

§ 1-201. General Definitions.

Subject to additional definitions contained in the subsequent Articles of this Act that are applicable to specific Articles or Parts thereof, and unless the context otherwise requires, in this Act:

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(19) [Except as otherwise provided with respect to letters of credit (Section 5-102(a)(7)) [or bulk sales (Section 6-102(1)(*))],] “Good faith” means honesty in fact and the observance of reasonable commercial standards of fair dealing.

REPORTER’S NOTES

a. *Reasons for change.* Current UCC section 1-201(19) defines “good faith” simply as honesty in fact; the definition contains no element of commercial reasonableness. Initially, that definition applied throughout the Code with only one exception. UCC section 2-103(1)(b) provided that “*in this 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 in three ways. First, it only applied to transactions within the scope of Article 2. Second, it applied only to merchants. Third, strictly construed it applied only to uses of the phrase “good faith” *in Article 2*; thus, so construed it would not define “good faith” for its most important use — the obligation of good faith imposed by UCC section 1-203.

Over time, however, amendments to the UCC brought the Article 2 concept of good faith (subjective honesty and objective reasonableness) into other Articles. First, Article 2A explicitly incorporated the Article 2 standard. See UCC 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., UCC sections 3-103(a)(4), 4A-105(a)(6), 8-102(a)(10). See also drafts of section 2B-102(16) (Sept. 1996 draft) and of revised sections 2-102(a)(24) (Sept. 1996 draft) and 9-105(a)(18) (Annual Meeting draft). 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 defined “good faith” solely in terms of subjective honesty, and if the revisions currently in progress are promulgated, only Article 6 and Article 7 will be without definitions of good faith. (It should be noted that, while revised Article 6 did not define good faith, Comment 2 to revised UCC section 6-102 states that “this Article adopts the definition of ‘good faith’ in [current] Article 1 in all cases, even when the buyer is a merchant.) Given this near unanimity, it is appropriate to move the definition of “good faith” to Article 1. The section will, of course, clearly indicate that this definition is subject to the more specific definition in revised Article 5. In the event that the Drafting Committee concludes, in light of Comment 2 to revised UCC section 6-102, that “good faith,” for purposes of revised Article 6 should mean only “honesty in fact,” bracketed language is supplied that would defer to an Article 6 definition. At present, however, revised Article 6 addresses this definitional issue only in the Comment; thus, if that choice is made, a new provision would be required in revised section 6-102.

b. *Article 7.* No drafting committee has considered the appropriate definition of “good faith” for purposes of Article 7 of the UCC. Accordingly, careful consideration should be given to the effects of this proposed revision on transactions governed and rights determined by that Article.

c. *A cautionary note.* There is a small risk that the augmented definition of “good faith” could be misinterpreted by courts as a floating commission to avoid the effects of UCC provisions perceived as being utilized in a commercially unreasonable way. For example, is it “commercially unreasonable” for a secured party to assert priority under Article 9 over an prior unperfected security

interest of which the subsequent secured party was aware? The duty and definition of good faith should not inappropriately encourage courts to so revise substantive decisions made elsewhere in the Code. Perhaps Comments to sections 1-201 and 1-203 should elaborate along the lines of PEB Commentary No. 10.