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Contracting in the Americas: Part I

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INTRODUCTION

Working on this paper rekindled youthful memories. I recall my family and all the funny characters; the small town outside Washington, D.C. I called home; the Five-and-Dime Store where I bought toys and the corner grocery. This was my America (towns and quaint settings). Communities were held together with nostalgia. Citizens used the foibles of their neighbors to entertain themselves. Old folks used folk tales to teach children about civilization's harsh realities. The world, they told us, was a dying place. People and machines slowed down and eventually stopped operating. To cope with the losses prompted by change, youngsters had to gather as much happiness and entertainment as they could manage in their lives.

In an America held together with nostalgia, citizens worshipped competition and the market mechanism. The world was defined by what people saw and heard. Contract law affirmed the work of enterprises producing goods that commanded economic value. Damages put people in positions they would have enjoyed if promises had been kept. Community disapprobation and local magistrates kept the mavericks in check. Crime was not the ubiquitous thing it is today.

This vision (at best isolationist) left Americans ill-equipped to deal with global problems. It did not furnish me (us) with a sophisticated vocabulary and a medium of discourse to cope with rapacious corporations, job dislocations, unruly foreign governments and international trade. America needed a new vision. Freud[1] and Drucker[2] supplied one. The world, they wrote, had gone through a westernizing process. Decolonization (local control of events) had taken root in Africa and Asia. Europeans (the agents of change) had retreated to their continent. Many maintained a presence in North America, South America and the southern tip of Africa.

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1. Sigmund Freud, *Thoughts for the Times on War and Death, in* 54 GREAT BOOKS OF THE WESTERN WORLD 755-66 (Mortimer J. Adler ed., 1982).

2. PETER F. DRUCKER, THE NEW REALITIES 3-58, 115-72 (1989).

There were civil wars in Europe (World Wars I and II) that never produced a victor. The United States and the Soviet Union were the apparent winners. The vacuum (hegemony to be won from decimated European powers) was filled by the aforementioned nations. In time, the United States and the Soviet Union got sucked into the Great Commercial Basin. Now the Basin's frontier begins with the state of Washington, in the United States, and extends east to the farthest European outpost in Russia.[3] Observers can see the market mechanism pumping riches from the landscape. Commercial discourse has been reduced to conversational English, French, Spanish, Russian, and German. The United States and Canada and the United Kingdom and France have been granted domains. Countries have formed economic unions, like NAFTA and EC, to free their people to compete with decolonized rivals like the City-State of Singapore, Saudi Arabia, Vietnam and Iraq.

Commercial laws have been reduced to tools to husband understanding and cooperation between basinites in an arena strewn with cultural obstacles. Utterances and representations—prompting detrimental reliance—have been reduced to obligations. Utterers, actors and reactors have submitted to a duty to act in good faith. Breach of the duty has given the injured party the right to modify an obligation or demand specific performance. When obligations have come to dreadful conclusions, the injured party has used international business conventions; the publication of the utterer's bad reputation; the law of obligations; and, reliance and balance theory;[4] to wrench their expectation from the malefactor.

These observations bring me to the task at hand. Having abandoned nostalgia for basin concepts the question is: What will become of contract law in North America? (There is a simple answer.) The law will get refashioned to deal with ceaseless change. Expectation Theory will guide what the jurisprudential alchemist do. This article surveys contract theories—the jurisprudence of our predecessors which haunts our practice. It covers ancient history, the views of Law Merchants, Objectivists, Revisionist, Relationist and some secured transaction cases.

ANCIENT HISTORY

Contract law is rooted in expectation theory.[5] It is something that

3. *Id.* at 27-30.

4. Joel Levin & Banks McDowell, *The Balance Theory of Contracts: Seeking Justice in Voluntary Obligations*, 29 MCGILL L.J. 24 (1983).

5. P. S. ATIYAH, THE RISE AND FALL OF FREEDOM OF CONTRACT 82-83, 105, 576-77 (1979). It is a way to capture reasons for ordering specific performance or awarding damages. *See Contracts, Torts, Relations and Reliance, in* STUDIES IN CONTRACTS LAW 236-311 (Barry J. Reiter & John Swan eds., 1980). If a promise is purchased with consideration, the plaintiff is entitled to contract damages. Damages amount to money a plaintiff needs to put her in a position she would have achieved absent breach. David H. Vernon, *Expectancy Damages for Breach of Contract: A Primer and Critique*, WASH. U. L.Q., Spring 1976, at 179, 183-89. It could be a sum to buy goods she sought in the

emerged during the Norman Conquest.[6] After the Normans pacified England they gave the booty to proxies to entrench Norman influence.[7] To insure that Norman influence survived the death of proxies, they invented estates in land.[8] The esteem heaped upon proxies was overtaken by the attention given to estates. Proxies and estates filled the void created by the Norman exit.[9] People (then) literally owned the wilderness. Individuals obsessed about property — eg., fields and streams, fish and game.[10] Rivals vied for property using power, profit, status, utility and violence to settle their spats.[11] In me, contract law overtook violence.[12] Competitors discovered that it was cheaper than violence and (much to their delight) rivals were inclined to sell their designs upon property. The purchaser's expectation was his rival's forbearance. The rival's expectation was compensation.

Expectation Theory flourished during this age of feudalism.[13] The theory amounted to the homage an estate holder owed a king or the forbearance a person extracted from someone with a contract.[14] The publication of the *Wealth of Nations* crystallized things. A chunk of expectation theory incubating inside contract law was added to this work. Merchants (a small band of entrepreneurs) used this to rationalize their decisions and actions.

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bargain or the financial gain she has lost. On a deeper level, it's implementing the articulated desires of the parties.

6. ATIYAH, *supra* note 5, at 105-06. Medieval lawyers had used property law to regulate future arrangements concerning land. It was a situation which modern lawyers would describe as contractual. *See also* 8 ENCYCLOPEDIA BRITANNICA, MICROPAEDIA 767; 22 ENCYCLOPEDIA BRITANNICA, MACROPAEDIA 929; 29 ENCYCLOPEDIA BRITANNICA, MACROPAEDIA 33, 36.

7. 8 ENCYCLOPEDIA BRITANNICA, MICROPAEDIA 767.

8. *Id. See* 22 ENCYCLOPEDIA BRITANNICA, MACROPAEDIA 929.

9. *See* ROBERT MCCRUM ET AL., THE STORY OF ENGLISH 73, 75-76 (1986). John was the last Norman King (1199-1216). He lost his fortune in France. In 1209, he was excommunicated by Pope Innocent. 29 ENCYCLOPEDIA BRITANNICA, MACROPAEDIA 37-38.

10. E.P. Thompson, Professor of History, Warwick University, Lectures on Customs and Common Rights at Queen's University, Kingston, Ontario, Canada (Feb. 3 & 10, 1988) (discussing the public obsession with property) [hereinafter Thompson Lectures]. *See* E.P. THOMPSON, WHIGS AND HUNTERS: THE ORIGIN OF THE BLACK ACTS 196-97 (1975).

11. Thompson Lectures, *supra* note 10.

12. *Id.*

13. 29 ENCYCLOPEDIA BRITANNICA, MACROPAEDIA 33.

14. Thompson Lectures, *supra* note 10. Copyholders were manor proxies, i.e., serfs who behaved as if they owned property outright. Their status emerged from transactions that were "grants of land for services." Their rights in land were conditional. Their claim had to be registered in the manor courts. The serfs had to render services or pay quick rent to the granting Lord to keep their property. Interview with E.P. Thompson, Professor of History, Warwick University, at Queen's University, Kingston, Ontario, Canada (Mar. 21, 1988). There were comparable transactions outside of the manorial setting. William the Conqueror gave large parcels of land to 180 great Tenants-in-Chief for knights service. 29 ENCYCLOPEDIA BRITANNICA, MACROPAEDIA 33.

LAW MERCHANTS

From the perspective of law merchants, contract law compensated people who relied upon promises.[15] The agreements were simple. If an utterance was in the right form (a promise);[16] it aroused an expectation.[17] If the expectation was beneficial,[18] and (or) accompanied by detrimental reliance;[19] the utterer was saddled with an obligation. Thus, when a person broke a COVENANT and or a BOND, the king awarded the plaintiff specific performance.[20]

Over time, the English judiciary found that specific performance obstructed the flow of commerce, was too difficult to obtain,[21] and took too much time to implement.[22] It jettisoned specific performance, replacing it with the damage remedy.[23] The damage remedy (it decided) did more to appease a plaintiff immediately after breach.[24]

Under the damage remedy, promisors were saddled with the absolute liability rule.[25] Defendants could not enter pleas for mercy or proffer an excuse in the plaintiff's case.[26] Claims against the plaintiff could only be asserted in a separate cause of action.[27] From the defendants' perspective, a damage award on their claim was a windfall. The damage awarded to the defendant could be used to reduce the amount of damages the defendant owed the plaintiff.

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15. J. Berryman, *The Specific Performance Damages Continuum: A Historical Perspective*, 17 OTTAWA L. REV. 295, 297 (1985). Contracts addressed the transfer of title or property or the enforcement of customary obligations between people from different occupations and stations in society. *See* Peter Gabel & Jay M. Feinman, *Contract Law as Ideology, in* POLITICS OF LAW: A PROGRESSIVE CRITIQUE 173-74 (David Kairys ed., 1982).

16. Pillans v. Van Mierop, 97 Eng. Rep. 1035, 1038 (1765). R.A. Samek, *On Contracting*, 4 DALHOUSIE L.J. 62, 67 (1977). In Medieval times, a promise established a contract if the utterer was royalty. JOHN ROGER COMMONS, ECONOMIC FOUNDATION OF CAPITALISM 216-17 (1959). Under the UCC, a writing was enough to transform a promise into a contract. With a contract you could compel the surrender of property or force a person to pay damages. U.C.C. §§ 2-204(1), 2-207, 2-716, 5-104, 5-105, 5-115, 9-201, 9-203(1)-(2), 9-501(1), 9-503, 9-504(1), 9-505(2). At one time, liability was promise-based. If a promise was accompanied by a writing or consideration, the court would create a contract. *Pillans*, 97 Eng. Rep. at 1038. After the parties made the contract, liability shifted to benefits and reliance. ATIYAH, *supra* note 5, at 3-4, 82-83, 428.

17. ATIYAH, *supra* note 5, at 83.

18. *Id.* at 104-05, 428.

19. *Id.* at 82-83.

20. Berryman, *supra* note 15, at 296.

21. *Id.* at 308.

22. *Id.*

23. *Id.* at 299, 305, 308.

24. *Id.*

25. Paradine v. Jane, Aleyn 26, 82 Eng. Rep. 897, Style 47, 82 Eng. Rep. 519 (K.B. 1647).

26. Monk v. Cooper, 2 Strange 763, 93 Eng. Rep. 833 (K.B. 1723). *See* GRANT GILMORE, THE DEATH OF CONTRACT 45-46 (1974).

27. GILMORE, *supra* note 26, at 45-46.

OBJECTIVISTS

Objectivists pruned the law merchants' conceptions. They saw the law in transcendental terms.[28] In the eyes of objectivists, contract law addressed the outward manifestations of the parties.[29] A contract was an obligation derived from offer and acceptance, or a promise supported by consideration.[30] Consideration was a promise, a benefit conferred upon somebody,[31] or a detriment.[32]

During this period, contract analysis excluded evidence about the actual intent of the parties.[33] Law began with society's impressions of what a person had done (said or wrote) and ended with mindless formalism.[34] Though judges might write opinions making claims upon an individual's freedom, time reduced these claims to empty utterances. These claims became the waifs of stare decisis. Judges used them to resolve new disputes.

As a result, contract law damages were low and sharply differentiated from the tort remedy.[35] Plaintiffs were compensated for the objects they sought under a contract or lost profits.[36] Some plaintiffs got reliance damages if it restored them to the position they enjoyed before the promise was made.[37] And, when a person received a gain without bargaining for it, the plaintiff was given restitution damages.[38]

The inequitable result of objectivism is made clear in a case like *Kirksey v. Kirksey*.[39] Mr. Kirksey sent Mrs. Kirksey a letter inviting her to come and live with him. The letter was prompted by the death of Mrs. Kirksey's husband, Henry, Mr. Kirksey's brother. Mrs. Kirksey

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28. A contract was a disembodied reality; or a vastness like space which could be grasped with legally trained minds. S. BENN & R. PETERS, THE PRINCIPLES OF POLITICAL THOUGHT: THE SOCIAL FOUNDATIONS OF THE DEMOCRATIC STATE 72-76 (1965). *See* ATIYAH, *supra* note 5, at 139, 427.

29. GILMORE, *supra* note 26, at 44, 48.

30. *See, e.g.*, Minneapolis & St. L. Ry. Co. v. Columbus Rolling Mill Co., 119 U.S. 149 (1886); Hamer v. Sidway, 27 N.E. 256 (N.Y. 1891); Adams v. Lindsell, 106 Eng. Rep. 250 (1818) and Routeledge v. Grant, 172 Eng. Rep. 415 (1828) (epitomizing the English view on the subject). *See* ATIYAH, *supra* note 5, at 446-47; James Oldham, *Reinterpretations of 18th-Century English Contract Theory: The View from Lord Mansfield's Trial Notes*, 76 GEO. L.J. 1949, 1961 (1988).

31. *E.g.*, Chicago & A. Ry. Co. v. Derkes, 3 N.E. 239 (Ind. 1885). In Roman Law, under the right circumstances, a promise created a legal obligation. As time passed, when a promise was given for a promise, the event saddled the utterers with legal obligations. E. ALLAN FARNSWORTH, CONTRACTS 10-12, 43 (1982). *See* GILMORE, *supra* note 26, at 19; ATIYAH, *supra* note 5, at 185.

32. *E.g.*, Tuckwiller v. Tuckwiller, 413 S.W.2d 274 (Mo. 1967); FARNSWORTH, *supra* note 31, at 20, 72.

33. *E.g.*, Fairway Ctr. Corp. v. U.I.P. Corp., 502 F.2d 1135 (8th Cir. 1974); Hotchkiss v. National City Bank, 200 F. 287, 293 (S.D.N.Y. 1911).

34. GILMORE, *supra* note 26, at 41.

35. *Id.* at 48.

36. *Id.* at 52. *See* Vernon, *supra* note 5, at 183-84.

37. GILMORE, *supra* note 26, at 89; L.L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages*, 46 YALE L.J. 52, 52-53 (1936). The rationale is provided in Flureau v. Thornhill, 96 Eng. Rep. 635 (C.P. 1776).

38. GILMORE, *supra* note 26, at 88-89. *See* Oldham, *supra* note 30, at 1963-69.

39. 8 Ala. 131 (1845).

terminated a lease (she could have maintained), gathered her family and belongings, then moved to the site specified in Mr. Kirksey's letter.

Mrs. Kirksey was provided with land and a dwelling for two years. At the end of that period, Mrs. Kirksey was told to leave the premises. She claimed there was a contract. In contrast, Mr. Kirksey claimed there was no contract. The court had to decide whether she was entitled to damages or an equitable remedy.

From a law merchant's perspective, a jurisprudence haunting what judges do, the brother-in-law made a promise in writing. This created a legal obligation. Since the promise aroused a beneficial expectation, Mrs. Kirksey should have gotten a dwelling; and the court should have found a legal agreement. From an objectivist's perspective, however, there was no contract. Although the promise was supported by consideration, and there was an offer and an acceptance, the court found the consideration insufficient. In 1834, women had a difficult time making enforceable agreements.[40] One reason was that, under benefit theory, a woman's companionship was not considered consideration.

REVISIONISTS

Something shook America in the 1950's sweeping away objectivist conceptions. Contracts came down to what was done by businessmen. Contract law was composed of pure theory, formation equations,[41]

40. In marriage the common law suspended a woman's separate legal existence. This was called coverture. When a woman amassed property by gift, a contract with her husband, or devise, the law provisioned her with a limited power to contract. LEO KANOWITZ, WOMEN AND THE LAW: THE UNFINISHED REVOLUTION 35, 38-39 (1970). If she promised to repay a debt and pledged her property as collateral, she could make a contract with anybody. *Id.* *See* 2 D. KELLY WEISBERG, WOMEN AND THE LAW: A SOCIAL HISTORICAL PERSPECTIVE 3, 36, 39. Before the Norman Conquest English widows who lived chaste lives, received protection from the church. *Id.* at 39. They were granted a separate legal identity. They could make wills, sell and inherit property. *Id.* In America women had a tougher time with contracts. There was a bias against the enforcement of family obligations like *Kirksey*. FARNSWORTH, *supra* note 31, at 91-92.

41. There were algebraic expressions like K = $\frac{o + a}{c}$, $\frac{p}{c}$ = k, $\frac{p}{r}$ = k and pf + a^{k}_{d} = QK. *C* represented consideration. *R* represented reliance. *O* and *A* represented offer and acceptance. *Pf* represented performance. *A* with the exponents *k* and *d* represented knowing and deliberate acceptance. *Q.K.* represented quasi-contract. These expressions were a shorthand for longer narratives about contract formation.

descriptive diagrams,[42] appraisals of the damage done to liberty by technology (thick-and thin analysis),[43] and public policy.

For years contract law fenced in fields of liberty with offer and acceptance. (Pure theory in that sense was not new.) There were rules for formation, performance and damages. When these rules proved unworkable judges resorted to discretionary rules found in philosophy and logic.

But, thick-and-thin analysis was new. Someone discovered that liberty was shrinking. Conservative revisionists thought liberty amounted to a person making uncoerced choices. If contracts had fenced in fields of liberty and statutes banned new liberties created by technology, liberty was indeed crumbling. To preserve the remnants of liberty,[44] contracts and

42. Contracts were emblematic of obligations. Obligations were built with performative terms like offer and acceptance. Contracts were valid if the bargainers got what each sought in the bargaining process. The bargaining place was an arena featuring prices, buyers and sellers. JOHN R. COMMONS, LEGAL FOUNDATIONS OF CAPITALISM 66 (1959). It was a square divided into four quarters. Actual buyers and sellers were put in the left quarter. Potential buyers and sellers were placed in the right quarters. Contracts emerged after actual buyers and sellers drifted to the lowest price or marginal difference between them. When folks established contracts without regard for the lowest price it was assumed that the buyer had been convinced that a larger package of non-cash guarantees was worth a higher price. Higher prices surfaced in a promotional realm - some place outside of the bargaining arena. It sheltered promises, guarantees and fantasies. *Id.* at 66, 76, 80. Common's diagram looked like this:

	Actual	Potential
Buyer	\$100	\$90
Seller	\$110	\$120

43. Liberty described a social wilderness where individuals made uncoerced choices. Contracts fenced fields of liberty with offer and acceptances. In this realm automation created new liberties which statutes promptly banned. Through this process the realm of liberty shrank. To preserve the remnants someone decided that contracts had to pass stringent validity tests. *See* CHARLES FRIED, CONTRACT AS PROMISE 7-27, 28-39, 44-45 (1981) (he reduced a contract to promises, acceptances and burden sharing) and RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 41-46, 55-59 (1972) (he used economic ideas to limit the uses of contracts).

Someone asked these questions. What's the domain of liberty? What's its length? What's its width? How thin is it? *See* HERBERT MARCUSE, ONE DIMENSIONAL MAN 1-18 (1964). The industrial revolution with its machines and automation reduced liberty to "one dimensional thinking and action." *Id.* at 12-13. People performed acts which mimicked habits and values linked with industrial goods (automobiles, clothes and computers). People were told what to buy. *Id.* at 12. Liberty was transformed. It amounted to freedom from control by economic forces; liberation from mass media politics and the restoration of independent thought. *Id.* at 4.

44. Fried abolished consideration and jettisoned unconscionability. FRIED, *supra* note 43, at 35, 105-06. He reduced contracts to promises and acceptances. *Id.* Posner reduced contracts to undertakings that were justified by economic considerations. *See* ANTHONY T. KRONMAN & RICHARD A. POSNER, THE ECONOMICS OF CONTRACT LAW 6 (1979). "Maximizing the power to implement decisions that wouldn't be countermanded by anybody" and "rewarding initiative" were the results sought by these strategies. Here is another example. A hospital furnished a patient with a blood transfusion. The blood was tainted with the human immune virus. The patient sued the hospital and the American Red Cross. She claimed that the blood was a good.

The question was: whether the sovereign should use contract-for-goods or contracts-for-services to resolve this dispute? This was a liberty question. Autonomy — the psychic space a person needs to think and make and act on decisions — was an aspect of this liberty. If the sovereign adopted the contract-for-services perspective it would crimp the patient's autonomy (her option to sue the hospital under a warranty theory); enhance the defendants' autonomy; preserve a vital industry; warn the industry to put safe fluids in the market; enrich (by degrees) the autonomy of other people; and chill the temptation in the defendants to hike the price for the good. Stated another way, if more liberties were saved than sacrificed, with a contract-for-services perspective, the court should (and did) statutes had to be trashed. Agreements had to pass stringent validity tests. And, statutes had to pass a proportionality test.[45]

Progressive revisionists saw the scene differently. The law was a sovereign's comment upon a living relationship. When a relationship was disturbed by an unforseen event, contract law provided continuity. Technology (they observed) had made some relationships obsolete. Since change was constant and no force known to man was going to arrest it, contract formation had to be sped-up with promises (reliance and statutes) to provide stability in the midst of change.[46]

Here is an example. The plaintiff, an inept individual, purchased a service from a hospital. The contract was enclosed in a standard form. The form contained an arbitration clause that divested the plaintiff of her right to prosecute the hospital in court for complications arising from the work the hospital's doctors did. Complications arose. The plaintiff sued the hospital. The hospital used the arbitration clause as a defense.

The questions were: first, was the standard form (which represented the parties collective memory) valid? Yes. Secondly, was the arbitration clause valid? No. These were liberty (non-interference) questions. Should the court endorse the hospital's use of a contract clause to block the plaintiff's right to use the courts? No. Arbitration clauses trumpeted the court, have to be negotiated, pointed out, and explained to inept plaintiffs before they sign form contracts. Because none of this was done, the court said, the contract clause was invalid.[47]

RELATIONISTS

Relationists adopted the revisionist's view. They thought a contract was what businessmen do.[48] Relationists believed contract law illuminated the parties' duties when there was a breakdown in performance. If the parties envisaged recurring acts they were under a duty to act in good faith.[49] Good faith amounted to what was revealed by recurring acts which people favor and follow; prior dealings between the parties; or, reciprocal standards of behavior.

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bar the patient's use of the contract-for-goods perspective. Kozup v. Georgetown Univ., 663 F. Supp. 1048 (D.D.C. 1987).

45. Regina v. Oakes, 26 D.L.R.4th 200, 226-28 (1986). It is the Canadian version. See Board of Trustees v. Fox, 493 U.S. 887 (1989). It is the American version.

46. Benjamin Cardozo and Grant Gilmore were progressive revisionists. GILMORE, *supra* note 26, at 62-63, 87-90. Their views overwhelmed objectivism. By Cardozo's lights, courts should find "contracts where ever possible rather than the other way around." *Id.* at 62. Reliance theory, according to Gilmore, was potent enough to create contracts out of promises which lacked consideration. *Id.* at 90-91.

47. Broemmer v. Abortion Servs. of Phoenix Ltd., 840 P.2d 1013 (Ariz. 1992).

48. *See* Peter Linzer, *Uncontracts: Context, Contorts and the Relational Approach*, 1988 ANN. SURV. AM. L. 139, 151, 155-60.

49. Good faith meant cooperation. *Id.* at 158-60.

Justice Brennan's dissenting opinion in *Patterson v. McLean Credit Union* epitomizes relationist thinking.[50] Brenda Patterson (a black woman) was employed by McLean Credit Union as a teller and file clerk coordinator. In July 1982 she was laid off. She brought an action in federal court under 42 U.S.C § 1981 (the 1866 Civil Rights Act). She said her employer harassed her; failed to promote her to accounting clerk; and discharged her because of her race. What was the result?

When a contract spans years, it should be characterized as a relationist contract. When the parties contemplate recurring acts there is a duty to act in good faith. In this instance, good faith was spelled out in the 1866 Civil Rights Act. An employer could not use a person's race to block contract formation.[51] An employer could not use a contract to saddle an African-American employee with more duties than a white employee.[52] An employer could not use race to block a person's access to a legal process, or a legal remedy.[53] An employer could not harass an employee in the midst of performance.[54] Finally, an employer could not use violence, intimidation, or meaningless tasks to fluster an employee.[55] Since there was evidence of harassment and a scheme for presenting that evidence to a jury under the 1866 Civil Rights Act (something Justice Brennan pointed out in his dissenting opinion), the Court should have accepted the plaintiff's instruction to the jury on the application of this statute to contract performance.[56]

SECURED TRANSACTIONS

Let's turn to some American secured transaction cases. I want to examine them from the various perspectives to enrich our understanding of what judges do. Let me begin this way. Secured transactions are driven by expectation theory. The agreements are relational. The parties are required to act in good faith.[57] Status resolves the disputes between rival creditors.[58] In some cases, an event determines whose expectation gets serviced first.[59] Security agreements furnish creditors with the right to siphon value from an object to satisfy a claim. Finally, the law of

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50. Patterson v. McLean Credit Union, 491 U.S. 164 (1989).
51. *Id.* at 196, 205, 209.
52. *Id.* at 205.
53. *Id.* at 201. There was an attempt to supplant the 1866 Act with the Equal Employment Opportunity Act of 1972.
54. *Id.* at 205.
55. *Id.*
56. *Id.* at 207, 211-15.
57. U.C.C. § 1-203. *See* Dennis M. Patterson, *Wittgenstein and the Code: A Theory of Good Faith Performance and Enforcement Under Article Nine*, 137 U. PA. L. REV. 335 (1988).
58. U.C.C. §§ 9-301(1)(a)-(b), 9-310.
59. U.C.C. §§ 9-301(2), (4); 9-307(3); 9-312(3)-(4).

secured transactions is what businessmen do. Let's look at ambiguous language.

AMBIGUOUS LANGUAGE

There is a dissonance between Articles II and IX regarding the notice to be given creditors about the status of an object. *In re Bildisco* points out the difficulty.[60] Bildisco and Gerber were parties to a consignment which covered "inventories of goods manufactured and shipped by Gerber Industries to Bildisco." Gerber filed a financing statement giving notice of the agreement. But, Gerber did not give notice of the consignment to Bildisco's secured creditors. Gerber did not post a sign on Bildisco's premises declaring its ownership of the goods. Because Bildisco was not known to its creditors to be a seller of goods on consignment, there was some confusion about the status of the goods. Four months after the consignment, Bildisco filed a petition in bankruptcy. On April 17, 1980, the bankruptcy court entered a judgment proclaiming that the two financing statements filed by Congress Financial Corporation (CFC) gave it a valid and duly perfected security interest in the assets of Bildisco. Included in those assets were the consigned goods. On April 28, 1980, Gerber instituted an adversary proceeding against Bildisco and CFC seeking possession of the consigned goods, and a determination that its interest in the goods was paramount. What were the issues? How did the court resolve them? How would a person steeped in expectation theory resolve them?

The issues were priority and intent. The court should have followed the pertinent statute and implemented the parties intent. In this case, the court found the pertinent statute ambiguous. Glossing over the parties intent, the court decided to do something to prevent debtors from masking the identity of inventory subject to prior perfected security interests.[61] It etched its belief into the Uniform Commercial Code.[62] It utilized an amendment to the Code (section 9-114) that was not in existence at the time of the dispute. Under the amendment, consignors were obliged to register their liens and give personal notice to prior perfected secured parties. Since Gerber had not done that, its claim was subordinated to CFC.

From a law merchant perspective Gerber made a sales and a security agreement. There was a writing. Gerber was listed as a secured party. Bildisco had granted Gerber a lien that aroused an expectation and caused reliance. Since Gerber complied with the proper statute (section 2-326),

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60. *In re* Bildisco, 11 B.R. 1019 (D.N.J. 1981), *aff'd*, 681 F.2d 804 (3d Cir. 1982).
61. *Id.* at 1021.
62. *Id.* at 1023.

and nothing covered the situation in Article IX, Gerber's expectation should have trumped CFC's claim.

In re Prior Brothers, Inc. is a better case.[63] First, the Code sections made sense. Second, the judges followed them. Third, the judges did not compound the ambiguity. Finally, they seized the right moment (in the unfolding of the security agreement) to resolve the dispute. What were the facts? The Bank of California (lender) loaned money to Prior Brothers Inc. (PBI). PBI granted the Bank a security interest in their farm equipment and after acquired farm equipment. Sometime after this lien was created PBI bought a new tractor. International Harvester was the seller. The agreement was a sale-on-approval. The buyer was saddled with possession of the good and a duty to signal acceptance by making a down payment. The sales agreement was made on April 8, 1976. PBI signalled acceptance on April 22, 1976. On April 27, 1976, International Harvester filed a financing statement on the new tractor. Thereafter, PBI went into receivership wherein PBI's assets were liquidated. On January 11, 1979, International Harvester filed a complaint seeking a judicial determination that its purchase money security interest in the tractor had priority over the Bank's security interest.

What were the issues? Was the sale-on-approval agreement evidence of the parties' intent to create a security interest in the new tractor? Should the seller's claim (his expectation that he would get paid first) assume a station above the Bank? From a law merchant's perspective each party had done what it could do to secure the best possible outcome under the UCC. If International Harvester was a purchase money secured creditor; and he had complied with section 9-312(4); his lien should have been given priority over the Bank. That was the position adopted by the Washington Court of Appeals.[64]

Under section 2-326(2) of the UCC a sale-on-approval was a bailment contract. A sales contract came into existence after the buyer signalled his acceptance.[65] On that date (April 22, 1976), the sales agreement became a security agreement. Since International Harvester filed its lien five days after the buyer signalled his acceptance—well within the ten day period allowed under the UCC—its lien transcended the expectations of the prior perfected secured party.[66]

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63. 632 P.2d 522 (Wash. Ct. App. 1981).
64. *Id.* at 529.
65. *Id.* at 527.
66. *Id.* at 530.

GOOD FAITH

Good faith is a big issue in secured transaction cases. It is a revisionist's concept — ambiguous to many — that some judges overlook in Article IX disputes. In *Chemlease World Wide, Inc. v. Brace, Inc.*, the lessor (Chemlease) provisioned the lessee (Brace) with computer equipment.[67] The lease forbade a sublease. The lessor furnished the lessee with the option to buy the equipment at the end of the lease period for one dollar. The lessee breached the sublease provision and failed to make his payments. Chemlease seized the equipment and gave the lessee notice of its intent to sell the property on February 12, 1979. Brace received notice of the sale on February 2, 1979. The property was sold on that date. The sale did not produce a sum to discharge the debt. Chemlease brought an action against Brace to recover the deficiency. The lessee asked the court to dismiss the action because the creditor (lessor) did not act in a commercially reasonable manner.[68] The court said the dispute was governed by section 9-504(3) of the UCC. When a creditor promises to sell property on a particular date (which he does not keep) the creditor is precluded from getting a deficiency judgment. We take a middle route in Minnesota, the court said, even though it has not been blazed by the UCC. A creditor may get his deficiency judgment provided he proves that it got a fair price for the good and acted in a commercially reasonable manner.

Now there would have been a different result if the judges had adopted a revisionist's or a relationist's perspective. The security agreement (Lease) was a relationist contract. It imposed a duty upon the parties to act in good faith. Good faith covered behavior which conformed with statutory duties under the lease. Since Chemlease acted in bad faith (when it breached its duty under 9-504(3)), the court should have denied Chemlease a deficiency judgment outright.

In *Reeves v. Foutz & Tanner, Inc.* the court ignored both the UCC text and comments.[69] It passed up an opportunity to grapple with the problem with good faith and expectation theory. What were the facts? The secured creditor was a pawnbroker who lent the debtor some money. The debtor surrendered possession of precious jewelry commanding more value than the loan. The debtor breached the loan agreement. The creditor retained possession of the jewelry pursuant to section 9-505(2) and sold it in the ordinary course of his business. The court said that the creditor could not sell property it had obtained under section 9-505(2).[70]

67. 338 N.W.2d 428 (Minn. 1983).

68. *Id.* at 437. Since the trial court didn't gather evidence on the price the case was remanded to the trial court to figure one out.

69. 617 P.2d 149 (N.M. 1980).

70. *Id.* at 151.

Without supporting evidence, it said that the Code section did not permit it. Although the event could have been analyzed in good faith terms the court said that the creditor's behavior clashed with the court's sentiment that surplus value (what was left after an indebtedness has been paid) should be transferred to the debtor. Under expectation theory and a vision about good faith (that a creditor is entitled to what's allotted by a statute policing his contract) the creditor was entitled to a sum of money which equated with the indebtedness (section 1-106). Since the property commanded more value than the indebtedness (a sum which the creditor tried to keep) the court should have said the creditor was obliged to convey the surplus value to the debtor. The creditor could not hide his greed behind a provision in the UCC.

PRIORITY

What about priorities? The ends championed by creditors (government and secured creditors) make sense when they are scrutinized with expectation theory. The government is trying to discharge an indebtedness by confiscating all of the taxpayer's property. A secured creditor is trying to do the same thing with property sought by the government. The conflict is a priority fight. The question is who gets first access to the property to discharge a debt? The pertinent statutes (Federal Tax Lien Act and UCC) are revisionist statements. A claimant's status and (or) an event determines who is given priority.[71] If the government has an unregistered tax lien; and its rival has a perfected security interest; the secured creditor will win priority.[72] However, if the government has a registered tax lien; and its rival has a perfected security interest in a taxpayer's existing inventory and after acquired inventory; new inventory (arising after the government's lien has been registered) belongs to the secured party.[73] If the government is a secured creditor; and his rival is a secured creditor; the government can not use its status to overcome the lien (the expectation) of his rival.[74]

As regards the spats between a secured creditor and a trustee in bankruptcy one can make similar observations. Expectation theory illuminates the goals pursued by the contestants. The pertinent statutes are revisionist. An event or a person's status determine when the desires of a contestant triumphs others. An illustration makes the point. Assume that John's, Inc. was engaged in the sale of Natural Gas owned a pipeline company. John's had plans to expand the pipeline company. John's

71. Texas Oil & Gas Corp. v. United States, 466 F.2d 1040 (5th Cir. 1972). *See* U.C.C. § 9-301(4), and the Federal Tax Lien Act, 26 U.S.C. §§ 6321, 6323(a)-(d), (h).
72. *See* United States v. Globe Corp., 546 P.2d 11 (Ariz. 1976).
73. Donald v. Madison Indus., Inc., 483 F.2d 837 (10th Cir. 1973).
74. United States v. Kimbell Foods, Inc., 440 U.S. 715 (1979).

borrowed $200,000 from Carol to finance the expansion, giving the lender a security interest in its accounts receivable ($110,000) and after acquired accounts receivable. John's borrowed an additional $50,000; repaid $60,000 and filed a petition in bankruptcy. John's indebtedness was $70,000. The accounts receivable was worth $50,000. The trustee claimed that there was a preference. Carol thought it was nonsense. What result?

First, there is a preference. Secondly, Article IX of the Uniform Commercial Code does not resolve the squabble. Thirdly, the amount of the preference varies with the mathematics ($180,000, $120,000, $70,000 and $60,000). Finally, the right answer depends upon a person's computations; his perspective on under-collateralization; and the latitude allotted the claimant by the pertinent statute.[75]

PREFERENCES

At Common Law a preference amounted to moral misconduct. It was paying one creditor without making provisions for the payment of all others. Under the Federal Bankruptcy Act this notion was harnessed to section 547(b). Any reduction in a secured creditor's under-collateralized situation or payment to a creditor (ninety days before bankruptcy) amounted to a preference. If John's made a $60,000 payment before the bankruptcy, that was a preference. If Carol's under-collateralized situation improved a bit (she had more property value to wipe-out John's indebtedness) the $180,000 was a preference. Since section 547(b) covers preferences; and section 547(c)(5) covers reductions in one's under-collateralized situation; the trustee could use that to retrieve money from Carol.

Sadly, the statute does not supply mathematics for computing the preference. Any methodology compatible with bankruptcy policy is alright. If you subtract $110,000 from $200,000, and $50,000 from $70,000, you can use the remainders to establish the preference ($70,000). You can subtract $110,000 from $250,000, and $50,000 from $70,000, to establish the preference ($120,000). You could add the $60,000 payment to the $120,000 preference to get the total preference if it is permitted by the statute.[76]

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75. *See* Richard F. Duncan, *Preferential Transfers, The Floating Lien, and Section 547(c)(5) of the Bankruptcy Reform Act of 1978*, 36 ARK. L. REV. 1, 19-29 (1983).
76. *Id.* at 27, 29. *But see* Bankruptcy Reform Act of 1978, 11 U.S.C. § 550(c).

JUMBLE

Of course, the court can muddle things. You can see it in *In re American Mariner Industries, Inc.* American Mariner was the debtor.[77] Crocker National Bank was the under-collateralized secured creditor. The debtor filed a petition in bankruptcy. The secured creditor demanded adequate protection. Under state law, it asserted, a secured creditor (upon default) may grab collateral; sell it; and loan the proceeds at interest. Since the Bankruptcy Act deprived him of an opportunity to make money out of encumbered collateral, the trustee should compensate him.

What's the response? First, state law recognizes a creditor's right to grab collateral and sell it. Secondly, state law does not discuss the creditor's right to loan proceeds at interest. Finally, the House Report on the Bankruptcy Act says nothing about the creditor's right to grab collateral; sell it; and loan the proceeds at interest.[78] Astonishingly the court of appeals—allowing its feelings to trump the evidence legitimized the creditor's point of view.

Now, it is true that a security agreement arouses an expectation that a creditor can grab encumbered collateral and sell it to erase an indebtedness. Whether the secured creditor was empowered to loan the proceeds at interest, however, should have been analyzed from the perspective of "What's in the security agreement?" Further, any depreciation in the value of collateral exacerbated by bankruptcy was a reason for paying compensation. The Bankruptcy Act, however, does not mention "a lost opportunity" to make money off of encumbered collateral (or its proceeds) as reasons for paying the secured creditor anything.[79]

CANADIAN PROSPECTIVE

Let's examine Canadian cases. The Personal Property Security Acts—prompted by the United States/Canadian Free Trade Agreement and NAFTA—resembles Article IX of UCC.[80] It memorializes efforts to transform Canada's cash economy into a credit economy.[81] The Act has been adopted by four provinces leaving the others to cope with competing

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77. 734 F.2d 426 (9th Cir. 1984). The holding was overturned in United Savings Ass'n v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365 (1988). The precursor was the Fifth Circuit Court of Appeal's opinion. It's a harsh critique of the *American Mariner* case. *See In re* Timbers of Inwood Forest Assocs., Ltd., 793 F.2d 1380 (5th Cir. 1986).

78. *American Mariner*, 734 F.2d at 431.

79. Bankruptcy Reform Act of 1978, 11 U.S.C. §§ 502(b)(2), 507(b). *See* United States v. Ron Pair Enters., Inc., 489 U.S. 235 (1989); *In re* Lapiana, 100 B.R. 998, 1002-03 (N.D. Ill. 1989).

80. David L. Voechting, *The Personal Property Security Act (Manitoba)—Review of Cases to the End of 1981*, 12 MANITOBA L.J. 147 (1983). *See* Ronald Cuming & Jacob S. Ziegel, *The Modernization of the Canadian Personal Property Security Law*, 31 U. TORONTO L.J. 249, 254 (1981).

81. Cuming & Ziegel, *supra* note 80, at 250.

statutes.[82] The Act is driven by expectation theory. The contracts are relational. The parties are free of the duty to act in good faith.[83] The text is ambiguous making litigation risky and mediation a tempting remedy. The Act covers leases of real property; long-term leases of personal property; and consignments.[84] There is a prejudice against the use of irregularities in a security agreement or a financing statement to defeat a lien.[85] Sellers cannot use "reservation of title" in a sales agreement to dislodge a prior perfected security interest.[86] Secured creditors can use the nation's Bankruptcy Act to overcome competing government liens.[87] Secured creditors can take collateral from the bankruptcy estate when the trustee can not prove that the debtor has equity in the property.[88]

MUDDLE

Sadly Canadians can make a muddle of the law as can be seen in *Rogerson Lumber Co. Ltd. v. Four Seasons Chalet Ltd.*[89] Four Seasons was the buyer. Rogerson was the seller. The Bank of Montreal was the prior perfected security party. In 1973, under the Bank Act, the buyer granted the Montreal Bank a lien in its existing and after-acquired inventory. In June 1976, the buyer entered into an oral sales agreement with Rogerson Lumber Company. The agreement was reduced to a writing on September 8, 1976. The seller promised to deliver the goods in lots between August and December. The buyer was to make the first payment in November. There was a breakdown in the security agreement with the Bank. On September 13, 1976, the Bank of Montreal confiscated the August delivery of lumber. The seller asserted the lumber belonged to him because he reserved title to the goods. The Bank claimed a lien in the goods by way of a prior perfected security interest.

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82. *Id.* at 249. British Columbia, Alberta, Saskatchewan, Manitoba and Ontario have adopted the Personal Property Security Act. Since Quebec has a different legal system, the provincial government has appointed a staff to draft a Civil Code Version of the Act. At this moment action is pending in the Atlantic provinces. Interview with Denis Magnusson, Professor of Bankruptcy Law, at Queen's University, Kingston, Ontario, Canada (June 15, 1990).

83. The Act omits a transcending provision on the duty to act in good faith. *See* Ontario Personal Property Security Act (O.P.P.S.A.), 29 CAN. ENCYCLOPEDIA DIGEST (Ontario) 131-17 to 131-72.

84. *See* LAW REFORM COMM'N OF SASK., REPORT ON PROPOSALS FOR A SASKATCHEWAN PERSONAL PROPERTY SECURITY ACT 7-8 (1977); David L. Voechting, *The Personal Property Security Act (Manitoba)—Review of 1982 and 1983 Cases*, 14 MANITOBA L.J. 95, 102 (1984). Fertilizer Co. v. Larry O. Hewitt, 52 O.R.2d 9 (1985) is a good consignment case. Assiniboine Credit Union v. Canadian Imperial Bank of Commerce, 5 W.W.R. 251 (1984), and Ranjoy Sales & Leasing Ltd. v. Down, 4 W.W.R. 16 (1982), are good real property cases.

85. *See* David L. Voechting, *The Personal Property Security Act (Manitoba) Review of 1984 and 1985 Cases*, 16 MANITOBA L.J. 15, 23-26 (1987).

86. *See* Rogerson Lumber Co. v. Four Seasons Chalet Ltd., 113 D.L.R.3d 671, 675-78 (1980).

87. Bank of Montreal v. Scott Road Enters. Ltd., 4 W.W.R. 566, 570-72 (1989).

88. *In re* Brodie, 51 C.B.R. (N.S.) 81 (1984).

89. *Rogerson*, 113 D.L.R.3d at 671.

In this case the court was asked to fix the priority between the contestants. It was tempted to obfuscate. Haunted by the seller's wishes (proclaimed in the oral agreement), it stumbled over the pertinent Common Law materials. It misinterpreted the Personal Property Security Act. It gravitated towards problematic ideas in the Bank Act to defeat the Bank's lien. Under The Bank Act (section 178) the court equated "ownership" with "rights in collateral." Since the vendor retained title to the goods until he was paid in full, and no payment had been made, the buyer had neither "rights in the collateral" nor "ownership" to which the Bank's lien could attach.[90] Of course, the proper use of expectation theory (memorialized in an Ontario Revised Statute), would have produced a different result.[91] If Rogerson wanted ownership of the goods (until he was paid in full), he should have reduced his desire to writing.[92]

Bank of Montreal v. Pulsar Ventures, Inc. is a better case.[93] There was a buyer, a seller, and a secured creditor (Bank of Montreal). The seller claimed that his reservation of title in a sales agreement defeated the secured creditor's lien. The Bank treated the seller's assertion as nonsense. The court resolved the dispute under the Bank Act. In "a fit of clear thinking," the court said that the sellers could not use the Personal Property Security Act to top liens created under the Bank Act. The Personal Property Security Act recognized liens created under the Bank Act. Registration of one's lien under the Personal Property Security Act could not force a registrant to accept that Act's regime on priorities.[94] If the Bank filed its lien first, the seller had to wait its turn to get paid.

PROCEEDS

Canadians are entitled to proceeds. *General Motors Acceptance Corp. v. Bank of Nova Scotia* reveals the obstacles a secured creditor has to overcome to get them.[95] General Motors Corporation (GMC) was the seller. Morrison (dealer) was the buyer. General Motors Acceptance Corporation (GMAC) and the Bank of Nova Scotia (BNS) were the lenders. In April 1976, Morrison obtained credit from GMAC to purchase vehicles for his dealership. GMAC was given the buyer's conditional sales

90. *Id.* at 678.
91. *Id.* at 675-76.
92. *Id.* at 676. In 1976, the Ontario Legislature repealed the Ontario Conditional Sales Act thereby reviving the Common Law rule on the reservation of title. A creditor can't use the Bank Act or Ontario's Personal Property Security Act to invalidate a clause proclaiming "the vendor's title to the property until he's paid in full." *Id.* at 676-77. A creditor can obtain a lien in property thereby subordinating some vendors after his debtors (purchaser) have secured equity in property. *Id.* at 678.
93. 1 W.W.R. 250 (1988).
94. *Id.* at 258-59.
95. 55 O.R.2d 438 (1986).

contracts, a lien in the goods, and the proceeds.[96] The vehicles were sold in the ordinary course of Morrison's business. Proceeds were deposited in an account Morrison had established with the Bank of Nova Scotia. In February 1981, BNS provisioned Morrison with a line of credit to run his business. The Bank was granted a lien in Morrison's accounts receivable and inventory. The credits and the proceeds were deposited in the self-same account Morrison had established with the Bank. In August 1982, there was a collapse of the agreement with the Bank. BNS seized the funds in the account. GMAC claimed the funds as proceeds. The court had to decide whether GMAC could trace proceeds commingled with other funds.

Although the court applied the appropriate section of the Personal Property Security Act, it ignored the section's mandate. It weakened the language by reading a common law notion into the statute. The court's language was impenetrable. It failed to distinguish between common law and statutory rights. Finally, it used the wrong American case to resolve this dispute between the parties.[97]

When proceeds are commingled with other funds, said the court, they lose their identity.[98] When funds are seized by someone who is aware of the proceeds, the secured party can retrieve them from that person. Of course, the authority to trace funds depends upon some agreement discussing proceeds.[99] Since the conditional sales contracts given to GMAC (after the cars were sold to Morrison) did not assign proceeds from the sale of these vehicles to GMAC, or require the dealer to hold them apart from other funds, GMAC could not use the Personal Property Security Act to get them from the Bank.[100]

TRUSTS

In Canada, unperfected secured parties rank below general creditors.[101] In an insolvency case general creditors get paid before unper-

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96. It is reflected in the financing statement. *Id.* at 440. *See* Ziegler, *Tracing Proceeds Under the Ontario Personal Property Security Act:* General Motors Acceptance Corp. of Canada, Ltd. v. Bank of Nova Scotia, 13 C.B. L.J. 177, 178 (1987).

97. *General Motors Acceptance Corp.*, 55 O.R.2d at 444 (citing Anderson, Clayton & Co. v. First American Bank of Erick, 614 P.2d 1091 (Okla. 1980)), was a major mistake. The facts clashed with the GMAC case. The opinion was gibberish. A creditor, who had given a junior creditor priority under a subordination agreement, breached his contract to secure proceeds. Since the breach clashed with the duty to act in good faith under the subordination agreement, see U.C.C. § 1-203, the court decided that proceeds commingled with other funds retained their identity. *Id.*

98. General Motors Acceptance Corp., 55 O.R.2d at 443.

99. *Id.*

100. *Id.*

101. SMYTH ET AL., THE LAW AND BUSINESS ADMINISTRATION IN CANADA 757 (5th ed. 1987). In an earlier version of the Ontario Act, R.S.O., ch. 375 (1980), *amended by* chs. 2, 58, S.O. 1981 (Can.), academics interpreted § 22 in the way that it's portrayed in the text. Nowadays holders of unperfected security interests rank with general creditors. Interview with C. Thomas Asplund, Professor of Commercial Law, at Queen's University, Kingston, Ontario, Canada (June 19, 1990).

fected secured creditors get anything.[102] When money conveyed by mistake or in violation of some agreement is mixed with proceeds, the entire fund becomes a trust.[103] In most ca,ses the conveyor gets his money before the secured party gets paid. Under the Personal Property Security Act, a debtor becomes a trustee. If proceeds are mixed with his funds and stored in some bank account, the funds in the account become a trust. When there is a withdrawal it is presumed that the debtor has used his funds, leaving the proceeds in the account.

In re Hallett Estates, cited in Ontario's Personal Property Security Act, supports this proposition.[104] The case was decided in 1879. Cotterill was the principal and Hallett was the agent. Cotterill furnished Hallett with money to make investments. In 1873, Hallett bought bonds for Cotterill. He provisioned her with a receipt acknowledging her ownership and statements about dividends. Hallett purchased similar bonds for himself. He put Cotterill's bonds and his own in the same bank. Sometime after, Hallett sold all the bonds putting the cash in his general bank account. Cotterill claimed the cash after Hallett's death. Hallett's trustees claimed the money belonged to the estate. The court had to decide whether Cotterill could trace her bond to Hallett's bank account.

The court's opinion was lengthy. The appellate judges bent over backwards to be respectful while shredding the trial judge's opinion. When a person promises to protect someone else's money, he becomes a trustee. The promise may be express or implied from the relationship between the parties. When bonds are reduced to cash and is mixed with the trustee's funds, the fund becomes a trust. If the trustee spends some of the money, it is presumed that he has spent his own funds.[105] If the fund is spent on property, which the trustee calls his own, the person (whose money was spent) is granted a lien which equates with the sum owed.[106]

The judges could have used expectation theory in this case. Hallett's receipt sparked a belief that Cotterill's money had been invested. The dividend statements aroused an expectation that her investments would be protected. By mixing her bonds with his own and reducing them to cash, Hallett destroyed Cotterill's expectation. The court had the option to award damages or impress the cash with a trust. The court elected to

102. *See* Fratkin v. Canadian Imperial Bank of Commerce, 2 W.W.R. 470 (1977) (trustee was provisioned with a general creditor's power to undo a security interest).

103. *In re* Hallett's Estates, 13 Ch. D. 696, 711, 719 (1880); *see* Bank of Nova Scotia v. Soriete Generale, J.D. of Calgary, No. 8601-08004 (Alta. Q.B. Feb. 16, 1987). *See* Robert P. Desbarats et al., *Recent Developments in the Law of Interest to Oil and Gas Lawyers*, 26 ALTA. L. REV. 152, 182-83 (1987). *See In re* Bankruptcy of Petroleum Royalties Ltd., 45 Alta. L.R. 273 (Q.B. 1986).

104. *See supra* note 103; *The Ontario Personal Property Security Act* § 108 n.29, 29 CAN. ENCYCLOPEDIA DIG. 313-39 (3d ed. 1985).

105. *In re* Hallett's Estates, 13 Ch. D. at 711.

106. *Id.* at 709.

follow the second option, thus provisioning Cotterill with an opportunity to get her funds out of Hallett's account.

Although *Ford Tractor and Equipment Company of Canadian Ltd*[107] is not a Personal Property Security Act case, the court's opinion expresses the prevailing sentiment about trusts in secured transactions. Ford Tractor and Equipment (Ford) was the seller and Otto Grudman Implements (retailer) was the buyer. Under a floor planning agreement Ford provisioned retailer with inventory on credit. Retailer provisioned Ford with a security interest in the inventory. The agreement contained a provision impressing a trust upon proceeds emerging from the sale of inventory. The retailer filed a petition in bankruptcy. The seller claimed the proceeds from the sale of the inventory. The trustee in bankruptcy claimed the proceeds were "property of the estate." The court had to decide who got the money. The court could have used relational theory because buyer and seller were parties to a long-term contract. The parties were under a duty to act in good faith. Good faith meant guarding the secured creditor's proceeds or paying damages. The seller's breach of that duty meant the secured party could get his money.

Putting aside relational theory, the court applied statutes it was obliged to follow in Manitoba.[108] When a debtor grants a creditor a security interest in inventory, and he has proceeds in his possession, then the proceeds are impressed with a trust. When the debtor holds proceeds after he has filed a petition in bankruptcy, the trustee must surrender them to the secured party. Under the Bankruptcy Act, proceeds are not treated as property of the estate. Further, the trustee cannot keep them. Under the Manitoba Bill of Sales Act the seller has done everything to garner what belonged to him.

CONCLUSION

In the pre-modern world, reality was composed of torts, property and contracts. Royal edicts or parliamentary declarations hermetically sealed each realm from the other. In the contemporary world, technology has eroded this reality. The boundaries between property and contracts and torts have gotten fuzzy. In some cases there has been a fusion of torts and contracts concepts. Courts have used "good faith" to provision plaintiffs with contract and tort damages.[109] Contracts have been depicted as property. Thanks to Charles Reich property has assumed other forms (the

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107. Ford Tractor & Equip. Sales Co. of Can. v. Otto Grundman, 72 W.W.R. 1 (Man. Can. 1970).
108. *Id.* at 4, 6.
109. *See, e.g.*, Nicholson v. United Pac. Ins. Co., 710 P.2d 1342 (Mont. 1985).

psychic space to make and implement decisions that will not be countermanded by anybody).[110]

Given these changes we need a new language to describe what has taken place. We could use good faith, expectation theory, and estates in things to make sense of human action.[111] If, for example, a Canadian

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110. *See* Charles A. Reich, *Toward the Humanistic Study of Law*, 74 YALE L.J. 1402 (1965).

111. A contract is a promise supported by consideration or a promise in writing. Since the parties are interested in continuity, their behavior is governed by the duty to act in good faith. If they breach this duty, the injured party may recover damages. If breach is inefficient, in the sense that it disrupts the work of the market, and/or denies consumers a good at a fair price, the injured party is entitled to tort-type damages.

The parties cannot hide a product's defect under some term in a contract. They cannot lie to procure an agreement. They cannot use duress. Aside from continuity the parties are entitled to what they sought under the agreement, e.g., money and profit, goods and status. Having said that, here is a gratuity.

There has been a flurry of articles on the production of energy within the last few months. *E.g.*, Suzanne McGee & Larry Lamphier, *Foothills Plans a Gas Pipeline for 3.74 Billion*, WALL ST. J., Oct. 31, 1989, at A2; Strickland, *Free Trade Agreement and Natural Gas Exports*, ON RECORD, Oct. 1989, at 1. Canada is preparing for a natural gas sales boom to America. There are a slew of oil and gas contract cases. What should an American investor know about producer-operator agreements in Canada? How should Americans analyze their risks under a take-or-pay contract?

In Canada, a producer-operator agreement is an oil-or-gas lease. The investors are tenants in common. One investor is assigned the role of manager. Under the Canadian Petroleum Landman (CAPL) contract, assuming a co-tenant-investor breaches his duty, the operator (manager) is given a possessory lien in the co-tenant's estate and an equitable lien in his well's production, proceeds, and equipment.

Americans should remember that Canadians differentiate between common law possessory and equitable liens. An equitable lien is a right to confiscate something to erase an indebtedness. The lien is established by contract, provided, there is a clause proclaiming it. The lien comes into existence 30 days after co-tenant has breached the lease agreement. Since Alberta has not adopted the Personal Property Security Act, a lien in production must be registered under the Sale of Goods Act. When there are competing liens, attachment and perfection, knowledge of the lien and status determine priority.

In America a take-or-pay contract is a gas purchase agreement. It is governed by Article Two of the UCC. The writing creates revisionist and relationist obligations. The parties are under a duty to act in good faith. The injured party is entitled to damages in expectation. A person can recover reliance damages outside of the UCC or specific performances when there is no market data on the goods or the data is sketchy. *See* Manchester Pipeline Corp. v. Peoples Natural Gas Co., 862 F.2d 1439 (10th Cir. 1988), Colorado Interstate Gas Co. v. Natural Gas Pipeline Co., 885 F.2d 683 (10th Cir. 1989), and Golsen v. ONG Western, Inc., 756 P.2d 1209 (Okla. 1988), all three cases are emblematic of the court's thinking. See Anthony T. Kronman, *Specific Performance*, 45 U. CHI. L. REV. 352-57 (1978).

In *Manchester v. Peoples Natural Gas*, (PNG) was the buyer. Manchester Pipeline Company was the seller. The parties commenced negotiations in 1983. PNG's representatives provided a Manchester employee, Davis, with sample gas purchase contracts to review. Davis met with Dononvan, a PNG gas contract representative, during April 1984. Donovan told the seller that any offer he made was subject to PNG's management approval. Donovan said that his superior, Bill Eliason, approved all offers or letters he sent in connection with the negotiations with Manchester. *Manchester*, 862 F.2d at 1440. Eliason confirmed that. *Id.* at 1441.

On May 14, 1984, Donovan sent Davis a letter "offering" to purchase natural gas from Manchester at the price of $2.65 per million British Thermal Units for 20 years. There was no acceptance. After that event, the parties spent several months on negotiations. On three or four occasions, Donovan sent Davis single copies of sample gas purchase contracts. On each copy "draft" was stamped in red ink. *Id.*

On September 12, 1984, Donovan sent Davis three copies of a document titled "Gas Purchase Contract" covering six wells in Manchester's fields. The document did not have the word "draft" stamped in red on the front page. The document provided for a term of 10 years. It contained detailed provisions concerning price, minimum "take" obligations, determinations of reserves, and the right of PNG to reduce the price paid for gas taken in order to remain competitive in the gas market. The copies were accompanied by a letter which stated in pertinent part:

concluded a deal with an American, he would know that there was a positive duty to cooperate (good faith). If an American made a security agreement with a Canadian (in Canada), he would know that his proceeds would be protected under a trust concept. If the parties made an agreement governed by a statute, in Canada or America, expectation theory would illuminate what each player would get. There would be damages, specific performance and payments to erase indebtedness.[112]

> Enclosed for your review and approval, please find three copies of our Gas Purchase Contract covering acreage referenced above. If you find this contract acceptable, please fully execute all three copies (including notary pages) and return to this office. Following (PNG's) execution, one completed copy will be forwarded to you.

Id.

On September 18, 1984, the Vice President of Manchester executed the three copies and returned them to Donovan. The documents (which PNG didn't sign) featured a provision covering Manchester's obligation to purchase rights of way and build a pipeline from its field to PNG's pipeline system. *Id.* at 1442. Davis said that he told his engineer to commence work. He said that, at PNG's request, Manchester used larger pipe in building the pipeline "to match up with the system (PNG) already had in place." After the signed copies were returned to PNG there was a breakdown in the relationship. PNG claimed that it had lost its largest customer and that the demand for its gas had gone down. Since it did not sign the purchase agreement and there was no demand for what it could supply, PNG felt it was under no obligation to buy gas from Manchester Pipeline Corporation.

The court decided that there was a contract. The cover letter and documents amounted to a offer under § 2-206 and Manchester's actions amount to acceptance. The court got entangled in damage calculations under § 2-723. It thought the seller was confined to damages in expectation. The court glossed over the fact that damages were difficult to calculate and that the UCC was not an exclusive remedy. Where damages are difficult to calculate, and there is evidence that certain expenditures came about because of a writing, the seller is entitled to reliance damages outside the UCC. *See* U.C.C. § 1-103.

Colorado Interstate Gas Co. v. Natural Gas Pipeline Co. was a good faith case. The buyer, Natural Gas Pipeline, entered into a long term gas purchase contract with Colorado Interstate Gas (CIG), the seller. The buyer was provisioned with the option to take its gas or reserve it for some other year. In 1982, 1983, and 1984, the buyer reserved its requirements. When the buyer purchased what it had reserved from another source of supply, its actions stifled CIG's contract with its supplier. The situation reduced CIG's excess capacity to sell or transport gas to other customers. Colorado lost 13% of its market and profits. The court (after it had assessed the facts), dismissed the injuries sustained by Colorado. The court found that the CIG had not sustained an injury since it had gotten paid. Further, Colorado could not use a common law notion like good faith to circumvent federal regulation of interstate gas contracts.

Golsen v. ONG Western, Inc. was an impossibility of performance case. Golsen was the seller. ONG Western was the buyer. There was a slack in demand for natural gas causing a decline in ONG's resale revenue. Because it could not resell the gas it had purchased from Golson profitably, ONG claimed its gas contract was impossible to perform. Citing U.C.C. § 2-615 and Comment Four, U.C.C., the court dismissed the argument. The parties, said the court, had addressed this eventuality under the contract. There was a provision authorizing a price adjustment or two when the market demand changed.

112. *See In re* O.P.M. Leasing Servs., Inc., 21 B.R. 993 (Bankr. S.D.N.Y. 1982). It is an interesting case. O.P.M. was the lessor. The State of West Virginia was the lessee. Lessee made an unconditional promise to pay rent on computers. O.P.M. promised to reimburse the lessee for payments to computer maintenance providers under the lease. O.P.M. used the lease as collateral for a loan. It breached its duty to reimburse the lessee for maintenance payments. West Virginia stopped payments under the lease. The secured party, the person to whom the lease was assigned as collateral, brought an action to recover the balance of the lease payments. O.P.M. filed a petition in bankruptcy. The court had to decide who was paid what.

The court had to solve a master lease and a security agreement problem. In the analysis there was a clash between objective and relationist perspectives. The court decided that the lessee was bound by its words, i.e., its unconditional promise to make rental payments. A finance lease, said the court, was composed of mutual and independent promises. There was a duty to act in good faith to reimburse the lessee for payments to maintenance providers. Unfortunately, breach of that duty would not excuse the lessee's duty to make rental payments to O.P.M. or its assignee. West Virginia owed O.P.M. money. *See In re* O.P.M. Leasing Servs., Inc., 56 B.R. 678 (Bankr. S.D.N.Y. 1986). In that case, Objectivism, revisionism and relationism would guide the judge's actions.[113]

the court discusses the calculation of damages and the order of payment in a bankruptcy proceeding.

113. *E.g.*, Petrogas Processing Ltd. v. Westcoast Transmission Co. Ltd., 59 Alta. L.R.2d 118 (1988). Jefferson Lake Petrochemical Ltd. made a contract with Westcoast Pipeline Company. Jefferson promised to supply gas to Westcoast. In return, Westcoast promised to buy natural gas on a take-or-pay basis. Thereafter, Jefferson assigned its contract to Petrogas Processing Ltd.

Under the assignment Petrogas promised to sell natural gas at negotiated (sometimes adjusted) prices. In 1960, Westcoast made a long-term contract with Northwest Pipeline Company, an American firm operating in the Pacific Northwest. At a mutually agreed upon price, Northwest promised to buy and Westcoast promised to sell all of the gas available under the Petrogas-Westcoast contract. *Id.* at 126.

In 1975, the provincial and the federal governments overturned the pricing schemes in the Westcoast's contracts. Under amended powers, Canada's National Energy Board told Westcoast to sell its gas at a fixed export price. The government of Alberta overturned both the pricing scheme in the Petrogas contract and Westcoast's method of purchase. Westcoast had to buy gas at cost; sell it to the Alberta Government; and repurchase it at a higher price. The prices erased Westcoast's profits and chilled Northwest's passion for natural gas. Northwest stopped buying gas. Westcoast took smaller volumes from its Alberta supplier. Petrogas brought an action to recover damages for gas Westcoast never took. Westcoast pled frustration. Petrogas asserted that Westcoast was estopped from using that defense. The trial court sided with Westcoast. The court of appeals sided with the trial court.

The court used the common law to decide this case. Frustration of purpose, it said, was a defense to breach. It amounted to state intervention which (a) made a contract illegal or (b) altered a contracting party's performance. *Id.* at 133, 136. Since Westcoast couldn't sell gas below a price established by the Ottawa government, nor export gas without purchasing it (first) from the Alberta government, its contracts were discharged.

This decision could have been explained with the expectation theory analysis—weighing the expression trumpeting the wishes of the parties. Westcoast sought gas at the negotiated price. Petrogas agreed to sell gas at a negotiated price. Since the state overturned the wishes of the parties neither of them should have sought enforcement. *Id.* at 137. The American buyer could have hidden behind the meeting of the minds theory. The price adjustment was a modification of an established agreement. It was something imposed upon him by the Alberta and the Ottawa governments. Since he didn't agree to it; and the modification wasn't supported by a new consideration, Northwest was obliged to purchase nothing.