 91 (1943).

<sup>48</sup> Annot., 158 A.L.R. 762 (1945). See Clafin, *The Credit Card—A New Instrument*, 33 Conn. B.J. 1 (1959). For a criminal case involving credit cards decided during the past year, see *United States v. Golden*, 166 F. Supp. 799 (S.D.N.Y. 1958).

<sup>49</sup> 184 N.Y.S.2d 783 (Sup. Ct., Nassau Co. 1959).

<sup>50</sup> Id. at 784-85.

matter, found it necessary to rely upon the tenuous ground that there was a collateral acceptance in this case. Some justification for the holding can be found in prior New York cases,<sup>51</sup> even though the draft held to be accepted was never identified in the collateral agreement. However, this is stretching the law on this point.<sup>52</sup> A more satisfactory way of finding liability would have been to hold the card bearer liable on his simple promise to pay which he made in the club regulation previously cited.

### III

#### SECURED TRANSACTIONS

There is little of significance to report in the field of secured transactions. One case, which touched the law surrounding security devices only tangentially, is discussed because of its importance in this field. The legislature continued to modify recent legislation governing installment selling,<sup>53</sup> the most important act being one which extended the scope of the Retail Instalment Sales Act<sup>54</sup> to dance studios, health clubs, reducing salons, and other enterprises involving long-term services to customers.<sup>55</sup>

*Conditional Sales—Third Party Promise to Assume Obligation—Statute of Frauds.*—In New York, by statute,<sup>56</sup> an oral promise to pay the debt of another is void. This rule is subject to an exception where the promisor would be independently liable irrespective of the liability of the principal debtor.<sup>57</sup> Whether such an independent liability existed was considered during the past year in *Biener Contracting Corp. v. Elberon Restaurant Corp.*<sup>58</sup> Defendant Wishnetzky held a chattel mortgage on fixtures in the Elberon Restaurant. When the restaurant became financially unstable he said to the plaintiff, who was the conditional vendor of other fixtures:

Do me a favor. Don't take that action, [legal action on the conditional sales agreement] . . . I have a lot of money invested in this place. I am going to . . . foreclose the mortgage, and I will take over

<sup>51</sup> *Merchants' Bank of Canada v. Griswold*, 72 N.Y. 472 (1878). Cf. *Ruiz v. Renauld*, 100 N.Y. 256, 3 N.E. 182 (1885); *Ulster County Bank v. McFarlan*, 3 Denio 553 (N.Y. 1846).

<sup>52</sup> Britton, Bills and Notes §§ 172-78 (1943).

<sup>53</sup> N.Y. Sess. Laws 1959, chs. 705, 755.

<sup>54</sup> N.Y. Pers. Prop. Law art. 10 (Supp. 1959). For an excellent article on this type of legislation, see Maleson, *Consumer Credit Regulation*, 23 Albany L. Rev. 297 (1959).

<sup>55</sup> N.Y. Sess. Laws 1959, ch. 705.

<sup>56</sup> N.Y. Pers. Prop. Law § 31(2) (1949).

<sup>57</sup> *White v. Rientoul*, 108 N.Y. 222, 15 N.E. 318 (1888).

<sup>58</sup> 7 App. Div. 2d 391, 183 N.Y.S.2d 756 (1st Dep't 1959), 28 Fordham L. Rev. 384 (1959). See also *Calamari, The Suretyship Statute of Frauds*, 27 Fordham L. Rev. 332 (1958), and *Conway, Subsequent Oral Promise to Perform Another's Duty and the New York Statute of Frauds*, 22 Fordham L. Rev. 119 (1953).

the place, the obligations. I am going to pay you. I want to run the place myself . . . and I will pay you each and every note in full.<sup>60</sup>

Wishnetzky did in fact take over the restaurant and pay some of the notes. Eventually, however, the business closed and the plaintiff sued to collect on the remaining notes. The court held the defendant's promise constituted an independent obligation given in order to secure a business advantage and enforceable though oral.

Except for the proposition that the mere unconditional form of a promise to pay another's debt will not take it outside of the statute,<sup>60</sup> little delineation of the New York rule has been made by the courts.<sup>61</sup> In holding that the above-quoted promise was sufficient to allow the plaintiff to avoid the Statute of Frauds, the *Biener* case does little to clarify the rule. The more important facts in the case appear to be those occurring subsequent to the oral agreement, viz., that the promisee looked to the promisor for payment as the new primary party and that the latter did, in fact, make some payments. It would have been proper for the court to find that these actions of the parties were of importance in determining defendant's liability.<sup>62</sup> Indeed, it seems impossible that the decision could have been reached by any other means.

#### IV

#### BANKING LAW

Neither the legislation nor the cases of the past year warrant detailed discussion herein. As usual, numerous bills of a technical nature were passed by the legislature. These are carefully collected elsewhere.<sup>63</sup> The most important proposals were the perennial attempts to sanction bank holding companies and to relax restrictions on branch banking, but these were once again defeated.<sup>64</sup>

Of the four cases which reached appellate tribunals, two were brought by customers claiming that the financial institution made an unauthorized payment from their accounts,<sup>65</sup> one by a bank against

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<sup>59</sup> *Biener Contracting Corp. v. Elberon Restaurant Corp.*, 7 App. Div. 2d 391, 397, 183 N.Y.S.2d 756, 757 (1st Dep't 1959).

<sup>60</sup> *Richardson Press v. Albright*, 224 N.Y. 497, 121 N.E. 362 (1918).

<sup>61</sup> 28 *Fordham L. Rev.* 384, 386 (1959).

<sup>62</sup> Cf. *Richardson Press v. Albright*, 224 N.Y. at 502, 121 N.E. at 364.

<sup>63</sup> N.Y. State Banking Dep't, *Legislative Summary* (1959).

<sup>64</sup> See *Harfield, Legal Restraints On Expanding Banking Facilities, Competition and the Public Interest*, 14 *Bus. Law.* 1016 (1959), and *N.Y. Times*, Mar. 27, 1959, p. 32, col. 2.

<sup>65</sup> *Romero v. Sjoberg*, 5 N.Y.2d 518, 158 N.E.2d 828, 186 N.Y.S.2d 246 (1959); *Karp v. Karp*, 6 App. Div. 2d 1055, 179 N.Y.S.2d 681 (2d Dep't 1958), *aff'd*, 5 N.Y.2d 933, 156 N.E.2d 818, 183 N.Y.S.2d 296 (1959).

a depositor who cashed a check on a closed account<sup>66</sup> and one by a plaintiff charging that the bank had failed to give timely notice of protest.<sup>67</sup>

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<sup>66</sup> *Manufacturers Trust Co. v. Diamond*, 17 Misc. 2d 909, 186 N.Y.S.2d 917 (Sup. Ct., App. T., 1st Dep't 1959).

<sup>67</sup> *Hoffower v. Pennsylvania Exch. Bank*, 8 App. Div. 2d 585, 183 N.Y.S.2d 620 (4th Dep't 1959).