

D R A F T
FOR DISCUSSION ONLY

**REVISION OF UNIFORM COMMERCIAL CODE
ARTICLE 1 – GENERAL PROVISIONS**

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

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**REVISION OF UNIFORM COMMERCIAL CODE
ARTICLE 1 – GENERAL PROVISIONS**

WITH PREFATORY NOTE AND COMMENTS

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**REVISION OF UNIFORM COMMERCIAL CODE
ARTICLE 1 – GENERAL PROVISIONS**

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REVISION OF UNIFORM COMMERCIAL CODE

ARTICLE 1 – GENERAL PROVISIONS

PREFATORY NOTE

I. Introduction

The Article 1 Drafting Committee has been assigned two related, but distinct, tasks. This draft represents one of those tasks – revision of the provisions currently in Article 1 of the Uniform Commercial Code. The second task consists of a reexamination of the entire Uniform Commercial Code from a perspective of internal harmonization.

II. Important Issues in This Draft

A. Organization

Current Article 1 is divided into two parts. Part 1 is entitled “Short Title, Construction, Application and Subject Matter of Act. Part 2 is entitled “General Definitions and Principles of Interpretation. The rationale for placement of particular sections in one part or the other is occasionally obscure.

In light of the reorganization of Articles 2, 2A, and 9, and the organization of Article 2B, this draft reorganizes Article 1 into three parts. Part 1 – “General Provisions – contains general rules about the UCC as a whole. Part 2 – “General Definitions and Principles of Interpretation – contains the Code’s major definitional section as well as additional rules of interpretation. Part 3 – “Territorial Applicability and General Rules – contains substantive rules that apply to all transactions that are within the scope of the Code.

B. Applicability of Supplemental Principles of Law

This draft merges current Sections 1-102 and 1-103 into revised Section 1-102. The revised section places greater limits than does current Section 1-103 on supplementing the Code with other law in cases in which the other law is inconsistent with Code policies.

C. “Opting In”

Revised Section 1-103 articulates a rule that allows parties to a transaction not governed by the Uniform Commercial Code (or governed by it only in part) to agree that provisions of the UCC will supply the rules governing their relationship. There is no parallel articulation in Section 1-103 of a right to “opt out” of the Code’s rules because such an agreement is governed by Section 1-303.

D. Electronic Writings and Notices

The definitions in Section 1-201 reflect the work of the Drafting Committees revising Articles 2 and 2A and preparing Article 2B, and of the Working Group on Electronic Writings and Notices of the Committee on the Law

of Commerce in Cyberspace and the Uniform Commercial Code Committee of the Section on Business Law of the American Bar Association, in attempting to make the various terms defined in this section reflect modern concepts of “writings”, “signatures”, and “notices.”

E. Definition of Good Faith

Section 1-201(22) replaces the current definition of “good faith” (“honesty in fact in the conduct or transaction concerned”) with the definition adopted by all but one of the recently revised UCC articles and those in the preparation or revision process: “honesty in fact *and the observance of reasonable commercial standards of fair dealing*.” The section explicitly provides, however, that its definition of “good faith” is subordinate to the definition in Article 5. In addition to centralizing the developments already taking place in other articles, the new definition resolves any ambiguity as to the proper definition to apply to the general duty of good faith imposed by Article 1.

F. Notice and Knowledge

At the suggestion of the Style Committee, the rules concerning notice and knowledge have been moved from their current location in three subsections of Section 1-201 to a separate substantive section. The Drafting Committee believes that the concepts are more clearly articulated in this fashion.

G. Definition of Security Interest

At the suggestion of the Style Committee, the portion of the definition of “security interest” that distinguishes true leases from security interests has been moved to a separate section. As a result, the remaining portion of the definition of “security interest” is clearer.

H. Scope of Application of Substantive Rules in Article 1

Current Article 1 contains several substantive rules. These rules are placed in part 3 of this draft. Occasionally courts and commentators have expressed uncertainty as to which transactions are governed by those substantive rules. Section 1-301 expresses a point that is implicit in current Article 1 – namely, that the substantive rules in Article 1 apply only to transactions within the scope of the other articles.

I. Choice of Law

Section 1-302 represents a significant rethinking of choice of law issues addressed in current UCC Section 1-105. 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. It does not, however, as suggested by some, address the effectiveness of forum selection clauses.

J. Course of Performance

Section 1-304 incorporates the concept of “course of performance” from Articles 2, 2A, and draft Article 2B into the Article 1 treatment of course of dealing and usage of trade.

K. Unconscionability

Section 1-306 incorporates the concept of unconscionability from Articles 2 and 2A. The section is placed in brackets to indicate that the Drafting Committee has made no final recommendation as to its inclusion. It should be noted that a doctrine of unconscionability has long been recognized outside the sale/lease context by, e.g., Restatement, Second, Contracts § 208 and California Civil Code § 1670.5.

L. Statute of Frauds

The Statute of Frauds appearing in current Section 1-206 has been deleted. The Drafting Committee noted that the other articles of the Uniform Commercial Code make individual determinations as to writing requirements for transactions within their scope, so that the only effect of Section 1-206 was to impose a writing requirement on transactions not otherwise governed by the UCC. The Drafting Committee decided that it is inappropriate for Article 1 to impose such writing requirements.

**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.

Revision Notes

This section is based on current UCC Section 1-101. Subsection (b) is new.

**SECTION 1-102. CONSTRUCTION OF ACT 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 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) Principles of law and equity may be utilized to supplement [the Uniform Commercial Code], except to the extent that those principles are inconsistent with

(1) either the terms or the purposes and policies of a particular provision of [the Uniform Commercial Code]; or

(2) the purposes and policies identified in subsection (a).

Revision Notes

This section merges subsections (1) and (2) of current UCC Section 1-102 with the basic concept of current UCC Section 1-103. Except for minor stylistic changes, subsection (a) repeats the content of subsections (1) and (2) of Section 1-102. Subsection (b) is based on current Section 1-103, and reflects a strengthening of the preemptive nature of the Uniform Commercial Code by placing greater limits on supplementing the Code with other law in cases in which the other law is inconsistent with Code policies.

SECTION 1-103. APPLICABILITY OF [UNIFORM COMMERCIAL CODE] BY AGREEMENT.

(a) Except as otherwise provided in subsection (b), to the extent that a transaction is not subject to [the Uniform Commercial Code], parties to the transaction may provide by agreement that one or more of the provisions of [the Uniform Commercial Code] determine any or all of their rights and obligations with respect to each other.

(b) An agreement described in subsection (a) is ineffective to vary a rule that, under the law that would otherwise apply to the transaction, is not variable by agreement.

Revision Notes

This section would explicitly authorize parties to “opt in” to the rules of the Uniform Commercial Code with respect to rights and obligations between them. See generally Robert A. Feldman and Frederick H. Miller, In and Out of (and Among?) the UCC Articles Via Contract, Commercial Law Newsletter (Nov. 1996). Subsection (b) prevents parties from contracting out of otherwise mandatory rules imposed by other law.

SECTION 1-104. CONSTRUCTION AGAINST IMPLIED REPEAL.

[The Uniform Commercial Code] is a general act intended as a unified coverage of its subject matter. No provision of it may be construed as having been repealed by

implication by subsequent legislation if this construction reasonably can be avoided.

Revision Notes

Other than minor stylistic changes, this section is identical to current UCC Section 1-104.

SECTION 1-105. SEVERABILITY. If a provision of [the Uniform Commercial Code], or an application thereof to any person or circumstance, is held invalid, the invalidity does not affect other provisions or applications of [the Uniform Commercial Code] that can be given effect without the invalid provision or application, and to this end the provisions of [the Uniform Commercial Code] are severable.

Revision Notes

Other than minor stylistic changes, this section is identical to current UCC Section 1-108.

SECTION 1-106. USE OF SINGULAR AND PLURAL; GENDER. In [the Uniform Commercial Code], unless the 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.

Revision Notes

Other than minor stylistic changes, this section is identical to current UCC Section 1-102(5).

PART 2
GENERAL DEFINITIONS AND
PRINCIPLES OF INTERPRETATION

SECTION 1-201. GENERAL DEFINITIONS. Subject to additional definitions contained in other articles of [the Uniform Commercial Code] that apply to particular articles or parts thereof, and unless the context otherwise requires, in [the Uniform Commercial Code]:

(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 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 1-304.

(4) “Authenticate means to sign or to execute or adopt a symbol, or encrypt a record in whole or in part with present intent to identify the authenticating party, or to adopt or accept a record or term, or to establish the authenticity of a record or term that contains the authentication or to which a record containing the authentication refers.

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

(6) “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.

(7) “Bill of lading means a record evidencing the receipt of goods for shipment issued by a person engaged in the business of transporting or forwarding goods.

(8) “Branch includes a separately incorporated foreign branch of a bank.

(9) “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.

(10) “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 minerals or the like, including oil and gas, 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 pre-existing contract for sale. Only a buyer that takes possession of the goods or has a right to recover the goods from the seller (Section [2-xxx]) may be a buyer in ordinary course of business. A person that acquires goods in a transfer in bulk or as security for or in total or partial satisfaction of a money debt is not a buyer in ordinary course of business.

(11) “Conspicuous means so displayed or presented that a reasonable person against whom it is to operate would likely have noticed it, or, in the case of an electronic message intended to evoke a response without the need for review by an individual, in a form that would enable the recipient or the recipient’s computer to take it into account or react to it without review of the message by an individual.

(12) “Contract” 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 party or other 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 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” means a record that 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 record and the goods it covers, including a bill of lading, dock warrant, dock receipt, warehouse receipt, or order for the delivery of goods contained in a record that purports 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) “Electronic agent” means a computer program or other electronic or automated means used, selected, or programmed by a party to initiate or respond to electronic messages or performances without review by an individual.

(18) “Electronic message” means a record stored, generated, or transmitted for purposes of communication to another party or an electronic agent by electronic, optical scanner, or similar means. The term includes electronic data interchange, electronic mail, facsimile, telex, telecopying, and similar communication.

(19) “Fault” means a wrongful act, omission, breach, or default.

(20) “Fungible goods” means either:

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

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

(21) “Genuine” means free of forgery or counterfeiting.

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

(23) “Holder” means:

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

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

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

(25) “Insolvent” means:

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

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

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

(26) “Money” means a medium of exchange 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.

(27) “Organization” means a person other than an individual.

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

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

(30) “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 of each case at the time the transaction was entered into.

(31) “Presumption or “presumed means that the trier of fact must find the existence of the fact presumed unless and until evidence is introduced which would support a finding of its nonexistence.

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

(33) “Purchaser means a person that takes by purchase.

(34) “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.

(35) “Remedy means relief to which an aggrieved party is entitled with or without resort to a tribunal.

(36) “Representative” means any 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.

(37) “Right” includes remedy.

(38) “Security interest” means an interest in personal property or fixtures that secures payment or performance of an obligation. The term also includes any interest of a consignor and a buyer of accounts, chattel paper, or a payment intangible in a transaction that is subject to Article 9. The special property interest of a buyer of goods on identification of those goods to a contract for sale under Section 2-xxx is not a “security interest”, but a buyer 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 (Section 2-xxx) is limited in effect to a reservation of a “security interest.”

(39) “Send” in connection with a writing, record, or notice means to:

(A) deposit in the mail properly addressed and, in the case of an instrument, to an address specified thereon or otherwise agreed, or, if there is none, to any address reasonable under the circumstances;

(B) transmit by any other usual means of communication in a form reasonable under the circumstances;

(C) deliver for such transmission with postage or other cost of transmission provided for; or

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

(40) “Sign” means to identify a record by means of a signature mark or other symbol with present intent to authenticate it.

(41) “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.

(42) “Surety” includes a guarantor or other secondary obligor.

(43) “Term” means a portion of an agreement that relates to a particular matter.

(44) “Unauthorized signature” means a signature made without actual, implied, or apparent authority. The term includes a forgery.

(45) “Warehouse receipt” means a receipt issued by a person engaged in the business of storing goods for hire.

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

Revision Notes

In addition to renumbering as a result of moving some provisions to other sections and minor stylistic changes:

Agreement. The sentence stating that the legal consequences of an agreement are determined by the Uniform Commercial Code and contract law will be moved to a Comment.

Airbill. The reference to “airbill” in the definition of Bill of lading has been deleted as no longer necessary.

Authenticate. Identical to UCC Section 2B-102(a)(2) (May 1997 Draft).

Bank. Derived from the first sentence of UCC Section 4A-105(a)(2).

Bill of lading. The definition of bill of lading is identical to that in current UCC Section 1-201(6), except that “record” has replaced “document,” and the definition of “airbill” has been deleted.

Buyer in ordinary course of business. The revised definition of buyer in ordinary course of business is the product of the Article 9 Drafting Committee. As noted by that Committee:

Many of the revisions to the definition of “buyer in ordinary course of business” in subsection [(10)] are for clarification and style. The second sentence of the subsection is new. It provides that the “ordinary course” requirement is met only if the sale is in the ordinary course of the seller’s business. The third

sentence, which tracks Section 6-102(1)(m), explains when a sale is in the ordinary course of the seller's business.

The penultimate sentence of subsection [(10)] also is new. It prevents a buyer that does not have the right to possession against the seller from taking free of the rights of third parties. The Article 2 sections referred to would be Sections 2-707 (specific performance) and 2-724 (prepaying buyer) of the March 1, 1996, Article 2 draft.

It should be noted that this issue is still under consideration by the Article 2 Drafting Committee.

Conspicuous. Identical to UCC Section 2-102(a)(7) (May 1997 Draft). It should be noted that there are differences that remain to be resolved between this formulation and that in Article 2B.

Consumer. This section does not contain a definition of "consumer" or "consumer transaction." Revised Articles 2, 2A, 2B, and 9 contain definitions that are similar but differ in light of their differing contexts. This draft defines those terms in Section 1-302 solely for purposes of that section. Consideration should be given to placing a uniform definition in Section 1-201.

Delivery. The reference to certificated securities has been deleted because Article 8 contains its own definition of delivery.

Document of title. The definition of "document of title" is identical to current UCC Section 1-201(15), except that "document" is replaced with "record."

Electronic message. Identical to UCC Section 2B-102(a)(14) (May 1997 Draft).

Fungible. The reference to securities has been deleted because Article 8 no longer uses the term "fungible" to describe securities.

Good faith. 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 current 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 current 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 Article 2B and revised

Articles 2 and 2A. 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 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 applicability of the narrower definition in revised Article 5.

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.

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. Comments to Sections 1-201 and 1-305 should make this point, elaborating along the lines of PEB Commentary No. 10.

Holder. Reorganized for clarity.

Honor. The definition of “honor” has been deleted. The term is used only once (in Article 2) outside of Article 5, where it is defined. Article 2 should simply cross-reference the Article 5 definition.

Insolvent. A reference to bona fide disputes has been added.

Notice and knowledge. These concepts have been moved to Section 1-202.

Organization. Revised to reflect standard NCCUSL language.

Person. Revised to reflect standard NCCUSL language.

Present value. This term is used in both Articles 1 and 2A. The embedded definition in current UCC Section 1-201(37) has been moved to a separate definitional subsection. Accordingly, the definition in Article 2A should be deleted.

Purchase. At the suggestion of the Article 9 Drafting Committee, an explicit reference to security interests has been added.

Security interest. The first paragraph of the definition of “security interest” has been revised, pursuant to decision of the Article 9 Drafting Committee, to turn the interests of all “consignors” (as defined in draft Section 2-xxx) into “security

interests. See generally Comments to revised Section 9-102. It should be noted that this issue is still under consideration by the Article 2 Drafting Committee. That portion of the definition that distinguishes a “true lease from a security interest has been moved to Section 1-203.

Send. The definition has been revised to reflect electronic transmission of messages and the possibility of transmission of a message directly by the sender.

Sign. Revised based on definition utilized in Uniform Limited Liability Company Act.

State. The standard NCCUSL definition has been utilized.

Surety. The definition of “surety” has been expanded to include all secondary obligors. The Comment will refer to the Restatement of Suretyship and Guaranty.

Value. This concept has been moved to Section 1-204.

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.

(c) “Discover”, “learn”, or words of similar import refer to knowledge rather than to notice.

(d) A person “notifies” or “gives” a notice or notification to another by taking such steps as may be reasonably required to inform the other 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 or system 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.

(g) The time and circumstances under which a notice or notification may cease to be effective are not determined by the Uniform Commercial Code.

Revision Notes

Derived from current UCC Section 1-201(25)-(27). At the suggestion of the Style Committee, these provisions have been relocated from the definitional section to this section.

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

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

(4) 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

(5) 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.

Revision Notes

This section is substantively identical to those portions of current UCC Section 1-201(37) that distinguish "true" leases from security interests, except that the definition of "present value" formerly embedded in this provision is left in UCC Section 1-201.

SECTION 1-204. VALUE. Except as otherwise provided in Articles 3, 4, 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.

Revision Notes

The rule in this section has been relocated from Section 1-201(44) at the suggestion of the Style Committee.

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.

Revision Notes

This section is derived from subsections (2) and (3) of current UCC Section 1-204. The concept in subsection (1) of that section is adequately dealt with in Section 1-303.

PART 3
SCOPE, TERRITORIAL APPLICABILITY,
AND GENERAL RULES

SECTION 1-301. SCOPE OF PART. Unless the context otherwise requires, this part applies to a transaction to the extent that it is governed by other articles of the Uniform Commercial Code.

Revision Notes

This section is new. It clarifies confusion that has occasionally arisen as to the applicability of the substantive rules in this article.

**SECTION 1-302. TERRITORIAL APPLICABILITY; PARTIES’
POWER TO CHOOSE APPLICABLE LAW.**

(a) Except as otherwise provided in subsection (c), an agreement by parties to a transaction to which the Uniform Commercial Code applies in whole or part that any or all of their rights and obligations with respect to each other are to be determined by the law of this State or another State or country is effective, whether or not the transaction bears a reasonable relation to that State or country, unless:

(1) the transaction is a consumer transaction and the State or country that is specified is not:

(A) the State or country in which the consumer resides at the time the transaction becomes enforceable or will reside within 30 days thereafter; or

(B) the State or country, under the contract establishing the transaction, in which the goods, services, or other consideration flowing to the consumer are to be received by the consumer or a person designated by the consumer;

(2) the law of the State or country that is specified is contrary to a fundamental public policy of the State or country whose law would determine their

rights and obligations if the parties had not selected the applicable law by agreement; or

(3) if the transaction does not bear a reasonable relationship to any country other than the United States, the contract specifies the law of a country other than the United States.

(b) Except as otherwise provided in subsection (c), in the absence of an effective agreement pursuant to subsection (a) the law that determines the rights and obligations of parties with respect to any aspect of a transaction governed by [the Uniform Commercial Code] is the law that would ordinarily be selected by application of this State's conflict of laws principles. [If, however, application of those principles to a transaction other than a consumer transaction would result in the unenforceability of all or part of an agreement that is enforceable under the law of this State, the law governing those rights and obligations is the law of this State unless the transaction does not bear an appropriate relationship to this State].

(c) To the extent that [the Uniform Commercial Code] would otherwise govern in the absence of agreement between the parties, the following provisions specify the governing law, and a contrary agreement is effective only to the extent permitted by those provisions:

- (1) Section 2-xxx
- (2) Sections 2A-xxx
- (3) Section 2B-xxx
- (4) Section 4-102
- (5) Section 4A-507
- (6) Section 5-116
- (7) Section 6-103
- (8) Section 8-110

(9) Section 9-xxx

(d) For purposes of this section, a “consumer” is an individual who enters into a transaction primarily for personal, family, or household purposes.

“Consumer transaction” has a corresponding meaning.

Revision Notes

This section replaces current UCC Section 1-105, with several significant changes.

a. Contractual choice of law. Subsection (a), which governs contractual choice of law clauses, allows parties broad freedom to select governing law, even if the transaction bears no relation to the State or country whose law is selected, with several important limitations. First, there are significant limitations on the freedom to select governing law in the context of consumer transactions. Second, contractual choice of law will not be given effect if it would be contrary to a fundamental public policy of the State or country whose law would otherwise be chosen under subsection (b). [The Drafting Committee is giving consideration to moving this limitation, now expressed in subsection (a)(2), to a Comment.] Third, the agreement of the parties may not select the law of a country other than the United States unless the transaction bears a reasonable relationship to a country other than the United States (not necessarily the country selected).

The Drafting Committee considered whether this section should provide for the ability of parties to designate non-legal codes such as trade codes as the set of rules governing their transaction. The Drafting Committee’s tentative decision is that Section 1-303 is adequate for this purpose. The Drafting Committee will give further consideration to this point, as well as to a related suggestion – that parties should be able to select recognized bodies of rules or principles applicable to commercial transactions promulgated by intergovernmental authorities such as UNCITRAL or UNIDROIT even to the extent that those rules could not have been selected via Section 1-303.

Choice of law in the absence of contract. Subsection (b) replaces the last sentence of current UCC Section 1-105(1), which determines which jurisdiction’s law governs a transaction in the absence of an effective contractual choice by the parties. Current Section 1-105(1), by providing that the law of the forum (*i.e.*, the UCC) applies if the transaction bears “an appropriate relation to this state” rather than, say, requiring that the forum be the location of the “most significant” contact, expresses a bias in favor of applying the forum’s law. This bias, while not universally respected by the courts, was most justifiable in light of the uncertainty that existed at the time of drafting as to whether the UCC would be adopted by all the States; the pro-forum bias would assure that the UCC would be applied so long as the transaction bore an “appropriate” relation to the forum. Inasmuch as the UCC has been adopted, at least in part, in all American 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. When the choice is between the law of two jurisdictions that have adopted the UCC, but whose law differs (whether because of differences in enacted

language or differing judicial interpretations), there is no strong justification for directing a court to apply different choice of law principles to its determination than it would apply if the matter were not governed by the UCC. Similarly, given the wide variety of operative choice of law principles applied by the States, it would not be prudent to designate only one such principle as the proper principle for transactions governed by the UCC. Accordingly, with the exception noted below, Section 1-302(b) simply directs the forum to apply its general choice of law principles to determine which jurisdiction's law governs.

Invalidating law. Once it is determined that there has been sufficient agreement to conclude that a contract has been formed, the law, with very few exceptions, treats the parties as intending to be bound by the terms of that contract. Nonetheless, the Uniform Commercial Code limits freedom of contract in several contexts, and the law of particular jurisdictions may limit such freedom in additional contexts. If a contract is formed that has an appropriate relation with more than one jurisdiction, and the law of one of those jurisdictions would invalidate the contract or a portion thereof while the law of another of those jurisdictions would validate it, the choice of law issue is critical. Given the intent to be bound that is presumed by the law, a strong argument can be made that if the forum's general choice of law principles would result in the application of the law of a different jurisdiction that would invalidate the contract or a portion of it, even though under the Uniform Commercial Code and other law of the forum that contract or portion would be held valid, the forum should apply its own validating law so as to effectuate the parties' intent. See ABA Task Force Report. Such a rule would also prevent transactions valid under the forum State's UCC from invalidation by application of another jurisdiction's non-UCC law. The bracketed language in subsection (b) would effectuate this principle.

Consumer transactions. Several provisions in this section embody a distinction between "consumer transactions", as defined in subsection (d) of this section, and other transactions.

Subsection (a)(1) limits the parties' ability in a consumer transaction to select contractually the jurisdiction whose law will govern to the selection of a State or nation to which the transaction bears a reasonable relation and in which the consumer party resides at the time the transaction becomes enforceable or within 30 days thereafter or in which, pursuant to the contract establishing the transaction, the consumer party is to receive the goods, services, or other consideration flowing to the consumer. This limitation is adapted from the similar limitation in current Section 2A-106.

In subsection (b), the preference for judicial selection of a law that enforces the parties' transaction does not apply in the case of consumer transactions. Limits that a State imposes on freedom of contract in consumer transactions are usually representative of a strong public policy interest. If the law that would be judicially selected but for the application of the rule in subsection (b) would invalidate a contract or portion thereof in a consumer transaction, the preference for a rule of validation would be in conflict with such public policy interests. Accordingly, this draft excludes application to consumer transactions of the preference for a rule of validation.

Primacy of other UCC choice of law rules. Subsection (c) repeats the list in current Section 1-105(2) and adds a placeholder for Article 2B.

Choice of forum. The use of contractual choice of forum clauses has expanded as judicial hostility to them has faded. See, e.g., *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585 (1991); *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972). See also Restatement of the Law (Second), Conflict of Laws § 80 (1971); Model Choice of Forum Act (1968, withdrawn 1975). The Drafting Committee considered whether to add a provision governing the effect of such clauses, as recommended by the ABA Task Force, but decided not to do so.

SECTION 1-303. 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.

(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.

Revision Notes

This section is substantively identical to subsections (3) and (4) of current UCC Section 1-102.

SECTION 1-304. 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;

(2) that party performs on one or more occasions; and

(3) 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 previous conduct 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 are to 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

where only 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 sections [on modification and waiver], 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.

Revision Notes

a. Addition of course of performance. As suggested by the ABA Task Force, this section integrates the “course of performance” concept into the principles of current 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 current UCC Section 1-205. There are also slight modifications to be more consistent with the definition of “agreement” in current Section 1-201(3).

b. Possible side effects of incorporating course of performance into Article 1. Incorporation of course of performance into Article 1 will require close examination of at least two issues. First, a course of performance that might otherwise create a defense to the obligation of a party to a negotiable instrument should not be available as a defense against a holder in due course who took the instrument without notice of the course of performance. A Comment in this section or in Section 3-302 may be sufficient to make this point, but it is possible that some statutory tweaking may be required.

Second, in light of the rule that course of performance may be relevant to establish a waiver or modification, consideration should be given to whether those concepts should be articulated in Article 1 or, rather, if the current treatment of these concepts in Articles 2, 2A, and 2B is sufficient. It has been suggested that subsection (g) be moved to a new section concerned with litigation matters.

SECTION 1-305. OBLIGATION OF GOOD FAITH. There is an obligation to act in good faith in the performance and enforcement of every contract and duty within the scope of [the Uniform Commercial Code].

Revision Notes

Slightly rewritten in light of suggestions of Drafting Committee.

[SECTION 1-306. UNCONSCIONABLE AGREEMENT OR TERM.

(a) If a court finds as a matter of law that an agreement or any term thereof was unconscionable at the time it was made [or was induced by unconscionable conduct], the court may refuse to enforce the agreement, enforce the remainder of the agreement without the unconscionable term, or so limit the application of any unconscionable term as to avoid an unconscionable result.

(b) Before making a finding of unconscionability under subsection (a), the court, on motion of a party or its own motion, shall afford the parties a reasonable opportunity to present evidence as to the setting, purpose, and effect of the agreement or term thereof or of the conduct.

(c) This section does not apply to the extent that an agreement is governed by Article 5 of [the Uniform Commercial Code].]

Revision Notes

This section is placed in brackets to indicate that the Drafting Committee has made no final recommendation as to its inclusion.

A decision to apply generally the unconscionability provision now present in Articles 2 and 2A could be justified as reflecting a policy decision that, in light of almost two decades of experience applying unconscionability principles to contracts generally under Restatement, Second, Contracts, § 208, and similar experience under California Civil Code § 1670.5, there is no longer any compelling reason to limit application of the principle in the Uniform Commercial Code to only

sales and leases. Of course, such a policy decision would be significant and should be considered carefully.

If it is decided to include this provision in Article 1, the language will, of course, be coordinated with the Drafting Committees for Articles 2, 2A, and 2B. At present, the unconscionability sections in those articles remain to be harmonized.

SECTION 1-307. 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. Neither consequential, special nor penal damages may be imposed except as expressly provided in [the Uniform Commercial Code] or by other statute or rule of law.

(b) A right or obligation provided for by [the Uniform Commercial Code] is enforceable by action unless the provision stating it specifies a different and limited effect.

Revision Notes

This section is substantively identical to current UCC Section 1-106.

SECTION 1-308. 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.

Revision Notes

This section is based on current UCC Section 1-107. It has been revised in two respects. First, the current section, 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. Revised Section 1-308 separates those concepts, and explicitly requires *agreement* of the required party. Second, the revised section reflects developments in electronic commerce by providing for memorialization in an authenticated record.

SECTION 1-309. PRIMA FACIE EVIDENCE BY THIRD PARTY DOCUMENTS. A record 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 record by the third party.

Revision Notes

This section is substantively identical to current UCC Section 1-202, except that "document" has been changed to "record." This section has been cited by courts only a handful of times in thirty years, and has been relied on as the basis for a decision even more rarely. The Drafting Committee will give consideration to deleting this section from revised Article 1.

SECTION 1-310. PERFORMANCE OR ACCEPTANCE UNDER RESERVATION OF RIGHTS.

(a) Except as otherwise provided in subsection (b), 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. Words such as "without prejudice", "under protest" or the like are sufficient.

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

Revision Notes

This section is substantively identical to current UCC Section 1-207.

SECTION 1-311. 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.

Revision Notes

This section is substantively identical to current UCC Section 1-208.

SECTION 1-312. SUBORDINATED OBLIGATIONS. An obligation may be issued as subordinated to payment of another obligation of the person obligated, or a creditor may subordinate its right to payment 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.

Revision Notes

This section is identical to current UCC Section 1-209, except that the language stating that the section “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.