

D R A F T
FOR APPROVAL

**PROPOSED REVISIONS OF
UNIFORM COMMERCIAL CODE
ARTICLE 2A – LEASES**

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

MEETING IN ITS ONE-HUNDRED-AND-EIGHTH YEAR
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JULY 23 – 30, 1999

**PROPOSED REVISIONS OF
UNIFORM COMMERCIAL CODE
ARTICLE 2A – LEASES**

*WITH A PREFATORY “INTRODUCTORY COMMENTS”
AND INTERIM SECTION COMMENTS*

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NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

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**DRAFTING COMMITTEE TO REVISE
UNIFORM COMMERCIAL CODE ARTICLE 2A – LEASES**

ROBERT J. TENNESSEN, 3400 City Center, 33 S. 6th Street, Minneapolis, MN 55402-3796, *Chair*
JOHN FOX ARNOLD, 714 Locust Street, St. Louis, MO 63101

MARION W. BENFIELD, JR., 10 Overlook Circle, New Braunfels, TX 78132, *National Conference
Reporter*

JEAN BRAUCHER, University of Arizona, College of Law, NW Corner of Speedway and Mountain
Streets, P.O. Box 210176, Tucson, AZ 85721-0176, *The American Law Institute Representative*

STEPHEN C. CAWOOD, 163 W. Short Street, Suite 300, Lexington, KY 40507-1361

ELLEN F. DYKE, Suite 400, 2010 Corporate Ridge, McLean, VA 22102

HENRY DEEB GABRIEL, JR., Loyola University, School of Law, 526 Pine Street, New Orleans,
LA 70118

MORRIS W. MACEY, 600 Marquis II, 285 Peachtree Center Avenue, N.E., Atlanta, GA 30303

THOMAS J. McCRACKEN, JR., Room 600, 134 N. LaSalle Street, Chicago, IL 60602

JAMES J. WHITE, University of Michigan, Law School, Hutchins Hall, Room 300, 625 South State
Street, Ann Arbor, MI 48109-1215, *The American Law Institute Representative*

EX OFFICIO

GENE N. LEBRUN, P.O. Box 8250, 9th Floor, 909 St. Joseph Street, Rapid City, SD 57709 *President*

BARRY H. EVENCHICK, 8th Floor, One Gateway Center, Newark, NJ 07102, *Division Chair*

AMERICAN BAR ASSOCIATION ADVISOR

MARVIN GARFINKEL, Suite 3800, 1735 Market Street, Philadelphia, PA 19103, *Real Property,
Probate & Trust Law Section Advisor*

THOMAS B. HUDSON, 2191 Defense Highway, Suite 304, Crofton, MD 21114, *Advisor*

EXECUTIVE DIRECTOR

FRED H. MILLER, University of Oklahoma, College of Law, 300 Timberdell Road, Norman,
OK 73019, *Executive Director*

WILLIAM J. PIERCE, 1505 Roxbury Road, Ann Arbor, MI 48104, *Executive Director Emeritus*

Copies of this Act may be obtained from:

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS
211 E. Ontario Street, Suite 1300

Chicago, Illinois 60611
312/915-0195

**PROPOSED REVISIONS OF
UNIFORM COMMERCIAL CODE
ARTICLE 2A – LEASES**

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2A-102	2A-103
2A-103	2A-102
2A-104	2A-104
2A-105	2A-105
2A-106	2A-106
2A-107	Deleted (Issue covered by Section 1-107).
2A-108	2A-107
2A-109	2A-108
2A-201	2A-201
2A-202	2A-202
2A-203	Deleted (Substance moved to 2A-201).
2A-204	2A-203
2A-205	2A-204
2A-206	2A-205
2A-207	2A-301
2A-208	2A-302
2A-209	2A-303
2A-210	2A-503
2A-211	2A-502
2A-212	2A-504
2A-213	2A-505
2A-214	2A-506
2A-215	2A-507
2A-216	2A-508
2A-217	2A-304
2A-218	2A-305
2A-219	2A-306
2A-220	Deleted (Breach issues moved to 2A-306).
2A-221	2A-307
2A-301	2A-401
2A-302	2A-402
2A-303	2A-403
2A-304	2A-404
2A-305	2A-405
2A-306	2A-406
2A-307	2A-407

Old	New
2A-308	2A-408
2A-309	2A-409
2A-310	2A-410
2A-311	2A-411
2A-401	2A-601
2A-402	2A-602
2A-403	2A-603
2A-404	2A-604
2A-405	2A-605
2A-406	2A-606
2A-407	2A-607
2A-501	2A-702
2A-502	2A-703
2A-503	2A-711
2A-504	2A-710
2A-505	2A-709
2A-506	2A-715
2A-506	2A-713
2A-508	2A-724
2A-509	2A-725
2A-510	2A-726
2A-511	2A-727
2A-512	2A-728
2A-513	2A-729
2A-514	2A-729
2A-515	2A-730
2A-516	2A-731
2A-517	2A-732
2A-518	2A-733
2A-519	2A-734
2A-520	2A-735
2A-521	2A-736
2A-522	2A-737
2A-523	2A-716
2A-524	2A-718
2A-525	2A-717
2A-526	2A-719
2A-527	2A-720
2A-528	2A-721
2A-529	2A-722

Old

2A-530

2A-531

2A-532

New

2A-706, 2A-707

2A-714

2A-723

CROSS REFERENCE TABLE

REVISED 2A SECTIONS TO PRESENT 2A SECTIONS

New	Old
2A-101	2A-101
2A-102	2A-103
2A-103	2A-102
2A-104	2A-104
2A-105	2A-105
2A-106	2A-106
2A-107	2A-108
2A-108	2A-109
2A-201	2A-201
2A-202	2A-202
2A-203	2A-204
2A-204	2A-205
2A-205	2A-206
2A-206	New
2A-207	New
2A-208	New
2A-209	New
2A-210	New
2A-301	2A-207
2A-302	2A-208
2A-303	2A-303
2A-304	2A-317
2A-305	2A-218
2A-306	2A-219
2A-307	2A-221
2A-308	2A-505
2A-401	2A-301
2A-402	2A-302
2A-403	2A-303
2A-404	2A-304
2A-405	2A-305
2A-406	2A-306
2A-407	2A-307
2A-408	2A-308

Old	New
2A-409	2A-309
2A-410	2A-310
2A-411	2A-311
2A-501	New
2A-502	2A-211
2A-503	2A-210
2A-504	2A-212
2A-505	2A-213
2A-506	2A-214
2A-507	2A-215
2A-508	2A-216
2A-601	2A-401
2A-602	2A-402
2A-603	2A-403
2A-604	2A-404
2A-605	2A-405
2A-606	2A-406
2A-607	2A-407
2A-701	New
2A-702	2A-510
2A-703	2A-502
2A-704	New
2A-705	New
2A-706	2A-520, 2A-530
2A-707	2A-520
2A-708	2A-521
2A-709	2A-505
2A-710	2A-504
2A-711	2A-503
2A-712	2A-505
2A-713	2A-507
2A-714	2A-531
2A-714	2A-506
2A-716	2A-523
2A-717	2A-525
2A-718	2A-524
2A-719	2A-526
2A-720	2A-427
2A-721	2A-528
2A-722	2A-529

Old	New
2A-723	2A-532
2A-724	2A-508
2A-725	2A-509
2A-726	2A-510
2A-727	2A-511
2A-728	2A-512
2A-729	2A-513
2A-730	2A-515
2A-731	2A-514
2A-732	2A-515, 2A-516
2A-733	2A-517
2A-734	2A-518
2A-735	2A-519
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2A-737	2A-522

1 **PROPOSED REVISIONS OF**
2 **UNIFORM COMMERCIAL CODE**
3 **ARTICLE 2A – LEASES**

4 *The Introductory Comments and Reporter’s Notes address selected topics*
5 *for the consideration of the Members of the National Conference of Commissioners*
6 *on Uniform State Laws at its 108th Annual Meeting. Complete and comprehensive*
7 *final Comments will be prepared after promulgation.*

8 **INTRODUCTORY COMMENTS**

9 Article 2A of the Uniform Commercial Code was originally promulgated by
10 the American Law Institute (ALI) and the National Conference of Commissioners
11 on Uniform State Laws (Conference) in 1987. It was amended in 1990. It has been
12 adopted in 48 jurisdictions.

13 Article 2A is being revised to take account of the revisions of Articles 2 and
14 9 (primarily Article 2). Article 2A is based largely on Article 2 and in general
15 follows the Article 2 sequence of sections. However, many present Article 2
16 sections were not adopted in Article 2A because the Article 2 sections dealt with
17 issues which were not significant in the leasing context or stated rules which were
18 inappropriate in leases. Other Article 2 sections were followed exactly or very
19 closely in the analogous Article 2A section. Some Article 2A sections follow the
20 policy of present Article 2, but the specific rules are different because of the
21 differences between sales and leases. Article 2A also contains a few provisions,
22 such as the sections on lessors of fixtures or accessions, which are based on the
23 similar provisions of Article 9.

24 The revision of Article 2 raised the issue of the extent to which Article 2A
25 should be revised to follow changes in policy or language in Article 2. The Article
26 2A Drafting Committee was appointed to examine that question. The charge to the
27 Committee is to examine Article 2 changes to sections used as the basis for Article
28 2A sections and adopt those Article 2 changes in Article 2A unless differences
29 between leases and sales justify a different rule for leases. Similarly new sections in
30 Article 2 and the provisions of the proposed Uniform Computer Information
31 Transactions Act (UCITA) were reviewed for possible addition to Article 2A.
32 Also, changes made by the Article 9 Committee were considered for possible
33 adoption in the relevant Article 2A sections. The Article 2A Committee charge is
34 not to serve as a review committee for decisions made by the Article 2 Committee
35 nor to decline to accept Article 2 changes in Article 2A merely because the Article
36 2A Committee disagrees with the Article 2 Committee decision.

1 The charge to the Article 2A Committee did not include authority to make
2 substantive changes to Article 2A which are not related to changes in Articles 2 or 9
3 or to provisions of new UCITA. However, the Committee does propose one
4 substantive change in its title warranties section that does bring it into congruence
5 with Article 2 changes as to title warranties. Presently, Article 2A does not follow
6 the Article 2 rules on title warranties. This matter is discussed below.

7 The Article 2A Committee has met a number of times, the last time in March
8 of this year. At each meeting the Article 2A Committee has reviewed the draft of
9 revised Article 2 current at that time. Since Article 2 and Article 2A are being
10 prepared for submission to the Conference for final approval at the same time, at the
11 time this memorandum is being prepared the Article 2A Drafting Committee has not
12 met to discuss changes made in revised Article 2 since April of this year. The
13 Article 2A Committee will met the day prior to the opening of the Annual Meeting
14 to consider whether recent changes in Article 2 should also be made in Article 2A.

15 As noted above, the instruction to the Article 2A Drafting Committee is to
16 conform Article 2A to revised Article 2 unless there is a reason for a different rule in
17 leases because of differences between sales and leases, including differences in
18 relevant practice.

19 A discussion follows of (1) matters on which Article 2A has failed to follow
20 revised Article 2 and (2) the one substantive amendment to Article 2A that the
21 Article 2A Committee is proposing that is not related to changes in other articles.
22 **Remember that the Article 2A Committee may decide to adopt the Article 2**
23 **position on some of the matters discussed below.**

24 As a preliminary matter, it should be noted that draft revised Article 2A
25 looks very different from present Article 2A. Language in almost every section,
26 following similar changes in Article 2, has been changed, and the sections have been
27 rearranged. Many of the language changes are not intended to be substantive. The
28 new language often merely clarifies the meaning of present sections or conforms to
29 the current style rules of the Conference. The section reordering is a result of the
30 addition of a number of new sections from Article 2 and reorganization, particularly,
31 in remedies parts of the Act.

32 **A. Section 2A-107. Attorney's fees in actions by consumers claiming**
33 **unconscionability; Special rule for determining whether standard terms in a**
34 **form contract are binding on consumers.**

35 **(1) Attorney's fees.**

1 Present Article 2A expanded the unconscionability provisions of Article 2 in
2 three ways as to consumer lessees. First, Article 2A gives a court power to grant
3 “appropriate relief” if it finds unconscionable conduct in the **collection of a claim**
4 arising from a lease contract. Second, courts are given power to grant relief if
5 agreement to the lease contract or to a term thereof was **induced by**
6 **unconscionable conduct**. Third, **attorney’s fees** are given to consumers who
7 prevail on an unconscionability claim (and attorney’s fees are given to the other
8 party if the court finds that the consumer lessee knew an asserted unconscionability
9 claim to be groundless).

10 The Article 2 Committee has adopted the provisions of Article 2A dealing
11 with unconscionable conduct in collection of a claim and in the inducement of
12 agreement to a contract or a term. Article 2, however, did not adopt the Article 2A
13 provision on attorney’s fees. The Article 2A Committee decided not to recede from
14 the current Article 2A attorney’s fee provision.

15 **(2) Rules for determining whether terms in a standard form contract**
16 **are binding on consumers.**

17 For several years the Article 2 Committee has been struggling with terms in
18 form contracts which a consumer party has not read and which may impose
19 unexpected, unbargained terms which are inconsistent with the bargained deal or
20 which impose onerous terms on the consumer. Article 2 has chosen to deal with the
21 problem by adding a new subsection (b) to the unconscionably section which
22 permits a court to find a term in a form contract with a consumer unconscionable if
23 it (1) eliminates the essential purpose of the contract, (2) conflicts with other
24 material terms to which the parties have expressly agreed, or (3) imposes manifestly
25 unreasonable risk or cost on the consumer.

26 Presently, Article 2A addresses the issue in a Comment to Section 2-107.
27 That 2 is fairly long (see Comments 2, 3, and 4 to Section 2A-107). However, the
28 heart of the Comment is the following sentence which appears in Comment 3.
29 “However, in [the form contract] setting a term which is inconsistent with the
30 essential purpose of the contract or conflicts with material terms to which the parties
31 have explicitly agreed , or terms which impose undue risk or cost on the consumer
32 under the circumstances, may be declared unconscionable by a court.”

33 Therefore, the basic difference between Article 2 and Article 2A is that
34 Article 2 puts in the statutory text what in Article 2A is a Comment. The Article 2A
35 Committee, at its meeting immediately before the Annual Meeting, will consider
36 whether the Article 2 language should be added to the text of Section 2A-107.

1 **B. The battle of the forms (no Article 2A section) (Continues existing**
2 **variation).**

3 Present Article 2A does not contain a section analogous to present Section
4 2-207. That section deals with formation of contract through the exchange of
5 forms, typically a purchase order and an acknowledgment. The provision was
6 omitted from Article 2A because leasing contracts are seldom, if ever, made through
7 such an exchange of forms. The typical leasing pattern is the execution of a single
8 writing (now “record”) by both parties.

9 The Article 2 Drafting Committee has tried a number of different approaches
10 to the battle of forms problem in revised Article 2. The present provisions in the
11 revision are Sections 2-203(d), 2-205(b), and 2-207. Under Sections 2-203(d) and
12 2-205(b), a definite expression of acceptance in a record is an acceptance even
13 though the record contains terms different from those of the offer unless the record
14 of one of the parties states that the party intends to contract only if the other party
15 agrees to all terms in that record. Section 2-207 then states rules for determining
16 the terms of a contract created by an exchange of forms which contain differing
17 terms.

18 The Article 2A Committee has decided to adhere to the original Article 2A
19 decision and not include “battle of the forms” provisions in Article 2A.

20 **C. Statue of frauds (Section 2A-201).**

21 The Article 2A Committee received strong representations from lessor
22 representatives that the present Article 2A statute of frauds should be retained as is.
23 The Committee agreed to retain the present Article 2A statute. (However, style
24 changes were made to conform to style changes in Article 2.) There are two major
25 differences between the revised Article 2 draft and present Article 2A. First, Article
26 2A requires a writing if the lease price is \$1,000 or more while revised Article 2 sets
27 the threshold at \$5,000. Revised Article 2A retains the \$1,000 threshold.

28 The typical leasing transaction is more complex than the typical sale. Even
29 small value leases are essentially always represented by a single written contract
30 signed by both parties. Most commercially important leases create a long term
31 continuing relationship between the parties which often involves multiple duties on
32 each side. Even short term consumer lease agreements are usually in writing.
33 Therefore, it is more important than in a sales transaction that the terms of the
34 agreement be in writing.

35 Second, revised Article 2 requires a party pleading the statute of frauds as a
36 defense to “den[y] facts from which an agreement may be found.” The Article 2A

1 Committee rejected that provision. Of course, revised Section 2A-201 contains the
2 present Article 2 and Article 2A provision that a contract is enforceable, though
3 oral, against a party that admits in its “pleadings, testimony, or otherwise in court
4 that a lease contract was made.” The Article 2A Committee was uncertain of the
5 effect of the new language and decided not to recommend it for Article 2A.

6 Retaining the present Article 2A statute of frauds creates some additional
7 incentive for parties to get the deal in writing. This is viewed by the people in the
8 industry as a good thing. Also, since leases are essentially always put in writing
9 today, retaining the present statute of frauds will not interfere with any significant
10 practice of entering into oral leases.

11 Revised Article 2 also includes a statute of frauds provision in its
12 modification of contract section (Section 2-209) which requires that any
13 modification of a contract which involves more than \$5,000 in change of price or
14 increases the quantity of goods by the value of \$5,000 or more must satisfy the
15 requirements of the statute of frauds. Article 2A currently makes no reference to
16 the statute of frauds in its modification section (Section 2A-303). The Article 2A
17 Committee decided not to follow the Article 2 revision. In the leasing context, the
18 Article 2A Committee prefers to leave the issue to the courts under the general
19 statute of frauds section. The Article 2 approach of tying the requirement of a
20 writing to the value of the modification will create some difficult factual questions in
21 the lease context. If the beginning term of a lease is changed by six months by an
22 oral modification, could one of the parties later claim that the modification adversely
23 affects it by more than \$5,000 (or whatever the triggering amount is).

24 **D. Extension of express warranties to remote lessees (no Article 2A**
25 **section).**

26 Section 2-408 of Revised Article 2 gives remote buyers and lessees rights
27 against sellers who make promises or representations in advertising or in materials
28 distributed with products. The Article 2A Committee has decided not to include a
29 similar provision in Article 2A because we know of no instances in which remote
30 lessors advertise or make representations in material to be delivered to remote
31 lessees. There may be instances in which “wholesale lessors” lease to “retail
32 lessors” but we know of no cases in which “wholesale lessors” make warranties to
33 remote lessees. Industry advisors have argued that Article 2A should not contain a
34 warranty provision that deals with a situation that does not exist in the industry.
35 (The Article 2 provision (Section 2-408) itself extends **seller** advertised, or with-the-
36 goods, warranties to remote lessees.) A Comment to Section 2A-501 states that if a
37 practice does develop of remote lessors advertising or providing representations in
38 material which accompanies goods leased to remote lessees, it would be appropriate
39 to apply Section 2-408 by analogy to such a remote lessor.

1 It should be noted that revised Section 2A-508, as did original Section
2 2A-216, extends lessor warranties, made to an immediate lessee, to some transferees
3 and other users who may be expected to use or be affected by the goods. The
4 particular provisions of revised Section 2A-508 are identical in substance to revised
5 Section 2-409 which is the replacement for present Section 2-316 (and Section
6 2A-216).

7 **E. Contractual modification of remedy (Section 2A-711).**

8 Article 2A adopted unchanged Section 2-719 of present Article 2. The
9 Article 2 Drafting Committee has changed that section (now Section 2-810) so that
10 limitations on consequential damages are unenforceable in consumer contracts if the
11 “agreed remedy” fails of its essential purpose.

12 The Article 2A Committee rejected that change to the section. The Article
13 2A Committee does not believe that the failure of a repair or replacement warranty,
14 for example, should automatically invalidate a disclaimer of liability for
15 consequential damages, even in a consumer transaction. Most cases under present
16 Article 2 hold that a limitation on consequential damages may be effective even if
17 the seller is unable to provide the agreed limited remedy. (The usual agreed remedy
18 is a repair or replacement promise.) Therefore, the issue is whether, if the lessor is
19 unable to repair or replace, a consumer lessee is, in all cases, entitled to recover
20 consequential damages even though the contract also separately excludes liability for
21 consequential damages. Under Article 2A, a consumer could attack the limitation of
22 liability for consequential damages as unconscionable, but would not be able to
23 automatically obtain consequential damages if an agreed remedy fails.

24 It should be noted that Article 2A presently contains consumer protections
25 which Article 2 does not have, including an expanded unconscionability section and
26 limitations on choice of law and choice of forum in consumer leases.

27 **F. Limitation on choice of law and choice of forum in consumer**
28 **transactions (Section 2A-107) (continues existing variation).**

29 Present Article 2A restricts the power of the parties to a consumer lease to
30 chose the applicable law or applicable forum. The law chosen must be that of
31 jurisdiction in which the lessee resides or the jurisdiction in which goods will be
32 used. A choice of forum is effective only if that jurisdiction would otherwise have
33 jurisdiction over the lessee. Present Article 2 has no such provisions and the Article
34 2 Drafting Committee has chosen not to adopt similar provisions in Article 2. The
35 Article 2A Committee, adopting the principle that it would not reduce consumer
36 protections in present Article 2A, has voted to retain those provision.

1 **G. Statute of limitations, accrual of cause of actions (Section 2A-**
2 **708) (continues existing variation).**

3 In present Article 2 a course of action generally accrues when the breach
4 occurs whether or not the other party knows of the breach, and breach of warranty
5 occurs when goods are delivered unless the warranty expressly extends to future
6 performance. The original Article 2A Drafting Committee rejected the time-of-
7 breach rule and instead adopted the rule that the time the other party learned, or
8 should have learned, of the breach is the time of the accrual of the cause of action.
9 (Article 2A adopted the Article 2 four year period for bringing action after accrual
10 of the cause of action.) The Article 2 revision has slightly modified the original
11 statute by extending the statute for an additional year, to five years maximum, if the
12 aggrieved party does not discover the breach until after it has occurred.

13 The Article 2A Committee decided to adhere to the present Article 2A
14 position as to the time of accrual of the cause of action. The Committee believes
15 that generally the time the injured party learned, or should have learned, of the
16 breach is a fairer rule and works even-handedly between lessors and lessees. In
17 sales, using the time the injured party learned, or should have learned, of the breach
18 would create the possibility of a warranty claim against a seller ten or twenty or
19 more years after the sale and long after the seller had any contact with the buyer or
20 the goods. In leases that problem for lessors exists only to a small degree, if at all.
21 In any event, the lessor business community is willing to accept that small additional
22 risk in order to also gain the advantage of not having the statute of limitations run
23 against lessors until the lessor discovers or should have discovered the breach.

24 **H. Remedial promise (no Article 2A section).**

25 Revised Article 2 adopts a new concept, the “remedial promise.” A remedial
26 promise is defined as a “promise by a seller to repair or replace the goods, or the
27 like, or to refund the price if (1) the goods do not conform to the contract or a
28 representation at the time of the delivery of the goods or if (2) the goods conform at
29 the time of delivery but fail thereafter to perform as agreed or (3) if the goods
30 contain a defect. The concept has two consequences in Article 2. First, the statute
31 of limitations does not begin to run for breach of the remedial promise until there is
32 failure to perform as promised. The usual rule for breach of warranty in Article 2 is
33 that the statute begins to run when the goods are delivered. However, the statute
34 does not begin to run on express warranties as to the future performance of goods
35 until the goods fail to perform as promised. (Section 2-814). Since some promises
36 to repair or replace might not be technically promises as to the future performance
37 of the goods, the remedial promise concept delays the running of the statute of
38 limitations in some cases where there would be no delay under present Article 2.

1 The second consequence is a special damages rule for breach of a remedial
2 promise. Under Sections 2-827(c) and 2-408(e)(2) the measure of damages for
3 breach of a remedial promise is the difference between the value of the promised
4 performance and the value of the actual performance. Presumably, the otherwise
5 applicable damages measure being replaced is difference in value of the goods as
6 they actually are and the value they would have had the remedial promise been
7 performed.

8 The Article 2A Committee decided not to adopt the “remedial promise”
9 concept in 2A. It is not needed for statute-of-limitations purposes since the basic
10 rule in Article 2A is that the statute does not begin to run until the default is or
11 should have been discovered.

12 Also, in the leasing context, a lessee is never seeking a recovery based on the
13 value of the goods; rather the recovery is based on the value of the use of the goods,
14 and it did not seem that the remedial promise concept assisted in damages
15 calculations in the leasing context. If, for example, a lessor promises to keep a
16 copying machine in working order and it fails in the last week of a one year lease,
17 the damages for failure of the lessor to repair the machine is going to be less than if
18 the machine fails in the first week and the lessor fails to repair. It does not seem
19 helpful in damages calculations in the leasing context to state a rule which refers to
20 difference in value between the promise made and the value of the actual
21 performance of the promise, rather than referring to either (1) difference between
22 the value for the use of the goods as promised and the value as they actually are
23 (Section 2A-736(b)) or (2) the loss resulting from the default determined in any
24 manner that is reasonable (Section 2A-736(a)).

25 **I. Consequential damages in consumer contracts.**

26 As a part of recent Article 2 changes relating to consumer issues, a provision
27 has been added to Section 2-806 reading: “Unless otherwise agreed, in a consumer
28 contract a seller may not recover consequential damages from a consumer.”

29 The Article 2A Committee has not yet had an opportunity to consider
30 whether that provision should be added to Article 2A. That matter will be
31 considered at the meeting of the Committee immediately prior to the Annual
32 Meeting.

33 **J. Proposed amendment of Article 2A title warranties not related to** 34 **changes in Article 2 (Section 2A-502).**

35 Under present Section 2A-211 non-finance lessors warrant only “that no
36 person holds a claim to or interest in the good **“that arose from an act or omission**

1 **of the lessor”** that will interfere with the leasehold estate. Finance lessors make no
2 warranty of quiet enjoyment at all. The Article 2A Committee modified those
3 warranties so that a non-finance lessor makes a general warranty of quiet enjoyment
4 (which protects against title defects even though not caused by an act or omission of
5 the lessor) and a finance lessor warranties against its own acts which cause
6 interference with the leasehold interest. The warranty also covers unfounded but
7 colorable claims that interfere with the leasehold interest.

8 The changes also conform to changes in the Article 2 title warranties section
9 (Section 2-402) which now protects against “colorable” claims. The concept of
10 “colorable claims is discussed in the Comment to Section 2A-502.

1 **PROPOSED REVISIONS OF**
2 **UNIFORM COMMERCIAL CODE**
3 **ARTICLE 2A – LEASES**

4 **PART 1**

5 **GENERAL PROVISIONS**

6 **SECTION 2A-101. SHORT TITLE.** This article may be cited as Uniform
7 Commercial Code – Leases.

8 **Comment**

9 **Rationale for Codification:**

10 The Comments below, prepared for the original promulgation of Article 2A,
11 relevant to revised Article 2A. They have been revised to refer to the sections of
12 this revised version of Article 2A and to the sections of revised Article 2 and Article
13 9.

14 There are several reasons for codifying the law with respect to leases of
15 goods. An analysis of the case law as it applies to leases of goods suggests at least
16 three significant issues to be resolved by codification. First, what is a lease? It is
17 necessary to define lease to determine whether a transaction creates a lease or a
18 security interest disguised as a lease. If the transaction creates a security interest
19 disguised as a lease, the lessor will be required to file a financing statement or take
20 other action to perfect its interest in the goods against third parties. There is no
21 such requirement with respect to leases. Yet the distinction between a lease and a
22 security interest disguised as a lease is not clear. Second, will the lessor be deemed
23 to have made warranties to the lessee? If the transaction is a sale the express and
24 implied warranties of Article 2 of the Uniform Commercial Code apply. However,
25 the warranty law with respect to leases is uncertain. Third, what remedies are
26 available to the lessor upon the lessee's default? If the transaction is a security
27 interest disguised as a lease, the answer is stated in Part 5 of the Article on Secured
28 Transactions (Article 9). There is no clear answer with respect to leases.

29 There are reasons to codify the law with respect to leases of goods in
30 addition to those suggested by a review of the reported cases. The answer to this
31 important question should not be limited to the issues raised in these cases. Is it not
32 also proper to determine the remedies available to the lessee upon the lessor's
33 default? It is, but that issue is not reached through a review of the reported cases.

1 This is only one of the many issues presented in structuring, negotiating and
2 documenting a lease of goods.

3 **Statutory Analogue:**

4 After it was decided to proceed with the codification project, the Drafting
5 Committee of the National Conference of Commissioners on Uniform State Laws
6 looked for a statutory analogue, gradually narrowing the focus to the Article on
7 Sales (Article 2) and the Article on Secured Transactions (Article 9). A review of
8 the literature with respect to the sale of goods reveals that Article 2 is predicated
9 upon certain assumptions: Parties to the sales transaction frequently are without
10 counsel; the agreement of the parties often is oral or evidenced by scant writings;
11 obligations between the parties are bilateral; applicable law is influenced by the need
12 to preserve freedom of contract. A review of the literature with respect to personal
13 property security law reveals that Article 9 is predicated upon very different
14 assumptions: Parties to a secured transaction regularly are represented by counsel;
15 the agreement of the parties frequently is reduced to a writing, extensive in scope;
16 the obligations between the parties are essentially unilateral; and applicable law
17 seriously limits freedom of contract.

18 The lease is closer in spirit and form to the sale of goods than to the creation
19 of a security interest. While parties to a lease are sometimes represented by counsel
20 and their agreement is often reduced to a writing, the obligations of the parties are
21 bilateral and the common law of leasing is dominated by the need to preserve
22 freedom of contract. Thus the Drafting Committee concluded that Article 2 was the
23 appropriate statutory analogue.

24 **Issues:**

25 The Drafting Committee then identified and resolved several issues critical to
26 codification:

27 **Scope:** The scope of the Article was limited to leases (Section 2A-103).
28 There was no need to include leases intended as security, *i.e.*, security interests
29 disguised as leases, as they are adequately treated in Article 9. Further, even if
30 leases intended as security were included, the need to preserve the distinction would
31 remain, as policy suggests treatment significantly different from that accorded
32 leases.

33 **Definition of Lease:** Lease was defined to exclude leases intended as
34 security (Section 2A-102(a)(21)). Given the litigation to date a revised definition of
35 security interest was suggested for inclusion in the Act. (Section 1-201(37)). This
36 revision sharpens the distinction between leases and security interests disguised as
37 leases.

1 **Filing:** The lessor was not required to file a financing statement against the
2 lessee or take any other action to protect the lessor’s interest in the goods (Section
3 2A-401). The refined definition of security interest will more clearly signal the need
4 to file to potential lessors of goods. Those lessors who are concerned will file a
5 protective financing statement (Section 9-505).

6 **Warranties:** Express and implied warranties provisions similar to those of
7 Article on Sales (Article 2) were included (Sections 2A-501 through 2A-508),
8 revised to reflect differences in lease transactions. The lease of goods is sufficiently
9 similar to the sale of goods to justify this decision. Further, many courts have
10 reached the same decision.

11 **Certificate of Title Laws:** Many leasing transactions involve goods subject
12 to certificate of title statutes. To avoid conflict with those statutes, this Article is
13 subject to them (Section 2A-104(a)(1)).

14 **Consumer Leases:** Many leasing transactions involve parties subject to
15 consumer protection statutes or decisions. To avoid conflict with those laws this
16 Article is subject to them to the extent provided in (Section 2A-104(a)(3) and (b)).
17 Further, certain consumer protections have been incorporated in the Article.

18 **Finance Leases:** Certain leasing transactions substitute the supplier of the
19 goods for the lessor as the party responsible to the lessee with respect to warranties
20 and the like. The definition of finance lease (Section 2A-102(a)(17)) was developed
21 to describe these transactions. Various sections of the Article implement the
22 substitution of the supplier for the lessor, including Sections 2A-303 and 2A-607.
23 No attempt was made to fashion a special rule where the finance lessor is an affiliate
24 of the supplier of goods; this is to be developed by the courts, case by case.

25 **Sale and Leaseback:** Sale and leaseback transactions are becoming
26 increasingly common. A number of state statutes treat transactions where
27 possession is retained by the seller as fraudulent *per se* or *prima facie* fraudulent.
28 That position is not in accord with modern practice and thus is changed by the
29 Article “if the buyer bought for value and in good faith” (Section 2A-408(d)).

30 **Remedies:** The Article has not only provided for lessor’s remedies upon
31 default by the lessee (Sections 2A-716 through 2A-723), but also for lessee’s
32 remedies upon default by the lessor (Sections 2A-724 through 2A-737). This is a
33 significant departure from Article 9, which provides remedies only for the secured
34 party upon default by the debtor. This difference is compelled by the bilateral nature
35 of the obligations between the parties to a lease.

1 **Damages:** Many leasing transactions are predicated on the parties' ability to
2 stipulate an appropriate measure of damages in the event of default. The rule with
3 respect to sales of goods (Section 2-809) is not sufficiently flexible to accommodate
4 this practice. Consistent with the common law emphasis upon freedom to contract,
5 the Article has created a revised rule that allows greater flexibility with respect to
6 leases of goods (Section 2A-710(a)).

7 **Relationship of Article 2A to Other Articles:**

8 The Article on Sales provided a useful point of reference for codifying the
9 law of leases. Many of the provisions of that Article were carried over, changed to
10 reflect differences in style, leasing terminology or leasing practices. Thus, the
11 Official Comments to those sections of Article 2 whose provisions were carried over
12 are incorporated by reference in Article 2A, as well; further, any case law
13 interpreting those provisions should be viewed as persuasive but not binding on a
14 court when deciding a similar issue with respect to leases. Any change in the
15 sequence that has been made when carrying over a provision from Article 2 should
16 be viewed as a matter of style, not substance. For lack of relevance or significance
17 not all of the provisions of Article 2 were incorporated in Article 2A.

18 This codification was greatly influenced by the fundamental tenet of the
19 common law as it has developed with respect to leases of goods: freedom of the
20 parties to contract. Note that, like all other Articles of this Act, the principles of
21 construction and interpretation contained in Article 1 are applicable throughout
22 Article 2A. These principles include the ability of the parties to vary the effect of
23 the provisions of Article 2A, subject to certain limitations including those that relate
24 to the obligations of good faith, diligence, reasonableness and care (Section
25 1-102(3)). Consistent with those principles no negative inference is to be drawn by
26 the episodic use of the phrase "unless otherwise agreed" in certain provisions of
27 Article 2A. Section 1-102(4). Indeed, the contrary is true, as the general rule in the
28 Act, including this Article, is that the effect of the Act's provisions may be varied by
29 agreement. Section 1-102(3). This conclusion follows even where the statutory
30 analogue contains the phrase and the correlative provision in Article 2A does not.

31 **SECTION 2A-102. DEFINITIONS AND INDEX OF DEFINITIONS.**

32 (a) In this article:

33 (1) "Authenticate" means:

34 (A) to sign; or

1 (B) otherwise to execute or adopt a symbol or sound, or to use
2 encryption or another process with respect to a record, with intent of the
3 authenticating person to:

4 (i) identify that person; or

5 (ii) adopt or accept the terms or a particular term of a record that
6 includes or is logically associated with, or linked to, the authentication or to which a
7 record containing the authentication refers.

8 (2) “Cancellation” means an act by either party which ends a lease
9 contract because of a default by the other party.

10 (3) “Commercial unit” means a unit of goods which by commercial
11 usage is a single whole for purposes of lease and whose division materially impairs
12 its character or value in the relevant market or in use. A commercial unit may be a
13 single article, such as a machine; a set of articles, such as a suite of furniture or a line
14 of machinery; a quantity, such as a gross or carload; or any other unit treated in use
15 or in the relevant market as a single whole.

16 (4) “Computer” means an electronic device that can perform substantial
17 computations, including numerous arithmetic operations or logic operations,
18 without human intervention during the computation or operation.

19 (5) “Conforming” goods or conduct under a lease contract means goods
20 or performance that are in accordance with the obligations under the contract.

21 (6) “Conspicuous”, with reference to a term, means so written,
22 displayed, or otherwise presented that a reasonable person against which it is to

1 operate ought to have noticed it. A term in an electronic record intended to evoke a
2 response by an electronic agent is conspicuous if it is presented in a form that would
3 enable a reasonably configured electronic agent to take it into account or react
4 without review of the record by an individual. Conspicuous terms include the
5 following:

6 (A) with respect to a person:

7 (i) a heading in capitals in a size equal to or greater than, or in
8 contrasting type, font, or color to, the surrounding text;

9 (ii) language in the body of a record or display in larger or other
10 contrasting type, font, or color or set off from the surrounding text by symbols or
11 other marks that call attention to the language; and

12 (iii) a term prominently referenced in an electronic record or
13 display which is readily accessible and reviewable from the record or display; and

14 (B) with respect to a person or an electronic agent, a term or
15 reference to a term that is so placed in a record or display that the person or
16 electronic agent can not proceed without taking some action with respect to the
17 term or reference.

18 (7) "Consumer" means an individual who leases or contracts to lease
19 goods that, at the time of contracting, are intended by the individual to be used
20 primarily for personal, family, or household purposes. Personal, family, or
21 household use does not include professional or commercial purposes, including

1 agriculture, business management, and investment management, other than
2 management of the individual's personal or family investments.

3 (8) "Consumer lease" means a lease between a merchant lessor and a
4 consumer.

5 *Legislative Note: Present Article 2A has a bracketed provision allowing States to*
6 *insert a dollar cap on leases designated as consumer leases, Revised Article 2*
7 *defines "consumer contract" and does not include a dollar cap in the definition.*
8 *Some States have not included a dollar cap in present Article 2A and States which*
9 *have adopted a dollar cap have stated varying amounts. If a State wishes to*
10 *include a dollar cap, the cap should be inserted here. Any cap probably should be*
11 *set high enough to bring within the definition most automobile leasing transactions*
12 *for personal, family, or household use.*

13 (9) "Delivery" means the voluntary transfer of physical possession or
14 control of goods.

15 (10) "Electronic" means relating to technology having electrical, digital,
16 magnetic, wireless, optical, or electromagnetic, or similar capabilities.

17 (11) "Electronic agent" means a computer program or electronic or
18 other automated means used to initiate an action or to respond to electronic
19 messages or performances without intervention by an individual at the time of the
20 action or response.

21 (12) "Electronic message" means an electronic record or display stored,
22 generated, or transmitted by electronic means for purposes of communication to
23 another person or electronic agent.

24 (13) "Electronic event" means an electronic authentication, message,
25 record, or performance.

1 (14) “Finance lease” means a lease with respect to which:

2 (A) the lessor does not select, manufacture, or supply the goods;

3 (B) the lessor acquires the goods or the right to possession and use

4 of the goods in connection with the lease or, in the case of goods that have been

5 leased previously by the lessor and are not being leased to a consumer, in

6 connection with another lease; and

7 (C) one of the following occurs:

8 (i) the lessee receives a copy of the agreement by which the

9 lessor acquired, or proposes to acquire, the goods or the right to possession and use

10 of the goods before authenticating the lease agreement;

11 (ii) the lessee’s approval of the agreement or of the general

12 contractual terms under which the lessor acquired or proposes to acquire the goods

13 or the right to possession and use of the goods is a condition to the effectiveness of

14 the lease contract;

15 (iii) the lessee, before authenticating the lease agreement,

16 receives an accurate and complete statement designating the promises and

17 warranties, and any disclaimers of warranties, limitations or modifications of

18 remedies, or liquidated damages, including those of a third party, such as the

19 manufacturer of the goods, provided to the lessor by the person supplying the goods

20 in connection with or as part of the contract by which the lessor acquired the goods

21 or the right to possession and use of the goods; or

1 (iv) if the lease is not a consumer lease, before the lessee
2 authenticates the lease agreement, the lessor informs the lessee in writing:

3 (I) of the identity of the person supplying the goods to the
4 lessor, unless the lessee has selected that person and directed the lessor to acquire
5 the goods or the right to possession and use of the goods from that person;

6 (II) that the lessee is entitled under this article to the promises
7 and warranties, including those of any third party, provided to the lessor by the
8 person supplying the goods in connection with or as part of the contract by which
9 the lessor acquired the goods or the right to possession and use of the goods; and

10 (III) that the lessee may communicate with the person
11 supplying the goods to the lessor and receive an accurate and complete statement of
12 those promises and warranties, including any disclaimers and limitations of them, or
13 a statement of remedies.

14 (15) “Good faith” means honesty in fact and the observance of
15 reasonable commercial standards of fair dealing.

16 (16) “Goods” means all things that are movable at the time of
17 identification to a lease contract, or which are fixtures. The term includes the
18 unborn young of animals. The term does not include money in which the rent is to
19 be paid, the subject of foreign exchange transactions, documents, letters of credit,
20 instruments, investment property, accounts, chattel paper, or general intangibles,
21 payment intangibles, or minerals, or the like, including oil and gas, before extraction.

1 (17) “Information processing system” means an electronic system for
2 creating, generating, sending, receiving, storing, displaying, or processing
3 information.

4 (18) “Lease” means the transfer of the right to possession and use of
5 goods for a period in return for consideration. The term includes a sublease unless
6 the context clearly indicates otherwise. The term does not include a sale, including a
7 sale on approval or a sale or return, or retention or creation of a security interest.

8 (19) “Lease agreement” means the bargain, with respect to the lease, of
9 the lessor and the lessee in fact as found in their language or inferred from other
10 circumstances, including course of performance, course of dealing, or usage of trade
11 as provided in this article. The term includes a sublease agreement unless the
12 context clearly indicates otherwise.

13 (20) “Lease contract” means the total legal obligation resulting from the
14 lease agreement as affected by this article and other applicable law. The term
15 includes a sublease contract unless the context clearly indicates otherwise.

16 (21) “Leasehold interest” means the interest of the lessor or the lessee
17 under a lease contract.

18 (22) “Lessee” means a person that acquires the right to possession and
19 use of goods under a lease. The term includes a sublessee unless the context clearly
20 indicates otherwise.

21 (23) “Lessee in ordinary course of business” means a person that, in
22 good faith and without knowledge that its lease is in violation of ownership rights, a

1 security interest, or a leasehold interest of a third party in the goods, leases in the
2 ordinary course from a person in the business of selling or leasing goods of that kind
3 for cash or by exchange of other property or on secured or unsecured credit,
4 including receiving goods or documents of title under a preexisting lease contract
5 but not including a transfer in bulk or as security for or in total or partial satisfaction
6 of a money debt. The term does not include a pawnbroker.

7 (24) “Lessor” means a person that transfers the right to possession and
8 use of goods under a lease. The term includes a sublessor unless the context clearly
9 indicates otherwise.

10 (25) “Lessor’s residual interest” means the lessor’s interest in goods
11 after expiration, termination, or cancellation of a lease contract.

12 (26) “Lien” means a charge against or interest in goods to secure
13 payment of a debt or performance of an obligation. The term does not include a
14 security interest.

15 (27) “Lot” means a parcel or single article that is the subject matter of a
16 separate lease or delivery, whether or not it is sufficient to perform the lease
17 contract.

18 (28) “Merchant lessee” means a lessee that is a merchant with respect to
19 goods of the kind subject to the lease.

20 (29) “Present value” means the amount as of a date certain of one or
21 more sums payable in the future, discounted to the date certain. In determining
22 present value, the discount is determined by the interest rate specified by the parties

1 if the rate was not manifestly unreasonable at the time the transaction was entered
2 into. Otherwise, the discount is determined by a commercially reasonable rate that
3 takes into account the facts and circumstances of each case at the time the
4 transaction was entered into.

5 (30) "Receive" means:

6 (A) with respect to goods, to take delivery; or

7 (B) with respect to a notice:

8 (i) to come to a person's attention; or

9 (ii) to be delivered to and available at a location designated by
10 agreement for the purpose of notice, or, in the absence of an agreed location:

11 (I) to be delivered at the person's residence, or the person's
12 place of business through which the contract was made, or at any other place held
13 out by the person as a place for the receipt of such notices; or

14 (II) in the case of an electronic record, to come into existence
15 in an information processing system in a form capable of being processed by or
16 perceived from a system of that type, if the recipient uses, has designated, or holds
17 out that system as a place for the receipt of the notices.

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

21 (32) "Send" means, with any costs provided for and properly addressed

1 or directed as reasonable under the circumstances or as otherwise agreed, to (i)
2 deposit in the mail or with a commercially reasonable carrier, (ii) deliver for
3 transmission to or creation in another location or system, or (iii) take the steps
4 necessary to initiate transmission to or creation in another location or system. In
5 addition, with respect to an electronic message, the term means to initiate operations
6 that in the ordinary course will cause the record to come into existence in an
7 information processing system in a form capable of being processed by or perceived
8 from a system of that type by the recipient, if the recipient uses, has designated, or
9 holds out that system or address as a place for the receipt of communications of the
10 kind. Receipt within the time in which it would have arrived if properly sent has the
11 effect of a proper sending.

12 (33) “Sublease” means a lease of goods whose right to possession and
13 use is acquired by the lessor as a lessee under an existing lease.

14 (34) “Supplier” means a person from which a lessor buys or leases
15 goods to be leased under a finance lease.

16 (35) “Supply contract” means a contract under which a lessor buys or
17 leases goods to be leased.

18 (36) “Termination” means the ending of a contract or a part thereof by
19 an act by a party under a power created by agreement or law, or by operation of the
20 terms of the agreement for a reason other than for a default by the other party.

21 (b) The following definitions in other articles apply to this article:

22 (1) “Account” Section 9-102(a)(2).

1 For a transaction to qualify as a consumer lease it must first qualify as a
2 lease. Note that this Article regulates the transactional elements of a lease, including
3 a consumer lease; consumer protection statutes, present and future, and existing
4 consumer protection decisions are unaffected by this Article. Section 2A-104(a)(3)
5 and (b). Of course, Article 2A as state law also is subject to federal consumer
6 protection law.

7 This definition is modeled after the definition of consumer lease in the
8 Consumer Leasing Act, 15 U.S.C. § 1667 (1982), and in the Unif. Consumer Credit
9 Code § 1.301(14), 7A U.L.A. 43 (1974). However, this definition of consumer
10 lease differs from its models in several respects: the lessor can be a person regularly
11 engaged either in the business of leasing or of selling goods, the lease need not be
12 for a term exceeding four months, a lease primarily for an agricultural purpose is not
13 covered.

14 This definition focuses on the parties as well as the transaction. If a lease is
15 within this definition, the lessor must be regularly engaged in the business of leasing
16 or selling, and the lessee must be an individual, not an organization; note that a lease
17 to two or more individuals having a common interest through marriage or the like is
18 not excluded as a lease to an organization under Section 1-201(28). The lessee
19 must take the interest primarily for a personal, family or household purpose. If
20 required by the enacting State, total payments under the lease contract, excluding
21 payments for options to renew or buy, cannot exceed the figure designated.

22 (14) "Finance Lease". This Article includes a subset of rules that applies
23 only to finance leases. Sections 2A-303, 2A-502(b), 2A-504(a), 2A-505,
24 2A-306(a), 2A-307, 2A-732(b), and 2A-733(a)(1) and (b).

25 For a transaction to qualify as a finance lease it must first qualify as a lease.
26 Unless the lessor is comfortable that the transaction will qualify as a finance lease,
27 the lease agreement should include provisions giving the lessor the benefits created
28 by the subset of rules applicable to the transaction that qualifies as a finance lease
29 under this Article.

30 A finance lease is the product of a three party transaction. The supplier
31 manufactures or supplies the goods pursuant to the lessee's specification, perhaps
32 even pursuant to a purchase order, sales agreement or lease agreement between the
33 supplier and the lessee. After the prospective finance lease is negotiated, a purchase
34 order, sales agreement, or lease agreement is entered into by the lessor (as buyer or
35 prime lessee) or an existing order, agreement or lease is assigned by the lessee to the
36 lessor, and the lessor and the lessee then enter into a lease or sublease of the goods.
37 Due to the limited function usually performed by the lessor, the lessee looks almost
38 entirely to the supplier for representations, covenants and warranties. If a

1 manufacturer's warranty carries through, the lessee may also look to that. Yet, this
2 definition does not restrict the lessor's function solely to the supply of funds; if the
3 lessor undertakes or performs other functions, express warranties, covenants and the
4 common law will protect the lessee.

5 This definition focuses on the transaction, not the status of the parties; to
6 avoid confusion it is important to note that in other contexts, *e.g.*, tax and
7 accounting, the term finance lease has been used to connote different types of lease
8 transactions, including leases that are disguised secured transactions. M. Rice,
9 *Equipment Financing*, 62-71 (1981). A lessor who is a merchant with respect to
10 goods of the kind subject to the lease may be a lessor under a finance lease. Many
11 leases that are leases back to the seller of goods (Section 2A-408(d)) will be finance
12 leases. This conclusion is easily demonstrated by a hypothetical. Assume that B has
13 bought goods from C pursuant to a sales contract. After delivery to and acceptance
14 of the goods by B, B negotiates to sell the goods to A and simultaneously to lease
15 the goods back from A, on terms and conditions that, we assume, will qualify the
16 transaction as a lease. In documenting the sale and lease back, B assigns the original
17 sales contract between B, as buyer, and C, as seller, to A. A review of these facts
18 leads to the conclusion that the lease from A to B qualifies as a finance lease, as all
19 three conditions of the definition are satisfied. Subparagraph (A) is satisfied as A,
20 the lessor, had nothing to do with the selection, manufacture, or supply of the
21 equipment. Subparagraph (B) is satisfied as A, the lessor, bought the equipment at
22 the same time that A leased the equipment to B, which certainly is in connection
23 with the lease. Finally, subparagraph (C)(i) is satisfied as A entered into the sales
24 contract with B at the same time that A leased the equipment back to B. B, the
25 lessee, will have received a copy of the sales contract in a timely fashion.

26 Subsection (A) requires the lessor to remain outside the selection,
27 manufacture and supply of the goods; that is the rationale for releasing the lessor
28 from most of its traditional liability. The lessor is not prohibited from possession,
29 maintenance or operation of the goods, as policy does not require such prohibition.
30 To insure the lessee's reliance on the supplier, and not on the lessor, subsection (B)
31 requires that the goods (where the lessor is the buyer of the goods) or that the right
32 to possession and use of the goods (where the lessor is the prime lessee and the
33 sublessor of the goods) be acquired in connection with the lease (or sublease) to
34 qualify as a finance lease. The scope of the phrase "in connection with" is to be
35 developed by the courts, case by case. Finally, as the lessee generally relies almost
36 entirely upon the supplier for representations and covenants, and upon the supplier
37 or a manufacturer, or both, for warranties with respect to the goods, subsection (C)
38 requires that one of the following occur: (A) the lessee receive a copy of the supply
39 contract before signing the lease contract; (B) the lessee's approval of the supply
40 contract is a condition to the effectiveness of the lease contract; (C) the lessee
41 receive a statement describing the promises and warranties and any limitations

1 relevant to the lessee before signing the lease contract; or (D) before signing the
2 lease contract and except in a consumer lease, the lessee receive a writing identifying
3 the supplier (unless the supplier was selected and required by the lessee) and the
4 rights of the lessee under Section 2A-303, and advising the lessee a statement of
5 promises and warranties is available from the supplier. Thus, even where oral
6 supply orders or computer placed supply orders are compelled by custom and usage
7 the transaction may still qualify as a finance lease if the lessee approves the supply
8 contract before the lease contract is effective and such approval was a condition to
9 the effectiveness of the lease contract. Moreover, where the lessor does not want
10 the lessee to see the entire supply contract, including price information, the lessee
11 may be provided with a separate statement of the terms of the supply contract
12 relevant to the lessee; promises between the supplier and the lessor that do not
13 affect the lessee need not be included. The statement can be a restatement of those
14 terms or a copy of portions of the supply contract with the relevant terms clearly
15 designated. Any implied warranties need not be designated, but a disclaimer or
16 modification of remedy must be designated. A copy of any manufacturer's warranty
17 is sufficient if that is the warranty provided. However, a copy of any Regulation M
18 disclosure given pursuant to 12 C.F.R. § 213.4(g) concerning warranties in itself is
19 not sufficient since those disclosures need only briefly identify express warranties
20 and need not include any disclaimer of warranty.

21 Under subsections (B) and (C), except when the new lease is to a consumer
22 lessee, a finance lessor can have that status on re-leasing the property after it is
23 returned from an original lease. However, in that case, the other elements required
24 for the lease to be a finance lessee must be complied with.

25 If a transaction does not qualify as a finance lease, the parties may achieve
26 the same result by agreement; no negative implications are to be drawn if the
27 transaction does not qualify. Further, absent the application of special rules (fraud,
28 duress, and the like), a lease that qualifies as a finance lease and is assigned by the
29 lessor or the lessee to a third party does not lose its status as a finance lease under
30 this Article. Finally, this Article creates no special rule where the lessor is an
31 affiliate of the supplier; whether the transaction qualifies as a finance lease will be
32 determined by the facts of each case.

33 (18) "Lease". There are several reasons to codify the law with respect to
34 leases of goods. An analysis of the case law as it applies to leases of goods suggests
35 at least several significant issues to be resolved by codification. First and foremost
36 is the definition of a lease. It is necessary to define lease to determine whether a
37 transaction creates a lease or a security interest disguised as a lease. If the
38 transaction creates a security interest disguised as a lease, the transaction will be
39 governed by the Article on Secured Transactions (Article 9) and the lessor will be
40 required to file a financing statement or take other action to perfect its interest in the

1 goods against third parties. There is no such requirement with respect to leases
2 under the common law and, except with respect to leases of fixtures (Section
3 2A-409), this Article imposes no such requirement. Yet the distinction between a
4 lease and a security interest disguised as a lease is not clear from the case law at the
5 time of the promulgation of this Article. DeKoven, *Leases of Equipment: Puritan*
6 *Leasing Company v. August, A Dangerous Decision*, 12 U.S.F. L.Rev. 257 (1978).

7 At common law a lease of personal property is a bailment for hire. While
8 there are several definitions of bailment for hire, all require a thing to be let and a
9 price for the letting. Thus, in modern terms and as provided in this definition, a
10 lease is created when the lessee agrees to furnish consideration for the right to the
11 possession and use of goods over a specified period of time. Mooney, *Personal*
12 *Property Leasing: A Challenge*, 36 Bus.Law. 1605, 1607 (1981). Further, a lease is
13 neither a sale (Section 2-102(32)) nor a retention or creation of a security interest
14 (Section 1-201(37)).

15 This section as well as Section 1-201(37) must be examined to determine
16 whether the transaction in question creates a lease or a security interest. The
17 following hypotheticals indicate the perimeters of the issue. Assume that A has
18 purchased a number of copying machines, new, for \$1,000 each; the machines have
19 an estimated useful economic life of three years. A advertises that the machines are
20 available to rent for a minimum of one month and that the monthly rental is \$100.00.
21 A intends to enter into leases where A provides all maintenance, without charge to
22 the lessee. Further, the lessee will rent the machine, month to month, with no
23 obligation to renew. At the end of the lease term the lessee will be obligated to
24 return the machine to A's place of business. This transaction qualifies as a lease
25 under the first half of the definition, for the transaction includes a transfer by A to a
26 prospective lessee of possession and use of the machine for a stated term, month to
27 month. The machines are goods (Section 2A-102(a)(23)). The lessee is obligated
28 to pay consideration in return, \$100.00 for each month of the term.

29 However, the second half of the definition provides that a sale or a security
30 interest is not a lease. Since there is no passing of title, there is no sale. Under pre-
31 Act security law this transaction would have created a bailment for hire or a true
32 lease and not a conditional sale. *Da Rocha v. Macomber*, 330 Mass. 611, 614-15,
33 116 N.E.2d 139, 142 (1953). Under Section 1-201(37) the same result would
34 follow. While the lessee is obligated to pay rent for the one month term of the lease,
35 one of the other four conditions of the second paragraph of Section 1-201(37) must
36 be met and none is. The term of the lease is one month and the economic life of the
37 machine is 36 months; thus, subparagraph (a) of Section 1-201(37) is not now
38 satisfied. Considering the amount of the monthly rent, absent economic duress or
39 coercion, the lessee is not bound either to renew the lease for the remaining
40 economic life of the goods or to become the owner. If the lessee did lease the

1 machine for 36 months, the lessee would have paid the lessor \$3,600 for a machine
2 that could have been purchased for \$1,000; thus, subparagraph (b) of Section
3 1-201(37) is not satisfied. Finally, there are no options; thus, subparagraphs (c) and
4 (d) of Section 1-201(37) are not satisfied. This transaction creates a lease, not a
5 security interest. However, with each renewal of the lease the facts and
6 circumstances at the time of each renewal must be examined to determine if that
7 conclusion remains accurate, as it is possible that a transaction that first creates a
8 lease, later creates a security interest.

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

16 Between these extremes there are many transactions that can be created.
17 Some of the transactions have not been properly categorized by the courts in
18 applying the 1978 and earlier Official Texts of Section 1-201(37). This subsection,
19 together with present Section 1-201(37) draws a brighter line, which should create a
20 clearer signal to the professional lessor and lessee.

21 (19) "Lease agreement". This definition is derived from the first sentence of
22 Section 1-201(3). Because the definition of lease is broad enough to cover future
23 transfers, lease agreement includes an agreement contemplating a current or
24 subsequent transfer. Thus it was not necessary to make an express reference to an
25 agreement for the future lease of goods.

26 The provisions of this Article, if applicable, determine whether a lease
27 agreement has legal consequences; otherwise the law of bailments and other
28 applicable law determine the same. Section 1-103.

29 (20) "Lease contract". This definition is derived from the definition of
30 contract in Section 1-201(11). Note that a lease contract may be for the future lease
31 of goods, since this notion is included in the definition of lease.

32 (26) "Lien". This term is used in Section 2A-407 (Priority of Liens Arising
33 by Attachment or Levy On Goods).

34 (28) "Merchant lessee". This term is used in Section 2A-727 (Merchant
35 Lessee's Duties; Lessee's Options as to Salvage). A person may satisfy the

1 requirement of dealing in goods of the kind subject to the lease as lessor, lessee,
2 seller, or buyer.

3 (29) “Present value”. Authorities agree that present value should be used to
4 determine fairly the damages payable by the lessor or the lessee on default. *E.g.*,
5 *Taylor v. Commercial Credit Equip. Corp.*, 170 Ga.App. 322, 316 S.E.2d 788
6 (1984). Present value is defined to mean an amount that represents the discounted
7 value as of a date certain of one or more sums payable in the future. This is a
8 function of the economic principle that a dollar today is more valuable to the holder
9 than a dollar payable in two years. While there is no question as to the principle,
10 reasonable people would differ as to the rate of discount to apply in determining the
11 value of that future dollar today. To minimize litigation, this Article allows the
12 parties to specify the discount or interest rate, if the rate was not manifestly
13 unreasonable at the time the transaction was entered into. In all other cases, the
14 interest rate will be a commercially reasonable rate that takes into account the facts
15 and circumstances of each case, as of the time the transaction was entered into.

16 (36) “Termination”. The effect of a termination is provided in Section
17 2A-308.

18 **SECTION 2A-103. SCOPE.** This article applies to any transaction regardless
19 of form which creates a lease.

20 *Legislative Note: If a jurisdiction has adopted the Uniform Computer Information*
21 *Transaction Act or similar legislation, a provision should be added to this section*
22 *which mirrors any provision of that Act which excludes from that Article certain*
23 *leasing transactions.*

24 **Comment**

25 **Uniform Statutory Analogue:** Section 9-109(a). Throughout this Article, unless
26 otherwise stated, references to “section” are to other sections of this Act.

27 This Article governs transactions as diverse as the lease of a hand tool to an
28 individual for a few hours and the leveraged lease of a complex line of industrial
29 equipment to a multi-national organization for a number of years.

30 To achieve that end it was necessary to provide that this Article applies to
31 any transaction, regardless of form, that creates a lease. Since lease is defined as a
32 transfer of an interest in goods (Section 2A-102(a)(21)) and goods is defined to
33 include fixtures (Section 2A-102(a)(19)), application is limited to the extent the
34 transaction relates to goods, including fixtures. Further, since the definition of lease

1 does not include a sale (Section 2-102(a)(32)) or retention or creation of a security
2 interest (Section 1-201(37)), application is further limited; sales and security
3 interests are governed by other Articles of this Act.

4 Finally, in recognition of the diversity of the transactions to be governed, the
5 sophistication of many of the parties to these transactions, and the common law
6 tradition as it applies to the bailment for hire or lease, freedom of contract has been
7 preserved. DeKoven, Proceedings After Default by the Lessee Under a True Lease
8 of Equipment, in 1C P. Coogan, W. Hogan, D. Vagts, *Secured Transactions Under*
9 *the Uniform Commercial Code*, § 29B.02[2] (1986). Thus, despite the extensive
10 regulatory scheme established by this Article, the parties to a lease will be able to
11 create private rules to govern their transaction. Section 1-102(3). However, there
12 are special rules in this Article governing consumer leases, as well as other state and
13 federal statutes, that may further limit freedom of contract with respect to consumer
14 leases.

15 Article 2A covers leases of goods. A pure services contract is not covered
16 by Article 2A, but a court, as in Article 2, could apply Article 2A to a mixed
17 transaction of goods and services if the lease of goods predominates. Also, courts
18 have applied Article 2 to disputes over the quality of goods furnished in transactions
19 in which services predominate. Such results under Article 2A are not precluded by
20 this section.

21 A court may apply this Article by analogy to any transaction, regardless of
22 form, that creates a lease of personal property other than goods, taking into account
23 the expressed intentions of the parties to the transaction and any differences between
24 a lease of goods and a lease of other property. Such application has precedent as
25 the provisions of the Article on Sales (Article 2) have been applied by analogy to
26 leases of goods. *E.g.*, Hawkland, *The Impact of the Uniform Commercial Code on*
27 *Equipment Leasing*, 1972 Ill.L.F. 446; Murray, *Under the Spreading Analogy of*
28 *Article 2 of the Uniform Commercial Code*, 39 Fordham L.Rev. 447 (1971).
29 Whether such application would be appropriate for other bailments of personal
30 property, gratuitous or for hire, should be determined by the facts of each case. *See*
31 *Mieske v. Bartell Drug Co.*, 92 Wash.2d 40, 46-48, 593 P.2d 1308, 1312 (1979).

32 Further, parties to a transaction creating a lease of personal property other
33 than goods, or a bailment of personal property may provide by agreement that this
34 Article applies. Upholding the parties' choice is consistent with the spirit of this
35 Article.

36 **Cross References:**
37 Sections 1-102(3), 1-201(37).

1 **Definitional Cross References:**
2 “Lease”. Section 2A-102(a)(18).

3 **SECTION 2A-104. TRANSACTIONS SUBJECT TO OTHER LAW.**

4 (a) A transaction subject to this article is also subject to:

5 (1) [list any certificate of title statutes covering automobiles, trailers,
6 mobile homes, boats, farm tractors, or the like] except as to the rights of a lessee in
7 the ordinary course of business under Sections 2A-404(d) and 2A-405(d) whose
8 rights arise before a certificate of title covering the goods is effective in the name of
9 any other purchaser.

10 (2) any applicable certificate-of-title statute of another jurisdiction;

11 (3) any applicable law which establishes a different rule for consumer
12 leases;

13 (4) any other law of this State to which the transaction is subject, such as
14 laws dealing with:

15 (A) the sale or lease of agricultural products;

16 (B) the consignment or transfer by artists of works of art or fine
17 prints;

18 (C) distribution agreements, franchises, and other relationships
19 through which goods are leased;

20 (D) liability for products which cause injury to person or property;

21 (E) the making and disclaimer of warranties; and

1 (F) dealers in particular products, such as automobiles, motorized
2 wheelchairs, agricultural equipment, and hearing aids.

3 (b) [Except as otherwise provided in [list], if] [If] a law of this State article
4 applies to a transaction subject to this article, the following rules apply:

5 (1) A requirement that a term, waiver, notice, or disclaimer be in a
6 writing is satisfied by a record.

7 (2) A requirement that a writing or a term be signed is satisfied by an
8 authentication.

9 (c) Except for the rights of a lessee in the ordinary course of business under
10 subsection (a)(1), in the event of a conflict between this article, other than Section
11 2A-105, 2A-401(c), or 2A-402(c), and a law referred to in subsection (a), that law
12 governs.

13 (d) Failure to comply with the laws referred to in subsection (a) has only the
14 effect specified therein.

15 [(e) A transaction under this article is subject to [the Uniform Electronic
16 Transactions Act]. However, in the event of a conflict between this article and that
17 [Act], this article controls.]

18 **Comment**

19 **Uniform Statutory Analogue:** Sections 9-201 and 9-311.

20 1. This Article creates a comprehensive scheme for the regulation of
21 transactions that create leases. Section 2A-103. Thus, the Article supersedes all
22 prior legislation dealing with leases, except to the extent set forth in this section.

23 2. Subsection (a) states the general rule that a lease, although governed by
24 the scheme of this Article, also may be governed by certain other applicable laws.

1 This may occur in the case of a consumer lease. Section 2A-102(a)(10). Those
2 laws may be state statutes existing prior to enactment of Article 2A or passed
3 afterward. In this case, it is desirable for this Article to specify which statute
4 controls. Or the law may be a pre-existing consumer protection decision. This
5 Article preserves such decisions. Or the law may be a statute of the United States.
6 Such a law controls without any statement in this Article under applicable principles
7 of preemption.

8 An illustration of a statute of the United States that governs consumer leases
9 is the Consumer Leasing Act, 15 U.S.C. §§ 1667-1667(e) (1982) and its
10 implementing regulation, Regulation M, 12 C.F.R. § 213 (1986); the statute
11 mandates disclosures of certain lease terms, delimits the liability of a lessee in leasing
12 personal property, and regulates the advertising of lease terms. An illustration of a
13 state statute that governs consumer leases and which if adopted in the enacting State
14 prevails over this Article is the Unif. Consumer Credit Code, which includes many
15 provisions similar to those of the Consumer Leasing Act, *e.g.*, Unif. Consumer
16 Credit Code §§ 3.202, 3.209, 3.401, 7A U.L.A. 108-09, 115, 125 (1974), as well as
17 provisions in addition to those of the Consumer Leasing Act, *e.g.*, Unif. Consumer
18 Credit Code §§ 5.109-.111, 7A U.L.A. 171-76 (1974) (the right to cure a default).
19 Such statutes may define consumer lease so as to govern transactions within and
20 without the definition of consumer lease under this Article.

21 3. Under subsection (b), subject to certain limited exclusions, in case of
22 conflict a statute or a decision described in subsection (a) prevails over this Article.
23 For example, a provision like Unif. Consumer Credit Code § 5.112, 7A U.L.A. 176
24 (1974), limiting self-help repossession, prevails over Section 2A-517(b). A
25 consumer protection decision rendered after the effective date of this Article may
26 supplement its provisions. For example, in relation to Article 9 a court might
27 conclude that an acceleration clause may not be enforced against an individual
28 debtor after late payments have been accepted unless a prior notice of default is
29 given. To the extent the decision establishes a general principle applicable to
30 transactions other than secured transactions, it may supplement Section 2A-502.

31 4. Consumer protection in lease transactions is primarily left to other law.
32 However, several provisions of this Article do contain special rules that may not be
33 varied by agreement in the case of a consumer lease. *E.g.*, Sections 2A-106,
34 2A-107, and 2A-108(2). Were that not so, the ability of the parties to govern their
35 relationship by agreement together with the position of the lessor in a consumer
36 lease too often could result in a one-sided lease agreement.

37 5. In construing this provision the reference to statute should be deemed to
38 include applicable regulations. A consumer protection decision is “final” on the
39 effective date of this Article if it is not subject to appeal on that date or, if subject to

1 appeal, is not later reversed on appeal. Of course, such a decision can be overruled
2 by a later decision or superseded by a later statute.

3 **Cross References:**

4 Sections 2A-102(a)(10), 2A-106, 2A-107, 2A-108(2), and 2A-717(b).

5 **Definitional Cross References:**

6 “Lease”. Section 2A-102(a)(18).

7 **SECTION 2A-105. TERRITORIAL APPLICATION OF ARTICLE TO**
8 **GOODS COVERED BY CERTIFICATE OF TITLE.**

9 (a) This section applies to goods covered by a certificate of title, even if
10 there is no other relationship between the jurisdiction under whose certificate-of-title
11 law the goods are covered and the goods or the lessee or lessor.

12 (b) Goods become covered by a certificate of title when a valid application
13 for the certificate of title and the application fee are delivered to the appropriate
14 authority. Goods cease to be covered by a certificate of title at the earlier of the
15 time the certificate of title ceases to be effective under the law of the issuing
16 jurisdiction or the time the goods become covered subsequently by a certificate of
17 title issues by another jurisdiction.

18 (c) Subject to Sections 2A-404(d) and 2A-405(d), with respect to goods
19 covered by a certificate of title under a statute of this State or of another
20 jurisdiction, compliance and the effect of compliance or noncompliance with the
21 certificate-of-title statute are governed by the local law of the jurisdiction whose
22 certificate covers the goods from the time the goods become covered by the
23 certificate until the goods cease to be covered by the certificate.

1 **Comment**

2 **Uniform Statutory Analogue:** Section 9-303(b), (c).

3 The new certificate referred to in (b) must be permanent, not temporary.
4 Generally, the lessor or creditor whose interest is indicated on the most recently
5 issued certificate of title will prevail over interests indicated on certificates issued
6 previously by other jurisdictions. This provision reflects a policy that it is reasonable
7 to require holders of interests in goods covered by a certificate of title to police the
8 goods or risk losing their interests when a new certificate of title is issued by another
9 jurisdiction.

10 **Cross References:**

11 Sections 2A-404(d), 2A-405(d), 9-303(b), (c).

12 **Definitional Cross References:**

13 “Goods”. Section 2A-102(a)(16).

14 **SECTION 2A-106. LIMITATION ON POWER OF PARTIES TO**
15 **CONSUMER LEASE TO CHOOSE APPLICABLE LAW OR JUDICIAL**
16 **FORUM.**

17 (a) A choice-of-law term in a consumer lease contract is not enforceable if
18 the law chosen is that of a jurisdiction other than one in which the lessee resides at
19 the time the lease agreement becomes enforceable or within 30 days thereafter or in
20 which the goods are to be used.

21 (b) The parties may choose an exclusive judicial form. However, in a
22 consumer lease, the choice is not enforceable if the chosen jurisdiction would not
23 otherwise have jurisdiction over the consumer and the choice unfairly disadvantages
24 the consumer. A choice of forum in a term of an agreement is not exclusive unless
25 the agreement expressly so provides.

26 **Comment**

1 **Uniform Statutory Analogue:** Unif. Consumer Credit Code § 1.201(8), 7A
2 U.L.A. 36 (1974).

3 There is a real danger that a lessor may induce a consumer lessee to agree
4 that the applicable law will be a jurisdiction that has little effective consumer
5 protection, or to agree that the applicable forum will be a forum that is inconvenient
6 for the lessee in the event of litigation. As a result, this section invalidates these
7 choice of law or forum clauses, except where the law chosen is that of the State of
8 the consumer's residence or where the goods will be kept, or the forum chosen is
9 one that otherwise would have jurisdiction over the lessee.

10 Subsection (a) limits potentially abusive choice of law clauses in consumer
11 leases. This section has no effect on choice of law clauses in leases that are not
12 consumer leases. Such clauses would be governed by other law.

13 Subsection (b) prevents enforcement of potentially abusive jurisdictional
14 consent clauses in consumer leases. By using the term judicial forum, this section
15 does not limit selection of a nonjudicial forum, such as arbitration. This section has
16 no effect on choice of forum clauses in leases that are not consumer leases; such
17 clauses are, as a matter of current law, "prima facie valid". *The Bremen v. Zapata*
18 *Off-Shore Co.*, 407 U.S. 1, 10 (1972). Such clauses would be governed by other
19 law, including the Model Choice of Forum Act (1968).

20 **Definitional Cross References:**
21 "Consumer lease". Section 2A-102(a)(8).
22 "Goods". Section 2A-102(a)(16).
23 "Lease agreement". Section 2A-102(a)(19).
24 "Lessee". Section 2A-102(a)(22).
25 "Party". Section 1-201(29).

26 **SECTION 2A-107. UNCONSCIONABILITY.**

27 (a) If a court as a matter of law finds that a lease contract or any term
28 thereof to have been unconscionable at the time it was made, the court may refuse
29 to enforce the contract, enforce the remainder of the contract without the
30 unconscionable term, or so limit the application of an unconscionable term as to
31 avoid an unconscionable result.

(b) With respect to a consumer lease, if the court finds as a matter of law that a lease contract or a term of the contract was induced by unconscionable conduct or that unconscionable conduct has occurred in the collection of a claim arising from the lease contract, the court may grant appropriate relief.

(c) If it is claimed or appears to the court that a contract or any term thereof may be unconscionable, the parties must be afforded a reasonable opportunity to present evidence of its commercial setting, purpose, and effect of the lease contract or of the conduct, to aid the court in making the determination.

(d) In an action in which a lessee claims unconscionability with respect to a consumer lease, the following rules apply:

(1) If the court finds unconscionability under subsection (a) or (b) [or (c)], the court shall award reasonable attorney's fees to the lessee.

(2) If the court does not find unconscionability and the lessee claiming unconscionability has brought or maintained an action the lessee knew to be groundless, the court shall award reasonable attorney's fees to the party against which the claim is made.

(3) In determining attorney's fees, the amount of the recovery on behalf of the claimant under subsections (a) or (b) is not controlling.

Comment

Uniform Statutory Analogue: Section 2-104 and Unif. Consumer Credit Code § 5.108, 7A U.L.A. 167-69 (1974).

Subsection (a) is taken almost verbatim from the provisions of Section 2-302(1) of original Article 2. Subsection (b) is suggested by the provisions of Unif. Consumer Credit Code § 5.108(1), (2), 7A U.L.A. 167 (1974). Subsection (c),

1 taken from the provisions of Section 2-302(2), has been expanded to cover
2 unconscionable conduct. Unif. Consumer Credit Code § 5.108(3), 7A U.L.A. 167
3 (1974). The provision for the award of attorney's fees to consumers, subsection
4 (d), covers unconscionability under subsection (a) as well as subsection (b).
5 Subsection (d) is modeled on the provisions of Unif. Consumer Credit Code
6 § 5.108(6), 7A U.L.A. 169 (1974).

7 1. Subsections (a) and (c) of this section apply the concept of
8 unconscionability reflected in the provisions of original Section 2-302 to leases. *See*
9 *Dillman & Assocs. v. Capitol Leasing Co.*, 110 Ill.App.3d 335, 342, 442 N.E.2d
10 311, 316 (App.Ct.1982). As this Comment later explains, an expansion of the
11 concept of "substantive" unconscionability is also intended. Subsection (c) omits
12 the adjective "commercial" found in Section 2-302(2) because subsection (c) is
13 concerned with all leases and the relevant standard of conduct is determined by the
14 context.

15 The balance of the section is modeled on the provisions of Unif. Consumer
16 Credit Code § 5.108, 7A U.L.A. 167-69 (1974). Thus subsection (b) recognizes
17 that a consumer lease or a clause in a consumer lease may not itself be
18 unconscionable but that the agreement would never have been entered into if
19 unconscionable means had not been employed to induce the consumer to agree. It
20 would be a frustration of the policy against unconscionable contracts for a lessor to
21 be able to use unconscionable acts or practices to obtain an agreement. For
22 example, it may be unconscionable to make a statement to induce the consumer to
23 lease the goods, in the expectation of invoking an integration clause in the lease to
24 exclude the statement's admissibility in a subsequent dispute. *See, e.g., Capital*
25 *Associates, Inc. v. Hudgens*, 455 So. 2d 651 (1984) in which the court refused to
26 enforce a liquidated damages provision in a lease which would have lead to a
27 \$12,000 liability because the lessee had been told that she could terminate the lease
28 at anytime.

29 2. Subsection (b) also provides a consumer remedy for unconscionable
30 conduct, such as using or threatening to use force or violence, in the collection of a
31 claim arising from a lease contract. These provisions are not exclusive. The
32 remedies of this section are in addition to remedies otherwise available for the same
33 conduct under other law, for example, an action in tort for abusive debt collection or
34 under another statute of this State for such conduct. The reference to appropriate
35 relief in subsection (b) is intended to foster liberal administration of this remedy.

36 3. A particular application of the principle of unconscionability may be
37 found in consumer contracts that involve the use of a standard form contract
38 prepared by a merchant lessor and used in circumstances in which there is no
39 expectation that the consumer will fully review the terms of the form before entering

1 into the contract. Of course, the use of a standard form in and of itself cannot be
2 considered unconscionable and the mere fact that a particular clause would not be
3 expected by the consumer is not enough to justify a finding of unconscionability.
4 However, in that setting a term which is inconsistent with the essential purpose of
5 the contract or conflicts with material terms to which the parties have explicitly
6 agreed, or terms which impose undue risk or cost on the consumer under the
7 circumstances, may be declared unconscionable by a court.

8 In short, a term in a standard form consumer contract that might be
9 considered to fall short of “oppression” as it was defined in *Jones v. Star Credit*
10 *Corp.*, 59 Misc. 2d 189, 298 N.Y.S. 2d 264 (1969) (goods valued at \$300 sold for
11 \$900 plus credit service charges), but that goes beyond an allocation of risks merely
12 because of superior bargaining power, or beyond a term that the lessor knows
13 might be surprising and unacceptable to the consumer, may be found to be
14 unconscionable. For example, a standard form arbitration clause is not per se
15 unconscionable even though the clause is surprising to the consumer and, had the
16 consumer known of the clause, the consumer would have objected to it. But, if the
17 arbitration clause requires a consumer lessee who is leasing furniture for at \$200 a
18 month for a year to arbitrate in a tribunal which requires a non-refundable filing fee
19 of \$2000 a court could find the clause unconscionable. The result in *Brower v.*
20 *Gateway 2000, Inc.*, 246 A.D. 246, 676 N.Y.S. 2d (1998) is instructive. There the
21 court held that including an arbitration clause in a standard form sales agreement
22 was not in itself unconscionable but that the particular clause which compelled
23 arbitration in a tribunal which required an initial deposit of \$4000 (\$2000 of which
24 was a nonrefundable filing fee) was unconscionable in transactions many of which
25 involved less than \$2000. Another example of a possibly unconscionable standard
26 form term is a term that allocates to the sole judgment of the lessor all decisions
27 involving default under the lease unless the lessee establishes that the lessor willfully
28 disregarded facts known to the lessor.

29 In most cases involving an alleged unconscionable term there must be both
30 procedural and substantive unconscionability to support relief under this section.
31 Further, mere use of a standard form cannot be considered procedurally
32 unconscionable: there almost always must be some affirmative procedural difficulty
33 beyond the mere use of the form such as hidden terms in obscure print, suggesting
34 that the consumer need not read the form, efforts to prevent the consumer from
35 reading the form, or a false representation that the form has been approved by a
36 governmental or consumer organization.

37 However, in some cases a term may be sufficiently substantively
38 unconscionable that it is proper to give relief even though there is no procedural
39 unconscionability. See, e.g., *Brower v. Gateway 2000, Inc.*, *supra*, in which the
40 court held that there was no procedural unconscionability on the facts of that case,

1 but that the arbitration clause was sufficiently unconscionable that it would not be
2 enforced. *See also Dean v. Universal C.I.T. Credit Corp.*, 114 N.J. Super. 132, 275
3 A.2d 154 (1971) in which the court held unconscionable a clause in a security
4 agreement which required the debtor to give notice by certified mail within five days
5 after repossession if the debtor claimed that any personal articles were left in a
6 repossessed automobile or lose any claim to such articles. The court did not discuss
7 whether the debtor was aware of the clause or the location and size of type of the
8 provision in the security agreement.

9 4. In the form contract setting there is justification for finding a somewhat
10 less than oppressive term to be unconscionable. Examples of terms which might be
11 found to be sufficiently substantively unconscionable to justify relief might be: (1) a
12 term in a lease that provides an exclusive remedy of repair and excludes all other
13 relief, even consequential damages, in all circumstances, including refusal of the
14 lessor to honor the promise of repair, or (2) a term which permits a lessor to declare
15 a default for failure to pay even though the parties have explicitly agreed that the
16 consumer will be protected by loss of income insurance that lessor agrees to procure
17 and separately charges for.

18 5. Subsection (d) authorizes an award of reasonable attorney's fees if the
19 court finds unconscionability with respect to a consumer lease under subsection (a)
20 or (b). Provision is also made for recovery by the party against whom the claim was
21 made if the court does not find unconscionability and does find that the consumer
22 knew the action to be groundless. Further, subsection (d)(2) is independent of, and
23 thus will not override, a term in the lease agreement that provides for the payment of
24 attorney's fees.

25 **Cross References:**
26 Section 1-106(1).

27 **Definitional Cross References:**
28 "Action". Section 1-201(1).
29 "Consumer lease". Section 2A-102(a)(8).
30 "Lease contract". Section 2A-102(A)(20).
31 "Lessee". Section 2A-102(a)(22).
32 "Party". Section 1-201(29).

33 **SECTION 2A-108. OPTION TO ACCELERATE AT WILL.**

34 (a) A term in a lease agreement providing that one party or that party's
35 successor in interest may accelerate payment or performance or require collateral or

1 additional collateral “at will” or when the party “deems itself insecure”, or words of
2 similar import, mean that the party has power to do so only if it in good faith
3 believes that the prospect of payment or performance is impaired.

4 (b) In a consumer lease, the burden of establishing good faith under
5 subsection (a) is on the party that exercised the power. In all other leases, the
6 burden of establishing lack of good faith is on the party against which the power has
7 been exercised.

8 **Comment**

9 **Uniform Statutory Analogue:** Section 1-208 and Unif. Consumer Credit Code
10 § 5.109(2), 7A U.L.A. 171 (1974).

11 A lease provision allowing acceleration at the will of the lessor or when the
12 lessor deems itself insecure is of critical importance to the lessee. In a consumer
13 lease it is a provision that is not usually agreed to by the parties but is usually
14 mandated by the lessor. Therefore, where its invocation depends not on specific
15 criteria but on the discretion of the lessor, its use should be regulated to prevent
16 abuse. Subsection (a) imposes a duty of good faith upon its exercise. Subsection
17 (b) shifts the burden of establishing good faith to the lessor in the case of a
18 consumer lease, but not otherwise.

19 **Cross References:**
20 Section 1-208.

21 **Definitional Cross References:**
22 “Burden of establishing”. Section 1-201(8).
23 “Consumer lease”. Section 2A-102(a)(8).
24 “Good faith”. Sections 1-201(19) and 2-102(a)(15).
25 “Party”. Section 1-201(29).
26 “Term”. Section 1-201(42).

27 **SECTION 2A-109. EFFECT OF AGREEMENT; QUESTIONS**
28 **DETERMINED BY COURT.**

(a) Unless a section in this article otherwise provides, the effect of any provision of this article may be varied by agreement.

(b) The presence of mandatory language, such as “must” or “shall,” or the absence of enabling language, such as “unless otherwise agreed,” does not by itself preclude the parties from varying by agreement a provision of this article.

(c) Whenever this article allocates a risk or imposes a burden as between the parties, they may agree to shift the allocation and apportion the risk or burden.

(d) Whether a term is conspicuous or is unconscionable under Section 2A-107 is a question to be determined by the court.

Comment

Uniform Statutory Analogue: Section 2-108

See the Comment to Section 2-108.

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PART 2
FORMATION, TERMS, AND READJUSTMENT
OF LEASE CONTRACT; ELECTRONIC CONTRACTS

[SUBPART A. FORMATION, TERMS, AND READJUSTMENT]

SECTION 2A-201. FORMAL REQUIREMENTS.

(a) Except as otherwise provided in this section, a lease contract is not enforceable by way of action or defense unless:

(1) the total payments to be made under the lease contract, excluding payments for options to renew or buy, are less than \$1,000; or

(2) there is a record, authenticated by the party against which enforcement is sought or its authorized agent as the record of that person which is sufficient to indicate that a lease contract has been made between the parties and to describe the goods leased and the duration of the lease.

(b) A record is not insufficient merely because it omits a term, including a quantity term, or incorrectly states a term agreed upon, but, if the record contains a quantity term, the contract is not enforceable beyond the quantity of goods shown in the record.

(c) Any description of the leased goods or of the duration of the lease is sufficient and satisfies subsection (a)(2), whether or not it is specific, if it reasonably identifies what is described.

(d) An otherwise valid lease contract that does not satisfy the requirements of subsection (a) is nevertheless enforceable:

1 (1) if the goods are to be specially manufactured or obtained for the
2 lessee and are not suitable for lease or sale by the lessor to others in the ordinary
3 course of business, and the lessor, before notice of repudiation is received and under
4 circumstances that reasonably indicate that the goods are for the lessee, has made
5 either a substantial beginning of their manufacture or commitments for their
6 procurement;

7 (2) if the party against which enforcement is sought admits in its
8 pleading, testimony in court, or otherwise under oath that a lease contract was
9 made, but the lease contract is not enforceable under this provision beyond the
10 quantity of goods admitted; or

11 (3) with respect to goods that have been received and accepted by the
12 lessee.

13 (e) The duration of a lease under a contract referred to in subsection (d) is:

14 (1) if there is a record authenticated by the party against which
15 enforcement is sought or by that party's authorized agent specifying the duration of
16 the lease, the period so specified;

17 (2) if the party against which enforcement is sought admits in that party's
18 pleading, testimony, or otherwise in court, the duration of the lease, the period so
19 admitted; or

20 (3) a reasonable duration.

1 (f) An enforceable lease contract under this section is not unenforceable
2 merely because it is not capable of being performed within one year or any other
3 applicable period after its making.

4 (g) The affixing of a seal to a record evidencing a contract or offer does not
5 make the record a sealed instrument. The law with respect to sealed instruments
6 does not apply to the contract or offer.

7 **Comment**

8 **Uniform Statutory Analogue:** Section 2-201.

9 This section is modeled on Section 2-201, with changes to reflect the
10 differences between a lease contract and a contract for the sale of goods. In
11 particular, subsection (a)(2) adds a requirement that the writing “describe the goods
12 leased and the lease term”, borrowing that concept, with revisions, from the
13 provisions of Section 9-203(b)(3).

14 This section conforms the provisions of Section 2-201 to custom and usage
15 in lease transactions. Section 2-201(b), stating a special rule between merchants,
16 was not included in this section as the number of such transactions involving leases,
17 as opposed to sales, was thought to be modest. Subsection (d) creates no exception
18 for transactions where payment has been made and accepted. This represents a
19 departure from the analog, Section 2-201(c)(2). The rationale for the departure is
20 grounded in the distinction between sales and leases. Unlike a buyer in a sales
21 transaction, the lessee does not tender payment in full for goods delivered, but only
22 payment of rent for one or more months. It was decided that, as a matter of policy,
23 this act of payment is not a sufficient substitute for the required memorandum.
24 Subsection (e) was needed to establish the criteria for supplying the lease term if it is
25 omitted, as the lease contract may still be enforceable under subsection (d).

26 This section retains the requirement of original Article 2A that contracts for
27 \$,1000 or more must satisfy the requirements of this section. Leases, more than
28 sales, involve an often complex on-going relationship between the lessor and lessee.
29 Therefore, it is more important that the agreement be evidenced by a writing and a
30 strong statute of frauds encourages the reduction of lease agreements to writing.

31 **Cross References:**
32 Section 2-201.

1 **Definitional Cross References:**
2 “Action”. Section 1-201(1).
3 “Agreed”. Section 1-201(3).
4 “Authenticate”. Section 2-102(a)(1).
5 “Goods”. Section 2-102(a)(16).
6 “Lease”. Section 2A-102(a)(18).
7 “Lease contract”. Section 2A-102(a)(20).
8 “Lessee”. Section 2A-102(a)(22).
9 “Lessor”. Section 2A-102(a)(24).
10 “Notice”. Section 1-201(25).
11 “Party”. Section 1-201(29).
12 “Record”. Section 2A-102(a)(31).
13 “Term”. Section 1-201(42).

14 **SECTION 2A-202. PAROL OR EXTRINSIC EVIDENCE.**

15 (a) Terms on which the confirmatory records of the parties agree, or which
16 are otherwise set forth in a record intended by the parties as a final expression of
17 their agreement with respect to the included terms, may not be contradicted by
18 evidence of any previous agreement or of a contemporaneous oral agreement.
19 However, terms in such a record may be supplemented by evidence of:

20 (1) consistent additional terms, unless the court finds that the record was
21 intended as a complete and exclusive statement of the terms of the agreement; and
22 (2) course of performance, course of dealing, or usage of trade.

23 (b) Terms in a record may be explained by evidence of course of
24 performance, course of dealing, or usage of trade without a preliminary
25 determination by the court that the language used is ambiguous. Terms in a record
26 may also be explained from other sources as determined by the court under
27 applicable law.

1 **Comment**

2 **Uniform Statutory Analogue:** Section 2-202.

3 **Definitional Cross References:**

4 “Agreement”. Section 1-201(3).

5 “Course of dealing”. Section 1-205.

6 “Party”. Section 1-201(29).

7 “Term”. Section 1-201(42).

8 “Usage of trade”. Section 1-205.

9 “Record”. Section 2A-102(a)(31).

10 **SECTION 2A-203. FORMATION IN GENERAL.**

11 (a) A lease contract may be made in any manner sufficient to show
12 agreement, including by offer and acceptance, conduct of both parties which
13 recognizes the existence of a contract, or the interaction of electronic agents.

14 (b) If the parties so intend, an agreement sufficient to constitute a contract
15 may be found even if the time of its making is undetermined, one or more terms are
16 left open or to be agreed upon, the records of the parties do not otherwise establish
17 a contract, or one party reserves the right to modify terms.

18 (c) Even if one or more terms are left open or to be agreed upon, a lease
19 contract does not fail for indefiniteness if the parties intended to make a contract and
20 there is a reasonably certain basis for giving an appropriate remedy.

21 **Comment**

22 **Uniform Statutory Analogue:** Section 2-204.

23 **Definitional Cross References:**

24 “Agreement”. Section 1-201(3).

25 “Lease contract”. Section 2A-102(a)(20).

26 “Party”. Section 1-201(29).

27 “Remedy”. Section 1-201(34).

1 “Term”. Section 1-201(42).

SECTION 2A-204. FIRM OFFERS. An offer by a merchant to enter into a lease contract made in an authenticated record that by its terms gives assurance that the offer will be held open is not revocable for lack of consideration during the time stated. If a time is not stated, the offer is irrevocable for a reasonable time not exceeding 90 days. A term of assurance in a record supplied by the offeree is ineffective unless the term is conspicuous.

8	Comment
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9 **Uniform Statutory Analogue:** Section 2-204.

10 Definitional Cross References:

11 “Authenticate”. Section 2A-102(a)(1).
12 “Conspicuous”. Section 2A-102(a)(6).
13 “Goods”. Section 2A-102(a)(16).
14 “Lease”. Section 2A-102(a)(18).
15 “Merchant”. Section 2-102(a)(27).
16 “Person”. Section 1-201(30).
17 “Reasonable time”. Section 1-204(1) and (2).
18 “Term”. Section 1-201(42).
19 “Record”. Section 2A-102(a)(31).

20 **SECTION 2A-205. OFFER AND ACCEPTANCE.**

(a) Unless otherwise unambiguously indicated by the language or circumstances, an offer to make a lease contract must be construed as inviting acceptance in any manner and by any medium reasonable under the circumstances.

(b) If the beginning of a requested performance is a reasonable mode of acceptance, an offeror that is not notified of acceptance within a reasonable time may treat the contract as terminated.

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Comment

Uniform Statutory Analogue: Section 2-206(a)(1) and (c).
Definitional Cross References:
“Lease contract”. Section 2A-102(a)(20).
“Notifies”. Section 1-201(26).
“Reasonable time”. Section 1-204(1) and (2).

[SUBPART B. ELECTRONIC CONTRACTS]

SECTION 2A-206. ELECTRONIC CONTRACTING; FORMATION.

Except as otherwise provided in Sections 2A-207 to 2A-210, the following rules apply:

(1) A contract may be formed by the interaction of electronic agents. If the interaction resulting from the electronic agents’ engaging in operations is sufficient to show an agreement under Section 2A-203 or 2A-205, a contract is formed unless the operations resulted from fraud, electronic mistake, or the like.

(2) A contract may be formed by the interaction of an electronic agent and an individual, acting on the individual’s own behalf or for another person. A contract is formed in the individual takes actions that the individual is free to refuse to take or makes a statement that the individual has reason to know will:

(A) cause the electronic agent to complete the transaction or performance; or

(B) indicate acceptance of an offer, regardless of other expressions or actions by the individual to which the electronic agent cannot react.

1 (3) In an interaction between individuals, if an offer evokes an electronic
2 message in response, a contract is formed:

3 (A) if the offer is accepted under Section 2A-205, when the acceptance
4 is received; or

5 (B) if the offer is accepted by an electronic performance, when the
6 performance is received, unless the originating message required acceptance in a
7 different manner.

8 **Definitional Cross References:**

9 “Electronic”. Section 2A-102(a)(10).

10 “Electronic agent”. Section 2A-102(a)(11).

11 “Electronic message”. Section 2A-102(a)(12).

12 **SECTION 2A-207. LEGAL RECOGNITION OF ELECTRONIC**
13 **RECORDS AND AUTHENTICATIONS.**

14 (a) A record or authentication may not be denied legal effect or
15 enforceability solely because it is in electronic form.

16 (b) This article does not require that a record or authentication be
17 generated, stored, sent, received, or otherwise processed by electronic means or in
18 electronic form.

19 (c) In any transaction, a person may establish reasonable requirements
20 regarding the type of authentication or record acceptable to it.

21 **Definitional Cross References:**

22 “Authenticate”. Section 2A-102(a)(1).

23 “Electronic”. Section 2A-102(a)(10).

24 “Electronic record.” Section 2A-102(a)(13).

25 “Record”. Section 2A-102(a)(31).

1 **SECTION 2A-208. ATTRIBUTION.** An electronic record is attributed to a
2 person if it was the act of that person or its electronic agent, or if the person is
3 otherwise bound by it under the law of agency. The party relying on attribution of
4 an electronic record to another person has the burden of establishing attribution.

5 **Definitional Cross References:**

6 “Electronic”. Section 2A-102(a)(10).
7 “Electronic agent”. Section 2A-102(a)(11).
8 “Electronic Record”. Section 2A-102(a)(13).
9 “Record.” Section 2A-102(a)(31).

10 **SECTION 2A-209. CONTRACT FORMATION; ELECTRONIC**
11 **RECORD.**

12 (a) Except as otherwise provided in subsection (b), an electronic record is
13 effective when received, even if no other person is aware of its receipt.

14 (b) If an offer in an electronic message evokes an electronic message in
15 response, a contract, if any, is formed as determined in Section 2A-206.

16 (c) Receipt of an electronic acknowledgment establishes that the message
17 was received but does not establish by itself that the content sent corresponds to the
18 content received.

19 **Definitional Cross References:**

20 “Electronic”. Section 2A-102(a)(10).
21 “Electronic message”. Section 2A-102(a)(12).
22 “Electronic record.” Section 2A-102(a)(13).
23 “Record”. Section 2A-102(a)(31).

1 **SECTION 2A-210. CONTRACT FORMATION; ELECTRONIC**
2 **AGENTS.**

3 (a) A person that uses an electronic agent for authentication, agreement, or
4 performance is bound by the operations of the electronic agent even if no person
5 was aware of or reviewed the agent's actions or the results of the operations.

6 (b) Whether a contract is formed by the interaction of electronic agents or
7 the interaction of an electronic agent and a person is determined by Section 2A-206.

8 **Definitional Cross References:**

9 "Authenticate". Section 2A-102(a)(1).

10 "Electronic". Section 2A-102(a)(10).

11 "Electronic agent." Section 2A-102(a)(11).

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PART 3
CONSTRUCTION OF LEASE CONTRACT

**SECTION 2A-301. COURSE OF PERFORMANCE OR PRACTICAL
CONSTRUCTION.**

(a) If a 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 agreement.

(b) The express terms of an agreement and any course of performance, course of dealing, and usage of trade must be construed whenever reasonable as consistent with each other. However, if the 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.

(c) Subject to Section 2A-302, course of performance is relevant to show a waiver or modification of a term inconsistent with the course of performance.

Comment
Uniform Statutory Analogue: Sections 2-208 and 1-205(4).

The section should be read in conjunction with Section 2A-202. In particular, although a specific term may control over course of performance as a

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

3 **Cross References:**

4 Sections 1-205(4), 2-208 and 2A-302.

5 **Definitional Cross References:**

6 “Course of dealing”. Section 1-205.

7 “Knowledge”. Section 1-201(25).

8 “Lease agreement”. Section 2A-102(a)(19).

9 “Lease contract”. Section 2A-10(2)(a)(20).

10 “Party”. Section 1-201(29).

11 “Term”. Section 1-201(42).

12 “Usage of trade”. Section 1-205.

13 **SECTION 2A-302. MODIFICATION, RESCISSION, AND WAIVER.**

14 (a) An agreement made in good faith modifying a lease contract needs no
15 consideration to be binding.

16 (b) An authenticated record containing a term that prohibits modification or
17 rescission except by an authenticated record may not be otherwise modified or
18 rescinded. Such a term in a form record supplied by a merchant to a nonmerchant
19 must be separately authenticated. A party whose language or conduct is
20 inconsistent with the term is precluded from asserting the term if the assertion is
21 unjust in view of a material change of position in reliance on the language or
22 conduct.

23 (c) A condition in a contract may be waived by the party for whose benefit
24 it was included. Language or conduct is relevant to show a waiver. A waiver
25 affecting an executory portion of a contract may be retracted by reasonable notice
26 received by the other party that strict performance will be required of any term

1 waived unless the retraction would be unjust in view of a material change of position
2 in reliance on the waiver.

3 **Comment**

4 **Uniform Statutory Analogue:** Section 2-209.

5 This section does not contain subsection (b) of revised Section 2-209 that
6 the requirements of the statute of frauds be satisfied if the modification affects the
7 price of the quantity of goods by more than \$5000.00. In the leasing context, it is
8 better to leave statute of frauds issues in modifications to the courts on the facts of
9 each case. In considering whether the statute frauds must be satisfied as to a
10 modification in a lease where there is no lease agreement provision requiring that
11 modifications be in writing, it should be remembered that under Section 201, it is
12 not necessary that the writing contain all the terms of the agreement, nor is it fatal
13 that the writing incorrectly states a term agreed upon. However, under Section
14 2A-201, the writing must describe the goods and the duration of the lease.

15 **Cross References:**
16 Sections 2-201 and 2-209.

17 **Definitional Cross References:**
18 “Agreement”. Section 1-201(3).
19 “Authenticate”. Section 2A-102(a)(1)
20 “Between merchants”. Section 2-102(a)(2).
21 “Lease agreement”. Section 2A-102(a)(19).
22 “Lease contract”. Section 2A-102(a)(20).
23 “Merchant”. Section 2-102(a)(27).
24 “Notification”. Section 1-201(26).
25 “Party”. Section 1-201(29).
26 “Record”. Section 2A-102(a)(31).
27 “Term”. Section 1-201(42).
28 “Written”. Section 1-201(46).

29 **SECTION 2A-303. LESSEE UNDER FINANCE LEASE AS**
30 **BENEFICIARY OF SUPPLY CONTRACT.**

31 (a) The benefit of the supplier’s promises to the lessor under a supply
32 contract and of all warranties, whether express or implied, including those of any

1 third party provided in connection with or as part of the supply contract, extends to
2 the lessee to the extent of the lessee's leasehold interest under a finance lease related
3 to the supply contract but is subject to the terms of the warranty and supply contract
4 and all defenses or claims arising therefrom.

5 (b) The extension of the benefit of a supplier's promises and of warranties
6 to the lessee does not modify the rights and obligations of the parties to the supply
7 contract, whether arising therefrom or otherwise, or impose any duty or liability
8 under the supply contract on the lessee.

9 (c) A modification or rescission of a supply contract by the supplier and the
10 lessor is effective between the supplier and the lessee unless, before the modification
11 or rescission, the supplier has received notice that the lessee has entered into a
12 finance lease related to the supply contract. If the modification or rescission is
13 effective between the supplier and the lessee, the lessor assumes, in addition to the
14 obligations of the lessor to the lessee under the lease contract, the promises of the
15 supplier to the lessor and warranties that were so modified or rescinded as they
16 existed and were available to the lessee before modification or rescission.

17 (d) In addition to the extension of the benefit of the supplier's promises and
18 of warranties to the lessee under subsection (a), the lessee retains all rights that the
19 lessee may have against the supplier which arise from a contract between the lessee
20 and the supplier or under other law.

21 **Comment**

1 This section is modeled on original 1972 Article 9 Section 9-318, the
2 Restatement (Second) of Contracts §§ 302-315 (1981), and leasing practices. *See*
3 *Earman Oil Co. v. Burroughs Corp.*, 625 F.2d 1291, 1296-97 (5th Cir.1980).

4 1. The function performed by the lessor in a finance lease is extremely
5 limited. Section 2A-102(a)(17). The lessee looks to the supplier of the goods for
6 warranties and the like or, in some cases as to warranties, to the manufacturer if a
7 warranty made by that person is passed on. That expectation is reflected in
8 subsection (a), which is self-executing. As a matter of policy, the operation of this
9 provision may not be excluded, modified or limited; however, an exclusion,
10 modification, or limitation of any term of the supply contract or warranty, including
11 any with respect to rights and remedies, and any defense or claim such as a statute
12 of limitations, effective against the lessor as the acquiring party under the supply
13 contract, is also effective against the lessee as the beneficiary designated under this
14 provision. For example, the supplier is not precluded from excluding or modifying
15 an express or implied warranty under a supply contract. Sections 2-402(c) and
16 2-406, or Section 2A-506. Further, the supplier is not precluded from limiting the
17 rights and remedies of the lessor and from liquidating damages. Sections 2-809 and
18 2-810 or Sections 2A-710 and 2A-711. If the supply contract excludes or modifies
19 warranties, limits remedies, or liquidates damages with respect to the lessor, such
20 provisions are enforceable against the lessee as beneficiary. Thus, only selective
21 discrimination against the beneficiaries designated under this section is precluded,
22 *i.e.*, exclusion of the supplier's liability to the lessee with respect to warranties made
23 to the lessor. This section does not affect the development of other law with respect
24 to products liability.

25 2. Enforcement of this benefit is by action. Section 1-106(2).

26 3. The benefit extended by these provisions is not without a price, as this
27 Article also provides in the case of a finance lease that is not a consumer lease that
28 the lessee's promises to the lessor under the lease contract become irrevocable and
29 independent upon the lessee's acceptance of the goods. Section 2A-607.

30 4. Subsection (b) limits the effect of subsection (a) on the supplier and the
31 lessor by preserving, notwithstanding the transfer of the benefits of the supply
32 contract to the lessee, all of the supplier's and the lessor's rights and obligations
33 with respect to each other and others; it further absolves the lessee of any duties
34 with respect to the supply contract that might have been inferred from the extension
35 of the benefits thereof.

36 5. Subsections (b) and (c) also deal with difficult issues related to
37 modification or rescission of the supply contract. Subsection (b) states a rule that
38 determines the impact of the statutory extension of benefit contained in subsection

(a) upon the relationship of the parties to the supply contract and, in a limited respect, upon the lessee. This statutory extension of benefit, like that contained in Sections 2A-508 and 2-409, is not a modification of the supply contract by the parties. Thus, subsection (c) states the rules that apply to a modification or rescission of the supply contract by the parties. Subsection (c) provides that a modification or rescission is not effective between the supplier and the lessee if, before the modification or rescission occurs, the supplier received notice that the lessee has entered into the finance lease. On the other hand, if the modification or rescission is effective, then to the extent of the modification or rescission of the benefit or warranty, the lessor by statutory dictate assumes an obligation to provide to the lessee that which the lessee would otherwise lose. For example, assume a reduction in an express warranty from four years to one year. No prejudice to the lessee may occur if the goods perform as agreed. If, however, there is a breach of the express warranty after one year and before four years pass, the lessor is liable. A remedy for any prejudice to the lessee because of the bifurcation of the lessee's recourse resulting from the action of the supplier and the lessor is left to resolution by the courts based on the facts of each case.

6. Subsection (d) makes it clear that the rights granted to the lessee by this section do not displace any rights the lessee otherwise may have against the supplier.

Cross References:

Sections 2A-102(a)(17), 2A-607.

Definitional Cross References:

“Action”. Section 1-201(1).
“Finance lease”. Section 2A-102(a)(14).
“Leasehold interest”. Section 2A-102(a)(21).
“Lessee”. Section 2A-102(a)(22).
“Lessor”. Section 2A-102(a)(24).
“Notice”. Section 1-201(25).
“Party”. Section 1-201(29).
“Rights”. Section 1-201(36).
“Supplier”. Section 2A-102(a)(34).
“Supply contract”. Section 2A-102(a)(35).
“Term”. Section 1-201(42).

SECTION 2A-304. IDENTIFICATION. Identification of existing goods as goods to which a lease contract refers may be made at any time and in any manner

1 expressly agreed to by the parties. In the absence of express agreement,
2 identification occurs:

3 (1) if the contract is for the lease of already existing and designated goods,
4 when the lease contract is made;

5 (2) if the contract is for the lease of future goods other than those described
6 in subsection (3), when the goods are shipped, marked, or otherwise designated by
7 the lessor as goods to which the lease contract refers, if the lease contract is for a
8 lease of goods that are not existing and identified; or

9 (3) if the lease contract is for a lease of unborn young of animals, when the
10 young are conceived.

11 **Comment**

12 **Uniform Statutory Analogue:** Section 2-502.

13 This section, together with Section 2A-305, is derived from the provisions
14 of Section 2-502, with changes to reflect lease terminology; however, this section
15 omits as irrelevant to leasing practice the treatment of special property.

16 With respect to subsection (2) there is a certain amount of ambiguity in the
17 reference to when goods are designated, *e.g.*, when the lessor is both selling and
18 leasing goods to the same lessee/buyer and has marked goods for delivery but has
19 not distinguished between those related to the lease contract and those related to the
20 sales contract. As in Section 2-502, this issue has been left to be resolved by the
21 courts, case by case.

22 **Cross References:**
23 Sections 2-502 and 2A-305.

24 **Definitional Cross References:**
25 “Agreement”. Section 1-201(3).
26 “Goods”. Section 2A-102(a)(16).
27 “Lease”. Section 2A-102(a)(18).
28 “Lease contract”. Section 2A-102(a)(20).
29 “Lessor”. Section 2A-102(a)(24).

1 “Party”. Section 1-201(29).

2 **SECTION 2A-305. INSURANCE AND PROCEEDS.**

3 (a) A lessee obtains an insurable interest in existing goods identified to the
4 lease contract even if the goods are nonconforming and the lessee has an option to
5 return or reject them.

6 (b) If a lessee has an insurable interest only by reason of the lessor’s
7 identification of the goods, the lessor may substitute other goods for those identified
8 until the lessee’s default or insolvency or notice to the lessee that the identification is
9 final.

10 (c) The lessor retains an insurable interest until an option to buy has been
11 exercised by the lessee and risk of loss has passed to the lessee.

12 (d) This section does not affect any insurable interest recognized under any
13 other law.

14 (e) The parties, by agreement, may determine that one or more parties have
15 an obligation to obtain and pay for insurance covering the goods and determine the
16 beneficiary of the proceeds of the insurance.

17 **Comment**

18 **Uniform Statutory Analogue:** Section 2-502.

19 This section, together with Section 2A-217, is derived from the provisions of
20 Section 2-502, with changes and additions to reflect leasing practices and
21 terminology.

22 Subsection (b) states a rule allowing substitution of goods by the lessor
23 under certain circumstances, until default or insolvency of the lessor, or until
24 notification to the lessee that identification is final. Subsection (c) states a rule

1 regarding the lessor's insurable interest that, by virtue of the difference between a
2 sale and a lease, necessarily is different from the rule stated in Section 2-502(b)
3 regarding the seller's insurable interest. For this purpose the option to buy shall be
4 deemed to have been exercised by the lessee when the resulting sale is closed, not
5 when the lessee gives notice to the lessor. Further, subsection (e) is new and
6 reflects the common practice of shifting the responsibility and cost of insuring the
7 goods between the parties to the lease transaction.

8 **Cross References:**
9 Sections 2-502, and 2A-304.

10 **Definitional Cross References:**
11 "Agreement". Section 1-201(3).
12 "Conforming". Section 2A-102(a)(5).
13 "Goods". Section 2A-102(a)(16).
14 "Insolvent". Section 1-201(23).
15 "Lease contract". Section 2A-102(a)(20).
16 "Lessee". Section 2A-102(a)(22).
17 "Lessor". Section 2A-102(a)(24).
18 "Notification". Section 1-201(26).
19 "Party". Section 1-201(29).

20 **SECTION 2A-306. RISK OF LOSS.**

21 (a) Except in the case of a finance lease, risk of loss is retained by the lessor
22 and does not pass to the lessee. In the case of a finance lease, risk of loss passes to
23 the lessee.

24 (b) If under the lease contract risk of loss will pass to the lessee but the
25 agreement does not specify when the risk passes, except as otherwise provided in
26 subsection (c), risk of loss passes to the lessee regardless of the conformity of the
27 goods to the contract, as follows:

1 (1) Subject to this subsection, the risk of loss passes to a lessee upon
2 receipt of the goods. If the lessee does not intend to take possession, risk of loss
3 passes to the lessee when the lessee receives control of the goods.

4 (2) If the lease contract requires or authorizes a lessor to ship goods by
5 carrier, the following rules apply:

6 (A) If the contract does not require delivery at a particular
7 destination, the risk of loss passes to the lessee when the goods are duly delivered to
8 the carrier.

9 (B) If the contract requires delivery at a particular destination and
10 the goods arrive there in the possession of the carrier, the risk of loss passes to the
11 lessee when the goods are so tendered as to enable the lessee to take delivery.

12 (3) If goods are held by a bailee to be delivered without being moved,
13 the risk of loss passes to the lessee on acknowledgment by the bailee to the lessee of
14 the lessee's right to possession of the goods.

15 (c) A default under the lease contract by either party affects the risk of loss
16 only in the following cases:

17 (1) If the lessee rightfully rejects the goods or justifiably revokes
18 acceptance of the goods, the lessor has the risk of loss from the time that the
19 rejection or revocation is effective.

20 (2) If the lessor has tendered nonconforming goods so that the lessee
21 would have the right to reject the goods or revoke acceptance of the goods, the
22 goods are damaged or lost before the lessee effectively rejects or revokes

1 acceptance, and the risk of loss would have otherwise passed to the lessee under
2 subsection (b) or (c), the lessor has the risk of loss to the extent the nonconformity
3 of the goods caused the damage or loss.

4 (3) If conforming goods are identified to the lease contract when the
5 lessee repudiates or is otherwise in breach and the risk of loss has not otherwise
6 passed to the lessee, the lessee has the risk of loss for those goods for a
7 commercially reasonable time after the breach or repudiation.

8 **Comment**

9 **Uniform Statutory Analogue:** Section 2-612.

10 Subsection (a) states rules related to retention or passage of risk of loss
11 consistent with current practice in lease transactions. This section does not deal
12 with responsibility for loss caused by the wrongful act of either the lessor or the
13 lessee.

14 **Cross References:**
15 Section 2-612.

16 **Definitional Cross References:**
17 “Delivery”. Section 1-201(14).
18 “Finance lease”. Section 2A-102(a)(14).
19 “Goods”. Section 2A-102(a)(16).
20 “Lease contract”. Section 2A-102(a)(20).
21 “Lessee”. Section 2A-102(a)(22).
22 “Lessor”. Section 2A-102(a)(24).
23 “Merchant”. Section 2-102(a)(27).
24 “Receive”. Section 2A-102(a)(30).
25 “Rights”. Section 1-201(36).
26 “Supplier”. Section 2A-102(a)(34).

27 **SECTION 2A-307. CASUALTY TO IDENTIFIED GOODS.** If the lease
28 contract requires for its performance goods identified when the contract is made and
29 the goods suffer casualty without the fault of the lessee, the lessor, or the supplier

1 before delivery or if the goods suffer casualty before the risk of loss passes to the
2 lessee under the lease agreement or Section 2A-306, the following rules apply:

3 (1) If the loss occurs before the goods are delivered to the lessee, the lessor
4 or supplier shall seasonably notify the lessee of the nature and extent of the loss.

5 (2) If the loss is total, the lease contract is avoided.

6 (3) If the loss is partial or the goods no longer conform to the lease
7 contract, the lessee may nevertheless demand inspection and may treat the lease
8 contract as avoided or, except in a finance lease that is not a consumer lease, accept
9 or retain the goods with due allowance from the rent payable for the balance of the
10 duration of the lease for the nonconformity but without further right against the
11 lessor.

12 **Comment**

13 **Uniform Statutory Analogue:** Section 2-714

14 Due to the vagaries of determining the amount of due allowance (Section
15 2-714(c)), no attempt was made in subsection (3) to treat a problem unique to lease
16 contracts and installment sales contracts: determining how to recapture the
17 allowance, *e.g.*, application to the first or last rent payments or allocation, *pro rata*,
18 to all rent payments.

19 **Cross References:**
20 Section 2-714.

21 **Definitional Cross References:**
22 “Conforming”. Section 2A-102(a)(5).
23 “Consumer lease”. Section 2A-102(a)(8).
24 “Delivery”. Section 1-201(14).
25 “Finance lease”. Section 2A-102(a)(14).
26 “Goods”. Section 2A-102(a)(16).
27 “Lease”. Section 2A-102(a)(18).
28 “Lease agreement”. Section 2A-102(a)(19).
29 “Lease contract”. Section 2A-102(a)(20).

- 1 “Lessee”. Section 2A-102(a)(22).
- 2 “Lessor”. Section 2A-102(a)(24).
- 3 “Rights”. Section 1-201(36).
- 4 “Supplier”. Section 2A-102(a)(34).

5 **SECTION 2A-308. TERMINATION; SURVIVAL OF OBLIGATIONS.**

6 (a) Except as otherwise provided in subsection (b), on the termination of a

7 lease contract, all obligations that are still executory on both sides are discharged.

8 (b) The following survive termination of a lease contract:

9 (1) a right based on a previous default or performance of the contract;

10 (2) a term limiting the scope, manner, method, or location of the exercise

11 of rights in the goods;

12 (3) an obligation of confidentiality, nondisclosure, or noncompetition;

13 (4) a choice of law or forum;

14 (5) an obligation to return or dispose of goods or return any unearned

15 part of the rent;

16 (6) an obligation to arbitrate or otherwise resolve disputes through

17 alternative dispute resolution procedures;

18 (7) a term limiting the time for bringing an action or for providing notice;

19 (8) an indemnity term;

20 (9) a limitation of remedy or disclaimer of warranty;

21 (10) an obligation to provide an accounting and make any payment due

22 under the accounting;

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PART 4
EFFECT OF LEASE CONTRACT

SECTION 2A-401. ENFORCEABILITY OF LEASE CONTRACT.

Except as otherwise provided in [the Uniform Commercial Code], a lease contract is effective and enforceable according to its terms between the parties, against purchasers of the goods, and against creditors.

Comment

Uniform Statutory Analogue: Section 9-201(a).

1. This section establishes a general rule regarding the validity and enforceability of a lease contract. The lease contract is effective and enforceable between the parties and against third parties. Exceptions to this general rule arise where there is a specific rule to the contrary in this Article. Enforceability is, thus, dependent upon the lease contract meeting the requirements of the Statute of Frauds provisions of Section 2A-201. Enforceability is also a function of the lease contract conforming to the principles of construction and interpretation contained in the Article on General Provisions (Article 1).

2. The effectiveness or enforceability of the lease contract is not dependent upon the lease contract or any financing statement or the like being filed or recorded; however, the priority of the interest of a lessor of fixtures with respect to the interests of certain third parties in such fixtures is subject to the provisions of the Article on Secured Transactions (Article 9). Prior to the adoption of this Article filing or recording was not required with respect to leases, only leases intended as security. The definition of security interest, as amended concurrently with the adoption of this Article, more clearly delineates leases and leases intended as security and thus signals the need to file. Section 1-201(37). Those lessors who are concerned about whether the transaction creates a lease or a security interest will continue to file a protective financing statement. Section 9-408. Coogan, Leasing and the Uniform Commercial Code, in *Equipment Leasing-Leveraged Leasing* 681, 744-46 (2d ed. 1980).

3. Hypothetical:

(a) In construing this section it is important to recognize its relationship to other sections in this Article. This is best demonstrated by reference to a

1 hypothetical. Assume that on February 1 A, a manufacturer of combines and other
2 farm equipment, leased a fleet of six combines to B, a corporation engaged in the
3 business of farming, for a 12 month term. Under the lease agreement between A
4 and B, A agreed to defer B's payment of the first two months' rent to April 1. On
5 March 1 B recognized that it would need only four combines and thus subleased
6 two combines to C for an 11 month term.

7 (b) This hypothetical raises a number of issues that are answered by the
8 sections contained in this part. Since lease is defined to include sublease (Section
9 2A-102(a)(21) and (36)), this section provides that the prime lease between A and B
10 and the sublease between B and C are enforceable in accordance with their terms,
11 except as otherwise provided in this Article; that exception, in this case, is one of
12 considerable scope.

13 (c) The separation of ownership, which is in A, and possession, which is in
14 B with respect to four combines and which is in C with respect to two combines, is
15 not relevant. Section 2A-402. A's interest in the six combines cannot be challenged
16 simply because A parted with possession to B, who in turn parted with possession of
17 some of the combines to C. Yet it is important to note that by the terms of Section
18 2A-402 this conclusion is subject to change if otherwise provided in this Article.

19 (d) B's entering the sublease with C raises an issue that is treated by this
20 part. In a dispute over the leased combines A may challenge B's right to sublease.
21 The rule is permissive as to transfers of interests under a lease contract, including
22 subleases. Section 2A-403(b). However, the rule has two significant qualifications.
23 If the prime lease contract between A and B prohibits B from subleasing the
24 combines, or makes such a sublease an event of default, Section 2A-403(b) applies;
25 thus, while B's interest under the prime lease may be transferred under the sublease
26 to C, A may have a remedy pursuant to Section 2A-403(e). Absent a prohibition or
27 default provision in the prime lease contract A might be able to argue that the
28 sublease to C materially increases A's risk; thus, while B's interest under the prime
29 lease may be transferred under the sublease to C, A may have a remedy pursuant to
30 Section 2A-403(e). Section 2A-403(e)(2)(ii).

31 (e) Resolution of this issue is also a function of the section dealing with the
32 sublease of goods by a prime lessee (Section 2A-405). Subsection (a) of Section
33 2A-405, which is subject to the rules of Section 2A-403 stated above, provides that
34 C takes subject to the interest of A under the prime lease between A and B.
35 However, there are two exceptions. First, if B is a merchant (Sections
36 2A-102(a)(31) and 2-102(a)(27)) dealing in goods of that kind and C is a sublessee
37 in the ordinary course of business (Sections 2A-102(a)(26 and 2A-102(a)(25)), C
38 takes free of the prime lease between A and B. Second, if B has rejected the six

1 combines under the prime lease with A, and B disposes of the goods by sublease to
2 C, C takes free of the prime lease if C can establish good faith. Section 2A-727(e).

3 (f) If the facts of this hypothetical are expanded and we assume that the
4 prime lease obligated B to maintain the combines, an additional issue may be
5 presented. Prior to entering the sublease, B, in satisfaction of its maintenance
6 covenant, brought the two combines that it desired to sublease to a local
7 independent dealer of A's. The dealer did the requested work for B. C inspected
8 the combines on the dealer's lot after the work was completed. C signed the
9 sublease with B two days later. C, however, was prevented from taking delivery of
10 the two combines as B refused to pay the dealer's invoice for the repairs. The
11 dealer furnished the repair service to B in the ordinary course of the dealer's
12 business. If under applicable law the dealer has a lien on repaired goods in the
13 dealer's possession, the dealer's lien will take priority over B's and C's interests and
14 also should take priority over A's interest, depending upon the terms of the lease
15 contract and the applicable law. Section 2A-406.

16 (g) Now assume that C is in financial straits and one of C's creditors obtains
17 a judgment against C. If the creditor levies on C's subleasehold interest in the two
18 combines, who will prevail? Unless the levying creditor also holds a lien covered by
19 Section 2A-406, discussed above, the judgment creditor will take its interest subject
20 to B's rights under the sublease and A's rights under the prime lease. Section
21 2A-407(b). The hypothetical becomes more complicated if we assume that B is in
22 financial straits and B's creditor holds the judgment. Here the judgment creditor
23 takes subject to the sublease unless the lien attached to the two combines before the
24 sublease contract became enforceable. Section 2A-407(b). However, B's judgment
25 creditor cannot prime A's interest in the goods because, with respect to A, the
26 judgment creditor is a creditor of B in its capacity as lessee under the prime lease
27 between A and B. Thus, here the judgment creditor's interest is subject to the lease
28 between A and B. Section 2A-407(a).

29 (h) Finally, assume that on April 1 B is unable to pay A the deferred rent
30 then due under the prime lease, but that C is current in its payments under the
31 sublease from B. What effect will B's default under the prime lease between A and
32 B have on C's rights under the sublease between B and C? Section 2A-401
33 provides that a lease contract is effective against the creditors of either party. Since
34 a lease contract includes a sublease contract (Section 2A-102(a)(21)), the sublease
35 contract between B and C arguably could be enforceable against A, a prime lessor
36 who has extended unsecured credit to B, the prime lessee/sublessor, if the sublease
37 contract meets the requirements of Section 2A-201. However, the rule stated in
38 Section 2A-401 is subject to other provisions in this Article. Under Section
39 2A-405, C, as sublessee, would take subject to the prime lease contract in most
40 cases. Thus, B's default under the prime lease will in most cases lead to A's

1 recovery of the goods from C. Section 2A-716. A and C could provide otherwise
2 by agreement. Section 2A-411. C's recourse will be to assert a claim for damages
3 against B. Sections 2A-502 and 2A-724.

4 **4. Relationship Between Sections:**

5 (a) As the analysis of the hypothetical demonstrates, Part 4 of the Article
6 focuses on issues that relate to the enforceability of the lease contract (Sections
7 2A-401, 2A-402, and 2A-403) and to the priority of various claims to the goods
8 subject to the lease contract (Sections 2A-404, 2A-405, 2A-406, 2A-407, 2A-408,
9 2A-409, 2A-410, and 2A-411).

10 (b) This section states a general rule of enforceability, which is subject to
11 specific rules to the contrary stated elsewhere in the Article. Section 2A-402
12 negates any notion that the separation of title and possession is fraudulent as a rule
13 of law. Finally, Section 2A-403 states rules with respect to the transfer of the
14 lessor's interest (as well as the residual interest in the goods) or the lessee's interest
15 under the lease contract. Qualifications are imposed as a function of various issues,
16 including whether the transfer is the creation or enforcement of a security interest or
17 one that is material to the other party to the lease contract. In addition, a system of
18 rules is created to deal with the rights and duties among assignor, assignee and the
19 other party to the lease contract.

20 (c) Sections 2A-404 and 2A-405 are twins that deal with good faith
21 transferees of goods subject to the lease contract. Section 2A-404 creates a set of
22 rules with respect to transfers by the lessor of goods subject to a lease contract; the
23 transferee considered is a subsequent lessee of the goods. The priority dispute
24 covered here is between the subsequent lessee and the original lessee of the goods
25 (or persons claiming through the original lessee). Section 2A-405 creates a set of
26 rules with respect to transfers by the lessee of goods subject to a lease contract; the
27 transferees considered are buyers of the goods or sublessees of the goods. The
28 priority dispute covered here is between the transferee and the lessor of the goods
29 (or persons claiming through the lessor).

30 (d) Section 2A-406 creates a rule with respect to priority disputes between
31 holders of liens for services or materials furnished with respect to goods subject to a
32 lease contract and the lessor or the lessee under that contract. Section 2A-407
33 creates a rule with respect to priority disputes between the lessee and creditors of
34 the lessor and priority disputes between the lessor and creditors of the lessee.

35 (e) Section 2A-408 creates a series of rules relating to allegedly fraudulent
36 transfers and preferences. The most significant rule is that set forth in subsection (d)

1 which validates sale-leaseback transactions if the buyer-lessor can establish that he
2 or she bought for value and in good faith.

3 (f) Sections 2A-409 and 2A-410 create a series of rules with respect to
4 priority disputes between various third parties and a lessor of fixtures or accessions,
5 respectively, with respect thereto.

6 (g) Finally, Section 2A-411 allows parties to alter the statutory priorities by
7 agreement.

8 **Cross References:**

9 Article 1, especially Section 1-201(37), and Sections 2A-102(a)(21), 2A-103(a)(23),
10 2A-102(a)(25), 2A-102(a)(26), 2A-102(a)(36), 2A-102(b), 2A-102(c), 2A-201,
11 2A-401 through 2A-411, 2A-724, 2A-727(d), 2A-726, Article 9, especially Sections
12 9-201 and 9-505.

13 **Definitional Cross References:**

14 “Creditor”. Section 1-201(12).

15 “Goods”. Section 2A-102(a)(16).

16 “Lease contract”. Section 2A-102(a)(20).

17 “Party”. Section 1-201(29).

18 “Purchaser”. Section 1-201(33).

19 “Term”. Section 1-201(42).

20 **SECTION 2A-402. TITLE TO AND POSSESSION OF GOODS.** Except

21 as otherwise provided in this article, the application of this article is not affected by

22 whether the lessor or a third party has title to the goods, by whether the lessor, the

23 lessee, or a third party has possession of the goods, or by any statute or rule of law

24 that possession or the absence of possession is fraudulent.

25 **Comment**

26 **Uniform Statutory Analogue:** Section 9-202.

27 The separation of ownership and possession of goods between the lessor and
28 the lessee (or a third party) has created problems under certain fraudulent
29 conveyance statutes. *See, e.g., In re Ludlum Enters.*, 510 F.2d 996 (5th Cir. 1975);
30 *Suburbia Fed. Sav. & Loan Ass’n v. Bel-Air Conditioning Co.*, 385 So.2d 1151
31 (Fla.Dist.Ct.App.1980). This section provides, among other things, that separation

1 of ownership and possession *per se* does not affect the enforceability of the lease
2 contract. Sections 2A-401 and 2A-408.

3 **Cross References:**

4 Sections 2A-401, 2A-408, and 9-202.

5 **Definitional Cross References:**

6 “Goods”. Section 2A-102(a)(16).

7 “Lessee”. Section 2A-102(a)(22).

8 “Lessor”. Section 2A-102(a)(24).

9 **SECTION 2A-403. ALIENABILITY OF PARTY’S INTEREST UNDER**
10 **LEASE CONTRACT OR OF LESSOR’S RESIDUAL INTEREST IN**
11 **GOODS; DELEGATION OF PERFORMANCE; TRANSFER OF RIGHTS.**

12 (a) In this section, “creation of a security interest” includes the sale of a
13 lease contract that is subject to Article 9 by reason of Section 9-109(a)(3).

14 (b) Except as otherwise provided in subsection (c) and Section 9-407, a
15 provision in a lease agreement which (i) prohibits the voluntary or involuntary
16 transfer, including a transfer by sale, sublease, creation or enforcement of a security
17 interest, or attachment, levy, or other judicial process, of an interest of a party under
18 the lease contract or of the lessor’s residual interest in the goods, or (ii) makes such
19 a transfer an event of default, gives rise to the rights and remedies provided in
20 subsection (e). However, a transfer that is prohibited or is an event of default under
21 the lease agreement is otherwise effective.

22 (c) In a consumer lease, to prohibit the transfer of an interest of a party
23 under the lease contract or to make a transfer an event of default, the language must
24 be specific, be in a record, and be conspicuous.

1 (d) A term in a lease agreement which (i) prohibits a transfer of a right to
2 damages for default with respect to the whole lease contract or of a right to payment
3 arising out of the transferor's due performance of the transferor's entire obligation,
4 or (ii) makes such a transfer an event of default, is not enforceable. Such a transfer
5 is not a transfer that materially impairs the prospect of obtaining return performance
6 by, materially changes the duty of, or materially increases the burden or risk imposed
7 on, the other party to the lease contract within the meaning of subsection (e).

8 (e) Subject to subsection (d) and Section 9-407:

9 (1) if a transfer is made that is an event of default under a lease
10 agreement, the other party to the lease contract has the rights and remedies
11 described in Section 2A-702(b), unless that party waives the default or otherwise
12 agrees; and

13 (2) if paragraph (1) does not apply and a transfer is made that (i) is
14 prohibited under a lease agreement or (ii) materially impairs the prospect of
15 obtaining return performance by, materially changes the duty of, or materially
16 increases the burden or risk imposed on, the other party to the lease contract, unless
17 the party not making the transfer agrees at any time to the transfer in the lease
18 contract or otherwise or unless limited by contract:

19 (A) the transferor is liable to the party not making the transfer for
20 damages caused by the transfer to the extent that the damages could not reasonably
21 be prevented by the party not making the transfer; and

1 (B) a court having jurisdiction may grant other appropriate relief,
2 including cancellation of the lease contract or an injunction against the transfer.

3 (f) A transfer of “the lease” or of “all my rights under the lease”, or a
4 transfer in similar general terms, is a transfer of rights and, unless the language or
5 the circumstances, as in a transfer for security, indicate the contrary, the transfer is a
6 delegation of duties by the transferor to the transferee. Acceptance by the transferee
7 constitutes a promise by the transferee to perform those duties. The promise is
8 enforceable by either the transferor or the other party to the lease contract.

9 (g) Unless otherwise agreed by the lessor and the lessee, a delegation of
10 performance does not relieve the transferor as against the other party of any duty to
11 perform or liability for default.

12 *Legislative Note: Former subsection (3) was stricken to be replaced by the rules of*
13 *revised Section 9-407. If a jurisdiction adopting this Act has not adopted revised*
14 *Article 9, the following provision should be incorporated into this section:*

15 (d) *A term of a lease agreement which prohibits the creation or*
16 *enforcement of a security interest in an interest of a party under the lease contract*
17 *or in the lessor’s residual interest in the goods, or which makes such a transfer an*
18 *event of default, is enforceable only to the extent that there is a transfer by the*
19 *lessee of the lessee’s right of possession or use of the goods in violation of the*
20 *provision or a delegation of a material performance of either party to the lease*
21 *contract in violation of the provision. Neither the granting nor the enforcement of*
22 *a security interest in the lessor’s interest under the lease contract, or the lessor’s*
23 *residual interest in the goods, is a transfer that materially impairs the prospect of*
24 *obtaining return performance by, materially changes the duty of, or materially*
25 *increases the burden or risk imposed on, the lessee within the meaning of*
26 *subsection (e) unless, and only to the extent that, there is a delegation of a material*
27 *performance of the lessor.*

28 **Comment**

29 **Uniform Statutory Analogue:** Sections 2-503 and 9-401.

1 The provisions of Sections 2-503 and 9-401 are incorporated in this section,
2 with substantial modifications to reflect leasing terminology and practice and to
3 harmonize the principles of the respective provisions, *i.e.*, limitations on delegation
4 of performance on the one hand and alienability of rights on the other. This section
5 deals with involuntary as well as voluntary transfers. Moreover, the principle of
6 Section 9-406 denying effectiveness to contractual terms prohibiting assignments of
7 receivables due and to become due also is implemented.

8 1. Subsection (b) states a rule, consistent with Section 9-401, that voluntary
9 and involuntary transfers of an interest of a party under the lease contract or of the
10 lessor's residual interest, including by way of the creation or enforcement of a
11 security interest, are effective, notwithstanding a provision in the lease agreement
12 prohibiting the transfer or making the transfer an event of default. Although the
13 transfers are effective, the provision in the lease agreement is nevertheless
14 enforceable, but only as provided in subsection (e). Under subsection (e) the
15 prejudiced party is limited to the remedies on "default under the lease contract" in
16 this Article and, except as limited by this Article, as provided in the lease agreement,
17 if the transfer has been made an event of default. Section 2A-702(d). Usually, there
18 will be a specific provision to this effect or a general provision making a breach of a
19 covenant an event of default. In those cases where the transfer is prohibited, but not
20 made an event of default, the prejudiced party may recover damages; or, if the
21 damage remedy would be ineffective adequately to protect that party, the court can
22 order cancellation of the lease contract or enjoin the transfer. This rule that such
23 provisions generally are enforceable is subject to subsections (d) and Section 9-407,
24 which make such provisions unenforceable in certain instances.

25 2. The first such instance is described in Section 9-407. A provision in a
26 lease agreement which prohibits the creation or enforcement of a security interest,
27 including sales of lease contracts subject to Article 9 makes it an event of default is
28 generally not enforceable. However, that policy gives way to the doctrine which
29 gives one party to a contract the right to protect itself against an actual delegation
30 (but not just a provision under which delegation might later occur) of a material
31 performance by the other party. Accordingly, such a provision in a lease agreement
32 is enforceable when the transfer delegates a material performance. Generally, as
33 expressly provided in subsection (f), a transfer for security is not a delegation of
34 duties. However, inasmuch as the creation of a security interest includes the sale of
35 a lease contract, if there are then unperformed duties on the part of the lessor/seller,
36 there could be a delegation of duties in the sale, and, if such a delegation actually
37 takes place and is of a material performance, a provision in a lease agreement
38 prohibiting it or making it an event of default would be enforceable, giving rise to
39 the rights and remedies stated in subsection (e). The statute does not define
40 "material." The parties may set standards to determine its meaning. The term is
41 intended to exclude delegations of matters such as accounting to a professional

1 accountant and the performance of, as opposed to the responsibility for,
2 maintenance duties to a person in the maintenance service industry.

3 3. For similar reasons, the lessor is entitled to protect its residual interest in
4 the goods by prohibiting anyone but the lessee from possessing or using them.
5 Accordingly, under Section 9-407 if there is an actual transfer by the lessee of its
6 right of possession or use of the goods in violation of a provision in the lease
7 agreement, such a provision likewise is enforceable, giving rise to the rights and
8 remedies stated in subsection (e). A transfer of the lessee's right of possession or
9 use of the goods resulting from the enforcement of a security interest granted by the
10 lessee in its leasehold interest is a "transfer by the lessee" under this subsection.

11 4. Finally, Section 9-407 protects against a claim that the creation or
12 enforcement of a security interest in the lessor's interest under the lease contract or
13 in the residual interest is a transfer that materially impairs the prospect of obtaining
14 return performance by, materially changes the duty of, or materially increases the
15 burden or risk imposed on the lessee so as to give rise to the rights and remedies
16 stated in subsection (e), unless the transfer involves an actual delegation of a
17 material performance of the lessor.

18 5. While it is not likely that a transfer by the lessor of its right to payment
19 under the lease contract would impair at a future time the ability of the lessee to
20 obtain the performance due the lessee under the lease contract from the lessor, if
21 under the circumstances reasonable grounds for insecurity as to receiving that
22 performance arise, the lessee may employ the provision of this Article for demanding
23 adequate assurance of due performance and has the remedy provided in that
24 circumstance. Section 2A-601.

25 6. Sections 9-403, 9-404, 9-405, and 9-406 also are relevant. Section 9-403
26 sanctions an agreement by a lessee not to assert certain types of claims or defenses
27 against the lessor's assignee. Sections 9-404, 9-405, and 9-406, deal with, among
28 other things, the other party's rights against the assignee where Section 9-403(b)
29 does not apply. The definition of account debtor under Section 9-102(a)(2) and
30 (a)(3) includes a lessee of goods. As a result, Section 9-403 applies to lease
31 agreements, and there is no need to restate those sections in this Article.

32 7. Subsection (d) makes unenforceable a prohibition against transfers of
33 certain rights to payment or a provision making the transfer an event of default. It
34 also provides that such transfers do not materially impair the prospect of obtaining
35 return performance by, materially change the duty of, or materially increase the
36 burden or risk imposed on, the other party to the lease contract so as to give rise to
37 the rights and remedies stated in subsection (e). Accordingly, a transfer of a right to
38 payment cannot be prohibited or made an event of default, or be one that materially

1 impairs performance, changes duties or increases risk, if the right is already due or
2 will become due without further performance being required by the party to receive
3 payment. Thus, a lessor can transfer the right to future payments under the lease
4 contract, including by way of a grant of a security interest, and the transfer will not
5 give rise to the rights and remedies stated in subsection (e) if the lessor has no
6 remaining performance under the lease contract. The mere fact that the lessor is
7 obligated to allow the lessee to remain in possession and to use the goods as long as
8 the lessee is not in default does not mean that there is “remaining performance” on
9 the part of the lessor. Likewise, the fact that the lessor has potential liability under a
10 “non-operating” lease contract for breaches of warranty does not mean that there is
11 “remaining performance.” In contrast, the lessor would have “remaining
12 performance” under a lease contract requiring the lessor to regularly maintain and
13 service the goods or to provide “upgrades” of the equipment on a periodic basis in
14 order to avoid obsolescence. The basic distinction is between a mere potential duty
15 to respond which is not “remaining performance,” and an affirmative duty to render
16 stipulated performance. Although the distinction may be difficult to draw in some
17 cases, it is instructive to focus on the difference between “operating” and “non-
18 operating” leases as generally understood in the market place. Even if there is
19 “remaining performance” under a lease contract, a transfer for security of a right to
20 payment that is made an event of default or that is in violation of a prohibition
21 against transfer does not give rise to the rights and remedies under subsection (e) if
22 it does not constitute an actual delegation of a material performance under Section
23 9-407.

24 8. The application of either the rule of Section 9-407 or the rule of
25 subsection (d) to the grant by the lessor of a security interest in the lessor’s right to
26 future payment under the lease contract may produce the same result. Both
27 subsections generally protect security transfers by the lessor in particular because
28 the creation by the lessor of a security interest or the enforcement of that interest
29 generally will not prejudice the lessee’s rights if it does not result in a delegation of
30 the lessor’s duties. To the contrary, the receipt of loan proceeds or relief from the
31 enforcement of an antecedent debt normally should enhance the lessor’s ability to
32 perform its duties under the lease contract. Nevertheless, there are circumstances
33 where relief might be justified. For example, if ownership of the goods is transferred
34 pursuant to enforcement of a security interest to a party whose ownership would
35 prevent the lessee from continuing to possess the goods, relief might be warranted.
36 See 49 U.S.C. § 1401(a) and (b) which places limitations on the operation of aircraft
37 in the United States based on the citizenship or corporate qualification of the
38 registrant.

39 9. Relief on the ground of material prejudice when the lease agreement does
40 not prohibit the transfer or make it an event of default should be afforded only in
41 extreme circumstances, considering the fact that the party asserting material

1 prejudice did not insist upon a provision in the lease agreement that would protect
2 against such a transfer.

3 10. Subsection (e) implements the rule of subsection (b). Subsection (b)
4 provides that, even though a transfer is effective, a provision in the lease agreement
5 prohibiting it or making it an event of default may be enforceable as provided in
6 subsection (e). *See Brummond v. First National Bank of Clovis*, 656 P.2d 884, 35
7 U.C.C.Rep.Serv. (Callaghan) 1311 (N.Mex.1983), stating the analogous rule for
8 Section 9-411 (then Section 9-311). If the transfer prohibited by the lease
9 agreement is made an event of default, then, under subsection (e)(1) unless the
10 default is waived or there is an agreement otherwise, the aggrieved party has the
11 rights and remedies referred to in Section 2A-702(d), viz. those in this Article and,
12 except as limited in the Article, those provided in the lease agreement. In the
13 unlikely circumstance that the lease agreement prohibits the transfer without making
14 a violation of the prohibition an event of default or, even if there is no prohibition
15 against the transfer, and the transfer is one that materially impairs performance,
16 changes duties, or increases risk (for example, a sublease or assignment to a party
17 using the goods improperly or for an illegal purpose), then subsection (e)(2) is
18 applicable. In that circumstance, unless the party aggrieved by the transfer has
19 otherwise agreed in the lease contract, such as by assenting to a particular transfer
20 or to transfers in general, or agrees in some other manner, the aggrieved party has
21 the right to recover damages from the transferor and a court may, in appropriate
22 circumstances, grant other relief, such as cancellation of the lease contract or an
23 injunction against the transfer.

24 11. If a transfer gives rise to the rights and remedies provided in subsection
25 (e), the transferee as an alternative may propose, and the other party may accept,
26 adequate cure or compensation for past defaults and adequate assurance of future
27 due performance under the lease contract. Subsection (e) does not preclude any
28 other relief that may be available to a party to the lease contract aggrieved by a
29 transfer subject to an enforceable prohibition, such as an action for interference with
30 contractual relations.

31 12. Subsection (c) requires that a provision in a consumer lease prohibiting
32 a transfer, or making it an event of default, must be specific, written and
33 conspicuous. *See* Section 2A-102(a)(8). This assists in protecting a consumer
34 lessee against surprise assertions of default.

35 13. Subsection (f) states a rule of construction that distinguishes a
36 commercial assignment, which substitutes the assignee for the assignor as to rights
37 and duties, and an assignment for security or financing assignment, which substitutes
38 the assignee for the assignor only as to rights. Note that the assignment for security
39 or financing assignment is a subset of all security interests. Security interest is

1 defined to include any interest of a buyer of chattel paper. Section 1-201(37).
2 Chattel paper is defined to include a lease. Section 9-102(a)(11). Thus, a buyer of
3 leases is the holder of a security interest in the leases. That conclusion should not
4 influence this issue, as the policy is quite different. Whether a buyer of leases is the
5 holder of a commercial assignment, or an assignment for security or financing
6 assignment should be determined by the language of the assignment or the
7 circumstances of the assignment.

8 **Cross References:**

9 Sections 1-201(11), 1-201(37), 2-503, 2A-601, 9-403, 9-404, 9-405, 9-406, and
10 9-407.

11 **Definitional Cross References:**

12 “Agreed” and “Agreement”. Section 1-201(3).
13 “Conspicuous”. Section 2A-(a)(6).
14 “Goods”. Section 2A-102(a)(16).
15 “Lease”. Section 2A-102(a)(18).
16 “Lease contract”. Section 2A-102(a)(20).
17 “Lessee”. Section 2A-102(a)(22).
18 “Lessor”. Section 2A-102(a)(24).
19 “Lessor’s residual interest”. Section 2A-102(a)(25).
20 “Notice”. Section 1-201(25).
21 “Party”. Section 1-201(29).
22 “Person”. Section 1-201(30).
23 “Reasonable time”. Section 1-204(1) and (2).
24 “Rights”. Section 1-201(36).
25 “Record”. Section 2A-102(a)(31).
26 “Term”. Section 1-201(42).

27 **SECTION 2A-404. SUBSEQUENT LEASE OF GOODS BY LESSOR.**

28 (a) Subject to Section 2A-403, a subsequent lessee from a lessor of goods
29 under an existing lease contract obtains, to the extent of the leasehold interest
30 transferred, the leasehold interest that the lessor had or had power to transfer and,
31 except as otherwise provided in subsections (b) and Section 2A-720(d), takes
32 subject to the existing lease contract.

1 (b) A lessor with voidable rights or voidable title acquired in a purchase of
2 goods from a transferor has power to transfer a good leasehold interest to a good
3 faith subsequent lessee for value. Under this subsection, voidable rights or voidable
4 title is acquired when the goods have been delivered under a transaction of purchase
5 even if:

6 (1) the transferor was deceived as to the identity of the lessor;

7 (2) the delivery was in exchange for a check later dishonored;

8 (3) it was agreed that the transaction was to be a cash sale; or

9 (4) the delivery was procured through fraud punishable under criminal
10 law.

11 (c) A subsequent lessee in the ordinary course of business from a lessor that
12 is a merchant dealing in goods of that kind to which the goods were entrusted by the
13 existing lessee of that lessor before the interest of the subsequent lessee became
14 enforceable against that lessor obtains, to the extent of the leasehold interest
15 transferred, all rights to the goods of that lessor and the existing lessee, and takes
16 free of the existing lease contract.

17 (d) A subsequent lessee from the lessor of goods that are subject to an
18 existing lease contract and are covered by a certificate of title issued under a statute
19 of this State or of another jurisdiction takes no greater rights than those provided
20 both by this section and by the certificate-of-title statute.

21 **Comment**

22 **Uniform Statutory Analogue:** Section 2-504.

1 1. This section must be read in conjunction with, as it is subject to, the
2 provisions of Section 2A-403, which govern voluntary and involuntary transfers of
3 rights and duties under a lease contract, including the lessor's residual interest in the
4 goods.

5 2. This section must also be read in conjunction with Section 2-504. This
6 section and Section 2A-405 are similar to Section 2-504, which states a unified
7 policy on good faith purchases of goods. Given the scope of the definition of
8 purchaser (Section 1-201(33)), a person who bought goods to lease as well as a
9 person who bought goods subject to an existing lease from a lessor will take
10 pursuant to Section 2-504. Further, a person who leases such goods from the
11 person who bought them should also be protected under Section 2-504, first
12 because the lessee's rights are derivative and second because the definition of
13 purchaser should be interpreted to include one who takes by lease.

14 3. Subsection (a) states a rule with respect to the leasehold interest obtained
15 by a subsequent lessee from a lessor of goods under an existing lease contract. The
16 interest will include such leasehold interest as the lessor has in the goods as well as
17 the leasehold interest that the lessor had the power to transfer. Thus, the
18 subsequent lessee obtains unimpaired all rights acquired under the law of agency,
19 apparent agency, ownership or other estoppel, whether based upon statutory
20 provisions or upon case law principles. Section and 1-103. In general, the
21 subsequent lessee takes subject to the existing lease contract, including the existing
22 lessee's rights thereunder. Furthermore, the subsequent lease contract is, of course,
23 limited by its own terms, and the subsequent lessee takes only to the extent of the
24 leasehold interest transferred thereunder.

25 4. Subsection (b) further provides that a lessor with voidable title has power
26 to transfer a good leasehold interest to a good faith subsequent lessee for value. In
27 addition, subsections (b)(1) through (4) provide specifically for the protection of the
28 good faith subsequent lessee for value in a number of specific situations which have
29 been troublesome under prior law.

30 5. The position of an existing lessee who entrusts leased goods to its lessor
31 is not distinguishable from the position of other entrusters. Thus, subsection (c)
32 provides that the subsequent lessee in the ordinary course of business takes free of
33 the existing lease contract between the lessor entruster and the lessee entruster, if
34 the lessor is a merchant dealing in goods of that kind. Further, the subsequent lessee
35 obtains all of the lessor entruster's and the lessee entruster's rights to the goods, but
36 only to the extent of the leasehold interest transferred by the lessor entruster. Thus,
37 the lessor entruster retains the residual interest in the goods. Section
38 2A-102(a)(28). However, entrustment by the existing lessee must have occurred
39 before the interest of the subsequent lessee became enforceable against the lessor.

1 Entrusting is defined in Section 2-403(3) and that definition applies here. Section
2 2A-102(b).

3 6. Subsection (d) states a rule with respect to a transfer of goods from a
4 lessor to a subsequent lessee where the goods are subject to an existing lease and
5 covered by a certificate of title. The subsequent lessee's rights are no greater than
6 those provided by this section and the applicable certificate of title statute, including
7 any applicable case law construing such statute. Where the relationship between the
8 certificate of title statute and Section 2-504, the statutory analogue to this section,
9 has been construed by a court, that construction is incorporated here. Sections
10 2A-102(b) and 1-102(1) and (2). The better rule is that the certificate of title
11 statutes are in harmony with Section 2-504 (original Section 2-403) and thus would
12 be in harmony with this section. *E.g., Atwood Chevrolet-Olds v. Aberdeen Mun.*
13 *School Dist.*, 431 So.2d 926, 928 (Miss.1983); *Godfrey v. Gilsdorf*, 476 P.2d 3, 6,
14 86 Nev. 714, 718 (1970); *Martin v. Nager*, 192 N.J.Super. 189, 197-98, 469 A.2d
15 519, 523 (Super.Ct.Ch.Div.1983). Where the certificate of title statute is silent on
16 this issue of transfer, this section will control.

17 **Cross References:**

18 Sections 1-102, 1-103, 1-201(33), 2-504, 2A-102(b), 2A-403, and 2A-405.

19 **Definitional Cross References:**

20 "Agreed". Section 1-201(3).

21 "Delivery". Section 1-201(14).

22 "Entrusting". Section 2-504(d).

23 "Good faith". Section 2A-102(a)(15).

24 "Goods". Section 2A-102(a)(16).

25 "Lease". Section 2A-102(a)(18).

26 "Lease contract". Section 2A-102(a)(20).

27 "Leasehold interest". Section 2A-102(a)(21).

28 "Lessee". Section 2A-102(a)(22).

29 "Lessee in the ordinary course of business". Section 2A-102(a)(23).

30 "Lessor". Section 2A-102(a)(24).

31 "Merchant". Section 2-102(a)(27).

32 "Rights". Section 1-201(36).

33 "Value". Section 1-201(44).

34 **SECTION 2A-405. SALE OR SUBLEASE OF GOODS BY LESSEE.**

35 (a) Subject to Section 2A-403, a buyer or sublessee from the lessee of
36 goods under an existing lease contract obtains, to the extent of the interest

1 transferred, the leasehold interest in the goods that the lessee had or had power to
2 transfer and, except as otherwise provided in subsection (b) and Section 2A-727(e),
3 takes subject to the existing lease contract.

4 (b) A lessee with a voidable leasehold interest acquired in a lease transaction
5 from a lessor has power to transfer a good leasehold interest to a good faith
6 subsequent lessee for value to which the goods have been delivered. Under this
7 subsection, a voidable leasehold interest is acquired when the goods have been
8 delivered under the lease contract even if:

9 (1) the lessor was deceived as to the identity of the lessee;

10 (2) the delivery was in exchange for a check later dishonored; or

11 (3) the delivery was procured through fraud punishable under criminal
12 law.

13 (c) A buyer in the ordinary course of business or a sublessee in the ordinary
14 course of business from a lessee that is a merchant dealing in goods of that kind to
15 which the goods were entrusted by the lessor obtains, to the extent of the interest
16 transferred, all of the rights of the lessor and lessee to the goods and takes free of
17 the existing lease contract.

18 (d) A buyer or sublessee from the lessee of goods that are subject to an
19 existing lease contract and are covered by a certificate of title issued under a statute
20 of this State or of another jurisdiction takes no greater rights than those provided
21 both by this section and by the certificate-of-title statute.

22 **Comment**

1 **Uniform Statutory Analogue:** Section 2-504.

2 This section, a companion to Section 2A-404, states the rule with respect to
3 the leasehold interest obtained by a buyer or sublessee from a lessee of goods under
4 an existing lease contract. *Cf.* Section 2A-404 Official Comment. Note that this
5 provision is consistent with existing case law, which prohibits the bailee's transfer of
6 title to a good faith purchaser for value. *See Rohweder v. Aberdeen Product. Credit*
7 *Ass'n*, 765 F.2d 109 (8th Cir. 1985) decided under then Section 2-403(1), now
8 Section 2-504(b).

9 Subsection (c) is also consistent with existing case law. *American Standard*
10 *Credit, Inc. v. National Cement Co.*, 643 F.2d 248, 269-70 (5th Cir. 1981); *but cf.*
11 *Exxon Co., U.S.A. v. TLW Computer Indus.*, 37 U.C.C.Rep.Serv. (Callaghan) 1052,
12 1057-58 (D.Mass.1983). Unlike Section 2A-404(c), this subsection does not
13 contain any requirement with respect to the time that the goods were entrusted to
14 the merchant. In Section 2A-404(c) the competition is between two customers of
15 the merchant lessor; the time of entrusting was added as a criterion to create
16 additional protection to the customer who was first in time: the existing lessee. In
17 subsection (c) of this section the equities between the competing interests were
18 viewed as balanced.

19 Subsection (d) states a rule of construction with respect to a transfer of
20 goods from a lessee to a buyer or sublessee, where the goods are subject to an
21 existing lease and covered by a certificate of title. *Cf.* Section 2A-404 Official
22 Comment.

23 **Cross References:**
24 Sections 2-504, 1-201(9), 2A-404.

25 **Definitional Cross References:**
26 “Buyer”. Section 2-102(a)(2).
27 “Buyer in the ordinary course of business”. Section 1-201(9).
28 “Delivery”. Section 1-201(14).
29 “Entrusting”. Section 2-504(d).
30 “Good faith”. Sections 1-201(19); 2-102(a)(23); 2A-102(a)(15).
31 “Goods”. Section 2A-102(a)(16).
32 “Lease”. Section 2A-102(a)(18).
33 “Lease contract”. Section 2A-102(a)(20).
34 “Leasehold interest.” Section 2A-102(a)(21).
35 “Lessee”. Section 2A-102(a)(22).
36 “Lessee in the ordinary course of business”. Section 2A-102(a)(23).
37 “Lessor”. Section 2A-102(a)(24).
38 “Merchant”. Section 2-102(a)(27).

1 “Rights”. Section 1-201(36).
2 “Sale”. Section 2-102(a)(32).
3 “Sublease”. Section 2A-102(a)(33).
4 “Value”. Section 1-201(44).

5 **SECTION 2A-406. PRIORITY OF CERTAIN LIENS ARISING BY**

6 **OPERATION OF LAW.** If a person in the ordinary course of its business
7 furnishes services or materials with respect to goods subject to a lease contract, a
8 lien upon those goods in the possession of that person given by statute or rule of law
9 for those materials or services has priority over any interest of the lessor or lessee
10 under the lease contract or this article unless the lien is created by statute and the
11 statute provides otherwise, or the lien is created by rule of law and the rule of law
12 provides otherwise.

13 **Comment**

14 **Uniform Statutory Analogue:** Section 9-333.

15 This section should be interpreted to allow a qualified lessor or a qualified
16 lessee to be the competing lienholder if the statute or rule of law so provides. The
17 reference to statute includes applicable regulations and cases; these sources must be
18 reviewed in resolving a priority dispute under this section.

19 **Cross References:**
20 Section 9-333.

21 **Definitional Cross References:**
22 “Goods”. Section 2A-102(a)(16).
23 “Lease contract”. Section 2A-102(a)(20).
24 “Lessee”. Section 2A-102(a)(22).
25 “Lessor”. Section 2A-102(a)(24).
26 “Lien”. Section 2A-102(a)(26).
27 “Person”. Section 1-201(30).

1 **SECTION 2A-407. PRIORITY OF LIENS ARISING BY**
2 **ATTACHMENT OR LEVY ON GOODS.**

3 (a) Except as otherwise provided in Section 2A-406, a creditor of a lessee
4 takes subject to the lease contract.

5 (b) Except as otherwise provided in subsection (c) and Sections 2A-406 and
6 2A-408, a creditor of a lessor takes subject to the lease contract unless the creditor
7 holds a lien that attached to the goods before the lease contract became enforceable.

8 (c) Except as otherwise provided in Sections 9-317, 9-321, and 9-323, a
9 lessee takes a leasehold interest subject to a security interest held by a creditor of the
10 lessor.

11 *Legislative Note: Subsections (b)(2), (b)(3), (c), and (d) of former Section 2A-407*
12 *were placed in revised Article 9. Section 9-317 covers rights of third parties*
13 *against unperfected security interests. Section 9-321 covers lessees in ordinary*
14 *course of business. Section 9-323 covers rights of third parties as against future*
15 *advances made under perfected security interests. If a jurisdiction adopting this*
16 *Act has not adopted revised Article 9, the deleted subsections of former Section*
17 *2A-407 set out below should be inserted here:*

18 (b) Except as otherwise provided in subsections (c) and (d) and Sections
19 2A-406 and 2A-408, a creditor of a lessor takes subject to the lease contract
20 unless:

21 (1) the creditor holds a lien that attached to the goods before the lease
22 contract became enforceable;

23 (2) the creditor holds a security interest in the goods and the lessee did
24 not give value and receive delivery of the goods without knowledge of the security
25 interest; or

26 (3) the creditor holds a security interest in the goods which was
27 perfected under Article 9 before the lease contract became enforceable.

28 (c) A lessee in the ordinary course of business takes the leasehold interest
29 free of a security interest in the goods created by the lessor even if the security
30 interest is perfected under Article 9 and the lessee knows of its existence.

31 (d) A lessee other than a lessee in the ordinary course of business takes a
32 leasehold interest free of a security interest to the extent that it secures future

1 *advances made after the secured party acquires knowledge of the lease or more*
2 *than 45 days after the lease contract becomes enforceable, whichever first occurs,*
3 *unless the future advances are made pursuant to a commitment entered into without*
4 *knowledge of the lease and before the expiration of the 45-day period.*

5 **Comment**

6 1. Subsection (a) states a general rule of priority that a creditor of the lessee
7 takes subject to the lease contract. The term lessee (Section 2A-102(a)(25))
8 includes sublessee. Therefore, this subsection not only covers disputes between the
9 prime lessor and a creditor of the prime lessee but also disputes between the prime
10 lessor, or the sublessor, and a creditor of the sublessee. Section 2A-401 Official
11 Comment 3(g). Further, by using the term creditor (Section 1-201(12)), this
12 subsection will cover disputes with a general creditor, a secured creditor, a lien
13 creditor and any representative of creditors. Section 2A-102(b).

14 2. Subsection (b) states a general rule of priority that a creditor of a lessor
15 takes subject to the lease contract. Note the discussion above with regard to the
16 scope of these rules. Section 2A-401 Official Comment 3(g). Thus, the section will
17 not only cover disputes between the prime lessee and a creditor of the prime lessor
18 but also disputes between the prime lessee, or the sublessee, and a creditor of the
19 sublessor.

20 3. To take priority over the lease contract, and the interests derived
21 therefrom, the creditor's lien (Section 2A-102(a)(29)) must have attached before the
22 lease contract became enforceable (Section 2A-401). 4. The rules of this section
23 operate in favor of whichever party to the lease contract may enforce it, even if one
24 party perhaps may not, *e.g.*, under Section 2A-201(1)(b).

25 4. The rules of this section operate in favor of whichever party to the lease
26 contract can enforce it, even if one party may not, *e.g.*, because of Section 2A-201.

27 5. The provisions of the predecessor of this section, original Section
28 2A-307, which dealt with the relationship between a secured creditor of the lessor
29 and a lessee have been moved to revised Article 9 in Sections 9-317, 9-321, and
30 9-323. See those sections and the Comments thereto.

31 **Cross References:**

32 Sections 1-201(12), 1-201(25), 1-201(37), 1-201(44), 2A-102(a)(25),
33 2A-102(a)(26), 2A-102(a)(29), 2A-102(b), 2A-401 Official Comment 3(g), Article
34 9, especially Sections 9-317, 9-321, and 9-323).

35 **Definitional Cross References:**

36 "Creditor". Section 1-201(12).

1 “Goods”. Section 2A-102(a)(16).
2 “Knowledge” and “Knows”. Section 1-201(25).
3 “Lease”. Section 2A-102(a)(18).
4 “Lease contract”. Section 2A-102(a)(20).
5 “Leasehold interest”. Section 2A-102(a)(21).
6 “Lessee”. Section 2A-102(a)(22).
7 “Lessee in the ordinary course of business”. Section 2A-102(a)(23).
8 “Lessor”. Section 2A-102(a)(24).
9 “Lien”. Section 2A-102(a)(26).
10 “Party”. Section 1-201(29).
11 “Security interest”. Section 1-201(37).

12 **SECTION 2A-408. SPECIAL RIGHTS OF CREDITORS.**

13 (a) Except as otherwise provided in subsections (b) and (c), the rights of
14 creditors of the lessor with respect to goods identified to a lease contract and
15 retained by the lessor are subject to the lessee’s rights under Sections 2A-708,
16 2A-724(d), and 2A-737, if the lessee’s rights vest before a creditor’s claim in rem
17 attaches to the goods.

18 (b) A creditor of a lessor may treat a lease or an identification of goods to a
19 lease contract as void if as against the creditor a retention of possession or
20 identification by the lessor is fraudulent under any law of the State in which the
21 goods are situated. However, the retention of possession in good faith and current
22 course of trade by a merchant lessor for a commercially reasonable time after a lease
23 or identification is not fraudulent.

24 (c) Except as otherwise provided in subsection (a) and Sections 2A-404 and
25 2A-405, this article does not impair the rights of creditors of the lessor if
26 identification to the lease contract or delivery is not made in current course of trade

1 but is made in satisfaction of or as security for a preexisting claim for money,
2 security, or the like under circumstances that under any law of the State where the
3 goods are situated, apart from this article, would constitute a fraudulent transfer or a
4 voidable preference.

5 (d) A creditor of a seller may treat a sale or an identification of goods to a
6 contract for sale as void if, as against the creditor a retention of possession by the
7 seller is fraudulent under any law of the State where the goods are situated.
8 However, it is not fraudulent for a seller to retain possession of the goods pursuant
9 to a lease contract entered into by the seller as lessee and the buyer as lessor in
10 connection with the sale or identification of the goods if the buyer bought for value
11 and in good faith.

12 **Comment**

13 **Uniform Statutory Analogue:** Section 2-505.

14 Subsection (b) states a general rule of avoidance where the lessor has
15 retained possession of goods if such retention is fraudulent under any statute or rule
16 of law. However, the subsection creates an exception under certain circumstances
17 for retention of possession of goods for a commercially reasonable time after the
18 lease contract becomes enforceable.

19 Subsection (c) also preserves the possibility of an attack on the lease by
20 creditors of the lessor if the lease was made in satisfaction of or as security for a
21 pre-existing claim, and would constitute a fraudulent transfer or voidable preference
22 under other law.

23 Finally, subsection (d) states a new rule with respect to sale-leaseback
24 transactions, *i.e.*, transactions where the seller sells goods to a buyer but possession
25 of the goods is retained by the seller pursuant to a lease contract between the buyer
26 as lessor and the seller as lessee. Notwithstanding any statute or rule of law that
27 would treat such retention as fraud, whether *per se*, *prima facie*, or otherwise, the
28 retention is not fraudulent if the buyer bought for value (Section 1-201(44)) and in

1 good faith (Sections 1-201(19) and 2-102(a)(23). This provision overrides Section
2 2-505(b) to the extent it would otherwise apply to a sale-leaseback transaction.

3 **Cross References:**
4 Sections 1-201(19), 1-201(44), 2-505.

5 **Definitional Cross References:**
6 “Buyer”. Section 2-102(a)(3).
7 “Contract”. Section 1-201(11).
8 “Creditor”. Section 1-201(12).
9 “Good faith”. Sections 1-201(19), 2-102(a)(23), and 2A-102(a)(15).
10 “Goods”. Section 2A-102(a)(16).
11 “Lease contract”. Section 2A-102(a)(20).
12 “Lessee”. Section 2A-102(a)(22).
13 “Lessor”. Section 2A-102(a)(24).
14 “Money”. Section 1-201(24).
15 “Reasonable time”. Section 1-204(1) and (2).
16 “Rights”. Section 1-201(36).
17 “Sale”. Section 2-102(a)(32).
18 “Seller”. Section 2-102(a)(33).
19 “Value”. Section 1-201(44).

20 **SECTION 2A-409. RIGHTS OF LESSOR AND LESSEE WHEN GOODS**
21 **BECOME FIXTURES.**

22 (a) In this section:

23 (1) “Construction mortgage” means a mortgage to the extent that it
24 secures an obligation incurred for the construction of an improvement on land
25 including the acquisition cost of the land, if a recorded record of the mortgage so
26 indicates.

27 (2) “Encumbrance” includes a real property mortgage, other lien on real
28 estate, and any other right in real property which is not an ownership interest.

1 (3) “Fixture filing” means a filing, in the office where a mortgage on the
2 real property would be filed or recorded, of a financing statement covering goods
3 that are or are to become fixtures and conforming to the requirements of Section
4 9-502(a).

5 (4) “Fixtures” means goods that have become so related to particular
6 real property that an interest in them arises under real property law.

7 (5) “Purchase money lease” means a lease in which the lessee does not
8 have possession or use of the goods or the right to possession or use of the goods
9 [before] [until] the lease agreement is enforceable.

10 (b) A lease under this article may be of goods that are fixtures or may
11 continue in goods that become fixtures, but there may be no lease under this article
12 of ordinary building materials incorporated into an improvement on land.

13 (c) This article does not prevent creation of a lease of fixtures under real
14 property law.

15 (d) The perfected interest of a lessor of fixtures has priority over a
16 conflicting interest of an encumbrancer or owner of the real property if the lessee
17 has an interest of record in or is in possession of the real property and:

18 (1) except as otherwise provided in subsection (f), the lease is a purchase
19 money lease, the interest of the encumbrancer or owner arises before the goods
20 become fixtures, and the interest of the lessor is perfected by a fixture filing before
21 the goods become fixtures or within 20 days thereafter; or

1 (2) the interest of the lessor is perfected by a fixture filing before the
2 interest of the encumbrancer or owner is of record, and the lessor's interest has
3 priority over any conflicting interest of a predecessor in title of the encumbrancer or
4 owner.

5 (e) The interest of a lessor of fixtures, whether or not perfected, has priority
6 over the conflicting interest of an encumbrancer or owner of the real property if:

7 (1) the fixtures are readily removable factory or office machines, readily
8 removable equipment that is not primarily used or leased for use in the operation of
9 the real property, or readily removable replacements of domestic appliances that are
10 goods subject to a consumer lease, and, before the goods become fixtures, the lease
11 contract is enforceable;

12 (2) the conflicting interest is a lien on the real property obtained by legal
13 or equitable proceedings after the lease contract is enforceable;

14 (3) the encumbrancer or owner has, in a authenticated record, consented
15 to the lease or has disclaimed an interest in the goods as fixtures; or

16 (4) the lessee has a right to remove the goods as against the
17 encumbrancer or owner, but if the lessee's right to remove terminates, the priority of
18 the interest of the lessor continues for a reasonable time.

19 (f) Except as otherwise provided in subsections (d) and (e), the interest of a
20 lessor of fixtures, including the lessor's residual interest, is subordinate to the
21 conflicting interest of an encumbrancer of the real property under a construction
22 mortgage recorded before the goods become fixtures if the goods become fixtures

1 before the completion of the construction. A mortgage has this priority to the same
2 extent as a construction mortgage to the extent that it is given to refinance a
3 construction mortgage.

4 (g) In cases not covered by subsections (c) through (f), priority between the
5 interest of a lessor of fixtures, including the lessor's residual interest, and the
6 conflicting interest of an encumbrancer or owner of the real property which is not
7 the lessee is determined by the priority rules governing conflicting interests in real
8 property.

9 (h) If the interest of a lessor of fixtures, including the lessor's residual
10 interest, has priority over all owners and encumbrancers of the real property, the
11 lessor or the lessee may on default, expiration, termination, or cancellation of the
12 lease contract, but subject to the lease agreement and this article, or if necessary to
13 enforce other rights of the lessor or lessee under this article, remove the goods from
14 the real property, free and clear of all conflicting interests of all owners and
15 encumbrancers of the real property. However, the lessor or lessee shall reimburse
16 any encumbrancer or owner of the real property that is not the lessee and which has
17 not otherwise agreed for the cost of repair of any physical injury, but not for any
18 diminution in value of the real property caused by the absence of the goods removed
19 or by any necessity of replacing them. A person entitled to reimbursement may
20 refuse permission to remove until the party seeking removal gives adequate security
21 for the performance of this obligation.

(i) Even if the lease agreement does not create a security interest, the interest of a lessor of fixtures, including the lessor's residual interest, is perfected by filing a financing statement as a fixture filing for leased goods that are or are to become fixtures in accordance with the pertinent provisions of Article 9.

Comment

Uniform Statutory Analogue: Sections 9-334, 9-604.

1. Subsection (1)(d) defines purchase money lease to exclude leases where the lessee had possession or use of the goods or the right thereof before the lease agreement became enforceable. This term is used in subsection (d)(1) as one of the conditions that must be satisfied to obtain priority over the conflicting interest of an encumbrancer or owner of the real estate.

2. Under subsection (d) it is not necessary for a lessor who had leased the goods before they became fixtures to file under Article 9 if the lease is of readily removable factory or office machines, readily removable equipment that is not used in the operation of the real estate, or readily removable replacements of domestic appliances that are consumer goods.

3. The rule stated in subsection (g) is more liberal than the rule stated in Section 9-334(c) in that issues of priority not otherwise resolved in this subsection are left for resolution by the priority rules governing conflicting interests in real estate, as opposed to the Section 9-334(c) automatic subordination of the security interest in fixtures. Note that, for the purpose of this section, where the interest of an encumbrancer or owner of the real estate is paramount to the interest of the lessor, the latter term includes the residual interest of the lessor.

4. The rule stated in subsection (h) is more liberal than the rule stated in Section 9-604(c) in that the right of removal is extended to both the lessor and the lessee and the occasion for removal includes expiration, termination or cancellation of the lease agreement, and enforcement of rights and remedies under this Article, as well as default. The new language also provides that upon removal the goods are free and clear of conflicting interests of owners and encumbrancers of the real estate.

5. Finally, subsection (i) provides a mechanism for the lessor of fixtures to perfect its interest by filing a financing statement under the provisions of the Article on Secured Transactions (Article 9), even though the lease agreement does not create a security interest. Section 1-201(37). The relevant provisions of Article 9

1 must be interpreted permissively to give effect to this mechanism as it implicitly
2 expands the scope of Article 9 so that its filing provisions apply to transactions that
3 create a lease of fixtures, even though the lease agreement does not create a security
4 interest.

5 **Cross References:**

6 Sections 1-201(37), Article 9, especially Sections 9-334 and 9-604.

7 **Definitional Cross References:**

8 “Agreed”. Section 1-201(3).
9 “Cancellation”. Section 2A-102(a)(2).
10 “Conforming”. Section 2A-102(a)(6).
11 “Consumer lease”. Section 2A-10(a)(8).
12 “Goods”. Section 2A-102(a)(16).
13 “Lease”. Section 2A-102(a)(18).
14 “Lease agreement”. Section 2A-102(a)(19).
15 “Lease contract”. Section 2A-10(a)(20).
16 “Lessee”. Section 2A-102(a)(22).
17 “Lessor”. Section 2A-10(a)(24).
18 “Lien”. Section 2A-102(a)(26).
19 “Mortgage”. Section 9-102(a)(55).
20 “Party”. Section 1-201(29).
21 “Person”. Section 1-201(30).
22 “Reasonable time”. Section 1-204(1) and (2).
23 “Remedy”. Section 1-201(34).
24 “Rights”. Section 1-201(36).
25 “Record”. Section 2A-102(a)(31).
26 “Security interest”. Section 1-201(37).
27 “Termination”. Section 2A-102(a)(36).
28 “Value”. Section 1-201(44).

29 **SECTION 2A-410. LESSOR’S AND LESSEE’S RIGHTS WHEN**
30 **GOODS BECOME ACCESSIONS.**

31 (a) In this section, “accessions” mean goods that are installed in or affixed
32 to other goods.

33 (b) Except as otherwise provided in subsection (c), the interest of a lessor or
34 a lessee under a lease contract entered into before the goods become accessions is

1 superior to all interests in the whole and valid against all persons subsequently
2 acquiring interests in the whole but is invalid against any person with an interest in
3 the whole which has not in a record consented to the lease or disclaimed an interest
4 in the goods as part of the whole.

5 (c) The interest of a lessor or a lessee under a lease contract described in
6 subsection (b) is subordinate to the interest of:

7 (1) a buyer in the ordinary course of business or a lessee in the ordinary
8 course of business of any interest in the whole acquired after the goods became
9 accessions; or

10 (2) a creditor with a security interest in the whole perfected before the
11 lease contract was made to the extent that the creditor makes subsequent advances
12 without knowledge of the lease contract.

13 (d) If under this section a lessor or lessee holds an interest in accessions
14 which has priority over the claims of all persons that have interests in the whole, the
15 lessor or lessee on default, expiration, termination, or cancellation of the lease
16 contract by the other party but subject to the provisions of the lease contract and
17 this article or, if necessary to enforce other rights under this article, may remove the
18 goods from the whole. However, the lessor or lessee shall reimburse any holder of
19 an interest in the whole which is not the lessee and which has not otherwise agreed
20 for the cost of repair of any physical injury but not for any diminution in value of the
21 whole caused by the absence of the goods removed or by any necessity for replacing
22 them. A person entitled to reimbursement may refuse permission to remove the

1 goods until the party seeking removal gives adequate security for the performance
2 of this obligation.

3 **Comment**

4 **Uniform Statutory Analogue:** 1972 Article 9 Section 9-314.

5 Subsections (a) and (b) restate the provisions of subsection (1) of Section
6 9-314 to clarify the definition of accession and to add leasing terminology to the
7 priority rule that applies when the lease is entered into before the goods become
8 accessions. Subsection (c) restates the provisions of subsection (2) of Section 9-314
9 to add leasing terminology to the priority rule that applies when the lease is entered
10 into on or after the goods become accessions. Unlike the rule with respect to
11 security interests, the lease is merely subordinate, not invalid.

12 Subsection (d) creates two exceptions to the priority rules stated in
13 subsections (b) and (c). Subsection (d) deletes the special priority rule found in the
14 provisions of Section 9-314(3)(b) as the interests of the lessor and lessee are entitled
15 to greater protection.

16 Finally, subsection (e) is modeled on the provisions of Section 9-314(4) with
17 respect to removal of accessions, restated to reflect the parallel changes in Section
18 2A-409(h).

19 **Cross References:**

20 Section 2A-409(h), 1972 Article 9 Section 9-314.

21 **Definitional Cross References:**

22 “Agreed”. Section 1-201(3).

23 “Buyer in the ordinary course of business”. Section 1-201(9).

24 “Cancellation”. Section 2A-102(a)(2).

25 “Creditor”. Section 1-201(12).

26 “Goods”. Section 2A-102(a)(16).

27 “Holder”. Section 1-201(20).

28 “Knowledge”. Section 1-201(25).

29 “Lease”. Section 2A-102(a)(18).

30 “Lease contract”. Section 2A-102(a)(20).

31 “Lessee”. Section 2A-102(a)(22).

32 “Lessee in the ordinary course of business”. Section 2A-102(a)(23).

33 “Lessor”. Section 2A-102(a)(24).

34 “Party”. Section 1-201(29).

35 “Person”. Section 1-201(30).

36 “Remedy”. Section 1-201(34).

1 “Rights”. Section 1-201(36).
2 “Record”. Section 2A-102(a)(31).
3 “Security interest”. Section 1-201(37).
4 “Termination”. Section 2A-102(a)(36).
5 “Value”. Section 1-201(44).

6 **SECTION 2A-411. PRIORITY SUBJECT TO SUBORDINATION.**

7 Nothing in this article prevents subordination by agreement by any person entitled to
8 priority.

9 **Comment**

10 **Uniform Statutory Analogue:** Section 9-339.

11 The several preceding sections deal with questions of priority. This section
12 is inserted to make it entirely clear that a person entitled to priority may effectively
13 agree to subordinate the claim. Only the person entitled to priority may make such
14 an agreement: the rights of such a person cannot be adversely affected by an
15 agreement to which that person is not a party.

16 **Cross References:**
17 Sections 1-102 and 2A-404 through 2A-410.

18 **Definitional Cross References:**

19 “Agreement”. Section 1-201(3).
20 “Person”. Section 1-201(30).

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PART 5
WARRANTIES

SECTION 2A-501. DEFINITIONS. In this part:

- (1) “Damage” means all loss resulting from a breach of warranty, including incidental and consequential damages.
- (2) “Goods” includes a component incorporated into other goods.
- (3) “Immediate lessee” means a lessee that has a contract with the lessor.
- (4) “Remote lessee” means a lessee from a lessor other than the lessor or seller against which a claim under this part is asserted.
- (5) “Representation” means a description of the goods, affirmation of fact or promise about the quality or performance of to the goods the be delivered, or sample or model of the goods.

Comment

Uniform Statutory Analogue: Section 2-401.

- 1. This section is identical to Section 2-401 except that subsection (6) dealing with auctioneers is omitted as not relevant to leasing transactions. The only changes to subsections (1) through (5) are the substitution of the words “lessor” and “lessee” for “seller” and “buyer” at appropriate places. The much of the Comment below is taken from Section 2-401 modified to reflect the leasing context and the fact that Article 2A does not have the remedial promise concept which is referred to in the Comments to Section 2-401.
- 2. **Overview.** In Revised Article 2A the warranty provisions are placed in a separate Part 5. The primary objective has been to clarify or restate the law of warranty, not to expand the lessor’s liability or to make it more difficult for a lessor to control or limit what is said about the goods, whether to an immediate lessee or the public, or to limit or exclude a warranty made.

1 Nevertheless, at least two developments support a revision that is sensitive
2 to the interests of lessees who pay the rent for the goods leased.

3 The first is the almost universal acceptance of the so-called “economic loss”
4 rule. Under a common version of this judge-made doctrine, the law of torts does
5 not apply if the non-conforming goods cause only disappointed expectations
6 [economic loss] or damage to the goods sold or leased. In these cases, it is the law
7 of contracts, represented by Article 2, that controls. *See, e.g., Alloway v. General*
8 *Marine Indus., L.P.*, 694 A.2d 264 (N.J. 1997); *Bocre Leasing Corp. v. General*
9 *Motors Corp.*, 645 N.E.2d 1195 (N.Y. 1995); American Law Institute, Restatement
10 of the Law Torts: Products Liability §§ 1, 21 (1998). Thus, the lessee of goods
11 manufactured by a remote seller but leased from a retailer or dealer who suffers
12 economic loss from a non-conformity is limited by the Code’s contract rules on
13 privity, notice, disclaimers and the statute of limitations unless it has sufficient
14 bargaining power to protect itself. In consumer contracts at least, many question
15 whether consumers have sufficient information and choice to adequately protect
16 their interest through bargaining with their lessor.

17 The second is the increasing use by sellers of advertising and other methods
18 of electronic communication to stimulate sales, whether made directly to buyers by
19 telephone, television, or the internet, or through retailers and dealers. Since former
20 Article 2 was based upon somewhat different assumptions about how contracts for
21 sale were advertised, negotiated and concluded, and how goods were distributed,
22 the question is whether the older model is still viable. For example, since many
23 sales are now concluded after advertising to the public or through warranties passed
24 through a dealer by a manufacturer, Article 2 has been revised to codify the existing
25 case law in this area rather than leave it to the common law process. See Section
26 2-408.

27 Article 2A has not adopted Article 2 Section 2-408. That section, titled
28 Express Warranty Obligation to Remote Buyer and Transferee, is based on the
29 assumption that many sellers advertise to remote buyers, or include statements
30 which are express warranties in materials accompanying the goods which are to be
31 delivered to remote buyers. That section addresses the liability incurred to remote
32 buyers and lessees when advertisements or materials accompanying the goods create
33 express warranties. There seems to be no present practice of remote *lessors*
34 engaging in the conduct covered by Section 2-408. Therefore, a similar provision is
35 not included in this article. Section 2-408 itself gives rights to remote lessees
36 against remote *sellers* that were in the chain of distribution to their lessor. If any
37 practice develops in the future of lessors engaging in conduct like that covered by
38 Section 2-408, it would be appropriate to apply that section by analogy to such
39 lessors (Section 2A-508 is the analog of Section 2-409, not Section 2-408).

1 3. **Definitions.** Section 2A-501, which is new, provides common
2 definitions for use in Part 4.

3 **Damage.** Unless otherwise provided in Part 5, damages for breach of
4 warranty or other obligations created in Part 5 include all loss resulting from the
5 breach, including incidental, Section 2A-706, and consequential damages, Section
6 2A-707. Consequential damages include loss to property other than the goods sold
7 and “injury to person” proximately resulting from any breach of warranty,” Section
8 2A-707(2).

9 **Goods.** “Goods” include a component incorporated into other goods.
10 Unless otherwise provided in Part 5, goods include both new and used goods.

11 **Immediate lessee.** An immediate lessee is in a contractual relationship with
12 the lessor. Thus, express warranties, Section 2-503, and implied warranties,
13 Sections 2-504, 2-505, are made by lessors to immediate lessees. Express
14 warranties under Section 2-408 are made by sellers to “remote lessees.”

15 **Remote lessee.** A “remote lessee” is a lessee from a person other than the
16 seller or lessor against which a claim under Part 5 is made. The phrase is used only
17 in Section 2A-408.

18 **Representation.** The word “representation” is used as a short hand for the
19 elements of an express warranty, and includes a description of the goods, an
20 affirmation of fact or promise about the quality or performance of the goods to be
21 delivered, or a sample or model of the goods. The word is used extensively in Part
22 5.

23 A representation, if resulting in an express warranty or an obligation, creates
24 a standard of quality or performance to which the goods must conform at the time
25 of tender of delivery. A representation includes affirmations or promises that the
26 goods will both conform to meet the agreed standard of quality or performance at
27 the time of delivery and a promise that they will continue to meet the agreed
28 standard for a specified length of time.

29 **Definitional Cross References:**
30 “Goods”. Section 2A-102(a)(16).
31 “Lessee”. Section 2A-102(a)(22).
32 “Lessor.” Section 2A-102(a)(24).

1 **SECTION 2A-502. WARRANTY AGAINST INTERFERENCE AND**
2 **AGAINST INFRINGEMENT; LESSEE’S OBLIGATION AGAINST**
3 **INFRINGEMENT.**

4 (a) Except in a finance lease, a lessor in a lease contract warrants that,
5 except for claims by any person by way of infringement or the like, for the duration
6 of the lease no person holds:

7 (1) a claim to or interest in the goods which will interfere with the
8 lessee’s enjoyment of its leasehold interest; or

9 (2) a colorable claim to or interest in the goods which will unreasonably
10 expose the lessee to litigation.

11 (b) A finance lessor warrants that, except for claims by way of infringement
12 or the like, for the duration of the lease no person holds:

13 (1) a claim or interest in the goods that arose from an act or omission of
14 the lessor which will interfere with the lessee’s enjoyment of its leasehold interest; or

15 (2) a colorable claim to or interest in the goods that arose from an act or
16 omission of the lessor which will unreasonably expose the lessee to litigation.

17 (c) Except in a finance lease, a lessor that is a merchant regularly dealing in
18 goods of the kind warrants that the goods will be delivered free of the rightful claim
19 of a third party by way of infringement or the like. However, a lessee that furnishes
20 specifications to the lessor holds the lessor harmless against any claim of
21 infringement or the like that arises out of compliance with the specifications.

1 (d) A warranty under subsections (a) through (c) may be disclaimed or
2 modified only by specific language or by circumstances that give the lessee reason to
3 know that the lessor purports to transfer only such right as the lessor or a third party
4 may have.

5 **Comment**

6 **Uniform Statutory Analogue:** Section 2-412.

7 **1. Scope of warranty of title.** Unlike other warranties in Part 5, the
8 warranty made by a lessor in subsections (a), (b), and (c) is standardized but can be
9 disclaimed or modified under subsection (d).

10 The lessor, other than a finance lessor, warrants that (1) that no person
11 holds an interest that interfere with the lessee's enjoyment of its leasehold, (a
12 warranty of quite enjoyment) and (2) the transfer does not unreasonably expose the
13 buyer to litigation. An unreasonable exposure to litigation occurs when a third
14 person has or asserts a "colorable" claim to or interest in the goods.

15 The following cases illustrate the concept of colorable claims: *Frank Arnold*
16 *KRS, Inc. v. L.S. Meier Auction Co., Inc.*, 806 F.2d 462 (3d Cir. 1986) (two law
17 suits contest title); *Jeanneret v. Vichey*, 693 F.2d 259 (2d Cir. 1982) (export
18 restrictions in country from which painting was taken affect value); *Colton v.*
19 *Decker*, 540 N.W.2d 172 (S.D. 1995) (conflicting vehicle identification numbers).
20 As one court put it, there "need not be an actual encumbrance of the purchaser's
21 title or actual disturbance of possession to permit a purchaser to recover for a
22 breach of warranty of title when he demonstrates the existence of a cloud on his
23 title, regardless of whether it eventually develops that a third party's title is
24 superior." The policy is that a purchaser "should not be required to engage in a
25 contest over the validity of his ownership." *Maroon Chevrolet, Inc. v. Nordstrom*,
26 587 So.2d 514, 518 (Fla.App. 1991) (conflicting vehicle identification numbers).
27 Revised Article 2A follows this principle.

28 **2.** A finance lessor is essentially a middle-man between a supplier and the
29 lessee: the lessee, therefore, looks to the supplier (seller or lessor) for warranty
30 protection, including warranties of title. Section 2A-302. Therefore, a finance
31 lessor warrants only against its own acts. Subsection (b).

32 **3. Warranty against infringement.** Subsection (c) continues the warranty
33 against infringement in former Section 2A-211). Unlike the warranty of title, the
34 lessor must be a merchant who "regularly deals in goods of the kind sold." The

1 warranty can be disclaimed or modified under subsection (d). *See Bonneau Co. v.*
2 *AG Industries, Inc.*, 116 F.3d 155 (5th Cir. 1997), which holds that if the buyer
3 furnishes specifications to a seller who follows them, there is no warranty against
4 infringement under Section 2-312(3).

5 4. **Disclaimers.** Subsection (d) deals with the disclaimer or modification of
6 the warranty of title or against infringement and states the general standard that
7 must be met to disclaim or modify against an immediate lessee. The language need
8 not be conspicuous or in a record. The warranty against “infringement” can also be
9 disclaimed under subsection (c). Whether a warranty of title or against infringement
10 extends beyond the immediate lessee is determined by Section 2A-408: Unless
11 disclaimed, there is a limited extension beyond an immediate consumer lessee.
12 There are relatively few cases on whether lack of privity is a defense in warranty of
13 title suits. See Note, 45 Bus. Lawyer 2289, 2300 (1995); *Mitchell v. Webb*, 591
14 S.W.2d 547 (Tex.Civ.App. 1979) (lack of privity no defense).

15 **Cross References:**

16 Sections 2-402, 2A-503, and 2A-506.

17 **Definitional Cross References:**

18 “Delivery”. Section 1-201(14).
19 “Finance lease”. Section 2A-102(a)(14).
20 “Goods”. Section 2A-102(a)(16).
21 “Lease”. Section 2A-102(a)(18).
22 “Lease contract”. Section 2A-102(a)(20).
23 “Leasehold interest”. Section 2A-102(a)(21).
24 “Lessee”. Section 2A-102(a)(22).
25 “Lessor”. Section 2A-102(a)(24).
26 “Merchant”. Section 2-102(a)(27).
27 “Person”. Section 1-201(30).
28 “Supplier”. Section 2A-102(a)(34).

29 **SECTION 2A-503. EXPRESS WARRANTIES TO LESSEE.**

30 (a) Any representation made by the lessor to the lessee, including a
31 representation made in any medium of communication to the public, such as
32 advertising, which relates to the goods and becomes part of the basis of the bargain
33 creates an express warranty that the goods will conform to the representation or,

1 with respect to a sample or model, that the whole of the goods will conform to the
2 sample or model.

3 (b) To create an express warranty, it is not necessary to create an express
4 warranty that the lessor use formal words such as “warranty” or “guaranty” or have
5 a specific intention to make a warranty. However, a representation merely of the
6 value of the goods or an affirmation purporting to be merely the lessor’s opinion or
7 commendation of the goods does not create an express warranty under subsection
8 (a).

9 (c) A representation, including a representation made in any medium of
10 communication to the public, such as advertising, which was made to the lessee and
11 which relates to the goods becomes part of the basis of the bargain unless:

12 (1) the lessee knew that the representation was not true;

13 (2) a reasonable person in the position of the lessee would not believe
14 that the representation was part of the agreement; or

15 (3) in the case of a representation made in a medium for communication
16 to the public, including advertising, the lessee did not know of the representation at
17 the time of the agreement.

18 (d) A right of action for breach of warranty under this section accrues as
19 provided under Section 2A-715(c).

20 **Comment**

21 **Uniform Statutory Analogue:** Section 2-403.

22 All of the express and implied warranties of the Article on Sales (Article 2)
23 are included in this Article, revised to reflect the differences between a sale of goods

1 and a lease of goods. Sections 2A-501 through 2A-508. The lease of goods is
2 sufficiently similar to the sale of goods to justify this decision. Hawkland, *The*
3 *Impact of the Uniform Commercial Code on Equipment Leasing*, 1972 Ill.L.F. 446,
4 459-60. Many state and federal courts have reached the same conclusion.

5 Value of the goods, as used in subsection (b), includes rental value.

6 See also the Comment to Section 2-403.

7 **Cross References:**

8 Article 2, especially Section 2-403, and Sections 2A-501 through 2A-508.

9 **Definitional Cross References:**

10 “Conforming”. Section 2A-102(a)(5).

11 “Goods”. Section 2A-102(a)(16).

12 “Lessee”. Section 2A-102(a)(22).

13 “Lessor”. Section 2A-102(a)(24).

14 “Value”. Section 1-201(44).

15 **SECTION 2A-504. IMPLIED WARRANTY OF MERCHANTABILITY.**

16 (a) Except in a finance lease and subject to Sections 2A-506 and 2A-507, a
17 warranty that the goods are merchantable is implied in a contract for their lease if
18 the lessor is a merchant with respect to goods of that kind.

19 (b) Goods, to be merchantable, must:

20 (1) pass without objection in the trade under the contract description;

21 (2) in the case of fungible goods, be of fair, average quality within the
22 description;

23 (3) be fit for the ordinary purposes for which goods of that description
24 are used;

25 (4) run, within the variation permitted by the lease agreement, of even
26 kind, quality, and quantity within each unit and among all units involved;

1 (5) be adequately contained, packaged, and labeled as the lease
2 agreement or circumstances may require; and

3 (6) conform to any representations made on the container or label.

4 (c) Subject to 2A-506, other implied warranties may arise from course of
5 dealing or usage of trade.

6 **Comment**

7 **Uniform Statutory Analogue:** Section 2-404.

8 Section 2-404 is revised to reflect leasing practices and terminology. *E.g.*,
9 *Glenn Dick Equip. Co. v. Galey Constr., Inc.*, 97 Idaho 216, 225, 541 P.2d 1184,
10 1193 (1975) (implied warranty of merchantability (Article 2) extends to lease
11 transactions).

12 See also the Comment to Section 2-404.

13 **Definitional Cross References:**

14 “Conforming”. Section 2A-102(a)(5).

15 “Course of dealing”. Section 1-205.

16 “Finance lease”. Section 2A-102(a)(14).

17 “Fungible”. Section 1-201(17).

18 “Goods”. Section 2A-102(a)(16).

19 “Lease agreement”. Section 2A-102(a)(19).

20 “Lease contract”. Section 2A-102(a)(20).

21 “Lessor”. Section 2A-102(a)(24).

22 “Merchant”. Section 2-102(a)(27).

23 “Usage of trade”. Section 1-205.

24 **SECTION 2A-505. IMPLIED WARRANTY OF FITNESS FOR**

25 **PARTICULAR PURPOSE.** Except in a finance lease and subject to Section

26 2A-506, if a lessor at the time of contracting has reason to know any particular

27 purpose for which the goods are required and that the lessee is relying on the

1 lessor's skill or judgment to select or furnish suitable goods, there is an implied
2 warranty that the goods are fit for that purpose.

3 **Comment**

4 **Uniform Statutory Analogue:** Section 2-405.

5 Section 2-405 is revised to reflect leasing practices and terminology. *E.g.*,
6 *All-States Leasing Co. v. Bass*, 96 Idaho 873, 879, 538 P.2d 1177, 1183 (1975)
7 (implied warranty of fitness for a particular purpose (Article 2) extends to lease
8 transactions).

9 See also the Comment to Section 2-405.

10 **Definitional Cross References:**

11 "Finance lease". Section 2A-102(a)(14).

12 "Goods". Section 2A-102(a)(16).

13 "Knows". Section 1-201(25).

14 "Lease contract". Section 2A-102(a)(20).

15 "Lessee". Section 2A-102(a)(22).

16 "Lessor". Section 2A-102(a)(24).

17 **SECTION 2A-506. DISCLAIMER OR MODIFICATION OF**
18 **WARRANTY.**

19 (a) Words or conduct relevant to the creation of an express warranty and
20 words or conduct tending to disclaim or modify an express warranty must be
21 construed wherever reasonable as consistent with each other. However, subject to
22 Section 2A-202, words or conduct disclaiming or modifying an express warranty are
23 ineffective to the extent that this construction is unreasonable.

24 (b) Subject to subsection (c), to disclaim or modify an implied warranty of
25 merchantability or fitness, or any part of either implied warranty, the following rules
26 apply:

- 1 (1) The language must be in a record and be conspicuous.
- 2 (2) In other than a consumer lease contract, the language is sufficient if:
- 3 (A) in the case of an implied warranty of merchantability , it mentions
- 4 merchantability; and
- 5 (B) in the case of an implied warranty of fitness, the language states,
- 6 for example, that “There are no warranties which extend beyond the description on
- 7 the face hereof.”
- 8 (3) In a consumer contract, the language must:
- 9 (A) in the case of an implied warranty of merchantability, state “The
- 10 lessor make no representations about and is not responsible for the quality of the
- 11 goods except, as otherwise provided in this contract”; and
- 12 (B) in the case of an implied warranty of fitness , state “The lessor
- 13 makes no representations that the goods will be fit for any particular purpose for
- 14 which you may be buying these goods, except as otherwise provided in the
- 15 contract.”
- 16 (4) Language that is sufficient to disclaim or modify an implied warranty
- 17 under paragraph (3) is also sufficient to disclaim or modify an implied warranty
- 18 under paragraph (2).
- 19 (c) Unless the circumstances indicate otherwise all implied warranties are
- 20 disclaimed by expressions such as “as is” or “with all faults” or similar language or
- 21 conduct that in common understanding make it clear to the lessee that the lessor
- 22 assumes no responsibility for the quality or fitness of the goods. In a consumer

1 contract, the requirements of this subsection must be satisfied by conspicuous
2 language in a record.

3 (d) An implied warranty may also be disclaimed or modified by course of
4 performance, course of dealing, or usage of trade.

5 (e) If a lessee before entering into the contract has examined the goods or
6 the sample or model as fully as desired or has refused to examine the goods, there is
7 no implied warranty with regard to defects which a reasonable examination ought in
8 the circumstances to have revealed to the lessee.

9 (f) Remedies for breach of warranty may be limited in accordance with this
10 article with respect to liquidation or limitation of damages and contractual
11 modification of remedy.

12 **Comment**

13 **Uniform Statutory Analogue:** Sections 2-406

14 See the Comment to Section 2-406.

15 **Cross References:**

16 Article 2, especially Section 2-406, and Sections 2A-503, 2A-504, and 2A-505.

17 **Definitional Cross References:**

18 “Conspicuous”. Section 2A-102(a)(6).

19 “Course of dealing”. Section 1-205.

20 “Goods”. Section 2A-102(a)(16).

21 “Knows”. Section 1-201(25).

22 “Lease”. Section 2A-102(a)(18).

23 “Lease contract”. Section 2A-102(a)(20).

24 “Lessee”. Section 2A-102(a)(22).

25 “Person”. Section 1-201(30).

26 “Record”. Section 2A-102(a)(31).

27 “Usage of trade”. Section 1-205.

1 use or be affected by the goods and who suffers damage other than injury to the
2 person resulting from a breach of warranty. The lessor may not disclaim, modify, or
3 limit damages arising under this section unless the lessor has a substantial interest in
4 having a warranty extend only to the immediate consumer lessee.

5 **Alternative A**

6 (b) A lessor's warranty whether express or implied extends to any individual
7 who is in the family or household of the immediate lessee or who is a guest in the
8 immediate lessee's home if it is reasonable for the lessor to expect that the individual
9 may use, consume, or be affected by the goods and who is injured in person by
10 breach of the warranty. A lessor may not disclaim or limit the operation of this
11 subsection.

12 **Alternative B**

13 (b) A lessor's warranty whether express or implied extends to any individual
14 who may reasonably be expected to use, consume, or be affected by the goods and
15 who is injured in person by breach of the warranty. A lessor may not disclaim or
16 limit the operation of this subsection.

17 **End of Alternatives**

18 (c) Nothing in this article diminishes the rights and remedies of any third-
19 party beneficiary or assignee under the law of contracts or of persons to which
20 goods are transferred by operation of law or displaces any other law that extends a
21 warranty to or for the benefit of any other person.

(d) The scope of any warranty extended under this section to other than the immediate lessee and the remedies for breach may be limited by the enforceable terms of the contract between the lessor and the immediate lessee. To the extent not limited:

(1) the scope of the warranty is determined by Sections 2A-402, 2A-403, 2A-404, and 2A-405; and

(2) the remedies for breach of warranty for other than the immediate lessee are determined by the terms of the contract between the lessor and the lessee and this article.

(e) A right of action for breach of warranty under this section accrues under Section 2A-705.

Comment

Uniform Statutory Analogue: Section 2-509.

See the Comment to Section 2-509.

Cross References:

Article 2, especially Section 2-409, and Sections 2A-506, 2A-710, and 2A-711.

Definitional Cross References:

“Consumer.” Section 2A-102(a)(7).

“Consumer lessee”. Section 2A-102(a)(8).

“Goods”. Section 2A-102(a)(16).

“Lessee”. Section 2A-102(a)(22).

“Person”. Section 1-201(30).

“Remedy”. Section 1-201(34).

“Rights”. Section 1-201(36).

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PART 6
PERFORMANCE OF LEASE CONTRACT:
REPUDIATION, SUBSTITUTION, AND EXCUSE

SECTION 2A-601. RIGHT TO ADEQUATE ASSURANCE OF
PERFORMANCE.

(a) A lease contract imposes an obligation on each party not to impair the other’s expectation of receiving due performance. If reasonable grounds for insecurity arise with respect to the performance of either party, the other party may demand in a record adequate assurance of due performance and, until that assurance is received, if commercially reasonable, may suspend any performance for which the agreed return has not already been received.

(b) Between merchants, the reasonableness of grounds for insecurity and the adequacy of any assurance offered is determined according to commercial standards.

(c) Acceptance of improper delivery or payment does not prejudice an aggrieved party’s right to demand adequate assurance of future performance.

(d) After receipt of a demand under subsection (a), failure to provide within a reasonable time, not exceeding 30 days, assurance of due performance which is adequate under the circumstances of the particular case is a repudiation of the contract under Section 2A-602.

Comment
Uniform Statutory Analogue: Section 2-711.
See the Comment to Section 2-711.

1 Subsection (d) specifically states that failure to give adequate assurance is a
2 repudiation of the contract under Section 2A-602.

3 **Definitional Cross References:**

4 “Aggrieved party”. Section 1-201(2).
5 “Agreed”. Section 1-201(3).
6 “Between merchants”. Section 2-102(a)(2).
7 “Conforming”. Section 2A-102(a)(5).
8 “Delivery”. Section 1-201(14).
9 “Lease contract”. Section 2A-102(a)(20).
10 “Party”. Section 1-201(29).
11 “Reasonable time”. Section 1-204(1) and (2).
12 “Receive”. Section 2A-102(a)(30).
13 “Rights”. Section 1-201(36).
14 “Record”. Section 2A-102(a)(31).

15 **SECTION 2A-602. ANTICIPATORY REPUDIATION.**

16 (a) If either party to a lease contract repudiates a performance not yet due
17 and the loss of performance will substantially impair the value of the lease contract
18 to the other, the aggrieved party may:

19 (1) await performance by the repudiating party for a commercially
20 reasonable time, or resort to any remedy for default, even if it has urged the
21 repudiating party to retract the repudiation or has notified the repudiating party that
22 it would await the agreed performance; and

23 (2) in either case, suspend its own performance or, if a lessor, proceed in
24 accordance with Section 2A-718.

25 (b) Repudiation includes language that one party will not or cannot make a
26 performance still due under the contract or voluntary, affirmative conduct that
27 reasonably appears to the other party to make a future performance impossible.

1 **Comment**

2 **Uniform Statutory Analogue:** Section 2-712.

3 Note that Section 2A-601(d) explicitly states that failure to give adequate
4 assurances under Section 2A-601 is a repudiation.

5 See also the Comment to Section 2-712.

6 **Definitional Cross References:**

7 “Aggrieved party”. Section 1-201(2).

8 “Goods”. Section 2A-102(a)(16).

9 “Lease contract”. Section 2A-102(a)(20).

10 “Lessor”. Section 2A-102(a)(24).

11 “Notifies”. Section 1-201(26).

12 “Party”. Section 1-201(29).

13 “Reasonable time”. Section 1-204(1) and (2).

14 “Remedy”. Section 1-201(34).

15 “Rights”. Section 1-201(36).

16 “Value”. Section 1-201(44).

17 **SECTION 2A-603. RETRACTION OF ANTICIPATORY**

18 **REPUDIATION.**

19 (a) A repudiating party may retract a repudiation until its next performance
20 is due unless the aggrieved party, after the repudiation, has canceled the lease
21 contract, materially changed its position, or otherwise indicated that the repudiation
22 is considered to be final.

23 (b) A retraction may be by any method that clearly indicates to the
24 aggrieved party that the repudiating party intends to perform the contract.

25 However, a retraction must include any assurance justifiably demanded under
26 Section 2A-601.

1 (c) Retraction reinstates a repudiating party's rights under the lease contract
2 with due excuse and allowance to the aggrieved party for any delay caused by the
3 repudiation.

4 **Comment**

5 **Uniform Statutory Analogue:** Section 2-713

6 See the Comment to Section 2-713.

7 **Definitional Cross References:**

8 "Aggrieved party". Section 1-201(2).
9 "Cancellation". Section 2A-102(a)(2).
10 "Lease contract". Section 2A-102(a)(20).
11 "Party". Section 1-201(29).
12 "Rights". Section 1-201(36).

13 **SECTION 2A-604. SUBSTITUTED PERFORMANCE.**

14 (a) If, without the fault of the lessee, lessor, or supplier, agreed berthing,
15 loading, or unloading facilities, or an agreed type of carrier becomes unavailable, or
16 an agreed manner of delivery otherwise becomes commercially impracticable, a
17 party may claim excuse under Section 2A-605 unless a commercially reasonable
18 substitute is available. In that case, reasonable substitute performance must be
19 tendered and accepted.

20 (b) If an agreed means or manner of payment fails because of domestic or
21 foreign governmental statute, regulation, or order, the lessor may withhold or stop
22 delivery or cause the supplier to withhold or stop delivery until the lessee provides a
23 means or manner of payment which is commercially a substantial equivalent. If
24 delivery has already been made, payment by the means or in the manner provided by

1 the statute, regulation, or order discharges the lessee's obligation unless the statute,
2 regulation, or order is discriminatory, oppressive, or predatory.

3 **Comment**

4 **Uniform Statutory Analogue:** Section 2-715.

5 See the Comment to Section 2-715.

6 **Definitional Cross References:**

7 "Agreed". Section 1-201(3).

8 "Delivery". Section 1-201(14).

9 "Lessee". Section 2A-102(a)(22).

10 "Lessor". Section 2A-102(a)(24).

11 "Supplier". Section 2A-102(a)(34).

12 **SECTION 2A-605. EXCUSE BY FAILURE OF PRESUPPOSED**
13 **CONDITIONS.**

14 (a) Subject to Section 2A-604 and subsection (b), delay in performance or
15 nonperformance by the lessor or supplier is not a default under the lease contract if
16 performance as agreed has been made impracticable by:

17 (1) the occurrence of a contingency the nonoccurrence of which was a
18 basic assumption on which the lease contract was made; or

19 (2) compliance in good faith with any applicable foreign or domestic
20 governmental statute, regulation, or order, whether or not it later proves to be
21 invalid.

22 (b) A party claiming excuse under subsection (a) shall seasonably notify the
23 other party that there will be delay or nonperformance. If a finance lessor claims
24 excuse under subsection (a) it shall seasonably notify both the lessor and the lessee

1 that there will be delay or non-performance. If the claimed excuse affects only a
2 part of the lessor's or supplier's capacity to perform, the lessor or supplier shall also
3 allocate production and deliveries among its customers in a manner that is fair and
4 reasonable and notify the lessee of the estimated quota made available. In allocating
5 production and deliveries, the lessor or supplier may include regular customers not
6 them under contract as well as its own requirements for further manufacture.

7 **Comment**

8 **Uniform Statutory Analogue:** Section 2-716.

9 See the Comment to Section 2-716.

10 **Definitional Cross References:**

11 "Agreed". Section 1-201(3).
12 "Contract". Section 1-201(11).
13 "Delivery". Section 1-201(14).
14 "Finance lease". Section 2A-102(a)(14).
15 "Good faith". Section 2A-102(a)(15).
16 "Knows". Section 1-201(25).
17 "Lease". Section 2A-102(a)(18).
18 "Lease contract". Section 2A-102(a)(20).
19 "Lessee". Section 2A-102(a)(22).
20 "Lessor". Section 2A-102(a)(24).
21 "Notifies". Section 1-201(26).
22 "Sale". Section 2-102(a)(32).
23 "Seasonably". Section 1-204(3).
24 "Supplier". Section 2A-102(a)(34).

25 **SECTION 2A-606. PROCEDURE ON NOTICE CLAIMING EXCUSE.**

26 (a) A party that receives notice of a material or indefinite delay in
27 performance or an allocation permitted under Section 2A-307 or 2A-605 as to any
28 delivery concerned, or of there is a breach of the whole contract under Section
29 2A-726(c), by notice in a record may:

(1) terminate and thereby discharge any unexecuted portion of the lease contract; or

(2) except in a finance lease that is not a consumer lease, modify the contract by agreeing to take the available allocation in substitution under Section 2A-605 or by accepting the goods with due allowance from the rent payable for the balance of the lease period for the deficiency as provided in Section 2A-604.

(b) If, after receipt of a notice under Section 2A-604 or 2A-605, a party does not terminate or modify the lease contract within a reasonable time not exceeding 30 days, the contract is terminated with respect to any performance affected.

(c) This section may be varied by agreement only to the extent that the parties have assumed a different obligation under Sections 2A-604 and 2A-605.

Comment

Uniform Statutory Analogue: Section 2-717.

Note that subsection (a)(1) allows the lessee under a lease, including a finance lease, the right to terminate the lease for excused performance (Sections 2A-604 and 2A-605). However, subsection (a)(1), which allows the lessee the right to modify the lease for excused performance, excludes a finance lease that is not a consumer lease. This exclusion is compelled by the same policy that led to codification of provisions with respect to irrevocable promises. Section 2A-607.

Definitional Cross References:

“Consumer lease”. Section 2A-102(a)(8).

“Delivery”. Section 1-201(14).

“Finance lease”. Section 2A-102(a)(14).

“Goods”. Section 2A-102(a)(16).

“Lease agreement”. Section 2A-102(a)(19).

“Lease contract”. Section 2A-102(a)(20).

“Lessee”. Section 2A-102(a)(22).

“Lessor”. Section 2A-102(a)(24).

1 “Notice”. Section 1-201(25).
2 “Reasonable time”. Section 1-204(1) and (2).
3 “Receive”. Section 2-102(a)(30).
4 “Record”. Section 2A-102(a)(31).
5 “Rights”. Section 1-201(36).
6 “Termination”. Section 2A-102(a)(36).
7 “Value”. Section 1-201(44).

8 **SECTION 2A-607. IRREVOCABLE PROMISES: FINANCE LEASES.**

9 (a) In a finance lease that is not a consumer lease, the lessee’s promises
10 under the lease contract become irrevocable and independent upon the lessee’s
11 acceptance of the goods.

12 (b) A promise that has become irrevocable and independent under
13 subsection (a):

14 (1) is effective and enforceable between the parties and by or against
15 third parties including assignees of the parties; and

16 (2) is not subject to cancellation, termination, modification, repudiation,
17 excuse, or substitution without the consent of the party to which the promise runs.

18 (c) This section does not affect the validity under any other law of a
19 covenant in any lease agreement making the lessee’s promises irrevocable and
20 independent upon the lessee’s acceptance of the goods.

21 **Comment**

22 1. This section extends the benefits of the classic “hell or high water” clause
23 to a finance lease that is not a consumer lease. This section is self-executing; no
24 special provision need be added to the contract. This section makes covenants in a
25 finance lease irrevocable and independent due to the function of the finance lessor in
26 a three party relationship: the lessee is looking to the supplier to perform the
27 essential covenants and warranties. Section 2A-209. Thus, upon the lessee’s
28 acceptance of the goods the lessee’s promises to the lessor under the lease contract

1 become irrevocable and independent. The provisions of this section remain subject
2 to the obligation of good faith (Section 2A-102(a)(18)) and the lessee's revocation
3 of acceptance (Section 2A-733).

4 2. The section requires the lessee to perform even if the lessor's
5 performance after the lessee's acceptance is not in accordance with the lease
6 contract; the lessee may, however, have and pursue a cause of action against the
7 lessor, *e.g.*, breach of certain limited warranties (Sections 2A-503 and 2A-502(a)).
8 This is appropriate because the benefit of the supplier's promises and warranties to
9 the lessor under the supply contract and, in some cases, the warranty of a
10 manufacturer who is not the supplier, is extended to the lessee under the finance
11 lease. Section 2A-303. Despite this balance, this section excludes a finance lease
12 that is a consumer lease. That a consumer be obligated to pay notwithstanding
13 defective goods or the like is a principle that is not tenable under case law (*Unico v.*
14 *Owen*, 50 N.J. 101, 232 A.2d 405 (1967)), state statute (Unif. Consumer Credit
15 Code §§ 3.403-.405, 7A U.L.A. 126-31 (1974), or federal statute (15 U.S.C.
16 § 1666i (1982)).

17 3. The relationship of the three parties to a transaction that qualifies as a
18 finance lease is best demonstrated by a hypothetical. A, the potential lessor, has
19 been contacted by B, the potential lessee, to discuss the lease of an expensive line of
20 equipment that B has recently placed an order for with C, the manufacturer of such
21 goods. The negotiation is completed and A, as lessor, and B, as lessee, sign a lease
22 of the line of equipment for a 60-month term. B, as buyer, assigns the purchase
23 order with C to A. If this transaction creates a lease (Section 2A-102(a)(21)), this
24 transaction should qualify as a finance lease. Section 2A-102(a)(17).

25 4. The line of equipment is delivered by C to B's place of business. After
26 installation by C and testing by B, B accepts the goods by signing a certificate of
27 delivery and acceptance, a copy of which is sent by B to A and C. One year later
28 the line of equipment malfunctions and B falls behind in its manufacturing schedule.

29 5. Under this Article, because the lease is a finance lease, no warranty of
30 fitness or merchantability is extended by A to B. Sections 2A-504 and 2A-505.
31 Absent an express provision in the lease agreement, application of Section 2A-503
32 or Section 2A-502(a), or application of the principles of law and equity, including
33 the law with respect to fraud, duress, or the like (Section 1-103), B has no claim
34 against A. B's obligation to pay rent to A continues as the obligation became
35 irrevocable and independent when B accepted the line of equipment (Section
36 2A-607(a)). B has no right of set-off with respect to any part of the rent still due
37 under the lease. Section 2A-724(e). However, B may have another remedy.
38 Despite the lack of privity between B and C (the purchase order with C having been
39 assigned by B to A), B may have a claim against C. Section 2A-303(a).

1 6. This section does not address whether a “hell or high water” clause, *i.e.*,
2 a clause that is to the effect of this section, is enforceable if included in a finance
3 lease that is a consumer lease or a lease that is not a finance lease. That issue will
4 continue to be determined by the facts of each case and other law which this section
5 does not affect. However, with respect to finance leases that are not consumer
6 leases courts have enforced “hell or high water” clauses. *In re O.P.M. Leasing*
7 *Servs.*, 21 Bankr. 993, 1006 (Bankr.S.D.N.Y.1982).

8 7. Subsection (b) further provides that a promise that has become
9 irrevocable and independent under subsection (a) is enforceable not only between
10 the parties but also against third parties. Thus, the finance lease can be transferred
11 or assigned without disturbing enforceability. Further, subsection (b) also provides
12 that the promise cannot, among other things, be canceled or terminated without the
13 consent of the lessor.

14 **Cross References:**

15 Sections 1-103, 1-203, 2A-102(a)(17), 2A-303, 2A-503, 2A-504, 2A-505,
16 2A-733(a)(2).

17 **Definitional Cross References:**

18 “Cancellation”. Section 2A-102(a)(2).
19 “Consumer lease”. Section 2A-102(a)(8).
20 “Finance lease”. Section 2A-102(a)(14).
21 “Goods”. Section 2A-102(a)(16).
22 “Lease contract”. Section 2A-102(a)(20).
23 “Lessee”. Section 2A-102(a)(22).
24 “Party”. Section 1-201(29).
25 “Termination”. Section 2A-102(a)(36).

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PART 7
DEFAULT

[SUBPART A. GENERAL]

SECTION 2A-701. SUBJECT TO GENERAL LIMITATIONS. The remedies of the lessee, lessor, and other protected persons under this article are subject to the general limitations and principles stated in Sections 2A-702 through 2A-715

Comment

Uniform Statutory Analogue: Section 2-801

This section is new and sets out the remedial hierarchy of Part 7. Subpart A (Sections 2A-701 through 2A-715) contain sections that are applicable to lessees, lessors and other persons entitled to enforce obligations under this article. Persons other than lessors and lessees who are able to enforce obligations under this article include those persons who may enforce warranties or warranty obligations under Part 5 of this article. Subpart A sets forth remedial policies that control the application of the more specific remedial rules in Subpart B (lessor’s remedies are set forth in Sections 2A-716 through 2A-723) and Subpart C (buyer’s remedies are set forth in Sections 2A-724 through 2A-737).

SECTION 2A-702. DEFAULT: PROCEDURE.

- (a) Whether the lessor or the lessee is in default under a lease contract is determined by the lease agreement and this article.
- (b) The cumulative effect of individual, insubstantial defaults may substantially impair the value of the whole contract to the other party.
- (c) If a party is in default under the lease contract, the party seeking enforcement:

(1) has the rights and remedies under this article and, except as limited by this article, under the lease agreement.

(2) may reduce its claim to judgment or otherwise enforce the lease contract by self-help or any available administrative or judicial procedure or the like, including arbitration or other dispute-resolution procedure if agreed to by the parties; and

(3) may enforce the rights granted by and remedies available under other law.

(d) If the lease agreement covers both real property and goods, the party seeking enforcement may proceed under this part as to the goods, or under other applicable law as to both the real property and the goods in accordance with that party's rights and remedies in respect of the real property, in which case this part does not apply.

Comment

Uniform Statutory Analogue: Sections 9-601, 9-602, 9-603.

1. Subsection (a) represents a departure from the Article on Secured Transactions (Article 9) as the subsection makes clear that whether a party to the lease agreement is in default is determined by this Article as well as the agreement. Sections 2A-724 and 2A-716. It further departs from Article 9 in recognizing the potential default of either party, a function of the bilateral nature of the obligations between the parties to the lease contract.

2. Subsection (c)(1) is a version of the first sentence of 1972 Article 9 Section 9-501(1), revised to reflect leasing terminology.

3. Subsection (c)(2), an expansive version of the second sentence of 1972 Article 9 Section 9-501(1), lists the procedures that may be followed by the party seeking enforcement; in effect, the scope of the procedures listed in subsection (d) is

1 consistent with the scope of the procedures available to the foreclosing secured
2 party.

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

15 **Cross References:**

16 Sections 1-106, 2A-724, 2A-716, Article 9, especially Sections 9-601, 9-602, and
17 9-603.

18 **Definitional Cross References:**

19 "Goods". Section 2A-102(a)(16).
20 "Lease agreement". Section 2A-102(a)(19).
21 "Lease contract". Section 2A-102(a)(20).
22 "Lessee". Section 2A-102(a)(22).
23 "Lessor". Section 2A-102(a)(24).
24 "Party". Section 1-201(29).
25 "Remedy". Section 1-201(34).
26 "Rights". Section 1-201(36).

27 **SECTION 2A-703. NOTICE AFTER DEFAULT.** Except as otherwise
28 provided in this article or the lease agreement, a lessor or lessee in default under a
29 lease contract is not entitled to notice of default or notice of enforcement from the
30 other party.

31 **Comment**

32 This section makes clear that absent agreement to the contrary or provision
33 in this Article to the contrary, *e.g.*, Section 2A-732(c)(1), the party in default is not
34 entitled to notice of default or enforcement. While a review of Part 6 of Article 9

1 leads to the same conclusion with respect to giving notice of default to the debtor, it
2 is never stated. Although Article 9 requires notice of disposition and strict
3 foreclosure, the different scheme of lessors' and lessees' rights and remedies
4 developed under the common law, and codified by this Article, generally does not
5 require notice of enforcement; furthermore, such notice is not mandated by due
6 process requirements. However, certain sections of this Article do require notice.
7 *E.g.*, Section 2A-733(d).

8 **Cross References:**

9 Sections 2A-732, 2A-733, and Article 9, especially Part 6.

10 **Definitional Cross References:**

11 "Lease agreement". Section 2A-102(a)(19).

12 "Lease contract". Section 2A-102(a)(20).

13 "Lessee". Section 2A-102(a)(22).

14 "Lessor". Section 2A-102(a)(24).

15 "Notice". Section 1-201(25).

16 "Party". Section 1-201(29).

17 **SECTION 2A-704. REMEDIES IN GENERAL.**

18 (a) In accordance with Section 1-106, the remedies provided in this article
19 must be liberally administered with the purpose of placing the affirmed party in as
20 good a position as if the other party had fully performed.

21 (b) Unless the lease contract provides for liquidated damages enforceable
22 under Section 2A-710 or a limited remedy enforceable under Section 2A-711, an
23 aggrieved party may not recover that part of a loss resulting from a default that
24 could have been avoided by reasonable measures under the circumstances. The
25 burden of establishing that reasonable measures under the circumstances were not
26 taken is on the defaulting party.

27 (c) The rights and remedies provided in this article are cumulative, but a
28 party may not recover more than once for the same injury.

(d) This article does not impair a remedy for breach of an obligation or promise collateral or ancillary to a lease contract.

Comment

Uniform Statutory Analogue: Section 2-803.

Subsection (a) is derived from the statement of remedial policy in Section 1-106. This remedial policy is designed to allow an aggrieved party to recover the value of its expectation interest or the benefit of the bargain. See Restatement (Second) of Contracts, section 344. The specific remedies in Subparts B and C are designed to compensate the aggrieved party based upon its expectation interest.

3. Subsection (b) contains a statement of the mitigation principle derived from the Restatement (Second) of Contracts, section 350. An aggrieved lessee who has not accepted the goods has two alternative measures of damages, the cover rent minus the contract rent (Section 2A-734) or the market rent minus the contract rent (Section 2A-735). The aggrieved lessee is not required to cover although the statement of the mitigation principle in subsection (b) may preclude the recovery of loss that could have been prevented if the aggrieved lessee could have reasonably avoided that loss by making a cover transaction. If the lessee covers under Section 2A-734 by reasonably and in good faith entering a lease in substitution for the lease from the lessor without undue delay, the lessor has appropriately mitigated under the principle of this section and may recover its damages based upon the cover rent even if the market rent based measurement would result in a smaller damage award.

An aggrieved lessor has three alternative damage measurements, the contract rent minus the rent received in a replacement lease which is substantially similar to the defaulted lease (Section 2A-720), the contract rent minus the market rent (Section 2A-721(a)) or lost profit and reliance expenditures (Section 2A-721(b)). The lessor is not required to relet or otherwise dispose of the goods. Again, the mitigation principle of subsection (b) may prevent the lessor from recovering the part of the loss that could have been prevented if the lessor could have reasonably have disposed of the goods. If the lessor does relet and complies with the requirements of Section 2A-720, the lessor has appropriately mitigated the loss and may recover its damages based upon the relet rent even if the market rent based measurement would result in a smaller damage award.

4. Subsection (c) declares that the rights and remedies are cumulative. This statement accords with the former Article 2A's rejection of a policy of an election of remedies subject to a preclusion of double recovery for the same harm. See Comment to Section 2A-702. As stated in the Comment to Section 2A-702, whether the exercise of one remedy may preclude use of another remedy depends

upon whether the use of both remedies violates the principles stated in Subpart A, including the principles of this section. Any choice among remedial options must be made in good faith.

SECTION 2A-705. MEASUREMENT OF DAMAGES IN GENERAL. If a default occurs, the aggrieved party may recover compensation for the loss resulting in the ordinary course from the default as determined under Sections 2A-716 through 2A-737 or as determined in any reasonable manner, together with incidental damages and consequential damages, less expenses and costs saved as a result of the default.

Comment

Uniform Statutory Analogue: Section 2-804.

1. Section 2A-705 is new and provides a general statement of a measurement rule that can be used if the specific measurement rules are not sufficient to compensate the aggrieved party's expectancy interest under the principle of Section 2A-704(a). Although compensation of the expectancy interest of the aggrieved party is the general rule, a party may also use this measurement to compensate the aggrieved party's reliance or restitution interests. See Restatement (Second) of Contracts, section 349 and section 371. For example, assume a lessee is unable to recover any damages based upon either the cover or market rent measurements because the rent for the good has not changed but the lessee has incurred damages in preparing to perform its part of the contract. Even if an aggrieved party cannot establish any general or direct damages, an aggrieved party may recover incidental and consequential damages resulting from the breach. Reliance based expenses that do not fall into the category of incidental or consequential damages but could also be recovered under this section. Of course, recovery under this section is subject to the general principles stated in Section 2A-704.

2. An aggrieved party should not be able to use Section 2A-705 to recover damages based upon its reliance or restitutionary interests when those interests are greater than its expectancy interest. Recovery based upon the reliance or restitution interest that exceeds the expectancy interest of the aggrieved party should not be allowed when the aggrieved party enters into a losing contract.

1 **SECTION 2A-706. INCIDENTAL DAMAGES.** Incidental damages
2 resulting from a default under a lease contract include compensation for any
3 commercially reasonable charges, expenses, or commissions with respect to:
4 (1) inspection, receipt, transportation, care, or custody of identified goods
5 which are the subject of the default;
6 (2) stopping delivery or shipment;
7 (3) effecting cover, return, or disposition of the goods;
8 (4) reasonable efforts otherwise to minimize or avoid the consequences of
9 default; and
10 (5) effectuating other remedies after the default or otherwise dealing with the
11 goods.

Comment

13 **Uniform Statutory Analogue:** Section 2-805.

1. Section 2A-706 combines former Section 2A-520(1) and former Section 2A-530 into one section. However, the recovery of incidental damages is not limited for an aggrieved lessee to goods rightfully rejected.

2. An aggrieved party should be able to recover damages based on this section for expenses that are incurred in dealing with the goods after a breach, in mitigation of the consequence of the breach, or in exercising other remedies for the breach. The incurring of charges or other expenses must be commercially reasonable to be recovered. Compensating an aggrieved party for its incidental damages is part of placing the aggrieved party in the position it would have been in if the contact had been fully performed. Section 2A-704(a).

24 **SECTION 2A-707. CONSEQUENTIAL DAMAGES.** Consequential
25 damages resulting from a default include compensation for:

(1) any loss resulting from the aggrieved party's general or particular requirements and needs of which the defaulting party at the time of contracting had reason to know and which could not reasonably be prevented; and

(2) injury to person or property proximately resulting from any breach of warranty.

Comment

Uniform Statutory Analog: Section 2-806.

1. Section 2-707 replaces the provision governing lessee's consequential damages in former Section 2A-520(2) with the following changes. First, the section has been rephrased to govern both the lessor and lessee as the aggrieved party. This change rejects the position under former Article 2A that a lessor should not be entitled to consequential damages for a lessee's default on a lease contract. Second, damage to property other than the goods leased is governed by the foreseeability test and mitigation principle in subsection (a)(1) and not the proximate cause test of subsection (a)(2). The proximate cause test turns on whether it was reasonable for the person to use the goods without an inspection that would have revealed the defect on which the breach of warranty is based. If it was unreasonable to use the goods without such an inspection or the defect was in fact discovered prior to use, the personal injury is not a proximate result of the breach of warranty. Whether a person is entitled to enforce a breach of warranty which has resulted in personal injury depends upon other provisions of this article. See Part 5 of this article.

2. Compensating an aggrieved party for consequential loss is part of placing the aggrieved party in the position it would have occupied but for the default. Section 2A-704(a). Assuming the contract does not contain an enforceable exclusion of consequential damages (Section 2A-711), the aggrieved party must satisfy four conditions to recover:

(a) The loss must result from (be caused by) the default. This cause-in-fact requirement is common to all breach of contract claims, but may be more difficult to establish when the loss is remote from the breach.

(b) The loss must result from general or particular requirements of the aggrieved party of which the defaulting party had reason to know at the time of contracting. This statement of the foreseeability test rejects the tacit agreement test for recover of consequential damages. The party in breach need not have consciously accepted this liability nor is liability limited to situations where the party

1 in breach fails to act in good faith. The aggrieved party's particular needs must be
2 made known to the party in breach but the general needs must rarely be made
3 known to charge the party in default with knowledge.

4 (c) An otherwise foreseeable loss is not recoverable if it could have been
5 reasonably prevented by either the aggrieved or the defaulting party. This limitation
6 is a specific application of the mitigation principle of Section 2A-704(b). Normally,
7 the defaulting party must establish that the aggrieved party failed to mitigate. See
8 Section 2-704(b). In cases where both parties could have avoided the loss by the
9 same or similar acts and it is "equally reasonable" to expect the defaulting party to
10 minimize damages, the defaulting party is in no position to contend that the
11 aggrieved party failed to mitigate. *See, e.g., Nezperce Storage Co. v. Zenner*, 670
12 P.2d 871 (Id. 1983). Decisions about actions taken to mitigate harm must be made
13 in good faith.

14 (d) The plaintiff must prove the loss with reasonable certainty. This
15 limitation controls loss in complex cases of remote or speculative damage, (*e.g.*, loss
16 of good will, new businesses). This does not require the aggrieved party to
17 demonstrate mathematical precision in the proof of loss. Loss may be determined in
18 any manner which is reasonable under the circumstances.

19 3. Some courts have used the Restatement (Second) of Contracts, section
20 351(3) to limit consequential damages if under the circumstances "justice so
21 requires in order to avoid disproportionate compensation." *See Perini Corp. v.*
22 *Great Bay Hotel & Casino, Inc.*, 610 A.2d 364, 381-83 (N. J. 1992) (disproportion
23 between loss suffered by aggrieved party and price charged by breaching party);
24 *International Ore & Fertilizer Corp. v. SGS Control Services, Inc.*, 743 F. Supp.
25 250 (S.D.N.Y. 1990) (same). The essence of the principle is that in some cases the
26 consequential damages sought may be significantly greater than the risk the party in
27 breach assumed under the contract. That principle may be appropriate to apply in
28 some cases under this article.

29 **SECTION 2A-708. SPECIFIC PERFORMANCE.**

30 (a) The court may enter a decree for specific performance if the goods or
31 the agreed performance of the defaulting party are unique or in other proper
32 circumstances. In a lease other than a consumer lease, the court may enter a decree
33 for specific performance if the parties have agreed to that remedy. However, even if

1 the parties agree to specific performance, the court may not enter a decree for
2 specific performance if the breaching party's sole remaining contractual obligation is
3 the payment of money.

4 (b) The decree for specific performance may include terms and conditions as
5 to payment of the rent, damages, or other relief the court considers just.

6 **Comment**

7 **Uniform Statutory Analogue:** Section 2-807.

8 1. Section 2A-708 replaces former Section 2A-521(1) and (2) but is no
9 longer limited to a lessee's remedy. Either party may obtain a decree for specific
10 performance in an appropriate case. Subsection (a) recognizes that unique goods or
11 unique performance as well as other circumstances that are not based upon
12 uniqueness may be the basis for a specific performance decree. Uniqueness should
13 be determined in light of the total circumstances of the contract and is not limited to
14 goods identified when the contract is formed. Evidence of other circumstances in
15 which it might be appropriate to order specific performance include when a lessee is
16 unable to cover or when a lessor has no other outlet for the goods.

17 2. This section recognizes that the parties may agree to specific
18 performance. The parties' agreement to specific performance could be enforced
19 even if legal remedies are entirely adequate. This enforceability of an agreement to
20 specific performance has been limited to commercial cases to avoid having a
21 consumer lessee be forced to take and pay for goods that the consumer may not
22 want. Even in a commercial contract, the third sentence of subsection (a) prevents
23 the aggrieved party from getting specific performance if the party in default is only
24 obligated to pay money. Thus in the case of accepted goods, the lessee who is
25 obligated to pay the rent (Section 2A-722), should not have that obligation enforced
26 by an action for specific performance. The lessor's right to be paid in that case
27 should be enforced through an action for the rent. Section 2A-722.

28 3. Nothing in this section constrains the court's exercise of its equitable
29 discretion in deciding whether to enter a decree for specific performance or in
30 determining the conditions or terms of such a decree. This section assumes that the
31 decree for specific performance will condition the decree on full performance by the
32 party who seeks the other party's specific performance of its obligation. Thus, a
33 lessor seeking to enforce a "take and pay" term should be required to tender goods
34 that conform to the contract requirements.

1 **SECTION 2A-709. CANCELLATION; EFFECT.**

2 (a) An aggrieved party may cancel a contract if the conditions of Section
3 2A-716 or 2A-724 are satisfied or the agreement so provides, unless there is a
4 waiver of the default or the right to cancel under Section 2A-302 or there is a right
5 to cure the default under Section 2A-729.

6 (b) Upon cancellation, the lessee is subject to the same obligations and
7 duties with respect to goods in its possession or control as the lessee would be if it
8 had rejected a nonconforming tender and remained in control of the goods of the
9 lessor or if the lease contract had terminated according to its own terms.

10 (c) Except as otherwise provided in subsection (e), upon cancellation, all
11 obligations that are still executory on both sides are discharged.

12 (d) The obligations surviving cancellation include:

13 (1) a right based on previous default or performance of the contract;

14 (2) any term limiting disclosure of information;

15 (3) an obligation to return or dispose of goods;

16 (4) a term establishing a choice of law or forum;

17 (5) a term creating an obligation to arbitrate or otherwise resolve
18 disputes by alternative dispute resolution procedures;

19 (6) a term limiting the time for commencing an action or for providing
20 notice;

21 (7) a remedy for breach of the whole contract or any unperformed
22 balance;

1 (8) any other right, remedy, or obligation stated in the agreement as
2 surviving cancellation to the extent enforceable under law other than this article; and

3 (9) other rights, remedies, or limitations if under the circumstances their
4 survival is necessary to achieve the purposes of the parties.

5 (e) Unless a contrary intention clearly appears, language of cancellation,
6 rescission, or avoidance of the lease contract, or similar language, is not a
7 renunciation or discharge of any claim in damages for an antecedent default.

8 **Comment**

9 **Uniform Statutory Analog:** Section 2-808.

10 1. Both a lessor and a lessee have a right to cancel as a remedy for default
11 as under former Article 2A. This section provides greater definition to the exercise
12 of cancellation as a remedy for default. Cancellation is defined in Section
13 2A-102(a)(4) as a party ending a contract because of the other party's default.
14 Cancellation of a contract as a remedy for default generally affects only future
15 performance of the contract and is not a rescission of the contract. Performances
16 accepted prior to cancellation need not be returned to the other party as cancellation
17 does not operate as a rescission of the contract.

18 2. Subsection (a) makes clear that the right to cancel depends upon a
19 default. The index of lessor's remedies (Section 2A-716) and the index of lessee's
20 remedies (Section 2A-724) both list cancellation as a remedy for default. A lessee
21 may not cancel the contract if the lessor has a right to cure under Section 2A-729.
22 A lessor's right to cure depends in part upon sending timely notice of the intent to
23 cure to the lessee. If the lessee does not receive notice of the lessor's intent to offer
24 a cure that satisfies Section 2A-729 within the seasonable time for notice, the lessee
25 may cancel the contract.

26 3. Subsection (c) continues the rule from former Section 2A-505(2) that
27 upon cancellation, all obligations that are executory on both sides are discharged. If
28 the parties have already rendered their performance so that obligations are not
29 executory on both sides, then cancellation is a meaningless remedy.

30 4. Subsection (d) provides a nonexclusive list of other rights that survive
31 cancellation. Under former law, the rights that survived cancellation of the contract
32 were rights based on a prior default or performance and rights for remedy of breach

1 of the whole contract or an unperformed balance. Subsection (d) continues those
2 rules. In addition, courts have found that other rights that survive cancellation are
3 rights based upon a term in the agreement concerning dispute resolution processes,
4 a term concerning choice of law or choice of forum, and terms that provide rights
5 the parties specify should survive a cancellation. Those rights are reflected in the list
6 of rights in subsection (d). Of course, the parties are free to specify any rights
7 created in the contract survive cancellation of the contract. In addition, the court
8 may find that a right must survive cancellation even if the parties did not explicitly
9 specify in order to achieve the purposes of the parties.

10 5. Subsection (e) is the same as former Section 2A-505(3). A party's use of
11 the term cancellation or rescission should not result in an impairment or waiver of a
12 right to a remedy for a default that has occurred unless there is a clear statement that
13 the canceling party intends to so waive those rights.

14 **SECTION 2A-710. LIQUIDATION OF DAMAGES; DEPOSITS.**

15 (a) Damages for default or any other act or omission, including indemnity
16 for loss or diminution of anticipated tax benefits or loss or damage to lessor's
17 residual interest, may be liquidated in the lease agreement but only at an amount or
18 by a formula that is reasonable in light of either the actual loss or the then
19 anticipated loss caused by the default or other act or omission. If a term liquidating
20 damages is unenforceable under this subsection, the aggrieved party may pursue the
21 remedies provided in this article. A term that does not liquidate damages but
22 attempts to limit damages available to the aggrieved party must be evaluated under
23 Section 2A-712.

24 (b) If the lessor justifiably withholds delivery of goods or stops performance
25 because of the lessee's default or insolvency, the lessee is entitled to restitution of
26 the amount by which the sum of payments exceeds the amount to which the lessor is
27 entitled under a term liquidating damages in accordance with subsection (a).

1 (c) The lessee's right to restitution under subsection (b) is subject to setoff
2 to the extent that the lessor establishes a right to recover damages under the
3 provisions of this article other than subsection (a) and to the extent of the amount or
4 value of any benefits received by the lessee directly or indirectly by reason of the
5 lease contract.

6 **Comment**

7 **Uniform Statutory Analogue:** Section 2-809.

8 1. Many leasing transactions are predicated on the parties' ability to agree to
9 an appropriate amount of damages or formula for damages in the event of default or
10 other act or omission. The rule with respect to sales of goods (Section 2-809) may
11 not be sufficiently flexible to accommodate this practice. Thus, consistent with the
12 common law emphasis upon freedom to contract with respect to bailments for hire,
13 this section has created a revised rule that allows greater flexibility with respect to
14 leases of goods.

15 2. Subsection (a), a significantly modified version of the provisions of
16 Section 2-809(a), provides for liquidation of damages in the lease agreement at an
17 amount or by a formula. Section 2-809(a) does not by its express terms include
18 liquidation by a formula; this change was compelled by modern leasing practice.
19 Subsection (a), in a further expansion of Section 2-809(a), provides for liquidation
20 of damages for default as well as any other act or omission.

21 A liquidated damages formula that is common in leasing practice provides
22 that the sum of lease payments past due, accelerated future lease payments, and the
23 lessor's estimated residual interest, less the net proceeds of disposition (whether by
24 sale or re-lease) of the leased goods is the lessor's damages. Tax indemnities, costs,
25 interest and attorney's fees are also added to determine the lessor's damages.
26 Another common liquidated damages formula utilizes a periodic depreciation
27 allocation as a credit to the aforesaid amount in mitigation of a lessor's damages. A
28 third formula provides for a fixed number of periodic payments as a means of
29 liquidating damages. Stipulated loss or stipulated damage schedules are also
30 common. Whether these formulae are enforceable will be determined in the context
31 of each case by applying a standard of reasonableness in light of the harm
32 anticipated when the formula was agreed to. Whether the inclusion of these
33 formulae will affect the classification of the transaction as a lease or a security
34 interest is to be determined by the facts of each case. Section 1-201(37). *E.g., In re*
35 *Noack*, 44 Bankr. 172, 174-75 (Bankr.E.D.Wis.1984).

1 3. This section does not incorporate two other tests that under sales law
2 determine enforceability of liquidated damages, *i.e.*, difficulties of proof of loss and
3 inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. The
4 ability to liquidate damages is critical to modern leasing practice; given the parties'
5 freedom to contract at common law, the policy behind retaining these two additional
6 requirements here was thought to be outweighed. The impact of local, state and
7 federal tax laws on a leasing transaction can result in an amount payable with
8 respect to the tax indemnity many times greater than the original purchase price of
9 the goods. The parties are free to negotiate a formula, restrained by the rule of
10 reasonableness in this section. The rules of this section should invite the parties to
11 liquidate damages. Peters, *Remedies for Breach of Contracts Relating to the Sale*
12 *of Goods Under the Uniform Commercial Code: A Roadmap for Article Two*, 73
13 Yale L.J. 199, 278 (1963).

14 4. Subsection (a) provides that if the liquidated damages provision is not
15 enforceable, remedy may be had as provided in this Article.

16 **Cross References:**

17 Sections 1-201(37), 2-809.

18 **Definitional Cross References:**

19 "Consumer lease". Section 2A-102(a)(8).

20 "Delivery". Section 1-201(14).

21 "Goods". Section 2A-102(a)(16).

22 "Insolvent". Section 1-201(23).

23 "Lease agreement". Section 2A-102(a)(19).

24 "Lease contract". Section 2A-102(a)(20).

25 "Lessee". Section 2A-102(a)(22).

26 "Lessor". Section 2A-102(a)(24).

27 "Lessor's residual interest". Section 2A-102(a)(25).

28 "Party". Section 1-201(29).

29 "Present value". Section 2A-102(a)(29).

30 "Remedy". Section 1-201(34).

31 "Rights". Section 1-201(36).

32 "Term". Section 1-201(42).

33 "Value". Section 1-201(44).

34 **SECTION 2A-711. CONTRACTUAL MODIFICATION OF REMEDY.**

35 (a) Except as otherwise provided in this article, the lease agreement may
36 include rights and remedies for default in addition to or in substitution for those

1 provided in this article and may limit or alter the measure of damages recoverable
2 under this article.

3 (b) Resort to a remedy provided under this article or in the lease agreement
4 is optional unless the remedy is expressly agreed to be exclusive. If circumstances
5 cause an exclusive or limited remedy to fail of its essential purpose, or provision for
6 an exclusive remedy is unconscionable, remedies may be pursued as provided in this
7 article.

8 (c) Consequential damages may be liquidated under Section 2A-710, or may
9 otherwise be limited, altered, or excluded unless the limitation, alteration, or
10 exclusion is unconscionable. Limitation, alteration, or exclusion of consequential
11 damages for injury to the person in the case of consumer goods is presumed to be
12 unconscionable, but limitation, alteration, or exclusion of damages where the loss is
13 commercial is not presumed to be unconscionable.

14 (d) This article does not impair rights and remedies on default by the lessor
15 or the lessee with respect to any obligation or promise collateral or ancillary to the
16 lease contract.

17 **Comment**

18 **Uniform Statutory Analogue:** Section 2-810.

19 1. A significant purpose of this Part is to provide rights and remedies for
20 those parties to a lease who fail to provide them by agreement or whose rights and
21 remedies fail of their essential purpose or are unenforceable. However, it is
22 important to note that this implies no restriction on freedom to contract. Section
23 102(3). Thus, subsection (a) allows the parties to the lease agreement freedom to
24 provide for rights and remedies in addition to or in substitution for those provided in
25 this Article and to alter or limit the measure of damages recoverable under this
26 Article. Except to the extent otherwise provided in this Article (*e.g.*, Sections

1 2A-105, 106, and 107(1) and (2)), this Part shall be construed neither to restrict the
2 parties' ability to provide for rights and remedies or to limit or alter the measure of
3 damages by agreement, nor to imply disapproval of rights and remedy schemes other
4 than those set forth in this Part.

5 2. Subsection (a) makes explicit that if an exclusive remedy is held to be
6 unconscionable, remedies under this Article are available.

7 3. Subsection (c) makes clear that consequential damages may also be
8 liquidated.

9 4. Subsection (d) leaves the treatment of default with respect to obligations
10 or promises collateral or ancillary to the lease contract to other law. Section 1-103.
11 An example of such an obligation would be that of the lessor to the secured creditor
12 which has provided the funds to leverage the lessor's lease transaction; an example
13 of such a promise would be that of the lessee, as seller, to the lessor, as buyer, in a
14 sale-leaseback transaction.

15 **Cross References:**

16 Sections 1-102(3), 1-103, 2-809, 2A-105, 2A-106, 2A-107(1)(2), and 2A-710.

17 **Definitional Cross References:**

18 "Agreed". Section 1-201(3).

19 "Consumer goods". Section 9-102(a)(23).

20 "Lease agreement". Section 2A-102(a)(19).

21 "Lease contract". Section 2A-102(a)(20).

22 "Lessee". Section 2A-102(a)(22).

23 "Lessor". Section 2A-102(a)(24).

24 "Person". Section 1-201(30).

25 "Remedy". Section 1-201(34).

26 "Rights". Section 1-201(36).

27 **SECTION 2A-712. REMEDIES FOR MISREPRESENTATION OR**

28 **FRAUD.** Remedies for material misrepresentation or fraud include all remedies

29 available under this article for nonfraudulent default. Rescission or a claim for

30 rescission of a lease contract or rejection or return of the goods does not bar and is

31 not inconsistent with a claim for damages or other remedy.

1 **Comment**

2 **Uniform Statutory Analogue:** Section 2-811.

3 This section is the same in substance as former Section 2A-505(4). This
4 section continues the policy that the remedies for material misrepresentation or fraud
5 should be construed in light of the policy of this Article that remedies are designed
6 to place the aggrieved party in the position that it would have been in if the contract
7 had been performed. Thus a party who claims fraud but affirms the contract should
8 be entitled to damages based upon its expectation interest. Similarly, a party
9 claiming to rescind the contract and seeking to return the goods to the lessor should
10 also be able to enforce its remedies under this article in light of that same principle
11 of compensation of its expectancy interest. Section 2A-704. A return of the goods
12 to the lessor or a claim of rescission does not preclude remedies for fraud or rights
13 under other law. Rejection and revocation of an acceptance are not a rescission of
14 the contract and do not result in a cancellation of a contract. Cancellation is an
15 additional remedy for default. Sections 2A-716 and 2A-724.

16 **SECTION 2A-713. PROOF OF MARKET RENT.**

17 (a) Damages based on market rent are determined according to the rent for
18 the use of the goods concerned for a lease term identical to the remaining period of
19 the original lease agreement and prevailing at the times specified in Sections 2A-721
20 and 2A-735.

21 (b) If evidence of rent for the use of the goods concerned for a period
22 identical to the remaining period of the original lease agreement and prevailing at the
23 times or places described in this article is not readily available, the following rules
24 apply:

25 (1) The rent prevailing within any reasonable time before or after the
26 time described may be used.

27 (2) The rent prevailing at any other place or for a different lease period
28 which in commercial judgment or usage of trade is a reasonable substitute may be

used, making proper allowance for the difference, including the cost of transporting the goods to or from the other place.

(3) Evidence of a relevant rent prevailing at another time or place or for a lease period other than the one described in this section offered by one party is not admissible unless the party has given the other party notice that the court finds sufficient to prevent unfair surprise.

(c) If the prevailing rent or value of goods regularly leased in any established market is in dispute, reports in official publications or trade journals or in newspapers, periodicals, or other means of communication in general circulation and published as the reports of that market, are admissible in evidence. The circumstances of the preparation of such a report may affect the weight of the evidence but not its admissibility.

Comment

Uniform Statutory Analogue: Section 2-812.

Sections 2A-721 and 2A-735 specify the times as of which market rent is to be determined.

See also the Comment to Section 2-812.

Definitional Cross References:

“Goods”. Section 2A-102(a)(16).

“Lease”. Section 2A-102(a)(18).

“Lease agreement”. Section 2A-102(a)(19).

“Notice”. Section 1-201(25).

“Party”. Section 1-201(29).

“Reasonable time”. Section 1-204(1) and (2).

“Usage of trade”. Section 1-205.

“Value”. Section 1-201(44).

1 “Lessee”. Section 2A-102(a)(22).
2 “Lessor”. Section 2A-102(a)(24).
3 “Party”. Section 1-201(29).
4 “Rights”. Section 1-201(36).
5 “Security interest”. Section 1-201(37).

6 **SECTION 2A-715. STATUTE OF LIMITATIONS.**

7 (a) An action for default under a lease contract, including breach of
8 warranty or indemnity, must be commenced within four years after the right of
9 action has accrued. Except in a consumer lease or an action for indemnity, the
10 original lease agreement may reduce the period of limitations to not less than one
11 year.

12 (b) Except as otherwise provided in subsection (c), a right of action accrues
13 when the act or omission on which the default or breach of warranty is based is or
14 should have been discovered by the aggrieved party. A right of action for indemnity
15 accrues when the act or omission on which the claim for indemnity is based is or
16 should have been discovered by the indemnified party.

17 (c) If an action commenced within the applicable period of limitation is
18 terminated but a remedy by another action for the same default or breach of
19 warranty or indemnity is available, the other action may be commenced after the
20 expiration of the time limitation and within six months after the termination of the
21 first action unless the termination resulted from voluntary discontinuance or from
22 dismissal for failure to prosecute.

1 (d) This section does not alter the law on tolling of the statute of limitations
2 and does not apply to a right of action that accrued before this article took effect.

3 **Comment**

4 **Uniform Statutory Analogue:** Section 2-814.

5 Subsection (a) permits the parties to reduce the period of limitations to not
6 less than one year and also permits them to extend the period. Breach of warranty
7 and indemnity claims often arise in a lease transaction; with the passage of time such
8 claims often diminish or are eliminated. To encourage the parties to commence
9 litigation under these circumstances makes little sense. Therefore, the ability to
10 extend the limitations period is particularly valuable in the lease context.

11 Subsection (b) provides that the statute of limitations begins to run when the
12 default or other act or omission which is the basis of the claim is or should have
13 been discovered. With respect to indemnity, a similarly liberal rule is adopted.

14 **Cross References:**
15 Section 2-814.

16 **Definitional Cross References:**
17 “Action”. Section 1-201(1).
18 “Aggrieved party”. Section 1-201(2).
19 “Lease contract”. Section 2A-102(a)(20).
20 “Party”. Section 1-201(29).
21 “Remedy”. Section 1-201(34).
22 “Termination”. Section 2A-102(a)(36).

23 [SUBPART B. LESSOR’S REMEDIES]

24 **SECTION 2A-716. LESSOR’S REMEDIES IN GENERAL.**

25 (a) If the lessee wrongfully rejects or revokes acceptance of goods or fails
26 to make a payment when due or repudiates with respect to a part or the whole, the
27 lessee is in default under the lease contract with respect to any goods involved, and
28 with respect to all of the goods if under an installment lease contract the value of the

1 whole lease contract is substantially impaired, and the lessor may do one or more of
2 the following:

3 (1) withhold delivery of the goods and take possession of goods
4 previously delivered;

5 (2) stop delivery of the goods by any carrier or bailee under Section
6 2A-719(b);

7 (3) proceed under Section 2A-718 with respect to goods still
8 unidentified to the lease contract or unfinished;

9 (4) obtain specific performance under Section 2A-708 or recover the
10 rent under Section 2A-722;

11 (5) dispose of the goods and recover damages under Section 2A-720 or
12 retain the goods and recover damages under Section 2A-721;

13 (6) recover incidental and consequential damages under Sections 2A-706
14 and 2A-707;

15 (7) cancel the lease contract under Section 2A-709;

16 (8) recover liquidated damages under Section 2A-710;

17 (9) enforce limited remedies under Section 2A-711;

18 (10) recover damages under Section 2A-705; or

19 (11) exercise any other rights or pursue any other remedies provided in
20 the lease agreement.

21 (b) If the lessor does not fully exercise a right or obtain a remedy to which
22 the lessor is entitled under subsection (a), the lessor may recover the loss resulting in

1 the ordinary course of events from the lessee's default as determined in any
2 reasonable manner, together with incidental damages, less expenses avoided as a
3 result of the lessee's default.

4 (c) If the lessee is otherwise in default under a lease contract, the lessor may
5 exercise the rights and pursue the remedies provided in the lease agreement, which
6 may include a right to cancel the lease. In addition, except as otherwise provided in
7 the lease agreement:

8 (1) if the default substantially impairs the value of the lease contract to
9 the lessor, the lessor may exercise the rights and pursue the remedies under
10 subsection (a) or (b); or

11 (2) if the default does not substantially impair the value of the lease
12 contract to the lessor, the lessor may recover under subsection.

13 **Comment**

14 **Uniform Statutory Analogue:** Section 2-815.

15 1. Subsection (a) is an index to Sections 2A-717 through 2A-723 and states
16 that the remedies provided in those sections are available for the defaults referred to
17 in subsection (a): wrongful rejection or revocation of acceptance, failure to make a
18 payment when due, or repudiation. In addition, remedies provided in the lease
19 contract are available. Subsection (b) sets out a remedy if the lessor does not
20 pursue to completion a right or actually obtain a remedy available under subsection
21 (a), and subsection (c) sets out statutory remedies for defaults not specifically
22 referred to in subsection (a). Subsection (c) provides that, if any default by the
23 lessee other than those specifically referred to in subsection (a) is material, the lessor
24 can exercise the remedies provided in subsection (a) or (b); otherwise the available
25 remedy is as provided in subsection (c). A lessor who has brought an action seeking
26 or has nonjudicially pursued one or more of the remedies available under subsection
27 (a) may amend so as to claim or may nonjudicially pursue a remedy under subsection
28 (b) unless the right or remedy first chosen has been pursued to an extent actually
29 inconsistent with the new course of action. The intent of the provision is to reject
30 the doctrine of election of remedies and to permit an alteration of course by the

1 lessor unless such alteration would actually have an effect on the lessee that would
2 be unreasonable under the circumstances. Further, the lessor may pursue remedies
3 under both subsections (a) and (b) unless doing so would put the lessor in a better
4 position than it would have been in had the lessee fully performed.

5 2. The lessor and the lessee can agree to modify the rights and remedies
6 available under the Article; they can, among other things, provide that for defaults
7 other than those specified in subsection (a) the lessor can exercise the rights and
8 remedies referred to in subsection (a), whether or not the default would otherwise
9 be held to substantially impair the value of the lease contract to the lessor; they can
10 also create a new scheme of rights and remedies triggered by the occurrence of the
11 default. Section 1-102(3).

12 3. Subsection (a) lists various cumulative remedies of the lessor where the
13 lessee wrongfully rejects or revokes acceptance, fails to make a payment when due,
14 or repudiates. The subsection also allows the lessor to exercise any contractual
15 remedy.

16 4. This Article rejects any general doctrine of election of remedy. Whether,
17 in a particular case, one remedy bars another, is a function of whether lessor has
18 been put in as good a position as if the lessee had fully performed the lease contract.
19 Multiple remedies are barred only if the effect is to put the lessor in a better position
20 than it would have been in had the lessee fully performed under the lease. Sections
21 2A-704(c) and 1-106(1).

22 5. **Hypothetical:** To better understand the application of subparagraphs (a)
23 through (e), it is useful to review a hypothetical. Assume that A is a merchant in the
24 business of selling and leasing new bicycles of various types. B is about to engage in
25 the business of subleasing bicycles to summer residents of and visitors to an island
26 resort. A, as lessor, has agreed to lease 60 bicycles to B. While there is one master
27 lease, deliveries and terms are staggered. 20 bicycles are to be delivered by A to B's
28 island location on June 1; the term of the lease of these bicycles is four months. 20
29 bicycles are to be delivered by A to B's island location on July 1; the term of the
30 lease of these bicycles is three months. Finally, 20 bicycles are to be delivered by A
31 to B's island location on August 1; the term of the lease of these bicycles is two
32 months. B is obligated to pay rent to A on the 15th day of each month during the
33 term for the lease. Rent is \$50 per month, per bicycle. B has no option to purchase
34 or release and must return the bicycles to A at the end of the term, in good
35 condition, reasonable wear and tear excepted. Since the retail price of each bicycle
36 is \$400 and bicycles used in the retail rental business have a useful economic life of
37 36 months, this transaction creates a lease. Sections 2A-102(a)(21) and 1-201(37).

1 6. A's current inventory of bicycles is not large. Thus, upon signing the
2 lease with B in February, A agreed to purchase 60 new bicycles from A's principal
3 manufacturer, with special instructions to drop ship the bicycles to B's island
4 location in accordance with the delivery schedule set forth in the lease.

5 7. The first shipment of 20 bicycles was received by B on May 21. B
6 inspected the bicycles, accepted the same as conforming to the lease and signed a
7 receipt of delivery and acceptance. However, due to poor weather that summer,
8 business was terrible and B was unable to pay the rent due on June 15. Pursuant to
9 the lease A sent B notice of default and proceeded to enforce his rights and remedies
10 against B.

11 8. A's counsel first advised A that under Section 2A-726 and the terms of
12 the lease B's failure to pay was a default with respect to the whole. Thus, to
13 minimize A's continued exposure, A was advised to take possession of the bicycles.
14 If A had possession of the goods A could refuse to deliver. Section 2A-717(a).
15 However, the facts here are different. With respect to the bicycles in B's
16 possession, A has the right to take possession of the bicycles, without breach of the
17 peace. Section 2A-717(b). If B refuses to allow A access to the bicycles, A can
18 proceed by action, including replevin or injunctive relief.

19 9. With respect to the 40 bicycles that have not been delivered, this Article
20 provides various alternatives. First, assume that 20 of the remaining 40 bicycles
21 have been manufactured and delivered by the manufacturer to a carrier for shipment
22 to B. Given the size of the shipment, the carrier was using a small truck for the
23 delivery and the truck had not yet reached the island ferry when the manufacturer (at
24 the request of A) instructed the carrier to divert the shipment to A's place of
25 business. A's right to stop delivery is recognized under these circumstances.
26 Section 2A-719(b). Second, assume that the 20 remaining bicycles were in the
27 process of manufacture when B defaulted. A retains the right (as between A as
28 lessor and B as lessee) to exercise reasonable commercial judgment whether to
29 complete manufacture or to dispose of the unfinished goods for scrap. Since A is
30 not the manufacturer and A has a binding contract to buy the bicycles, A elected to
31 allow the manufacturer to complete the manufacture of the bicycles, but instructed
32 the manufacturer to deliver the completed bicycles to A's place of business. Section
33 2A-718(a)(1).

34 10. Thus, so far A has elected to exercise the remedies referred to in
35 subparagraphs (1) through (3) in subsection (a). None of these remedies bars any of
36 the others because A's election and enforcement merely resulted in A's possession
37 of the bicycles. Had B performed A would have recovered possession of the
38 bicycles. Thus A is in the process of obtaining the benefit of his bargain. Note that
39 A could exercise any other rights or pursue any other remedies provided in the lease

1 contract (subsection (a)(11)), or elect to recover his loss due to the lessee's default
2 under Section 2A-716(b).

3 11. A's counsel next would determine what action, if any, should be taken
4 with respect to the goods. As stated in subparagraph (e) and as discussed fully in
5 Section 2A-720(a)) the lessor may, but has no obligation to, dispose of the goods by
6 a substantially similar lease (indeed, the lessor has no obligation whatsoever to
7 dispose of the goods at all) and recover damages based on that action, but lessor
8 will not be able to recover damages which put it in a better position than
9 performance would have done, nor will it be able to recover damages for losses
10 which it could have reasonably avoided. In this case, since A is in the business of
11 leasing and selling bicycles, A will probably inventory the 60 bicycles for its retail
12 trade.

13 12. A's counsel then will determine which of the various means of
14 ascertaining A's damages against B are available. Subparagraphs (a)(4) and (a)(5)
15 catalogue each relevant section. First, under Section 2A-720(b) the amount of A's
16 claim is computed by comparing the original lease between A and B with any
17 subsequent lease of the bicycles but only if the subsequent lease is substantially
18 similar to the original lease contract. While the section does not define this term, the
19 Official Comment does establish some parameters. If, however, A elects to lease the
20 bicycles to his retail trade, it is unlikely that the resulting lease will be substantially
21 similar to the original, as leases to retail customers are considerably different from
22 leases to wholesale customers like B. If, however, the leases were substantially
23 similar, the damage claim is for accrued and unpaid rent to the beginning of the new
24 lease, plus the present value as of the same date, of the rent reserved under the
25 original lease for the balance of its term less the present value as of the same date of
26 the rent reserved under the replacement lease for a term comparable to the balance
27 of the term of the original lease, together with incidental damages less expenses
28 saved in consequence of the lessee's default.

29 13. If the new lease is not substantially similar or if A elects to sell the
30 bicycles or to hold the bicycles, damages are computed under Section 2A-721 or
31 2A-722.

32 14. If A elects to pursue his claim under Section 2A-721(a) damages are
33 measured from default if the lessee never took possession of the goods or from the
34 time when the lessor did or could have regained possession and that the standard of
35 comparison is not the rent reserved under a substantially similar lease entered into by
36 the lessor but a market rent, as defined in Section 2A-713. Further, if the facts of
37 this hypothetical were more elaborate A may be able to establish that the measure of
38 damage under subsection (a) is inadequate to put him in the same position that B's

1 performance would have, in which case A can claim the present value of his lost
2 profits.

3 15. Yet another alternative for computing A's damage claim against B
4 which will be available in some situations is recovery of the present value, as of
5 entry of judgment, of the rent for the then remaining lease term under Section
6 2A-722. However, this formulation is not available if the goods have been
7 repossessed or tendered back to A. For the 20 bicycles repossessed and the
8 remaining 40 bicycles, A will be able to recover the present value of the rent only if
9 A is unable to dispose of them, or circumstances indicate the effort will be
10 unavailing. If A has prevailed in an action for the rent, at any time up to collection
11 of a judgment by A against B, A might dispose of the bicycles. In such case A's
12 claim for damages against B is governed by Section 2A-720 or 2A-721. The
13 resulting recalculation of claim should reduce the amount recoverable by A against
14 B and the lessor is required to cause an appropriate credit to be entered against the
15 earlier judgment. However, the nature of the post-judgment proceedings to resolve
16 this issue, and the sanctions for a failure to comply, if any, will be determined by
17 other law.

18 16. Finally, if the lease agreement had so provided pursuant to subparagraph
19 (a)(11), A's claim against B would not be determined under any of these statutory
20 formulae, but pursuant to a liquidated damages clause. Section 2A-710(a).

21 17. These various methods of computing A's damage claim against B are
22 alternatives subject to Section 2A-704(c). However, the pursuit of any one of these
23 alternatives is not a bar to, nor has it been barred by, A's earlier action to obtain
24 possession of the 60 bicycles. These formulae, which vary as a function of an overt
25 or implied mitigation of damage theory, focus on allowing a recovery of the benefit
26 of his bargain with B. Had B performed, A would have received the rent as well as
27 the return of the 60 bicycles at the end of the term.

28 18. Finally, A's counsel should also advise A of his right to cancel the lease
29 contract under Section 2A-709. Cancellation will discharge all existing obligations
30 but preserve A's rights and remedies.

31 19. Subsection (b) recognizes that a lessor who is entitled to exercise the
32 rights or to obtain a remedy granted by subsection (a) may choose not to do so. In
33 such cases, the lessor can recover damages as provided in subsection (b). For
34 example, for non-payment of rent, the lessor may decide not to take possession of
35 the goods and cancel the lease, but rather to merely sue for the unpaid rent as it
36 comes due plus lost interest or other damages "determined in any reasonable
37 manner." Subsection (b) also negates any loss of alternative rights and remedies by

1 reason of having invoked or commenced the exercise or pursuit of any one or more
2 rights or remedies.

3 20. Subsection (c) allows the lessor access to a remedy scheme provided in
4 this Article as well as that contained in the lease contract if the lessee is in default for
5 reasons other than those stated in subsection (a). Note that the reference to this
6 Article includes supplementary principles of law and equity, *e.g.*, fraud,
7 misrepresentation and duress. Section 1-103.

8 21. There is no special treatment of the finance lease in this section. Absent
9 supplementary principles of law to the contrary, in most cases the supplier will have
10 no rights or remedies against the defaulting lessee. Section 2A-303(b). Given that
11 the supplier will look to the lessor for payment, this is appropriate. However, there
12 is a specific exception to this rule with respect to the right to identify goods to the
13 lease contract. Section 2A-718(a)(1) The parties are free to create a different result
14 in a particular case. Section 1-102(3).

15 **Cross References:**

16 Sections 1-102(3), 1-103, 1-106(1), 1-201(37), 2A-303, 2A-702, 2A-710, 2A-709,
17 2A-713, 2A-726, 2A-716 through 2A-723.

18 **Definitional Cross References:**

19 "Delivery". Section 1-201(14).
20 "Goods". Section 2A-102(a)(16).
21 "Lease contract". Section 2A-102(a)(20).
22 "Lessee". Section 2A-102(a)(22).
23 "Lessor". Section 2A-102(a)(24).
24 "Remedy". Section 1-201(34).
25 "Rights". Section 1-201(36).
26 "Value". Section 1-201(44).

27 **SECTION 2A-717. LESSOR'S RIGHT TO POSSESSION OF GOODS.**

28 (a) Upon a default by the lessee under a lease contract of the type described
29 in Section 2A-716(a) or (c)(1) or, if agreed, upon other default by the lessee, the
30 lessor may take possession of the goods. If the lease agreement so provides, the
31 lessor may require the lessee to assemble the goods and make them available to the
32 lessor at a place to be designated by the lessor which is reasonably convenient to

1 both parties. Without removal, the lessor may render unusable any goods employed
2 in trade or business and may dispose of goods on the lessee's premises.

3 (b) A lessor may proceed under subsection (b) without judicial process if it
4 can be done without breach of the peace, or the lessor may proceed by judicial
5 process.

6 **Comment**

7 **Uniform Statutory Analogue:** Sections 2-816 and 9-609.

8 1. Subsection (a) allows the lessor to refuse to deliver goods if the lessee is
9 insolvent.

10 2. Subsection (a) also allows the lessor, on a Section 2A-716(a) or
11 2A-716(c)(1) default by the lessee, the right to take possession of or reclaim the
12 goods. Also, the lessor can contract for the right to take possession of the goods
13 for other defaults by the lessee. Therefore, since the lessee's insolvency is an event
14 of default in a standard lease agreement, subsection (a) is the functional equivalent
15 of Section 2-816(b). Further, subsection (a) sanctions the classic crate and delivery
16 clause obligating the lessee to assemble the goods and to make them available to the
17 lessor. Finally, the lessor may leave the goods in place, render them unusable (if
18 they are goods employed in trade or business), and dispose of them on the lessee's
19 premises.

20 3. Subsection (b) allows the lessor to proceed under subsection (a) without
21 judicial process, absent breach of the peace, or by action. Sections 2A-702(b) and
22 1-201(1). In the appropriate case action includes injunctive relief. *Clark Equip. Co.*
23 *v. Armstrong Equip. Co.*, 431 F.2d 54 (5th Cir.1970), *cert. denied*, 402 U.S. 909
24 (1971). This section, as well as a number of other sections in this Part, are included
25 in the Article to codify the lessor's common law right to protect the lessor's
26 reversionary interest in the goods. Section 2A-102(a)(28). These sections are
27 intended to supplement and not displace principles of law and equity with respect to
28 the protection of such interest. Section 1-103. Such principles apply in many
29 instances, *e.g.*, loss or damage to goods if risk of loss passes to the lessee, failure of
30 the lessee to return goods to the lessor in the condition stipulated in the lease, and
31 refusal of the lessee to return goods to the lessor after termination or cancellation of
32 the lease. See also Section 2A-723.

33 **Cross References:**

34 Sections 1-106(2), 2-816(b), 2A-702(b), 2A-723, and 9-609.

1 **Definitional Cross References:**
2 “Action”. Section 1-201(1).
3 “Delivery”. Section 1-201(14).
4 “Discover”. Section 1-201(25).
5 “Goods”. Section 2A-102(a)(16).
6 “Insolvent”. Section 1-201(23).
7 “Lease contract”. Section 2A-102(a)(20).
8 “Lessee”. Section 2A-102(a)(22).
9 “Lessor”. Section 2A-102(a)(24).
10 “Party”. Section 1-201(29).
11 “Rights”. Section 1-201(36).

12 **SECTION 2A-718. LESSOR’S RIGHT TO IDENTIFY GOODS TO**
13 **LEASE CONTRACT DESPITE DEFAULT OR TO SALVAGE**
14 **UNFINISHED GOODS.**

15 (a) Upon default by the lessee under the lease contract of the type described
16 in Section 2A-716(a) or (c)(1) or, if agreed, after other default by the lessee, the
17 lessor may:

18 (1) identify to the lease contract conforming goods not already identified
19 if they are in the lessor’s or supplier’s possession or control at the time the lessor
20 learned of the default; and

21 (2) dispose of goods that are shown to have been intended for the
22 particular lease contract even if those goods are unfinished.

23 (b) If goods are unfinished at the time of default, an aggrieved lessor or the
24 supplier, in the exercise of reasonable commercial judgment to for the purposes of
25 minimizing loss and of effective realization, may complete the manufacture and
26 wholly identify the goods to the lease contract, cease manufacture and lease, sell, or

1 otherwise dispose of the goods for scrap or salvage value, or proceed in any other
2 reasonable manner.

3 **Comment**

4 **Uniform Statutory Analogue:** Section 2-718.

5 The remedies provided by this section are available to the lessor (i) if there
6 has been a default by the lessee which falls within Section 2A-716(a) or
7 2A-716(c)(1) or (ii) if there has been any other default for which the lease contract
8 gives the lessor the remedies provided by this section. Under “(ii)”, the lease
9 contract may give the lessor the remedies of identification and disposition provided
10 by this section in various ways. For example, a lease provision might specifically
11 refer to the remedies of identification and disposition, or it might refer to this section
12 by number (*i.e.*, Section 2A-718), or it might do so by a more general reference
13 such as “all rights and remedies provided by Article 2A for default by the lessee.”

14 **Definitional Cross References:**

15 “Aggrieved party”. Section 1-201(2).
16 “Conforming”. Section 2A-102(a)(5).
17 “Goods”. Section 2A-102(a)(16).
18 “Learn”. Section 1-201(25).
19 “Lease”. Section 2A-102(a)(18).
20 “Lease contract”. Section 2A-10(a)(20).
21 “Lessor”. Section 2A-102(a)(24).
22 “Rights”. Section 1-201(36).
23 “Supplier”. Section 2A-102(a)(34).
24 “Value”. Section 1-201(44).

25 **SECTION 2A-719. LESSOR’S REFUSAL TO DELIVER BECAUSE OF**
26 **LESSEE’S INSOLVENCY; STOPPAGE IN TRANSIT OR OTHERWISE.**

27 (a) A lessor that discovers that the lessee is insolvent may refuse to deliver
28 the goods.

29 (b) Subject to subsection (d), the lessor may stop delivery of goods in the
30 possession of a carrier or other bailee if the lessee is insolvent or repudiates or fails
31 to make a payment due before delivery, whether for rent, security, or otherwise

1 under the lease contract or if, for any other reason, the lessor has a right to withhold
2 or reclaim the goods.

3 (c) As against a lessee under subsection (b), the lessor may stop delivery
4 until:

5 (1) receipt of the goods by the lessee;

6 (2) acknowledgment to the lessee by any bailee of the goods, other than
7 a carrier, or a carrier by reshipment or as a warehouseman, that the bailee holds the
8 goods for the lessee; or

9 (3) acknowledgment to the lessee by a carrier by reshipment or as
10 warehouseman that the carrier holds the goods for the lessee.

11 (d) If notice to stop delivery has been given, the following rules apply:

12 (1) The notice must afford the carrier or bailee a reasonable opportunity
13 to prevent delivery of the goods.

14 (2) After notice, the carrier or bailee shall hold and deliver the goods
15 according to the directions of the lessor. The lessor is liable to the bailee or carrier
16 for any resulting charges or damages. A carrier or bailee need not stop delivery if
17 the lessor does not provide indemnity for charges or damages upon the carrier's or
18 bailee's demand.

19 (3) A carrier or bailee that has issued a nonnegotiable document need
20 not obey a notice to stop received from a person other than the person named in the
21 document as the person from which the goods have been received for shipment or
22 storage.

1 **Comment**

2 **Uniform Statutory Analogue:** Section 2-816.

3 **Definitional Cross References:**

4 “Bill of lading”. Section 1-201(6).

5 “Delivery”. Section 1-201(14).

6 “Discover”. Section 1-201(25).

7 “Goods”. Section 2A-102(a)(16).

8 “Insolvent”. Section 1-201(23).

9 “Lease contract”. Section 2A-102(a)(20).

10 “Lessee”. Section 2A-102(a)(22).

11 “Lessor”. Section 2A-102(a)(24).

12 “Notifies” and “Notification”. Section 1-201(26).

13 “Person”. Section 1-201(30).

14 “Receive”. Section 2-102(a)(30).

15 “Remedy”. Section 1-201(34).

16 “Rights”. Section 1-201(36).

17 **SECTION 2A-720. LESSOR’S RIGHTS TO DISPOSE OF GOODS.**

18 (a) Upon a default by a lessee under the lease contract of the type described
19 in Section 2A-716(a) or (c)(1), or upon the lessor’s refusal to deliver or taking
20 possession of goods under Section 2A-717 or 2A-719, or, if agreed, upon other
21 default by a lessee, the lessor may dispose of the goods concerned or the
22 undelivered balance thereof by lease, sale, or otherwise.

23 (b) Except as otherwise provided with respect to damages liquidated in the
24 lease agreement or otherwise determined by agreement of the parties, if the
25 disposition is by lease agreement substantially similar to the original lease agreement
26 and the new lease agreement is made in good faith and in a commercially reasonable
27 manner, the lessor may recover from the lessee as damages compensation for:

(1) accrued and unpaid rent as of the date of the commencement of the period of the new lease agreement;

(2) the present value, as of the same date, of the total rent for the then remaining lease period 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 part of the new lease period which is comparable to the then remaining period of the original lease agreement; and

(3) any incidental damages allowed under Section 2A-706, less expenses avoided as a result of the lessee's default.

(c) If the lessor's disposition is by a lease agreement that for any reason does not qualify for treatment under subsection (b), or is by sale or otherwise, the lessor may recover from the lessee as if the lessor had elected not to dispose of the goods, and Section 2A-721 governs.

(d) A person that subsequently buys or leases from the lessor in good faith for value as a result of a disposition under this section takes the goods free of the original lease contract and any rights of the original lessee even if the lessor fails to comply with one or more of the requirements of this article.

(e) A lessor is not accountable to the lessee for any profit made on any disposition. A lessee that has rightfully rejected or justifiably revoked acceptance shall account to the lessor for any excess over the amount of the lessee's security interest.

Comment

Uniform Statutory Analogue: Section 2-819

1. Subsection (a) gives 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-717(a), 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. 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.

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 (a) and such disposition is by lease that qualifies under subsection (b), the measure of damages set forth in subsection (b) will apply, absent agreement to the contrary.

3. The lessor's damages will be established using the new lease agreement as a measure if the following three criteria are satisfied: (i) the lessor disposed of the goods by lease, (ii) the lease agreement is substantially similar to the original lease agreement, and (iii) such disposition was in good faith, and in a commercially reasonable manner. Thus, the lessor will be entitled to recover from the lessee the accrued and unpaid rent as of the date of commencement of the term of the new lease, and the present value, as of the same date, of the rent, under the original lease for the then remaining term less the present value as of the same date of the rent under the new lease agreement applicable to the period of the new lease comparable to the remaining term under the original lease, together with incidental damages less expenses saved in consequence of the lessee's default. If the lessor's disposition does not satisfy the criteria of subsection (b), the lessor may calculate its claim against the lessee pursuant to Section 2A-721. Section 2A-716(a)(4), (5).

4. Two of the three criteria to be met by the lessor are familiar, but the concept of the new lease agreement that is substantially similar to the original lease agreement is not. Given the many variables facing a party who intends to lease goods and the rapidity of change in the market place, the policy decision was made not to draft with specificity. It was thought unwise to seek to establish certainty at the cost of fairness. The decision of whether the new lease agreement is substantially similar to the original will be determined case by case.

1 5. While the section does not draw a bright line, it is possible to describe
2 some of the factors that should be considered in a finding that a new lease
3 agreement is substantially similar to the original. The various elements of the new
4 lease agreement should be examined. Those elements include the options to
5 purchase or release; the lessor's representations, warranties and covenants to the
6 lessee as well as those to be provided by the lessee to the lessor; and the services, if
7 any, to be provided by the lessor or by the lessee. All of these factors allocate cost
8 and risk between the lessor and the lessee and thus affect the amount of rent to be
9 paid. These findings should not be made with scientific precision, as they are a
10 function of economics, nor should they be made independently, as it is important
11 that a sense of commercial judgment pervade the finding. See Section 2A-713. To
12 establish the new lease as a proper measure of damage under subsection (b), these
13 various factors, taken as a whole, must result in a finding that the new lease
14 agreement is substantially similar to the original. If the differences between the
15 original lease and the new lease can be easily valued, it would be appropriate for a
16 court to find that the new lease is substantially similar to the old lease, adjust the
17 difference in the rent between the two leases to take account of the differences, and
18 award damages under this section. If, for example, the new lease requires the lessor
19 to insure the goods in the hands of the lessee, while the original lease required the
20 lessee to insure, the usual cost of such insurance could be deducted from rent due
21 under the new lease before the difference in rental between the two leases is
22 determined.

23 6. The following hypothetical illustrates the difficulty of providing a bright
24 line. Assume that A buys a jumbo tractor for \$1 million and then leases the tractor
25 to B for a term of 36 months. The tractor is delivered to and is accepted by B on
26 May 1. On June 1 B fails to pay the monthly rent to A. B returns the tractor to A,
27 who immediately releases the tractor to C for a term identical to the term remaining
28 under the lease between A and B. All terms and conditions under the lease between
29 A and C are identical to those under the original lease between A and B, except that
30 C does not provide any property damage or other insurance coverage, and B agreed
31 to provide complete coverage. Coverage is expensive and difficult to obtain. It is a
32 question of fact whether it is so difficult to adjust the recovery to take account of
33 the difference between the two leases as to insurance that the second lease is not
34 substantially similar to the original.

35 7. A new lease can be substantially similar to the original lease even though
36 its term extends beyond the remaining term of the original lease, so long as both (a)
37 the lease terms are commercially comparable (*e.g.*, it is highly unlikely that a one-
38 month rental and a five-year lease would reflect similar realities), and (b) the court
39 can fairly apportion a part of the rental payments under the new lease to that part of
40 the term of the new lease which is comparable to the remaining lease term under the
41 original lease. Also, the lease term of the new lease may be comparable to the

1 remaining term of the original lease even though the beginning and ending dates of
2 the two leases are not the same. For example, a two-month lease of agricultural
3 equipment for the months of August and September may be comparable to a two-
4 month lease running from the 15th of August to the 15th of October if in the
5 particular location two-month leases beginning on August 15th are basically
6 interchangeable with two-month leases beginning August 1st. Similarly, the term of
7 a one-year truck lease beginning on the 15th of January may be comparable to the
8 term of a one-year truck lease beginning January 2d. If the lease terms are found to
9 be comparable, the court may base cover damages on the entire difference between
10 the costs under the two leases.

11 8. Subsection (c) provides that if the lessor's disposition is by lease that
12 does not qualify under subsection (b), or is by sale or otherwise, Section 2A-721
13 governs.

14 9. Subsection (d) applies to protect a subsequent buyer or lessee who buys
15 or leases from the lessor in good faith and for value, pursuant to a disposition under
16 this section. Note that by its terms, the rule in Section 2A-304(1), which provides
17 that the subsequent lessee takes subject to the original lease contract, is controlled
18 by the rule stated in this subsection.

19 10. Subsection (e) provides that the lessor is not accountable to the lessee
20 for any profit made by the lessor on a disposition. This rule follows from the
21 fundamental premise of the bailment for hire that the lessee under a lease of goods
22 has no equity of redemption to protect.

23 **Cross References:**

24 Sections 1-102(3), 2-816, 2A-404, 2A-710, 2A-713, 2A-716(a)(4), (5), 2A-717,
25 2A-720, and 2A-721.

26 **Definitional Cross References:**

27 "Buyer". Section 2-102(a)(3).
28 "Delivery". Section 1-201(14).
29 "Good faith". Section 2A-102(a)(15).
30 "Goods". Section 2A-102(a)(16).
31 "Lease". Section 2A-102(a)(18).
32 "Lease contract". Section 2A-102(a)(20).
33 "Lessee". Section 2A-102(a)(22).
34 "Lessor". Section 2A-102(a)(24).
35 "Present value". Section 2A-102(a)(29).
36 "Rights". Section 1-201(36).
37 "Sale". Section 2-102(a)(32).
38 "Security interest". Section 1-201(37).

1 “Value”. Section 1-201(44).

2 **SECTION 2A-721. LESSOR’S DAMAGES FOR NONACCEPTANCE,**
3 **FAILURE TO PAY, OR REPUDIATION.**

4 (a) Except as otherwise provided with respect to damages liquidated in the
5 lease agreement under Section 2A-710 or otherwise determined by agreement of
6 the parties under Sections 1-102(3) and 2A-711, if a lessor elects to retain the goods
7 or elects to dispose of the goods and the disposition is by lease agreement that for
8 any reason does not qualify for treatment under Section 2A-720(b) or is by sale or
9 otherwise, the lessor may recover from the lessee as damages for a default of the
10 type described in Section 2A-716(a) or (c)(1), or if agreed for other default of the
11 lessee:

12 (1) accrued and unpaid rent as of the date of default if the lessee has
13 never taken possession of the goods, or, if the lessee has taken possession of the
14 goods, as of the date the lessor repossesses the goods or an earlier date on which
15 the lessee makes a tender of the goods to the lessor;

16 (2) the present value, as of the date determined under paragraph (1), of
17 the total rent for the then remaining period of the original lease agreement, minus
18 the present value as of the same date of the market rent at the place where the goods
19 are located computed for the same lease term; and

20 (3) any incidental or consequential damages allowed under Section
21 2A-706 or 2A-707, less expenses saved in consequence of the lessee’s default.

(b) If the measure of damages provided in subsection (a) or Section 2A-720 is inadequate under Section 2A-704(a), a lessor may recover damages measured by other than the market price or the amount received on a disposition of the goods, together with incidental and consequential damages, including:

(1) the present value of lost profits, including reasonable overhead, resulting from the default of the lessee determined in any reasonable manner; and

(2) reasonable expenditures made in preparing for or performing the contract.

Comment

Uniform Statutory Analogue: Section 2-821.

1. Subsection (a) states the basic rule governing the measure of lessor's damages for a default described in Section 2A-716(a) or (c)(1), 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 Section 2A-720(b). Note that under some of these conditions, the lessor may recover damages from the lessee pursuant to the rule set forth in Section 2A-722. There is no sanction for disposition that does not qualify under Section 2A-720(b). Application of the rule set forth in this section is subject to agreement to the contrary. Sections 2A-711 and 1-102(3).

2. If the lessee has never taken possession of the goods, the measure of damage is the accrued and unpaid rent as of the date of default together with the present value, as of the date of default, of the original rent for the remaining term of the lease less the present value as of the same date of market rent, and incidental damages, less expenses saved in consequence of the default. Note that the reference in subsection (a)(1) and (2) is to the date of default not to the date of an event of default. An event of default under a lease agreement becomes a default under a lease agreement only after the expiration of any relevant period of grace and compliance with any notice requirements under this Article and the lease agreement. American Bar Foundation, *Commentaries on Indentures*, § 5-1, at 216-217 (1971). Section 2A-716(a). This conclusion is also a function of whether, as a matter of fact or law, the event of default has been waived, suspended or cured. Section 1-103. If the lessee has taken possession of the goods, the measure of damages is the accrued

1 and unpaid rent as of the earlier of the time the lessor repossesses the goods or the
2 time the lessee tenders the goods to the lessor plus the difference between the
3 present value, as of the same time, of the rent under the lease for the remaining lease
4 term and the present value, as of the same time, of the market rent.

5 3. Market rent will be computed pursuant to Section 2A-713.

6 4. Subsection (b) states a measure of damages which applies if the measure
7 of damages in subsection (a) is inadequate to put the lessor in as good a position as
8 performance would have. The measure of damage is the lessor's profit, including
9 overhead, together with incidental damages, with allowance for costs reasonably
10 incurred and credit for payments or proceeds of disposition. In determining the
11 amount of due credit with respect to proceeds of disposition a proper value should
12 be attributed to the lessor's residual interest in the goods. Section 2A-102(a)(28).

13 5. In calculating profit, a court should include any expected appreciation of
14 the goods, *e.g.*, the foal of a leased brood mare. Because this subsection is intended
15 to give the lessor the benefit of the bargain, a court should consider any reasonable
16 benefit or profit expected by the lessor from the performance of the lease agreement.
17 *See Honeywell, Inc. v. Lithonia Lighting, Inc.*, 317 F.Supp. 406, 413
18 (N.D.Ga.1970); *Locks v. Wade*, 36 N.J.Super. 128, 131, 114 A.2d 875, 877
19 (Super.Ct.App.Div.1955). Further, in calculating profit the concept of present value
20 must be given effect. *Taylor v. Commercial Credit Equip. Corp.*, 170 Ga.App. 322,
21 316 S.E.2d 788 (Ct.App.1984). *See generally* Section 2A-103(1)(u).

22 **Cross References:**

23 Sections 1-102(3), 2-819, 2A-102(a)(32), 2A-602, 2A-711, 2A-713, 2A-720, and
24 2A-722.

25 **Definitional Cross References:**

26 "Agreement". Section 1-201(3).
27 "Goods". Section 2A-102(a)(16).
28 "Lease". Section 2A-102(a)(18).
29 "Lease agreement". Section 2A-102(a)(19).
30 "Lessee". Section 2A-102(a)(22).
31 "Lessor". Section 2A-1032(a)(24).
32 "Party". Section 1-201(29).
33 "Present value". Section 2A-102(a)(29).
34 "Sale". Section 2-102(a)(32).

35 **SECTION 2A-722. LESSOR'S ACTION FOR THE RENT.**

1 (a) Upon a default by the lessee under the lease contract of the type
2 described in Section 2A-716(a) or (c)(1) or if agreed upon another default by the
3 lessee, if the lessor complies with subsection (c), the lessor may recover from the
4 lessee the damages specified in subsection (b) for:

5 (1) goods accepted by the lessee and not repossessed by or tendered to
6 the lessor;

7 (2) goods identified to the lease contract if the lessor is unable after
8 reasonable effort to dispose of them at a reasonable price or the circumstances
9 reasonably indicate that effort will be unavailing; and

10 (3) conforming goods lost or damaged after risk of loss passes to the
11 lessee, but if the lessor has retained or regained control of the goods, the loss or
12 damage must occur within a commercially reasonable time after the risk of loss has
13 passed to the lessee.

14 (b) The damages available under the circumstances described in subsection
15 (a) are:

16 (1) accrued and unpaid rent as of the date of entry of judgment in favor
17 of the lessor;

18 (2) the present value as of the same date of the rent for the then
19 remaining lease term of the lease agreement; and

20 (3) any incidental or consequential damages allowed under Section
21 2A-706 or 2A-707, less expenses avoided as a result of the lessee's default.

(c) Except as otherwise provided in subsection (d), a lessor shall hold for the lessee for the remaining period of the lease agreement any goods that have been identified to the lease contract and are in the lessor's control.

(d) A lessor may dispose of the goods at any time before collection of the judgment for damages obtained pursuant to subsection (a). If the disposition is before the end of the remaining period of the lease agreement, the lessor's recovery against the lessee for damages is governed by Section 2A-720 or 2A-721, and the lessor shall provide an appropriate credit against a judgment for damages to the extent that the amount of the judgment exceeds the recovery available under Section 2A-720 or 2A-721.

(e) Payment of the judgment for damages obtained under subsection (a) entitles the lessee to the use and possession of the goods not then disposed of for the remaining period of, and in accordance with, the lease agreement.

(f) Upon default by the lessee under the lease contract of the type described in Section 2A-716(a) or (c)(1) or if agreed upon other default by the lessee, a lessor that is not entitled to rent under this section is still entitled to damages for nonacceptance under Section 2A-720 or 2A-721.

Comment

Uniform Statutory Analogue: Section 2-821.

1. Absent a lease contract provision to the contrary, an action for the full unpaid rent (discounted to present value as of the time of entry of judgment as to rent due after that time) is available as to goods not lost or damaged only if the lessee retains possession of the goods or the lessor is or apparently will be unable to dispose of them at a reasonable price after reasonable effort. There is no general right in a lessor to recover the full rent from the lessee upon holding the goods for

1 the lessee. If the lessee tenders goods back to the lessor, and the lessor refuses to
2 accept the tender, the lessor will be limited to the damages it would have suffered
3 had it taken back the goods. The rule in Article 2 that the seller can recover the
4 price of accepted goods is rejected here. In a lease, the lessor always has a residual
5 interest in the goods which the lessor usually realizes upon at the end of a lease term
6 by either sale or a new lease. Therefore, it is not a substantial imposition on the
7 lessor to require it to take back and dispose of the goods if the lessee chooses to
8 tender them back before the end of the lease term: the lessor will merely do earlier
9 what it would have done anyway, sell or relet the goods. Further, the lessee will
10 frequently encounter substantial difficulties if the lessee attempts to sublet the goods
11 for the remainder of the lease term. In contrast to the buyer who owns the entire
12 interest in goods and can easily dispose of them, the lessee is selling only the right to
13 use the goods under the terms of the lease and the sublessee must assume a
14 relationship with the lessor. In that situation, it is usually more efficient to eliminate
15 the original lessee as a middleman by allowing the lessee to return the goods to the
16 lessor who can then redispense of them.

17 2. In some situations even where possession of the goods is reacquired, a
18 lessor will be able to recover as damages the present value of the full rent due, not
19 under this section, but under Section 2A-721(b) which allows a lost profit recovery
20 if necessary to put the lessor in the position it would have been in had the lessee
21 performed. Following is an example of such a case. A is a lessor of construction
22 equipment and maintains a substantial inventory. B leases from A a backhoe for a
23 period of two weeks at a rental of \$1,000. After three days, B returns the backhoe
24 and refuses to pay the rent. A has five backhoes in inventory, including the one
25 returned by B. During the next 11 days after the return by B of the backhoe, A
26 rents no more than three backhoes at any one time and, therefore, always has two on
27 hand. If B had kept the backhoe for the full rental period, A would have earned the
28 full rental on that backhoe, plus the rental on the other backhoes it actually did rent
29 during that period. Getting this backhoe back before the end of the lease term did
30 not enable A to make any leases it would not otherwise have made. The only way
31 to put A in the position it would have been in had the lessee fully performed is to
32 give the lessor the full rentals. A realized no savings at all because the backhoe was
33 returned early and might even have incurred additional expense if it was paying for
34 parking space for equipment in inventory. A has no obligation to relet the backhoe
35 for the benefit of B rather than leasing that backhoe or any other in inventory for its
36 own benefit. Further, it is probably not reasonable to expect A to dispose of the
37 backhoe by sale when it is returned in an effort to reduce damages suffered by B.
38 Ordinarily, the loss of a two-week rental would not require A to reduce the size of
39 its backhoe inventory. Whether A would similarly be entitled to full rentals as lost
40 profit in a one-year lease of a backhoe is a question of fact: in any event the lessor,
41 subject to mitigation of damages rules, is entitled to be put in as good a position as it
42 would have been had the lessee fully performed the lease contract.

1 3. Under subsection (c) a lessor who is able and elects to sue for the rent
2 due under a lease must hold goods not lost or damaged for the lessee. Subsection
3 (d) creates an exception to the subsection (c) requirement. If the lessor disposes of
4 those goods prior to collection of the judgment (whether as a matter of law or
5 agreement), the lessor's recovery is governed by the measure of damages in Section
6 2A-720 if the disposition is by lease that is substantially similar to the original lease,
7 or otherwise by the measure of damages in Section 2A-721.

8 4. Subsection (e) further reinforces the requisites of subsection (c). In the
9 event the judgment for damages obtained by the lessor against the lessee pursuant to
10 subsection (b) is satisfied, the lessee regains the right to use and possession of the
11 remaining goods for the balance of the original lease term; a partial satisfaction of
12 the judgment creates no right in the lessee to use and possession of the goods.

13 5. The relationship between subsections (c) and (e) is important to
14 understand. Subsection (c) requires the lessor to hold for the lessee identified goods
15 in the lessor's possession. Absent agreement to the contrary, whether in the lease or
16 otherwise, under most circumstances the requirement that the lessor hold the goods
17 for the lessee for the term will mean that the lessor is not allowed to use them.
18 Section 1-203. Further, the lessor's use of the goods could be viewed as a
19 disposition of the goods that would bar the lessor from recovery under this section,
20 remitting the lessor to the two preceding sections for a determination of the lessor's
21 claim for damages against the lessee.

22 6. Subsection (f) further reinforces the thrust of subsection (d) by stating
23 that a lessor who is held not entitled to rent under this section has not elected a
24 remedy; the lessor must be awarded damages under Sections 2A-720 and 2A-721.
25 This is a function of two significant policies of this Article – that resort to a remedy
26 is optional, unless expressly agreed to be exclusive (Section 2A-711(b)) and that
27 rights and remedies provided in this Article generally are cumulative (Section
28 2A-704(c)).

29 **Cross References:**

30 Sections 1-203, 2-821, 2A-704(c), 2A-711(b), 2A-710, 2A-717(a)(4), (5), 2A-717,
31 2A-720, 2A-721, and 2A-722.

32 **Definitional Cross References:**

33 "Action". Section 1-201(1).
34 "Conforming". Section 2A-102(a)(5).
35 "Goods". Section 2A-102(a)(16).
36 "Lease". Section 2A-102(a)(18).
37 "Lease agreement". Section 2A-102(a)(19).
38 "Lease contract". Section 2A-102(a)(20).

- 1 (1) cancel the lease contract under Section 2A-709;
- 2 (2) recover so much of the rent and security as has been paid and is just
- 3 under the circumstances;
- 4 (3) cover and obtain damages Section 2A-734;
- 5 (4) recover damages for nondelivery under Section 2A-735;
- 6 (5) if an acceptance of goods has not been justifiably revoked, recover
- 7 damages for default with regard to accepted goods under Section 2A-736;
- 8 (6) enforce a security interest under subsection (d);
- 9 (7) recover identified goods under Section 2A-737;
- 10 (8) obtain specific performance under Section 2A-708;
- 11 (9) recover incidental and consequential damages under Sections 2A-706
- 12 and 2A-707;
- 13 (10) recover liquidated damages under Section 2A-710;
- 14 (11) enforce limited remedies under Section 2A-711;
- 15 (12) recover damages under Section 2A-705; or
- 16 (13) exercise any other rights or pursue any other remedy provided in the
- 17 lease contract.
- 18 (b) If the lessor is otherwise in default under a lease contract, the lessee may
- 19 exercise the rights and pursue the remedies provided in the lease agreement, which
- 20 may include a right to cancel the lease, and the rights and remedies under Section
- 21 2A-736(a).

1 (c) If a lessor has breached a warranty, whether express or implied, the
2 lessee may recover damages under Section 2A-736(b).

3 (d) On rightful rejection or justifiable revocation of acceptance, a lessee has
4 a security interest in goods in the lessee's possession or control for any rent and
5 security that has been paid and any expenses reasonably incurred in their inspection,
6 receipt, transportation, care, and custody. In that case, the lessee may hold the
7 goods and dispose of them in good faith and in a commercially reasonable manner.
8 The disposition is subject to Section 2A-720(d) and (e).

9 (e) Subject to Section 2A-607, a lessee, on so notifying the lessor, may
10 deduct all or any part of the damages resulting from any default under the lease
11 contract from any part of the rent still due under the same contract.

12 **Comment**

13 **Uniform Statutory Analogue:** Section 2-823.

14 1. This section is an index to Sections 2A-725 through 2A-737 which set
15 out the lessee's rights and remedies after the lessor's default. The lessor and the
16 lessee can agree to modify the rights and remedies available under this Article; they
17 can, among other things, provide that for defaults other than those specified in
18 subsection (a) the lessee can exercise the rights and remedies referred to in
19 subsection (a); and they can create a new scheme of rights and remedies triggered by
20 the occurrence of the default. Section 1-102(3).

21 2. Subsection (a) lists the remedies of the lessee where the lessor has failed
22 to deliver conforming goods or has repudiated the contract, or the lessee has
23 rightfully rejected or justifiably revoked. Subsection (a) also allows the lessee to
24 exercise any contractual remedy. This Article rejects any general doctrine of
25 election of remedy. To determine if one remedy bars another in a particular case is a
26 function of whether the lessee has been put in as good a position as if the lessor had
27 fully performed the lease agreement. Use of multiple remedies is barred only if the
28 effect is to put the lessee in a better position than it would have been in had the
29 lessor fully performed under the lease. Sections 2A-704(c) and 1-106(1).
30 Subsection (a)(2), in recognition that no bright line can be created that would

1 operate fairly in all installment lease cases and in recognition of the fact that a lessee
2 may be able to cancel the lease (revoke acceptance of the goods) after the goods
3 have been in use for some period of time, does not require that all lease payments
4 made by the lessee under the lease be returned upon cancellation. Rather, only such
5 portion as is just of the rent and security payments made may be recovered. If a
6 defect in the goods is discovered immediately upon tender to the lessee and the
7 goods are rejected immediately, then the lessee should recover all payments made.
8 If, however, for example, a 36-month equipment lease is terminated in the 12th
9 month because the lessor has materially breached the contract by failing to perform
10 its maintenance obligations, it may be just to return only a small part or none of the
11 rental payments already made.

12 3. Subparagraphs (a)(7) and(8) list two alternative remedies for the
13 recovery of the goods by the lessee; however, each of these remedies is cumulative
14 with respect to other remedies listed in subsection (a).

15 4. Subsection (b) covers defaults which do not deprive the lessee of the
16 goods and which are not so serious as to justify rejection or revocation of
17 acceptance under subsection (a). It also covers defaults for which the lessee could
18 have rejected or revoked acceptance of the goods but elects not to do so and retains
19 the goods. In either case, a lessee which retains the goods is entitled to recover
20 damages as stated in Section 2A-735(c). That measure of damages is “the loss
21 resulting in the ordinary course of events from the lessor’s default as determined in
22 any manner that is reasonable together with incidental and consequential damages,
23 less expenses saved in consequence of the lessor’s breach.”

24 5. Subparagraph (a)(13) and subsection (b) recognize that the lease
25 agreement may provide rights and remedies in addition to or different from those
26 which Article 2A provides. In particular, subsection (b) provides that the lease
27 agreement may give the remedy of cancellation of the lease for defaults by the lessor
28 that would not otherwise be material defaults which would justify cancellation under
29 subsection (a). If there is a right to cancel, there is, of course, a right to reject or
30 revoke acceptance of the goods.

31 6. Subsection (c) merely adds to the completeness of the index by including
32 a reference to the lessee’s recovery of damages upon the lessor’s breach of
33 warranty; such breach may not rise to the level of a default by the lessor justifying
34 revocation of acceptance. If the lessee properly rejects or revokes acceptance of the
35 goods because of a breach of warranty, the rights and remedies are those provided
36 in subsection (a) rather than those in Section 2A-736(b).

37 7. Subsection (d) recognizes, on rightful rejection or justifiable revocation,
38 the lessee’s security interest in goods in its possession and control. Pursuant to

1 Section 2A-721(d), a purchaser who purchases goods from the lessee in good faith
2 takes free of any rights of the lessor, or in the case of a finance lease, the supplier.
3 Such goods, however, must have been rightfully rejected and disposed of pursuant
4 to Section 2A-727 or 2A-728. However, Section 2A-733(e) provides that the
5 lessee will have the same rights and duties with respect to goods where acceptance
6 has been revoked as with respect to goods rejected. Thus, Section 2A-721(d) will
7 apply to the lessee's disposition of such goods.

8 8. Pursuant to Section 2A-720(e), the lessee must account to the lessor for
9 the excess proceeds of such disposition, after satisfaction of the claim secured by the
10 lessee's security interest.

11 9. Subsection (e) sanctions a right of set-off by the lessee, subject to the rule
12 of Section 2A-607 with respect to irrevocable promises in a finance lease that is not
13 a consumer lease, and further subject to an enforceable "hell or high water" clause in
14 the lease agreement. Section 2A-607 Official Comment. No attempt is made to
15 state how the set-off should occur; this is to be determined by the facts of each case.

16 10. There is no special treatment of the finance lease in this section. Absent
17 supplemental principles of law and equity to the contrary, in the case of most finance
18 leases, following the lessee's acceptance of the goods, the lessee will have no rights
19 or remedies against the lessor, because the lessor's obligations to the lessee are
20 minimal. Sections 2A-502 and 2A-503. Since the lessee will look to the supplier
21 for performance, this is appropriate. Section 2A-303.

22 **Cross References:**

23 Sections 1-102(3), 1-103, 1-106(1), Article 2, especially Section 2-823, and
24 Sections 2A-303, 2A-502, 2A-503, 2A-607, 2A-702, 2A-704(c), 2A-725 through
25 2A-737.

26 **Definitional Cross References:**

27 "Conforming". Section 2A-102(a)(5).
28 "Delivery". Section 1-201(14).
29 "Good faith". Section 2A-102(a)(15).
30 "Goods". Section 2A-102(a)(16).
31 "Lease contract". Section 2A-102(a)(20).
32 "Lessee". Section 2A-102(a)(22).
33 "Lessor". Section 2A-102(a)(24).
34 "Notifies". Section 1-201(26).
35 "Receive". Section 2A-102(a)(30).
36 "Remedy". Section 1-201(34).
37 "Rights". Section 1-201(36).
38 "Security interest". Section 1-201(37).

SECTION 2A-726. INSTALLMENT LEASE CONTRACT: DEFAULT.

(a) In this section, “installment lease contract” means a lease contract in which the terms require or the circumstances permit the delivery of goods in separate lots to be separately accepted, even if the lease agreement requires payment other than in installments or contains a term stating “Each delivery is a separate lease,” or words of similar import.

(b) In an installment contract, the lessee may reject any nonconforming installment of delivery of goods if the nonconformity of the goods substantially impairs the value of that installment to the buyer.

(c) If a nonconformity or default with respect to one or more installments in an installment contract is a substantial impairment of the value to the aggrieved party of the whole contract, there is a breach of the whole contract and the aggrieved party may reject any nonconforming unaccepted installment and cancel the contract. If the aggrieved party accepts a nonconforming installment without seasonably giving notice of cancellation, brings an action with respect only to past installments, or demands performance as to future installments, the contract has not been canceled.

Comment

Uniform Statutory Analogue: Section 2-710.

See the Comment to Section 2-710.

Definitional Cross References:

“Action”. Section 1-201(1).

“Aggrieved party”. Section 1-201(2).

“Cancellation”. Section 2A-102(a)(2).

1 “Conforming”. Section 2A-102(a)(7).
2 “Delivery”. Section 2A-102(a)(9).
3 “Lessee”. Section 2A-102(a)(22).
4 “Lessor”. Section 2A-102(a)(24).
5 “Notifies”. Section 1-201(26).
6 “Seasonably”. Section 1-204(3).
7 “Supplier”. Section 2A-102(a)(34).
8 “Value”. Section 1-201(44).

9 **SECTION 2A-727. MERCHANT LESSEE’S DUTIES; LESSEE’S**
10 **OPTIONS AS TO SALVAGE.**

11 (a) Subject to a lessee’s security interest under Section 2A-724(e), if the
12 lessor or supplier does not have an agent or place of business at the market where
13 the goods were rejected or acceptance was revoked, a merchant lessee, after an
14 effective rejection or justifiable revocation of acceptance of goods in the lessee’s
15 possession or control, shall follow any reasonable instructions received from the
16 lessor or supplier with respect to the goods. In the absence of such instructions, a
17 merchant lessee shall make a reasonable effort to sell, lease, or otherwise dispose of
18 the goods for the lessor’s account if they threaten to decline speedily in value. In
19 the case of a rightful rejection or justifiable revocation of acceptance, instructions
20 are not reasonable if, on demand, indemnity for expenses is not forthcoming.

21 (b) In the case of a rightful rejection or justifiable revocation of acceptance:

22 (1) A merchant lessee that sells or leases goods under subsection (a) is
23 entitled to reimbursement from the lessor or supplier, or out of the proceeds, for the
24 reasonable expenses of caring for and disposing of them.

(2) If the expenses under paragraph (1) do not include a disposition commission, the lessee is entitled to a commission usual in the trade or, if there is none, to a reasonable sum not exceeding 10 percent of the gross proceeds.

(c) Except as otherwise provided in subsection (a), after an effective rejection or a justifiable revocation of acceptance, a lessee may store the rejected goods for the account of the lessor or supplier, reship them to the lessor or supplier, or resell them for the account of the lessor or supplier, with reimbursement in the case of a rightful rejection or a justifiable revocation of acceptance as provided in subsection (b).

(d) In complying with this section or Section 2A-728, the lessee shall act in good faith. Conduct in good faith under this section does not constitute acceptance or conversion and may not be the basis of a claim for damages.

(e) A person that purchases in good faith from a lessee under this section or Section 2A-728 takes the goods free of any rights of the lessor and the supplier, even if the lessee fails to comply with the requirements of this article.

Comment

Uniform Statutory Analogue: Section 2-705.

See the Comment to Section 2-705.

Definitional Cross References:

“Action”. Section 1-201(1).

“Good faith”. Section 2A-102(a)(15).

“Goods”. Section 2A-102(a)(16).

“Lease”. Section 2A-102(a)(18).

“Lessee”. Section 2A-102(a)(22).

“Lessor”. Section 2A-102(a)(24).

“Merchant lessee”. Section 2A-102(a)(28).

1 “Purchaser”. Section 1-201(33).
2 “Rights”. Section 1-201(36).
3 “Security interest”. Section 1-201(37).
4 “Supplier”. Section 2A-102(a)(34).
5 “Value”. Section 1-201(44).

6 **SECTION 2A-728. LESSEE'S DUTIES AS TO RIGHTFULLY**
7 **REJECTED GOODS.**

(a) Subject to Sections 2A-724(e) and 2A-727, after an effective rejection or justifiable revocation of acceptance, a lessee in physical possession of the goods shall hold the goods with reasonable care at lessor's or supplier's disposition for a sufficient time to permit the lessor or supplier to remove them. However, the lessee has no further obligation with regard to goods rightfully rejected or to which an acceptance has been justifiably revoked.

14 (b) An action by the lessee under subsection (a) is not acceptance or
15 conversion.

16 **Comment**

17 **Uniform Statutory Analogue:** Section 2-704.

18 See the Comment to Section 2-704.

19 **Definitional Cross References:**

20 “Action”. Section 1-201(1).
21 “Goods”. Section 2A-102(a)(16).
22 “Lessee”. Section 2A-102(a)(22).
23 “Lessor”. Section 2A-102(a)(24).
24 “Notification”. Section 1-201(26).
25 “Reasonable time”. Section 1-204(1) and (2).
26 “Seasonably”. Section 1-204(3).
27 “Security interest”. Section 1-201(37).
28 “Supplier”. Section 2A-102(a)(34).
29 “Value”. Section 1-201(44).

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1 “Lessor”. Section 2A-102(a)(24).
2 “Money”. Section 1-201(24).
3 “Notifies”. Section 1-201(26).
4 “Reasonable time”. Section 1-204(1) and (2).
5 “Seasonably”. Section 1-204(3).
6 “Supplier”. Section 2A-102(a)(34).

7 **SECTION 2A-730. WHAT CONSTITUTES ACCEPTANCE OF GOODS.**

8 (a) Goods are accepted when the lessee:

9 (1) after a reasonable opportunity to inspect the goods, signifies to the
10 lessor or the supplier that the goods conform or will be taken or retained in spite of
11 their nonconformity;

12 (2) after a reasonable opportunity to inspect the goods, fails to make an
13 effective rejection; or

14 (3) does any act inconsistent with the interest of the lessor or supplier in
15 the goods or inconsistent with the lessor’s claim of rejection or revocation of
16 acceptance and the act is ratified by the lessor or supplier as an acceptance.

17 (b) Acceptance of a part of a commercial unit is acceptance of the entire
18 unit.

19 **Comment**

20 **Uniform Statutory Analogue:** Section 2-706.

21 See the Comment to Section 2-706.

22 **Definitional Cross References:**

23 “Commercial unit”. Section 2A-102(a)(3).
24 “Conforming”. Section 2A-102(a)(5).
25 “Goods”. Section 2A-102(a)(16).
26 “Lessee”. Section 2A-102(a)(22).
27 “Lessor”. Section 2A-102(a)(24).

1 “Supplier”. Section 2A-102(a)(34).

2 **SECTION 2A-731. WAIVER OF DEFAULT; PARTICULARIZATION**

3 **OF NONCONFORMITY.** A lessee is precluded from relying on a nonconforming
4 performance as follows:

(1) The lessee's failure to state, in connection with a rejection under Section 2A-725, a particular nonconformity that is ascertainable by reasonable inspection precludes reliance on the unstated nonconformity to justify rejection or to [establish default] if:

9 (A) the lessor, upon a seasonable particularization, had a right to cure
10 under Section 2A-729 and would have cured the nonconformity; or

(B) between merchants, the lessor or the supplier after rejection has made a request in a record for a full and final statement in a record of all nonconformities on which the lessee proposes to rely.

(2) The lessee's failure to state, in connection with a revocation of acceptance under Section 2A-733, the nonconformity that justifies the revocation precludes the lessee from relying on the nonconformity to justify the revocation or to establish default if the lessor had a right to cure the default under Section 2A-729 and could have cured the breach.

19 **Comment**

20 **Uniform Statutory Analogue:** Section 2-702.

Subsections (a) and (b) of the analogous Article 2 Section 2-702, requires either party to a sales contract that knows that the other party is in breach to object to the breach within a reasonable time. Failure to notify precludes using the breach

1 to justify cancellation and also bars a damages recover if the breaching party has
2 changed position reasonably and in good faith relying on the aggrieved party's
3 inaction. Those provisions are inconsistent with the rule of Section 2A-703 (original
4 Article 2A Section 2A-502) that a lessee or lessor in default under a lease contract is
5 not entitled to notice.

6 This section contains an exception to the rule that no notice of default is
7 required.

8 See also Comment 7 to Section 2-702.

9 **Definitional Cross References:**

10 "Between merchants". Section 2-102(a)(2).
11 "Goods". Section 2A-102(A)(16).
12 "Lessee". Section 2A-102(a)(22).
13 "Lessor". Section 2A-102(a)(24).
14 "Merchant lessee". Section 2A-102(a)(28).
15 "Rights". Section 1-201(36).
16 "Record". Section 2A-102(a)(34).
17 "Seasonably". Section 1-204(3).
18 "Supplier". Section 2A-102(a)(34).

19 **SECTION 2A-732. EFFECT OF ACCEPTANCE; NOTICE OF**
20 **DEFAULT; BURDEN OF ESTABLISHING DEFAULT AFTER**
21 **ACCEPTANCE; NOTICE OF CLAIM OR LITIGATION TO PERSON**
22 **ANSWERABLE OVER.**

23 (a) A lessee shall pay rent in accordance with the lease contract for any
24 goods accepted.

25 (b) Acceptance of goods by a lessee precludes rejection of the goods
26 accepted but does not by itself impair any other remedy provided by this article or
27 the lease agreement for nonconformity.

28 (c) If a tender of delivery has been accepted, the following rules apply:

1 (1) The lessee, or a person entitled to enforce a warranty or warranty
2 obligation shall notify the party claimed against within a reasonable time after the
3 default or breach of warranty was discovered or should have been discovered.
4 However, a failure to give timely notice bars the lessee from a remedy only to the
5 extent that the party entitled to notice establishes that it was prejudiced by the
6 failure.

7 (2) Except in the case of a consumer lease, if a claim for infringement or
8 the like is made against a lessee for which a lessor or supplier is answerable over and
9 the lessee is sued as a result of that claim, the lessee shall notify the lessor or
10 supplier within a reasonable time after receiving notice of the litigation or be barred
11 from any remedy over for liability established by the litigation.

12 (d) A lessee has the burden of establishing a default with respect to goods
13 accepted. A person entitled to enforce a warranty obligation under Section 2A-508
14 has the burden of establishing that the warranty was breached.

15 (e) In a claim for breach of a warranty, indemnity, or other obligation
16 against the lessee for which another party is answerable over, the following rules
17 apply:

18 (1) The lessee may give notice of the litigation to the other party in a
19 record, and the person notified may then give similar notice of the litigation to any
20 other person that is answerable over. If the notice invites the person notified to
21 intervene in the litigation and defend and states that failure to do so will bind the
22 person notified in any action later brought by the lessor as to any determination of

1 fact common to the two actions, the person notified is so bound, unless, after
2 seasonable receipt of the notice, the person notified intervenes in the litigation and
3 defends.

4 (2) If the claim is one for infringement or the like, the original lessor or
5 supplier may demand in a record that its lessee turn over control of the litigation,
6 including settlement, or otherwise be barred from any remedy over. If the lessor or
7 supplier also agrees to bear all expense and to satisfy any adverse judgment, the
8 lessee is so barred unless, after seasonable receipt of the demand, control is turned
9 over to the lessor or supplier.

10 (f) Subsections (c), (d), and (e) apply to an obligation of a lessee to hold the
11 lessor or the supplier harmless against infringement or the like.

12 **Comment**

13 **Uniform Statutory Analogue:** Section 2-707.

14 1. Subsection (c)(1) requires the lessee to give notice of default, within a
15 reasonable time after the lessee discovered or should have discovered the default. In
16 a finance lease, notice may be given either to the supplier, the lessor, or both, but
17 remedy is barred against the party not notified. In a finance lease, the lessor is
18 usually not liable for defects in the goods and the essential notice is to the supplier.
19 While notice to the finance lessor will often not give any additional rights to the
20 lessee, it would be good practice to give the notice since the finance lessor has an
21 interest in the goods. Subsection (c)(1) does not use the term finance lease, but the
22 definition of supplier is a person from whom a lessor buys or leases goods to be
23 leased under a finance lease. Section 2A-102(a)(37). Therefore, there can be a
24 “supplier” only in a finance lease. Subsection (e) applies similar notice rules as to
25 lessors and suppliers if a lessee is sued for a breach of warranty or other obligation
26 for which a lessor or supplier is answerable over.

27 2. Subsection (c)(2) requires the lessee to give the lessor notice of litigation
28 for infringement or the like. There is an exception created in the case of a consumer
29 lease. While such an exception was considered for a finance lease, it was not
30 created because it was not necessary – the lessor in a finance lease does not give a

1 warranty against infringement. Section 2A-502. Even though not required under
2 subsection (c)(2), the lessee who takes under a finance lease should consider giving
3 notice of litigation for infringement or the like to the supplier, because the lessee
4 obtains the benefit of the suppliers' promises subject to the suppliers' defenses or
5 claims. Sections 2A-303 and 2-707(e)(2).

6 **Cross References:**

7 Sections 2-707(e)(2), 2A-102(a)(37), 2A-303, 2A-502, 2A-503, and 2A-733.

8 See also the Comment to Section 2-707.

9 **Definitional Cross References:**

10 "Action". Section 1-201(1).
11 "Agreement". Section 1-201(3).
12 "Burden of establishing". Section 1-201(8).
13 "Conforming". Section 2A-102(a)(5).
14 "Consumer lease". Section 2A-102(a)(8).
15 "Delivery". Section 2A-102(a)(9).
16 "Discover". Section 1-201(25).
17 "Finance lease". Section 2A-102(a)(14).
18 "Goods". Section 2A-102(a)(16).
19 "Knowledge". Section 1-201(25).
20 "Lease agreement". Section 2A-102(a)(19).
21 "Lease contract". Section 2A-102(a)(20).
22 "Lessee". Section 2A-102(a)(22).
23 "Lessor". Section 2A-102(a)(24).
24 "Notice". Section 1-201(25).
25 "Notifies". Section 1-201(26).
26 "Person". Section 1-201(30).
27 "Reasonable time". Section 1-204(1) and (2).
28 "Receive". Section 2-102(a)(30).
29 "Remedy". Section 1-201(34).
30 "Record". Section 2A-102(a)(31).
31 "Seasonably". Section 1-204(3).
32 "Supplier". Section 2A-102(a)(34).

1 **SECTION 2A-733. REVOCATION OF ACCEPTANCE OF GOODS.**

2 (a) A lessee may revoke acceptance of a lot or commercial unit whose
3 nonconformity substantially impairs its value to the lessee if the lot or unit was
4 accepted:

5 (1) except in the case of a finance lease, on the reasonable assumption
6 that its nonconformity would be cured and it has not been seasonably cured; or

7 (2) without discovery of its nonconformity if acceptance was reasonably
8 induced either by the lessor's assurances or, except in the case of a finance lease, by
9 the difficulty of discovery before acceptance.

10 (b) Except in the case of a finance lease that is not a consumer lease, a
11 lessee may revoke acceptance of a lot or commercial unit if the lessor defaults under
12 the lease contract and the default substantially impairs the value of that lot or
13 commercial unit to the lessee.

14 (c) If the lease agreement so provides, the lessee may revoke acceptance of
15 a lot or commercial unit because of other defaults by the lessor.

16 (d) A lessee's acceptance must be revoked under subsections (a) and (b)
17 within a reasonable time after the lessee discovers or should have discovered the
18 ground for it and before any substantial change in condition of the goods which is
19 not caused by their own defects. The revocation is not effective until the lessee
20 notifies the lessor of it.

(e) A lessee that justifiably revokes acceptance has the same rights and duties under Sections 2A-727 and 2A-728 with regard to the goods involved as if they had been rejected.

Comment

Uniform Statutory Analogue: Section 2-708.

1. Subparagraphs (a)(1) and (2) create special rules for finance leases. Subparagraph (a)(1) precludes revocation if acceptance is made with knowledge of nonconformity with respect to the lease agreement, as opposed to the supply agreement. This is not inequitable as the lessee has a direct claim against the supplier. Section 2A-303. Revocation of acceptance of a finance lease is permitted if the lessee's acceptance was without discovery of the nonconformity (with respect to the lease agreement, not the supply agreement) and was reasonably induced by the lessor's assurances. However, if the finance lessor gave no assurances, then there is no right to revoke under subparagraph (a)(2) based on difficulty of discovering the defect before acceptance. However, the lessee may be able to get the agreement of the finance lessor to take the goods back and revoke the finance lessor's acceptance as against the supplier.

2. If a finance lessor has made an express warranty to the lessee under Section 2A-502 or 2A-503, revocation of acceptance is not prohibited even after the lessee's promise has become irrevocable and independent. Section 2A-607 Official Comment. Where the finance lease creates a security interest, the rule may be to the contrary. *General Elec. Credit Corp. of Tennessee v. Ger-Beck Mach. Co.*, 806 F.2d 1207 (3rd Cir. 1986).

3. The section states the situations under which the lessee may return the goods to the lessor and cancel the lease. Subsection (b) recognizes that the lessor may have continuing obligations under the lease and that a default as to those obligations may be sufficiently material to justify revocation of acceptance of the leased items and cancellation of the lease by the lessee. For example, a failure by the lessor to fulfill its obligation to maintain leased equipment or to supply other goods which are necessary for the operation of the leased equipment may justify revocation of acceptance and cancellation of the lease.

4. Subsection (c) specifically provides that the lease agreement may provide that the lessee can revoke acceptance for defaults by the lessor which in the absence of such an agreement might not be considered sufficiently serious to justify revocation. That is, the parties are free to contract on the question of what defaults are so material that the lessee can cancel the lease.

1 5. See also the Comment to Section 2-708.

2 **Definitional Cross References:**

3 “Commercial unit”. Section 2A-102(a)(3).
4 “Conforming”. Section 2A-102(a)(5).
5 “Discover”. Section 1-201(25).
6 “Finance lease”. Section 2A-102(a)(14).
7 “Goods”. Section 2A-102(a)(16).
8 “Lessee”. Section 2A-102(a)(22).
9 “Lessor”. Section 2A-102(a)(24).
10 “Lot”. Section 2A-102(a)(27).
11 “Notifies”. Section 1-201(26).
12 “Reasonable time”. Section 1-204(1) and (2).
13 “Rights”. Section 1-201(36).
14 “Seasonably”. Section 1-204(3).
15 “Value”. Section 1-201(44).

16 **SECTION 2A-734. COVER; LESSEE’S ACQUISITION OF**
17 **SUBSTITUTE GOODS.**

18 (a) Upon a default by a lessor under the lease contract of the type described
19 in Section 2A-724(a), or if agreed, upon other default by the lessor, the lessee may
20 cover by making in good faith and without unreasonable delay any purchase or lease
21 of, or contract to purchase or lease, comparable goods to substitute for those due
22 from the lessor.

23 (b) Except as otherwise provided with respect to damages liquidated in the
24 lease agreement or determined by agreement of the parties, if a lessee’s cover is by a
25 lease contract substantially similar to the original lease contract and the new lease
26 contract is made in good faith and in a commercially reasonable manner, a lessee
27 that covers in the manner required by subsection (a) may recover damages
28 measured by the present value, as of the date of the commencement of the period of

1 the new lease contract, of the rent under the new lease contract applicable to that
2 part of the new lease period which is comparable to the then remaining period of the
3 original lease contract minus the present value as of the same date of the total rent
4 for the then remaining lease period of the original lease contract together with any
5 incidental or consequential damages, less expenses avoided as a result of the lessor's
6 default.

7 (c) If a lessee's cover is by a lease agreement that for any reason does not
8 qualify for treatment under subsection (b), or is by purchase or otherwise, the lessee
9 may recover from the lessor as if the lessee had elected not to cover, and Section
10 2A-735 governs.

11 **Comment**

12 **Uniform Statutory Analogue:** Section 2-825.

13 1. Subsection (a) allows the lessee to take action to fix its damages after
14 default by the lessor. Such action may consist of the lease of goods. The decision
15 to cover is a function of commercial judgment, not a statutory mandate replete with
16 sanctions for failure to comply.

17 2. Subsection (b) states a rule for determining the amount of lessee's
18 damages provided that there is no agreement to the contrary. The lessee's damages
19 will be established using the new lease agreement as a measure if the following
20 criteria are met: (i) the lessee's cover is by lease agreement, (ii) the lease agreement
21 is substantially similar to the original lease agreement, and (iii) such cover was
22 effected in good faith, and in a commercially reasonable manner. This the lessee will
23 be entitled to recover from the lessor the present value, as of the time of the
24 commencement of the term of the new lease agreement, of the rent under the new
25 lease agreement applicable to that period which is comparable to the then remaining
26 term of the original lease agreement less the present value of the rent reserved for
27 the remaining term under the original lease, together with incidental and
28 consequential damages less expenses saved in consequence of the lessor's default.
29 Consequential damages may include the loss suffered by the lessee because of
30 deprivation of the use of the goods during the period between the default and the

1 acquisition of the goods under the new lease agreement. If the lessee's cover doe
2 not satisfy the criteria of subsection (b), Section 2A-735 governs.

3 3. Two of the three criteria to be met by the lessee are familiar, but the
4 concept of the new lease agreement being substantially similar to the original lease
5 agreement is not. Given the man variations facing a party who intends to lease
6 goods and the rapidity of change in the market place, the policy decision was made
7 not to draft with specificity. It was thought unwise to seek to establish certainty at
8 the cost of fairness. Thus, the decision whether the new lease agreement is
9 substantially similar to the original will be determined case by case.

10 4. While the section does not draw a bright line, it is possible to describe
11 some of the factors that should be considered in finding that a new lease agreement
12 is substantially similar to the original. First the goods subject to the new lease
13 agreement should be examined. For example, in a lease of computer equipment the
14 new lease might be for more modern equipment. However, it may be that at the
15 time of the lessor's breach it was not possible to obtain the same type of goods in
16 the market place. Because the lessee's remedy under Section 2A-735 is intended to
17 place the lessee in essentially the same position as if she had covered, if goods
18 similar to those to have been delivered under the original lease are not available,
19 then the computer equipment in this hypothetical should quality as a commercially
20 reasonable substitute.

21 5. Second, the various elements of the new lease agreement should also be
22 examined. Those elements include the present or absence of options to purchase or
23 release; the lessor's representations, warranties, and covenants to the lessee, as well
24 as those to be to be provided by the lessee to the lessor; and the services, if any, to
25 be provided by the lessor or the lessee. All of these factors allocate cost and risk
26 between the lessor and the lessee and thus affect the amount of rent to be paid. If
27 the differences between the original lease and the new lease can be easily valued, it
28 would be appropriate for a court to adjust the difference in rental to take account of
29 the difference between the two leases, find that the new lease is substantially similar
30 to the old lease, and award cover damages under this section. If, for example, the
31 new lease requires the lessor to insure the goods in the hands of the lessee, while the
32 original lease requires the lessee to insure, the usual cost of such insurance could be
33 deducted from the rent due under the new lease before determining the difference in
34 rental between the two leases.

35 6. Having examined the goods and the agreement, the test to be applied is
36 whether, in the light of these comparisons, the new lease agreement I substantially
37 similar to the original lease agreement. These findings cannot be made with
38 scientific precision, as they are a function of economics, nor should they be made
39 independently with respect to the goods and each element of the agreement, as it is

1 important that a sense of commercial judgment pervade the finding. To establish the
2 new lease as a proper measure of damages under subsection (b), these factors, taken
3 as a whole, must result in a finding that the new lease agreement is substantially
4 similar to the original.

5 7. A new lease can be substantially similar to the original lease even though
6 its term extends beyond the remaining term of the original lease, so long as both (a)
7 the lease terms are commercially comparable (*e.g.*, it is highly unlikely that a one-
8 month rental and a five-year lease would reflect similar commercial realities), and (b)
9 the court can fairly apportion a part of the rental payment under the new lease to
10 that part of the term of the new lease which is comparable to the remaining lease
11 term under the original lease. Also, the lease term of the new lease may be
12 comparable to the term of the original lease even though the beginning and ending
13 dates of the two leases are not the same. For example, a two-month lease of
14 agricultural equipment for the months of August and September may be comparable
15 to a two – month lease running from the 15th of August to the 15th of October if in
16 the particular location two-month leases beginning on August 15th are basically
17 interchangeable with two-month leases beginning August 1st. Similarly, the term of
18 a one-year truck lease beginning on the 15th of January may be comparable to the
19 term of a one-year lease beginning on January 2d. If the court finds the two lease
20 terms to be comparable, the court may base cover damages on the entire difference
21 between the costs under the two leases.

22 **Cross References:**
23 Section 2A-735.

24 **Definitional Cross References:**
25 “Agreement”. Section 1-203(3).
26 “Contract”. Section 1-201(11).
27 “Good faith”. Section 2A-102(a)(15).
28 “Goods”. Section 2A-102(a)(16).
29 “Lease”. Section 2A-102(a)(18).
30 “Lease agreement”. Section 2A-102(a)(19).
31 “Lease contract”. Section 2A-102(a)(20).
32 “Lessee”. Section 2A-102(a)(22).
33 “Lessor”. Section 2A-102(a)(24).
34 “Present value”. Section 2A-102(a)(29).

**SECTION 2A-735. LESSEE'S DAMAGES FOR NONDELIVERY,
REPUDIATION, DEFAULT, AND BREACH OF WARRANTY IN REGARD
TO ACCEPTED GOODS.**

(a) Except as otherwise provided with respect to damages liquidated in the lease agreement or otherwise determined by agreement of the parties, 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-734, or is by purchase or otherwise, the measure of damages for nondelivery 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 period of the original lease agreement, together with incidental and consequential damages, less expenses saved in consequence of the lessor's default.

(b) Market rent is determined as of the place for tender or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival.

Comment

Uniform Statutory Analogue: Section 2-820.

1. Subsection (a) states the basic rule governing the measure of lessee's damages for non-delivery or repudiation by the lessor or for rightful rejection or revocation of acceptance by the lessee. This measure will apply, absent agreement to the contrary, if the lessee does not cover or if the cover does not qualify under Section 2A-734. There is no sanction for cover that does not qualify.

2. The measure of damage is the present value, as of the date of default, of the market rent for the remaining term of the lease less the present value of the original rent for the remaining term of the lease, plus incidental and consequential damages less expenses saved in consequence of the default. Note that the reference

1 in subsection (a) is to the date of default not to the date of an event of default. An
2 event of default under a lease agreement becomes a default under a lease agreement
3 only after the expiration of any relevant period of grace and compliance with any
4 notice requirements under this Article and the lease agreement. American Bar
5 Foundation, *Commentaries on Indentures*, § 5-1, at 216-217 (1971). Section
6 2A-702(a). This conclusion is also a function of whether, as a matter of fact or law,
7 the event of default has been waived, suspended or cured. Section 1-103.

8 3. Subsection (b) states the rule with respect to determining market rent.

9 **Cross References:**

10 Section 2-826.

11 **Definitional Cross References:**

12 “Conforming”. Section 2A-102(a)(5).

13 “Delivery”. Section 2A-102(a)(9).

14 “Goods”. Section 2A-102(a)(16).

15 “Lease”. Section 2A-102(a)(18).

16 “Lease agreement”. Section 2A-102(a)(19).

17 “Lessee”. Section 2A-102(a)(22).

18 “Lessor”. Section 2A-102(a)(24).

19 “Notification”. Section 1-201(26).

20 “Present value”. Section 2A-102(a)(29).

21 “Value”. Section 1-201(44).

22 **SECTION 2A-736. LESSEE’S DAMAGES FOR DEFAULT**

23 **REGARDING ACCEPTED GOODS.**

24 (a) Except as otherwise agreed, a lessee that has accepted goods and not
25 justifiably revoked acceptance and has given notice pursuant to Section 2A-732(c)
26 may recover as damages for any nonconforming tender or other default by a lessor
27 the loss resulting in the ordinary course of events from the lessor’s default as
28 determined in any reasonable manner.

29 (b) Except as otherwise agreed, a measure of damages for breach of a
30 warranty of quality is the present value at the time and place of acceptance of the

1 difference between the value of the use of the goods accepted and the value if they
2 had been as warranted for the lease period, unless special circumstances show
3 proximate damages of a different amount.

4 (c) A lessee may also recover incidental and consequential damages.

5 **Comment**

6 1. Subsection (a) states the measure of damages where goods have been
7 accepted and acceptance is not revoked. The subsection applies both to defaults
8 which occur at the inception of the lease and to defaults which occur subsequently,
9 such as failure to comply with an obligation to maintain the leased goods. The
10 measure in essence is the loss, in the ordinary course of events, flowing from the
11 default.

12 5. Subsection (b) states the measure of damages for breach of warranty.
13 The measure in essence is the present value of the difference between the value of
14 the goods accepted and of the goods if they had been as warranted.

15 **Cross References:**

16 Section 2-827.

17 **Definitional Cross References:**

18 “Conforming”. Section 2A-102(a)(5).

19 “Goods”. Section 2A-102(a)(16).

20 “Lessee”. Section 2A-102(a)(22).

21 “Lessor”. Section 2A-102(a)(24).

22 **SECTION 2A-737. PREPAYING LESSEE’S RIGHT TO GOODS.**

23 (a) A lessee that pays all or a part of the rent or security for goods identified
24 to the lease contract, whether or not they have been shipped, on making and keeping
25 good a tender of any unpaid portion of the rent and security due under the lease
26 contract, has a right to recover them from the lessor if the lessor repudiates or fails
27 to deliver as required by the contract.

(b) A lessee may recover from the lessor by replevin, detinue, sequestration, claim and delivery, or the like, goods identified to the lease contract if, after reasonable efforts, the lessee is unable to effect cover for the goods or the circumstances reasonably indicate that an effort to obtain cover would be unavailing.

(c) If the requirements of subsection (a) or (b) are satisfied, the lessor's right vests upon identification of the goods to the lease contract even if the lessor has not then repudiated the lease contract or failed to deliver as required by the contract.

Comment

This section does not give a lessee in a finance lease a direct right against the supplier.

See also the Comment to Section 2-824.

Cross References:
Section 2-824.