The purpose of this column is to identify some of the most disconcerting judicial decisions interpreting the Uniform Commercial Code or related commercial laws. The purpose of the column is not to be mean. It is not to get judges recalled, law clerks fired, or litigators disciplined for incompetence. Instead, it is to shine a spotlight on analytical errors, and thereby provide practitioners and judges with reason to disregard the opinion.

_Nationwide Transport Finance v. Cass Information Systems, Inc., 523 F.3d 1051 (9th Cir. 2008)_

This case presents a very narrow and troubling view of the obligations of an account debtor’s payment agent.

The case involved Nationwide Transport Finance, which purchases freight invoices from a variety of carriers. In essence, Nationwide was a factor of accounts. Cass Information Systems operates a freight invoice payment system. Merchants who need their goods shipped hire Cass to handle the processing and payment of the freight invoices. Typically, a shipper agrees to pay Cass all of the shipper’s verified freight invoices, and Cass forwards those funds to the carrier or its assignee. If Nationwide buys invoices, it notifies Cass to pay it directly. The parties’ relationships can be depicted as follows:

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Shippers ——— Cass ——— Carriers
            |accounts
Nationwide Transport Finance
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Over the years, Cass occasionally made a mistake, such as by paying the carrier after being instructed to pay Nationwide. In each instance, Cass worked with Nationwide to obtain payment. After one such error in 2003, Cass asserted its rights under a hold harmless agreement signed by Nationwide in 1986. Thereafter, Nationwide terminated that agreement and refused to sign another. Cass then refused to pay any further Nationwide invoices.

Nationwide responded by suing for intentional interference with contract and intentional interference with prospective economic advantage, on the theory that Cass was really trying to steal Nationwide’s business. Nationwide alleged that Cass was motivated by a desire to get the carriers to use Cass’s own factoring service. Both of these torts require a showing that the defendant’s conduct lacks privilege or justification, which in turn rests on whether the actions are “improper.” See Restatement (Second) of Torts § 767. Nationwide claimed that Cass’s actions were improper because they violated § 9-406(a). That provision requires account debtors to pay the assignee of an account after the account debtor receives an instruction to do so.
The trial court excluded testimony about § 9-406 and refused to instruct the jury about it. On appeal, the Ninth Circuit concurred. It ruled that because Cass was not the account debtor – the shippers were – Cass’s actions could not have violated § 9-406. The court then ruled that neither principles of agency law nor industry practices made § 9-406 applicable to Cass. This is the most disconcerting aspect of the decision.

In reaching its conclusion, the court relied on two main points. First, that the Code imposes a principal’s duties on its agent in only one place, § 8-407, and references agents in several others, e.g., §§ 2-201(1), 3-311(d), but that § 9-406 makes no reference to agents. That may be true, but such silence is irrelevant. Article 1 makes it clear that the law of principal and agent supplements the Code. See § 1-103(b). While the common law of agency cannot supplant Code rules, see § 1-103 comment 2, extending the rules of § 9-406 to the account debtor’s agent presents no risk of that. If anything, such an extension would give greater effect to § 9-406.

Second, the court noted that the Restatement (Third) of Agency lacks reference to the proposition that the agent is liable if it acts in a way that violates a statutory duty of the principal. That is not entirely accurate. The agent can incur tort liability by breaching a duty to the principal if the conduct involved also breaches an express or implied promise of the agent and the plaintiff is a third party beneficiary of that promise. See Restatement (Third) of the Law of Agency § 7.02 cmt. d & ill. 9. That is quite arguably the situation Cass was in. As the dissent pointed out, Cass promised to make the invoiced payments by accepting the agency. It should therefore have been bound. In other words, the shippers had an absolute duty to pay under § 9-406, Cass accepted that duty by accepting the agency, therefore Cass had an absolute duty to pay. As a result, Cass’s decision to hold up payment to obtain a benefit for itself was improper.

Unfortunately, the court’s decision leaves us with the asymmetry that shippers may be bound by Cass’s actions, but Cass is not necessarily bound by the shippers’ duties. As the court explained near the end of its opinion, Nationwide has a claim against the shippers, and the shippers may have a claim against Cass, but there’s no direct action by Nationwide against Cass. That seems unnecessarily circuitous and likely to promote unnecessary litigation. More to the point, Cass not only avoided tort liability, but under the court’s analysis, it is entitled to demand a hold harmless agreement from the account buyers that its principals – the shippers – could not insist upon.


Last year this column highlighted a case involving a “double booking” of home mortgage loans, Provident Bank v. Community Home Mortgage Corp., 498 F. Supp. 2d 558 (E.D.N.Y.). This case presents similar facts, but a different error of law. Like Provident Bank, this case involves a fraudulent mortgage-loan scheme. The fraudfeasor, Euro-Funding Corporation, required four borrowers, for whom it originated a total of eight residential mortgage loans, to execute duplicate original promissory notes. It indorsed and delivered the first set of notes to Home Loan Mortgage Corporation, which funded the mortgages through its warehouse lender, First Collateral. Home Loan’s interest in the notes was later assigned to Windvest Corporation. At a later date, the second, identical set of notes was delivered to DLJ Mortgage Capital in return for valuable consideration. The following diagram illustrates the essential facts:
The borrowers paid the notes in full to Windvest, and DLJ, which had not received payment, brought suit to recover the payments, which it claimed should have been made to it. As is so frequently the case, the fraudfeasors were nowhere to be found, leaving innocent parties to litigate the dispute against one another. Both sides moved for summary judgment, and the trial court held that only the first set of notes, which had been delivered to Home Loan, was enforceable.

In analyzing the parties’ rights, the California Court of Appeal correctly rejected DLJ’s contention that the Home Loan notes were never legally issued within the meaning of § 3-105(a) – and thus not legally enforceable – because Home Loan received the notes prior to the close of escrow and the funding of the loans. DLJ’s argument was flawed because it is premised on the incorrect assumption that negotiable instruments are enforceable only when supported by consideration. While holder-in-due-course status does require that the holder have given value for the instrument, see §§ 3-302(a)(2)(i), 3-303, consideration is not a requirement for an instrument to be negotiable. See § 3-104(a). Even if it were, a lack of consideration would not necessarily render an instrument unenforceable. The terms “non-negotiable” and “unenforceable” are not synonyms. Negotiability affects the competing rights of third parties, or, alternatively, of a third party against an original party to the instrument. Enforceability, on the other hand, is essentially a matter of contract law and addresses the rights of the instrument’s original parties against one another.

The court also correctly held that, even if the instrument had not been properly issued, nonissuance might not have barred Home Loan from recovery. Nonissuance is a personal defense that would not be effective as against a holder in due course. See § 3-105 comment 2. Thus, whether Home Loan would have been successful on this point would depend on whether it was found to be a holder in due course, a matter that the court did not address.

Despite this sound beginning, the court went on to make a serious error. Without any analysis and without citation to any authority, the court blithely stated that the second set of original promissory notes – the ones delivered to DLJ – were not negotiable instruments because the borrowers intended to be obligated only on a single note for each loan. This statement wholly misconstrues the nature of negotiability. The test for negotiability, which is found in § 3-104(a), depends entirely on the form of the instrument; the issuer’s intent is irrelevant. The court’s suggestion to the contrary is both wrong and disturbing. If applied in other contexts, it could seriously undermine the holder-in-due-course doctrine.

Nevertheless, the result in this case may be correct. Arguably, the defrauded borrowers should pay only once, even at the expense of an innocent party. They were defrauded into executing the duplicate original, and such fraud may well qualify as a defense against enforcement, even as against a holder in due course such as DLJ. See § 3-305(a)(1)(iii).
This case presents an odd circumstance in which two courts (and ostensibly also the parties) continually referred to the transaction in question as a lease, but went on to apply Article 9 rather than Article 2A.

The case involved a vehicle lease agreement between Gelco Corporation as the lessor, Mr. Rooter of Central Florida, Inc., as the lessee, and its president, John Burley, as guarantor. After Rooter and Burley defaulted, the court ordered that the vehicles be surrendered to Gelco, which then sold them at auction. The auction yielded $44,180, leaving a balance due of about $56,000. When Gelco sued Rooter and Burley for the deficiency, Burley defended on two Article 9 grounds: (1) Gelco’s failure to provide him with pre-disposition notice pursuant to § 9-611; and (2) Gelco’s failure to conduct a commercially reasonable sale pursuant to § 9-610. The lower court granted summary judgment in favor of Gelco, and Burley appealed. In reversing, the District Court of Appeal ruled that factual questions as to the reasonableness of both the notice and the sale precluded summary judgment. Throughout its holding, the court applied Article 9, rather than Article 2A, without explaining why it had done so. Presumably, the lower court did the same.

However, Article 9 does not apply to a true lease. Instead, Article 2A governs such a transaction.1 White & Summers put it simply: “A lessor’s rights to leased personal property is not an Article 9 security interest.” JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 30-3 (4th Practr. ed. 2002). Although some transactions structured as leases are in reality a sale with a retained security interest – in which case Articles 2 and 9 govern – neither the court nor the parties suggested that was the case here. The court’s only discussion of the applicability of Article 9 appears in a footnote in which the court stated that “Burley could properly seek the protections afforded by the U.C.C. because a guarantor is a debtor for Article 9 purposes.” Of course, this hardly proves the point. Burley could avail himself of the protections in Article 9 only if the transaction itself falls within Article 9. Even then, the court’s assertion is not technically accurate. A guarantor is not a debtor under revised Article 9 because the debtor is someone with an ownership interest in the collateral. See § 9-102(a)(28). Instead, Article 9 refers to guarantors as secondary obligors. See § 9-102(a)(59), (71). However, to the extent that the court was suggesting that, as a guarantor, Burley would be entitled to notification of a disposition and damages for conducting a commercially unreasonable sale, the court was correct, see §§ 9-611(c)(2), 9-625(c)(1), but only if Article 9 provided the governing law.

Because the transaction in this case apparently involved an ordinary Article 2A lease, the parties’ rights should have been analyzed under Article 2A. Pursuant to § 2A-527, Gelco had the right to dispose of the goods without sending advance notification to Rooter and Burley, and pursuant to § 2A-528, Gelco is entitled to recover damages from Rooter and Burley regardless of whether its sale of the goods was commercially reasonable.

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1 This case does not fall within the narrow confines of §9-110, which brings a security interest created under §2A-508(5) within the purview of Article 9. Notably, such a security interest would exist under these facts only if the lessor had defaulted – not the lessee.