UNIFORM COMMERCIAL CODE COMMITTEE

REPORT PREPARED FOR THE JUNE 3, 2006 COUNCIL MEETING

BUSINESS LAW SECTION

1. Next Scheduled Meeting of the Committee

There is no meeting of the Committee presently scheduled although I intend to schedule one this summer.

2. Council Approval

There are no matters pertaining to the Committee that require Council approval.

3. Membership

The list of members of the Committee was updated at the end of 2005.

4. Accomplishments Toward Committee Objectives

I am keeping abreast of current developments which are transmitted to the Committee members and other interested parties on a periodic basis.

5. Meetings and Programs

I do not presently anticipate any need for future programs. A meeting of the Committee will be scheduled for some time this summer.

6. Publications

Three articles on UCC topics will be published in the summer issue of the Michigan Business Law Journal along with two non-UCC articles.

7. Legislative/Judicial Administrative Developments

Attached please find a memorandum and summary of recent decisions relating to Michigan UCC provisions. This memo and summary have been sent to all members of the UCC Committee.

8. Miscellaneous

Nothing else to report.

Respectfully submitted,

Patrick E. Mears

MEMORANDUM

TO: All Members of the UCC Committee

FROM: Patrick E. Mears

DATE: May 19, 2006

RE: UCC Committee of Business Law Section of the State Bar

To All:

I am sending to you with this Memorandum brief summaries of recent decisions applying and interpreting provisions of Michigan's UCC.

I would like to schedule a meeting of the UCC Committee sometime in July or August here in Grand Rapids. Telephonic participation would be available. What I am interested in is getting ideas from all of you concerning possible Committee projects and seminars. Please let me know ASAP if you would be interested in participating in such a meeting.

Thank you.

Patrick E. Mears

MEMORANDUM

TO: All Members of the UCC Committee

FROM: Patrick E. Mears

DATE: May 19, 2006

RE: Recent Michigan Decisions Construing Provisions of the Uniform Commercial Code

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The following are brief summaries of recent court decisions applying and interpreting provisions of Michigan's UCC.

A. ARTICLE 2

1. *Dow Chemical Company v. General Electric Company*, 2005 WL 1862418 (E.D. Mich. August 4, 2005) (Lawson, D.J.)

In this litigation, Dow Chemical Company and a Mexican subsidiary (collectively, "Dow") commenced a civil action against General Electric Company and two of its subsidiaries (collectively, "GE") in the United States District Court for the Eastern District of Michigan by filing a complaint seeking a declaratory judgment that no enforceable contract for the sale of goods by Dow to GE existed under Article 2 of the UCC. GE filed an answer and counterclaim requesting a declaration that a contract between the parties existed and Dow was guilty of a breach of that contract. After extensive discovery, both Dow and GE moved for partial summary judgment.

Judge David Lawson granted limited relief with respect to both motions but reserved the issue of whether an enforceable contract resulted from the long and tortuous negotiations between the parties. In his opinion, Judge Lawson considered the applicability of the contract formation rules contained in MCL §§ 440.2204 and 440.2206. Judge Lawson also reviewed the statute of frauds provision in MCL 440.2201 and case law decided thereunder in dismissing Dow's affirmative defense that the alleged contract failed to satisfy the UCC's statute of frauds requirement.

2. *Pidcock v. Ewing*, 371 F.Supp. 870 (E.D. Mich. 2005) (Cohn, D.J.). The plaintiffs, the purchasers of a motor home, commenced an action against two manufacturers of the home and the dealer that sold the plaintiffs the home by filing a complaint asserting breach of warranty claims against all defendants in the United States District Court for the Eastern District of Michigan. The plaintiffs claim for breach of express warranty against Monaco Coach Corporation ("Monaco"), the manufacturer of the "house" portion of the motor home, was dismissed as barred by the contractual statute of limitations upon Monaco's motion for summary judgment. Monaco's express warranties were subject to a 12 month/24,000 mile contractual

limitation, as permitted by MCL 440.2725. The plaintiffs commenced their action after expiration of this warranty, which proved fatal to their claim. Judge Avern Cohn also dismissed plaintiffs' claim for breach of implied warranties against Monaco and Road Master Chassis, the manufacturer of the motor home's chassis ("Road Master"), on the ground that no privity existed between the plaintiffs and these two defendants as required by Michigan law to support a claim for economic losses arising from breach of an implied warranty. In reviewing Michigan case law, Judge Cohn noted that the "modern trend" required privity, citing primarily *Mt. Holly Ski Area v. U.S. Elec. Motors*, 666 F.Supp 115 (E.D. Mich. 1987). However, Judge Cohn cited other Michigan cases decided to the contrary, e.g., *Michels v. Monaco Coach Corporation*, 298 F.Supp.2d 642 (E.D. Mich. 2003) (Duggan, D.J.). Judge Cohn also dismissed plaintiffs' claim against Monaco and Road Master that they had revoked their acceptance of the goods under MCL § 440.2608; the plaintiffs lacked the necessary privity. Judge Cohn dismissed the plaintiffs' independent claim against these two manufacturing defendants and the dealer for breach of the duty of good faith and fair dealing under MCL § 440.1203. Judge Cohn wrote that this Code provision does not create an independent claim for failure to perform or enforce a contract for the sale of goods in good faith, citing the Official Comment to this UCC section. Finally, the Court dismissed the plaintiffs' claims against the dealer for breach of express and implied warranties because these warranties had been effectively disclaimed under MCL § 440.2316(2).

3. *Gernhardt v. Winnebago Industries*, 2005 WL 2562783 (E.D. Mich. Oct. 12, 2005) (Borman, D.J.). The facts of this case and the claims asserted therein are remarkably similar to those present in *Pidcock v. Ewing*, supra. What is important about this decision is that Judge Borman reversed his earlier decision rendered in the same litigation and concluded that privity is not necessary to support a claim for economic loss on a breach of implied warranty claim. Judge Borman granted the plaintiff's request to amend their Complaint to assert these claims, thereby disagreeing with Judge Cohn's ruling in *Pidcock*.

4. *Chainworks, Inc. v. Webco Industries, Inc.*, Case No. 1:05-cv-135 (W.D. Mich. Feb. 24, 2006) (Bell, D.J.). In this litigation commenced by a buyer of goods under a requirements contract, the plaintiff sought a declaration from Federal District Judge Robert Holmes Bell that the defendant seller could not pass on raw material price increases to the buyer under a theory of commercial impracticability embodied in MCL § 440.2615. In support of his decision granting the buyer's motion for summary judgment, Judge Bell found that the parties knew that the price of steel was volatile and that they contracted against this background. Thus, the seller could not sustain its claim that an increase in the price of steel was unforeseeable and that the nonoccurrence of such a price increase "was a basic assumption underlying the agreement," as required by MCL § 440.2615.

5. *Deerfield Mfg., Inc. v. JEM Investment Properties*, 2005 WL 2562956 (E.D. Mich. Oct. 11, 2005) (Cohn, D.J.). This litigation involved competing claims by two purchasers to two metal stamping presses sold twice by the seller, the former owner of a building in which the presses were located. The seller first entered into a contract for the sale of the land and building localed thereon to JEM Investment Properties ("JEM"). This contract provided that title to the two presses would not pass to JEM unless the presses were removed within 90 days of the closing of the sale. If this removal did not occur within this period (which, in fact, happened), the contract provided that title to the presses would then pass to JEM. Prior to the closing of the

sale, the seller contracted with Deerfield Mfg., Inc. ("Deerfield") for the sale of the presses. However, Deerfield failed to remove these goods within the 90-day period following closing. In his opinion granting partial summary judgment to JEM, Judge Avern Cohn concluded that the seller had voidable title to the presses under MCL § 2-403(1) sufficient to pass title to JEM and that JEM had paid value for them under MCL § 440.1201(44)(d). The only remaining issue that remained to be decided at trial was whether JEM acted in good faith in taking title.

B. ARTICLES 3, 4 AND 4A

1. *In re Broucek*, Case No. SG 02-12883 (Bankr. W.D. Mich. April 17, 2006) (Stevenson, B.J.). Daniel Broucek, an individual, conducted a Ponzi scheme whereby his promised stratospheric returns to investors arising from his purchase and resale of fictitious goods. Eventually, the scheme failed and Broucek became the subject of a Chapter 7 case commenced in the United States Bankruptcy Court for the Western District of Michigan. The Ponzi scheme collapsed when, among other things, the United States government seized $6 million plus in an account established at Bank One, N.A. at a branch in Grand Rapids, Michigan (the "Pupler Account"). The mechanics of the scheme, according to Judge Jo Ann Stevenson, worked as follows. Investors would provide Broucek with funds in the form of official or "bank" checks that Broucek would deposit in the Pupler Account. Broucek then caused to be issued bank checks for principal and interest payable to investors as a return on their investment also from the Pupler Account. These checks were delivered to a third party who then deposited them to each investor's account maintained at another Bank One branch. This second branch accepted these deposits and credited each investor's account the amount of each bank check and then issued other bank checks for these amounts payable to Broucek. These checks were then returned to the third-party intermediary, who would then deposit them at the first Bank One branch. "There, the official checks were honored and the cycle would begin again."

As a result of the United States' seizure of the Pupler Account, Bank One suffered an overdraft loss of $678,295.81. Bank One then filed a proof of claim for $1.5 million plus in Broucek's Chapter 7 case. The Chapter 7 trustee thereafter objected to this claim and an evidentiary hearing was thereafter conducted on this objection before Judge Stevenson.

Bank One claimed that Broucek was liable for its overdraft losses under its account agreement with Broucek and also under Articles 3 and 4 of the UCC. Bank One asserted that "each time [Broucek] endorsed an investor's check for deposit, he represented and warranted that the check was not subject to any claim or defense and recoupment," citing MCL § 440.3416 and 440.4207. According to Bank One, it relied upon these representations and warranties, processed the checks, and paid certified funds into the Pupler Account. Nevertheless, Judge Stevenson rejected the Bank One's breach of warranty claims on the ground that Bank One and not the investors issued the checks that were the subject of these claims. In sum, Judge Stevenson concluded Broucek did not breach any transfer warranties that would support the Bank One's claim.

2. *Hoerstman General Contracting, Inc. v. Hahn*, Case No. 126958 (Mich. March 23, 2006).

This case involved a dispute between homeowners and a general contractor concerning a contract to remodel and reconstruct the owner's lakeside residence. The general contractor delayed its work and caused cost overruns. When the general contractor failed to meet the contract deadline, the homeowners advised the contractor that they would pay the extra costs incurred just to get the job finished. Upon completion of the work, a dispute developed over the proper price. The homeowners tendered a check to the contractor for a sum less than the amount demanded, writing "final payment" on the check. The contractor deposited the check after striking out the "final payment" legend and thereafter sued the homeowners for the difference.

On appeal to the Michigan Supreme Court, that court found that the parties reached an accord and satisfaction under MCL 440.3311. The Supreme Court thereby reversed the decision of the Michigan Court of Appeals and remanded the case to the trial court with the direction to enter judgment in favor of the defendants.

3. *Bibler v. Arcata Investments 2, LLC*, 2005 WL 3304127 (Mich. Ct. App. Dec. 6, 2005).

This action involved an action to quiet title to certain mortgaged real estate that was occasioned by the bankruptcy case of Commonpoint Mortgage Company. One issue decided on appeal involved the negotiability of a promissory note that was accompanied by a mortgage. The Michigan Court of Appeals reversed the trial court's ruling that the note and mortgage must be "read together as one document rendering them nonnegotiable." The Court of Appeals relied on MCL 440.3106(2)(a) in concluding that the promise to pay in the note was not rendered conditional by the "reference to another writing for a statement of rights with respect to collateral, prepayment, or acceleration." Thus, the promissory note contained an "unconditional promise or order to pay a fixed amount of money" as required by the negotiability standard of MCL § 440.3104(1).

4. *Prime Financial Services, LLC v. Bank One, N.A.*, Case No. 1:04-cv-414 (W.D. Mich. Feb. 14, 2006) (Quist, D.J.). This action also arose from the Broucek Ponzi scheme previously described herein. In this civil action, the plaintiff, Prime Financial Services, LLC ("Prime") commenced an action against Bank One, N.A. for recovery of $635,000 plus interest that was transferred from Prime's checking account to Broucek. Prime asserted that these transfers were unauthorized under Article 4A of the UCC and, therefore, recoverable. Prime filed a motion for summary judgment on this claim, which was denied in large part by Federal District Court Judge Gordon J. Quist on the ground that a generic issue of material fact existed as to whether a transfer of $630,000 was authorized by Prime. Judge Quist, however, granted Prime's motion with respect to a separate transfer of $5,000 made by Bank One from Prime's account. In his decision, Judge Quist discussed in detail the provisions of Article 4A of the UCC governing "funds transfers" as adopted in Michigan.

C. ARTICLE 9

1. *Meoli v. Citicorp Trust Bank (In re Oswalt)*, Case No. 05-1075 (6th Cir. April 20, 2006).

In this recent decision, the Sixth Circuit Court of Appeals held that a 2004 amendment of the Michigan statutes governing perfection of liens in mobile homes, MCL §§ 125.230-125.2350, granted retroactive effect to a 2003 amendment of those same rules. The 2003 amendment specifically permits a creditor to perfect a lien in a mobile home by recording a mortgage covering the real estate upon which the home rests. This same amendment legislatively overruled the Sixth Circuit's earlier decision in *Boyd v. Chase Manhattan Mortgage Corp. (In re Kroskie)*, 315 F.3d 644 (6th Cir. 2003), which permitted a bankruptcy trustee of the mobile home owner to avoid a security interest in a mobile home when the creditor failed to perfect in accordance with the Michigan Mobile Home Commission Act by having the lien noted on the mobile home's certificate of title. This avoidance was allowed notwithstanding that the creditor had recorded a mortgage on the underlying realty.

2. *Fodale v. Waste Management of Michigan, Inc.*, Case No. 253446 (Mich. Ct. App. May 2, 2006).

This decision involved litigation commenced by a borrower against a creditor holding a security interest in an option to purchase the plaintiff's interest in a shareholder redemption agreement. The UCC claims asserted against the secured creditor were (i) violations of "old" part 5 of Article 9 of the UCC pertaining to dispositions of collateral; and (ii) breach of the secured creditor's implied covenant of good faith and fair dealing. This decision contains an extensive discussion of various "old" Article 9 provisions, much of which continues to be relevant under revised Article 9. Matters addressed in the opinion include (i) definitions of collateral; (ii) notices of dispositions of collateral; (iv) payment of surplus after sale; (v) redemption rights; and (vi) acceptance of collateral in satisfaction of debt (*viz.*, strict foreclosure). The Michigan Court of Appeals found that, even though certain of the plaintiff's post-default rights had been violated by the secured creditor's actions, these did not affect the outcome of the case. The Court found that the plaintiff had "acquiesced to defendant's proposal to accept the collateral in satisfaction of the debt" by failing to object in writing within 21 days after the secured creditor transmitted its proposal to the plaintiff. In addition, the Court of Appeals followed establish precedent in upholding the trial court's dismissal of plaintiff's breach of contract claim. The Court declared that "Michigan does not recognize a cause of action for breach of the implied covenant of good faith and fair dealings."