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### Sales and Secured Transactions

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# SALES AND SECURED TRANSACTIONS

DOUGLASS G. BOSHKOFF†

In the Michigan sales cases decided during the past year the chattels involved, ranging from second-hand pickle barrels to a luke warm, if not hot, car, formed the nuclei of some interesting fact situations. Only four cases have been discussed in the body of this article. The remaining few have been relegated to a footnote, either because of complete lack of novelty or absence of detail in the official reports.<sup>1</sup> The four cases discussed are in the areas of warranties, chattel mortgages and trust receipts.

## WARRANTIES

When the buyer of goods is dissatisfied with his purchase and is faced with an uncooperative seller, a common course of action is to claim either the breach of some express warranty or of one of the implied warranties of quality, either merchantability or fitness. In *Kaufman v. Katz*<sup>2</sup> the plaintiff, a pickle manufacturer, had purchased some second-hand barrels from the defendant and used them in his pickle manufacturing process. A large part of the product had a peculiar flavor and became soft due to an alleged defect in the barrels. Plaintiff then brought an action for damages on the theories that there had been a breach of both an express and an implied warranty that the barrels were fit for a special purpose. At both the trial and appellate level there were the usual arguments about the conversations as to the nature of the barrels and whether the alleged defect caused the spoilage. This far the case is ordinary and the jury, the trial judge, and the Michigan Supreme Court accepted the plaintiff's contentions.

The unusual part of the case centers around the fact that the barrels were second-hand goods although they had purportedly been reconditioned by the defendant. It was his position that the very fact that the barrels were second-hand prevented assertion of an implied warranty of fitness for a special purpose, and he had some Michigan authority in his favor. Back in 1916, on facts occurring before adoption of the Uniform Sales Act,<sup>3</sup> it had been held that there was no implied warranty of fitness for a special purpose on the sale of a

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1. *Patrick v. Carrier-Stevens Co.*, 358 Mich. 94, 99 N.W.2d 518 (1959); *Ladney v. Ternes Steel Co.*, 359 Mich. 228, 102 N.W.2d 178 (1960); *Kirkhof Elec. Co. v. Wolverine Express, Inc.*, 175 F. Supp. 43 (E.D. Mich. 1959), affirmed 269 F.2d 147 (6th Cir. 1959).

2. 356 Mich. 354, 97 N.W.2d 56 (1959).

3. C.L. §§ 440.1-78, M.S.A. §§ 19.241-320.

used automobile because of the second-hand nature of the chattel.<sup>4</sup> Subsequently, two Michigan opinions had paid lip service to this principle, by way of dictum, but each time stating that the announced principle was "generally" applicable.<sup>5</sup>

No definite answer to this problem is supplied by the Uniform Sales Act as its definition of goods, to which the implied warranty obligation attaches, neither includes nor excludes used goods.<sup>6</sup> The Michigan Supreme Court, speaking through Justice Kavanagh, aligned itself with the more modern jurisdictions in repudiating the 1916 decision and permitting plaintiff to recover on an implied warranty theory.<sup>7</sup>

Lest there be widespread concern among second-hand merchants of all varieties, it should be noted that the holding is only that, as a matter of law, the second-hand nature of the goods will not in all cases preclude recovery on an implied warranty theory. Plaintiff still has the burden, which he sustained in this case, of proving that there is an implied warranty of fitness for a special purpose. Thus it must be shown that the buyer has made his special need clear to the seller and has relied on the seller's selection of the product.<sup>8</sup> Further, it is clear that the implied warranty of merchantability was not in issue here. Such a warranty imposes the obligation only to deliver goods of merchantable quality, and the seller's position as a merchant of used goods would be relevant in determining the standard of merchantability.<sup>9</sup>

A second interesting warranty case was decided by the Sixth Circuit and reported just before the end of this Survey period. The plaintiff in *Hansen v. Firestone Tire and Rubber Co.*<sup>10</sup> had purchased tubeless tires<sup>11</sup> directly from the defendant manufacturer. At the time of the purchase he had viewed certain selling literature

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4. *Bayer v. Winton Motor Car Co.*, 194 Mich. 222, 160 N.W. 642 (1916).

5. *Hysko v. Morawski*, 230 Mich. 221, 202 N.W. 923 (1925); *Kirby v. Gibson Refrigeration Co.*, 274 Mich. 395, 401, 260 N.W. 840 (1936).

6. C.L. § 440.76(1), M.S.A. § 19.316(1) provides:

"'Goods' include all chattels personal other than things in action and money.

The term includes emblements, industrial growing crops, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale."

7. This holding was only in the alternative since the court found that plaintiff could also recover for breach of an express warranty.

8. C.L. § 440.15(1), M.S.A. § 19.255(1).

9. C.L. § 440.15(2), M.S.A. § 19.255(2); 1 Williston, Sales § 232 (1948); U.C.C. § 2-314(2) and comment 3.

10. 276 F.2d 254 (6th Cir. 1960).

11. Other cases involving warranty actions and tubeless tires are: *Senter v. B. F. Goodrich Co.*, 127 F. Supp. 705 (D. Colo. 1954); *Ein v. Goodyear Tire & Rubber Co.*, 173 F. Supp. 497 (N.D. Ind. 1959); *B. F. Goodrich Co. v. Hammond*, 269 F.2d 501 (10th Cir. 1959) (wrongful death action).

extolling the safety features of the product. Defendant's employees managed to mount the tires, although some difficulty was experienced, and plaintiff was later injured in an accident caused by the demounting of these tires while he was traveling around a curve at a high speed.

Plaintiff's complaint alleged two claims, one in tort for negligence and the other in warranty, the former being abandoned during the trial. The trial court granted defendant's motion for judgment *n.o.v.* on the theory that the only possible basis for liability was improper installation of the tires by defendant's employees. This being true, plaintiff's abandonment of the negligence claim precluded consideration of any allegedly negligent acts in determining warranty liability. The Sixth Circuit reversed without considering the interesting question of whether negligent acts may be used as the basis for claiming breach of warranty.<sup>12</sup> It pointed out that the evidence showed that plaintiff had reasonably relied on the manufacturer's advertising literature characterizing the tires in question as "safe enough to control one or two tons . . . at speeds up to 80 miles an hour . . . safe enough to cling to the road on dangerous curves."<sup>13</sup> These statements constituted an express warranty to the purchaser.

In the course of his opinion, Judge Martin noted:

Negligence on the part of the buyer would not operate as a defense to the breach of warranty. If the manufacturer chooses to extend the scope of his liability by certifying certain qualities as existent, the negligent acts of the buyer, bringing about the revelation that the qualities do not exist, would not defeat recovery.<sup>14</sup>

In so stating he relied upon the Michigan decision in *Bahlman v. Hudson Motor Car Co.*<sup>15</sup> wherein the plaintiff sued for breach of warranty, having learned that his car roof was not as safe as he had been told. In the *Bahlman* case, Justice Butzel rejected the contention that since the plaintiff was driving in a negligent manner, he could not recover for breach of warranty.<sup>16</sup>

Use of the phrase "contributory negligence" in this context can blur some distinctions best illustrated by two hypothetical situations suggested by the *Bahlman* decision. Suppose that P, having had several severe accidents, wishes to drive a car that will protect him from his reckless inclinations. He purchases a car from S after receiving an express warranty that the roof will hold up if the car rolls

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12. Such a situation would be unusual. Warranty is usually the refuge of those unable to establish facts showing negligence.

13. 276 F.2d at 256.

14. 276 F.2d at 258.

15. 290 Mich. 683, 288 N.W. 309 (1939).

16. *Id.* at 688-693, 288 N.W. at 310-313.

over. While driving at an excessive rate of speed he is struck by another automobile driven by T. P is injured when the roof caves in while the car is rolling over after the crash. T will not be liable to P, assuming that T was driving negligently, because P is barred by contributory negligence. However, the relation between P and S is not disturbed by P's reckless acts. If P sues S for breach of express warranty the issue is not one of negligence or contributory negligence but only whether P reasonably relied on S's affirmation that the course of conduct actually pursued and the consequences would not injure P.

Varying the facts slightly, assume that P was injured not by a vulnerable roof but because the door popped open on impact and he was thrown out. The P-T suit is resolved as before. But when P sues S the result is different. P cannot recover. This is not because he was guilty of contributory negligence. His acts were the same in both examples. It is because his injury cannot be linked to non-performance of an assurance given by S and characterization of P's conduct as negligence does not solve problems in this area.<sup>17</sup>

#### CHATTEL MORTGAGES

Migratory automobiles subject to chattel mortgages create serious and sometimes perplexing problems. Judging by the amount of reported litigation,<sup>18</sup> it is not uncommon for a car to be transported across state lines and sold quickly without discharge of any encumbrances. Then the seller skips and the chattel mortgagee in one state and the purchaser in another are left with a law suit.

In *Commerce Acceptance Co. v. Denton*,<sup>19</sup> S purchased a new car in Oklahoma which he sold soon thereafter to defendant, a Michigan automobile dealer. Plaintiff, who was the holder of a chattel mortgage on the car, recorded in Oklahoma, sought to replevy it. The Oklahoma certificate of title, which had been exhibited to defendant by S, contained space for the notation of liens, but with these cautionary words: "This is not an office of record for the filing of liens and does not guarantee the state as to liens in this certificate of title."<sup>20</sup>

The majority rule in the United States, reached in 1941 in Michigan through legislative action,<sup>21</sup> is that the recording laws of the state of execution will protect the mortgagee if the chattel is removed from

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17. Justice Butzel's reasoning on the issue of contributory negligence is questioned in Leidy, *Another New Tort?*, 38 Mich. L. Rev. 964, 981-984 (1940). The defense of the user's unreasonable conduct is discussed in Prosser, *The Assault Upon the Citadel (Strict Liability to the Consumer)*, 69 Yale L.J. 1099, 1147-48 (1960).

18. Annot. 18 A.L.R.2d 813 (1951).

19. 357 Mich. 394, 98 N.W.2d 633 (1959).

20. Defendant's Exhibit 1, Defendant's Appendix, p. 13a.

21. C.L. § 566.140a, M.S.A. § 26.929(1).

the jurisdiction without his consent. Since Oklahoma permits, but does not require,<sup>22</sup> notation of the lien in the certificate, it would seem to follow that the chattel mortgage would be good as against the Michigan purchaser.

Defendant, however, advanced a defense of estoppel. His argument was that since there were steps which plaintiff could conceivably have taken to secure notation of the lien on the certificate, he was now estopped from claiming an interest in the automobile. The Michigan Supreme Court in affirming the trial court's judgment for the plaintiff held, (1) that defendant was not a bona fide purchaser in good faith and (2) rejected the possibility that there was any basis for invoking an estoppel.

On the first ground, the court reasoned that since a disclaimer appeared on the face of the certificate, defendant did not act in good faith. This is in direct conflict with a decision of the Supreme Court of Arizona dealing with the same type of Oklahoma certificate.<sup>23</sup> Adoption of this absolute rule in Michigan precludes consideration of any fault in plaintiff's conduct. The trial court's suggestion that defendant, an experienced merchant, did not act in good faith because he knew the name of the new car dealer and could have called him or checked with the proper recording office is preferable.<sup>24</sup>

The second ground of decision rests on a firmer foundation. "As a matter of fact, the grounds for an estoppel do not here exist."<sup>25</sup> The record does not reveal facts showing that the plaintiff in any way prevented notation of the lien on the certificate. In such a situation the result might well be different.<sup>26</sup>

### TRUST RECEIPTS

The final case worthy of note involved a construction of the Uniform Trust Receipts Act, adopted in Michigan in 1952.<sup>27</sup> The trust receipt, a security device with which some lawyers are not familiar,<sup>28</sup> gives the lender (designated as the entruster) a security interest in goods held by the borrower (designated as the trustee). The indi-

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22. Okla. Laws 1935, § 1, 46 Okla. Stat. Ann. § 57 (1954); Okla. Laws 1955, § 1, 47 Okla. Stat. Ann. § 23.3 (1960 Supp.).

23. *Dissing v. Jones*, 85 Ariz. 139, 333 P.2d 725 (1958).

24. Record, pp. 36-37 as cited in defendant's Appendix, pp. 10a-11a.

25. 357 Mich. at 399, 98 N.W.2d at 635. Only defendant filed a brief and appendix so that it is not possible to have a complete picture of what happened when S secured his mortgage.

26. See, e.g., *Dissing v. Jones*, supra note 21.

27. C.L. §§ 555.401-419, M.S.A. §§ 19.535(1)-(19).

28. See *Dart Nat'l Bank v. Mid-States Corp.*, plaintiff's Appendix, p. 21b, infra note 30.

vidual loan transactions are not recorded; only a yearly statement of intention to engage in this type of financing is necessary. If the entruster conforms to the many technical requirements of the act, he will secure protection against the honest insolvency of the trustee by being able to retake the security. He also secures some protection against the trustee's dishonest disposition of the goods, but the extent of this depends upon the nature of the security, when filing occurred in relation to the time of disposition of the security, and the type of person to whom the security was transferred, e.g. a bulk buyer or a chattel mortgagee.

If the trustee sells the goods and is to account for the proceeds of the sale to the entruster then the entruster acquires a substituted security interest in the proceeds.<sup>29</sup> In *Dart Nat'l Bank v. Mid-States Corp.*,<sup>30</sup> E, the Entruster, provided the credit with which T, the trustee, was able to acquire some trailers for the purpose of retail sale. Upon the conditional sale of one trailer to P, T failed to account to E, but negotiated and assigned the conditional sales note and contract to B, a bank. The required statement of trust receipt financing had been filed but B had no actual notice of it. E discovered the fraud of T and secured possession of the trailer from P. B, claiming title to the trailer because of a default under the conditional sales contract,<sup>31</sup> brought an action of replevin against E.

Since the conditional sales contract and note were the proceeds of a sale of entrusted property, the question before the court was whether the entruster had a superior claim to that of B. Under the statute,

Nothing . . . shall limit the rights of purchasers in good faith and for value from the trustee of negotiable instruments or negotiable documents, and purchasers taking from the trustee for value, in good faith, and by transfer in the customary manner, instruments in such form as are by common practice purchased and sold as if negotiable, shall hold such instruments free of the entruster's interest; and filing under this act shall not be deemed to constitute notice of the entruster's interest to purchasers in good faith and for value of such documents or instruments, other than transferees in bulk.<sup>32</sup>

The court held that the note was negotiable and the contract an instrument within the quoted statutory language, and further that the transfer to B was in the customary manner for instruments which are treated as negotiable. It, therefore, affirmed the lower court's

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29. C.L. § 555.410, M.S.A. § 19.535(10).

30. 356 Mich. 574, 97 N.W.2d 98 (1959).

31. The default was not in payment but in permitting the entruster to take possession. See defendant's Appendix, p. 28a.

32. C.L. § 555.409(1)(a), M.S.A. § 19.535(9)(1)(a).

judgment for the purchasing bank, a decision which is in conformity with authority in other jurisdictions.<sup>33</sup>

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33. *Citizens Nat. Trust & Sav. Bank v. Beverly Fin. Co.*, 127 Cal. App.2d 853, 273 P.2d 714 (1954); *Canandaigua Nat'l Bank & Trust Co. v. Commercial Credit Corp.*, 285 App. Div. 7, 135 N.Y.S.2d 66 (1954) (Sup. Ct. 1953).

The outline of the Uniform Trust Receipts Act in the text is necessarily sketchy because of its complex nature. Those wishing to know more about it may consult the following: McGowan, *Trust Receipts* (1947); Bogert, *Effect of the Uniform Trust Receipts Act*, 3 U. of Chi. L. Rev. 26 (1935); Rohr, *Some Problems in Trust Receipt Financing*, 3 Wayne L. Rev. 22 (1956), Vold, *Sales* §§ 70-75 (1959). A comprehensive bibliography can be found in Hanna, *Cases and Materials on Security* 52-53 (1959).