ises; the underlying dispute was between Lane and a newspaper in which the storeowner advertised. However, would free speech activities on a store's sidewalk wholly unrelated to the owner's business still be protected? *Hoffman* might be taken as an indication that it would. The leafletting there was not directed at the activities of the station's owners, but only sought to educate the soldiers present in the station on a subject unrelated to the business of the railroad. However, *Hoffman* might be distinguished from the store situation, because of the station's clearly more public nature—not only are the station's functions much more extensive than those of the store,[14] but also the railroad industry is subject to extensive public regulation. Furthermore, the evil *Lane* sought to avoid—that a store's customers would be effectively prevented from learning of the owner's alleged unfair employment or merchandising practices because a private parking lot surrounded the store—would not be present if the leafletting was unrelated to the use of the property. If the handbiller's only motive in choosing the store's sidewalk was its convenience as a forum, the court would have less justification for restricting the owner's control of his property. Still, the court has been extremely protective of nondisruptive handbilling, and it might find it to be an exercise of free speech whether or not it related to the property in question.

In re Lane raises as many questions as it answers, but it does serve to illustrate the significant expansion of free speech rights on private property which has recently occurred in both the California and the United States Supreme Courts. It also demonstrates the potentially wide sweep that *Logan Valley* may be given in the future.

M.L.M.

IV

CONTRACTS

A. Parol Evidence Rule

Pacific Gas & Electric Company v. G.W. Thomas Drayage & Rigging Company,[1] *Delta Dynamics, Incorporated v. Arioto*,[2] and *Estate of Russell*.[3] The supreme court continued to liberalize the rules

14. See note 13 *supra*.

1. 69 Cal. 2d 33, 442 P.2d 641, 69 Cal. Rptr. 561 (1968) (Traynor, C.J.) (6-1 decision).

2. 69 Cal. 2d 525, 446 P.2d 785, 72 Cal. Rptr. 785 (1968) (Traynor, C.J.) (4-3 decision).

3. 69 Cal. 2d 200, 444 P.2d 353, 70 Cal. Rptr. 561 (1968) (Sullivan, J.) (6-1 decision).

governing the admissibility of extrinsic evidence in actions involving written instruments, holding that the trial court should consider all relevant extrinsic evidence in determining whether the language of an instrument is reasonably susceptible of more than one meaning;[4] if in light of such extrinsic evidence the instrument's language is reasonably susceptible of more than one meaning, the court should admit all extrinsic evidence relevant to prove any meaning to which the language is reasonably susceptible.[5]

In *Pacific Gas*, the defendant had contracted to replace the metal cover on the plaintiff's steam turbine. The contract provided that the defendant was to perform the work "at [its] own risk" and that the defendant would "indemnify" the plaintiff "against all loss, damage, expense, and liability resulting from . . . injury to property, arising out of or in any way connected with" the work.[6] The turbine was damaged during the course of the work, and the plaintiff sought to recover damages from the defendant nnder the indemnity clause. At the trial, the defendant offered extrinsic evidence to prove that the indemnity provision had been intended only to protect the plaintiff from liability to third persons and not to cover property damage sustained by the plaintiff itself. The trial court refused to admit the evidence, ruling that the "plain language" of the indemnity provision established the defendant's liability. The supreme court reversed, holding that the proffered evidence should have been admitted to aid the court in interpreting the written contract.

In the *Delta Dynamics* case, the plaintiff and the defendant had entered into a five-year exclusive agency agreement, under which the defendant agreed to sell a certain minimum number of the plaintiff's trigger lock devices per year. The contract provided, "Should [the defendant] fail to distribute in any one year the minimum number of devices to be distributed by it . . . this agreement shall be subject to termination" by plaintiff on 30 days notice.[7] The defendant failed to meet its quota for the first year, whereupon the plaintiff elected to terminate the agreement and brought an action for damages. At trial, the defendant offered parol evidence to prove that termination was in-

4. "[R]ational interpretation requires at least a preliminary consideration of all credible evidence offered to prove the intention of the parties." Pacific Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co., 69 Cal. 2d 33, 39-40, 442 P.2d 641, 645, 69 Cal. Rptr. 561, 565 (1968).

5. "The test of admissibility of extrinsic evidence to explain the meaning of a written instrument is not whether it appears to the court to be plain and unambiguous on its face, but whether the offered evidence is relevant to prove a meaning to which the language of the instrument is reasonably susceptible." *Id.* at 37, 442 P.2d at 644, 69 Cal. Rptr. at 564.

6. *Id.* at 36, 442 P.2d at 643, 69 Cal. Rptr. at 563.

7. 69 Cal. 2d at 526-27, 446 P.2d at 786, 72 Cal. Rptr. at 786.

tended to be the plaintiff's sole remedy. The trial court ruled that the evidence was inadmissible and found in the plaintiff's favor. The supreme court reversed, holding that the language of the termination clause was reasonably susceptible of the meaning contended for by the defendant, and that therefore his extrinsic evidence should have been admitted.

Russell involved the contest of a holographic will, the residuary clause of which read, "I leave everything I own Real & Personal to Chester H. Quinn & Roxy Russell."[8] Extrinsic evidence disclosed a latent ambiguity in the will: Roxy Russell was the testatrix's Airedale dog.[9] In an attempt to remove this ambiguity, the trial court admitted extrinsic evidence of the circumstances surrounding the execution of the will. After hearing this evidence, the trial court agreed with Quinn that the apparent bequest to Roxy was merely precatory, and that the testatrix intended to leave her entire estate to Chester Quinn, who she hoped would use some of the property to take care of her pet.[10] Reversing the trial court's decision, the supreme court held that the language of the will, read in light of the circumstances surrounding its execution, was not reasonably susceptible of the meaning ascribed to it by Quinn and the trial court, and that the extrinsic evidence was therefore inadmissible for the purpose of proving that meaning; accordingly, half of the estate passed under the laws of intestacy.

Problems of extrinsic evidence can arise in two different situations. First, extrinsic evidence may be offered to prove that the parties to a written contract collaterally agreed to certain terms not expressed in the writing. This is a problem of integration, and the question is whether the evidence of the alleged collateral terms is rendered inadmissible by the parol evidence rule, which excludes extrinsic evidence tending to add to, vary, or contradict the terms of a fully integrated written contract.[11] Second, extrinsic evidence may be offered to show what the parties intended by the terms they did include in the written instrument. Here the problem is one of interpretation. Since, by definition, evidence of interpretation is not offered to vary or contradict the terms of the writing, but rather to determine the meaning of those terms,[12] it is not

8. 69 Cal. 2d at 214, 444 P.2d at 355, 70 Cal. Rptr. at 563.

9. Animals are not included among those entitled to take by will in California. CAL. PROB. CODE § 27 (West Supp. 1969).

10. "To ascribe to her the belief that her dog could acquire title to real property with all the rights and obligations incident to ownership is to describe a person who would probably be incompetent to make a will at all. There is no other evidence of incompetency and certainly incompetency is not presumed." Clerk's Transcript at 19.

11. C. MCCORMICK, EVIDENCE § 211 (1954); RESTATEMENT OF CONTRACTS § 237 (1932).

12. 3 A. CORBIN, CONTRACTS § 579 (1960 ed.).

subject to the exclusionary provisions of the parol evidence rule.[13] Such evidence may still not be admissible, however, because of some related exclusionary rule, such as the so-called "plain meaning" rule.[14]

California's statutory provisions recognize the dichotomy between problems of integration and interpretation. With respect to integration, Civil Code section 1625 provides that the execution of a written contract integrates all antecedent and contemporaneous agreements between the parties concerning its subject matter.[15] And section 1856 of the Code of Civil Procedure provides that when an agreement has been reduced to writing, there can be no evidence of its terms other than the contents of the writing itself.[16] In interpreting that writing, however, section 1856 expressly permits the admission of evidence of the circumstances surrounding the execution of the written agreement.[17] Section 1860 of the Code of Civil Procedure also provides for the introduction of extrinsic evidence to aid the court in interpretation "so that the Judge be placed in the position of those whose language he is to interpret."[18] Other code sections provide that while the parties' intent governs an instrument's interpretation,[19] that intent is to be ascertained, so far as possible, from the writing alone.[20]

Prior to 1968, California case law preserved the dichotomy between integration and interpretation, formulating different exclusionary rules for extrinsic evidence in each type of case. In integration cases, extrinsic evidence was not admissible to add to, vary, or contradict the terms of a written integration;[21] where a writing integrated only part of an agreement, the same rule applied as to that part.[22] In interpretation

13. *Id.*; C. MCCORMICK, *supra* note 11, § 217.

14. See note 28 *infra* and accompanying text.

15. CAL. CIV. CODE § 1625 (West 1954).

16. CAL. CODE CIV. PRO. § 1856 (West 1955) (statutory statement of the parol evidence rule).

17. *Id.*

18. CAL. CODE CIV. PRO. § 1860 (West 1955). *See also* CAL. CIV. CODE § 1647 (West 1954), which provides: "A contract may be explained by reference to the circumstances under which it was made, and the matter to which it relates."

19. CAL. CIV. CODE § 1636 (West 1954); CAL. PROB. CODE § 101 (West 1956).

20. CAL. CIV. CODE § 1639 (West 1954); *cf.* CAL. PROB. CODE § 105 (West 1956). In interpreting a writing, its terms are presumed to have been used "in their primary and general acceptation," but evidence that the terms were understood to have a "peculiar signification" is admissible to rebut this presumption. CAL. CODE CIV. PRO. § 1861 (West 1955); *cf.* CAL. PROB. CODE § 106 (West 1956), which provides: "The words of a will are to be taken in their ordinary and grammatical sense, unless a clear intention to use them in another sense can be collected, and that other can be ascertained." *But see* CAL. CIV. CODE § 1638 (West 1954), which provides: "The language of a contract is to govern its interpretation, if the language is clear and explicit, and does not involve an absurdity."

21. *E.g.*, Polyanna Homes, Inc. v. Berney, 56 Cal. 2d 676, 365 P.2d 401, 16 Cal. Rptr. 345 (1961); Hale v. Bohannon, 38 Cal. 2d 458, 241 P.2d 4 (1952).

22. Hulse v. Juillard Fancy Foods Co., 61 Cal. 2d 571, 394 P.2d 65, 39 Cal. Rptr. 529 (1964).

cases, extrinsic evidence was admissible to explain the terms of a written instrument, but not to give the language a meaning to which it did not seem reasonably susceptible.[23] In both integration and interpretation cases, however, the application of the above standards was limited by the "face-of-the-document" rule, which required that all questions of admissibility of extrinsic evidence be resolved without recourse to any evidence outside the four corners of the writing. Thus in determining whether a writing was an integration, only the face of the document could be consulted;[24] if the writing itself purported to be an integration,[25] or if the document appeared to the court to be complete on its face,[26] extrinsic evidence of collateral terms was excluded. Similarly, in deciding whether an instrument's language was reasonably susceptible of more than one meaning, the face of the document was controlling;[27] if the language seemed clear and unambiguous to the court—that is, seemed reasonably susceptible of only one meaning—extrinsic evidence was inadmissible to show that the parties intended a different meaning.[28]

In 1968, the supreme court abandoned the "face-of-the-document" rule in both integration and interpretation cases. In so doing, the court rephrased the rules of extrinsic evidence in terms of admissibility rather than exclusion, and thus greatly liberalized the potential use of extrinsic evidence. The landmark case of *Masterson v. Sine*[29] discarded the "face-of-the-document" rule in integration cases, holding that all extrinsic evidence of collateral terms should be admitted unless likely to mislead the trier of fact. In determining whether such evidence might mislead the fact finder, the trial judge must first hear the proffered testimony and then, if he finds it credible, admit the evidence. *Masterson* suggested two possible tests of credibility which might be employed. The *Restatement of Contracts* test would admit extrinsic evidence of any term which the parties might *naturally* have agreed upon collat-

23. *E.g.*, Parsons v. Bristol Dev. Co., 62 Cal. 2d 861, 402 P.2d 839, 44 Cal. Rptr. 767 (1965); Coast Bank v. Minderhout, 61 Cal. 2d 311, 392 P.2d 265, 38 Cal. Rptr. 505 (1964).

24. *E.g.*, Polyanna Homes, Inc. v. Berney, 56 Cal. 2d 676, 365 P.2d 401, 16 Cal. Rptr. 345 (1961).

25. See cases cited *supra* note 21.

26. *E.g.*, Ferguson v. Koch, 204 Cal. 342, 268 P. 342 (1928); Harrison v. McCormick, 89 Cal. 327, 26 P. 830 (1891).

27. *E.g.*, Universal Sales Corp. v. California Press Mfg. Co., 20 Cal. 2d 751, 128 P.2d 665 (1942).

28. See cases cited *supra* note 23. This has been referred to as the "plain meaning" rule. *See* Corbin, *The Interpretation of Words and the Parol Evidence Rule*, 50 CORNELL L.Q. 161 (1965); McBaine, *The Rule Against Disturbing Plain Meaning of Writings*, 31 CALIF. L. REV. 145 (1943).

29. 68 Cal. 2d 222, 436 P.2d 561, 65 Cal. Rptr. 545 (1968). For a more thorough discussion of *Masterson* see *The Supreme Court of California 1967-1968*, 56 CALIF. L. REV. 1612, 1671-76 (1968).

erally.[30] The Uniform Commercial Code test would admit extrinsic evidence of any term that the parties would not *certainly* have included in the writing.[31] Shortly after the decision in *Masterson, Pacific Gas* removed the "face-of-the-document" limitation from interpretation cases, holding that when extrinsic evidence is offered to interpret a writing, the trial court must hear the evidence and then determine whether the language, read in light of the proffered evidence, is reasonably susceptible of the contended interpretation. If it is, the extrinsic evidence must be admitted.

Two potential problem areas present themselves in the principal cases. First, while the abandonment of the "face-of-the-document" rule, together with the expanded importance of extrinsic evidence, makes careful observance of the distinction between integration and interpretation questions critical,[32] the supreme court has yet to address itself to the question of where interpretation leaves off and variance begins.[33] The importance of deciding this question correctly is illustrated by the decision in *Delta Dynamics.* There the issue was whether the parties intended the contract remedy of termination to be exclusive. The supreme court considered this a question of interpretation and, applying the *Pacific Gas* standard, concluded that the language of the contract could reasonably be interpreted to mean either that termination was provided in addition to damages or as the exclusive remedy. These two interpretations were equally reasonable because the written contract made no mention of exclusivity or nonexclusivity. However, since the document is silent on the remedy's exclusivity, the question might also be framed in terms of integration—whether the parties collaterally agreed that the contract remedy was to be exclusive.[34] Yet the supreme court never considered whether this might be the case and whether the *Masterson* test, rather than that of *Pacific Gas,* should be applied. Had it done so, the court might have reached the opposite result. Depending on whether the *Restatement* test or the UCC test is used, the defendant would have to show either that it was "natural" not to include such an agreement in the writing, or that it was not "certain" that they

30. RESTATEMENT OF CONTRACTS § 240(1)(b) (1932).

31. UNIFORM COMMERCIAL CODE § 2-202, Comment 3.

32. In jurisdictions adhering to a rigid parol evidence rule in integration cases, extrinsic evidence of collateral terms is often admitted under the guise of interpretation. *See* Sweet, *Contract Making and Parol Evidence: Diagnosis and Treatment of a Sick Rule,* 53 CORNELL L. REV. 1036, 1041 (1968). The more modern approach to integration initiated by *Masterson,* however, should lessen the temptation to engage in this subterfuge.

33. *See* 3 A. CORBIN, *supra* note 12, § 543, at 132.

34. *See* CAL. COMM. CODE § 2719(1)(b) (West Supp. 1969), which presumes nonexclusivity in the absence of an express agreement to the contrary.

would have included such an agreement. It is evident that the defendant might have had difficulty satisfying either standard.

A second problem arises in the application of *Pacific Gas*'s "reasonably susceptible" standard. Prior to the decision in *Pacific Gas*, the "reasonably susceptible" standard, taken in conjunction with the "face-of-the-document" rule, was nothing more than a rephrasing of the so-called "plain meaning" rule.[35] Under the *Pacific Gas* formulation, however, the reasonable susceptibility of language to one or more interpretations is to be determined in light of extrinsic evidence. Whether the "reasonably susceptible" standard gives the trial court sufficient guidance is questionable, particularly in light of the supreme court's opinion in *Russell*. There the court's finding that the bequest to Roxy Russell, when read in light of the extrinsic evidence, could not be interpreted as merely precatory was conclusory—no explanation of this result is offered. While this case might be rationalized in terms of the supreme court's unwillingness, as a matter of policy, to disturb the language of wills, the *Russell* court expressly states that it is applying the *Pacific Gas* test. Therefore, *Russell* must be dealt with in all future interpretation cases.

A better standard for admitting extrinsic evidence in interpretation cases might be no standard at all—that is, the trial court should admit all relevant extrinsic evidence offered to aid in interpreting a document; the trial court would then decide, on the basis of all the evidence, what meaning the parties intended their language to convey.[36] This position has long been advocated by Professor Corbin[37] and finds ample statutory support.[38] The chief advantage of this approach is that it focuses the trial court's attention on the crucial question of interpretation, rather than the somewhat scholastic issue of the evidence's admissibility, from the outset.[39]

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35. See note 28 *supra* and accompanying text. The "plain meaning" rule has been roundly criticized by the commentators. *See, e.g.*, 3 A. CORBIN, *supra* note 12, § 579; C. MCCORMICK, *supra* note 11, §§ 217, 220; 9 J. WIGMORE, EVIDENCE § 2470 (3d ed. 1940); Corbin, *The Interpretation of Words and the Parol Evidence Rule*, 50 CORNELL L.Q. 161 (1965).

36. The courts must be careful, however, not to allow parties to introduce extrinsic evidence of collateral agreements under the guise of interpretation.

37. Corbin, *The Interpretation of Words and the Parol Evidence Rule*, 50 CORNELL L.Q. 161 (1965).

38. *See* CAL. CIV. CODE §§ 1636, 1647 (West 1954); CAL. CODE CIV. PRO. §§ 1860-61 (West 1955); CAL. PROB. CODE §§ 101, 106 (West 1956).

39. Unlike questions of integration, where misleading evidence must be kept from a jury, interpretation is uniquely within the province of the court. Parsons v. Bristol Dev. Co., 62 Cal. 2d 861, 402 P.2d 839, 44 Cal. Rptr. 767 (1965). Under the *Pacific Gas* approach, the trial judge must hear the extrinsic evidence whether he admits it or not. Should he decide not to admit the evidence, he has, as a practical matter, made a ruling on the merits; if the judge does admit the evidence, he must still rule on

While the court's present approach to admitting extrinsic evidence seems a step in the right direction, this area of the law is bound to remain uncertain until the new standards have been applied to a variety of cases. In the meantime, practitioners would be best advised to concentrate not on excluding the adversary's extrinsic evidence but rather upon persuading the court to decide in their favor on the merits.

S.F.

B. Surety—Duty of Continuing Disclosure

Sumitomo Bank of California v. Iwasaki.[1] The supreme court formulated a new rule to define all situations where a creditor or obligee has a special duty to disclose to a surety known facts concerning the principal debtor. If before a surety has undertaken his obligation, the creditor knows facts unknown to the surety that materially increase the risk beyond that which the creditor has reason to believe the surety intends to assume, the creditor also has reason to believe that these facts are unknown to the surety, and the creditor has a reasonable opportunity to communicate them to the surety, then failure of the creditor to notify the surety of such facts relieves the surety from his obligations.[2]

Plaintiff bank brought this action on a "Continuing Guaranty" agreement under which the defendant guaranteed all present and future indebtedness of Mr. and Mrs. Nagayama to the extent of 5000 dollars principal plus interest. Plaintiff sought recovery of the amounts owed by the Nagayamas on three loans, one of which was made several months after defendant executed the continuing guaranty. The trial court entered judgment for the plaintiff on the first two loans, but held that the defendant was discharged from liability on the third loan by plaintiff's failure to disclose to defendant that the Nagayamas required that loan to pay their federal taxes. The supreme court agreed with the trial court that the failure of the plaintiff to disclose to the surety a material fact known about the debtor before a new extension of credit

the merits. It would be far simpler to admit the evidence and then rule on the merits in the first instance, particularly where a record is to be preserved for appeal.

1. 70 Adv. Cal. 82, 447 P.2d 956, 73 Cal. Rptr. 564 (1968) (Tobriner, J.) (unanimous decision).

2. The court adopts the rule of the RESTATEMENT OF SECURITY § 124(1) (1941), explaining that it accurately synthesizes the law of the earlier California cases. The court cites Coke v. Reliance Ins. Co., 262 Cal. App. 2d 406, 68 Cal. Rptr. 741 (1968), as the first case expressly to recognize the *Restatement* rule. 70 Adv. Cal. at 92 n.8, 447 P.2d at 963 n.8, 73 Cal. Rptr. at 571 n.8. Actually, the *Restatement* rule was approved earlier that year in an opinion which was subsequently vacated. *See* U.S. Leasing Corp. v. DuPont, 255 Adv. Cal. App. 472, 64 Cal. Rptr. 120, *modified*, 256 Adv. Cal. App. 595 (1967), *vacated*, 69 Cal. 2d 275, 444 P.2d 65, 70 Cal. Rptr. 393 (1968).

in the "continuing guaranty" situation would release the surety from his obligation. The court remanded the cause to the trial court for retrial on the issue of the defendant's liability on the third loan only because the evidence was insufficient to support a finding that the facts known to the plaintiff materially increased the risk which the surety had assumed.

The California courts have often imposed a duty of disclosure on a creditor in specific suretyship situations. The cases prior to *Sumitomo Bank*, however, provided only a poorly articulated theoretical base for future decisions on the extent of the duty to disclose. A review of those cases will indicate the confusing approaches too often taken by the courts.

Historically, general statements as to the relationship between the surety and the creditor have conflicted with specific holdings. Courts have broadly proclaimed that in all suretyship relations, the creditor owes to the surety a duty of continuous good faith and fair dealing.[3] But while the surety is thus said to be a "favorite of the law," the creditor does not stand in a fiduciary relationship to the surety. Civil Code section 2837[4] applies the rules governing contracts in general to the suretyship agreement, and no general duty imposes upon the creditor the obligation to disclose to the surety such matters as the creditor knows might affect the surety's risk.[5] Only under "certain circumstances" does a more burdensome disclosure duty arise. While the judicial instinct seems to have adequately found those "circumstances," the proffered mechanical rules might be misleading when applied to different facts.

The first "circumstance" which the courts recognized as exceptional was the basic relationship of a fidelity bond.[6] In the fidelity suretyship, the employer's very act of offering or continuing the employment suggests to the surety that the employer trusts the employee.

3. Thus, in County of Glenn v. Jones, 146 Cal. 518, 520, 80 P. 695, 696 (1905), the court said: "The contract of suretyship imports entire good faith and confidence between the parties as to the whole transaction. The creditor is bound to observe good faith with the surety. He must withhold nothing, conceal nothing, release nothing which will possibly benefit the surety. He must not do any act injurious to the surety or inconsistent with his rights. He must not omit to do any act required by the surety which duty enjoins him to do, if such omission injures the surety." *Accord*, Ely v. Liscomb, 24 Cal. App. 224, 228, 140 P. 1086, 1088 (1st Dist. 1914). *See generally* A. STEARNS, THE LAW OF SURETYSHIP §§ 7.13-.16 (5th ed. 1951); Note, *Fraud and Duress as Defenses of a Surety*, 40 COLUM. L. REV. 1226, 1227-31 (1940).

4. "In interpreting the terms of a contract of suretyship, the same rules are to be observed as in the case of other contracts." CAL. CIV. CODE § 2837 (West 1954). *Accord*, RESTATEMENT OF SECURITY § 88 (1941).

5. *See* 70 Adv. Cal. at 86 & n.3, 447 P.2d at 959 & n.3, 73 Cal. Rptr. at 567 & n.3.

6. A fidelity bond has been defined as a guaranty of the personal honesty of the officer furnishing indemnity against his defalcation or negligence. Phillips v. Board of Educ., 283 Ky. 173, 176, 140 S.W.2d 819, 822 (1940).

This is markedly different from the basic credit suretyship, where the surety is put on notice of the questionable nature of the debtor's financial ability by the creditor's very act of requesting a surety. In addition, the employer in the case of a fidelity bond enjoys direct access to information material to the surety's risk, while a creditor such as a bank is usually in no better position than the surety to inquire into the debtor's position. These differences have resulted in a sharp distinction between fidelity and credit suretyships. The courts have imposed on the obligee of a fidelity bond an absolute duty to volunteer disclosure of all facts materially affecting the risk to the surety.[7] Irrespective of motive or intent, mere nondisclosure of facts known by the obligee which materially affect the surety's risk, such as prior dishonesty of the principal on the fidelity bond, therefore discharges the surety.[8] In the case of a credit suretyship, however, the rule differs; the creditor does not owe an absolute duty to the surety to disclose, without request by the surety, all facts within its knowledge which may materially affect the surety's risk.[9]

Other "circumstances," however, have turned the courts from the basic credit suretyship rule. The first clearly enunciated exception was the case of the creditor-solicited surety. *American National Bank v. Donnellan*[10] concerned the duty of a bank to disclose certain facts to a surety whom the bank had solicited. The bank did not reveal to the surety certain losses which the bank had sustained because of the debtor; further, it induced the debtor not to inform the surety—his father—of such losses. The court held that where the creditor himself solicits the surety, mere noncommunication of circumstances material to the surety in evaluating his risks, and within the knowledge of the creditor, is undue concealment, sufficient to invalidate the contract of suretyship.

The *Donnellan* court went on, however, to offer dicta concerning the *debtor*-solicited surety. "In such cases," the court said, "the general holding is that no duty of disclosure is incumbent upon the creditor, since, . . . without breach of any faith, he may assume that the debtor himself has informed the intending surety of all that the latter desires to know."[11] Later courts have construed this statement to mean

7. The leading case is Railton v. Mathews, 8 Eng. Rep. 993 (1844). California has followed this rule. Guardian Fire & Life Assurance Co. v. Thompson, 68 Cal. 208, 9 P. 1 (1885); West American Finance Co. v. Pacific Indemnity Co., 17 Cal. App. 2d 225, 61 P.2d 963 (1st Dist. 1936).

8. *But see* Anaheim Union Water Co. v. Parker, 101 Cal. 483, 35 P. 1048 (1894); Pacific Fire Ins. Co. v. Pacific Sur. Co., 93 Cal. 7, 28 P. 842 (1892). The former case was expressly overruled by the *Sumitomo Bank* decision. 70 Adv. Cal., at 88 n.4, 447 P.2d at 960 n.4, 73 Cal. Rptr. at 568 n.4.

9. 70 Adv. Cal. at 88, 447 P.2d at 960, 73 Cal. Rptr. at 568.

10. 170 Cal. 9, 148 P. 188 (1915).

11. *Id.* at 21, 148 P. at 193.

that a debtor-solicited surety has no right to disclosure from the creditor.[12] But such a construction ignores the remainder of the court's statement: "[The creditor's] duty therefore is performed if he fully and fairly answers the questions put to him, and conceals nothing which he himself believes might influence the surety's conduct."[13] Solicitation of the surety by the creditor clearly was not contemplated as a condition precedent to the establishment of a creditor's duty to a surety to disclose facts materially affecting the surety's risk;[14] instead, it is merely one "circumstance" which brings about the special duty.

Nevertheless, two important later cases, *Mahoney v. Founders' Insurance Company*[15] and *Produce Clearings v. Butler*,[16] intimated in dicta that creditor solicitation was a necessary condition to a duty of disclosure, and thus delayed recognition of other "circumstances" which might compel such a duty. In *Mahoney*, the plaintiff had entered into a contract with *A*, whose obligation was secured by a bond. *A* conducted all negotiations for the bond, the surety having no communications with plaintiff. As a defense to an action on the bond, the surety contended that the plaintiff had a duty to come forward and reveal his knowledge when he discovered that the bond contained an inaccurate recital of the consideration for the contract. The court held that the surety had no right to disclosure from the creditor, since he had been solicited by the debtor, and, in any event, the fact concealed was not material to the surety's risk. The court did recognize that another factor in finding a duty to disclose might be the existence of negotiations between the creditor and surety, but where there were no negotiations, the court limited the duty to the situation where "it is patently clear that the facts affecting the risk were misrepresented by the principal, and that the surety does not possess knowledge of the true facts."[17] This insufficiently protects the surety, for there may be situations where the principal has not made misrepresentations to him, but he should nonetheless be entitled to disclosure. An example might be where the creditor has knowledge of material facts because of a special relationship to the debtor. Insofar as the *Produce Clearings* case accepts these intimations of a narrow rule emerging from the *Donnellan* case, it also is unsatisfactory.[18]

The refined factual situation in *Sumitomo Bank*, involving a con-

12. See text accompanying note 17 *infra*.

13. 170 Cal. at 21, 148 P. at 193.

14. 70 Adv. Cal. at 90-91 n.7, 447 P.2d at 961-62 n.7, 73 Cal. Rptr. at 569-70 n.7.

15. 190 Cal. App. 2d 430, 12 Cal. Rptr. 114 (2d Dist. 1961).

16. 231 Cal. App. 2d 494, 42 Cal. Rptr. 114 (2d Dist. 1964).

17. 190 Cal. App. 2d at 439, 12 Cal. Rptr. at 118. This holding is disapproved in *Sumitomo Bank*. 70 Adv. Cal. at 90-91 n.7, 447 P.2d at 961-62 n.7, 73 Cal. Rptr. at 569-70 n.7.

18. The *Produce Clearings* limitation is similarly expressly rejected. *Id.*

tinuing guaranty and a debtor-solicited surety, yet containing the possibility of nondisclosure by the creditor of a known material fact, could not equitably be treated by application of the mechanical rules defining the disclosure duty. Clearly, neither the "fidelity-bond" nor "creditor-solicited-surety" touchstones could be used here. Instead, the court swept away these tests and promulgated a set of guidelines to define all situations when creditor disclosure would be required by the fundamental contract rule of continuous good faith and fair dealing. The rule of the *Restatement of Security*[19] adopted by the court seems to depend on two factors: the nature of the risk guaranteed and the relationship of the parties involved.[20] The court expressed the rule in terms of three conditions for the duty to disclose:

> (a) "the creditor has reasons to believe" that [facts it knows about the debtor] materially increase the risk "beyond that which the surety intends to assume;" (b) the creditor "has reason to believe that the facts are unknown to the surety;" and (c) the creditor "has a reasonable opportunity to communicate" the facts to the surety.[21]

These conditions may be best understood by considering their application.

The *Sumitomo Bank* case itself exemplifies the application of these conditions to the problem of material facts coming to light during the course of the suretyship relationship rather than at its inception. During the course of the relationship, the surety is concerned with facts which would induce him to withdraw his guaranty.[22] Since the surety

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19. RESTATEMENT OF SECURITY § 124(1) (1941). See note 2 *supra.*

20. "Circumstances of the transactions vary the risks which will be regarded as normal and contemplated by the surety. While no surety takes the risk of material concealment, what will be deemed material concealment in respect of one surety may not be regarded so in respect of another. A creditor may have a lesser burden of bringing facts to the notice of a compensated surety who is known to make careful investigations before taking any obligation than to a casual surety who relies more completely upon the appearances of a transaction." RESTATEMENT OF SECURITY § 124, comment *b* at 329 (1941).

21. 70 Adv. Cal. 94-95, 447 P.2d at 965, 73 Cal. Rptr. at 573.

22. Again, a distinction might be drawn between fidelity and credit suretyships. Unlike the uncompensated credit surety, the compensated surety on a fidelity bond is not free to revoke at any time simply by giving written notice to the obligee. Thus the surety on a fidelity bond must be afforded full opportunity to learn of possible defenses, and the obligee therefore owes him an absolute duty of disclosure throughout their relationship. RESTATEMENT OF SECURITY § 124(2) (1941) provides: "Where, during the existence of the suretyship relation, the creditor discovers facts unknown to the surety which would give the surety the privilege of terminating his obligation to the creditor as to liability for subsequent defaults, and the creditor has reason to believe these facts are unknown to the surety and has a reasonable opportunity to communicate them to the surety without a violation of confidential duty, the creditor has a duty to notify the surety, and breach of this duty is a defense to the surety except in respect of his liability for defaults which have occurred before such disclosure should have been made."

on a continuing guaranty, such as in *Sumitomo Bank*, may revoke as to future liability at any time merely by giving written notice to the creditor,[23] he does not need the benefit of a continuous duty of disclosure; he does need that protection, however, prior to every new extension of credit to the principal. The creditor, therefore, owes the same duty of disclosure[24] immediately prior to each new extension of credit as he owes at the inception of the suretyship relationship.[25]

A second case exemplifying the *Restatement* approach is *Beverly Hills National Bank v. Glynn*.[26] Glynn was surety for his longtime legal client, O'Toole. When the bank sued Glynn on the suretyship obligation, Glynn urged that the bank had failed in its duty to disclose to him facts relating to O'Toole's financial condition. The court found that the bank owed Glynn no duty of disclosure since he had come forward at the request of the debtor. The creditor's sole duty, the court held, citing *Produce Clearings* and *Mahoney*, was fully and fairly to answer questions put to him and conceal nothing which he himself believed might influence the surety's conduct. After the supreme court handed down the *Sumitomo Bank* opinion, the lower court modified its opinion in *Glynn*.[27] More satisfactorily, the court found that the bank was fully entitled to believe that Glynn knew full well the risks he ran and that he was assuming those risks voluntarily in order to favor his client. This puts the case on a broader base of supportive "circumstances," rather than the simple fact that the debtor had solicited the surety.

Although the rule of the *Restatement* adopted by the court does little to change existing California case law, other than significantly clarifying the standard of disclosure in an hitherto confused area, it may, by introducing broad and somewhat vague standards of reasonableness, have an *in terrorem* effect on creditors in a borderline disclosure situation. The court insists that the rule places no undue bur-

23. CAL. CIV. CODE § 2815 (West 1954); White Sewing Machine Co. v. Courtney, 141 Cal. 674, 75 P. 296 (1904).

24. "The rule stated in Subsection (1) applies not only to cases where the surety has made an offer for a single obligation but also to offers to guarantee successive extensions of credit. The fact that the surety is already bound on one obligation does not excuse the creditor from disclosing material facts before the second obligation is incurred." RESTATEMENT OF SECURITY § 124, comment *c* at 330 (1941).

25. The *Sumitomo Bank* case focused in particular on whether plaintiff had reason to believe that the Nagayamas' inability to pay their federal taxes without a loan materially increased the risk of defendant beyond that which he intended to assume. Since the evidence could not support a finding that the risk was materially increased, a fortiori, it could not support a finding that plaintiff had reason to believe his silence would materially increase that risk.

26. 267 Adv. Cal. App. 967, 73 Cal. Rptr. 808, *modified*, 268 Adv. Cal. App. 612, 73 Cal. Rptr. 815 (2d Dist. 1968).

27. 268 Adv. Cal. App. at 612, 73 Cal. Rptr. at 815.

den on the creditor because it does not require the creditor "to investigate for the surety's benefit . . . [or] to take any unusual steps to assure himself that the surety is acquainted with facts which he may assume are known to both of them."[28] Nevertheless, it seems clear that the effect of allowing a court to balance the equities will be to induce a creditor to disclose any facts which he feels may be material, whether he is in fact under a legal duty to do so or not. It cannot be said, however, that the *Restatement* rule is surprising or innovative; instead, it merely spells out the special application in suretyship of the fundamental rule of contracts that fraud creates a defense.[29]

L.S.K.

C. Unruh Act

Morgan v. Reasor Corporation.[1] In this case, the California supreme court made clear its intention to construe the Unruh Act[2] liberally for the benefit of the consumer. The court's construction was so liberal that the California Legislature quickly amended the Unruh Act to overrule *Morgan* in part. The *Morgan* court, first, extended the Act's protection to installment contracts for the construction of residential housing; second, sharply curtailed the defenses available to an assignee of the vendor's rights by holding that the assignee's constructive, as well as actual, knowledge of Unruh Act violations would preclude him from claiming the protected status of a holder in due course; third, declared that the entire amount of interest and service charges ("time price differential"[3]) will be forfeited for violations of the Act; and fourth, held that attorney's fees will be awarded to the prevailing party regardless of the form of action brought.

The California Legislature overruled the first of these holdings.[4] While the extension of the Unruh Act's protection to installment con-

28. RESTATEMENT OF SECURITY § 124, comment *b*, at 328 (1941).

29. *See* RESTATEMENT OF CONTRACTS §§ 475-76 (1932).

1. 69 Cal. 2d 881, 447 P.2d 638, 73 Cal. Rptr. 398 (1968) (Tobriner, J.) (unanimous decision).

2. CAL. CIV. CODE §§ 1801-12.10 (West Supp. 1968), *as amended*, ch. 554, [1969] Cal. Stats. (5 CAL. LEG. SERV. 1006 (July 18, 1969)).

3. "'Time price differential' . . . means the amount however denomiated or expressed which the retail buyer contracts to pay or pays for the privilege of purchasing goods or services to be paid for by the buyer in installments . . . ." CAL. CIV. CODE § 1802.10 (West Supp. 1968). Simply phrased, it is the difference between the amount charged the buyer who pays cash and the amount charged the individual who pays for his purchase over a period of time. The term does not include any amount charged for life insurance premiums nor expenses incurred by the seller in collecting from a defaulting buyer.

4. Ch. 554, §§ 1-2, [1969] Cal. Stats. (5 CAL. LEG. SERV. 1006 (July 18, 1969)).

tracts for the construction of residential housing[5] would have had the most far-reaching implications, the court's remaining three holdings—and in particular its holding that the knowledge requirement of the Act is satisfied by constructive knowledge—are of considerable importance to consumers.

The Unruh Act[6] is California's response to the problems posed by the growth of consumer credit from the occasional extension of personal credit by an individual vendor into a billion-dollar industry[7] characterized by the vendor's sale of his customer's note to a finance company which is a stranger to the original transaction. The vast growth of consumer credit has made it a very important factor in the national economy and its evolution from the original personal relationship of retailer and customer has led to numerous abuses. In too many instances it had become a subterfuge to avoid the usury laws. The vendor who discounts his customers' notes by prearrangement with a particular finance company will receive the same amount of cash, often on the same day, as he would if he had made a cash sale. If the finance company had loaned the consumer the money with which to make his purchase, the percentage of interest it could charge on the loan would have been subject to a statutory maximum.[8] Since installment contracts were not subject to such a statutory ceiling, the finance company which purchased a consumer's note would enjoy three or four times the return it could legally have exacted if it had made the loan directly to the consumer.[9]

These exorbitant charges were usually exacted from those least able to bear them[10]—those whose education and economic status made them too poor a credit risk for reputable finance companies and easy prey for the unscrupulous salesman. Since these individuals presumably could not afford to pay the lower interest rates charged by reputable lenders, their rate of default on these contracts was extremely high.[11]

5. 69 Cal. 2d at 885, 887-89, 447 P.2d at 640, 642-43, 73 Cal. Rptr. at 400, 402-03.

6. *Morgan* marks the first occasion in the eight-year history of the Act that it reached the supreme court. The Unruh Act took effect January 1, 1960; the decision in *Morgan* was handed down on December 8, 1968.

7. 69 Cal. 2d at 891-92 n.16, 447 P.2d at 645-46 n.16, 73 Cal. Rptr. at 405-06 n.16.

8. *E.g.*, CAL. FIN. CODE §§ 18655, 22451 (West Supp. 1968); *Id.* § 24451 (West 1968).

9. In at least one instance, a mechanical ceiling was imposed on such a finance company by the inability of its business machines to compute above 100 percent. REPORT OF THE SUBCOMM. ON LENDING AND FISCAL AGENCIES, 2 J. CAL. ASSEMBLY, 1959 REG. SESS., appendix at 55.

10. Although at least one M.D.—whose education and income was presumably above the national median—fell into the same trap. *Id.* at appendix 93-94.

11. *See Resort to the Legal Process in Collecting Debts From High Risk Credit*

Default was followed by attachment of wages, dismissal by the employer, and even, at times, the dissolution of the family unit to qualify for public assistance.[12] The Unruh Act thus attacked a widespread, and often tragic, problem.

It would be difficult to disagree with the objectives of the Act or the moderate means it employs to carry them out. Only the most flagrant abuses are prohibited; the Act forbids such practices as securing the buyer's signature to contracts which are undated, contain blank spaces, are embodied in several pieces of paper, or fail to disclose the total cost of the purchase.[13] It requires the seller to provide the buyer with a legible copy of the contract.[14] It sets limits on the amount of interest, service, and delinquency charges which can be assessed.[15] It regulates balloon payments, add-on purchases, prepayment, and the ultimate discharge of the debt.[16] In case of default the buyer is protected against a deficiency judgment and immediate garnishment, while the finance company is required to elect either to retake the goods or to sue for a personal judgment.[17] In addition, the Act provides that assignment of the contract shall not cut off the buyer's rights against the seller.[18] The Act incorporates its own safeguards and penalties: a contract provision in violation of its terms is void, a buyer cannot waive its protection, willful violation is a misdemeanor, and knowledge of a violation deprives the seller or his assignee of the right to collect any part of the time price differential.[19]

It was against this statutory background that *Morgan* arose. In October of 1962, plaintiffs William Morgan and his wife signed a "Lien Contract and Deed of Trust" by which they agreed to buy, and the defendant vendor[20] agreed to sell, the goods and services necessary for the construction of a house on land belonging to the Morgans, the land and improvements serving as security. In addition, the Morgans signed a separate promissory note in favor of the vendor for the sum of 19,398 dollars: 11,844 dollars principal plus a 7,544 dollar time price differ-

Buyers in Los Angeles—Alternative Methods for Allocating Present Costs, 14 U.C.L.A. L. REV. 879, 894-96 (1967).

12. REPORT OF THE SUBCOMM. ON LENDING AND FISCAL AGENCIES, 2 J. CAL. ASSEMBLY, 1959 REG. SESS., appendix at 75-77 (1959).

13. CAL. CIV. CODE §§ 1803.1-.4 (West Supp. 1968).

14. *Id.* § 1803.7.

15. *Id.* §§ 1803.6, 1805.1-.5, 1808.6, 1810.6.

16. *Id.* §§ 1806.1-.4, 1806.3, 1807.3, 1808.1-.6. A balloon payment is a final installment payment which is more than twice the size of the average preceding payments.

17. *Id.* §§ 1812.1-.5.

18. *Id.* § 1804.2.

19. *Id.* §§ 1801.1, 1804.4, 1812.6-.7.

20. The original vendor was the IBC Corporation which, after the contract was executed, merged into the defendant Reasor Corporation, the latter assuming all of IBC's rights and liabilities.

ential. The note was payable in 71 monthly installments of 116 dollars and a final installment of 11,157 dollars.

Within three months the vendor assigned both the contract and the note to the defendant Midwest Homes Acceptance Corporation. The finance company accepted the note with " 'full knowledge of all of the terms and conditions' of the note and contract."[21]

In 1966 a dispute arose over the amount to be paid on the contract and the Morgans brought suit for a declaratory judgment to release them from the necessity of paying any part of the time price differential. This was the statutory remedy for violations of the Act.[22] There was no dispute that the Act, if it applied to this transaction, had been violated. The two documents signed by the Morgans were separate instruments;[23] the promissory note was not dated at the time it was executed;[24] and the "Lien Contract and Deed of Trust", at the time it was signed by the Morgans, contained blank spaces which were later filled in by the vendor and the finance company.[25] The issue was whether the Unruh Act's provisions applied to a contract for the construction of residential housing.[26]

The supreme court held that it did, reasoning that the Unruh Act's definition of goods and services included the materials and labor purchased here.[27] The Act's definition of goods includes all tangible chattels bought for a noncommercial purpose.[28] The court ruled that the Morgans' house was a tangible chattel on the theory that the character

21. 69 Cal. 2d at 893, 447 P.2d at 646, 73 Cal. Rptr. at 406.

22. CAL. CIV. CODE § 1812.7 (West Supp. 1968).

23. In violation of *id.* § 1803.2: "[E]very retail installment contract shall be contained in a single document which shall contain . . . . [t]he entire agreement of the parties . . . ."

24. In violation of *id.* § 1803.1: "A retail installment contract shall be dated . . . ."

25. In violation of *id.* § 1803.4: "The seller shall not obtain the signature of the buyer to a contract when it contains blank spaces to be filled in after it has been signed."

26. The defendants had the unenviable task of persuading Justice Mosk that he had been wrong in 1962 when, as Attorney General of California, he had produced an opinion that a contract for the construction of a residence with a hypothetical set of facts almost identical with the facts in this case, was subject to the Unruh Act. 40 OP. CAL. ATT'Y GEN. 232 (1962). That the defendants failed to convince Justice Mosk or any of his brethren is not surprising in view of the statutory language and the facts of the case.

27. "The essential distinction drawn by these definitions lies between goods and services acquired for personal use and those obtained for business or commercial purposes. Residential housing by definition serves personal rather than commercial ends." 69 Cal. 2d at 887, 447 P.2d at 642, 73 Cal. Rptr. at 402.

28. CAL. CIV. CODE § 1802.1 (West Supp. 1968): " 'Goods' means tangible chattels bought for use primarily for personal, family or household purposes . . . including goods which, at the time of the sale or subsequently are to be so affixed to real property as to become a part of such real property . . . ."

of goods is determined as of the amount of execution of the contract.[29] At the time the Morgans executed the contract, their prospective realty was still a collection of boards and nails. The crucial point, according to the court, is that at the time of execution, "the dwelling was not attached, or affixed in any way, to the real property owned by the plaintiffs."[30] By this test, not only the Morgans' unbuilt home but even a prefabricated house completely ready to install would be treated as a chattel for purposes of the Unruh Act.[31] Moreover, lest the Act's coverage of a contract for the sale of goods be frustrated, the court found it necessary to extend the Act's coverage to a contract that conveys real property in conjunction with goods. The Act extends not only to goods but also to all services purchased for noncommercial purposes.[32] The court held that under either the goods or services provision, "The Unruh Act would apply to a sale of land together with a house *to be* constructed thereon."[33]

The Legislature reacted to this rather startling unmasking of a house as personal property by adding a section to the Unruh Act which specifically abrogates this holding.[34] The new section provides that the Act shall not apply to contracts for the construction or sale of a residence or a commercial structure, whether sold alone or together with a plot of land.[35]

The effects of the *Morgan* holding, had it remained the law, would have been mixed.[36] The Legislature, however, has rendered moot the interesting question of whether *Morgan*, on balance, helped the homebuyer more than it hurt him.[37] The legislative action was not di-

29. 69 Cal. 2d at 887-88, 447 P.2d at 642, 73 Cal. Rptr. at 402.

30. *Id.* at 888, 447 P.2d at 642, 73 Cal. Rptr. at 402.

31. *Id.*

32. CAL. CIV. CODE § 1802.2 (West Supp. 1968): "'Services' means work, labor and services, for other than a commercial or business use, including services furnished in connection with . . . the improvement of real property . . . ."

33. 69 Cal. 2d at 888 n.8, 447 P.2d at 642-43 n.8, 73 Cal. Rptr. at 402-03 n.8.

34. Ch. 554, § 2, [1969] Cal. Stats. (5 CAL. LEG. SERV. 1006 (July 18, 1969)).

35. *Id.* § 1 (adding CAL. CIV. CODE § 1801.4):

> The provisions of this chapter [the Unruh Act] shall not apply to any contract or series of contracts providing for the construction, sale, or construction and sale of an entire residence [no comma] of all or part of a structure designed for commercial or industrial occupancy, with or without a parcel of real property or an interest therein, or for the sale of a lot or parcel of real property, including any site preparation incidental to such sale.

The language of this section would seem to preclude the Unruh Act's coverage of the sale of a house trailer which is specifically treated as personal property in CAL. CODE CIV. PRO. § 512 (West Supp. 1968).

36. Both finance companies and vendors of houses would have had to make significant changes in their formal and substantive methods of doing business, or face penalties of the magnitude exacted in *Morgan*.

37. The homebuyer would have gained needed protection against the cruder forms of unfair dealing. *See* Warren, *Regulation of California Housing Financing: A*

rected against *Morgan*'s holdings on constructive knowledge, forfeiture of the entire time price differential and the award of attorney's fees. Accordingly; these holdings will continue to apply to all transactions still subject to the Unruh Act.

The first of these holdings, that constructive knowledge alone will render an assignee liable to the buyer for violations of the Unruh Act, makes *Morgan* a significant milestone in the California supreme court's increasing protection of the consumer. The Unruh Act provides that "any person who acquires a contract or installment account with knowledge of . . . noncompliance [with the terms of the Act] . . . is barred from recovery of any time price differential . . . ."[38] Although there was no need to reach the question of constructive knowledge in *Morgan*—the assignee finance company had actual knowledge of the Unruh Act violations[39]—the court held that "knowledge of facts sufficient to put a reasonable man on inquiry"[40] would satisfy the requirement of the Unruh Act.[41] To reach this result it held that the Act[42] repealed the rule that a holder in due course does not bear a duty to investigate suspicious circumstances when he acquires commercial paper.[43] The court limited its holding on constructive knowledge to

Forgotten Consumer, 8 U.C.L.A.L. REV. 555, 580 (1961). But he would have lost the protection against personal liability afforded by CAL. CODE CIV. PRO. § 726 (West 1955), which requires the mortgagee to exhaust the security before proceeding against the mortgagor. Although the Unruh Act forbids a deficiency judgment, since it has no "one form of action" limitation, the homeowner still could have been personally liable for the full amount of the debt. The Act provides (CAL. CIV. CODE § 1812.2 (West Supp. 1968)): "In the event of . . . default . . . the creditor may proceed to recover judgment for the balance due without retaking the goods . . . ." Moreover, the homebuyer would have been faced with strict foreclosure if the creditor chose to move against the property (*Id.* § 1812.2): "If the holder gives notice of his intention to retain the goods in satisfaction of the indebtedness he shall be deemed to have done so at the end of the 10-day period if the goods are not redeemed . . . ."

38. CAL. CIV. CODE § 1812.7 (West Supp. 1968).

39. 69 Cal. 2d at 885, 447 P.2d at 640, 73 Cal. Rptr. at 400.

40. *Id.* at 893, 447 P.2d at 646, 73 Cal. Rptr. at 406.

41. CAL. CIV. CODE § 1812.7 (West Supp. 1968): "In case of failure by any person to comply with the provisions of this chapter, such person or any person who acquires a contract with knowledge of such noncompliance is barred from recovery of any time price differential . . . ."

42. *Id.* § 1804.2: "Except as provided in Section 1812.7, an assignee of the seller's rights is subject to all claims and defenses of the buyer against the seller arising out of the sale . . . ."

43. 69 Cal. 2d at 891-92, 447 P.2d at 645-46, 73 Cal. Rptr. at 405-06. The court cited Popp v. Exchange Bank, 189 Cal. 296, 208 P. 113 (1922), as authority for the rule it was overturning without mentioning the fact that *Popp* merely paraphrased a section of the Civil Code, a section which was still in effect when the Morgans' contract was assigned. *Popp* held that: "Mere knowledge of facts sufficient to put a reasonable man on inquiry, without actual knowledge, or mere suspicion of an infirmity . . . does not preclude the transferee from occupying the position of a holder in due course, unless the circumstances or suspicions are so cogent and obvious that to remain passive would amount to bad faith." *Id.* at 303, 208 P. at 116. This was a

contracts governed by the Unruh Act and justified their abandonment of the previous rule by invoking the spirit, if not the letter, of the Act. Since the Act itself is limited to sales made to a retail buyer whose purchases are primarily for personal, family, or household purposes, the holding will not effect the negotiability of commercial paper in a wholly commercial setting.

The court enhances the effect of this holding by broadly defining constructive knowledge. The facts from which constructive knowledge is presumed may be either intrinsic defects in the contract or note, or extrinsic circumstances, such as the vendor's offer of his contracts at an unusually high discount rate, or knowledge of previous complaints against the vendor.[44] In addition, when the assignee is closely connected with the vendor or the sale, he will be considered an original party to the transaction, with constructive knowledge of any violations.[45]

Morgan's second intact holding is that the entire time price differential will be forfeited for a violation of the Unruh Act. The Act provides that an assignee with knowledge of violations "is barred from recovery of any time price differential . . . and the buyer shall have the right to recover . . . any of such charges paid . . . ."[46] Such violations may be corrected, in which case no penalties will be assessed, but "The correction shall be made by delivery to the buyer of a corrected copy of the contract within 30 days of the execution of the original contract . . . ."[47] The trial court in *Morgan* had allowed the de-

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paraphrase of ch. 751, § 3137, [1917] Cal. Stats. 1541 (former Civil Code section 3137), which provided that: "To constitute notice of an infirmity in the instrument or defect in the title of the person negotiating the same, the person to whom it is negotiated must have had actual knowledge of the infirmity or defect, or knowledge of such facts that his action in taking the instrument amounted to bad faith." This statute was repealed when California adopted the Uniform Commercial Code on January 1, 1965. It was replaced by CAL. COMM. CODE §§ 3304, 8103, 8304 (West Supp. 1968). *Id.* § 9203 specifically provides that if any of its terms conflict with those of the Unruh Act, the latter is controlling.

However, in 1962, when the Morgans executed the contract with IBC and when IBC assigned the note and contract to Midwest, former Civil Code section 3137 was still in effect. The Unruh Act, though here interpreted as "repealing" *Popp*, makes no provision for repeal of any existing statute, nor is it, by its terms, controlling. Thus it can be argued that the constructive knowledge interpretation of section 1812.7 should not apply to contracts assigned prior to January 1, 1965. *Accord,* Templeton Feed & Grain Co. v. Ralston Purina Co., 69 Cal. 2d 461, 466 n.3, 446 P.2d 152, 155 n.3, 72 Cal. Rptr. 344, 347 n.3 (1968).

Since Midwest had actual knowledge of the violations the argument outlined above would have been of no avail in *Morgan*. In any event, it is now clear that constructive knowledge of violations is sufficient to prevent the assignee from collecting any time price differential for contracts assigned after December 31, 1964.

44. 69 Cal. 2d at 893, 447 P.2d at 646, 73 Cal. Rptr. at 406.

45. *Id.* at 894-96, 447 P.2d at 647-48, 73 Cal. Rptr. at 407-08.

46. CAL. CIV. CODE § 1812.7 (West Supp. 1968).

47. *Id.* § 1812.8.

fendants to correct the contract four years after execution and collect the time price differential accruing after the date the corrected contract was delivered to plaintiffs.[48] The supreme court reversed, holding that if violations were not corrected within the statutory 30-day period, collection of any part of the time price differential was barred for the life of the contract.[49] In view of the statutory language one can only wonder how the trial court reached the conclusion it did.

The obvious implication of this holding is that a finance company with constructive knowledge of violations which receives a defective note 31 days after its execution, when corrective action is no longer possible, will still be barred from collecting any part of the time price differential. Although the Act may never again cause the imposition of a penalty as great as the 7,544 dollars forfeited here, such a bar is still a significant sanction for violation of the Act. This fact should encourage finance companies to take affirmative action to protect themselves by insuring that the vendors with whom they deal hew to the strict letter of the Unruh Act. And even if finance companies fail to take such action and vendors continue to violate the Act, it is still more equitable that their violations be paid for by a finance company which can pass the cost on to all the assignors with whom it does business, than by the individual consumer who must alone bear the entire loss caused by an inequitable contract.[50]

The final holding was that attorney's fees may be awarded to the prevailing party even in an action for declaratory relief. The trial court had awarded attorney's fees to plaintiffs, but the court of appeal reversed.[51] The supreme court reinstated the award, stating that the purpose of the Legislature in passing Civil Code section 1811.1[52] was to encourage attorneys to accept cases arising under the Unruh Act, regardless of their nature, and that this purpose would be frustrated by the court of appeal's strict construction of the Act.[53] The report of the legislative subcommittee which drafted the Unruh Act makes it clear that the supreme court's holding is in accord with the legislative intent. It characterizes this section as awarding attorney's fees to the

48. 69 Cal. 2d at 897, 447 P.2d at 649, 73 Cal. Rptr. at 409.

49. *Id.*

50. *Id.* at 890, 447 P.2d at 644, 73 Cal. Rptr. at 404. The voluminous testimony collected by the legislative committee which drafted the Unruh Act and the inherent nature of the practices forbidden by the Act establish a strong presumption against the possible existence of a contract which, though technically in violation of the Act, is still fair, just and equitable. *See* REPORT OF THE SUBCOMM. ON LENDING AND FISCAL AGENCIES, 2 J. CAL. ASSEMBLY, CAL. 1959 REG. SESS., appendix at 47-95.

51. Morgan v. Reasor Corp., 67 Cal. Rptr. 577, 583 (3rd Dist. 1968).

52. CAL. CIV. CODE § 1811.1 (West Supp. 1968): "Reasonable attorney's fees and costs shall be awarded to the prevailing party in any action on a contract or installment account subject to the provisions of this chapter . . . ."

53. 69 Cal. 2d at 896-97, 447 P.2d at 648-49, 73 Cal. Rptr. at 408-09.