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Waiver of Defense Clauses and Consumer Protection in Installment Sales Contracts

WAIVER OF DEFENSE CLAUSES AND CONSUMER PROTECTION IN INSTALLMENT SALES CONTRACTS

I. INTRODUCTION

American courts, of late, have been vexed with the problems arising from the use of waiver of defense clauses in conditional sales contracts. Advocates of consumer protection, believing that these clauses are just one more device used by "emboldened loan sharks and slippery salesmen to take advantage of an often too-trusting public,"[1] urge their per se invalidity. Consumer protection, they argue, is necessary because of the "pressure" selling methods employed by some dealers and because the typical consumer has little or no understanding of what he is signing nor does he comprehend the complexity of the transaction.[2] Few consumers realize that when a waiver clause is effectively utilized they will be required to pay the full purchase price even though their purchase might never work correctly or even be delivered. In such a situation, the consumer's only apparent remedy will be to sue the seller for any loss suffered since his defenses will be cut off as against the assignee of his installment contract.[3]

Restrictions upon financing institutions may also be warranted by the increased number of consumer bankruptcies resulting, to a large degree, from widespread ignorance of the legal implications of installment buying,[4] and by "present credit practices [which] are simply too complicated, complex, and confusing" for the consumer to understand.[5] Almost every argument for increased consumer protection points out that the average buyer (1) does not fully read nor fully understand all the papers he is confronted with in a credit transaction; (2) is rarely able to ascertain the existence of any defects in the product or its performance at the time of the sale; and (3) is generally unaware of any of his limited rights in connection with the sale transaction.[6]

It has also been urged that between two "innocent parties," the buyer and the financing institution, the latter is in a better position to absorb any loss which might occur because of a defect in the item or a default by the seller. This theory is based on the idea that the financing institution is usually in a close business relationship with the seller and consequently should be better able to determine the solvency or good faith of the parties.[7] Moreover, the installment buyer is usually without any real remedy because he generally is, unlike the finance company, a person of limited means and is, therefore, unable to pursue

1. Life, July 28, 1967, at 4 (editorial).

2. See King, The Unprotected Consumer-Maker Under the Uniform Commercial Code, 65 Dick. L. Rev. 207, 211-13 (1961).

3. See generally Vernon, Priorities, The Uniform Commercial Code and Consumer Financing, 4 B.C. Ind. & Com. L. Rev. 531, 542-48 (1963).

4. See generally 113 Cong. Rec. 8872-73 (daily ed. June 26, 1967).

5. 113 Cong. Rec. 7520 (daily ed. May 31, 1967).

6. See notes 2 & 3 supra.

7. See generally 2 Report of the New York Law Revision Commission 1131-33 (1954).

costly litigation against the dealer. If he is able to go into court, his attempt may be thwarted if the seller cannot be found or has gone into bankruptcy.[8]

Though these arguments weigh quite heavily in favor of the consumer, much has been said in defense of the financing institutions. The invalidation of these waiver clauses and similar restrictions would disrupt the present system of installment financing[9] in that they would make it very difficult for dealers and sellers to dispose of the chattel paper which arises out of the sale of consumer goods.[10] And if dealers were in this way forced to retain and collect their own installment obligations, they would suffer a substantial decrease in working capital. Therefore, since the only way a large majority of people can purchase most consumer goods is through financing institutions, it is to the consumer's benefit that the ability of these institutions to engage profitably in retail-consumer installment transactions be preserved.[11]

Restrictions upon financing institutions also have the effect of putting the credit customer in a better position than the buyer who negotiates a loan directly with a bank or small loan company and then uses the money to purchase consumer goods. If the dealer defaulted or the item failed to work satisfactorily, what justification would the buyer have for withholding his installments from the bank when they fall due?[12] The typical transaction where waiver clauses are used involves a seller and a financing institution who have entered into an arrangement whereby the seller discounts his installment contracts to the financing institution. Those who favor giving effect to waiver clauses contend that such an arrangement should not be viewed as a joint venture between the financing institution and the seller. Rather, they argue that its main function is to supply the buyer with ready cash so he can obtain immediate possession of the goods, which cash he is to repay over an extended period of time. Moreover, since no party representing the financing institution is in any way connected with the sale itself, the finance company should not be bound by any representations made by the seller for the purpose of inducing the sale.[13]

The foregoing discussion indicates the existence of many valid policy considerations which might affect judicial thinking on the enforceability of waiver clauses. Unfortunately, however, the courts have shied away from the complexities of sociological jurisprudence and have focused their energies instead on a rather formalistic development of statutory interpretation, with a perhaps undue reliance on antiquated judicial precedent.

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8. See generally Hogan, A Survey of State Retail Installment Sales Legislation, 44 Cornell L.Q. 38 (1958); Gilmore, The Commercial Doctrine of Good Faith Purchase, 63 Yale L.J. 1057 (1954); See also, Mutual Finance Co. v. Martin, 63 So. 2d 649 (Fla. 1953).

9. 2 Report of the New York Law Revision Commission 1196 (1954).

10. See Vernon, Priorities, The Uniform Commercial Code and Consumer Financing, 4 B.C. Ind. & Com. L. Rev. 531, 547 (1963).

11. Note, 51 Ky. L.J. 134, 138 (1962).

12. See Jones, Finance Companies as Holders in Due Course of Consumer Paper, 1958 Wash. U.L.Q. 177; 7 Personal Finance L.Q. 76 (1953).

13. 2 Report of the New York Law Revision Commission 1106 (1954).

The waiver clause problem has been further complicated where non-consumer goods as opposed to consumer goods are involved. The Uniform Commercial Code has attempted to rectify this situation with section 9-206(1), but recent decisions in this area show that the present status of these clauses is still in confusion. It is relevant to point out that the Code purposely left the question of the validity of these clauses where consumer goods are involved up to the state courts and legislatures, but made them valid in all cases where non-consumer goods are involved. However, since little statutory or decisional law to the contrary exists, consumer and non-consumer transactions have been treated almost identically.

It is necessary to examine the pre-Code decisions in this area and to compare them with cases under the Code and under other statutory regulations in the field of installment financing in order to arrive at a determination of what the status of the law presently is in this area and what it will be in light of the Code's rules as to the validity of a waiver clause.

II. PRE-CODE

Waiver of defense clauses are typically found in conditional sales contracts which are used by sellers who offer time payment or installment purchase plans. These clauses facilitate the discounting of the note and contract to a third party, usually a bank or finance company.[14] These waiver clauses are found with both negotiable and non-negotiable instruments and usually arise where a buyer purchases goods by making a down payment and signing a note and a contract for the balance. Shortly after this transaction occurs, both the note and the contract containing the waiver clause will be assigned to the finance company or bank who will pay the dealer the face amount of the note less the standard discount.[15] If, however, something should happen to the goods subsequent to this assignment, the buyer would have recourse only against the original seller since the waiver clause in the contract would cut off any defenses which may arise as against the assignee of the note and contract.

An early draft of section 9-206[16] had specifically declared that all waiver clauses were unenforceable by any person, even a holder in due course of a negotiable instrument. Such a holder would have been subject to all the defenses of the maker whether he proceeded upon the instrument or upon the security agreement. As written, this draft abrogated the weight of authority both in New York and in other jurisdictions, which, in order to facilitate day-to-day commer-

14. See 75 Harv. L. Rev. 437 (1961).

15. See, Vernon, Priorities, The Uniform Commercial Code and Consumer Financing, 4 B.C. Ind. & Com. L. Rev. 531, 542 (1963).

16. "An agreement by a buyer of consumer goods as part of the contract for sale that he will not assert against an assignee any claim or defense arising out of the sale is not enforceable by any person. If such a buyer as part of one transaction signs both a negotiable instrument and a security agreement even a holder in due course of a negotiable instrument is subject to such claims or defense if he seeks to enforce the security interest either by proceeding under the security agreement or by attaching or levying upon the goods in an action upon the instrument." Uniform Commercial Code § 9-206(1) (1952 version).

cial financing,[17] had generally upheld these clauses in the absence of some special affront to public policy.

However, many early cases had struck down certain waiver clauses as being against public policy,[18] even though no more than the normal business relationship existed between the assignee and the seller. These cases treated the assignment as an integral part of the sales transaction itself.[19] The leading case of

17. E.g., United States v. Hansett, 120 F.2d 121 (2d Cir. 1941); United States v. Bryant, 58 F. Supp. 663 (S.D. Fla. 1945), aff'd, 157 F.2d 767 (5th Cir. 1946); Coral Gables, Inc. v. Heim, 120 Conn. 419, 181 A. 613 (1935); Jones v. Universal C.I.T. Credit Corp., 88 Ga. App. 24, 75 S.E.2d 822 (1953); National City Bank v. La Porta, 109 N.Y.S.2d 143 (Sup. Ct. 1951); Glen Falls Nat'l Bank & Trust Co. v. Sansivere, 136 N.Y.S.2d 672 (Saratoga County Ct. 1955). In United States ex rel. Adm'r v. Troy-Parisian, Inc., 115 F.2d 224 (9th Cir. 1940), a case involving breach of warranty on laundry equipment, the court said: "Buyer and seller stood on equal footing and it is evident that this clause was deliberately inserted as a means of facilitating the financing of the sale through the named local bank. Unless in circumstances affronting public policy, it is no part of the business of the courts to decline to give effect to contracts which the parties have fairly and deliberately made." Id. at 226. See also United States v. Novsam Realty Corp., 125 F.2d 456 (2d Cir. 1942) where the court held that unless the assignee had actual notice, he takes free of all defenses.

More specifically, the courts have sustained these waiver clauses because of the deeply-rooted idea that the free flow of commerce should not be impaired. See National City Bank v. Prospect Syndicate Inc., 170 Misc. 611, 10 N.Y.S.2d 759 (N.Y.C. Mun. Ct. 1939). Basic also has been the idea that between two innocent parties the holder in due course should prevail. See, e.g., Cotton v. John Deere Plow Co., 246 Ala. 36, 18 So.2d 727 (1944); B.A.C. Corp. v. Cirucci 131 N.J.L. 93, 35 A.2d 36 (1944); Commercial Credit Co. v. M. McDonough Co., 238 Mass. 73, 130 N.E. 179 (1921); cf. King, The Unprotected Consumer-Maker under the Uniform Commercial Code, 65 Dick. L. Rev. 207, 210-11 (1960).

Another theory for upholding these clauses has been advanced by assignees, both in New York and in other jurisdictions, and has been characterized as the "estoppel theory." National City Bank v. Prospect Syndicate, Inc., 170 Misc. 611, 10 N.Y.S.2d 759 (N.Y.C. Mun. Ct. 1939); Bank of Centerville v. Larson, 47 S.D. 374, 199 N.W. 46 (1924); Guaranty Sec. Co. v. Equitable Trust Co., 136 Md. 417, 110 A. 860 (1920); Continental Nat'l Bank v. National Bank of the Commonwealth, 50 N.Y. 575 (1872). Under this theory, a buyer would only be estopped by his conduct from asserting any defenses against an assignee if (1) the buyer signed the contract in order to induce the assignee to purchase the contract or to enable the seller to assign it; (2) the assignee relied on this representation; (3) the buyer signed the contract with knowledge that it would be assigned; and (4) the assignee had no knowledge of the defenses of the seller. President and Directors of Manhattan Co. v. Monogram Associates, Inc., 276 App. Div. 766, 92 N.Y.S.2d 579, rehearing and appeal denied, 276 App. Div. 870, 93 N.Y.S.2d 923 (3d Dep't 1949), appeal dismissed mem., 300 N.Y. 677, 91 N.E.2d 328 (1950). See also Public Nat'l Bank & Trust Co. v. Fernandez, 121 N.Y.S.2d 721 (N.Y.C. Mun. Ct. 1952), which indicates some circumstances where the defendant would not be estopped. As a practical matter, it was seldom found that a buyer affirmatively, knowingly and intentionally made such a waiver, so consequently this theory has received little judicial recognition. See generally Annot., 44 A.L.R.2d 8 (1955).

18. E.g., Equipment Acceptance Corp. v. Arwood Can Mfg. Co., 117 F.2d 442 (6th Cir. 1941).

19. See General Motors Acceptance Corp. v. Associates Discount Corp., 38 N.Y.S.2d 972 (Syracuse Mun. Ct. 1942) rev'd on other grounds, 267 App. Div. 1032, 48 N.Y.S.2d

Commercial Credit Co. v. Childs,[20] held that where a retailer negotiates installment paper to a finance company with whom he has a close, but not abnormal, connection, it is very likely that the finance company will be subject to the defenses of the buyer. Here, the defendant purchased an automobile upon the false and fraudulent representations by the dealer that the car was in practically perfect condition, when it was actually of little or no value. The plaintiff had prepared the written assignment before the contract was executed, financed the whole transaction, prepared all the necessary papers and took the assignment the same day the contract was executed.[21] The court reasoned that the dealer and the finance company were so closely connected with the sale that the finance company could not be a holder in due course and for all practical purposes, it was an original party to the transaction[22] and subject, therefore, to the personal defense of fraud.

Public National Bank & Trust Co. v. Fernandez[23] also adopted this reasoning. This court stated: "Basic fair dealings and public policy would appear to dictate that this rule [prima facie validity of waiver clauses] be limited to those cases where the assignment is bona fide and where the assignee is not so identified with the seller, to an extent that it could fairly be said that the dealings of one are inextricably interwoven with that of the other."[24]

Here, the plaintiff purchased a television set from a dealer and signed a conditional sales contract with a waiver clause which was assigned the following day to the plaintiff. The set never worked properly, and after the defendant defaulted in his payments to the plaintiff, the set was removed, ostensibly for repairs, but was sold by the plaintiff, who then sued the defendant for the deficiency. Here the evidence showed that (1) all installments were to be made to the plaintiff; (2) title remained either in the dealer or its assignee; and (3) the sale and the assignment were made simultaneously, even before the physical delivery of the set.[25] The court decided that these circumstances were sufficient to raise a question of fact as to whether the dealer was merely an agent for the plaintiff and, therefore, whether their relationship might be sufficient to negate the plaintiff's status as a holder in due course.[26] The relationship between the dealer and plaintiff herein was not unlike that in the *Childs* case and the court, while not specifically saying so, was adhering to the view that where the parties'

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242 (4th Dep't 1944); Buffalo Indus. Bank v. De Marzio, 162 Misc. 742, 296 N.Y.S. 783 (Buffalo City Ct. 1937), rev'd on other grounds, 6 N.Y.S.2d 568 (Sup. Ct. 1937).

20. 199 Ark. 1073, 137 S.W.2d 260 (1940).

21. Id. at 1074, 137 S.W.2d at 261.

22. Accord, see cases cited in note 19 supra.

23. 121 N.Y.S.2d 721 (N.Y.C. Mun. Ct. 1952).

24. Id. at 724.

25. Id.

26. This case relied substantially on Buffalo Indus. Bank v. De Marzio, 162 Misc. 742, 296 N.Y.S. 783 (Buffalo City Ct.), rev'd on other grounds, 6 N.Y.S.2d 568 (Sup. Ct. 1937), which held that if a finance company was connected in any way with a seller, it "should be no more allowed to escape from the effects of the misrepresentation of a salesman than is the merchant himself." 162 Misc. at 745, 296 N.Y.S. at 786.

dealings are "inextricably interwoven," the good faith of the assignee will be cast into doubt. Another reason advanced was the so-called "single contract" theory, which was typified by the case of *State National Bank v. Cantrell.*[27] Here, the court announced the rule that when a purchaser of a negotiable instrument is simultaneously assigned a conditional sale contract, he is subject to all defenses arising from the contract, even though he might have been a holder in due course of the note. This rule has been applied in a few New York cases,[28] but it has not met with judicial favor and for all practical purposes is irrelevant to present judicial determinations in this area.[29]

Where non-negotiable instruments were involved, some courts refused to uphold waiver clauses because they felt that to do so would give a non-negotiable instrument the attribute of negotiability.[30] However, other courts have reached the opposite result upon the theory that since a defense would have been cut off by a holder in due course if the note was negotiable, it is not an affront to public policy if a waiver clause is allowed to give a non-negotiable instrument limited attributes of negotiability.[31]

III. Section 9-206(1) and Amendments Thereto

The present Code provision which concerns agreements not to assert defenses against an assignee provides:

Subject to any statute or decision which establishes a different rule for buyers or lessees of consumer goods, an agreement by a buyer or a lessee that he will not assert against an assignee any claim or defense which he may have against the seller or lessor is enforceable by an assignee who takes the assignment for value, in good faith and without notice of a claim or defense, except as to defenses of a type which may be asserted against a holder in due course of a negotiable instrument under the Article on Commercial Paper (Article 3). A buyer who as part of one transaction signs both a negotiable instrument and a security agreement makes such an agreement.[32]

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27. 47 N.M. 389, 143 P.2d 592 (1943).

28. See C.I.T. Corp. v. Joffe, 157 Misc. 225, 283 N.Y.S. 881, (N.Y.C. Mun. Ct. 1935), rev'd on other grounds sub nom. State Bank v. Bache, 162 Misc. 328, 293 N.Y.S. 659 (Sup. Ct. 1937); Federal Credit Bureau, Inc. v. Zelkor Dining Car Corp., 238 App. Div. 379, 264 N.Y.S. 723 (1st Dep't 1933), overruled on other grounds in Gellens v. 11 West 42nd Street Inc., 259 App. Div. 435, 19 N.Y.S.2d 525, rehearing and appeal denied, 259 App. Div. 1002, 20 N.Y.S.2d 985 (1st Dep't 1940).

29. See Annot., 44 A.L.R.2d 8 (1955). In United States v. Novsam Realty Corp., 125 F.2d 456 (2d Cir. 1942), the court, in applying New York law, held that this doctrine was opposed to the current authority in the state and therefore refused to follow it.

30. See Old Colony Trust Co. v. Stumpel, 126 Misc. 375, 213 N.Y.S. 536 (Sup. Ct. 1926), aff'd mem., 219 App. Div. 771, 220 N.Y.S. 893 (1st Dep't 1927), aff'd mem., 247 N.Y. 538, 161 N.E. 173 (1928); Hare & Chase v. Volansky, 127 Misc. 26, 215 N.Y.S. 168 (Sup. Ct. 1926).

31. See Glens Falls Nat'l Bank & Trust Co. v. Sansivere, 136 N.Y.S.2d 672 (Saratoga County Ct. 1955); United States ex rel. Adm'r v. Troy-Parisian, Inc., 115 F.2d 224 (9th Cir. 1940).

32. N.Y. U.C.C. § 9-206(1) (emphasis added).

A literal reading of this section indicates that consumer goods are given special recognition, but the case law construing it does not, unfortunately, talk in terms of consumer and non-consumer goods.[33] Comment 2 to section 9-206 states that "[t]his Article takes no position on the controversial question whether a buyer of consumer goods may effectively waive defenses by a contractual clause or by execution of a negotiable note."[34] New York has enacted specific statutory requirements which are aimed at preserving a consumer's defenses against an assignee of both the negotiable instrument and the retail installment contract.[35] Only Massachusetts would seem to have legislation to the same effect.[36]

To cut off the defenses of the buyer under section 9-206(1), the assignee must take for value,[37] in good faith,[38] and without notice of a claim or defense.[39] In any event, all "real defenses" are available to the buyer in an action brought either on the note or the contract.[40] These "real defenses" are infancy, if it is a defense to a simple contract; other incapacity, duress or illegality which renders the transaction void; fraud in the factum; discharge in insolvency; and any other discharge the holder has notice of when he takes the instrument.[41]

Pre-Code decisions have sustained defenses advanced by the buyer where the assignee and the seller were in a close business relationship.[42] The fact that this relationship existed led the courts to infer that the assignee was not in "good faith" and, consequently, the assignee had "reason to know" that a claim or defense existed.[43] To date, "good faith" has not been construed in connection

33. See part IV infra.

34. N.Y. U.C.C. § 9-109 defines goods as consumer goods "if they are used or bought for use primarily for personal, family or household purposes."

35. N.Y. Pers. Prop. Law §§ 302(9), 403(1), (3). See notes 67-85 infra and accompanying text.

36. Mass. Ann. Laws ch. 255, § 12C (Supp. 1966) states: "If any contract for sale of consumer goods on credit entered into in the commonwealth between a retail seller and a retail buyer requires or involves the execution of a promissory note, such note shall have printed on the face thereof the words 'consumer note,' and such a note with the words 'consumer note' printed thereon shall not be a negotiable instrument within the meaning of the Uniform Commercial Code—Commercial Paper." Three other states, Michigan, Pennsylvania, and Oregon, have legislated in this area, but all three are very limited in scope. See Vernon, Priorities, the Uniform Commercial Code and Consumer Financing, 4 B.C. Ind. & Com. L. Rev. 531, 544-46 (1963).

37. The definition of "value" in N.Y. U.C.C. § 3-303 is more restrictive than the definition of value in N.Y. U.C.C. § 1-201(44). It is submitted that an assignee, who would not qualify as to § 3-303 and therefore not be considered a holder in due course, could come in under § 1-201(44) as the section applies to Article 9 while the former does not.

38. N.Y. U.C.C. § 1-201(19) defines "good faith" as "honesty in fact in the conduct or transaction concerned." § 9-105(4) would seem to make the definition applicable to Article 9.

39. N.Y. U.C.C. § 1-201(25) defines three instances where a person is said to have "notice" of a fact.

40. See note 32 supra and accompanying text.

41. N.Y. U.C.C. § 3-305.

42. See notes 22-27 supra and accompanying text.

43. See N.Y. U.C.C. § 1-201(25)(C); See also Buffalo Indus. Bank v. De Marzio,

with section 9-206(1), but it would seem that, since "good faith" is an elusive term as defined in the Code, the particular circumstances of each case will dictate a flexible application of this concept.[44]

As stated above, the earlier drafts of section 9-206(1) declared that waiver clauses were "unenforceable" when contained in installment contracts covering consumer goods. Prior to the enactment of the Code, the courts had never clearly defined the effect and validity of such a waiver clause but with the earlier drafts so written, the Law Revision Commission felt that "at least, this Section now settles with certainty an existing uncertain state of the law."[45] However, the effect of these early drafts was to deny negotiability to a negotiable instrument when it was accompanied by a security device. Here, the only recourse the assignee had would be to sue on the note alone as he would then have the status of a holder in due course if he met the requirements of section 3-302.[46] However, the foregoing would be true only if the assignee proceeded against property which was not covered by the security agreement. As written, this section was at variance with the traditional rules as to a holder in due course and also gave favored treatment to a consumer-buyer at the expense of the commercial finance industry.[47] In the 1957 draft, which is now in force in New York with one minor change, the revisioners, partly because of the lobbying of financial institutions,[48] modified the section so that purchasers of consumer goods could waive all defenses which could not be raised against a holder in due course, absent any state statute or decision to the contrary.[49]

As noted previously, the present New York version of section 9-206(1) differs substantially from the earlier drafts and gives full effect to waiver clauses with a limitation as to consumer goods. That is, under section 9-206(1), waiver clauses are enforceable, "subject to any statute or decision which establishes a different rule . . . ." The official comments to this section suggest that these waiver clauses will be valid unless a statute or decision restricts "the waiver's effectiveness in the case of a buyer of consumer goods."[50] It has, however, been argued that a waiver clause will be valid under section 9-206(1) only if a particular state has a statute or judicial decision making it so,[51] but the reasoning of the official comments would seem more logical. At the present time in New York, there is no judicial decision to the "contrary" but two statutes now

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162 Misc. 742, 296 N.Y.S. 783 (Buffalo City Ct. 1937), rev'd on other grounds, 6 N.Y.S.2d 568 (Sup. Ct. 1937); cf. Note, 23 S. Cal. L. Rev. 580, 583 (1950).

44. See Note, 23 U. Pitt. L. Rev. 754 (1962).

45. Supplement No. 1 to the 1952 Official Draft of Text and Comments of the Uniform Commercial Code, Part II, at 184 (1955).

46. Cf. Comment, 55 Nw. U.L. Rev. 389, 401 (1960).

47. See generally Shattuck, Secured Transactions Under the U.C.C., 29 Wash. L. Rev. 1, 36-38 (1954).

48. 2 New York State Law Revision Commission, Hearings on the Uniform Commercial Code 1099-1108.

49. See note 32 supra and accompanying text.

50. N.Y. U.C.C. § 9-206, Comment 2.

51. Comment, supra note 46, at 401-02.

in effect do, to a limited extent, preserve the defenses of the consumer-buyer against the assignee.[52]

Under the present section,[53] the absence of any provision to the contrary constitutes a waiver of defenses as against an assignee when the buyer signs both a negotiable instrument and a security agreement. To date there has been no judicial interpretation of this clause with regard to either consumer or non-consumer goods, but it would seem that the mere absence of a clause specifically retaining defenses may now constitute an affirmative waiver, even in light of the prior judicial treatment of the theory of estoppel by conduct.[54]

The last official text amendment to section 9-206(1) was adopted by New York in 1963 when the section was made applicable to leases as well as conditional sales contracts.[55] This amendment was occasioned in part by the tremendous growth of lease financing which has produced controversies not dissimilar to those which have arisen with conditional sales contracts.[56] This amendment was apparently not intended to bring a strict lease arrangement within the limits of Article 9; rather, it seems to be limited to "bailment leases."[57] As yet, there have been no reported cases dealing with a lessee waiving his defense against an assignee, but there is no apparent reason for courts to treat this method of financing[58] any differently from the ordinary conditional sales contract since lease financing is just another type of purchase money security interest.

IV. Consumer vs. Non-Consumer Goods and the New York Personal Property Law

In the field of non-consumer goods, there have been a number of recent decisions construing section 9-206(1) in New York as well as other jurisdictions. The latest New York cases have sustained a validity of a waiver clause where the plaintiff-assignee has been able to show that he has fulfilled the requirements of the statute.[59] In *National State Bank v. Dzurita*,[60] the court held that the

52. See Part IV infra.

53. N.Y. U.C.C. § 9-206(1).

54. See note 17 supra.

55. N.Y. U.C.C. § 9-206(1).

56. Report No. 1 of the Permanent Editorial Board for the Uniform Commercial Code 55 (1962).

57. Comment, 5 B.C. Ind. & Com. L. Rev. 360, 380 (1964). A "bailment lease" is one where the lessee has an option to buy the goods and his rental is applied to the purchase price if the option is exercised. See Commonwealth v. Two Ford Trucks, 185 Pa. Super. 292, 137 A.2d 847 (1958).

58. Lease financing is similar to a transaction where a conditional sales contract is discounted to a finance company or a bank. Here the lessor receives the value of the lease less the normal discount from the financial institution who in turn receives the monthly payments from the lessee. See Federal Credit Bureau, Inc. v. Zelkor Dining Car Corp., 238 App. Div. 379, 264 N.Y.S. 723 (1st Dep't 1933), overruled on other grounds, Gellens v. 11 West 42nd Street, Inc., 259 App. Div. 435, 19 N.Y.S.2d 525, (1st Dep't 1940).

59. See notes 37-44 supra and accompanying text.

60. 2 U.C.C. Rptr. 728 (N.Y. Sup. Ct. 1965).

waiver clause was valid under section 9-206(1) and, quoting from *National City Bank v. Prospect Syndicate, Inc.*,[61] reasoned that "if effect were not given to these provisions, it would be impossible for banks to finance installment purchases."[62] A later New York case[63] upheld this construction of section 9-206(1) but decided that it was a question of fact whether the plaintiff had met the requirements of the section, and it therefore refused to grant summary judgment in favor of the assignee on the contract.

A reading of these cases indicates that the New York rule concerning the validity of these clauses in conjunction with sales of non-consumer goods is that they will be upheld where the assignee takes the assignment in good faith, without the intent to defeat any of the buyer's rights and where the court feels that the defendant-buyer dealt with the seller and the assignee at arm's length so it cannot be definitely said that the buyer did not know or understand what he read.[64]

Recent decisions in other jurisdictions would seem to support the New York view where non-consumer goods are involved. In the Kentucky case of *McCoy v. Mosely Machinery, Co.*,[65] a buyer signed a conditional sales contract for a compression baler and agreed in the contract not to assert any claims or defenses against anyone except the original seller. Realizing that the baler was defective, the buyer sued for rescission and the assignee defended with the waiver clause. The court held that the waiver clause would be valid if it could be proven that the assignee "took the assignment of the conditional sale agreement for value, in good faith and without notice of any default"[66] on the part of the buyer.[67] *Root v. John Deere Co.*,[68] another Kentucky case, upheld a waiver clause where equipment was involved. The court based its decision on two cases decided subsequent to the *McCoy* decision and held that the defense of breach of warranty cannot be asserted against an assignee who fulfills the requirements of section 9-206(1).[69]

61. 170 Misc. 611, 10 N.Y.S.2d 759 (Mun. Ct. 1939).

62. 2 U.C.C. Rptr. at 730 (emphasis omitted). See also Chemical Bank & Trust Co. v. Blane's, Inc., 39 Misc. 2d 15, 239 N.Y.S.2d 758 (New York City Ct. 1962); B.W. Acceptance Corp. v. Richmond, 46 Misc. 2d 447, 259 N.Y.S.2d 965 (Sup. Ct. 1965). Here the court noted § 9-206 of the New York Uniform Commercial Code and stated that it "is indicative of the public policy of this State as it will apply to future transactions of this type." Id. at 450, 259 N.Y.S.2d at 969.

63. Fairfield Lease Corp. v. Colonial Aluminum Sales, Inc., 3 U.C.C. Rptr. 858, (N.Y. Sup. Ct. 1966).

64. See Dunann Realty Corp. v. Harris, 5 N.Y.2d 317, 157 N.E.2d 597, 184 N.Y.S.2d 599 (1959). See also Glens Falls Nat'l Bank & Trust Co. v. Sansivere, 136 N.Y.S.2d 672 (Saratoga County Ct. 1955), which was cited in both the B.W. Acceptance Corp. and the Chemical Bank Trust Co. cases.

65. 33 F.R.D. 287 (E.D. Ky. 1963).

66. Id. at 288.

67. The court refused to grant summary judgment in favor of the assignee because the plaintiff claimed "that C.I.T. took the assignment without notice of plaintiff's claims . . . ." Id.

68. 413 S.W.2d 901 (Ky. Ct. App. 1967).

69. Morgan v. John Deere Co., 394 S.W.2d 453 (Ky. Ct. App. 1965); Hieb Sand &

In the field of consumer goods, on the other hand, New York, as well as other jurisdictions, has been in a continuing state of flux as to the validity of a waiver of defenses clause in a contract involving non-consumer goods. As noted previously, when consumer goods are involved, section 9-206(1) is expressly subject to any statute or decision to the contrary.[70] The New York decisions in point have been concerned in large measure with the issue of fraud and the extent, if any, to which the alleged fraud will vitiate the entire contract.

In an early pre-Code case, *National City Bank v. LaPorta*,[71] the supreme court held that the fact that the defendant-buyer had signed a contract which contained a waiver clause was sufficient notice of the possibility that the contract would be assigned and, therefore, the assignee's motion for summary judgment was granted.[72] Although the facts of the case do not indicate whether the issue of fraud was raised, it could be said that the court was justified in disposing of this case as if non-consumer goods were involved because a theory of estoppel[73] was applicable. The later case of *Mohawk National Bank v. Chalifaux*,[74] is more indicative of how New York has handled the waiver of defense clauses where consumer goods are involved. Here, the defendant purchased an automobile under a retail installment contract, but at the time of the purchase and unknown to the buyer, there was an outstanding chattel mortgage on the car. The contract was assigned to the plaintiff who later sued the defendant for breach of contract. The defendant claimed that the seller misrepresented that he had title to the car and that the defense of fraud could not be waived. Plaintiff contended that the doctrine of estoppel applied, but the court rejected this theory and held that there were triable issues of fact as to the alleged fraud, and thus the assignee's motion for summary judgment was denied. On appeal, the appellate division reversed the trial court on law and facts and granted the plaintiff's motion.[75] The trial court had erred in refusing to grant

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Gravel, Inc. v. Universal C.I.T. Credit Corp., 332 S.W.2d 619 (Ky. Ct. App. 1959). See also Beam v. John Deere Co., 240 Ark. 107, 398 S.W.2d 218 (1966).

70. See notes 51-53 supra and accompanying text.

71. 109 N.Y.S.2d 143 (Sup. Ct. 1951).

72. This court stated that it relied on the unreported case of Westchester Square Plumbing Supply Co. v. Vandroff. 109 N.Y.S.2d at 144.

73. See note 17 supra.

74. 33 Misc. 2d 987, 227 N.Y.S.2d 526 (Schenectady County Ct. 1962).

75. 18 App. Div. 2d 864 (3d Dep't 1963). This court relied on the authority of Bankers Commercial Corp. v. Guerra, 11 App. Div. 2d 654, 203 N.Y.S.2d 1015 (1st Dep't 1960), for its reversal. Here, the defendant purchased a car on time and signed a conditional sales contract which contained a waiver clause. The plaintiff was assigned the contract the same day but the defendant paid the seller in cash. The seller failed to notify the plaintiff of this, and after the defendant refused to pay any installments, the plaintiff sued on the contract. Both parties asked for summary judgment and the court held for the plaintiff. The judgment was affirmed in both the appellate term and appellate division, but there were no opinions in any of these courts. In his brief, the plaintiff relied on S. Williston, Contracts, § 432 (rev. ed. 1933), and National City Bank v. Prospect Syndicate, Inc., 170 Misc. 611, 10 N.Y.S.2d 759 (N.Y.C. Mun. Ct. 1939). The defendant set up two defenses: the seller did not have title, and the seller was the plaintiff's agent so therefore any payment to the seller was

summary judgment since the fraud which was alleged was of a type which would have been cut off by a holder in due course[76] and this would be true even though there would have been no estoppel by conduct under prior law.[77] The trial court did not discuss this point, but on the facts, it could be said that the plaintiff did meet the requirements of a holder in due course.[78]

From the foregoing it can be readily seen that the New York courts have treated a waiver clause in the same manner regardless of the type of goods involved as long as the assignee demonstrates that he has met the requirements of the statute. Since there have been relatively few cases concerning consumer goods both in New York and elsewhere which have dealt with section 9-206(1), reference must be had to the New York statutory regulations regarding consumer financing in order to determine what is and most probably will be the New York position as to the validity of these waiver clauses.

Under section 9-203(2), any transaction which is subject to Article 9 is also subject to both the New York Motor Vehicle Retail Installment Sales Act and the Retail Installment Sales Act.[79] The Motor Vehicle Retail Installment Sales Act prohibits the use of a negotiable instrument which would cut off a buyer's defenses against third parties, while the Retail Installment Sales Act merely prohibits the use of a waiver of defenses clause. However, these same sections validate these devices if the contract is transferred to an assignee who acts in good faith, gives value and fails to receive notice of a claim or defense within ten days after he sends the required notice of assignment to the buyer.[80] These prerequisites mirror those of section 9-206(1) except as to the limited ten-day period during which the buyer has the benefit of all defenses against the assignee.

These acts were supposedly enacted to afford broader protection to the consumer,[81] but it may be that the ten-day period affords the consumer-buyer too little time to discover any defaults of the seller.[82] It is true that the ten-day

payment to the plaintiff. As noted above, there were no opinions, but it is contended that the court held that these defenses were cut off as to the assignee-plaintiff since he had complied with all the requirements of § 302(9) N.Y. Pers. Prop. Law.

76. The fraud alleged here would be characterized as fraud in the inducement rather than fraud in the factum. See N.Y. U.C.C. § 3-305, Comment 7.

77. 33 Misc. 2d at 988, 227 N.Y.S.2d at 527-28.

78. N.Y. U.C.C. § 3-302 enumerates the requirements for a holder in due course.

79. N.Y. Pers. Prop. Law art. 9 & 10.

80. Section 403(3)(a)-(g) of the N.Y. Pers. Prop. Law requires that this notice give the full details of the assignment to the buyer: e.g., address of the assignee, name of the buyer and seller, and description of the goods. The notice must also warn the buyer, in at least eight point bold type, that (1) if there is an error in the statement or (2) if he has not received the goods, or (3) if the seller has not performed all he agreed to, the assignee must be notified within 10 days. However, services to be rendered more than ten days after the notice is given, are exempted.

81. Governor's Memoranda on Bills Approved, N.Y. State Legis. Annual at 503-04, McKinney's Sess. Laws at 1861-62 (1957).

82. Willier, Protection Instalment Buyers Didn't Get, 2 B.C. Ind. & Com. L. Rev. 287, 297 (1961).

period falls far short of providing sufficient protection for some consumer-buyers, but it does have the alternate effect of cutting off both unreasonable and bad faith defenses interposed by defaulting purchasers.[83]

The New York courts have been hesitant to sustain these waivers in any instance where the statute has not been strictly complied with.[84] In each instance, the burden of proof has been put on the assignee to show that his actions were in strict compliance with the requirements of the statute. In sustaining these clauses, the courts have considered compliance with the statutory norm;[85] allegations of fraud;[86] closeness or identity of the seller and the assignee;[87] and the good faith of the assignee.[88]

The courts have held that these acts are applicable only when both the note and the installment contract have been assigned.[89] If the note alone has been negotiated, the notice provisions need not be complied with and, in such cases, the rules relating to a holder in due course of a negotiable instrument would seem to determine whether a consumer-buyer's defenses would be cut off as to assignees.

The recent case of *Nassau Discount Corp. v. Allen*[90] illustrates how New York has dealt with a waiver clause where fraud in the inducement is involved. Here, a salesman representing the seller, fraudulently misrepresented to the plaintiff that certain books were required to be purchased for her school-aged child. The defendant signed an installment contract which contained a waiver clause, and the contract was assigned to the plaintiff within one week. The defendant never received the books she ordered but did receive the notice of assignment required by section 403(3)(a) of the Personal Property Law. The defendant's only response was to return plaintiff's coupon book unused. When the defendant refused to pay any installments, the plaintiff instituted suit upon the contract. The court, after reviewing prior New York law on the subject,[91] held that since

83. See, e.g., D.P.C. Corp. v. Jobson, 15 App. Div. 2d 861, 224 N.Y.S.2d 772 (4th Dep't 1962). See also Zenith Financial Corp. v. Jolly Gene Distributor Inc., 42 Misc. 2d 821, 249 N.Y.S.2d 30 (Sup. Ct. 1964), rev'd mem. on other grounds, 24 App. Div. 2d 507, 261 N.Y.S.2d 328 (2d Dep't 1965), where the assignee had to show that the notice of assignment was proper in all respects.

84. See, e.g., Coburn Credit Co. v. Forlivio, 32 Misc. 2d 91, 221 N.Y.S.2d 346 (Sup. Ct. 1961).

85. See, e.g., Marine Midland Trust Co. v. Blackburn, 50 Misc. 2d 954, 271 N.Y.S.2d 388 (Sup. Ct. 1966); Meadow Brook Nat'l Bank v. Rogers, 44 Misc. 2d 250, 253 N.Y.S.2d 501 (Dist. Ct. 1964); Merson v. Sun Insurance Co., 44 Misc. 2d 131, 253 N.Y.S.2d 51 (Civ. Ct. 1964).

86. See, e.g., Mohawk Nat'l Bank v. Chalifaux, 18 App. Div. 2d 864 (3d Dep't 1963); Bankers Commercial Corp. v. Guerra, 11 App. Div. 2d 654, 203 N.Y.S.2d 1015 (1st Dep't 1960).

87. See cases cited in notes 51-53, 70 supra.

88. Marine Trust Co. v. Richir, 34 Misc. 2d 271, 228 N.Y.S.2d 694, (Sup. Ct. 1962).

89. See, e.g., Household Discount Corp. v. Gleasman, 42 Misc. 2d 344, 247 N.Y.S.2d 981 (Sup. Ct. 1964); Tashman v. Campbell, 35 Misc. 2d 618, 231 N.Y.S.2d 245 (Sup. Ct. 1962).

90. 44 Misc. 2d 1007, 255 N.Y.S.2d 608 (Civ. Ct. 1965), rev'd, 47 Misc. 2d 671, 262 N.Y.S.2d 967 (Sup. Ct. 1965).

91. Id. at 1009-10, 255 N.Y.S.2d at 611-12.

the assignee was too closely associated with the seller, its good faith status was lost. Consequently, the assignee was held subject to the buyer's defenses of fraud in the inducement and non-delivery. Here, the court relied heavily on the fact that all the circumstances indicated that the assignee was a party to the original agreement.[92] Although the court cited both *Mohawk National Bank v. Chalifaux*[93] and *Bankers Commercial Corp. v. Guerra*[94] to indicate that waiver clauses had been upheld where fraud in the inducement was alleged, it evidently decided that the circumstances of this case warranted a different holding, even though the same type of fraud was involved in all three instances.

On this basis, the appellate term reversed, holding that the question of the assignee's good faith was not sufficiently explored in the agreed stipulation of facts submitted by the parties in view of the "flagrant" fraud involved in the case.[95] Apparently, the court reasoned that the association of the seller and assignee in prior transactions was insufficient ground for holding that the plaintiff did not take the assignment in "good faith." This reasoning would seem to be more in line with the current New York view towards sustaining the validity of these waiver of defense clauses, and it also indicates that in the future New York courts will most likely require more than just a summary showing of "closeness," "over-reaching," or the taking advantage of the unknowing consumer-purchaser. This will probably be true even though a close business relationship between the seller and the assignee received some early judicial recognition as a basis for denying validity to waiver clauses.[96] This is and will by the prevailing view on the subject in light of the position taken by section 9-206(1) and the Retail Installment Acts, the purpose of which is to try to strike a balance between the interests of installment financing and the protection of the consumer.

V. Conclusion

From the foregoing it is readily apparent that in the area of consumer financing, the uncertainty surrounding the validity of a waiver of defenses clause is quite substantial. The validity of these clauses in New York and elsewhere has and will depend upon the ability of the assignee to demonstrate to the court that he has satisfied all the requirements of section 9-206(1). Since these requirements are analogous to those stated in section 302(9) and 403(3)(a) of the New York Personal Property Law,[97] it appears that these clauses will be sustained where the assignee makes a prima facie showing of "good faith" throughout the whole transaction. In instances where fraud is alleged, although the overall burden of proof will still be on the assignee, it will be incumbent upon the buyer to establish uncontroverted facts which will justify the invalidation of

92. Id. at 1011, 255 N.Y.S.2d at 613. The court here cited the case of Public Nat'l Bank & Trust Co. v. Fernandez, 121 N.Y.S.2d 721 (N.Y.C. Mun. Ct. 1952), the facts of which the court felt were not unlike those of the instant case.

93. 18 App. Div. 2d 864 (3d Dep't 1963).

94. 11 App. Div. 2d 654, 203 N.Y.S.2d 1015 (1st Dep't 1960).

95. 47 Misc. 2d 671, 262 N.Y.S.2d 967 (Sup. Ct. 1965).

96. See notes 18-26 supra and accompanying text.

97. See notes 80-88 supra and accompanying text.

these clauses. The defenses of fraud in the factum or unscrupulous selling practices by retail merchants will no doubt sustain this burden.[98]

Although it is arguable that all buyers, consumer and non-consumer alike, should be treated equally, where fraud or unscrupulous practices are found to exist, public policy dictates that the courts and the legislature be allowed to establish different rules where the consumer-buyer is involved. However, until either of the above make a definitive statement as to the validity of these clauses, confusion will continue because of the ever present conflict between the maintaining of the negotiability of commercial paper and the interests of the retail sales financing industry, on one hand, and protection for the consumer-buyer, on the other.

98. See, e.g., Ram Indus. v. Van De Maele, 20 App. Div. 2d 783, 248 N.Y.S.2d 176, appeal dismissed, 14 N.Y.2d 968, 202 N.E.2d 383, 253 N.Y.S.2d 1005 (1964); Buffalo Indus. Bank v. De Marzio, 162 Misc. 742, 296 N.Y.S. 783 (Buffalo City Ct. 1937), rev'd on other grounds, 6 N.Y.S.2d 568 (Sup. Ct. 1937).