REVISION OF UNIFORM COMMERCIAL CODE

ARTICLE 1 – GENERAL PROVISIONS

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UNIFORM COMMERCIAL CODE ARTICLE 1 – GENERAL PROVISIONS

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REVISION OF UNIFORM COMMERCIAL CODE
ARTICLE 1 – GENERAL PROVISIONS

TABLE OF CONTENTS

PART 1 GENERAL PROVISIONS

REVISION OF UNIFORM COMMERCIAL CODE

ARTICLE 1 – GENERAL PROVISIONS

PART 1

GENERAL PROVISIONS

SECTION 1_101. SHORT TITLES.

(a) This [Act] may be cited as the Uniform Commercial Code.

(b) This article may be cited as Uniform Commercial Code – General Provisions.

Official Comments

Source: Former Section 1_101.

Changes from former law: Subsection (b) is new. It is added in order to make the structure of Article 1 parallel with that of the other articles of the Uniform Commercial Code.

1. Each other article of the Uniform Commercial Code (except Articles 10 and 11) may also be cited by its own short title. See Sections 2_101, 2A_101, 3_101, 4_101, 4A_101, 5_101, 6_101, 7_101, 8_101, and 9_101.

SECTION 1_102. SCOPE OF ARTICLE. This article applies to a transaction to the extent that it is governed by another article of [the Uniform Commercial Code].

Preliminary Comments

Source: New.

1. This section is intended to resolve confusion that has occasionally arisen as to the applicability of the substantive rules in this article. This section makes

clear what has always been the case – the rules in Article 1 apply to transactions to the extent that those transactions are governed by one of the other articles of the Uniform Commercial Code. See also Comment 1 to Section 1_301.

SECTION 1_103. CONSTRUCTION OF [UNIFORM COMMERCIAL CODE] TO PROMOTE ITS PURPOSES AND POLICIES; APPLICABILITY OF SUPPLEMENTAL PRINCIPLES OF LAW.

(a) [The Uniform Commercial Code] must be liberally construed and applied to promote its underlying purposes and policies, which are:

(1) to simplify, clarify, and modernize the law governing commercial transactions;

(2) to permit the continued expansion of commercial practices through custom, usage, and agreement of the parties; and

(3) to make uniform the law among the various jurisdictions.

(b) Unless displaced by the particular provisions of [the Uniform Commercial Code], the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, and other validating or invalidating cause supplement its provisions.

Official Comments

Source: Former Section 1_102 (1)_(2); Former Section 1_103.

Changes from former law: This section is derived from subsections (1) and (2) of former Section 1_102 and from former Section 1_103. Subsection (a) of this section combines subsections (1) and (2) of former Section 1_102. Except for changing the form of reference to the Uniform Commercial Code and minor

stylistic changes, its language is the same as subsections (1) and (2) of former Section 1_102. Except for changing the form of reference to the Uniform Commercial Code and minor stylistic changes, subsection (b) of this section is identical to former Section 1_103. The provisions have been combined in this section to reflect the interrelationship between them.

1. The Uniform Commercial Code is drawn to provide flexibility so that, since it is intended to be a semi_permanent and infrequently-amended piece of legislation, it will provide its own machinery for expansion of commercial practices. It is intended to make it possible for the law embodied in the Uniform Commercial Code to be applied by the courts in the light of unforeseen and new circumstances and practices. The proper construction of the Uniform Commercial Code requires, of course, that its interpretation and application be limited to its reason.

Even prior to the enactment of the Uniform Commercial Code, courts were careful to keep broad acts from being hampered in their effects by later acts of limited scope. See *Pacific Wool Growers v. Draper & Co.*, 158 Or. 1, 73 P.2d 1391 (1937), and compare Section 1_104. The courts have often recognized that the policies embodied in an act are applicable in reason to subject_matter that was not expressly included in the language of the act, *Commercial Nat. Bank of New Orleans v. Canal_Louisiana Bank & Trust Co.*, 239 U.S. 520, 36 S.Ct. 194, 60 L.Ed. 417 (1916) (bona fide purchase policy of Uniform Warehouse Receipts Act extended to case not covered but of equivalent nature), and did the same where reason and policy so required, even where the subject_matter had been intentionally excluded from the act in general. *Agar v. Orda*, 264 N.Y. 248, 190 N.E. 479 (1934) (Uniform Sales Act change in seller's remedies applied to contract for sale of choses in action even though the general coverage of that Act was intentionally limited to goods "other than things in action.") They implemented a statutory policy with liberal and useful remedies not provided in the statutory text. They disregarded a statutory limitation of remedy where the reason of the limitation did not apply. *Fiterman v. J. N. Johnson & Co.*, 156 Minn. 201, 194 N.W. 399 (1923) (requirement of return of the goods as a condition to rescission for breach of warranty; also, partial rescission allowed). Nothing in the Uniform Commercial Code stands in the way of the continuance of such action by the courts.

The Uniform Commercial Code should be construed in accordance with its underlying purposes and policies. The text of each section should be read in the light of the purpose and policy of the rule or principle in question, as also of the Uniform Commercial Code as a whole, and the application of the language should be construed narrowly or broadly, as the case may be, in conformity with the purposes and policies involved.

2. **Applicability of supplemental principles of law.** Subsection (b) states the basic relationship of the Uniform Commercial Code to supplemental bodies of

law. The Uniform Commercial Code was drafted against the backdrop of existing bodies of law, including the common law and equity, and relies on those bodies of law to supplement it provisions in many important ways. At the same time, the Uniform Commercial Code is the primary source of commercial law rules in areas that it governs, and its rules represent choices made by its drafters and the enacting legislatures about the appropriate policies to be furthered in the transactions it covers. Therefore, while principles of common law and equity may *supplement* provisions of the Uniform Commercial Code, they may not be used to *supplant* its provisions, or the purposes and policies those provisions reflect, unless a specific provision of the Uniform Commercial Code provides otherwise. In the absence of such a provision, the Uniform Commercial Code preempts principles of common law and equity that are inconsistent with either its provisions or its purposes and policies.

The language of subsection (b) is intended to reflect both the concept of supplementation and the concept of preemption. Some courts, however, had difficulty in applying the identical language of former Section 1_103 to determine when other law appropriately may be applied to supplement the Uniform Commercial Code, and when that law has been displaced by the Code. Some decisions applied other law in situations in which that application, while not inconsistent with the text of any particular provision of the Uniform Commercial Code, clearly was inconsistent with the underlying purposes and policies reflected in the relevant provisions of the Code. *See*, *e.g.*, *Sheerbonnet, Ltd. v. American Express Bank, Ltd.*, 951 F. Supp. 403 (S.D.N.Y. 1995). In part, this difficulty arose from Comment 1 to former Section 1_103, which stated that "this section indicates the continued applicability to commercial contracts of all supplemental bodies of law except insofar as they are explicitly displaced by this Act." The "explicitly displaced" language of that Comment did not accurately reflect the proper scope of Uniform Commercial Code preemption, which extends to displacement of other law that is inconsistent with the purposes and policies of the Uniform Commercial Code, as well as with its text.

3. **Application of subsection (b) to statutes.** The primary focus of Section 1_103 is on the relationship between the Uniform Commercial Code and principles of common law and equity as developed by the courts. State law, however, increasingly is statutory. Not only are there a growing number of state statutes addressing specific issues that come within the scope of the Uniform Commercial Code, but in some States many general principles of common law and equity have been codified. When the other law relating to a matter within the scope of the Uniform Commercial Code is a statute, the principles of subsection (b) remain relevant to the court's analysis of the relationship between that statute and the Uniform Commercial Code, but other principles of statutory interpretation that specifically address the interrelationship between statutes will be relevant as well. In some situations, the principles of subsection (b) still will be determinative. For example, the mere fact that an equitable principle is stated in statutory form rather

than in judicial decisions should not change the court's analysis of whether the principle can be used to supplement the Uniform Commercial Code – under subsection (b), equitable principles may supplement provisions of the Uniform Commercial Code only if they are consistent with the purposes and policies of the Uniform Commercial Code as well as its text. In other situations, however, other interpretive principles addressing the interrelationship between statutes may lead the court to conclude that the other statute is controlling, even though it conflicts with the Uniform Commercial Code. This, for example, would be the result in a situation where the other statute was specifically intended to provide additional protection to a class of individuals engaging in transactions covered by the Uniform Commercial Code.

4. **Listing not exclusive.** The list of sources of supplemental law in subsection (b) is intended to be merely illustrative of the other law that may supplement the Uniform Commercial Code, and is not exclusive. No listing could be exhaustive. Further, the fact that a particular section of the Uniform Commercial Code makes express reference to other law is not intended to suggest the negation of the general application of the principles of subsection (b). Note also that the word "bankruptcy" in subsection (b), continuing the use of that word from former Section 1_103, should be understood not as a specific reference to federal bankruptcy law but, rather as a reference to general principles of insolvency, whether under federal or state law.

SECTION 1_104. CONSTRUCTION AGAINST IMPLIED REPEAL. [The Uniform Commercial Code] being a general act intended as a unified coverage of its subject matter, no part of it shall be deemed to be impliedly repealed by subsequent legislation if such construction can reasonably be avoided.

Official Comments

Source: Former Section 1_104.

Changes from former law: Except for changing the form of reference to the Uniform Commercial Code, this section is identical to former Section 1_104.

1. This section embodies the policy that an act that bears evidence of carefully considered permanent regulative intention should not lightly be regarded as impliedly repealed by subsequent legislation. The Uniform Commercial Code, carefully integrated and intended as a uniform codification of permanent character

covering an entire "field" of law, is to be regarded as particularly resistant to implied repeal.

SECTION 1_105. SEVERABILITY. If any provision or clause of [the Uniform Commercial Code] or its application to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of [the Uniform Commercial Code] which can be given effect without the invalid provision or application, and to this end the provisions of [the Uniform Commercial Code] are severable.

Official Comments

Source: Former Section 1_108.

Changes from former law: Except for changing the form of reference to the Uniform Commercial Code, this section is identical to former Section 1_108.

1. This is the model severability section recommended by the National Conference of Commissioners on Uniform State Laws for inclusion in all acts of extensive scope.

SECTION 1_106. USE OF SINGULAR AND PLURAL; GENDER. In [the Uniform Commercial Code], unless the statutory context otherwise requires:

(1) words in the singular number include the plural, and those in the plural include the singular; and

(2) words of any gender also refer to any other gender.

Official Comments

Source: Former Section 1_102(5). See also 1 U.S.C. Section 1.

Changes from former law: Other than minor stylistic changes, this section is identical to former Section 1_102(5).

1. This section makes it clear that the use of singular or plural in the text of the Uniform Commercial Code is generally only a matter of drafting style – singular words may be applied in the plural, and plural words may be applied in the singular. Only when it is clear from the statutory context that the use of the singular or plural does not include the other is this rule inapplicable. *See, e.g.*, Section 9_322.

SECTION 1_107. SECTION CAPTIONS. Section captions are part of [the Uniform Commercial Code].

Official Comments

Source: Former Section 1_109.

Changes from former law: None.

1. Section captions are a part of the text of the Uniform Commercial Code, and not mere surplusage. This is not the case, however, with respect to subsection headings appearing in Article 9. See Comment 3 to Section 9_101 ("subsection headings are not a part of the official text itself and have not been approved by the sponsors.").

SECTION 1-108. RELATION TO ELECTRONIC SIGNATURES IN GLOBAL AND NATIONAL COMMERCE ACT. This [Act] modifies, limits, and supersedes the federal Electronic Signatures in Global and National Commerce Act~~,~~ (15 U.S.C. Section 7001, et. seq.) but does not modify, limit, or supersede Section 101(c) of that act (15 U.S.C. Section 7001(c)) or authorize electronic delivery of any of the notices described in Section 103(b) of that act (15 U.S.C. Section 103(b)).

Official Comments

Source: New

1. The federal Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 *et seq* became effective in 2000. Section 102(a) of that Act provides that a State statute may modify, limit, or supersede the provisions of section 101 of that Act with respect to state law if such statute, *inter alia*, specifies the alternative procedures or requirements for the use or acceptance (or both) of electronic records or electronic signatures to establish the legal effect, validity, or enforceability of contracts or other records, and (i) such alternative procedures or requirements are consistent with Titles I and II of that Act, (ii) such alternative procedures or requirements do not require, or accord greater legal status or effect to, the implementation or application of a specific technology or technical specification for performing the functions of creating, storing, generating, receiving, communicating, or authenticating electronic records or electronic signatures; and (iii) if enacted or adopted after the date of the enactment of that Act, makes specific reference to that Act. Article 1 fulfills the first two of those three criteria; this Section fulfills the third criterion listed above.

2. As stated in this section, however, Article 1 does not modify, limit, or supersede Section 101(c) of the Electronic Signatures in Global and National Commerce Act (requiring affirmative consent from a consumer to electronic delivery of transactional disclosures that are required by state law to be in writing); nor does it authorize electronic delivery of any of the notices described in Section 103(b) of that Act.

PART 2

GENERAL DEFINITIONS AND PRINCIPLES OF INTERPRETATION

SECTION 1_201. GENERAL DEFINITIONS.

(a) Unless the context otherwise requires, words or phrases defined in this section, or in the additional definitions contained in other articles of [the Uniform Commercial Code] that apply to particular articles or parts thereof, have the meanings stated.

(b) Subject to definitions contained in other articles of [the Uniform Commercial Code] that apply to particular articles or parts thereof:

(1) "Action", in the sense of a judicial proceeding, includes recoupment, counterclaim, set_off, suit in equity, and any other proceeding in which rights are determined.

(2) "Aggrieved party" means a party entitled to pursue a remedy.

(3) "Agreement", as distinguished from "contract", means the bargain of the parties in fact, as found in their language or inferred from other circumstances, including course of performance, course of dealing, or usage of trade as provided in Section 1_303.

(4) "Bank" means a person engaged in the business of banking and includes a savings bank, savings and loan association, credit union, and trust company.

(5) "Bearer" means a person in possession of a negotiable instrument, document of title, or certificated security that is payable to bearer or indorsed in blank.

(6) "Bill of lading" means a document evidencing the receipt of goods for shipment issued by a person engaged in the business of transporting or forwarding goods.

(7) "Branch" includes a separately incorporated foreign branch of a bank.

(8) "Burden of establishing" a fact means the burden of persuading the trier of fact that the existence of the fact is more probable than its nonexistence.

(9) "Buyer in ordinary course of business" means a person that buys goods in good faith, without knowledge that the sale violates the rights of another person in the goods, and in the ordinary course from a person, other than a pawnbroker, in the business of selling goods of that kind. A person buys goods in the ordinary course if the sale to the person comports with the usual or customary practices in the kind of business in which the seller is engaged or with the seller's own usual or customary practices. A person that sells oil, gas, or other minerals at the wellhead or minehead is a person in the business of selling goods of that kind. A buyer in ordinary course of business may buy for cash, by exchange of other property, or on secured or unsecured credit, and may acquire goods or documents of title under a preexisting contract for sale. Only a buyer that takes possession of the goods or has a right to recover the goods from the seller under Article 2 may be

a buyer in ordinary course of business. "Buyer in ordinary course of business" does not include a person that acquires goods in a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

(10) "Conspicuous", with reference to a term, means so written, displayed, or presented that a reasonable person against which it is to operate ought to have noticed it. Whether a term is "conspicuous" or not is a decision for the court. Conspicuous terms include the following:

(A) a heading in capitals equal to or greater in size than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same or lesser size; and

(B) language in the body of a record or display in larger type than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same size, or set off from surrounding text of the same size by symbols or other marks that call attention to the language.

(11) "Consumer" means an individual who enters into a transaction primarily for personal, family, or household purposes

(12) "Contract", as distinguished from "agreement", means the total legal obligation that results from the parties' agreement as determined by [the Uniform Commercial Code] as supplemented by any other applicable laws.

(13) "Creditor" includes a general creditor, a secured creditor, a lien creditor, and any representative of creditors, including an assignee for the benefit of

creditors, a trustee in bankruptcy, a receiver in equity, and an executor or administrator of an insolvent debtor's or assignor's estate.

(14) "Defendant" includes a person in the position of defendant in a counterclaim, cross-claim, or third-party claim.

(15) "Delivery", with respect to an instrument, document of title, or chattel paper, means voluntary transfer of possession.

(16) "Document of title" includes bill of lading, dock warrant, dock receipt, warehouse receipt or order for the delivery of goods, and also any other document which in the regular course of business or financing is treated as adequately evidencing that the person in possession of it is entitled to receive, hold, and dispose of the document and the goods it covers. To be a document of title, a document must purport to be issued by or addressed to a bailee and purport to cover goods in the bailee's possession which are either identified or are fungible portions of an identified mass.

(17) "Fault" means a default, breach, or wrongful act or omission.

(18) "Fungible goods" means:

(A) goods of which any unit, by nature or usage of trade, is the equivalent of any other like unit; or

(B) goods that by agreement are treated as equivalent.

(19) "Genuine" means free of forgery or counterfeiting.

(20) "Good faith," except as otherwise provided in Article 5, means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(21) "Holder" means:

(A) the person in possession of a negotiable instrument that is payable either to bearer or to an identified person that is the person in possession; or

(B) the person in possession of a document of title if the goods are deliverable either to bearer or to the order of the person in possession.

(22) "Insolvency proceeding" includes an assignment for the benefit of creditors or other proceeding intended to liquidate or rehabilitate the estate of the person involved.

(23) "Insolvent" means:

(A) having generally ceased to pay debts in the ordinary course of business other than as a result of bona fide dispute;

(B) being unable to pay debts as they become due; or

(C) being insolvent within the meaning of federal bankruptcy law.

(24) "Money" means a medium of exchange currently authorized or adopted by a domestic or foreign government. The term includes a monetary unit of account established by an intergovernmental organization or by agreement between two or more countries.

(25) "Organization" means a person other than an individual.

(26) "Party", as distinguished from "third party", means a person that has engaged in a transaction or made an agreement subject to [the Uniform Commercial Code].

(27) "Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency, or instrumentality, public corporation, or any other legal or commercial entity.

(28) "Present value" means the amount as of a date certain of one or more sums payable in the future, discounted to the date certain by use of either an interest rate specified by the parties if that rate is not manifestly unreasonable at the time the transaction is entered into or, if an interest rate is not so specified, a commercially reasonable rate that takes into account the facts and circumstances at the time the transaction is entered into.

(29) "Purchase" means taking by sale, lease, discount, negotiation, mortgage, pledge, lien, security interest, issue or reissue, gift, or any other voluntary transaction creating an interest in property.

(30) "Purchaser" means a person that takes by purchase.

(31) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

(32) "Remedy" means any remedial right to which an aggrieved party is entitled with or without resort to a tribunal.

(33) "Representative" means a person empowered to act for another, including an agent, an officer of a corporation or association, and a trustee, executor, or administrator of an estate.

(34) "Right" includes remedy.

(35) "Security interest" means an interest in personal property or fixtures which secures payment or performance of an obligation. "Security interest" includes any interest of a consignor and a buyer of accounts, chattel paper, a payment intangible, or a promissory note in a transaction that is subject to Article 9. "Security interest" does not include the special property interest of a buyer of goods on identification of those goods to a contract for sale under Section 2_ 401, but a buyer may also acquire a "security interest" by complying with Article 9. Except as otherwise provided in Section 2_505, the right of a seller or lessor of goods under Article 2 or 2A to retain or acquire possession of the goods is not a "security interest", but a seller or lessor may also acquire a "security interest" by complying with Article 9. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer under Section 2_401 is limited in effect to a reservation of a "security interest." Whether a transaction in the form of a lease creates a "security interest" is determined pursuant to Section 1_203.

(36) "Send" in connection with a writing, record, or notice means:

(A) to deposit in the mail or deliver for transmission by any other usual means of communication with postage or cost of transmission provided for and properly addressed and, in the case of an instrument, to an address specified

thereon or otherwise agreed, or if there be none to any address reasonable under the circumstances; or

(B) in any other way to cause to be received any record or notice within the time it would have arrived if properly sent.

(37) "Signed" includes using any symbol executed or adopted with present intention to adopt or accept a writing.

(38) "State" means a State of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States.

(39) "Surety" includes a guarantor or other secondary obligor.

(40) "Term" means a portion of an agreement that relates to a particular matter.

(41) "Unauthorized signature" means a signature made without actual, implied, or apparent authority. The term includes a forgery.

(42) "Warehouse receipt" means a receipt issued by a person engaged in the business of storing goods for hire.

(43) "Writing" includes printing, typewriting, or any other intentional reduction to tangible form. "Written" has a corresponding meaning.

Official Comments

Source: Former Section 1_201.

Changes from former law: In order to make it clear that all definitions in the Uniform Commercial Code (not just those appearing in Article 1, as stated in former Section 1-201, but also those appearing in other Articles) do not apply if the context otherwise requires, a new subsection (a) to that effect has been added, and the definitions now appear in subsection (b). The reference in subsection (a) to the

"context" is intended to refer to the context in which the defined term is used in the Uniform Commercial Code. In other words, the definition applies whenever the defined term is used unless the context in which the defined term is used in the statute indicates that the term was not used in its defined sense. Consider, for example, Sections 3_103(a)(9) (defining "promise," in relevant part, as "a written undertaking to pay money signed by the person undertaking to pay") and 3_303(a)(1) (indicating that an instrument is issued or transferred for value if "the instrument is issued or transferred for a promise of performance, to the extent that the promise has been performed"). It is clear from the statutory context of the use of the word "promise" in Section 3_303(a)(1) that the term was not used in the sense of its definition in Section 3_103(a)(9). Thus, the Section 3_103(a)(9) definition should not be used to give meaning to the word "promise" in Section 3_303(a).

Some definitions in former Section 1-201 have been reformulated as substantive provisions and have been moved to other sections. See Sections 1-202 (explicating concepts of notice and knowledge formerly addressed in Sections 1-201(25)-(27)), 1-204 (determining when a person gives value for rights, replacing the definition of "value" in former Section 1-201(44)), and 1-206 (addressing the meaning of presumptions, replacing the definitions of "presumption" and "presumed" in former Section 1-201(31)). Similarly, the portion of the definition of "security interest" in former Section 1-201(37) which explained the difference between a security interest and a lease has been relocated to Section 1-203.

Two definitions in former Section 1-201 have been deleted. The definition of "honor" in former Section 1-201(21) has been moved to Section 2-103(1)(b), inasmuch as the definition only applies to the use of the word in Article 2. The definition of "telegram" in former Section 1-201(41) has been deleted because that word no longer appears in the definition of "conspicuous."

Other than minor stylistic changes and renumbering, the remaining definitions in this section are as in former Article 1 except as noted below.

1. "Action." Unchanged from former Section 1_201, which was derived from similar definitions in Section 191, Uniform Negotiable Instruments Law; Section 76, Uniform Sales Act; Section 58, Uniform Warehouse Receipts Act; Section 53, Uniform Bills of Lading Act.

2. "Aggrieved party." Unchanged from former Section 1_201.

3. "Agreement." Derived from former Section 1_201. As used in the Uniform Commercial Code the word is intended to include full recognition of usage of trade, course of dealing, course of performance and the surrounding circumstances as effective parts thereof, and of any agreement permitted under the provisions of the Uniform Commercial Code to displace a stated rule of law.

Whether an agreement has legal consequences is determined by applicable provisions of the Uniform Commercial Code and, to the extent provided in Section 1_103, by the law of contracts.

4. "Bank." Derived from Section 4A_104.

5. "Bearer." Unchanged from former Section 1_201, which was derived from Section 191, Uniform Negotiable Instruments Law.

6. "Bill of Lading." Derived from former Section 1_201. The reference to, and definition of, an "airbill" has been deleted as no longer necessary.

7. "Branch." Unchanged from former Section 1_201.

8. "Burden of establishing a fact." Unchanged from former Section 1_201.

9. "Buyer in ordinary course of business." Except for minor stylistic changes, identical to former Section 1_201 (as amended in conjunction with the 1999 revisions to Article 9). The major significance of the phrase lies in Section 2_403 and in the Article on Secured Transactions (Article 9).

The first sentence of paragraph (9) makes clear that a buyer from a pawnbroker cannot be a buyer in ordinary course of business. The second sentence explains what it means to buy "in the ordinary course." The penultimate sentence prevents a buyer that does not have the right to possession as against the seller from being a buyer in ordinary course of business. Concerning when a buyer obtains possessory rights, see Sections 2_502 and 2_716. However, the penultimate sentence is not intended to affect a buyer's status as a buyer in ordinary course of business in cases (such as a "drop shipment") involving delivery by the seller to a person buying from the buyer or a donee from the buyer. The requirement relates to whether *as against the seller* the buyer or one taking through the buyer has possessory rights.

10. "Conspicuous." Derived from former Section 1_201(10). This definition states the general standard that to be conspicuous a term ought to be noticed by a reasonable person. Whether a term is conspicuous is an issue for the court. Subparagraphs (A) and (B) set out several methods for making a term conspicuous. Requiring that a term be conspicuous blends a notice function (the term ought to be noticed) and a planning function (giving guidance to the party relying on the term regarding how that result can be achieved). Although these paragraphs indicate some of the methods for making a term attention-calling, the test is whether attention can reasonably be expected to be called to it. The statutory language should not be construed to permit a result that is inconsistent with that test.

11. "Consumer." Derived from Section 9_102(a)(25).

12. "Contract." Except for minor stylistic changes, identical to former Section 1_201.

13. "Creditor." Unchanged from former Section 1_201.

14. "Defendant." Except for minor stylistic changes, identical to former Section 1_201, which was derived from Section 76, Uniform Sales Act.

15. "Delivery." Derived from former Section 1_201. The reference to certificated securities has been deleted in light of the more specific treatment of the matter in Section 8_301.

16. "Document of title." Unchanged from former Section 1_201, which was derived from Section 76, Uniform Sales Act. By making it explicit that the obligation or designation of a third party as "bailee" is essential to a document of title, this definition clearly rejects any such result as obtained in *Hixson v. Ward*, 254 Ill.App. 505 (1929), which treated a conditional sales contract as a document of title. Also the definition is left open so that new types of documents may be included. It is unforeseeable what documents may one day serve the essential purpose now filled by warehouse receipts and bills of lading. Truck transport has already opened up problems which do not fit the patterns of practice resting upon the assumption that a draft can move through banking channels faster than the goods themselves can reach their destination. There lie ahead air transport and such probabilities as teletype transmission of what may some day be regarded commercially as "Documents of Title." The definition is stated in terms of the function of the documents with the intention that any document which gains commercial recognition as accomplishing the desired result shall be included within its scope. Fungible goods are adequately identified within the language of the definition by identification of the mass of which they are a part.

Dock warrants were within the Sales Act definition of document of title apparently for the purpose of recognizing a valid tender by means of such paper. In current commercial practice a dock warrant or receipt is a kind of interim certificate issued by steamship companies upon delivery of the goods at the dock, entitling a designated person to have issued to him at the company's office a bill of lading. The receipt itself is invariably nonnegotiable in form although it may indicate that a negotiable bill is to be forthcoming. Such a document is not within the general compass of the definition, although trade usage may in some cases entitle such paper to be treated as a document of title. If the dock receipt actually represents a storage obligation undertaken by the shipping company, then it is a warehouse receipt within this section regardless of the name given to the instrument.

The goods must be "described," but the description may be by marks or labels and may be qualified in such a way as to disclaim personal knowledge of the

issuer regarding contents or condition. However, baggage and parcel checks and similar "tokens" of storage which identify stored goods only as those received in exchange for the token are not covered by this Article.

The definition is broad enough to include an airway bill.

17. "Fault." Derived from former Section 1_201. "Default" has been added to the list of events constituting fault.

18. "Fungible goods." Derived from former Section 1_201. References to securities have been deleted because Article 8 no longer uses the term "fungible" to describe securities. Accordingly, this provision now defines the concept only in the context of goods.

19. "Genuine." Unchanged from former Section 1_201.

20. "Good faith." Former Section 1_201(19) defined "good faith" simply as honesty in fact; the definition contained no element of commercial reasonableness. Initially, that definition applied throughout the Code with only one exception. Former Section 2_103(1)(b) provided that *"in that Article*, "'good faith' in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." This alternative definition was limited in applicability, though, because it applied only to transactions within the scope of Article 2 and it applied only to merchants.

Over time, however, amendments to the Uniform Commercial Code brought the Article 2 merchant concept of good faith (subjective honesty and objective commercial reasonableness) into other Articles. First, Article 2A explicitly incorporated the Article 2 standard. See Section 2A_103(7). Then, other Articles broadened the applicability of that standard by adopting it for all parties rather than just for merchants. *See*, *e.g.*, Sections 3_103(a)(4), 4A_105(a)(6), 7_102(a)(6), 8_102(a)(10), and 9_102(a)(43). Finally, Articles 2 and 2A were amended so as to apply the standard to non-merchants as well as merchants. See Sections 2_103(1)(j), 2A_103(1)(m). All of these definitions are comprised of two elements – honesty in fact *and* the observance of reasonable commercial standards of fair dealing. Only revised Article 5 defines "good faith" solely in terms of subjective honesty, and only Article 6 (in the few states that have not chosen to delete the Article) is without a definition of good faith. (It should be noted that, while revised Article 6 did not define good faith, Comment 2 to revised Section 6_102 states that "this Article adopts the definition of 'good faith' in Article 1 in all cases, even when the buyer is a merchant.")

Thus, the definition of "good faith" in this section merely confirms what has been the case for a number of years as Articles of the UCC have been amended or revised – the obligation of "good faith," applicable in each Article, is to be interpreted in the context of all Articles except for Article 5 as including both the

subjective element of honesty in fact and the objective element of the observance of reasonable commercial standards of fair dealing. As a result, both the subjective and objective elements are part of the standard of "good faith," whether that obligation is specifically referenced in another Article of the Code (other than Article 5) or is provided by this Article.

Of course, as noted in the statutory text, the definition of "good faith" in this section does not apply when the narrower definition of "good faith" in revised Article 5 is applicable.

As noted above, the definition of "good faith" in this section requires not only honesty in fact but also "observance of reasonable commercial standards of fair dealing." Although "fair dealing" is a broad term that must be defined in context, it is clear that it is concerned with the fairness of conduct rather than the care with which an act is performed. This is an entirely different concept than whether a party exercised ordinary care in conducting a transaction. Both concepts are to be determined in the light of reasonable commercial standards, but those standards in each case are directed to different aspects of commercial conduct. See e.g., Sections 3-103(a)(9) and 4-104(c) and Comment 4 to Section 3-103.

21. "Holder." Derived from former Section 1_201. The definition has been reorganized for clarity.

22. "Insolvency proceedings." Unchanged from former Section 1_201.

23. "Insolvent." Derived from former Section 1_201. The three tests of insolvency – "generally ceased to pay debts in the ordinary course of business other than as a result of a bona fide dispute as to them," "unable to pay debts as they become due," and "insolvent within the meaning of the federal bankruptcy law" – are expressly set up as alternative tests and must be approached from a commercial standpoint.

24. "Money." Substantively identical to former Section 1_201. The test is that of sanction of government, whether by authorization before issue or adoption afterward, which recognizes the circulating medium as a part of the official currency of that government. The narrow view that money is limited to legal tender is rejected.

25. "Organization." The former definition of this word has been replaced with the standard definition used in acts prepared by the National Conference of Commissioners on Uniform State Laws.

26. "Party." Substantively identical to former Section 1_201. Mention of a party includes, of course, a person acting through an agent. However, where an agent comes into opposition or contrast to the principal, particular account is taken of that situation.

27. "Person." The former definition of this word has been replaced with the standard definition used in acts prepared by the National Conference of Commissioners on Uniform State Laws.

28. "Present value." This definition was formerly contained within the definition of "security interest" in former Section 1_201(37).

29. "Purchase." Derived from former Section 1_201. The form of definition has been changed from "includes" to "means."

30. "Purchaser." Unchanged from former Section 1_201.

31. "Record." Derived from Section 9_102(a)(69).

32. "Remedy." Unchanged from former Section 1_201. The purpose is to make it clear that both remedy and right (as defined) include those remedial rights of "self help" which are among the most important bodies of rights under the Uniform Commercial Code, remedial rights being those to which an aggrieved party may resort on its own.

33. "Representative." Derived from former Section 1_201. Reorganized, and form changed from "includes" to "means."

34. "Right." Except for minor stylistic changes, identical to former Section 1_201.

35. "Security Interest." The definition is the first paragraph of the definition of "security interest" in former Section 1_201, with minor stylistic changes. The remaining portion of that definition has been moved to Section 1_203. Note that, because of the scope of Article 9, the term includes the interest of certain outright buyers of certain kinds of property.

36. "Send." Derived from former Section 1-201. Compare "notifies".

37. "Signed." Derived from former Section 1_201. Former Section 1_201 referred to "intention to authenticate"; because other articles now use the term "authenticate," the language has been changed to "intention to adopt or accept." The latter formulation is derived from the definition of "authenticate" in Section 9-102(a)(7). This provision refers only to writings, because the term "signed," as used in some articles, refers only to writings. This provision also makes it clear that, as the term "signed" is used in the Uniform Commercial Code, a complete signature is not necessary. The symbol may be printed, stamped or written; it may be by initials or by thumbprint. It may be on any part of the document and in appropriate cases may be found in a billhead or letterhead. No catalog of possible situations can be complete and the court must use common sense and commercial experience in passing upon these matters. The question always is whether the

symbol was executed or adopted by the party with present intention to adopt or accept the writing.

38. "State." This is the standard definition of the term used in acts prepared by the National Conference of Commissioners on Uniform State Laws.

39. "Surety." This definition makes it clear that "surety" includes all secondary obligors, not just those whose obligation refers to the person obligated as a surety. As to the nature of secondary obligations generally, see Restatement (Third), Suretyship and Guaranty Section 1 (1996).

40. "Term." Unchanged from former Section 1_201.

41. "Unauthorized signature." Unchanged from former Section 1_201.

42. "Warehouse receipt." Unchanged from former Section 1_201, which was derived from Section 76(1), Uniform Sales Act; Section 1, Uniform Warehouse Receipts Act. Receipts issued by a field warehouse are included, provided the warehouseman and the depositor of the goods are different persons.

43. "Written" or "writing." Unchanged from former Section 1_201.

SECTION 1_202. NOTICE; KNOWLEDGE.

(a) Subject to subsection (f), a person has "notice" of a fact if the person:

(1) has actual knowledge of it;

(2) has received a notice or notification of it; or

(3) from all the facts and circumstances known to the person at the time in question, has reason to know that it exists.

(b) "Knowledge" means actual knowledge. "Knows" has a corresponding meaning.

(c) "Discover", "learn", or words of similar import refer to knowledge rather than to reason to know.

(d) A person "notifies" or "gives" a notice or notification to another person by taking such steps as may be reasonably required to inform the other person in ordinary course, whether or not the other person actually comes to know of it.

(e) Subject to subsection (f), a person "receives" a notice or notification when:

(1) it comes to that person's attention; or

(2) it is duly delivered in a form reasonable under the circumstances at the place of business through which the contract was made or at another location held out by that person as the place for receipt of such communications.

(f) Notice, knowledge, or a notice or notification received by an organization is effective for a particular transaction from the time it is brought to the attention of the individual conducting that transaction and, in any event, from the time it would have been brought to the individual's attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless the communication is part of the individual's regular duties or the individual has reason to know of the transaction and that the transaction would be materially affected by the information.

Official Comments

Source: Derived from former Section 1_201(25)_(27).

Changes from former law: These provisions are substantive rather than purely definitional. Accordingly, they have been relocated from Section 1_201 to this section. The reference to the "forgotten notice" doctrine has been deleted.

1. Under subsection (a), a person has notice of a fact when, *inter alia*, the person has received a notification of the fact in question.

2. As provided in subsection (d), the word "notifies" is used when the essential fact is the proper dispatch of the notice, not its receipt. Compare "Send." When the essential fact is the other party's receipt of the notice, that is stated. Subsection (e) states when a notification is received.

3. Subsection (f) makes clear that notice, knowledge, or a notification, although "received," for instance, by a clerk in Department A of an organization, is effective for a transaction conducted in Department B only from the time when it was or should have been communicated to the individual conducting that transaction.

SECTION 1_203. LEASE DISTINGUISHED FROM SECURITY INTEREST.

(a) Whether a transaction in the form of a lease creates a lease or security interest is determined by the facts of each case.

(b) A transaction in the form of a lease creates a security interest if the consideration that the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease and is not subject to termination by the lessee, and:

(1) the original term of the lease is equal to or greater than the remaining economic life of the goods;

(2) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods;

(3) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement; or

(4) the lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement.

(c) A transaction in the form of a lease does not create a security interest merely because:

(1) the present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into;

(2) the lessee assumes risk of loss of the goods;

(3) the lessee agrees to pay, with respect to the goods, taxes, insurance, filing, recording, or registration fees, or service or maintenance costs;

(4) the lessee has an option to renew the lease or to become the owner of the goods;

(5) the lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed; or

(6) the lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.

(d) Additional consideration is nominal if it is less than the lessee's reasonably predictable cost of performing under the lease agreement if the option is not exercised. Additional consideration is not nominal if:

(1) when the option to renew the lease is granted to the lessee, the rent is stated to be the fair market rent for the use of the goods for the term of the renewal determined at the time the option is to be performed; or

(2) when the option to become the owner of the goods is granted to the lessee, the price is stated to be the fair market value of the goods determined at the time the option is to be performed.

(e) The "remaining economic life of the goods" and "reasonably predictable" fair market rent, fair market value, or cost of performing under the lease agreement must be determined with reference to the facts and circumstances at the time the transaction is entered into.

Official Comments

Source: Former Section 1_201(37).

Changes from former law: This section is substantively identical to those portions of former Section 1_201(37) that distinguished "true" leases from security interests, except that the definition of "present value" formerly embedded in Section 1_201(37) has been placed in Section 1_201(28).

1. An interest in personal property or fixtures which secures payment or performance of an obligation is a "security interest." See Section 1_201(37). Security interests are sometimes created by transactions in the form of leases. Because it can be difficult to distinguish leases that create security interests from

those that do not, this section provides rules that govern the determination of whether a transaction in the form of a lease creates a security interest.

2. One of the reasons it was decided to codify the law with respect to leases was to resolve an issue that created considerable confusion in the courts: what is a lease? The confusion existed, in part, due to the last two sentences of the definition of security interest in the 1978 Official Text of the Act, Section 1_201(37). The confusion was compounded by the rather considerable change in the federal, state and local tax laws and accounting rules as they relate to leases of goods. The answer is important because the definition of lease determines not only the rights and remedies of the parties to the lease but also those of third parties. If a transaction creates a lease and not a security interest, the lessee's interest in the goods is limited to its leasehold estate; the residual interest in the goods belongs to the lessor. This has significant implications to the lessee's creditors. "On common law theory, the lessor, since he has not parted with title, is entitled to full protection against the lessee's creditors and trustee in bankruptcy . . . ." 1 G. Gilmore, *Security Interests in Personal Property* Section 3.6, at 76 (1965).

Under pre_UCC chattel security law there was generally no requirement that the lessor file the lease, a financing statement, or the like, to enforce the lease agreement against the lessee or any third party; the Article on Secured Transactions (Article 9) did not change the common law in that respect. Coogan, Leasing and the Uniform Commercial Code, in *Equipment Leasing—Leveraged Leasing* 681, 700 n.25, 729 n.80 (2d ed.1980). The Article on Leases (Article 2A) did not change the law in that respect, except for leases of fixtures. Section 2A_309. An examination of the common law will not provide an adequate answer to the question of what is a lease. The definition of security interest in Section 1_201(37) of the 1978 Official Text of the Act provided that the Article on Secured Transactions (Article 9) governs security interests disguised as leases, *i.e.*, leases intended as security; however, the definition became vague and outmoded.

Lease is defined in Article 2A as a transfer of the right to possession and use of goods for a term, in return for consideration. Section 2A_103(1)(j). The definition continues by stating that the retention or creation of a security interest is not a lease. Thus, the task of sharpening the line between true leases and security interests disguised as leases continues to be a function of this Article.

This section begins where Section 1_201(35) leaves off. It draws a sharper line between leases and security interests disguised as leases to create greater certainty in commercial transactions.

Prior to enactment of the rules now codified in this section, the 1978 Official Text of Section 1_201(37) provided that whether a lease was intended as security (*i.e.*, a security interest disguised as a lease) was to be determined from the facts of each case; however, (a) the inclusion of an option to purchase did not itself

make the lease one intended for security, and (b) an agreement that upon compliance with the terms of the lease the lessee would become, or had the option to become, the owner of the property for no additional consideration, or for a nominal consideration, did make the lease one intended for security.

Reference to the intent of the parties to create a lease or security interest led to unfortunate results. In discovering intent, courts relied upon factors that were thought to be more consistent with sales or loans than leases. Most of these criteria, however, were as applicable to true leases as to security interests. Examples include the typical net lease provisions, a purported lessor's lack of storage facilities or its character as a financing party rather than a dealer in goods. Accordingly, this section contains no reference to the parties' intent.

Subsections (a) and (b) were originally taken from Section 1(2) of the Uniform Conditional Sales Act (act withdrawn 1943), modified to reflect current leasing practice. Thus, reference to the case law prior to the incorporation of those concepts in this article will provide a useful source of precedent. Gilmore, *Security Law, Formalism and Article 9*, 47 Neb.L.Rev. 659, 671 (1968). Whether a transaction creates a lease or a security interest continues to be determined by the facts of each case. Subsection (b) further provides that a transaction creates a security interest if the lessee has an obligation to continue paying consideration for the term of the lease, if the obligation is not terminable by the lessee (thus correcting early statutory gloss, *e.g.*, *In re Royer's Bakery, Inc.*, 1 U.C.C. Rep.Serv. (Callaghan) 342 (Bankr.E.D.Pa.1963)) and if one of four additional tests is met. The first of these four tests, subparagraph (1), is that the original lease term is equal to or greater than the remaining economic life of the goods. The second of these tests, subparagraph (2), is that the lessee is either bound to renew the lease for the remaining economic life of the goods or to become the owner of the goods. *In re Gehrke Enters.*, 1 Bankr. 647, 651_52 (Bankr.W.D.Wis.1979). The third of these tests, subparagraph (3), is whether the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or for nominal additional consideration, which is defined later in this section. *In re Celeryvale Transp.*, 44 Bankr. 1007, 1014_15 (Bankr.E.D.Tenn.1984). The fourth of these tests, subparagraph (4), is whether the lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration. All of these tests focus on economics, not the intent of the parties. *In re Berge*, 32 Bankr. 370, 371_73 (Bankr.W.D.Wis.1983).

The focus on economics is reinforced by subsection (c). It states that a transaction does not create a security interest merely because the transaction has certain characteristics listed therein. Subparagraph (1) has no statutory derivative; it states that a full payout lease does not *per se* create a security interest. *Rushton v. Shea*, 419 F.Supp. 1349, 1365 (D.Del.1976). Subparagraphs (2) and (3) provide the same regarding the provisions of the typical net lease. *Compare All_States Leasing Co. v. Ochs*, 42 Or.App. 319, 600 P.2d 899 (Ct.App.1979), *with In re*

Tillery, 571 F.2d 1361 (5th Cir.1978). Subparagraph (4) restates and expands the provisions of the 1978 Official Text of Section 1_201(37) to make clear that the option can be to buy or renew. Subparagraphs (5) and (6) treat fixed price options and provide that fair market value must be determined at the time the transaction is entered into. *Compare Arnold Mach. Co. v. Balls*, 624 P.2d 678 (Utah 1981), *with Aoki v. Shepherd Mach. Co.*, 665 F.2d 941 (9th Cir.1982).

The relationship of subsection (b) to subsection (c) deserves to be explored. The fixed price purchase option provides a useful example. A fixed price purchase option in a lease does not of itself create a security interest. This is particularly true if the fixed price is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed. A security interest is created only if the option price is nominal and the conditions stated in the introduction to the second paragraph of this subsection are met. There is a set of purchase options whose fixed price is less than fair market value but greater than nominal that must be determined on the facts of each case to ascertain whether the transaction in which the option is included creates a lease or a security interest.

It was possible to provide for various other permutations and combinations with respect to options to purchase and renew. For example, this section could have stated a rule to govern the facts of *In re Marhoefer Packing Co.*, 674 F.2d 1139 (7th Cir.1982). This was not done because it would unnecessarily complicate the definition. Further development of this rule is left to the courts.

Subsections (d) and (e) provide definitions and rules of construction.

SECTION 1_204. VALUE. Except as otherwise provided in Articles 3, 4, [and] 5, [and 6], a person gives value for rights if the person acquires them:

(1) in return for a binding commitment to extend credit or for the extension of immediately available credit, whether or not drawn upon and whether or not a charge_back is provided for in the event of difficulties in collection;

(2) as security for, or in total or partial satisfaction of, a preexisting claim;

(3) by accepting delivery under a preexisting contract for purchase; or

(4) in return for any consideration sufficient to support a simple contract.

Official Comments

Source: Former Section 1_201(44).

Changes from former law: Unchanged from former Section 1_201, which was derived from Sections 25, 26, 27, 191, Uniform Negotiable Instruments Law; Section 76, Uniform Sales Act; Section 53, Uniform Bills of Lading Act; Section 58, Uniform Warehouse Receipts Act; Section 22(1), Uniform Stock Transfer Act; Section 1, Uniform Trust Receipts Act. These provisions are substantive rather than purely definitional. Accordingly, they have been relocated from former Section 1_201 to this section.

1. All the Uniform Acts in the commercial law field (except the Uniform Conditional Sales Act) have carried definitions of "value." All those definitions provided that value was any consideration sufficient to support a simple contract, including the taking of property in satisfaction of or as security for a pre_existing claim. Subsections (1), (2), and (4) in substance continue the definitions of "value" in the earlier acts. Subsection (3) makes explicit that "value" is also given in a third situation: where a buyer by taking delivery under a pre_existing contract converts a contingent into a fixed obligation.

This definition is not applicable to Articles 3 and 4, but the express inclusion of immediately available credit as value follows the separate definitions in those Articles. See Sections 4_208, 4_209, 3_303. A bank or other financing agency which in good faith makes advances against property held as collateral becomes a bona fide purchaser of that property even though provision may be made for charge_back in case of trouble. Checking credit is "immediately available" within the meaning of this section if the bank would be subject to an action for slander of credit in case checks drawn against the credit were dishonored, and when a charge_back is not discretionary with the bank, but may only be made when difficulties in collection arise in connection with the specific transaction involved.

SECTION 1_205. REASONABLE TIME; SEASONABLENESS.

(a) Whether a time for taking an action required by [the Uniform Commercial Code] is reasonable depends on the nature, purpose, and circumstances of the action.

(b) An action is taken seasonably if it is taken at or within the time agreed or, if no time is agreed, at or within a reasonable time.

Official Comments

Source: Former Section 1_204(2)_(3).

Changes from former law: This section is derived from subsections (2) and (3) of former Section 1_204. Subsection (1) of that section is now incorporated in Section 1_302(b).

1. Subsection (a) makes it clear that requirements that actions be taken within a "reasonable" time are to be applied in the transactional context of the particular action.

2. Under subsection (b), the agreement that fixes the time need not be part of the main agreement, but may occur separately. Notice also that under the definition of "agreement" (Section 1_201) the circumstances of the transaction, including course of dealing or usages of trade or course of performance may be material. On the question what is a reasonable time these matters will often be important.

SECTION 1-206. PRESUMPTIONS. Whenever [the Uniform Commercial Code] creates a "presumption" with respect to a fact, or provides that a fact is "presumed," the trier of fact must find the existence of the fact unless and until evidence is introduced that supports a finding of its nonexistence.

Legislative Note: Former Section 1-206, a Statute of Frauds for sales of "kinds of personal property not otherwise covered," has been deleted. The other articles of the Uniform Commercial Code make individual determinations as to requirements for memorializing transactions within their scope, so that the primary effect of former Section 1_206 was to impose a writing requirement on sales transactions not otherwise governed by the UCC. Deletion of former Section 1-206 does not constitute a recommendation to legislatures as to whether such sales transactions should be covered by a Statute of Frauds; rather, it reflects a determination that there is no need for uniform commercial law to resolve that issue.

Official Comments

Source: Former Section 1-201(31).

Changes from former law. None, other than stylistic changes.

1. Several sections of the Uniform Commercial Code state that there is a "presumption" as to a certain fact, or that the fact is "presumed." This section, derived from the definition appearing in former Section 1-201(31), indicates the effect of those provisions on the proof process.

PART 3

TERRITORIAL APPLICABILITY AND GENERAL RULES

SECTION 1_301. TERRITORIAL APPLICABILITY; PARTIES' POWER TO CHOOSE APPLICABLE LAW.

(a) In this section:

(1) "Domestic transaction" means a transaction other than an international transaction.

(2) "International transaction" means a transaction that bears a reasonable relation to a country other than the United States.

(b) This section applies to a transaction to the extent that it is governed by another article of the [Uniform Commercial Code].

(c) Except as otherwise provided in this section:

(1) an agreement by parties to a domestic transaction that any or all of their rights and obligations are to be determined by the law of this State or of another State is effective, whether or not the transaction bears a relation to the State designated; and

(2) an agreement by parties to an international transaction that any or all of their rights and obligations are to be determined by the law of this State or of another State or country is effective, whether or not the transaction bears a relation to the State or country designated.

(d) In the absence of an agreement effective under subsection (c), and except as provided in subsections (e) and (g), the rights and obligations of the

parties are determined by the law that would be selected by application of this State's conflict of laws principles.

(e) If one of the parties to a transaction is a consumer, the following rules apply:

(1) An agreement referred to in subsection (c) is not effective unless the transaction bears a reasonable relation to the State or country designated.

(2) Application of the law of the State or country determined pursuant to subsection (c) or (d) may not deprive the consumer of the protection of any rule of law governing a matter within the scope of this section, which both is protective of consumers and may not be varied by agreement:

(A) of the State or country in which the consumer principally resides, unless subparagraph (B) applies; or

(B) if the transaction is a sale of goods, of the State or country in which the consumer both makes the contract and takes delivery of those goods, if such State or country is not the State or country in which the consumer principally resides.

(f) An agreement otherwise effective under subsection (c) is not effective to the extent that application of the law of the State or country designated would be contrary to a fundamental policy of the State or country whose law would govern in the absence of agreement under subsection (d).

(g) To the extent that [the Uniform Commercial Code] governs a transaction, if one of the following provisions of [the Uniform Commercial Code]

specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law so specified:

(1) Section 2_402;

(2) Sections 2A_105 and 2A_106;

(3) Section 4_102;

(4) Section 4A_507;

(5) Section 5_116;

[(6) Section 6_103;]

(7) Section 8_110;

(8) Sections 9_301 through 9_307.

Official Comment

Source: Former Section 1-105.

Summary of changes from former law: Section 1_301, which replaces former Section 1_105, represents a significant rethinking of choice of law issues addressed in that section. The new section reexamines both the power of parties to select the jurisdiction whose law will govern their transaction and the determination of the governing law in the absence of such selection by the parties. With respect to the power to select governing law, the draft affords greater party autonomy than former Section 1-105, but with important safeguards protecting consumer interests and fundamental policies.

Section 1-301 addresses contractual designation of governing law somewhat differently than does former Section 1-105. Former law allowed the parties to any transaction to designate a jurisdiction whose law governs if the transaction bears a "reasonable relation" to that jurisdiction. Section 1-301 deviates from this approach by providing different rules for transactions involving a consumer than for non-consumer transactions, such as "business to business" transactions.

In the context of consumer transactions, the language of Section 1-301, unlike that of former Section 1-105, protects consumers against the possibility of losing the protection of consumer protection rules applicable to the aspects of the transaction governed by the Uniform Commercial Code. In most situations, the

relevant consumer protection rules will be those of the consumer's home jurisdiction. A special rule, however, is provided for certain face-to-face sales transactions. (See Comment 3.)

In the context of business-to-business transactions, Section 1-301 generally provides the parties with greater autonomy to designate a jurisdiction whose law will govern than did former Section 1-105, but also provides safeguards against abuse that did not appear in former Section 1-105. In the non-consumer context, following emerging international norms, greater autonomy is provided in subsections (c)(1) and (c)(2) by deleting the former requirement that the transaction bear a "reasonable relation" to the jurisdiction. In the case of wholly domestic transactions, however, the jurisdiction designated must be a State. (See Comment 4.)

An important safeguard not present in former Section 1-105 is found in subsection (f). Subsection (f) provides that the designation of a jurisdiction's law is not effective (even if the transaction bears a reasonable relation to that jurisdiction) to the extent that application of that law would be contrary to a fundamental policy of the jurisdiction whose law would govern in the absence of contractual designation. Application of the law designated may be contrary to a fundamental policy of the State or country whose law would otherwise govern either because of the nature of the law designated or because of the "mandatory" nature of the law that would otherwise apply. (See Comment 6.)

In the absence of an effective contractual designation of governing law, former Section 1-105(1) directed the forum to apply its own law if the transaction bore "an appropriate relation to this state." This direction, however, was frequently ignored by courts. Section 1-301(d) provides that, in the absence of an effective contractual designation, the forum should apply the forum's general choice of law principles, subject to certain special rules in consumer transactions. (See Comments 3 and 7).

1. *Applicability of section.* This section is neither a complete restatement of choice of law principles nor a free-standing choice of law statute. Rather, it is a provision of Article 1 of the Uniform Commercial Code. As such, the scope of its application is limited in two significant ways.

First, this section is subject to Section 1-102, which states the scope of Article 1. As that section indicates, Article 1, and the rules contained therein, apply to transactions to the extent that they are governed by one of the other Articles of the Uniform Commercial Code. Thus, this section does not apply to matters outside the scope of the Uniform Commercial Code, such as a services contract, a credit card agreement, or a contract for the sale of real estate. This limitation was implicit in former Section 1-105, and is made explicit in Section 1-301(b).

Second, subsection (g) provides that this section is subject to the specific choice of law provisions contained in other Articles of the Uniform Commercial Code. Thus, to the extent that a transaction otherwise within the scope of this section also is within the scope of one of those provisions, the rules of that specific provision, rather than of this section, apply.

The following cases illustrate these two limitations on the scope of Section 1-301:

> **Example 1:** A, a resident of Indiana, enters into an agreement with Credit Card Company, a Delaware corporation with its chief executive office located in New York, pursuant to which A agrees to pay Credit Card Company for purchases charged to A's credit card. The agreement contains a provision stating that it is governed by the law of South Dakota. The choice of law rules in Section 1-301 do not apply to this agreement because the agreement is not governed by any of the other Articles of the Uniform Commercial Code.
>
> **Example 2:** A, a resident of Indiana, maintains a checking account with Bank B, an Ohio banking corporation located in Ohio. At the time that the account was established, Bank B and A entered into a "Bank-Customer Agreement" governing their relationship with respect to the account. The Bank-Customer Agreement contains some provisions that purport to limit the liability of Bank B with respect to its decisions whether to honor or dishonor checks purporting to be drawn on A's account. The Bank-Customer Agreement also contains a provision stating that it is governed by the law of Ohio. The provisions purporting to limit the liability of Bank B deal with issues governed by Article 4. Therefore, determination of the law applicable to those issues (including determination of the effectiveness of the choice of law clause as it applies to those issues) is within the scope of Section 1-301 as provided in subsection (b). Nonetheless, the rules of Section 1-301 would not apply to that determination because of subsection (g), which states that the

choice of law rules in Section 4-102 govern instead.

2. *Contractual choice of law.* This section allows parties broad autonomy, subject to several important limitations, to select the law governing their transaction, even if the transaction does not bear a relation to the State or country whose law is selected. This recognition of party autonomy with respect to governing law has already been established in several Articles of the Uniform Commercial Code (see Sections 4A-507, 5-116, and 8-110) and is consistent with international norms. See, e.g., Inter-American Convention on the Law Applicable to International Contracts, Article 7 (Mexico City 1994); Convention on the Law Applicable to Contracts for the International Sale of Goods, Article 7(1) (The Hague 1986); EC Convention on the Law Applicable to Contractual Obligations, Article 3(1) (Rome 1980).

There are three important limitations on this party autonomy to select governing law. First, a different, and more protective, rule applies in the context of consumer transactions. (See Comment 3). Second, in an entirely domestic transaction, this section does not validate the selection of foreign law. (See Comment 4.) Third, contractual choice of law will not be given effect to the extent that application of the law designated would be contrary to a fundamental policy of the State or country whose law would be applied in the absence of such contractual designation. (See Comment 6).

This Section does not address the ability of parties to designate non_legal codes such as trade codes as the set of rules governing their transaction. The power of parties to make such a designation as part of their agreement is found in the principles of Section 1_302. That Section, allowing parties broad freedom of contract to structure their relations, is adequate for this purpose. This is also the case with respect to the ability of the parties to designate recognized bodies of rules or principles applicable to commercial transactions that are promulgated by intergovernmental organizations such as UNCITRAL or Unidroit. See, e.g., Unidroit Principles of International Commercial Contracts.

3. *Consumer transactions.* If one of the parties is a consumer (as defined in Section 1-201(b)(11)), subsection (e) provides the parties less autonomy to designate the State or country whose law will govern.

First, in the case of a consumer transaction, subsection (e)(1) provides that the transaction must bear a reasonable relation to the State or country designated. Thus, the rules of subsection (c) allowing the parties to choose the law of a jurisdiction to which the transaction bears no relation do not apply to consumer transactions.

Second, subsection (e)(2) provides that application of the law of the State or country determined by the rules of this section (whether or not that State or country was designated by the parties) cannot deprive the consumer of the protection of rules of law which govern matters within the scope of Section 1-301, are protective of consumers, and are not variable by agreement. The phrase "rule of law" is intended to refer to case law as well as statutes and administrative regulations. The requirement that the rule of law be one "governing a matter within the scope of this section" means that, consistent with the scope of Section 1-301, which governs choice of law only with regard to the aspects of a transaction governed by the Uniform Commercial Code, the relevant consumer rules are those that govern those aspects of the transaction. Such rules may be found in the Uniform Commercial Code itself, as are the consumer-protective rules in Part 6 of Article 9, or in other law if that other law governs the UCC aspects of the transaction. See, for example, the rule in Section 2.403 of the Uniform Consumer Credit Code which prohibits certain sellers and lessors from taking negotiable instruments other than checks and provides that a holder is not in good faith if the holder takes a negotiable instrument with notice that it is issued in violation of that section.

With one exception (explained in the next paragraph), the rules of law the protection of which the consumer may not be deprived are those of the jurisdiction in which the consumer principally resides. The jurisdiction in which the consumer principally resides is determined at the time relevant to the particular issue involved. Thus, for example, if the issue is one related to formation of a contract, the relevant consumer protective rules are rules of the jurisdiction in which the consumer principally resided at the time the facts relevant to contract formation occurred, even if the consumer no longer principally resides in that jurisdiction at the time the dispute arises or is litigated. If, on the other hand, the issue is one relating to enforcement of obligations, then the relevant consumer protective rules are those of the jurisdiction in which the consumer principally resides at the time enforcement is sought, even if the consumer did not principally reside in that jurisdiction at the time the transaction was entered into.

In the case of a sale of goods to a consumer, in which the consumer both makes the contract and takes possession of the goods in the same jurisdiction and that jurisdiction is not the consumer's principal residence, the rule in subsection (e)(2)(B) applies. In that situation, the relevant consumer protective rules, the protection of which the consumer may not be deprived by the choice of law rules of subsections (c) and (d), are those of the State or country in which both the contract is made and the consumer takes delivery of the goods. This rule, adapted from Section 2A-106 and Article 5 of the EC Convention on the Law Applicable to Contractual Obligations, enables a seller of goods engaging in face-to-face transactions to ascertain the consumer protection rules to which those sales are subject, without the necessity of determining the principal residence of each buyer. The reference in subsection (e)(2)(B) to the State or country in which the consumer makes the contract should not be read to incorporate formalistic concepts of where

the last event necessary to conclude the contract took place; rather, the intent is to identify the state in which all material steps necessary to enter into the contract were taken by the consumer.

The following examples illustrate the application of Section 1-301(e)(2) in the context of a contractual choice of law provision:

> **Example 3:** Seller, located in State A, agrees to sell goods to Consumer, whose principal residence is in State B. The parties agree that the law of State A would govern this transaction. Seller ships the goods to Consumer in State B. An issue related to contract formation subsequently arises. Under the law of State A, that issue is governed by State A's uniform version of Article 2. Under the law of State B, that issue is governed by a non-uniform rule, protective of consumers and not variable by agreement, that brings about a different result than would occur under the uniform version of Article 2. Under Section 1-301(e)(2)(A), the parties' agreement that the law of State A would govern their transaction cannot deprive Consumer of the protection of State B's consumer protective rule. This is the case whether State B's rule is codified in Article 2 of its Uniform Commercial Code or is found elsewhere in the law of State B.

> **Example 4:** Same facts as Example 3, except that (i) Consumer takes all material steps necessary to enter into the agreement to purchase the goods from Seller, and takes delivery of those goods, while on vacation in State A and (ii) the parties agree that the law of State C (in which Seller's chief executive office is located) would govern their transaction. Under subsections (c)(1) and (e)(1), the designation of the law of State C as governing will be effective so long as the transaction is found to bear a reasonable relation to State C (assuming that the relevant law of State C is not contrary to a fundamental policy of the State whose law would govern in the absence of agreement), but that designation cannot deprive Consumer of the protection of

> any rule of State A that is within the scope of this section and is both protective of consumers and not variable by agreement. State B's consumer protective rule is not relevant because, under Section 1-301(e)(2)(B), the relevant consumer protective rules are those of the jurisdiction in which the consumer both made the contract and took delivery of the goods – here, State A – rather than those of the jurisdiction in which the consumer principally resides.

It is important to note that subsection (e)(2) applies to all determinations of applicable law in transactions in which one party is a consumer, whether that determination is made under subsection (c) (in cases in which the parties have designated the governing law in their agreement) or subsection (d) (in cases in which the parties have not made such a designation). In the latter situation, application of the otherwise-applicable conflict of laws principles of the forum might lead to application of the laws of a State or country other than that of the consumer's principal residence. In such a case, however, subsection (e)(2) applies to preserve the applicability of consumer protection rules for the benefit of the consumer as described above.

4. *Wholly domestic transactions.* While this Section provides parties broad autonomy to select governing law, that autonomy is limited in the case of wholly domestic transactions. In a "domestic transaction," subsection (c)(1) validates only the designation of the law of a State. A "domestic transaction" is a transaction that does not bear a reasonable relation to a country other than the United States. (See subsection (a)). Thus, in a wholly domestic non-consumer transaction, parties may (subject to the limitations set out in subsections (f) and (g)) designate the law of any State but not the law of a foreign country.

5. *International transactions.* This section provides greater autonomy in the context of international transactions. As defined in subsection (a)(2), a transaction is an "international transaction" if it bears a reasonable relation to a country other than the United States. In a non-consumer international transaction, subsection (c)(2) provides that a designation of the law of any State or country is effective (subject, of course, to the limitations set out in subsections (f) and (g)). It is important to note that the transaction need not bear a relation to the State or country designated if the transaction is international. Thus, for example, in a non-consumer lease of goods in which the lessor is located in Mexico and the lessee is located in Louisiana, a designation of the law of Ireland to govern the transaction would be given effect under this section even though the transaction bears no relation to Ireland. The ability to designate the law of any country in non-consumer international transactions is important in light of the common practice in many

commercial contexts of designating the law of a "neutral" jurisdiction or of a jurisdiction whose law is well-developed. If a country has two or more territorial units in which different systems of law relating to matters within the scope of this section are applicable (as is the case, for example, in Canada and the United Kingdom), subsection (c)(2) should be applied to designation by the parties of the law of one of those territorial units. Thus, for example, subsection (c)(2) should be applied if the parties to a non-consumer international transaction designate the laws of Ontario or Scotland as governing their transaction.

6. *Fundamental policy.* Subsection (f) provides that an agreement designating the governing law will not be given effect to the extent that application of the designated law would be contrary to a fundamental policy of the State or country whose law would otherwise govern. This rule provides a narrow exception to the broad autonomy afforded to parties in subsection (c). One of the prime objectives of contract law is to protect the justified expectations of the parties and to make it possible for them to foretell with accuracy what will be their rights and liabilities under the contract. In this way, certainty and predictability of result are most likely to be secured. See Restatement (Second) Conflict of Laws, Section 187, comment *e*.

Under the fundamental policy doctrine, a court should not refrain from applying the designated law merely because application of that law would lead to a result different than would be obtained under the local law of the State or country whose law would otherwise govern. Rather, the difference must be contrary to a public policy of that jurisdiction that is so substantial that it justifies overriding the concerns for certainty and predictability underlying modern commercial law as well as concerns for judicial economy generally. Thus, application of the designated law will rarely be found to be contrary to a fundamental policy of the State or country whose law would otherwise govern when the difference between the two concerns a requirement, such as a statute of frauds, that relates to formalities, or general rules of contract law, such as those concerned with the need for consideration.

The opinion of Judge Cardozo in *Loucks v. Standard Oil Co. of New York*, 120 N.E. 198 (1918), regarding the related issue of when a state court may decline to apply the law of another state, is a helpful touchstone here:

> Our own scheme of legislation may be different. We may even have no legislation on the subject. That is not enough to show that public policy forbids us to enforce the foreign right. A right of action is property. If a foreign statute gives the right, the mere fact that we do not give a like right is no reason for refusing to help the plaintiff in getting what belongs to him. We are

> not so provincial as to say that every solution of a problem is wrong because we deal with it otherwise at home. Similarity of legislation has indeed this importance; its presence shows beyond question that the foreign statute does not offend the local policy. But its absence does not prove the contrary. It is not to be exalted into an indispensable condition. The misleading word 'comity' has been responsible for much of the trouble. It has been fertile in suggesting a discretion unregulated by general principles.
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> * * *
>
> The courts are not free to refuse to enforce a foreign right at the pleasure of the judges, to suit the individual notion of expediency or fairness. They do not close their doors, unless help would violate some fundamental principle of justice, some prevalent conception of good morals, some deep-rooted tradition of the common weal.

120 N.E. at 201-02 (citations to authorities omitted).

Application of the designated law may be contrary to a fundamental policy of the State or country whose law would otherwise govern either (i) because the substance of the designated law violates a fundamental principle of justice of that State or country or (ii) because it differs from a rule of that State or country that is "mandatory" in that it *must* be applied in the courts of that State or country without regard to otherwise-applicable choice of law rules of that State or country and without regard to whether the designated law is otherwise offensive. The mandatory rules concept appears in international conventions in this field, *e.g.*, EC Convention on the Law Applicable to Contractual Obligations, although in some cases the concept is applied to authorize the *forum* state to apply *its* mandatory rules, rather than those of the State or country whose law would otherwise govern. The latter situation is not addressed by this section. (See Comment 9.)

It is obvious that a rule that is freely changeable by agreement of the parties under the law of the State or country whose law would otherwise govern cannot be construed as a mandatory rule of that State or country. This does not mean, however, that rules that cannot be changed by agreement under that law are, for that reason alone, mandatory rules. Otherwise, contractual choice of law in the context of the Uniform Commercial Code would be illusory and redundant; the parties

would be able to accomplish by choice of law no more than can be accomplished under Section 1-302, which allows variation of otherwise applicable rules by agreement. (Under Section 1-302, the parties could agree to vary the rules that would otherwise govern their transaction by substituting for those rules the rules that would apply if the transaction were governed by the law of the designated State or country without designation of governing law.) Indeed, other than cases in which a mandatory choice of law rule is established by statute (see, *e.g.*, Sections 9-301 through 9-307, explicitly preserved in subsection (g)), cases in which courts have declined to follow the designated law solely because a rule of the State or country whose law would otherwise govern is mandatory are rare.

7. *Choice of law in the absence of contractual designation.* Subsection (d), which replaces the second sentence of former Section 1_105(1), determines which jurisdiction's law governs a transaction in the absence of an effective contractual choice by the parties. Former Section 1_105(1) provided that the law of the forum (*i.e.*, the Uniform Commercial Code) applied if the transaction bore "an appropriate relation to this state." By using an "appropriate relation" test, rather than, for example, a "most significant relationship" test, Section 1-105(1) expressed a bias in favor of applying the forum's law. This bias, while not universally respected by the courts, was justifiable in light of the uncertainty that existed at the time of drafting as to whether the Uniform Commercial Code would be adopted by all the states; the pro_forum bias would assure that the Uniform Commercial Code would be applied so long as the transaction bore an "appropriate" relation to the forum. Inasmuch as the Uniform Commercial Code has been adopted, at least in part, in all U.S. jurisdictions, the vitality of this point is minimal in the domestic context, and international comity concerns militate against continuing the pro_forum, pro_UCC bias in transnational transactions. Whether the choice is between the law of two jurisdictions that have adopted the Uniform Commercial Code, but whose law differs (because of differences in enacted language or differing judicial interpretations), or between the Uniform Commercial Code and the law of another country, there is no strong justification for directing a court to apply different choice of law principles to that determination than it would apply if the matter were not governed by the Uniform Commercial Code. Similarly, given the variety of choice of law principles applied by the states, it would not be prudent to designate only one such principle as the proper one for transactions governed by the Uniform Commercial Code. Accordingly, in cases in which the parties have not made an effective choice of law, Section 1_301(d) simply directs the forum to apply its ordinary choice of law principles to determine which jurisdiction's law governs, subject to the special rules of Section 1-301(e)(2) with regard to consumer transactions.

8. *Primacy of other Uniform Commercial Code choice of law rules.* Subsection (g), which is essentially identical to former Section 1-105(2), indicates that choice of law rules provided in the other Articles govern when applicable.

9. *Matters not addressed by this section.* As noted in Comment 1, this section is not a complete statement of conflict of laws doctrines applicable in commercial cases. Among the issues this section does not address, and leaves to other law, three in particular deserve mention. First, a forum will occasionally decline to apply the law of a different jurisdiction selected by the parties when application of that law would be contrary to a fundamental policy of the forum jurisdiction, even if it would not be contrary to a fundamental policy of the State or country whose law would govern in the absence of contractual designation. Standards for application of this doctrine relate primarily to concepts of sovereignty rather than commercial law and are thus left to the courts. Second, in determining whether to give effect to the parties' agreement that the law of a particular State or country will govern their relationship, courts must, of necessity, address some issues as to the basic validity of that agreement. These issues might relate, for example, to capacity to contract and absence of duress. This section does not address these issues. Third, this section leaves to other choice of law principles of the forum the issues of whether, and to what extent, the forum will apply the same law to the non-UCC aspects of a transaction that it applies to the aspects of the transaction governed by the Uniform Commercial Code.

SECTION 1_302. VARIATION BY AGREEMENT.

(a) Except as otherwise provided in subsection (b) or elsewhere in [the Uniform Commercial Code], the effect of provisions of [the Uniform Commercial Code] may be varied by agreement.

(b) The obligations of good faith, diligence, reasonableness, and care prescribed by [the Uniform Commercial Code] may not be disclaimed by agreement. The parties, by agreement, may determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable. Whenever [the Uniform Commercial Code] requires an action to be taken within a reasonable time, a time that is not manifestly unreasonable may be fixed by agreement.

(c) The presence in certain provisions of [the Uniform Commercial Code] of the phrase "unless otherwise agreed", or words of similar import, does not imply that the effect of other provisions may not be varied by agreement under this section.

Official Comments

Source: Former Sections 1_102(3)_(4) and 1_204(1).

Changes: This section combines the rules from subsections (3) and (4) of former Section 1_102 and subsection (1) of former Section 1_204. No substantive changes are made.

1. Subsection (a) states affirmatively at the outset that freedom of contract is a principle of the Uniform Commercial Code: "the effect" of its provisions may be varied by "agreement." The meaning of the statute itself must be found in its text, including its definitions, and in appropriate extrinsic aids; it cannot be varied by agreement. But the Uniform Commercial Code seeks to avoid the type of interference with evolutionary growth found in pre-Code cases such as *Manhattan Co. v. Morgan*, 242 N.Y. 38, 150 N.E. 594 (1926). Thus, private parties cannot make an instrument negotiable within the meaning of Article 3 except as provided in Section 3_104; nor can they change the meaning of such terms as "bona fide purchaser," "holder in due course," or "due negotiation," as used in the Uniform Commercial Code. But an agreement can change the legal consequences that would otherwise flow from the provisions of the Uniform Commercial Code. "Agreement" here includes the effect given to course of dealing, usage of trade and course of performance by Sections 1_201 and 1_303; the effect of an agreement on the rights of third parties is left to specific provisions of the Uniform Commercial Code and to supplementary principles applicable under Section 1_103. The rights of third parties under Section 9_317 when a security interest is unperfected, for example, cannot be destroyed by a clause in the security agreement.

This principle of freedom of contract is subject to specific exceptions found elsewhere in the Uniform Commercial Code and to the general exception stated here. The specific exceptions vary in explicitness: the statute of frauds found in Section 2_201, for example, does not explicitly preclude oral waiver of the requirement of a writing, but a fair reading denies enforcement to such a waiver as part of the "contract" made unenforceable; Section 9_602, on the other hand, is a quite explicit limitation on freedom of contract. Under the exception for "the obligations of good faith, diligence, reasonableness and care prescribed by [the Uniform Commercial Code]," provisions of the Uniform Commercial Code prescribing such obligations are not to be disclaimed. However, the section also

recognizes the prevailing practice of having agreements set forth standards by which due diligence is measured and explicitly provides that, in the absence of a showing that the standards manifestly are unreasonable, the agreement controls. In this connection, Section 1_303 incorporating into the agreement prior course of dealing and usages of trade is of particular importance.

Subsection (b) also recognizes that nothing is stronger evidence of a reasonable time than the fixing of such time by a fair agreement between the parties. However, provision is made for disregarding a clause which whether by inadvertence or overreaching fixes a time so unreasonable that it amounts to eliminating all remedy under the contract. The parties are not required to fix the most reasonable time but may fix any time which is not obviously unfair as judged by the time of contracting.

2. An agreement that varies the effect of provisions of the Uniform Commercial Code may do so by stating the rules that will govern in lieu of the provisions varied. Alternatively, the parties may vary the effect of such provisions by stating that their relationship will be governed by recognized bodies of rules or principles applicable to commercial transactions. Such bodies of rules or principles may include, for example, those that are promulgated by intergovernmental authorities such as UNCITRAL or Unidroit (*see, e.g.*, Unidroit Principles of International Commercial Contracts), or non_legal codes such as trade codes.

3. Subsection (c) is intended to make it clear that, as a matter of drafting, phrases such as "unless otherwise agreed" have been used to avoid controversy as to whether the subject matter of a particular section does or does not fall within the exceptions to subsection (b), but absence of such words contains no negative implication since under subsection (b) the general and residual rule is that the effect of all provisions of the Uniform Commercial Code may be varied by agreement.

SECTION 1_303. COURSE OF PERFORMANCE, COURSE OF DEALING, AND USAGE OF TRADE.

(a) A "course of performance" is a sequence of conduct between the parties to a particular transaction that exists if:

(1) the agreement of the parties with respect to the transaction involves repeated occasions for performance by a party; and

(2) the other party, with knowledge of the nature of the performance and opportunity for objection to it, accepts the performance or acquiesces in it without objection.

(b) A "course of dealing" is a sequence of conduct concerning previous transactions between the parties to a particular transaction that is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct.

(c) A "usage of trade" is any practice or method of dealing having such regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such a usage must be proved as facts. If it is established that such a usage is embodied in a trade code or similar record, the interpretation of the record is a question of law.

(d) A course of performance or course of dealing between the parties or usage of trade in the vocation or trade in which they are engaged or of which they are or should be aware is relevant in ascertaining the meaning of the parties' agreement, may give particular meaning to specific terms of the agreement, and may supplement or qualify the terms of the agreement. A usage of trade applicable in the place in which part of the performance under the agreement is to occur may be so utilized as to that part of the performance.

(e) Except as otherwise provided in subsection (f), the express terms of an agreement and any applicable course of performance, course of dealing, or usage of

trade must be construed whenever reasonable as consistent with each other. If such a construction is unreasonable:

(1) express terms prevail over course of performance, course of dealing, and usage of trade;

(2) course of performance prevails over course of dealing and usage of trade; and

(3) course of dealing prevails over usage of trade.

(f) Subject to Section 2_209, a course of performance is relevant to show a waiver or modification of any term inconsistent with the course of performance.

(g) Evidence of a relevant usage of trade offered by one party is not admissible unless that party has given the other party notice that the court finds sufficient to prevent unfair surprise to the other party.

Official Comments

Source: Former Sections 1_205, 2_208, and Section 2A_207.

Changes from former law: This section integrates the "course of performance" concept from Articles 2 and 2A into the principles of former Section 1_205, which deals with course of dealing and usage of trade. In so doing, the section slightly modifies the articulation of the course of performance rules to fit more comfortably with the approach and structure of former Section 1_205. There are also slight modifications to be more consistent with the definition of "agreement" in former Section 1_201(3). It should be noted that a course of performance that might otherwise establish a defense to the obligation of a party to a negotiable instrument is not available as a defense against a holder in due course who took the instrument without notice of that course of performance.

1. The Uniform Commercial Code rejects both the "lay_dictionary" and the "conveyancer's" reading of a commercial agreement. Instead the meaning of the agreement of the parties is to be determined by the language used by them and by their action, read and interpreted in the light of commercial practices and other surrounding circumstances. The measure and background for interpretation are set

by the commercial context, which may explain and supplement even the language of a formal or final writing.

2. "Course of dealing," as defined in subsection (b), is restricted, literally, to a sequence of conduct between the parties previous to the agreement. A sequence of conduct after or under the agreement, however, is a "course of performance." "Course of dealing" may enter the agreement either by explicit provisions of the agreement or by tacit recognition.

3. The Uniform Commercial Code deals with "usage of trade" as a factor in reaching the commercial meaning of the agreement that the parties have made. The language used is to be interpreted as meaning what it may fairly be expected to mean to parties involved in the particular commercial transaction in a given locality or in a given vocation or trade. By adopting in this context the term "usage of trade," the Uniform Commercial Code expresses its intent to reject those cases which see evidence of "custom" as representing an effort to displace or negate "established rules of law." A distinction is to be drawn between mandatory rules of law such as the Statute of Frauds provisions of Article 2 on Sales whose very office is to control and restrict the actions of the parties, and which cannot be abrogated by agreement, or by a usage of trade, and those rules of law (such as those in Part 3 of Article 2 on Sales) which fill in points which the parties have not considered and in fact agreed upon. The latter rules hold "unless otherwise agreed" but yield to the contrary agreement of the parties. Part of the agreement of the parties to which such rules yield is to be sought for in the usages of trade which furnish the background and give particular meaning to the language used, and are the framework of common understanding controlling any general rules of law which hold only when there is no such understanding.

4. A usage of trade under subsection (c) must have the "regularity of observance" specified. The ancient English tests for "custom" are abandoned in this connection. Therefore, it is not required that a usage of trade be "ancient or immemorial," "universal," or the like. Under the requirement of subsection (c) full recognition is thus available for new usages and for usages currently observed by the great majority of decent dealers, even though dissidents ready to cut corners do not agree. There is room also for proper recognition of usage agreed upon by merchants in trade codes.

5. The policies of the Uniform Commercial Code controlling explicit unconscionable contracts and clauses (Sections 1_304, 2_302) apply to implicit clauses that rest on usage of trade and carry forward the policy underlying the ancient requirement that a custom or usage must be "reasonable." However, the emphasis is shifted. The very fact of commercial acceptance makes out a *prima facie* case that the usage is reasonable, and the burden is no longer on the usage to establish itself as being reasonable. But the anciently established policing of usage

by the courts is continued to the extent necessary to cope with the situation arising if an unconscionable or dishonest practice should become standard.

6. Subsection (d), giving the prescribed effect to usages of which the parties "are or should be aware," reinforces the provision of subsection (c) requiring not universality but only the described "regularity of observance" of the practice or method. This subsection also reinforces the point of subsection (c) that such usages may be either general to trade or particular to a special branch of trade.

7. Although the definition of "agreement" in Section 1_201 includes the elements of course of performance, course of dealing, and usage of trade, the fact that express reference is made in some sections to those elements is not to be construed as carrying a contrary intent or implication elsewhere. Compare Section 1_302(c).

8. In cases of a well established line of usage varying from the general rules of the Uniform Commercial Code where the precise amount of the variation has not been worked out into a single standard, the party relying on the usage is entitled, in any event, to the minimum variation demonstrated. The whole is not to be disregarded because no particular line of detail has been established. In case a dominant pattern has been fairly evidenced, the party relying on the usage is entitled under this section to go to the trier of fact on the question of whether such dominant pattern has been incorporated into the agreement.

9. Subsection (g) is intended to insure that this Act's liberal recognition of the needs of commerce in regard to usage of trade shall not be made into an instrument of abuse.

SECTION 1_304. OBLIGATION OF GOOD FAITH. Every contract or duty within [the Uniform Commercial Code] imposes an obligation of good faith in its performance and enforcement.

Official Comments

Source: Former Section 1_203.

Changes from former law: Except for changing the form of reference to the Uniform Commercial Code, this section is identical to former Section 1_203.

1. This section sets forth a basic principle running throughout the Uniform Commercial Code. The principle is that in commercial transactions good faith is

required in the performance and enforcement of all agreements or duties. While this duty is explicitly stated in some provisions of the Uniform Commercial Code, the applicability of the duty is broader than merely these situations and applies generally, as stated in this section, to the performance or enforcement of every contract or duty within this Act. It is further implemented by Section 1_303 on course of dealing, course of performance, and usage of trade. This section does not support an independent cause of action for failure to perform or enforce in good faith. Rather, this section means that a failure to perform or enforce, in good faith, a specific duty or obligation under the contract, constitutes a breach of that contract or makes unavailable, under the particular circumstances, a remedial right or power. This distinction makes it clear that the doctrine of good faith merely directs a court towards interpreting contracts within the commercial context in which they are created, performed, and enforced, and does not create a separate duty of fairness and reasonableness which can be independently breached.

2. "Performance and enforcement" of contracts and duties within the Uniform Commercial Code include the exercise of rights created by the Uniform Commercial Code.

SECTION 1_305. REMEDIES TO BE LIBERALLY ADMINISTERED.

(a) The remedies provided by [the Uniform Commercial Code] must be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special damages nor penal damages may be had except as specifically provided in [the Uniform Commercial Code] or by other rule of law.

(b) Any right or obligation declared by [the Uniform Commercial Code] is enforceable by action unless the provision declaring it specifies a different and limited effect.

Official Comments

Source: Former Section 1_106.

Changes from former law: Other than changes in the form of reference to the Uniform Commercial Code, this section is identical to former Section 1_106.

1. Subsection (a) is intended to effect three propositions. The first is to negate the possibility of unduly narrow or technical interpretation of remedial provisions by providing that the remedies in the Uniform Commercial Code are to be liberally administered to the end stated in this section. The second is to make it clear that compensatory damages are limited to compensation. They do not include consequential or special damages, or penal damages; and the Uniform Commercial Code elsewhere makes it clear that damages must be minimized. Cf. Sections 1_304, 2_706(1), and 2_712(2). The third purpose of subsection (a) is to reject any doctrine that damages must be calculable with mathematical accuracy. Compensatory damages are often at best approximate: they have to be proved with whatever definiteness and accuracy the facts permit, but no more. Cf. Section 2_204(3).

2. Under subsection (b), any right or obligation described in the Uniform Commercial Code is enforceable by action, even though no remedy may be expressly provided, unless a particular provision specifies a different and limited effect. Whether specific performance or other equitable relief is available is determined not by this section but by specific provisions and by supplementary principles. Cf. Sections 1_103, 2_716.

3. "Consequential" or "special" damages and "penal" damages are not defined in the Uniform Commercial Code; rather, these terms are used in the sense in which they are used outside the Uniform Commercial Code.

SECTION 1_306. WAIVER OR RENUNCIATION OF CLAIM OR RIGHT AFTER BREACH.

A claim or right arising out of an alleged breach may be discharged in whole or in part without consideration by agreement of the aggrieved party in an authenticated record.

Official Comments

Source: Former Section 1_107.

Changes from former law: This section changes former law in two respects. First, former Section 1_107, requiring the "delivery" of a "written waiver or renunciation" merges the separate concepts of the aggrieved party's agreement to forego rights and the manifestation of that agreement. This section separates those concepts, and explicitly requires *agreement* of the aggrieved party. Second, the revised section reflects developments in electronic commerce by providing for

memorialization in an authenticated record. In this context, a party may "authenticate" a record by (i) signing a record that is a writing or (ii) attaching to or logically associating with a record that is not a writing an electronic sound, symbol or process with the present intent to adopt or accept the record. See Sections 1-201(b)(37) and 9-102(a)(7).

1. This section makes consideration unnecessary to the effective renunciation or waiver of rights or claims arising out of an alleged breach of a commercial contract where the agreement effecting such renunciation is memorialized in a record authenticated by the aggrieved party. Its provisions, however, must be read in conjunction with the section imposing an obligation of good faith. (Section 1_304).

SECTION 1_307. PRIMA FACIE EVIDENCE BY THIRD-PARTY DOCUMENTS.

A document in due form purporting to be a bill of lading, policy or certificate of insurance, official weigher's or inspector's certificate, consular invoice, or any other document authorized or required by the contract to be issued by a third party is prima facie evidence of its own authenticity and genuineness and of the facts stated in the document by the third party.

Official Comments

Source: Former Section 1_202.

Changes from former law: Except for minor stylistic changes, this Section is identical to former Section 1-202.

1. This section supplies judicial recognition for documents that are relied upon as trustworthy by commercial parties.

2. This section is concerned only with documents that have been given a preferred status by the parties themselves who have required their procurement in the agreement, and for this reason the applicability of the section is limited to actions arising out of the contract that authorized or required the document. The list of documents is intended to be illustrative and not exclusive.

3. The provisions of this section go no further than establishing the documents in question as prima facie evidence and leave to the court the ultimate

determination of the facts where the accuracy or authenticity of the documents is questioned. In this connection the section calls for a commercially reasonable interpretation.

4. Documents governed by this section need not be writings if records in another medium are generally relied upon in the context.

SECTION 1_308. PERFORMANCE OR ACCEPTANCE UNDER RESERVATION OF RIGHTS.

(a) A party that with explicit reservation of rights performs or promises performance or assents to performance in a manner demanded or offered by the other party does not thereby prejudice the rights reserved. Such words as "without prejudice," "under protest," or the like are sufficient.

(b) Subsection (a) does not apply to an accord and satisfaction.

Official Comments

Source: Former Section 1_207.

Changes from former law: This section is identical to former Section 1_207.

1. This section provides machinery for the continuation of performance along the lines contemplated by the contract despite a pending dispute, by adopting the mercantile device of going ahead with delivery, acceptance, or payment "without prejudice," "under protest," "under reserve," "with reservation of all our rights," and the like. All of these phrases completely reserve all rights within the meaning of this section. The section therefore contemplates that limited as well as general reservations and acceptance by a party may be made "subject to satisfaction of our purchaser," "subject to acceptance by our customers," or the like.

2. This section does not add any new requirement of language of reservation where not already required by law, but merely provides a specific measure on which a party can rely as that party makes or concurs in any interim adjustment in the course of performance. It does not affect or impair the provisions of this Act such as those under which the buyer's remedies for defect survive acceptance without being expressly claimed if notice of the defects is given within a reasonable time. Nor does it disturb the policy of those cases which restrict the effect of a

waiver of a defect to reasonable limits under the circumstances, even though no such reservation is expressed.

The section is not addressed to the creation or loss of remedies in the ordinary course of performance but rather to a method of procedure where one party is claiming as of right something which the other believes to be unwarranted.

3. Subsection (b) states that this section does not apply to an accord and satisfaction. Section 3_311 governs if an accord and satisfaction is attempted by tender of a negotiable instrument as stated in that section. If Section 3_311 does not apply, the issue of whether an accord and satisfaction has been effected is determined by the law of contract. Whether or not Section 3_311 applies, this section has no application to an accord and satisfaction.

SECTION 1_309. OPTION TO ACCELERATE AT WILL. A term providing that one party or that party's successor in interest may accelerate payment or performance or require collateral or additional collateral "at will" or when the party "deems itself insecure," or words of similar import, means that the party has power to do so only if that party in good faith believes that the prospect of payment or performance is impaired. The burden of establishing lack of good faith is on the party against which the power has been exercised.

Official Comments

Source: Former Section 1_208.

Changes from former law: Except for minor stylistic changes, this section is identical to former Section 1_208.

1. The common use of acceleration clauses in many transactions governed by the Uniform Commercial Code, including sales of goods on credit, notes payable at a definite time, and secured transactions, raises an issue as to the effect to be given to a clause that seemingly grants the power to accelerate at the whim and caprice of one party. This section is intended to make clear that despite language that might be so construed and which further might be held to make the agreement void as against public policy or to make the contract illusory or too indefinite for enforcement, the option is to be exercised only in the good faith belief that the prospect of payment or performance is impaired.

Obviously this section has no application to demand instruments or obligations whose very nature permits call at any time with or without reason. This section applies only to an obligation of payment or performance which in the first instance is due at a future date.

SECTION 1_310. SUBORDINATED OBLIGATIONS. An obligation may be issued as subordinated to performance of another obligation of the person obligated, or a creditor may subordinate its right to performance of an obligation by agreement with either the person obligated or another creditor of the person obligated. Subordination does not create a security interest as against either the common debtor or a subordinated creditor.

Official Comments

Source: Former Section 1_209.

Changes from former law: This section is substantively identical to former Section 1_209. The language in that section stating that it "shall be construed as declaring the law as it existed prior to the enactment of this section and not as modifying it" has been deleted.

1. Billions of dollars of subordinated debt are held by the public and by institutional investors. Commonly, the subordinated debt is subordinated on issue or acquisition and is evidenced by an investment security or by a negotiable or non_negotiable note. Debt is also sometimes subordinated after it arises, either by agreement between the subordinating creditor and the debtor, by agreement between two creditors of the same debtor, or by agreement of all three parties. The subordinated creditor may be a stockholder or other "insider" interested in the common debtor; the subordinated debt may consist of accounts or other rights to payment not evidenced by any instrument. All such cases are included in the terms "subordinated obligation," "subordination," and "subordinated creditor."

2. Subordination agreements are enforceable between the parties as contracts; and in the bankruptcy of the common debtor dividends otherwise payable to the subordinated creditor are turned over to the superior creditor. This "turn_over" practice has on occasion been explained in terms of "equitable lien," "equitable assignment," or "constructive trust," but whatever the label the practice

is essentially an equitable remedy and does not mean that there is a transaction "that creates a security interest in personal property . . . by contract" or a "sale of accounts, chattel paper, payment intangibles, or promissory notes" within the meaning of Section 9_109. On the other hand, nothing in this section prevents one creditor from assigning his rights to another creditor of the same debtor in such a way as to create a security interest within Article 9, where the parties so intend.

3. The enforcement of subordination agreements is largely left to supplementary principles under Section 1_103. If the subordinated debt is evidenced by a certificated security, Section 8_202(a) authorizes enforcement against purchasers on terms stated or referred to on the security certificate. If the fact of subordination is noted on a negotiable instrument, a holder under Sections 3_302 and 3_306 is subject to the term because notice precludes him from taking free of the subordination. Sections 3_302(3)(a), 3_306, and 8_317 severely limit the rights of levying creditors of a subordinated creditor in such cases.

APPENDIX I

CONFORMING AMENDMENTS TO OTHER ARTICLES

Section	
2-103	Definitions and Index of Definitions
2-202	Final Written Expression: Parol or Extrinsic Evidence
2-208	Course of Performance or Practical Construction
2A-103	Definitions and Index of Definitions
2A-207	Course of Performance or Practical Construction
2A-501	Default: Procedure
2A-518	Cover; Substitute Goods
2A-519	Lessee's Damages for Non-delivery, Repudiation, Default and Breach of Warranty in Regard to Accepted Goods
2A-527	Lessor's Rights to Dispose of Goods
2A-528	Lessor's Damages for Non-acceptance, Failure to Pay, Repudiation, or Other Default
3-103	Definitions
4-104	Definitions and Index of Definitions
4A-105	Other Definitions
4A-106	Time Payment Order is Received
5-103	Scope
8-102	Definitions
9-102	Definitions and Index of Definitions

Section 2–103. DEFINITIONS AND INDEX OF DEFINITIONS.

(1) In this Article unless the context otherwise requires

(a) "Buyer" means a person who buys or contracts to buy goods.

(b) [Reserved.] ~~"Good faith" in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.~~

(c) "Receipt" of goods means taking physical possession of them.

(d) "Seller" means a person who sells or contracts to sell goods.

* * *

Section 2–202. FINAL WRITTEN EXPRESSION: PAROL OR EXTRINSIC EVIDENCE. Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented

(a) by course of performance, course of dealing, or usage of trade (Section ~~1–205~~ 1-303) ~~or by course of performance (Section 2–208)~~; and

(b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

Official Comment

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Cross References:

Point 3: Sections ~~1–205~~ 1-303, 2–207, 2–302 and 2–316.

Definitional Cross References:

"Agreed" and "agreement". Section 1–201.
"Course of dealing". Section ~~1–205~~ 1-303.
"Course of performance". Section 1-303.
"Party~~ies~~". Section 1–201.
"Term". Section 1–201.
"Usage of trade". Section ~~1–205~~ 1-303.
"Written" and "writing". Section 1–201.

~~**Section 2–208. COURSE OF PERFORMANCE OR PRACTICAL CONSTRUCTION.**~~

~~(1) Where the contract for sale involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement.~~

~~(2) The express terms of the agreement and any such course of performance, as well as any course of dealing and usage of trade, shall be construed whenever reasonable as consistent with each other; but when such construction is unreasonable, express terms shall control course of performance and course of performance shall control both course of dealing and usage of trade (Section 1–205).~~

~~(3) Subject to the provisions of the next section on modification and waiver, such course of performance shall be relevant to show a waiver or modification of any term inconsistent with such course of performance.~~

~~Official Comment~~

~~Prior Uniform Statutory Provision:~~ ~~No such general provision but concept of this section recognized by terms such as "course of dealing", "the circumstances of the case," "the conduct of the parties," etc., in Uniform Sales Act.~~

~~Purposes:~~

~~1. The parties themselves know best what they have meant by their words of agreement and their action under that agreement is the best indication of what that meaning was. This section thus rounds out the set of factors which determines the meaning of the "agreement" and therefore also of the "unless otherwise agreed" qualification to various provisions of this Article.~~

~~2. Under this section a course of performance is always relevant to determine the meaning of the agreement. Express mention of course of performance elsewhere in this Article carries no contrary implication when there is a failure to refer to it in other sections.~~

~~3. Where it is difficult to determine whether a particular act merely sheds light on the meaning of the agreement or represents a waiver of a term of the agreement, the preference is in favor of "waiver" whenever such construction, plus the application of the provisions on the reinstatement of rights waived (see Section 2-209), is needed to preserve the flexible character of commercial contracts and to prevent surprise or other hardship.~~

~~4. A single occasion of conduct does not fall within the language of this section but other sections such as the ones on silence after acceptance and failure to specify particular defects can affect the parties' rights on a single occasion (see Sections 2-605 and 2-607).~~

~~Cross References:~~

~~Point 1: Section 1-201.~~
~~Point 2: Section 2-202.~~
~~Point 3: Sections 2-209, 2-601 and 2-607.~~
~~Point 4: Sections 2-605 and 2-607.~~

Section 2A–103. DEFINITIONS AND INDEX OF DEFINITIONS.

* * *

(3) The following definitions in other Articles apply to this Article:

"Account". Section 9–102(a)(2).

"Between merchants". Section 2–104(3).

"Buyer". Section 2–103(1)(a).

"Chattel paper". Section 9–102(a)(11).

"Consumer goods". Section 9–102(a)(23).

"Document". Section 9–102(a)(30).

"Entrusting". Section 2–403(3).

"General intangible". Section 9–102(a)(42).

~~"Good faith". Section 2–103(1)(b).~~

"Instrument". Section 9–102(a)(47).

"Merchant". Section 2–104(1).

"Mortgage". Section 9–102(a)(55).

"Pursuant to commitment". Section 9–102(a)(68).

"Receipt". Section 2–103(1)(c).

"Sale". Section 2–106(1).

"Sale on approval". Section 2–326.

"Sale or return". Section 2–326.
"Seller". Section 2–103(1)(d).

* * *

Official Comment

(a) "Buyer in ordinary course of business". Section 1–201(b)(9).

* * *

(h) "Goods". Section ~~9–105(1)(h)~~ 9-102(a)(44). See Section 2A–103(3) for reference to the definition of "Account", "Chattel paper", "Document", "General intangibles" and "Instrument". See Section 2A–217 for determination of the time and manner of identification.

* * *

(j) "Lease". New. There are several reasons to codify the law with respect to leases of goods. An analysis of the case law as it applies to leases of goods suggests at least several significant issues to be resolved by codification. First and foremost is the definition of a lease. It is necessary to define lease to determine whether a transaction creates a lease or a security interest disguised as a lease. If the transaction creates a security interest disguised as a lease, the transaction will be governed by the Article on Secured Transactions (Article 9) and the lessor will be required to file a financing statement or take other action to perfect its interest in the goods against third parties. There is no such requirement with respect to leases under the common law and, except with respect to leases of fixtures (Section 2A–309), this Article imposes no such requirement. Yet the distinction between a lease and a security interest disguised as a lease is not clear from the case law at the time of the promulgation of this Article. DeKoven, *Leases of Equipment: Puritan Leasing Company v. August, A Dangerous Decision*, 12 U.S.F. L.Rev. 257 (1978).

At common law a lease of personal property is a bailment for hire. While there are several definitions of bailment for hire, all require a thing to be let and a price for the letting. Thus, in modern terms and as provided in this definition, a lease is created when the lessee agrees to furnish consideration for the right to the possession and use of goods over a specified period of time. Mooney, *Personal Property Leasing: A Challenge*, 36 Bus.Law. 1605, 1607 (1981). Further, a lease is neither a sale (Section 2–106(1)) nor a retention or creation of a security interest (Sections 1–201~~(37)~~(b)(35) and 1-203). Due to extensive litigation to distinguish true leases from security interests, an amendment to former Section 1–201(37) (now codified as Section 1-203) was ~~has been~~ promulgated with this Article to create a sharper distinction.

This section as well as Section ~~1–201(37)~~ 1-203 must be examined to determine whether the transaction in question creates a lease or a security interest. The following hypotheticals indicate the perimeters of the issue. Assume that A has purchased a number of copying machines, new, for $1,000 each; the machines have an estimated useful economic life of three years. A advertises that the machines are available to rent for a minimum of one month and that the monthly rental is $100.00. A intends to enter into leases where A provides all maintenance,

without charge to the lessee. Further, the lessee will rent the machine, month to month, with no obligation to renew. At the end of the lease term the lessee will be obligated to return the machine to A's place of business. This transaction qualifies as a lease under the first half of the definition, for the transaction includes a transfer by A to a prospective lessee of possession and use of the machine for a stated term, month to month. The machines are goods (Section 2A–103(1)(h)). The lessee is obligated to pay consideration in return, $100.00 for each month of the term.

However, the second half of the definition provides that a sale or a security interest is not a lease. Since there is no passing of title, there is no sale. Sections 2A–103(3) and 2–106(1). Under pre_Act security law this transaction would have created a bailment for hire or a true lease and not a conditional sale. *Da Rocha v. Macomber*, 330 Mass. 611, 614–15, 116 N.E.2d 139, 142 (1953). Under Section ~~1–201(37)~~ 1-203, ~~as amended with the promulgation of this Article,~~ the same result would follow. While the lessee is obligated to pay rent for the one month term of the lease, one of the other four conditions of ~~the second paragraph of Section 1–201(37)~~ Section 1-203(b) must be met and none is. The term of the lease is one month and the economic life of the machine is 36 months; thus, ~~subparagraph (a) of Section 1–201(37)~~ Section 1-203(b)(1) is not now satisfied. Considering the amount of the monthly rent, absent economic duress or coercion, the lessee is not bound either to renew the lease for the remaining economic life of the goods or to become the owner. If the lessee did lease the machine for 36 months, the lessee would have paid the lessor $3,600 for a machine that could have been purchased for $1,000; thus, ~~subparagraph (b) of Section 1–201(37)~~ Section 1-203(b)(2) is not satisfied. Finally, there are no options; thus, subparagraphs (~~c~~3) and (~~d~~4) of Section ~~1–201(37)~~ 1-203(b) are not satisfied. This transaction creates a lease, not a security interest. However, with each renewal of the lease the facts and circumstances at the time of each renewal must be examined to determine if that conclusion remains accurate, as it is possible that a transaction that first creates a lease, later creates a security interest.

Assume that the facts are changed and that A requires each lessee to lease the goods for 36 months, with no right to terminate. Under pre_Act security law this transaction would have created a conditional sale, and not a bailment for hire or true lease. *Hervey v. Rhode Island Locomotive Works*, 93 U.S. 664, 672–73 (1876). Under this subsection, and Section 1-203 ~~1–201(37), as amended with the inclusion of this Article in the Act~~, the same result would follow. The lessee's obligation for the term is not subject to termination by the lessee and the term is equal to the economic life of the machine.

Between these extremes there are many transactions that can be created. Some of the transactions ~~have~~ were not ~~been~~ properly categorized by the courts in applying the 1978 and earlier Official Texts of former Section 1–201(37). This subsection, together with Section 1-203 ~~1–201(37), as amended with the~~

~~promulgation of this Article~~, draws a brighter line, which should create a clearer signal to the professional lessor and lessee.

(k) "Lease agreement". This definition is derived from ~~the first sentence of~~ Section 1–201(b)(3). Because the definition of lease is broad enough to cover future transfers, lease agreement includes an agreement contemplating a current or subsequent transfer. Thus it was not necessary to make an express reference to an agreement for the future lease of goods (Section 2–106(1)). This concept is also incorporated in the definition of lease contract. Note that the definition of lease does not include transactions in ordinary building materials that are incorporated into an improvement on land. Section 2A–309(2).

The provisions of this Article, if applicable, determine whether a lease agreement has legal consequences; otherwise the law of bailments and other applicable law determine the same. Sections 2A–103(4) and 1–103.

(l) "Lease contract". This definition is derived from the definition of contract in Section 1–201~~(11)~~(b)(12). Note that a lease contract may be for the future lease of goods, since this notion is included in the definition of lease.

* * *

(o) "Lessee in ordinary course of business". Section 1–201(b)(9).

* * *

~~(u) "Present value". New. Authorities agree that present value should be used to determine fairly the damages payable by the lessor or the lessee on default. *E.g.*, *Taylor v. Commercial Credit Equip. Corp.*, 170 Ga.App. 322, 316 S.E.2d 788 (1984). Present value is defined to mean an amount that represents the discounted value as of a date certain of one or more sums payable in the future. This is a function of the economic principle that a dollar today is more valuable to the holder than a dollar payable in two years. While there is no question as to the principle, reasonable people would differ as to the rate of discount to apply in determining the value of that future dollar today. To minimize litigation, this Article allows the parties to specify the discount or interest rate, if the rate was not manifestly unreasonable at the time the transaction was entered into. In all other cases, the interest rate will be a commercially reasonable rate that takes into account the facts and circumstances of each case, as of the time the transaction was entered into.~~

(v) "Purchase". Section 1–201~~(32)~~(b)(29). This definition omits the reference to lien contained in the definition of purchase in Article 1 (Section 1–201~~(32)~~(b)(29)). This should not be construed to exclude consensual liens from the definition of purchase in this Article; the exclusion was mandated by the scope of the definition of lien in Section 2A–103(1)(r). Further, the definition of purchaser

in this Article adds a reference to lease; as purchase is defined in Section 1–201~~(32)~~(b)(29) to include any other voluntary transaction creating an interest in property, this addition is not substantive.

* * *

~~**Section 2A–207. COURSE OF PERFORMANCE OR PRACTICAL CONSTRUCTION.**~~

~~(1) If a lease contract involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection is relevant to determine the meaning of the lease agreement.~~

~~(2) The express terms of a lease agreement and any course of performance, as well as any course of dealing and usage of trade, must be construed whenever reasonable as consistent with each other; but if that construction is unreasonable, express terms control course of performance, course of performance controls both course of dealing and usage of trade, and course of dealing controls usage of trade.~~

~~(3) Subject to the provisions of Section 2A–208 on modification and waiver, course of performance is relevant to show a waiver or modification of any term inconsistent with the course of performance.~~

~~**Official Comment**~~

~~**Uniform Statutory Source:** Sections 2–208 and 1–205(4).~~

~~**Changes:** Revised to reflect leasing practices and terminology, except that subsection (2) was further revised to make the subsection parallel the provisions of Section 1–205(4) by adding that course of dealing controls usage of trade.~~

~~**Purposes:** The section should be read in conjunction with Section 2A–208. In particular, although a specific term may control over course of performance as a~~

~~matter of lease construction under subsection (2), subsection (3) allows the same course of dealing to show a waiver or modification, if Section 2A–208 is satisfied.~~

~~**Cross References:**~~

~~Sections 1–205(4), 2–208 and 2A–208.~~

~~**Definitional Cross References:**~~

~~"Course of dealing". Section 1–205.~~

~~"Knowledge". Section 1–201(25).~~

~~"Lease agreement". Section 2A–103(1)(k).~~

~~"Lease contract". Section 2A–103(1)(*l*).~~

~~"Party". Section 1–201(29).~~

~~"Term". Section 1–201(42).~~

~~"Usage of trade". Section 1–205.~~

Section 2A–501. DEFAULT: PROCEDURE.

* * *

(4) Except as otherwise provided in Section ~~1–106(1)~~ 1-305(a) or this Article or the lease agreement, the rights and remedies referred to in subsections (2) and (3) are cumulative.

* * *

Official Comment

Uniform Statutory Source: Former Section 9–501 (now codified as Section 9-601).

* * *

2. Subsection (2) is a version of the first sentence of Section ~~9–501(1)~~ 9-601(a), revised to reflect leasing terminology.

3. Subsection (3), an expansive version of the second sentence of Section ~~9–501(1)~~ 9-601(a), lists the procedures that may be followed by the party seeking enforcement; in effect, the scope of the procedures listed in subsection (3) is consistent with the scope of the procedures available to the foreclosing secured party.

4. Subsection (4) establishes that the parties' rights and remedies are cumulative. DeKoven, *Leases of Equipment: Puritan Leasing Company v. August, A Dangerous Decision*, 12 U.S.F.L.Rev. 257, 276–80 (1978). Cumulation, and largely unrestricted selection, of remedies is allowed in furtherance of the general policy of the Commercial Code, stated in Section ~~1–106~~ 1-305, that remedies be liberally administered to put the aggrieved party in as good a position as if the other party had fully performed. Therefore, cumulation of, or selection among, remedies is available to the extent necessary to put the aggrieved party in as good a position as it would have been in had there been full performance. However, cumulation of, or selection among, remedies is not available to the extent that the cumulation or selection would put the aggrieved party in a better position than it would have been in had there been full performance by the other party.

5. Section ~~9–501(3)~~ 9-602, which, among other things, states that certain rules, to the extent they give rights to the debtor and impose duties on the secured party, may not be waived or varied, ~~was~~ is not incorporated in this Article. Given the significance of freedom of contract in the development of the common law as it applies to bailments for hire and the lessee's lack of an equity of redemption, there ~~was~~ is no reason to impose that restraint.

Cross References:

Sections ~~1–106~~ 1-305, 2A–508, 2A–523, Article 9, especially Sections ~~9–501(1)~~ 9-601 and ~~9–501(3)~~ 9-602.

Definitional Cross References:

* * *

"Party". Section 1–201~~(29)~~(b)(26).
"Remedy". Section 1–201~~(34)~~(b)(32).
"Right~~s~~". Section 1–201~~(36)~~(b)(34).

Section 2A–518. COVER; SUBSTITUTE GOODS.

* * *

(2) Except as otherwise provided with respect to damages liquidated in the lease agreement (Section 2A–504) or otherwise determined pursuant to agreement of the parties (Sections ~~1–102(3)~~ 1-302 and 2A–503), if a lessee's cover is by a lease agreement substantially similar to the original lease agreement and the new lease agreement is made in good faith and in a commercially reasonable manner, the lessee may recover from the lessor as damages (i) the present value, as of the date of the commencement of the term of the new lease agreement, of the rent under the new lease agreement applicable to that period of the new lease term which is comparable to the then remaining term of the original lease agreement minus the present value as of the same date of the total rent for the then remaining lease term of the original lease agreement, and (ii) any incidental or consequential damages, less expenses saved in consequence of the lessor's default.

* * *

Official Comment

* * *

1. Subsection (1) allows the lessee to take action to fix its damages after default by the lessor. Such action may consist of the lease of goods. The decision to cover is a function of commercial judgment, not a statutory mandate replete with sanctions for failure to comply. *Cf.* Section ~~9–507~~ 9-625.

Cross References:

Sections 2–712(1), 2A–519 and ~~9–507~~ 9-625.

Definitional Cross References:

"Agreement". Section 1–201(b)(3).
"Contract". Section 1–201~~(11)~~(b)(12).
"Good faith". Section~~s~~ 1-201(b)(20) ~~1–201(19) and 2–103(1)(b)~~.
"Goods". Section 2A–103(1)(h).
"Lease". Section 2A–103(1)(j).
"Lease agreement". Section 2A–103(1)(k).
"Lease contract". Section 2A–103(1)(*l*).
"Lessee". Section 2A–103(1)(n).
"Lessor". Section 2A–103(1)(p).
"Party". Section 1–201~~(29)~~(b)(26).
"Present value". Section ~~2A–103(1)(u)~~ 1-201(b)(28).
"Purchase". Section 2A–103(1)(v).

Section 2A–519. LESSEE'S DAMAGES FOR NON_DELIVERY, REPUDIATION, DEFAULT, AND BREACH OF WARRANTY IN REGARD TO ACCEPTED GOODS.

(1) Except as otherwise provided with respect to damages liquidated in the lease agreement (Section 2A–504) or otherwise determined pursuant to agreement of the parties (Sections ~~1–102(3)~~ 1-302 and 2A–503), if a lessee elects not to cover or a lessee elects to cover and the cover is by lease agreement that for any reason does not qualify for treatment under Section 2A–518(2), or is by purchase or otherwise, the measure of damages for non_delivery or repudiation by the lessor or for rejection or revocation of acceptance by the lessee is the present value, as of the date of the default, of the then market rent minus the present value as of the same date of the original rent, computed for the remaining lease term of the original lease agreement, together with incidental and consequential damages, less expenses saved in consequence of the lessor's default.

* * *

Official Comment

* * *

Definitional Cross References:

"Conforming". Section 2A–103(1)(d).
"Delivery". Section 1–201~~(14)~~(b)(15).
"Goods". Section 2A–103(1)(h).
"Lease". Section 2A–103(1)(j).
"Lease agreement". Section 2A–103(1)(k).
"Lessee". Section 2A–103(1)(n).
"Lessor". Section 2A–103(1)(p).
"Notification". Section ~~1–201(26)~~ 1-202.
"Present value". Section ~~2A–103(1)(u)~~ 1-201(b)(28).
"Value". Section ~~1–201(44)~~ 1-204.

Section 2A–527. LESSOR'S RIGHTS TO DISPOSE OF GOODS.

* * *

(2) Except as otherwise provided with respect to damages liquidated in the lease agreement (Section 2A–504) or otherwise determined pursuant to agreement of the parties (Sections ~~1–102(3)~~ 1-302 and 2A–503), if the disposition is by lease agreement substantially similar to the original lease agreement and the new lease agreement is made in good faith and in a commercially reasonable manner, the lessor may recover from the lessee as damages (i) accrued and unpaid rent as of the date of the commencement of the term of the new lease agreement, (ii) the present value, as of the same date, of the total rent for the then remaining lease term of the original lease agreement minus the present value, as of the same date, of the rent under the new lease agreement applicable to that period of the new lease term which is comparable to the then remaining term of the original lease agreement,

and (iii) any incidental damages allowed under Section 2A–530, less expenses saved in consequence of the lessee's default.

* * *

Official Comment

* * *

1. Subsection (1), a revised version of the first sentence of subsection 2–706(1), allows the lessor the right to dispose of goods after a statutory or other material default by the lessee (even if the goods remain in the lessee's possession—Section 2A–525(2)), after the lessor refuses to deliver or takes possession of the goods, or, if agreed, after other contractual default. The lessor's decision to exercise this right is a function of a commercial judgment, not a statutory mandate replete with sanctions for failure to comply. Cf. Section ~~9–507~~ 9-625. As the owner of the goods, in the case of a lessor, or as the prime lessee of the goods, in the case of a sublessor, compulsory disposition of the goods is inconsistent with the nature of the interest held by the lessor or the sublessor and is not necessary because the interest held by the lessee or the sublessee is not protected by a right of redemption under the common law or this Article. Subsection 2A–527(5).

2. The rule for determining the measure of damages recoverable by the lessor against the lessee is a function of several variables. If the lessor has elected to effect disposition under subsection (1) and such disposition is by lease that qualifies under subsection (2), the measure of damages set forth in subsection (2) will apply, absent agreement to the contrary. Sections 2A–504, 2A–103(4) and ~~1–102(3)~~ 1-302.

* * *

Cross References:

Sections ~~1–102(3)~~ 1-302, 2–706(1), 2–706(5), 2–706(6), 2A–103(4), 2A–304(1), 2A–504, 2A–507(2), 2A–523(1)(e), 2A–525(2), 2A–527(5), 2A–528 and ~~9–507~~ 9-625.

Definitional Cross References:

"Buyer" and "Buying". Section 2–103(1)(a).
"Delivery". Section 1–201~~(14)~~(b)(15).
"Good faith". Section~~s~~ 1-201(b)(20)~~1–201(19) and 2–103(1)(b)~~.

"Goods". Section 2A–103(1)(h).
"Lease". Section 2A–103(1)(j).
"Lease contract". Section 2A–103(1)(*l*).
"Lessee". Section 2A–103(1)(n).
"Lessor". Section 2A–103(1)(p).
"Present value". Section ~~2A–103(1)(u)~~ 1-201(b)(28).
"Right~~s~~". Section 1–201~~(36)~~(b)(34).
"Sale". Section 2–106(1).
"Security interest". Section~~s~~ 1–201~~(37)~~(b)(35) and 1-203.
"Value". Section ~~1–201(44)~~ 1-204.

Section 2A–528. LESSOR'S DAMAGES FOR NON_ACCEPTANCE, FAILURE TO PAY, REPUDIATION, OR OTHER DEFAULT.

(1) Except as otherwise provided with respect to damages liquidated in the lease agreement (Section 2A–504) or otherwise determined pursuant to agreement of the parties (Sections ~~1–102(3)~~ 1-302 and 2A–503), if a lessor elects to retain the goods or a lessor elects to dispose of the goods and the disposition is by lease agreement that for any reason does not qualify for treatment under Section 2A–527(2), or is by sale or otherwise, the lessor may recover from the lessee as damages for a default of the type described in Section 2A–523(1) or 2A–523(3)(a), or, if agreed, for other default of the lessee, (i) accrued and unpaid rent as of the date of default if the lessee has never taken possession of the goods, or, if the lessee has taken possession of the goods, as of the date the lessor repossesses the goods or an earlier date on which the lessee makes a tender of the goods to the lessor, (ii) the present value as of the date determined under clause (i) of the total rent for the then remaining lease term of the original lease agreement minus the present value as of the same date of the market rent at the place where the goods are located computed

for the same lease term, and (iii) any incidental damages allowed under Section 2A–530, less expenses saved in consequence of the lessee's default.

* * *

Official Comment

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1. Subsection (1), a substantially revised version of Section 2–708(1), states the basic rule governing the measure of lessor's damages for a default described in Section 2A–523(1) or (3)(a), and, if agreed, for a contractual default. This measure will apply if the lessor elects to retain the goods (whether undelivered, returned by the lessee, or repossessed by the lessor after acceptance and default by the lessee) or if the lessor's disposition does not qualify under subsection 2A–527(2). Section 2A–527(3). Note that under some of these conditions, the lessor may recover damages from the lessee pursuant to the rule set forth in Section 2A–529. There is no sanction for disposition that does not qualify under subsection 2A–527(2). Application of the rule set forth in this section is subject to agreement to the contrary. Sections 2A–504, 2A–103(4) and ~~1–102(3)~~ 1-302.

* * *

Cross References:

Sections ~~1–102(3)~~ 1-302, 2–708, 2A–103(1)(u), 2A–402, 2A–504, 2A–507, 2A–527(2) and 2A–529.

Definitional Cross References:

"Agreement". Section 1–201(b)(3).
"Goods". Section 2A–103(1)(h).
"Lease". Section 2A–103(1)(j).
"Lease agreement". Section 2A–103(1)(k).
"Lessee". Section 2A–103(1)(n).
"Lessor". Section 2A–103(1)(p).
"Party". Section 1–201~~(29)~~(b)(26).
"Present value". Section ~~2A–103(1)(u)~~ 1-201(b)(28).
"Sale". Section 2–106(1).

Section 3–103. DEFINITIONS.

(a) In this Article:

* * *

(4) ~~"Good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing.~~ [reserved]

* * *

(10) "Prove" with respect to a fact means to meet the burden of establishing the fact (Section 1–201(b)(8)).

* * *

Official Comment

* * *

~~4. Subsection (a)(4) introduces a definition of good faith to apply to Articles 3 and 4. Former Articles 3 and 4 used the definition in Section 1–201(19). The definition in subsection (a)(4) is consistent with the definitions of good faith applicable to Articles 2, 2A, 4, and 4A. The definition requires not only honesty in fact but also "observance of reasonable commercial standards of fair dealing." Although fair dealing is a broad term that must be defined in context, it is clear that it is concerned with the fairness of conduct rather than the care with which an act is performed. Failure to exercise ordinary care in conducting a transaction is an entirely different concept than failure to deal fairly in conducting the transaction. Both fair dealing and ordinary care, which is defined in Section 3–103(a)(7), are to be judged in the light of reasonable commercial standards, but those standards in each case are directed to different aspects of commercial conduct.~~

~~5~~4. Subsection (a)(7) is a definition of ordinary care which is applicable not only to Article 3 but to Article 4 as well. See Section 4–104(c). The general rule is stated in the first sentence of subsection (a)(7) and it applies both to banks and to persons engaged in businesses other than banking. Ordinary care means observance of reasonable commercial standards of the relevant businesses prevailing in the area in which the person is located. The second sentence of subsection (a)(7) is a particular rule limited to the duty of a bank to examine an instrument taken by a bank for processing for collection or payment by automated means. This particular rule applies primarily to Section 4–406 and it is discussed in Comment 4 to that section. Nothing in Section 3–103(a)(7) is intended to prevent a

customer from proving that the procedures followed by a bank are unreasonable, arbitrary, or unfair.

~~6~~5. In subsection (c) reference is made to a new definition of "bank" in amended Article 4.

Section 4–104. DEFINITIONS AND INDEX OF DEFINITIONS.

* * *

(c) The following definitions in other Articles apply to this Article:

* * *

~~"Good faith" Section 3–103.~~

* * *

Section 4A–105. OTHER DEFINITIONS.

(a) In this Article:

* * *

(6) ~~"Good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing.~~ [reserved]

(7) "Prove" with respect to a fact means to meet the burden of establishing the fact (Section 1–201(b)(8)).

* * *

Section 4A–106. TIME PAYMENT ORDER IS RECEIVED.

(a) The time of receipt of a payment order or communication cancelling or amending a payment order is determined by the rules applicable to receipt of a

notice stated in Section ~~1–201(27)~~ 1-202. A receiving bank may fix a cut_off time or times on a funds_transfer business day for the receipt and processing of payment orders and communications cancelling or amending payment orders. Different cut_off times may apply to payment orders, cancellations, or amendments, or to different categories of payment orders, cancellations, or amendments. A cut_off time may apply to senders generally or different cut_off times may apply to different senders or categories of payment orders. If a payment order or communication cancelling or amending a payment order is received after the close of a funds_transfer business day or after the appropriate cut_off time on a funds_transfer business day, the receiving bank may treat the payment order or communication as received at the opening of the next funds_transfer business day.

* * *

Official Comment

The time that a payment order is received by a receiving bank usually defines the payment date or the execution date of a payment order. Section 4A–401 and Section 4A–301. The time of receipt of a payment order, or communication cancelling or amending a payment order is defined in subsection (a) by reference to the rules stated in Section ~~1–201(27)~~ 1-202. Thus, time of receipt is determined by the same rules that determine when a notice is received. Time of receipt, however, may be altered by a cut_off time.

§ 4A–204. REFUND OF PAYMENT AND DUTY OF CUSTOMER TO REPORT WITH RESPECT TO UNAUTHORIZED PAYMENT ORDER.

* * *

(b) Reasonable time under subsection (a) may be fixed by agreement as stated in Section ~~1–204(1)~~ 1-302(b), but the obligation of a receiving bank to refund payment as stated in subsection (a) may not otherwise be varied by agreement.

Section 5–103. SCOPE.

* * *

(c) With the exception of this subsection, subsections (a) and (d), Sections 5–102(a)(9) and (10), 5–106(d), and 5–114(d), and except to the extent prohibited in Sections ~~1–102(3)~~ 1-302 and 5–117(d), the effect of this article may be varied by agreement or by a provision stated or incorporated by reference in an undertaking. A term in an agreement or undertaking generally excusing liability or generally limiting remedies for failure to perform obligations is not sufficient to vary obligations prescribed by this article.

* * *

Official Comment

* * *

2. Like all of the provisions of the Uniform Commercial Code, Article 5 is supplemented by Section 1–103 and, through it, by many rules of statutory and common law. Because this article is quite short and has no rules on many issues that will affect liability with respect to a letter of credit transaction, law beyond Article 5 will often determine rights and liabilities in letter of credit transactions. Even within letter of credit law, the article is far from comprehensive; it deals only with "certain" rights of the parties. Particularly with respect to the standards of performance that are set out in Section 5–108, it is appropriate for the parties and the courts to turn to customs and practice such as the Uniform Customs and Practice for Documentary Credits, currently published by the International Chamber of Commerce as I.C.C. Pub. No. 500 (hereafter UCP). Many letters of credit specifically adopt the UCP as applicable to the particular transaction. Where the UCP are adopted but conflict with Article 5 and except where variation is prohibited, the UCP terms are permissible contractual modifications under Sections ~~1–102(3)~~ 1-302 and 5–103(c). See Section 5–116(c). Normally Article 5 should not be considered to conflict with practice except when a rule explicitly stated in the UCP or other practice is different from a rule explicitly stated in Article 5.

[remainder of comment 2 is unchanged]

* * *

Section 8–102. DEFINITIONS.

(a) In this Article:

* * *

(10) [reserved] ~~"Good faith," for purposes of the obligation of good faith in the performance or enforcement of contracts or duties within this Article, means honesty in fact and the observance of reasonable commercial standards of fair dealing.~~

* * *

Official Comment

* * *

10. ~~"~~Good faith.~~"~~ ~~Good faith is defined in Article 8 for purposes of the application to Article 8 of~~ Section 1–203~~, which~~ provides that "Every contract or duty within ~~this Act~~ [the Uniform Commercial Code] imposes an obligation of good faith in its performance or enforcement." Section 1-201(b)(20) defines "good faith" as "honesty in fact and the observance of reasonable commercial standards of fair dealing." ~~The sole function of the good faith definition in Revised Article 8 is to give content to the Section 1–203 obligation as it applies to contracts and duties that are governed by Article 8. The standard is one of "reasonable commercial standards of fair dealing."~~ The reference to commercial standards makes clear that assessments of conduct are to be made in light of the commercial setting. The substantive rules of Article 8 have been drafted to take account of the commercial circumstances of the securities holding and processing system. For example, Section 8–115 provides that a securities intermediary acting on an effective entitlement order, or a broker or other agent acting as a conduit in a securities transaction, is not liable to an adverse claimant, unless the claimant obtained legal process or the intermediary acted in collusion with the wrongdoer. This, and other similar provisions, see Sections 8–404 and 8–503(e), do not depend on notice of adverse claims, because it would impair rather than advance the interest of investors in having a sound and efficient securities clearance and settlement system to require intermediaries to investigate the propriety of the transactions they are processing. The good faith obligation does not supplant the standards of conduct established in provisions of this kind.

In Revised Article 8, the definition of good faith is not germane to the question whether a purchaser takes free from adverse claims. The rules on such questions as whether a purchaser who takes in suspicious circumstances is disqualified from protected purchaser status are treated not as an aspect of good faith but directly in the rules of Section 8–105 on notice of adverse claims.

* * *

Definitional Cross References:

"Agreement". Section 1–201(b)(3).
"Bank". Section 1–201(b)(4).
"Person". Section 1–201~~(30)~~(b)(27).
"Send". Section 1–201~~(38)~~(b)(36).
"Signed". Section 1–201~~(39)~~(b)(37).
"Writing". Section 1–201~~(46)~~(b)(43).

Section 9_102. DEFINITIONS AND INDEX OF DEFINITIONS.

(a) **[Article 9 definitions.]** In this article:

* * *

(43) [reserved] ~~"Good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing~~.

* * *

Official Comment

* * *

3. **Definitions Relating to Creation of a Security Interest.**

* * *

b. **"Security Agreement."** The definition of "security agreement" is substantially the same as under former Section 9_105–an agreement that creates or provides for a security interest. However, the term frequently was used colloquially in former Article 9 to refer to the document or writing that contained a debtor's security agreement. This Article eliminates that usage, reserving the term for the more precise meaning specified in the definition.

Whether an agreement creates a security interest depends not on whether the parties intend that the law *characterize* the transaction as a security interest but rather on whether the transaction falls within the definition of "security interest" in Section 1_201. Thus, an agreement that the parties characterize as a "lease" of goods may be a "security agreement," notwithstanding the parties' stated intention that the law treat the transaction as a lease and not as a secured transaction. See Section 1-203.

* * *

14. **Consignment-Related Definitions: "Consignee"; "Consignment"; "Consignor."** The definition of "consignment" excludes, in subparagraphs (B) and (C), transactions for which filing would be inappropriate or of insufficient benefit to justify the costs. A consignment excluded from the application of this Article by one of those subparagraphs may still be a true consignment; however, it is governed by non-Article 9 law. The definition also excludes, in subparagraph (D),

what have been called "consignments intended for security." These "consignments" are not bailments but secured transactions. Accordingly, all of Article 9 applies to them. See Sections 1-201~~(37)~~(b)(35), 9-109(a)(1). The "consignor" is the person who delivers goods to the "consignee" in a consignment.

The definition of "consignment" requires that the goods be delivered "to a merchant for the purpose of sale." If the goods are delivered for another purpose as well, such as milling or processing, the transaction is a consignment nonetheless because a purpose of the delivery is "sale." On the other hand, if a merchant-processor-bailee will not be selling the goods itself but will be delivering to buyers to which the owner-bailor agreed to sell the goods, the transaction would not be a consignment.

* * *

16. **"Document."** The definition of "document" is unchanged in substance from the corresponding definitions in former Section 9_105. See Section 1-201~~(15)~~(b)(16) and Comment ~~15~~16.

* * *

19. **"Good Faith."** This Article expands the definition of "good faith" to include "the observance of reasonable commercial standards of fair dealing." The definition in this section applies when the term is used in this Article, and the same concept applies in the context of this Article for purposes of the obligation of good faith imposed by Section 1_203. See subsection (c).